“ENRON AND BEYOND: LEGISLATIVE SOLUTIONS”

HEARING

BEFORE THE

SUBCOMMITTEE ON EMPLOYER-EMPLOYEE RELATIONS

OF THE

COMMITTEE ON EDUCATION AND THE WORKFORCE

HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

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ENRON AND BEYOND: LEGISLATIVE SOLUTIONS

Wednesday, February 27, 2002

Subcommittee on Employer-Employee Relations

Committee on Education and the Workforce

U.S. House of Representatives

Washington, D.C.

The Subcommittee met, pursuant to notice, at 10:40 a.m., in Room 2175, Rayburn House Office Building, Hon. Sam Johnson, Chairman of the Subcommittee, presiding.

Present: Representatives Johnson, Boehner, Fletcher, Ballenger, McKeon, Tiberi, Andrews, Payne, Kildee, Tierney, and Miller.

Staff present: David Connolly, Jr., Professional Staff Member; Christine Roth, Professional Staff Member; Kristin Fitzgerald, Professional Staff Member; Dave Thomas, Legislative Assistant; Ed Gilroy, Director of Workforce Policy; Victoria Lipnic, Workforce Policy Counsel; Dave Schnittger, Communications Director; Kevin Smith, Senior Communications Counselor; Heather Valentine, Press Secretary; Patrick Lyden, Professional Staff Member; Allison Dembeck, Executive Assistant; and, Deborah L. Samantar, Committee Clerk/Intern Coordinator.

John Lawrence, Minority Staff Director; Michele Varnhagen, Minority Labor Counsel/Coordinator; Cheryl Johnson, Minority Counsel; Daniel Weiss, Minority Special Assistant to the Ranking Member; and, Dan Rawlins, Minority Staff Assistant/Labor.

Chairman Johnson. The Subcommittee on Employer-Employee Relations will come to order. The Subcommittee will hear testimony on legislative solutions for worker retirement security, and I am here to proceed with our witnesses.

Opening statements are going to be limited to the Ranking Minority Member and myself. Other Members' statements will be included in the record, without objection, so ordered.

OPENING STATEMENT OF CHAIRMAN SAM JOHNSON, SUBCOMMITTEE ON EMPLOYER-EMPLOYEE RELATIONS, COMMITTEE ON EDUCATION AND THE WORKFORCE

You know, Americans want to retire with a nest egg, not a goose egg, right? So, in today's hearing, we're going to evaluate proposals to help them do just that. We're going to find a way to protect employee retirement accounts without over-burdening the system. By and large, we've found the defined contribution system works well, as a means for saving for a secure future. However, Enron has pointed out some areas of concern.

In the many hearings that we've held so far, we've learned that too many workers lack access to meaningful information about their retirement savings, especially quality investment advice on how to invest their hard-earned savings.

We've also learned that while so-called “blackout” periods are common in plans, workers may not have an adequate understanding of how blackout periods work. Or, in other words, enough advance notice for them to adequately prepare.

Time is important for someone nearing retirement, or taking out a loan to help buy a home, or pay for a child's education, which sometimes occurs out of those plans. Additionally, we've also heard about some risk associated with putting all your eggs in one basket, or what experts call “lack of diversification.”

We've also heard about employees greatly benefiting by voluntary company contributions, or company matches to employee retirement accounts. It's no secret that Enron employees were allowed to contribute up to 15 percent of their salaries to the 401(k) plan.

Yesterday, my other Committee, the Ways and Means Committee, discussed Enron's retirement system, and we discussed that at the end of 2000, the plan held almost 14.5 million shares of Enron stock. Employees had 20 different investment options, including Enron stock, and these investments could have been traded on a daily basis. In addition, of the 14.5 million shares, 89 percent was attributable to employee contributions, which could have been sold on a daily basis.

We can't ignore those facts, but throughout this process, our Committee has been focused on learning about the problems that exist so that when we legislate, we address only the problem areas and don't unintentionally harm a retirement system that, again, has worked remarkably well for two decades helping millions of people.

To that end, I have, along with Chairman Boehner, Subcommittee Vice-Chairman Fletcher, and other Members from both parties, introduced the President's Pension Security Act. The key components of the bill are aimed at increasing protections that a participant has under ERISA without upsetting the very delicate balance of employer-sponsored pension plans.

This measure sends a clear message that Congress is committed to restoring worker confidence in America's pension system in the wake of the Enron collapse. I know my colleague, Mr. Andrews, agrees with me on that statement. And it continues the Committee's commitment to ensure that our nation's workers realize their dream of a safe, secure retirement.

The Pension Security Act is a first step toward creating a consensus product that can eventually be signed into law, and help restore worker confidence. There are many legislative proposals pending before us, ranging from educating employers and employees about their retirement saving options to restricting employee choices about how to allocate their savings in a retirement plan. And as we consider the many proposals, we must be mindful of our responsibility not to jeopardize the retirement savings of millions of American workers, just because of regulation.

Today, the Subcommittee is going to hear from a panel of witnesses representing different groups of employers, employees, retirees, and service providers who have a keen interest in any pension legislation that will be considered by the House. We welcome your comments, and promise to keep your views in our mind as we deliberate on and vote on any legislative proposal that comes before us.

I now yield to my colleague, and the ranking member, Mr. Andrews, for any statement he might wish to make.

WRITTEN STATEMENT OF CHAIRMAN SAM JOHNSON, SUBCOMMITTEE ON EMPLOYER-EMPLOYEE RELATIONS, COMMITTEE ON EDUCATION AND THE WORKFORCE – SEE APPENDIX A

OPENING STATEMENT OF RANKING MEMBER ROBERT E. ANDREWS, SUBCOMMITTEE ON EMPLOYER-EMPLOYEE RELATIONS, COMMITTEE ON EDUCATION AND THE WORKFORCE

I thank the Subcommittee Chairman and the staff for putting together these hearings, and I appreciate the chance to hear from the witnesses this morning.

I think that Mr. Johnson is right. There are a number of proposals that have been made by Members of Congress as to how to respond to the catastrophe that we have seen recently, with respect to Enron. But those proposals need to look beyond the catastrophic facts of Enron to the more everyday facts of the vast majority of plans in our country, that are functioning properly. And we certainly do understand that we don't want to legislate on the basis of exceptions. We don't want to take the aberrant case of failure and use it as the model for writing laws that apply to every plan.

Having said that, we also want to be fully aware of the warning signals that may exist in plans that today seem healthy, warning signals such as over-concentration of assets in a given plan, warning signals such as a failure of investment advice, or sound investment information for participants, and warning signals with respect to doubts about the voracity of earnings reports, and financial data being put out in the public domain by various corporate entities.

I'm going to evaluate these legislative proposals by asking a series of questions that I know that Enron employees and pensioners are asking today. We had one of those employees testify before us a few weeks ago, a gentleman who was 59 years of age, who had worked in the energy field his entire adult life, who had a 401(k) plan, which, at its height, was worth in excess of $600,000. And because it is still 100 percent invested in the stock of Enron, it is, as far as I know, now worth essentially nothing.

The questions that people, like this witness, are asking are these. When an employer gives you stock as part of your compensation package, when does it become your property, and your money? When can you have control and dominion over decisions, with respect to the use of that stock, or money?

The second question is from what sources can you get advice as to what to do with the assets that are in your 401(k) plan? Who can you talk to? How are they compensated? What other interests do they have in the advice that they are giving you? And what happens when one of the people who are supposed to be responsible for overseeing the welfare of the plan that you're in receives information that poses a conflict?

What happens when that person who is a trustee of your plan is also an employee of the employer whose stock that your plan holds? And when she's wearing one hat as an executive of the company, who is supposed to be telling good news, and another hat as a trustee of your plan, where maybe the bad news needs to be told to you, so you can divest yourself of stock that is plunging in value, as was the case in Enron, what kind of responsibility does that person have? How should he or she exercise it, and when? I think the Enron facts are replete with examples of how it was not properly exercised.

What happens when all goes wrong? What kind of remedies do you have? What happens when there is a demonstrable breach of the fiduciary duty under ERISA, where you've been wronged and it's clear that you've been wronged? What can you do about it? Is the horse already out of the barn? What kind of remedies exist so that someone who has clearly been a victim of that kind of breach can be made whole, as a result of what has happened to them?

I hope that the Enron case will prove to be an aberrant example in the history of American pension law. But I think we are neglecting our responsibility here if we assume that it will be. I think that we are being careless here; if we assume that the structure that gave rise to Enron does not have some systemic flaws and issues that need to be addressed.

And I hope that as we hear from the witnesses this morning, we will raise some of the issues inherent in the questions that I've talked about, and I look forward to hearing what the witnesses have to say about that. I yield back the balance of my time.

Chairman Johnson. Thank you, Mr. Andrews.

Our first witness is Mr. Dave Evans, Vice-President of Retirement and Financial Services for the Independent Insurance Agents of America. We're glad to have you here.

I'm going to yield to the Chairman, Mr. Boehner, for the purpose of introducing the next witness.

Mr. Boehner. I'd like to extend a special welcome this morning to Angela Reynolds, the Director of International Pension and Benefits at NCR Corporation, who is here to testify today on behalf of the American Benefits Council.

The NCR Corporation employs more than 30,000 people in 100 countries around the world, and many of them are my constituents from Dayton, Ohio, where NCR is headquartered. Now that I also have the honor of representing more of Montgomery County, in the Dayton area, I'm sure I'll be representing many more of the NCR Corporation employees. So we're glad that you're here with us today. Thank you.

Chairman Johnson. You know, it's nice to see a group of witnesses that are all smiling. Because I tell you, how many times do we get them up here and they've got grim faces on?

Our third witness is Mr. Erik Olsen, who is on the Board of Directors for the AARP. The fourth witness is Dr. John Warner. Dr. Warner is a Corporate Executive Vice President for Science Applications International Corporation, testifying on behalf of PSCA. The fifth witness is Mr. Richard Ferlauto. Mr. Ferlauto is Director of Pensions and Benefits for AFSCME, and is testifying on behalf of AFSCME and the AFL-CIO. And our final witness today is Mr. John Vine. He's a partner in the law firm of Covington & Burling, and is testifying on behalf of ERIC.

Before the witnesses begin, I remind the Members that we will ask questions after the entire panel has testified. In addition, Committee Rule (2) imposes a five-minute limit on all questions. I've already explained the lights, so Mr. Evans you may begin your testimony.

STATEMENT OF DAVID EVANS, VICE PRESIDENT, RETIREMENT AND FINANCIAL SERVICES, INDEPENDENT INSURANCE AGENTS OF AMERICA, ALEXANDRIA, VA

I want to thank the Chairman, Sam Johnson, Ranking Member Andrews, and the rest of the Subcommittee for allowing me the opportunity to present my testimony regarding the important issue of providing safeguards for 401(k) plan participants.

My name is Dave Evans, and I am a Vice President of Retirement and Financial Services for the Independent Insurance Agents of America, IIAA. We're a non-profit trade association that represents over 300,000 independent agents and brokers and their employees, nationwide.

I've been in the retirement arena for over 20 years. I've been a consultant, an administrator, I've worked with companies, large and small, not-for-profits, unions, trade unions, and now I work for a trade association. Most of our members are smaller.

I also want to begin by saying that I applaud the Administration, Chairman Boehner, and the Employer-Employee Relations Subcommittee Chairman Johnson, for bringing to the forefront a number of issues of importance for retirement security.

While we believe that, overall, this is a very sound bill, we have one significant problem related to the fiduciary liability exemption afforded under ERISA, section 404(c). And this exemption, which I'll talk about, refers to the so-called "blackout'" period.

The blackout period, in case some of us don't know what that refers to, is the time that it takes when someone is changing record-keepers, or sometimes, investment managers. And for people that are involved with this, think about when you change your checking account, but do that for several hundred or several thousand people. It's a voluminous task.

And so, really, my concern today is not so much talking about large retirement plans. There are a lot of distinguished people to my left that will talk about. I want to mention smaller plans for a minute. And by that, I'm talking about plans where they don't have employer stock. They may be small businesses, they may be unions, and they have no reason to extend the blackout period. They just want to get it done as soon as possible. The reason for that is if you own a small business, or you are in a union, you want to be able to invest your monies as soon as possible. You don't want this to be prolonged.

And one of the things, in reading all the legislation, it seems that everyone wants more accountability, as a result of the Enron situation. But one of the concerns I have is that the legislation could, depending on how it comes out, encourage more small businesses to either go the IRA route, or a SEP (simplified employee pension), or a simple IRA. My concerns are thus.

We should not start to discourage qualified plans among smaller employers. Congress has just, over the last decade, done a great job of making them attractive again to smaller employers. When businesses put in simple IRAs and SEPs, their attorneys and accountants advising them that way, what happens first is the employee can access those monies in an IRA or a SEP, or simple IRA. They will pay penalty and interest, and they will give back a lot to the government, but the reality is they can exhaust their monies before they get to retirement.

The second thing is with a SEP, IRA, and a simple, there is no fiduciary liability on the plan sponsor. Under the law, it's not subject to ERISA. So, if I want to put a little plan in, and my employees put their investments in, there is nothing preventing them from putting 100 percent of their money into Enron stock, Global Crossing stock, or whatever, because at that point, it's my own issue.

So, while this blackout period is an issue with qualified plans, at least the big picture is they're in a qualified plan that encourages people to keep their money in the plan, and there are ERISA fiduciary requirements. Also, during this blackout period, if the data doesn't reconcile, you can't, obviously, let people start reinvesting their monies if things don't balance. And sometimes there is no way an employer knows until they make this switch. I don't think we want to discourage making the switch. Usually you do that because the statements are late, or you're not happy with the investment return.

We want employers to be taking that action. We want them to be moving when they feel it's in the best interest of the plan participants. And if we lose the exemption liability under ERISA 404(c), then some people will be frozen like a deer in the headlights. They'll be afraid to move, because of the potential liability. So, I think we might want to keep that in mind.

One other point I want to make is this. Under qualified plans, you need to purchase an ERISA bond. Most people now, especially after Enron, want to purchase directors and officers fiduciary liability coverage. Under simple IRAs, there is no fiduciary liability coverage, because it's not subject to that. And if we lose the exemption, I'm concerned that the insurance carriers will either increase premiums, which were seen because of the some of the terrorist things after September 11th, and/or they will just exclude the blackout period. I don't think that serves plan participants, because at the end of the day, we would rather have another deep pocket so if there is an issue and it's a warranted claim, the insurance company would pay off the plan participant. So I think that's a good thing to encourage.

Let me just close with a couple of points. In terms of some of the other proposals of the three-year diversification, I do think diversification is a good thing to allow. It does present some issues for the plan sponsors, whether the right time frame is three or five years. It's probably an appropriate thing to have.

And in terms of caps, I'm not a fan of caps, because sometimes a plan will be a second plan. So if I have a defined benefit pension plan, that's not the same as if it's my only plan, where there is a cap on employer stock. I think one-size-fits-all doesn't work with caps. I understand where people are going, but I think if they have diversification, that will do it.

I see that the red light is on, let me conclude by saying that I thank you for the opportunity to testify today, and we look forward to working with the Administration and this Committee to achieve the goals. Thank you.

WRITTEN STATEMENT OF DAVID EVANS, VICE PRESIDENT, RETIREMENT AND FINANCIAL SERVICES, INDEPENDENT INSURANCE AGENTS OF AMERICA, ALEXANDRIA, VA – SEE APPENDIX B

Chairman Johnson. Thank you, sir. I appreciate your comments.

Ms. Reynolds, you may begin your testimony now.

STATEMENT OF ANGELA REYNOLDS, DIRECTOR, INTERNATIONAL PENSION AND BENEFITS, NCR CORPORATION, DAYTON, OH, TESTIFYING ON BEHALF OF THE AMERICAN BENEFITS COUNCIL

Thank you, Chairman Johnson, Ranking Member Andrews, and the Subcommittee, and especially Mr. Boehner, for such a nice introduction. I appreciate that very much, and so does everyone in Dayton, Ohio.

I serve as Director of International Pension Benefits for NCR Corporation. We provide relationship technology solutions to customers worldwide. I'm here on behalf of the American Benefits Council representing Fortune 500 companies and other organizations that assist employers in providing retirement and health benefits. I want to start by giving you a summary.

Today, 56,000,000 Americans participate in 401(k), profit sharing, and employee stock ownership plans. These workers have amassed more than $2.5 trillion in retirement savings, and have built a substantial ownership stake in their companies. These employer-sponsored plans not only prepare workers for retirement, but also democratize corporate ownership. Congress has, over many decades, promoted these plans with very positive results for tens of millions of American workers. Despite the truly unfortunate developments of Enron, now is not the time to abandon this long-standing bipartisan support.

At NCR, the 18,400 employees and retirees participating in our 401(k) plan have amassed $1.54 billion in retirement assets. While our 401(k) plan match is not provided in stock but in cash, we make NCR stock available as one of our plan's investment options, and we also offer our employees an employee stock purchase plan.

Now, you may ask why? This is because our employees who want to share in the success of the company have asked to do so, and because NCR believes that the opportunity to invest in the company creates a positive culture of ownership and accountability. At the same time, we take the principle of diversification very seriously at NCR, and we make it a prime focus of our communications with our 401(k) participants. Like most employers that have company stock in their plans, NCR also sponsors a diversified, defined benefit pension to provide a guaranteed employer-funded benefit to our employees.

The council believes that retirement policy responses to Enron should focus on ensuring that 401(k) participants have the information, education and professional advice they need to wisely exercise investment responsibility. Chairman Johnson, this is the course that you and Chairman Boehner have charted. The proposals in your Pension Security Act to provide employees with advanced notice of transaction, suspension periods, as well as more regular benefit statements, will help achieve this goal.

The council also supports the provisions of H.R. 3762, drawn from Chairman Boehner's prior legislation that will help employers facilitate professional investment advice for 401(k) participants. Mr. Chairman, you've indicated that you want to work to improve H.R. 3762, and we're eager to work with you to ensure that employers' fiduciary liability during transaction suspension periods does not act as a deterrent to retirement plan maintenance.

And we also look forward to a continued dialogue on regulation of holding periods employers sometimes impose on the sale of company stock. We're very concerned that overly strict limits on these holding periods could risk reduced employer matching contributions.

We're pleased that Ranking Member Miller and Committee Members' focus from both sides of the aisle have rejected proposals to cap the percentage of employees' 401(k) account that can be invested in company stock. Yet, a number of other provisions in Representative Miller's bill give us very serious concern.

One is the 10-day limit that H.R. 3657 would impose on transaction suspension periods. These periods, which typically accompany a change in 401(k) record keeper, or the acquisition of a firm's employees in a company's plan, are a very normal and necessary part of 401(k) plan administration. In fact, the plan changes that require such suspensions are often undertaken to improve the services offered to the employees. Such periods are declining, due to market competition also, and I think we really need to take that into regard. But a fixed time limit is simply not practical, and we really believe that it will lead to mistakes.

Another source of concern is that H.R. 3657 does not advance targeted responses to specific issues raised by Enron, but rather, seeks to make wide ranging and fundamental changes to our nation's 401(k) system. This bill would radically change ERISA's enforcement mechanism by creating vast new categories of defendants and damages, fundamentally alter the retirement plan government system by requiring joint trusteeship, and substantially reduce the vesting schedule for employer contributions. Remedies will increase litigation and cost, joint trusteeship will increase workplace conflict, and hamper administration, and reduced vesting will lower employer contributions.

Under such a regime, many employers will question whether it makes sense to retain their voluntary retirement offerings, and businesses not yet in the system may see this as a deterrent from ever starting a plan. I need to sum up here. The unfortunate result will be fewer employees with retirement plan coverage.

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

Thank you very much, Mr. Chairman.

WRITTEN STATEMENT OF ANGELA REYNOLDS, DIRECTOR, INTERNATIONAL PENSION AND BENEFITS, NCR CORPORATION, DAYTON, OH, TESTIFYING ON

BEHALF OF THE AMERICAN BENEFITS COUNCIL – SEE APPENDIX C

Chairman Johnson. Thank you.

Mr. Olsen, you may begin your testimony, sir.

STATEMENT OF ERIK OLSEN, MEMBER, BOARD OF DIRECTORS, AARP, WASHINTON, D.C.

Thank you, Mr. Chairman. My name is Erik Olsen. I am a member of AARP Board of Directors, and 10 years into what I hope is a long and successful retirement career. We appreciate the opportunity to present our recommendations for policy changes that should be enacted to protect the retirement savings of American workers and retirees.

The financial collapse of Enron certainly illustrates weaknesses in our pension laws. Many of ERISA's extensive protections simply do not extend to new 401(k)-type plans, and we believe they must be updated. We should begin with the systemic problem of employer stock. While the single most important rule for investing is diversification, the assets of Enron's 401(k) plan, as well as hundreds of other companies today, are overly concentrated in employer stock.

Our testimony today will focus on several areas that we believe call for immediate action. First of all, disclosure, diversification, investment advice, and remedies under the law. The shift of risk and responsibilities to employees makes it imperative that employees receive complete, accurate, and timely information. This should include benefit statements at least quarterly, the detail of the status of participants' investments, and they ought to urge diversification. A plan should also provide ample advance notice of any temporary plan lock-down.

Diversification is the single most basic principle of sound investment practice. Few, if any, financial advisors would recommend investing more than a limited percentage in a single stock. This is especially true when that single stock is also the source of one's wages. But when it comes to employers' stock, the 401(k) system fails that test. Surveys indicate that about one-third of all funds are concentrated in company stock, and many have much more than that.

Current barriers to prudent investment diversification should be removed, including the ability of plans to compel employees to invest in employer stock and plan restrictions on shifting to other investments until some certain age, such as age 55. While rights to diversify are essential, they are not sufficient. Our pension system and corporate culture have tax incentives, conflicts, behavioral tendencies that have stacked the deck in favor of heavy investment in employer stock. This is true, even when employees are free to choose.

Employers also have their own financial reasons to encourage employee investment in the company stock. While individuals are free to invest personal funds in any way, the law should provide that tax-subsidized retirement plans be invested in a diversified manner. But any changes should avoid disincentives for employer contributions, while also addressing the combination of employer-provided stock and employee purchases of company stock that create such high concentrations.

One option is to provide the employer with the choice. The employer can continue to make contributions in stock, or the employer can include employer stock as an investment option for employees. Under this approach, employers, without a limit, can either contribute company stock, or permit employees to purchase stock as an investment option, but not both. It simply doesn't seem to us to be prudent for an employer to offer both. If I've heard Ms. Reynolds' testimony correctly, that's what NCR is doing, one of those two.

Unfortunately, we also know that too many Americans lack financial investment knowledge. For example, we did a recent survey that just over one-third of the people could correctly identify whether diversification reduces risk. Many participants simply want to be told where to invest. We agree that individual advice can be helpful, but such advice must be protected from financial conflicts of interest. Receiving unbiased, independent advice, as the Enron saga has demonstrated, is very critical. We should not carve out an exemption to ERISA's basic prohibitions on conflicted advice.

Another glaring problem is the inability of employees to properly enforce their pension rights. As part of any pension reform, it is, therefore, essential that we enable employees to recover losses due to fraud and other violations. Employees must have the tools to protect their own retirement funds.

In conclusion, we urge Congress this year to enact changes to better protect workers' pensions. The President has called for action, and we agree. We should act now to improve disclosure, improve diversification, and improve remedies for those who are harmed. Only with more comprehensive changes can we ensure greater retirement security for workers in today's pension environment.

Thank you very much, Mr. Chairman.

WRITTEN STATEMENT OF ERIK OLSEN, MEMBER, BOARD OF DIRECTORS, AARP, WASHINGTON, D.C. – SEE APPENDIX D

Chairman Johnson. Thank you, Mr. Olsen.

Dr. Warner, you may begin your testimony.

STATEMENT OF JOHN H. WARNER, JR., CORPORATE EXECUTIVE VICE PRESIDENT, SCIENCE APPLICATIONS INTERNATIONAL CORPORATION, SAN DIEGO, CA, TESTIFYING ON BEHALF OF THE PROFIT SHARING COUNCIL OF AMERICA

Chairman Boehner, Chairman Johnson, Congressman Andrews, and Members of the Subcommittee, thank you for this opportunity to speak on behalf of The Profit Sharing 401(k) Council of America about proposed legislative solutions in response to the Enron collapse.

I am Dr. John Warner, Corporate Executive Vice President, and also a Director at SAIC. SAIC is the largest employee-owned research and engineering firm in the nation, with over 40,000 employees, and with offices in over 150 cities worldwide.

PSCA shares a concern of Congress and the Administration about the Enron collapse, particularly the plight of Enron employees, who are heavily invested in Enron stock. The allegations of misconduct by Enron management and their auditors have resulted in a crisis of confidence in the American equity trading system.

We thank Chairman Boehner for conducting hearings by the Full Committee that have helped determine what happened at Enron. So far, there is a strong suggestion of corporate malfeasance, and only, perhaps, violations of existing laws controlling retirement plans. But until the facts are established, one cannot determine if present laws are inadequate. We think that it is critical to address this issue before considering any new laws. PSCA has consistently urged Washington policy makers to wait until the facts have been determined before recommending any changes to retirement plans. And we do so, again, now.

PSCA supports the decision by Chairmen Boehner and Johnson to introduce H.R. 3762, the Pension Security Act of 2002, which embodies the Administration's proposal. It is critically important that this Committee assert its right and role in any effort to change our country's voluntary employer-provided retirement system.

Many of the bills introduced are well intended, and they do contain ideas that should be further developed. Clearly, H.R. 3762 is in this category. The advice provision in H.R. 3762 will help some plan sponsors, as well a provision in H.R. 3669, co-sponsored by Representatives Portman and Cardin, that will allow workers to purchase financial advice with pre-tax dollars. Some other bills, frankly, seem to be designed to pursue an agenda of dissuading employers from offering a defined contribution retirement plan, or using employer stock as part of the funding strategy for such plans.

Unfortunately, all the bills introduced so far share one characteristic with varying degrees. They could well result in fewer American workers being offered plans. Furthermore, by drastically changing the ability of employers to continue a successful decades-old policy of making employees long-term owners of the company that employs them, the bills may result in less generous employer contributions. Employers will continue to provide meaningful retirement benefit programs, so long as they have the flexibility to design and fund plans that take into account their unique business strategy and the needs of their workforce.

PSCA's written statement for the Subcommittee further discusses our concerns. I would like to spend the remainder of my time discussing proposed changes in the diversification rights.

A pivotal question for this Subcommittee is whether or not employee ownership should be an element of 401(k) and other defined contribution plans. We feel strongly that the answer is yes. The large majority of America's largest and most successful corporations, as well as many smaller businesses use employer stock in a defined contribution plan to provide substantial retirement wealth for millions of American workers.

Employee ownership is a long-term process. By definition, it is about holding stock, not having employers simply making contributions in stock that an employee can convert to other assets. Most employers that make contributions in employer stock impose restrictions that limit a participant's ability to diversify. Employers use the flexibility provided in today's system to custom design employee-ownership plans that uniquely fit their business. If major changes are enacted, employers will re-examine their plans, and some will replace stock contributions with less generous cash contributions.

The proposed changes to diversification rights and other proposed regulations that curtail sponsors' ability to design flexible plans could seriously jeopardize SAIC's employee ownership programs. Employee ownership fuels the entrepreneurial spirit in our employee owners. It rewards outstanding performance. It enables SAIC to better perform for our customers, and help attract and retain our employees. This culture encourages us to take initiatives, suggest ways to solve problems, and find creative ways to better serve our customers.

Current employees, directors, their families, and participants in SAIC retirement plans own approximately 85 percent of the company's stock, either directly, or through SAIC retirement plans. SAIC's founder and CEO currently owns less than one-and-one-half percent of the total shares, making the ownership very broad-based.

As our business grows, it is our employee shareholders who benefit from our financial success. That's how we continue to grow in a very competitive environment. This is translated into more than 30 years of increasing SAIC stock values. In the past 5 years, SAIC stock price averaged 38 percent annual growth, and the 10-year annualized growth is 28 percent, benefiting, again, all of our employee owners of the corporation. Our founder and CEO, Dr. J. Robert Beyster, recently noted, “I can't tell you where we would be without employee ownership, but I'm convinced we would not be where we are today. Shared ownership and shared responsibility have created an effective entrepreneurial environment throughout SAIC with not just one or two on the top, but with thousands.”

To summarize, the use of company stock in a defined contributions plan has been extremely successful. More restrictive policies could well reduce the number of companies offering retirement plans, and reduce the company contributions to some existing plans. PSCA advocates that no action be taken that would restrict either the amount of contribution employees may invest in company stock, or change the current limitations employers may apply to diversification of employer contributions in company stock.

We will look forward to working with this Subcommittee and the Full Committee to ensure employee ownership and employer-provided retirement plans continue to flourish. Thank you, very much.

WRITTEN STATEMENT OF JOHN H. WARNER, JR., CORPORATE EXECUTIVE VICE PRESIDENT, SCIENCE APPLICATIONS INTERNATIONAL CORPORATION, SAN DIEGO, CA, TESTIFYING ON BEHALF OF PROFIT SHARING COUNCIL OF AMERICA – SEE APPENDIX E

Chairman Johnson. Thank you, sir.

Mr. Ferlauto, you may begin your testimony.

STATEMENT OF RICHARD FERLAUTO, DIRECTOR OF PENSIONS AND BENEFITS, AMERICAN FEDERATION OF STATE, COUNTY, AND MUNICIPAL EMPLOYEES (AFSCME), WASHINGTON, D.C., TESTIFYING ON BEHALF OF THE AFL-CIO

Thank you. Good morning, Chairman Boehner, Chairman Johnson, Ranking Member Andrews, Members of the Committee. My name is Richard Ferlauto, the Director of Pension and Benefit Policy for the American Federation of State, County, and Municipal Employees, testifying on behalf of our 1.3 million members, and the 65 unions and 13 million members of the AFL-CIO.

First, I will address reforms needed for defined contribution plan governance, second to mutual fund governance, and finally, to corporate governance as they all relate to the serious issue of retirement security raised by the collapse of Enron.

The labor movement believes that the central theme, both at Enron, the public corporation, and Enron, the ERISA plan sponsor was a conflict of interest between the worker's need for retirement security and Enron's interest in using its employee pension savings for its own benefit. This is not a problem exclusive to Enron; it is a fundamental problem in the governance of many company-defined contribution plans. As Enron workers painfully discovered, employers too often want workers to bear investment risks that workers alone cannot afford to bear. And employers cannot resist the temptation to view worker funds as a financing source for their firms.

Let me explain, with some background. The labor movement feels very strongly that a three-legged pyramid best finances retirement security. The first layer is social security. The next layer should be a defined benefit plan that provides a guaranteed benefit, financed by professionally managed funds. The top layer, then, is personal savings, sometimes in the form of tax-favored defined contribution plans, such as 401(k)s.

This money is at risk in the markets, and most certainly needs to be managed on sound investment based on sound investment practices and protected against employer manipulation. If a defined benefit fund has losses in its investment portfolio, employers must make up the shortfall. Employers, naturally, have come to prefer defined contribution plans. In these plans, when there are losses in the market, the employee bears all the risk, and has lower benefits. When workers have no defined benefit plans, and only defined contributions plans, they are at risk of a catastrophic loss to their retirement savings.

Moreover, some private sector employers have discovered that they can use worker retirement savings as a corporate finance tool. Employers can make their contribution to 401(k) accounts entirely in company stock. This is a cash-positive transaction for the company, as there is no cash cost to the employer, and the employer is able to take a tax deduction for the contribution. Great for the company, bottom line, but not so for the individual plan participant.

The labor movement believes that ERISA should give employers a choice with regard to contributions of company stock to a DC plan. If the employer does the right thing, and provides its employees with an appropriate defined contribution plan, then the employer could be allowed to make a contribution to a supplemental defined contribution plan in company stock, and offer company stock as an employee self-investment option. However, if a 401(k)-like plan is the only retirement plan, the employer should not be allowed to do both, because the plan would not be diversified enough to prudently protect the long-term retirement asset.

To protect retirement assets, we also need meaningful changes to 401(k) plan governance that empower employees as an effective counterweight to the conflict of interest in exclusive employer control of these defined contribution plans. The labor movement strongly supports the provisions of Ranking Member George Miller's bill that would require equal beneficiary representation on the boards of 401(k) plans. This provision recognizes that 401(k) money is workers' money, and workers should at least have some say in how it is managed.

This package of reforms would have made a difference for Enron employees. It also leaves in place ERISA's current protection against conflictive investment advice. The House has passed the Pension Security Act, seeking to remove these protections, letting the very money managers who have an interest in selling high-fee products give investment advice with conflicts of interest besetting workers' funds. We support independent advisors, where the only interest is giving good investment advice.

Mutual funds, as a major component of defined contribution plans, have been extremely resistant to basic transparency requirements for good governance. Although mutual fund advisors control the proxy voting authority for investors, all but a very few do not disclose to their investors how they vote their proxies, or their corporate governance policies at all.

Finally, I would like to turn to the actual governance of corporations that workers' retirement money is ultimately invested in. The AFL-CIO supports financial transparency, board accountability, and corporate responsibility as a means for protecting worker retirement assets.

In closing, let me talk about one example. Ronnie Chan, until very recently, was a member of Enron's audit committee. He serves on Motorola's board of directors. He apparently will be nominated by the company for re-election at the next annual meeting. We believe that the Motorola proxy solicitation will not inform shareholders that Mr. Chan participated in what the

Powers Report referred to as “inexcusable” decisions in his capacity as an Enron director.

Union and public funds to protect the billions of dollars invested in Motorola will have to run, at our own expense, a “vote no” campaign to prevent Mr. Chan from being re-elected. In short, shareholders need access to the director-nominating process, access to the company proxy, and other tools to hold directors accountable.

The AFL-CIO and AFSCME are ready to work with this Committee to take up the three great challenges of governance reform presented by the Enron fiasco: reform to 401(k) plan sponsorship governance, reform to mutual fund governance, and reform to corporate governance.

Thank you very much for your time.

WRITTEN STATEMENT OF RICHARD FERLAUTO, DIRECTOR OF PENSIONS AND BENEFITS, AMERICAN FEDERATION OF STATE, COUNTY, AND MUNICIPAL EMPLOYEES, WASHINGTON, D.C., TESTIFYING ON BEHALF OF THE AFL-CIO
SEE APPENDIX F

Chairman Johnson. Thank you, sir.

Mr. Vine, you may begin your testimony, sir.

STATEMENT OF JOHN M. VINE, ESQ., PARTNER, COVINGTON AND BURLING, WASHINGTON, D.C., TESTIFYING ON BEHALF OF THE ERISA INDUSTRY COMMITTEE

Good morning, Mr. Chairman, Ranking Member Andrews, Members of the Subcommittee. I've been asked to focus today on how ERISA's standards of fiduciary responsibility apply to investments and employer stock by individual account plans. Initially, I'd like to make five points regarding the pending bills that would impose new restrictions on individual account plans.

First, Congress should observe the adage, “Do no harm.” If Congress responds excessively to the risks associated with stock-based plans by imposing restrictions that prevent those plans from meeting employers' business needs, Congress will have addressed one risk by creating other, more dangerous risks. Millions of employees will be unable to share in their employer's success, and employers will reduce their plan commitments, and reduce employees' retirement savings.

Second, Congress should not prohibit employees from making their own investment decisions. Congress should not restrict an employee's ability to invest in employer stock.

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

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

Fifth, before imposing the restrictions, Congress should carefully consider what the consequences are likely to be. Increasingly onerous regulation of defined benefit plans during the 1980s had devastating effects on the willingness of employers to maintain those plans. Before imposing new restrictions on individual account plans, Congress should consider how employers are likely to respond.

Turning now to ERISA's fiduciary standards, I would emphasize that the fiduciaries of ERISA-governed stock-based plans are subject to rigorous fiduciary duties. They are subject to a duty of loyalty. They must act solely in the interest of participants and beneficiaries. They are also subject to a duty of prudence that requires them to act with care, skill, prudence, and diligence.

In general, fiduciaries must diversify the investments of the plan, to minimize the risk of large losses. While these general rules also allow stock-based plans to have substantial holdings of employer stock, planned fiduciaries remain subject to the duties of loyalty and prudence.

The Supreme Court has made it clear, for example, that the duty of loyalty forbids a fiduciary from making intentional misrepresentations to employees. Fiduciaries who breach their duties are personally liable to make good any losses to the plan, and to restore to the plan any gains the fiduciaries realize.

ERIC strongly opposes proposals to add new remedies to ERISA, and to impose liability on persons who are not planned fiduciaries. Expanding ERISA liability will strongly discourage employers from adopting health, retirement, and other plans for their employees. These proposals will harm employees, not help them.

ERIC also strongly opposes proposals that have been made for the joint trusteeship of individual account plans. Joint trusteeship will be divisive, disruptive, and counterproductive. It will politicize fiduciary responsibility. It will disrupt, rather than strengthen, plan management. It will discourage employers from setting up plans, and it will reduce retirement savings.

I would like to turn now to ERISA section 404(c). In very general terms, 404(c) allows a participant to direct the investment of the assets in his or her account. But 404(c) does not relieve the plan's fiduciaries of all fiduciary duties. The fiduciaries that select the plan's investment funds remain responsible for selecting and periodically re-evaluating those funds, in accordance with ERISA's fiduciary standards, including the duties of loyalty and prudence.

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

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

One of the most important challenges facing Congress is how to expand pension coverage. 404(c) has been an extremely effective tool in this effort. Because it has given employees the ability to direct the investment of their retirement savings, it has made saving for retirement more attractive to them, and has helped them to increase retirement savings. Congress should not cut back on one of the most effective tools in the effort to increase pension coverage and retirement savings.

That completes my statement. Thank you very much.

WRITTEN STATEMENT OF JOHN M. VINE, ESQ., PARTNER, COVINGTON & BURLING, WASHINGTON, D.C., TESTIFYING ON BEHALF OF THE ERISA INDUSTRY COMMITTEE
SEE APPENDIX G

Chairman Johnson. Thank you, sir. In your experience, Mr. Vine, why did employers become less willing to offer defined benefit plans over the years?

Mr. Vine. There are a variety of reasons, but surely among them was the increasing burdens that statute after statute imposes on employers.

Chairman Johnson. Government regulation?

Mr. Vine. Government regulation.

Chairman Johnson. Thank you. And how do you think the three-year diversification requirement would affect plans with a five-year vesting schedule?

Mr. Vine. The question relates to a plan with a five-year vesting schedule, but three-year diversification. My own judgment is that three years is too short a period to mandate diversification.

I can understand one of the interests of the Subcommittee in accelerating diversification, in view of the Enron affair, but it seems not to strike the proper balance between the employer's business objectives, and the understandable interest on the Subcommittee for providing diversification.

Chairman Johnson. What would you suggest in that regard?

Mr. Vine. Well, I have nothing specific to suggest. Something longer than three years that would ensure that employees actually do have a stake in the company. Some have suggested a rolling period so that, for example, after the stock has been in the plan for so many years, it would then be subject to diversification and not sort of a three-year cliff, which is the current proposal.

Chairman Johnson. Thank you, very much. Mr. Warner, why do you believe that employee ownership in 401(k)s ought to continue?

Mr. Warner. I believe that there are various ways that employees can become employee-owners, and we've implemented many of those ways at SAIC, through direct purchases, through options, et cetera.

But what we have found is that, in particular, our younger employees are very much interested in participating through 401(k) plans. It provides a means for them to use tax-deferred dollars to participate in employee ownership, and it also is something that they can do on a regular basis. And so, when we tried to actually limit participation in our retirement plan at SAIC, the biggest objection came from the younger employees that wanted to participate, which is what we want to achieve. We want to get them into retirement plans early.

Chairman Johnson. You say that you don't believe in caps. Would you like to elaborate on that a little?

Mr. Warner. Well, yes. In our case, for example, as I said earlier, 85 percent of our stock is owned by the people in the company, or in our retirement plans. And we're an employee-owned company, and we've grown from one person to 40,000 people with that kind of environment.

And specifically if we had situations where we have caps, it would affect the whole culture of the company, as well as our ability to function financially as a company. Unlike companies with public stock, we have to finance all of the stock buy-backs ourselves, through the corporation, which must compete with other uses of capital in that regard.

So on the one hand, we want to have employee ownership in a broad sense, and allow our employees to participate in any way in which they see, in terms of their own personal situation to be beneficial to them. And on the other hand, we need to make sure that we can look at what happens, financially, to the corporation over time to support them as employee-owners.

Chairman Johnson. Thank you. Ms. Reynolds, in the larger companies of your association, are 401(k) plans the only plan they offer?

Ms. Reynolds. With many large employers, 401(k) plans are not the only plans that are offered. Many also have the broadly diversified defined benefit programs.

Chairman Johnson. And do you know how much the company stock match is versus dollars?

Ms. Reynolds. In general, for stock, I believe, it was roughly one percent.

Chairman Johnson. I think less than one percent is the number I've heard.

Ms. Reynolds. There are roughly 2,000 employers that match in stock, which is less than 1 percent, but I think about 6 percent of assets.

Chairman Johnson. So most of the matches are in cash, or some other form?

Ms. Reynolds. That's correct.

Chairman Johnson. Does the employee have the right to put it wherever he wants?

Ms. Reynolds. The employee has the right to put it wherever he or she wants.

Chairman Johnson. Okay. And you believe that education and advice are the best way for Congress to help the pension system?

Ms. Reynolds. Absolutely, just look at Enron, how unbelievably unfortunate it is for those employees. And, from my own personal perspective, and in discussions with the Council, it is very clear that there was definitely a big gap somewhere in their employee education process. They had the ability to have 89 percent of their plan's assets, and to have many of them invested 100 percent employer stock is not what we would consider a company that is educated about diversification.

We take it very seriously at NCR. We have programs that are designed to assist our employees with understanding how to diversify. And as a result, employer stock is not a very large holding at NCR, but it is something that we want to offer to our employees, and we developed risk spectrums to educate employees on the meaning of company stock in plans.

Most plans have mutual funds that they offer, which are broadly diversified. Employer stock is not broadly diversified. When you're reflecting that on a risk spectrum, it's out to the far right-hand side. Even though it's your company, you still have to represent it that way, because it's a non-diversified option.

I clearly believe that employees that have been educated, and can obtain the appropriate advice, can understand the importance of diversification and what that means, especially throughout their different life stages.

Chairman Johnson. Thank you, very much. Mr. Andrews, would you care to query?

Mr. Andrews. I thank each of the witnesses for their very helpful testimony. Mr. Vine, I wanted to ask you a couple of questions.

We had testimony in the Enron matter that an individual who was a member of the administrative committee that had fiduciary responsibility for overseeing the 401(k) plan received information late in the year 2000 about Enron's problems. And for reasons that she claims are unrelated to that information, sells a substantial amount of her personal holdings in the Enron stock, millions and millions of dollars of the amount.

As a member of the administrative committee, she does not advise the other members of the committee of these problems, or of her sale of the stock, nor does she suggest that the administrative committee put out some educational information to the employees about difficulties with Enron's stock price. To the contrary, she's a part, evidently, of an effort by the Enron management to urge employees to continue to buy Enron stock. Do you think that's a breach of fiduciary duty under ERISA?

Mr. Vine. I understand your question, and I hope you'll bear with me. I don't want to comment specifically on the Enron matter, but let me just assume the facts that you've just described.

Mr. Andrews. Yes.

Mr. Vine. Obviously, I don't know all the facts in the Enron case.

Mr. Andrews. Assume they are as I outlined them and with that caveat.

Mr. Vine. Assuming they are as that you have outlined, I would have serious concerns about a breach of fiduciary duty.

Mr. Andrews. Well, are you concerned and do you think it is a breach of fiduciary duty?

Mr. Vine. Based on the facts that you've stipulated?

Mr. Andrews. Right.

Mr. Vine. Yes, there is a breach of fiduciary duty.

Mr. Andrews. Okay, now, what would be wrong in that? One of the reasons why no one in that situation put out any information about the company's problems to employees, including thousands of employees who own 100 percent of their 401(k), self-directed 401(k)s in Enron stock, is because everybody on the administrative committee was an executive management employee of Enron. Everybody.

So, everybody was in a position to go to the committee and say, “You know, as fiduciaries, we probably ought to tell these people that they're on a stock that is plunging and crashing.” If they did that, in all likelihood, their careers at the company would be rather neutralized, by making that kind of representation. And when they're wearing their employee hat, they really can't do that.

What would be wrong, in a case like that, with having a non-management rank and file employee or two on the committee overseeing the 401(k) plan? What would be wrong with that?

Mr. Vine. The question is, how you would first designate someone, non-management, to serve on the committees? The second question would be how do you find someone with the requisite expertise to serve in that capacity?

Mr. Andrews. Well, let's assume that we could overcome the technical problem of how the person is chosen. I know that's a very difficult problem, and has a lot of issues. But what I asked you, was "What's wrong with the idea?" You've testified that you think it's disruptive, and divisive, and really a terrible thing. What's so terrible about having someone sit on that administrative committee who isn't part of the management of the company, who might have blown the whistle in that case, and said, "You know what, fellas? We ought to put out some information here that this stock is tanking, and we've noticed that most of our plan members have all of their assets in their stock. Maybe they should reconsider doing something about it." What's so wrong with that?

Mr. Vine. There is nothing wrong with it, if a company chooses to do it. But what is wrong about it is Congress mandating it. The process is important. You've said, "Let's assume we can get over it." That's not a trivial problem.

Secondly, I'm not convinced that if there had been this hypothetical non-management person on the committee that that would have made all the difference. That person might not have had access to the same information that the executives had. And if the person didn't have access to the information, he wouldn't have been in a position to, as you put it, "blow the whistle."

Mr. Andrews. What if the non-management member had access to information in the public domain, in which the record shows that the stock started to drop rather precipitously? And then in his or her position as fiduciary, knew that most of the employees were 100 percent vested in their self-directed accounts?

Do you think they maybe would have put out some information that would have said, "You might want to reconsider your position?"

Chairman Johnson. For the record, let me just state that in the Enron case, they did do that. Every day, they tracked the stock for the employees.

Mr. Andrews. That's true. And it's also true, Mr. Chairman, that none of the members of the administrative committee took the time to send out an e-mail or a flyer in the paycheck that said, "Maybe you should reconsider your position." As a matter of fact, they did the contrary, as I understand it. They continued to boost the sale of the stock up to the very calamitous end.

So what's wrong with having somebody on the committee doing that?

Mr. Vine. I haven't said that there is anything wrong.

Mr. Andrews. You did. That was your testimony. You said it would be divisive and disruptive.

Mr. Vine. I said mandating it would be wrong.

Mr. Andrews. Oh, I see.

Mr. Vine. Mandating it would be wrong.

Mr. Andrews. Do you think it would happen if we didn't mandate it by law?

Mr. Vine. In some cases, in my own firm, for example, there are rank-and-file employees on our committee. And I assume at other companies they do it, some companies, they don't.

Mr. Andrews. If you could, for the record, if you have the opportunity, I'd like you to supplement the record by telling us how many ERISA plans have voluntarily put rank-and-file employees on their management committee.

Mr. Vine. If I can get access to that information, I'd be happy to.

Mr. Andrews. I would appreciate that. I yield back the balance of my time.

Chairman Johnson. Thank you. I didn't mean to interrupt you.

Mr. Andrews. That's okay.

Chairman Johnson. Does Mr. Boehner care to query?

Mr. Boehner. Thank you, Mr. Chairman. Let me follow up on the line of questioning from my friend and colleague from New Jersey, Mr. Andrews. And let's free up the facts for the moment, but let's assume that there is a fiduciary breach under the facts as Mr. Andrews outlined them. And if there were a breach of fiduciary duty, can you outline what kind of liability that fiduciary would have?

Mr. Vine. Under ERISA, assuming there has been a breach of fiduciary duty, the fiduciary in question would be personally liable to restore to the plan any losses that the plan incurred as a result of the breach. And in addition, if the fiduciary personally realized any gain from the breach, he would be liable to restore to the plan the gains that he derived from the breach of fiduciary duty. In addition, if other fiduciaries knowingly facilitated his breach, they too could be liable for participation in the breach, under ERISA's co-fiduciary liability provisions.

Mr. Boehner. So, under the example outlined by my friend from New Jersey, Mr. Andrews, if, in fact, if there was a breach of fiduciary duty at Enron, all of the members of the management committee who were fiduciaries to the plan could, in fact, be held liable.

Mr. Vine. All of those who either committed the breach themselves, or knowingly facilitated others in committing a breach could be personally liable, that's correct.

Mr. Boehner. There's some increasing talk about whether the remedies within ERISA are sufficient to protect the interests of the employees. And I would ask you, Mr. Vine, and others who may be interested in your comments, as well, as to whether you think that the remedies under the law today are sufficient.

Mr. Vine. I think they are sufficient. Under the law today, the fiduciary violations of the fiduciary duty provisions of ERISA can be enforced by participants, by beneficiaries, and by other plan fiduciaries who feel that some other fiduciaries violated the law, by the Secretary of Labor, and in some cases, by the IRS.

They can pursue these remedies in federal court, and they can even pursue remedies not only against fiduciaries, but also against parties in interest who participate in prohibited transactions under ERISA. So there are very ample remedies available today, under the law.

Mr. Boehner. Mr. Evans?

Mr. Evans. I think that's a great question. And certainly transferring that risk, even if they are at risk, which they certainly are, the fact of the matter is if their net worth, being an executive of the company has also gone down significantly, which happened with Enron, to have adequate fiduciary liability coverage shifted to a third party benefits all concerned.

And certainly Mr. Andrews's point about having rank-and-file employees serving, if I was selected, I would want to insist that they have that coverage purchased on my behalf, because I wouldn't want to put my house and my assets at risk. So, I think that's something the private sector does well, and we're going to see more of.

Mr. Boehner. Mr. Olsen?

Mr. Olsen. I'm not an attorney or an accountant. But it's my understanding that the remedies don't exist to the degree, if the person isn't a fiduciary. And again, using some of the examples that were used, it's questionable whether the CEO was a fiduciary, and therefore had a breach. My understanding, then, is that the remedy to that person would be limited to something called equitable relief, which would not make the person whole in the plan, and so there is a little void.

In my view, there is a void in ERISA since the employee is not made whole when there is wrongdoing by someone who may skirt outside the fiduciary position. And I think we need to get back to what the name of the law is, what the “E” stands for.

Mr. Boehner. Well, either you're a fiduciary, or you're not.

Mr. Olsen. Well, there is a category for others, and if they aren't a fiduciary, I'm right at the level of my knowledge on this one, for sure. But you can only get equitable relief, and you can't get made whole from that source.

Now, if that's the case in the law, I think that ought to be tightened up. And I, again, would say that the “E” in ERISA stands for employee, not employer, and certainly not Enron.

Mr. Boehner. Mr. Warner?

Mr. Warner. I happen to chair SAIC's retirement committee that gets involved in all of the plans. And when I took that chairmanship, one of the first things I got was a briefing by an outside attorney on the fiduciary responsibilities for that committee.

And we also make sure that all of the other members of the committee get that type of presentation, to understand that their attention should be focused on the beneficiaries and the participants, and not on the corporation itself when the committee meets. And I can tell you when I got that briefing from the attorneys, it was sobering in terms of all the different consequences that are out there.

And relative to Congressman Andrews' comments about having the technical rank-and-file, that's exactly what we do. We have a technical environment committee. The chair of that committee sits in on the administration. It's very easy, within existing plans, to accommodate that type of situation, and very positive for the administration of the plan.

Mr. Boehner. Thank you. My time has expired. Mr. Chairman?

Chairman Johnson. Thank you, sir. Does the gentleman from California, Mr. Miller, care to query?

Mr. Miller. I do. Thank you, Mr. Chairman.

Mr. Vine, in your statement on page nine, you talk about 404(c) that does not absolve the plan's fiduciary from all responsibility. Then you talk about a fiduciary that selects the plan's investments, remaining responsible for selecting and periodically re-evaluating these funds, in accordance with ERISA's fiduciary standards. Also, you state that it includes any employer stock fund that the plan offers.

So what's your understanding of the fiduciary responsibility of the plan board to that block of stock that is contributed by the company, in terms of periodic review of whether that continues to be a proper investment vehicle?

Mr. Vine. ERISA does permit plans to make substantial investments in company stock.

Mr. Miller. Right.

Mr. Vine. But it does not relieve the plan fiduciaries of responsibility for exercising the duty of loyalty that is acting solely in the interest of participants and acting prudently. If the fiduciaries looking at that investment conclude that it is simply not in the interest of participants to have this as an investment offering because the stock is headed nowhere but south, or because it's too volatile for a retirement plan, or for some other reason, they have a duty, under ERISA, to put a stop to it.

Mr. Miller. And that is not relieved by the fact that that stock may be encumbered, that it's not for sale until you're age 55 or 50, or not for 10 years. They still are not, if I read what you're saying here, and I don't want to put words in your mouth, relieved of the fiduciary responsibility as to whether or not that continues to be a prudent vehicle for their investment.

Mr. Vine. That's absolutely right. The person who writes the plan can write the plan out of ERISA's fiduciary duties.

Mr. Miller. Right.

Mr. Vine. Prudence, and the duty of loyalty remain in effect, even for such a plan.

Mr. Miller. So, Ms. Olson, who saw the Watkins memo and sold her own stock, but said nothing to the plan, if she had made a decision that, “Gee, maybe my friends in this company ought to get rid of some of this stock,” she, theoretically, could have made, and some would argue should have made, the decision that this was no longer a prudent vehicle certainly in this concentration.

Mr. Vine. Again, without commenting on Enron specifically, absolutely. Yes. And you know, under current law, the trustees of an ERISA plan, the fiduciaries in an ERISA plan are subject to the duties that are equivalent to those of a common law trustee, which is you're supposed to look out for these people.

Mr. Miller. So the situation, conceivably, can be, if you have a three-year holding period, or a one-year holding period, as I have in my bill, or you have a holding period that extends until you're age 55, assuming you're a 45-year-old employee, you can get prudent advice from the plan's board that you ought to sell the stock, or the stock considering concentrations, is not a prudent investment. You would be prohibited from selling it.

Mr. Vine. I'm not sure I understand.

Mr. Miller. The stock has conditions. You can't sell it until you reach age 55.

Mr. Vine. Yes. And then the plan can under current law, so provide.

Mr. Miller. So, the plan, conceivably, can be in conflict with the fiduciary's prudent advice.

Mr. Vine. No. There is no doubt prudence supersedes what the plan says. If the fiduciary concludes that, as a matter of prudent investment judgment, this plan should not be holding company stock, the terms of the plans are superseded. ERISA could not be clearer about that.

Mr. Miller. So, a fiduciary that runs the plan should no longer think that their advice is not relevant to that block of stock, which is conditioned by the company as to the conditions of sale.

Mr. Vine. That's absolutely right. Under ERISA, a fiduciary is obligated to comply with the terms of the plan, only to the extent that those terms are not inconsistent with the other requirements of ERISA, which include the duty of loyalty and prudence.

Mr. Miller. And then obviously, this was about 10 percent of the stock. I think we keep saying that the employees had access to 89 or 90 percent of the other Enron stock. But in some cases, even with a mixed portfolio, much less concentration than what the Enron employees had, a 10 percent holding in that particular single energy stock can be a concentration that's not really what you'd consider diversification.

Held in a mutual fund, that same stock might be fine. If it was held in a general fidelity energy futures, or whatever it's called something select. Everything is select with fidelity nothing is general with fidelity. That might be a prudent investment, to hold Enron in a larger energy mutual fund, but to hold 10 percent of only Enron stock? You don't think that there is a conflict there, for the fiduciary?

Mr. Vine. I think the fiduciary has a duty to look at what the plan is offering and the investment options the plan is offering.

Mr. Miller. Then what happens to the employee if I want to get rid of that 10 percent? I can't get rid of it for three years, or I can't get rid of it until I'm age 55.

Mr. Vine. It depends on the plan's rules.

Mr. Miller. Let's assume age 55.

Mr. Vine. That's right.

Mr. Miller. I'm 45 years old, the fiduciary comes in and says, “You know, I think people ought to check their holdings on Enron,” and my holdings are in the contributed stock. I'm prohibited from acting in my best interest.

Mr. Vine. Oh, let me be clear about this. The fiduciary may have a duty not to give advice to the participants, but to cause the plan to sell the stock because it's no longer a prudent investment for the plan to hold.

So, it's not a question of the fiduciary going to participants and saying, “you ought to sell the stock, too bad you can't, because you're not the requisite age, or have the requisite service.” The fiduciary may have a superseding duty to cause the plan to sell the stock, regardless of the choices made by participants, and regardless of the terms of the plan.

Mr. Miller. Well, for that block of stock they're in control. They could make that decision, and the decision could be made to sell?

Chairman Johnson. The gentleman's time is expired.

Mr. Vine. Yes, the fiduciary has the duty to exercise prudence, regardless of the terms of the plan.

Mr. Miller. This is a different question, but if you're the senior vice president of the company, and you walk in and say, “Sell the plan stock,” I think that sounds like a career-ender.

Chairman Johnson. No, but he's correct, Mr. Miller, on what the fiduciary responsibility.

Mr. Miller. No, I understand that. But the question is, can the fiduciary, Mr. Chairman, exercise that responsibility when they're on the fast track, and you only report to Mr._?

Chairman Johnson. I understand where you're coming from, but that's what the fiduciary's responsibility is.

Mr. Miller. Yes, because I'm sure you won't want the answer to the question, Mr. Chairman.

Chairman Johnson. The time has expired, and we have to vote. We have about seven minutes left. The Subcommittee will adjourn for 15 minutes.

[Recess.]

Mr. McKeon. [Presiding] The Chairman has gone to vote. He said, in the interest of time, I should take the Chair and move this forward. In the interest of time, I'm going to do that.

I really appreciate your comments and your testimony here today. I think Enron has been something that has caught the public's attention. It certainly has caught the attention of all the politicians here. My concern is when something like this happens, politicians respond quickly, and sometimes do something that you commented on, Mr. Vine. We're concerned, I'm concerned, that we over-react and cause some potential damage with unintended consequences.

There are lots of pension programs out there, lots of retirement programs out there, lots of companies, and lots of employees that are moving along just fine. And because of one or two very serious cases that caused great harm, we have to be, I think, very careful to proceed very cautiously, and not get stampeded into doing something that will end up causing more harm than the harm that has been caused to this point. I am concerned that people may be excluded from retirement plans if we are precipitous and drive companies to the point where they say it's not worth the risk, or the problems involved.

I do have some questions. Dr. Warner, one of the suggestions that have come up is to limit employees in their choice. Have you ever put controls on employees' purchase of SAIC stock in their 401(k)s, and if so, what was the reaction?

Mr. Warner. Before January of 2001, relative to the 401(k) plans, we didn't have any restrictions, in terms of what the employee could do with money they contribute. We did have some restrictions on how rollovers would occur as we acquired other companies. When the plans merged into our plan we limited the rollovers to 50 percent. And in January, we decided to begin restricting what our employees could do, and cut them back to 25 percent and then got a tremendous reaction from the employees.

What we found out is that employees were looking for flexibility in their investment options, and some of the employees had relied very heavily on being able to use tax-deferred dollars to participate in employee ownership of the corporation. And so, their 401(k) plan was a way in which they could participate in employee ownership, which is fundamental to the culture of the corporation.

As I said earlier, it was some of the younger employees who we try to encourage to get into plans early for the compounding effects in order to build a retirement later, that really raised the issue that they were being discriminated against because of the action that the operating committee of the board took to restrict them.

Now, we've changed that back. We still have a little bit of restriction, in the sense that we've raised it to 50 percent restriction, but that only applies to those employees that have more than $50,000 in stock. So we did a tiered approach, and we said, “Anybody that doesn't have a lot of employer stock and wants to participate through 401(k) can, but if you get up to some limit, then we're going to restrict you by 50 percent.”

And the point here is that for the company, having the flexibility to do what was right for the employees, was fundamentally important, as opposed to having a set of rules that we have to follow, that you can only do this, or you can only do that, which might affect the environment and culture we have in the corporation. So, I urge flexibility.

Mr. McKeon. Did the employees that were over $50,000 accept that restriction?

Mr. Warner. We did not hear very much back from that set of employees with that particular restriction. But given how much money can be contributed per year, and the limit now $11,000, it takes some time for that to build up, even if they're doing 100 percent contribution.

Mr. McKeon. Thank you. Mr. Evans, are you familiar with the bill that was presented by Chairmen Boehner, Johnson, and Mr. Fletcher?

Mr. Evans. The Pension Security Act?

Mr. McKeon. Yes.

Mr. Evans. Yes, sir.

Mr. McKeon. What affect does the blackout proposals in their bill have?

Mr. Evans. One of the things that we wanted to bring to the table is that it's our opinion that the exemption should still continue during the blackout period under 404(c). Meaning, in English, that if there is a two-week or a month period where people can't change their investments and the stock market goes up, that those trustees aren't liable in a fiduciary sense for the opportunity gain. We just think that's sound practice.

Mr. McKeon. You don't see any problem with leveling it out so that the employees and the management all have the same opportunity to buy and sell?

Mr. Evans. That's correct. I think that notification is a good thing. If you ask the folks here that sponsor plans, I think most companies give notice before any blackout period, if someone wants to take a loan out, if someone wants to change investments. So, practically speaking, it's common sense that you would let the employees have ample time to know that if they want to initiate something, to do it. And I think to continue to allow that without a lot of restrictions, companies are going to do the right thing, they really are, in terms of that.

This Enron thing not withstanding, generally, most companies don't want unhappy employees. They don't want them at work worried about their retirement plans, because they can't be productive.

Mr. McKeon. Under current law during a blackout period, what are the requirements and obligations of fiduciaries to their participants in the individual accounts?

Mr. Evans. Well, it's the general fiduciary requirement that they do the prudent thing, they act timely. I think the biggest thing in the blackout period is that you act timely. Also, remember that the plan has to balance. If there is a shortfall when you go to change, the company is liable. The plan has to make the plan whole. So there is both a fiduciary sense and a real balance sense under ERISA that the plan has to be in balance.

So, as fiduciaries, really it's speed and care to get it done, but they can't go forward if it doesn't balance. And you don't know that. If you're changing because you have a problem, you sometimes don't know the problem until you get into it.

Mr. McKeon. Thank you. Ms. Reynolds, in your opinion, what would be a reasonable restriction on the amount of time an employee may be required to hold company stock?

Ms. Reynolds. I really don't believe that there should be a restriction on the amount of time that an employee would be required to hold company stock. That was your question?

Mr. McKeon. There is a restriction right now, I think. They have a limit of five years. And one of the proposals is that that be limited to three years.

Ms. Reynolds. Yes.

Mr. McKeon. If you don't agree with those limits, what would be a reasonable time?

Ms. Reynolds. I don't think that it should be legislated. I believe that there are employers out there that do have such restrictions on their employer stock, as far as how long it must be owned. And there are obviously reasons why they do that such as to create an ownership culture in the company among other reasons.

I don't believe that that is something we should legislate, or mandate, as far as that's concerned, because why they would impose any of those restrictions is very deeply ingrained into those organizations and their cultures. And I must add that the restrictions aren't being imposed on employee contributions. I think that's an important point to make, in that it does get lost somewhat in light of the Enron situation.

Mr. McKeon. Thank you. Mr. Olsen, have you any survey information of how many of your members have company stock in their retirement accounts?

Mr. Olsen. We don't have because our membership is so broad but I think we can probably speak relatively with the whole country. About 50 percent of the people have pension plans, roughly. And as I understand it, a third have company stock. So, I presume that that would probably be very close to the number for our membership.

And in response should it be legislated, pension plans are a tax-supported endeavor. And so any justification for any legislation, I think, lies in the fact that this is probably the largest tax subsidy, it's my understanding about $90 billion a year, that the government makes which, of course is designed to ensure that people have adequate funds for their retirement.

Mr. McKeon. Have you done any polling? Do you have any polling data as to how your membership regards the use of company stock in retirement plans?

Mr. Olsen. I don't have that, specifically, but if the company has it, and we have statistics on everything, I will send it in to you.

Mr. McKeon. So we can get it in the record?

Mr. Olsen. Yes, I will. Yes.

Mr. McKeon. Thank you. Ms. Reynolds, what kind of communications does your company give to employees regarding their defined contribution plans?

Ms. Reynolds. We have a multi-tiered communications strategy when it comes to our 401(k) plan, because we have the ability to reach our employees by the Intranet, Internet, e-mail, and direct campaigns to them. Each year we have a very multi-faceted approach whereby we offer investment seminars over the web via a Webcast. Also, we have provided those at our major locations with individuals that are basically there to assist our employees in understanding the importance of diversification.

We very frequently are sending messages on our Intranet, on what's called HRExpress through which all of our employees are very well aware of the information that's out there. Also we'll target e-mails to them. With the recent situation with Enron, we actually took this opportunity to target employees who had more than 20 percent of their account invested in employer stock, and provided a targeted communication to them basically explaining the principles of diversification, and the importance of it.

So, we have an annual, ongoing program every year where we basically sit down and map out what our communications are going to be to our employees. Education is not a one-time deal it is ongoing. And today we'd like to realize as many of the different mechanisms to reach our employees as possible.

Mr. McKeon. Thank you very much. My time has expired, and the Chairman has returned. I'll return the chair to him. Thank you very much.

Chairman Johnson. The Chair recognizes Mr. Andrews for questions.

Mr. Andrews. Thank you, Mr. Chairman.

Ms. Reynolds, I noted in one of the footnotes in your written testimony, and correct me if I'm wrong about this, in the 401(k) plan, which is among the many plans that your company offers, and I commend you for that, apparently 3.9 percent of the 401(k) plan assets are in NCR stock, is that right?

Ms. Reynolds. That's correct.

Mr. Andrews. Okay. And I understand that what happens here is that when NCR matches, it matches with a cash contribution, correct?

Ms. Reynolds. That's correct.

Mr. Andrews. I believe you said that in your oral testimony, also. NCR stands out among some major employers in that regard. When we had an earlier hearing, the Committee had introduced into the record a list of major employers in the country, Procter & Gamble, Sherwin Williams, Pfizer, Coca Cola, major blue chip employers in the country, where in excess of two-thirds to three-quarters of 401(k) plan assets were in the stock of the company at the choice of the employees in self-directed accounts.

Ms. Reynolds. Right.

Mr. Andrews. Why is it, do you think, that your percentage is so low, and your 401(k) accounts of your employees are so diverse, relative to these other plans?

And by the way, let me just preface it by saying I'm not implying anything wrong about NCR or about these plans. I'm simply saying it's striking that at Procter & Gamble, which is another major employer in your part of the world, 94.7 percent of 401(k) plan assets are in P&G stock, while it's 3.9 percent at your company. Why is that?

Ms. Reynolds. I think part of it stems from NCR's history. If you take a look at our organization, or know anything about NCR, we were acquired by AT&T Corporation in the early 1990s, and we were spun off in the end of 1996. There was a lot of confusion for our employees as far as who we were as a company. We've been vastly working at regaining our corporate identity.

Compare that to a Procter & Gamble. You walk into the grocery store and you see their products every day, and the employees generally at that company have more of an ownership culture. And I would think some of it's attributed to the fact that NCR has been reinventing itself since the spin-off from AT&T.

We also heavily promote our employee stock purchase plan, and have about 28 percent of our employees that are currently in it contributing up to 10 percent of their salary. So that is another vehicle where ownership is something that our employees are looking to.

I think that those are two big differences as to why we'd be a little bit lower.

Mr. Andrews. I understand.

Chairman Johnson. May I interrupt since there are only two of us?

Mr. Andrews. Sure. I'll yield to the chair.

Chairman Johnson. Thank you. I think many stocks like Procter & Gamble, which he mentioned, or GE are diversified by the fact that the companies operate in hundreds of different product and field areas. Some of the companies, like Enron that we've been talking about, are solely in one field, and there is no diversification of their stock.

Ms. Reynolds. I believe Procter & Gamble also has employer stock as part of their contribution in one of their plans.

Chairman Johnson. Yes. But all the big companies overall in the United States are less than one percent. You know, you just picked one or two that have a pretty big employee influence in their stock.

Mr. Andrews. Also, although they may be one percent of the companies, they represent far more than one percent of the employees in the country. It's about six percent of the employees.

Ms. Reynolds. Six percent.

Mr. Andrews. So it's a lot. I want to ask Mr. Ferlauto a quick question. Hopefully I'll have an extension of time, with the Chairman's graciousness.

What is your assessment of the adequacy of remedies under ERISA for people like the Enron employees, who have been victims of a breach of fiduciary duty? As a practical matter, what can someone do right now, who believes that his or her pension has been vastly injured by a breach of fiduciary duty by an Enron fiduciary?

Mr. Ferlauto. As a practical matter, an individual employee has recourse to the courts, but not much else. And as we've seen in the Enron case, for example, and many other cases, it isn't necessarily clear that the employee will actually be made whole for their losses.

And I think that's a significant problem. There may be some punitive damage, but the employee, ultimately the person whose retirement asset we're trying to protect, is not going to receive back the commensurate loss that they had suffered, and that's a significant problem.

Mr. Andrews. Thank you.

Chairman Johnson. Thank you. Let me just say, that's the difference between defined benefit and 401(k). You can't define profit and loss in a 401(k), because it's up and down with the stock market, if you choose to put your money in stocks.

Mr. Ferlauto. And that's the very problem, actually, because employees bear all the risk for their retirement future, as opposed to sharing it with the employer.

Chairman Johnson. That's right. But they choose that program. In the case of Enron, they offered three different programs that they could have chosen from. And most companies do.

Does your company offer more than one program? I think I asked you that once.

Ms. Reynolds. Yes, we do.

Chairman Johnson. Mr. Tierney, do you care to question?

Mr. Tierney. I do, Mr. Chairman, thank you. Well, staying on that issue for a second, you know, my understanding is that in Enron, though there might have been three plans, that the primary retirement plan for the Enron employees was the 401(k). I think that's pretty clear, from what we know.

So, I'm curious. We have, in ERISA, with respect to defined benefit retirement plans, the fiduciary responsibility to diversify the investments of the plan, so as to minimize the risk of large losses, yet we turn around and we have a 401(k) plan that is, effectively, the primary retirement plan, and we don't have any fiduciary obligation to diversify the investments of the plan so as to minimize the risk for large losses.

Mr. Ferlauto, can you reconcile those two situations?

Mr. Ferlauto. Actually, I think it's a major problem. The responsibility for defined benefit plans actually goes beyond that, in that there are procedural requirements that have been established, through ERISA and the DOL, in terms of procedural prudence: hiring well-versed professionals, seeking counsel, either in terms of investment policy or in terms of legal policy about certain types of investments and conflicts of interest.

None of that professional support is available to and/or required for defined contribution participants. The individual is left to think on his or her own, where a defined benefit plan participant has a myriad of support through professionals who spend full-time working on this. You can't expect a defined contribution participant to invest as effectively as a defined benefit participant, because they're just not knowledgeable, and they don't have the supports required to do that.

Mr. Tierney. Thank you. Mr. Vine, can you reconcile those two concepts for me, why we are so concerned? If both the retirement vehicles are the primary retirement vehicles, why, in the one instance, are we concerned about making sure a fiduciary diversifies to minimize risk, but in the other, some people advocate that we don't have a precaution like that?

Mr. Vine. There are major differences between the two types of plans. The defined benefit plan guarantees a benefit, and Pension Benefit Guaranty Corporation backs up that guarantee.

Mr. Tierney. But in that instance, even with those guarantees, you add on the fiduciary responsibility to diversify.

Mr. Vine. That's correct.

Mr. Tierney. Take the other plan that doesn't have those guarantees, and you add further risk to it by saying, “We have no requirement that you diversify, even though it's your primary retirement vehicle.”

Mr. Vine. Yes. Well, it's been pointed out in a great many cases, particularly the companies that belong to ERIC, the group that I'm in.

Mr. Tierney. But I'm not talking about those, sir, I'm talking about the ones where it is the primary retirement vehicle.

Mr. Vine. Right.

Mr. Tierney. Do you have any objection in at least isolating those cases, and doing something about that to make it more in line with defined benefit plan?

Mr. Vine. The question would be, and this is a difficult technical challenge, to distinguish between those companies where they have an adequate defined plan, and a 401(k) plan that supplements it, versus the kind of company that you're concerned about, where, let's say, the 401(k) is the only plan.

Mr. Tierney. Well, the primary if people are being led to get into it as a primary vehicle. You know, sometimes you have an option, but you don't really have an option, everybody is doing one thing, or the company is doing really well.

Ms. Olson was supposedly told by her advisors that she had an emotional attachment to her company, and that's why she loaded up all her stock in there. She is a sophisticated woman, she is very smart, and yet when she went to her advisor, the advisor said, “Well, you know, you've just got such an emotional attachment, you've got to diversify. And, you know, you shouldn't have it all in there.” She said, “Well, the company is doing well, and I want to take the ride up, you know.”

And he was telling her that you have to diversify, because that's generally what wise advisors tell their people, they have to diversify.

So, it seems to me it's worth the effort to make the distinction that when there is a plan like a 401(k) plan that has served as the principal retirement vehicle, that if it's good for defined benefit plans, it ought well to be good for those, to make sure that there is some diversification protection.

Mr. Vine. I think that the challenge, and it's a formidable challenge, is going to be to identify that class of cases. It's not going to be an easy matter.

And if you do that the second challenge will, in effect, discourage employers from having a plan at all. Congress has done a pretty good job of discouraging employers from having a defined benefit plan.

Mr. Tierney. Yes. I mean, as far as I see it, employers get the gravy train here on this thing. But why don't employers just give them cash, let them buy whatever the heck they want to buy?

Mr. Vine. Well, depending on what the outcome of this process is, that might be the result.

Mr. Tierney. Yes.

Mr. Vine. That might be the result.

Mr. Tierney. You know, I'm wondering what's wrong? Then the businesses wouldn't get their little fancy tax breaks, which seem to be the motivating factor. And despite all the conversation about how they want to help their employees, or whatever, give them cash and let them buy either the company stock, or let them buy something else. If it were a good company, presumably they'd want to. But it's compensation.

Mr. Vine. Well, that's a possible result. I mean bear in mind the cash is going to be immediately deductible for the company. There is no fancy tax break that the company is losing; it's the employees who will lose.

Mr. Tierney. Well, the company is going to lose, too. Who is kidding whom? This is a good deal for companies, to be able to do this. I mean you're not going to seriously sit there, straight-faced, and tell me that there is no benefit to the corporations to make these contributions as part of the compensation package?

Mr. Vine. No. Of course there is benefit to the companies. The companies wouldn't be doing it, otherwise. But my point is that the tax break to which you refer isn't the motivation.

Mr. Tierney. But there are other advantages to add on to that.

And you know, just in closing, ERIC seems to take the position not only with this but I've had an exchange of letters with the organization before on retiree's health benefit plans. It always seems to be ERIC's position, “Gee, if you protect the employee, we're going to take our marbles and go home."

If we're people that say they're so concerned about employee's rights and employee's benefits, I'm a little disturbed by that constant sort of knee-jerk reaction, that "If you regulate us in any way to protect employees, or if you require that we maintain a promise to employees, then we're just going to take them home, and nobody is going to get anything from us."

Mr. Tierney. That's just an editorial statement. You may not agree.

Mr. Vine. Yes, I wouldn't agree with it, but we'll let it rest there.

Mr. Tierney. There you go.

Chairman Johnson. I thank the gentleman from Massachusetts. You don't have any more editorial statements for us, do you?

Mr. Tierney. If you've got the time, I've got the statements.

[Laughter.]

Is that an offer to give me the time?

Chairman Johnson. No, thank you.

[Laughter.]

Chairman Johnson. Without objection, I ask that the record to be held open for 14 days, to allow for Members' statements, witnesses' written testimony, and other material to be submitted for the record. Hearing no objection, so ordered.

I want to thank the witnesses for your time and testimony. I know your time is valuable. Thanks again to the Members for their participation. If there is no further business, the Committee stands adjourned.

Whereupon, at 12:40 p.m., the Subcommittee was adjourned.

APPENDIX A - WRITTEN STATEMENT OF CHAIRMAN SAM JOHNSON, SUBCOMMITTEE ON EMPLOYER-EMPLOYEE RELATIONS, COMMITTEE ON EDUCATION AND THE WORKFORCE

Opening Statement of Chairman Sam Johnson

Subcommittee on Employer-Employee Relations

February 27, 2002

Americans want to retire with a nest egg, not a goose egg…

In today's hearing we'll evaluate proposals to help them do just that.

We're going to find a way to protect employee retirement accounts without over-burdening the system.

By and large, we have found the defined contribution system works very well as a means for saving for a secure future.

However, Enron has pointed out for us some areas of concern.

In the many hearings we have held so far, we have learned that too many workers lack access to meaningful information about their retirement savings, especially quality investment advice on how to invest their hard-earned savings.

We have also learned that while so-called "blackout" periods are common in plans, workers may not have an adequate understanding of blackout periods or enough advance notice to adequately prepare for them.

That time is important for someone nearing retirement or taking out a loan to help buy a home or pay for a child's education.

Additionally, we have also heard about some risks associated with putting all your eggs into one basket -- or what experts call lack of diversification in retirement accounts.

We have also heard about many employees greatly benefiting by voluntary company contributions or matches to employee retirement accounts.

It's no secret that Enron employees were allowed to contribute up to 15 percent of their salaries to the 401(k) plan.

Yesterday, my other committee, the Ways and Means Committee, discussed Enron's retirement system.

We discussed that at of the end of 2000, the plan held almost 14.5 million shares of Enron stock.

Employees had 20 different investment options, including Enron stock. these investments could be traded on a daily basis. In addition, Of the 14.5 million shares..., 89 percent was attributable to employee contributions, which could have been sold on a daily basis.

These are facts we can not ignore.

Throughout this process, our Committee has been focused on learning the problems that exist with retirement plans so when we legislate, we address only problem areas and don't unintentionally harm a retirement system that, again, has worked remarkably well for two decades – helping millions of people.

To that end, myself, along with Chairman Boehner, Subcommittee Vice-Chairman Fletcher and other members from both parties, introduced president Bush's Pension Security Act.

The key components of the bill are aimed at increasing the protections that a participant has under ERISA without upsetting the very delicate balance of employer sponsored pension plans.

This measure sends a clear message that Congress is committed to restoring worker confidence in America's pension system in the wake of the Enron collapse and it continues the committee's commitment to ensuring that our nation's workers realize their dream of a safe, secure retirement.

The Pension Security Act is the first step toward creating a consensus product that can eventually be signed into law and will help restore worker confidence in the nation's retirement security and pension system.

There are many legislative proposals pending before us -- ranging from educating employees about their retirement savings options to restricting employees' choices about how to allocate their savings in a retirement plan.

As we consider all of the many proposals, we must be mindful of our responsibility not to jeopardize the retirement savings of millions of American workers at the hand of over regulation.

We should also keep in mind the impact of any legislation to our over all economy.

Today, the Subcommittee will hear from a panel of witnesses representing different groups of employers, employees, retirees and service providers who have a keen interest in any pension legislation that will be considered by the House.

We welcome their comments and will promise to keep their views in mind as we deliberate and vote on legislative proposals.

APPENDIX B - WRITTEN STATEMENT OF DAVID EVANS, VICE PRESIDENT, RETIREMENT AND FINANCIAL SERVICES, INDEPENDENT INSURANCE AGENTS OF AMERICA, ALEXANDRIA, VA

Testimony of Mr. David Evans, Vice President

Retirement and Financial Services for the Independent Insurance Agents of America

February 27, 2002

I want to thank Chairman Sam Johnson, Ranking Member Andrews, and the rest of the Committee for allowing me the opportunity to present my testimony regarding the important issue of providing safeguards for 401(k) plan participants. I am Dave Evans, Vice President of Retirement and Financial Planning for the Independent Insurance Agents of America (IIAA). IIAA is a non-profit trade association that represents over 300,000 independent insurance agents and brokers and their employees nationwide. I have been involved in the retirement plan arena for over twenty years as a consultant and administrator working with companies, not-for-profit organizations, unions, and currently a trade association comprised of smaller businesses.

I want to begin by saying that IIAA applauds the Administration, Chairman Boehner, and Employer-Employee Subcommittee Chairman Johnson for bringing to the forefront a number of issues of importance for retirement security. While we believe that, overall, this is a sound bill, we have one significant objection related to the fiduciary liability exemption afforded under ERISA Section 404(c) to plan sponsors, particularly as it relates to the so-called "blackout" period. If unresolved, this issue will serve as a disincentive for employers to sponsor qualified retirement plans.

During the 1980's, with the trend towards letting plan participants direct the investment of their own accounts, plan sponsors were concerned about their potential liability should participants become unhappy with the outcome of their investment decisions. After much thought and input encompassing five years, the Department of Labor promulgated ERSIA 404(c) which provides a framework for plan sponsors to follow. The guidelines have become the standard since most plan sponsors have adopted adequate diversification of investment options and offer timely information regarding the participant's account values. ERISA 404(c), coupled with thoughtful simplification of retirement plan rules, has stimulated the growth of 401(k) plans particularly among smaller employers.

The Enron situation has certainly focused attention on 401(k)s and the general issue of retirement security. However, we urge Congress to be careful because the devil is in the details. The major concern of small business owners, plan participants and independent agents (who are also business owners) is the blackout period. The blackout period refers to the time period following a change in 401(k) plan record-keepers in which plan participants cannot change how they have their accounts invested. The reason for this is that the new record-keeper must fully reconcile plan participant balances as reported under the prior record-keeper with the information provided by the bank and/or investment managers' statements. Furthermore, additional information has to be reconciled, including participant loan balances and payments, and vesting of employer contributions.

For larger retirement plans, given the sophistication of their resources, this work is normally completed within a couple of weeks if everything balances. However, for smaller employers and unions that sponsor 401(k) plans, the blackout period can take several weeks, or if a significant problem occurs with reconciling the information can be prolonged. During this blackout period, participants' accounts are usually still invested, although they are unable to change investment options or commence a plan loan. It is important to note that the plan sponsor has no motivation other than to complete the transition and minimize the inconvenience to plan participants.

Regarding the Enron 401(k) plan which required employer stock in the plan, the concern remains that a change in administrators was initiated to create a blackout period which would thwart the ability of plan participants to make a change in their plan investments, particularly in Enron stock. However, the vast majority of plans, traditionally smaller companies and unions, do not have employer stock as an option. In fact, most companies dread making a change in plan record-keepers and generally do so as a result of service problems and/or inadequate investment returns. If plan sponsors feel that they will have exposure to liabilities should the blackout period become prolonged, this will serve as a strong disincentive for plan sponsors to take the appropriate action to change record-keepers and/or investment advisors when warranted.

Another reason that the blackout issue is a particular problem for smaller employers is that when they choose to sponsor an IRA, SEP (Simplified Employer Pension) or SIMPLE IRA, they do not have fiduciary liability exposure as it relates to the investments because the employees can move their account to any investment vehicle. This ability becomes a two-edged sword because they can choose to take monies out of these accounts even though they have to pay an excise tax in addition to ordinary income tax. Yet, some employees will do this, damaging their future standard of living in retirement, in order to get their hands on the money. 401(k) plans restrict both the ability of plan participants to access their account balance while employed as well as the possibility of exhausting the funds prior to retirement. Regulations increasing the plan sponsors' exposure to liability will only serve to encourage smaller sized plan sponsors to avoid qualified plans for non-qualified plans such as IRAs, SEPs and SIMPLE IRAs.

I respectfully suggest that the fiduciary liability exemption afforded during the blackout period not be suspended. We stand ready to work with you and the Administration to achieve these goals.

APPENDIX C - WRITTEN STATEMENT OF ANGELA REYNOLDS, DIRECTOR, INTERNATIONAL PENSION AND BENEFITS, NCR CORPORATION, DAYTON, OH, TESTIFYING ON BEHALF OF THE AMERICAN BENEFITS COUNCIL

Testimony of Angela Reynolds, Director

International Pension & Benefits for NCR Corporation

Testifying on behalf of the American Benefits Council

February 27, 2002

Good morning, Chairman Johnson, Ranking Member Andrews and members of the Subcommittee, and thank you for the opportunity to appear this morning. I am Angela Reynolds, Director of International Pension and Benefits at the NCR Corporation of Dayton, Ohio. NCR is a leader in providing relationship technology solutions to customers worldwide in the retail, financial, communications, manufacturing, travel and transportation, and insurance markets. NCR employs 31,400 people in more than 100 countries, and is a component stock of the Standard & Poor's 500 Index.

I am here this morning on behalf of the American Benefits Council, which is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement, stock and health plans covering more than 100 million Americans.

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

Let me begin, Mr. Chairman, by sharing the Council's perspective on our nation's 401(k) and employee ownership system. Today more than 42 million Americans participate in 401(k) plans and 14 million more participate in profit-sharing and employee stock ownership plans (ESOPs). These 56 million workers have amassed more than $2.5 trillion in retirement savings and many have built a substantial ownership stake in their company. These successful employer-sponsored plans not only prepare workers for retirement and democratize corporate ownership, but also serve as an engine of economic growth by providing one of our nation's most significant sources of investment capital. Congress has, over many decades, promoted these retirement savings and employee ownership plans through tax and other incentives, with very positive results for tens of millions of American workers.

Workers at NCR Corporation are among those enjoying these very positive results. The 18,400 employees and retirees participating in our 401(k) plan have amassed $1.54 billion in retirement assets. While our 401(k) match is provided in cash, we make NCR stock available as one of our plan's investment options. Why? Because our employees, who want to share in the success of the company, have asked us to do so. And because NCR believes that the opportunity to invest in the company creates a culture of ownership and accountability among employees that promotes productivity and employment stability. Other firms that provide for an employee ownership opportunity share these same positive outcomes. At the same time, we at NCR take the principle of diversification very seriously, making it a prime focus of our communications to 401(k) participants.

For many of the same reasons described above, NCR also maintains an employee stock purchase plan (ESPP), under which employees may voluntarily purchase NCR stock at a discount. Approximately 28 percent of our U.S. workforce participate in this stock purchase plan. Together with our 401(k) and stock purchase plans, NCR also sponsors a defined benefit pension plan to help our employees build retirement security with a guaranteed, employer-funded benefit.

Indeed, maintenance of a diversified defined benefit pension is typical of employers that provide a 401(k) match in company stock or that offer company stock as a 401 (k) plan investment option. Thus, most workers with employer stock in their 401(k) plans enjoy an employer-funded pension benefit that is diversified as well as guaranteed by the federal government. This pension benefit is one that most American workers and retirees lack. Therefore, it is important to ask whether employees whose 401(k) plans are invested in company stock are really the workers whose retirement income security is the least protected and diversified and most in need of congressional action.

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

The Appropriate Response: Information, Education and Professional Advice

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

In order to avoid unintended harms, the Council believes that retirement policy responses to Enron should focus on ensuring that 401(k) participants have the information, education and professional advice they need to wisely exercise their investment responsibility. Chairman Johnson, this is the course that you and

Chairman Boehner have charted. We support the proposals contained in your Pension Security Act of 2002 (H.R. 3762) to provide employees with advance notice of transaction suspension periods as well as more regular retirement plan benefit statements that stress the importance of diversification. The Council likewise supports the provisions of H.R. 3762 that will help employers facilitate professional investment advice for 401(k) participants. We have supported Chairman Boehner's Retirement Security Advice Act (H.R. 2669) since it was first introduced and believe it will help many more 401(k) plan participants get the professional investment advice they desire. We are pleased that the Bush Administration has made this advice legislation a key part of its 401(k) reform package and that you and Chairman Boehner have now included it the Pension Security Act.

Mr. Chairman, you and Chairman Boehner have indicated that you would like to work with all interested parties to make further improvements to H.R. 3762. We at the Council look forward to this opportunity. As you know, there has been concern about the Bush Administration's proposal for heightened fiduciary liability during transaction suspension periods. We are eager to work with you to ensure that any changes in this area do not act as a deterrent to retirement plan formation and maintenance. The Council also looks forward to a continued dialogue with you on regulation of the holding periods sometimes imposed by employers on the sale of company stock they contribute to retirement plans. We are concerned that overly strict limits on these holding periods could risk reduced matching contributions in some circumstances since employers will no longer be able to guarantee that every worker has a long-term ownership stake. As a general matter, we believe that the earlier in a worker's career that he or she is permitted to sell company shares and the greater the percentage of shares the employee may sell, the greater the risk that some employers will reduce their matching contributions.

Percentage Caps on Company Stock Would Harm Employees

We at the Council want to thank members of the Education and the Workforce Committee on both sides of the aisle for rejecting proposals to cap the percentage of an employee's 401(k) account that can be invested in company stock. These caps would be unpopular with -- and contrary to the best interests of -- the many employees who benefit from having an ownership stake in their company. Indeed, recent research has shown that 401(k) investment returns for workers would be lower were company stock removed from these plans. Moreover, Congress simply cannot know how much investment in employer stock is appropriate for each 401(k) participant. This decision depends upon a myriad of personal variables -- a worker's age and planned retirement date, traditional pension coverage or lack thereof, the existence of retirement savings from prior jobs or non-workplace savings, the pension situation of a spouse, etc. Given this reality, Congress should not substitute its judgment for that of the individual. Rather than limiting employee opportunity through the imposition of caps, we believe Congress should empower workers to wisely exercise their freedom of choice through provision of the new informational and educational tools discussed above.

Percentage caps would also prevent employers from continuing to provide 401(k) matching contributions in stock. Under a typical 401(k) matching formula, employers provide a 50% match on employee contributions up to a certain percentage of pay, often 6%. Thus, for every dollar of employee savings, the employer contributes 50 cents in stock. For the typical worker this would produce an account 33% invested in employer stock, which would violate the 20% ceiling contained in the leading cap proposal (S. 1838). Unable to achieve their purpose of providing an ownership stake to employees via the stock match -- and given the greater expense of matching in cash -- many employers may respond to caps by reducing their matching contributions. The unfortunate result will be fewer employer match dollars contributed to employee accounts. This will weaken one of the most effective incentives for employee saving and inadvertently harm the very people Congress wishes to protect.

Transaction Suspension Periods Are Normal and Necessary

While pleased that Ranking Member Miller excluded percentage caps from his recent retirement plan legislation (H.R. 3657), a number of the bill's other provisions give us very serious concern. One is the 10-day limit that H.R. 3657 would impose on transaction suspension periods (during which employees are unable to make investment changes in their accounts). These periods, which typically accompany a change in 401(k) record-keeper or the inclusion of an acquired firm's employees in a company's plan, are a normal and necessary part of 401(k) plan administration. In fact, the plan changes that require such suspensions are often undertaken to improve the services or investment options offered to employees. While we certainly understand the desire to minimize the length of these periods, a fixed time limit is simply not practical. The length of the transaction suspension period is highly dependent on factors such as the quality of the participant data, the sophistication of the computer systems and programs involved, the number of plan participants and the number of plan loans outstanding. Furthermore, individuals' account information and investment selections must be correct when the transaction is complete, with neither employers nor employees tolerant of mistakes. I can assure you that employers seek to minimize the length of suspension periods, and such periods are declining due to competition among 401 (k) providers. Yet employers and providers will not always be able to meet fixed time limits and attempting to do so will lead to mistakes. Employee relations and market forces, together with the advance notice required under both the Boehner and Miller bills, will ensure that 401(k) participants are well served.

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

One of our other concerns about H.R. 3657 is that, unlike the Boehner/Johnson legislation (H.R. 3762), it does not advance targeted responses to the specific issues raised by Enron but rather seeks to make wide-ranging and fundamental changes to our nation's defined contribution plan retirement system. The bill would fundamentally alter the governance system for 401(k) and other defined contribution plans, radically change the enforcement mechanism applicable to all

ERISA claims (not just those in the pension area), and substantially revise the rules on vesting of employer contributions. The results would be increased workplace conflict, hampered plan administration, more litigation, fewer employer contributions and, for many employees, no retirement plan at all. These changes would undermine the 401(k) system's current success and should be rejected.

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

Time for a Renewed Congressional Commitment to Defined Benefit Plans

In one potentially fortunate development, the losses suffered by Enron 401(k) participants have renewed interest in defined benefit pension plans. These plans, which are funded by the employer and insured by the federal government, make an effective complement to a 401(k) program. Yet the number of these plans continues to decline from a high of 175,000 in 1983 to fewer than 50,000 today, with the decline partly attributable to over-regulation and its attendant costs and complexities. We believe Congress should use the occasion of its Enron review to streamline the rules that apply to defined benefit pensions so that more companies can provide these employer-funded and insured benefits to their workers.

Chairman Johnson, you have led the way in addressing one of the most vexing problems faced today by defined benefit plan sponsors – the inflated liabilities, funding requirements and premium obligations that have resulted from the buyback and discontinuation of the 30-year Treasury bond. As you know, rates on 30-year bonds have fallen to historic lows as these bonds have become scarcer. Yet our pension laws require the 30-year rate to be used to calculate pension plan liabilities. The result has been to artificially inflate these liabilities by 15 to 25 percent, forcing many employers to make huge and unwarranted pension contributions in the midst of an economic downturn. You were instrumental, Mr. Chairman, in including relief from these unwarranted obligations in the House-passed economic stimulus legislation (H.R. 3529) and we could not be more pleased that you have joined with several of your colleagues this week to introduce bipartisan legislation to provide this necessary pension interest rate relief. With enactment of this urgently needed measure, Congress can move quickly to shore up the defined benefit pension system, preventing additional employers from abandoning these guaranteed plans that effectively advance workers' retirement security.

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

Conclusion

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

APPENDIX D - WRITTEN STATEMENT OF ERIK OLSEN, MEMBER, BOARD OF DIRECTORS, AARP, WASHINGTON, D.C.

Testimony of Mr. Erik Olson, Board Member

AARP

February 27, 2002

Thank you Mr. Chairman and Members of the Committee for providing me with the opportunity to testify today. My name is Erik Olsen, and I am a member of the Board of Directors of AARP. AARP is the largest organization representing the interests of older persons. Of our 35 million members, about one-third are still working. AARP appreciates the opportunity to present our views and recommendations for policy changes that should be enacted to make retirement plans more secure and to protect the retirement savings of American workers.

Background

The financial collapse of the Enron Corporation illustrates weaknesses in our pension laws and the need to update the legal and regulatory framework to reflect changes in pension coverage since the enactment of the Employee Retirement Income Security Act (ERISA) in 1974. ERISA was established in the wake of large corporate failures that left their workers without promised pensions. ERISA established minimum vesting, participation and funding standards, required plan termination insurance for defined benefit plans, prohibited certain transactions, and established standards for fiduciary conduct. These protections were designed to ensure that workers would not lose pensions they had worked for and earned throughout their lifetimes. While we have experienced profound changes in the types of pension coverage -- as well as many other aspects of the private retirement system – over the past 25 years, the law has not changed to fully reflect these changes. The collapse of Enron, and the large numbers of employees who have seen their pension accounts dramatically reduced, only amplifies the need for change.

The percentage of the private sector workforce covered by an employer-sponsored pension plan has remained around 50 percent since the early 1970s. While the number of covered workers has remained relatively unchanged, there has been a substantial shift in the type of coverage from defined benefit to defined contribution plans, including an increase in the establishment of defined contribution plans to provide supplemental coverage to employees already participating in defined benefit plans.

While the number of defined benefit pension plans has declined, the number of 401 (k) plans has grown dramatically. Section 401(k) of the Internal Revenue Code did not exist in 1974, and plans named for this tax code section did not really began their growth until the early 1980's. In just over two decades, there are now an estimated 350,000 401(k) plans, covering 42 million workers, and holding an estimated $2 trillion in assets. However, for the most part, the basic framework of pension security underlying the nation's pension system has not been updated to reflect these trends and developments.

In the traditional defined benefit plan, the employer invests all plan assets, bears the risk of investment, and provides a guaranteed benefit to participants. In addition, the Pension Benefit Guaranty Corporation (PBGC) guarantees payment of benefits should a company go bankrupt with insufficient assets to pay benefits. However, many of the extensive ERISA protections and safeguards originally provided to defined benefit plans simply do not extend to the different structure of 401(k) and other defined contribution plans. For example, in 401(k) and other individually directed account plans, the individual controls the investment allocation and bears the risk of investment loss. The individual must invest well in order to ensure an adequate level of retirement benefits, and there is no PBGC guarantee protection. Unfortunately, millions of workers are simply not prepared to handle this dramatic shift in investment responsibility and risk for their retirement savings.

The sudden and dramatic collapse of Enron has demonstrated that neither ERISA nor any other federal statute provides American workers with the protections or guidance commensurate with the financial risk they are asked to bear in managing their defined contribution plans.

Although Enron's bankruptcy is the largest and most dramatic to date, other companies have experienced major financial troubles resulting in a steep drop in stock price and a corresponding decline in the value of workers' 401(k) accounts. The plight of the employees of Color Tile Corporation captured congressional attention in 1996 when that company filed for bankruptcy. Eighty-five percent of the employees' assets in that company's 401(k) plan were invested in Color Tile real estate. Employees lost most of their retirement savings. However, legislation to address the problem in Color Tile was narrowed significantly during the legislative process, leaving more problems for the future.

While only a small percentage of companies face such dramatic downturns, such downturns are inevitable. For example, the price of a share of Lucent Corporation common stock declined by 91 percent between 1999 and 2001. Some employees, according to news articles, had as much as 80 percent of their Lucent 401(k) plan balances invested in Lucent stock, although the workers were afforded 16 investment options. Another recent example is the Polaroid Corporation, which filed for bankruptcy in October 2001. Approximately 40 percent of the company's 401(k) plan assets were invested in the stock of the company.

Individual account plans such as 401(k) plans have become important components of our private retirement income framework. The phenomenal growth of these plans over the past two decades is a tribute to their success in gaining acceptance among the American population. However, AARP believes it is important that we begin to address some of the problems associated with defined contribution plans, beginning with the systemic problem of the over-concentration of employer stock in those plans that have employer stock as an investment option. In each of the firms noted above, workers' retirement assets were simply not properly diversified. Despite the fact that the single most important rule for investing is diversification, the assets of the 401(k) plans of each of the bankrupt companies -- as well as hundreds of other companies today -- were overly concentrated in the stock (or real property) of the plan sponsor.

The time has come for Congress to enact a better framework for employees in defined contribution plans. Ultimately, this will mean better plan security, and better assurances that our highly tax supported retirement system meets the long-term goal of providing an adequate retirement income. Our testimony today will focus on several areas that warrant immediate Congressional attention and action: disclosure, risk and diversification, investment advice and remedies under the law.

Disclosure

Among the allegations concerning Enron is that participants did not receive complete, accurate and timely information concerning their plan and the employer stock in which they invested. The shift of risk and responsibility to employees makes it imperative that employees receive complete, accurate and timely disclosure of information to help them make more informed decisions about their retirement security. This includes defined contribution benefit statements on no less than a quarterly basis, detailing the status of participants' investments and investment activity. Similarly, defined benefit plans should be required to furnish regular benefit statements to participants on an automatic basis, without the current-law requirement that the participant first request the statement.

Employees must also be given prompt and accurate information about their company's financial performance. Employees should not only receive this information on a regular basis, but they should also be affirmatively informed when there is new information or a material change. This information should be required automatically, without requiring employees to request it. Although most courts agree that a failure to provide material information even without an inquiry is a breach of fiduciary duty, the Fifth Circuit (where Enron is located) has called this proposition into question. We believe that any legislation should affirm the position that a majority of courts have taken.

Other improvements in disclosure are needed to help address the problems that are highlighted by the Enron debacle. If a plan intends to implement a temporary suspension, limitation, or "lockdown" of participants' normal ability to exercise control over their plan accounts, it must provide participants with ample advance notice. In addition, the Department of Labor should be directed to facilitate effective disclosure by publishing a model benefit statement that plan administrators could use or adapt. In addition to information on the participant's accrued and vested benefits, the statement would include information on the percentage of the participant's account that is invested in employer stock (and real property), on the importance of diversification, and other information relevant to the employee.

In addition, in order to minimize the risk of errors in determining pension benefits, participants who are ready to receive a distribution of their benefits should have the right to request an explanation of how the benefits were calculated. Such disclosures will help participants to confirm that they are in fact receiving the full benefits to which they are entitled.

Diversification of Risk

The Enron, Lucent, Polaroid, and other unfortunate cases illustrate the danger of defined contribution plan participants over-investment in company stock. There is no more basic and fundamental principle of sound investment practice than diversification. That is why few financial planners or investment advisors would recommend investing more than a limited percentage of a client's portfolio in a single stock. This is true even where the portfolio is not the plan on which the individual's retirement security depends, and is especially true when that single stock is also the one on which the individual's job security and wage check depends.

It is hardly surprising, therefore, that ERISA's fiduciary standards, based on the common law of trusts, generally require that retirement assets be invested as a prudent expert would invest them, including diversification "so as to minimize the risk of large losses." ERISA section 404(a)(1). However, when ERISA was enacted in 1974, certain exceptions to the fundamental principle of prudent diversification were included. One exception gives plan sponsors and other fiduciaries a measure of relief from fiduciary responsibility for investments that were self-directed by plan participants in accordance with the statute. Another exception allows employers to design most individual account plans to invest up to 100% of plan assets in the stock or real property of the sponsoring employer.

ERISA recognized employer stock as a plan investment that involves a conflict of interest for the employer. However, the law excused most defined contribution plans from the 10% limit it imposed on pension plan investment in employer stock. This was done as an accommodation to a limited existing practice in the very different pension system that was then in effect. In the early 1970s, well before the advent of the 401(k) plan, defined contribution plan coverage was far more limited than it is today. Defined contribution plans tended to be thought of as supplemental to the basic employer pension protection afforded by traditional defined benefit plans. A large fraction of the defined contribution plans at that time were more highly regulated money purchase pension plans or were profit sharing plans that, in either case, were funded mostly by employer (not employee) contributions. The investment of these employer contributions generally was not directed by the employee. In addition, when ERISA was enacted, retirement plan investment in employer stock was far less prevalent than it later became. Accordingly, the focus of ERISA's regulation of investments was on what was then the main type of plan, the defined benefit pension plan, and on employer contributions the investment of which was directed by the plan sponsor or its designated professional investment managers or advisers.

Much has changed. Over the years, plan sponsors have shifted the responsibility for funding retirement plans increasingly from the employer to the employee through 401(k) salary reduction arrangements, and have concurrently shifted to employees both the investment risk and the responsibility for directing the investment of their accounts. At the same time, to a far greater extent than ERISA's framers imagined, the defined contribution plan system has become heavily invested in employer stock. These trends have converged to result in a very different situation from the one Congress confronted in 1974: millions of workers now rely mainly or heavily on employee-funded defined contribution plans that require employees to direct their own investments and that, in may cases, encourage employees to invest in employer stock. Corporate financing needs, special tax incentives directed to employer stock, management's interest in placing stock in friendly hands, and other factors have skewed the playing field and resulted in the over-concentration of defined contribution plan assets in company stock.

In fact, when it comes to employer stock, the current 401(k) system as a whole fails any broad test of diversification. There are far too many plans in which employees hold large concentrations of company stock. The Profit Sharing/401(k) Council of America found in its recent annual survey that company stock accounted for about 39 percent of all 401(k) plan assets. The level of concentration is highest in plans with 5,000 participants or more. In these plans, company stock accounts for 40 percent or more of plan assets, and data published by the Employee Benefit Research Institute suggest that heavy investment in company stock is more prevalent among lower-income workers.

In particular, it is this combination of trends – toward 401(k) plans fueled largely by employee contributions, increasing self-direction of investments by employees, and the rise of specially tax-preferred employer stock as an investment choice heavily favored by the system and by employers – that was least foreseen by the framers of ERISA. Thus the focus of ERISA's fiduciary protections relating to employer stock was limited to the prevalent type of plan, the defined benefit pension plan (and money purchase pension plans). ERISA currently prohibits these plans from investing more than 10% of plan assets in the employer's stock or real estate. This diversification requirement limits the risk to the funded status of the plan in the event of a catastrophic drop in the value of the plan sponsor's stock.

Currently, 401(k) plans, other profit sharing and stock bonus plans, and employee stock ownership plans (ESOPs) acquire company stock in two ways: (1) through employer contributions, including those employer contributions that match employee contributions, and (2) through the investment of employee contributions on a pretax (401(k)) or, less frequently, an after-tax basis. Current law allows a plan sponsor to compel employees to invest up to 10 percent of their employee contributions in employer stock as a condition of participating in a 401(k) plan. Many plans also restrict the ability of participants to shift employer contributions from company stock into other investments offered by the plan until the participant reaches a specified age (such as 50 or 55) or years-of-service milestone. These barriers to prudent diversification of both employer and employee contributions should be removed in order to protect employees from excessive risk of losing their retirement savings in circumstances that tend to threaten their job security as well. Participants must have the right to reduce their exposure to employer stock in the interest of diversification.

The need for diversification rights extends to ESOPs as well as other plans. Although ESOPs are designed to be primarily invested in employer securities, they are required under current law to provide participants limited rights to diversify employer shares in their accounts. But those rights are too restrictive. Unless the plan sponsor chooses to grant more generous rights, ESOP diversification rights apply only to participants who are at least age 55 and have at least ten years of participation in the plan, lasts only for a period of six years, and apply each year only to a portion of the shares in the individual's account. ESOPs have expanded and evolved far beyond their traditional forms and have acquired an array of valuable tax incentives. Instead of receiving an ESOP only as a supplement to one or more retirement plans, however, employees in many companies are now expected to rely on an ESOP for a major portion of their employer-provided retirement savings. In many corporate settings, the ESOP has been presented as the main or only retirement plan. Accordingly, it is long past time to revisit and broaden the minimum standards for ESOP diversification.

Both the diversification rights for employees in defined contribution plans generally and the expansion of current-law diversification rights in ESOPs need to be designed in a manner that takes into account the voluntary nature of our private retirement system. Legislative changes must be sensitive to the potential impact on employer incentives to continue maintaining these plans and to make employer matching and nonmatching contributions.

While rights to diversify out of employer stock investments are important and necessary, they are not sufficient to protect workers. As evidenced by the high concentration of employer stock in 401(k) plans, our pension system and corporate culture have tax incentives and behavioral tendencies that in effect have "stacked the deck" in favor of heavy investment in employer stock. This is true even when employees are free to choose.

Enron is a case in point. It appears that most Enron 401(k) participants were free to sell most of their Enron shares during most of the decline in the share price. According to press reports, the Enron plan restrictions on diversification by employees under age 50 applied only to the company shares in which employer contributions were invested. The employee contributions, which appear to have accounted for most of the assets in most of the accounts, were free to be diversified. Thus Enron 401(k) plan participants reportedly were technically free to diversify a majority of their Enron shares, except during the temporary "lockdown" period.

Clearly, there have been well-publicized reasons to believe that employees' voluntary retention of Enron shares might have been exacerbated by special circumstances – including allegedly misleading information and inadequate disclosures – that would not be expected to occur in most other companies. But there are many other instances where many or most plan participants who are not precluded from diversifying have in fact remained over-concentrated in their employers' stock in the absence of any apparent corporate misinformation or misconduct. The reasons employees tend to over-concentrate in company stock have to do with both tax advantages and less tangible factors.

First, the tax rules encourage plan participants to invest in employer stock because employees generally receive special preferential tax treatment when they take distributions of employer stock from a qualified plan. (Provided that certain conditions are satisfied, the "net unrealized appreciation" of employer stock while held by the plan – the gain from the time the plan acquired the shares until it distributed them – is taxed at favorable long-term capital gain rates, deferred until the stock is disposed of by the distributee.) Second, and more important, many employers have powerful tax incentives to encourage heavy employee plan investment in employer stock, even when inconsistent with prudent diversification of retirement savings. Plan sponsors can obtain a number of valuable tax incentives if they label the plan (including a 401(k) plan) – or a portion of the plan – an ESOP and meet the conditions of ESOP status. It appears that most defined contribution plan sponsors that are seriously interested in converting the plan's employer contribution to an ESOP are able to do so, where the relevant portion of the plan is primarily invested in employer stock.

One key tax incentive for ESOPs is the dividend deduction under section 404(k) of the Internal Revenue Code. While a corporation ordinarily cannot claim a federal income tax deduction for dividends it pays on its stock, dividends are deductible when paid on employer stock held in an ESOP (provided that the treatment of the dividends satisfies certain conditions, which were recently liberalized in last year's tax cut legislation). This dividend deduction can generate very substantial tax savings to the employer. In addition, employers that sponsor ESOPs can claim a number of other special tax incentives beyond the valuable tax benefits normally accorded qualified retirement plans, including special provisions for "leveraged" ESOPs that can make corporate financing easier or more advantageous and higher tax deductions for employer contributions to their plans, among others.

Finally, both employers and employees have powerful non-tax incentives that tend to lead to over-concentration of plan investments in employer stock. There is, of course, the effect of simple inertia: many employees who have full investment choice do not devote adequate attention or analysis to their plan investment strategy. If the employer contributes stock, many employees may not take the initiative to change the investment.

Building on this phenomenon, there is evidence suggesting that employees often tend to follow the employer's lead with respect to investment in employer stock (as well as other investments) by interpreting the employer's decision to contribute company stock to the plan as an implicit endorsement by the company of its stock as a wise investment choice for a large portion of employees' account balances.

Employees may also feel that loyalty to the company demands or suggests that they invest their retirement accounts heavily in employer shares (or may feel that this is the company's view of what loyalty demands). And loyalty aside, some employees may feel more comfortable investing in the one company they know best rather than in other businesses, believing that their company is a safe investment compared with the unknown risk of a diversified stock portfolio. These decisions ignore, of course, the imprudence of compounding retirement savings risk with job security risk.

Employers also may prefer to contribute stock to the plan instead of cash because, while each type of contribution is tax deductible, only the stock contribution is costless in terms of cash flow. Employers' motives for encouraging heavy plan investment in employer stock also include, in some instances, a desire to place a substantial number of shares in friendly hands for defense against hostile takeovers or proxy contests (or perhaps in the hope that plan participants will tend to be slower than other shareholders to sell in a falling market). In addition, the employer may believe that employees who hold substantial quantities of employer stock will tend to identify more closely with the goals of management and shareholders, to be more loyal to the company, and to be more productive workers. Indeed, consistent with fair and accurate disclosure and compliance with all applicable laws, management has every reason to encourage the work force at all levels to believe in the company and to have confidence in its future. But the measures necessary to motivate employees may also encourage employee exuberance or optimism regarding the company's stock that could further explain the imprudent over-concentration in that investment.

Some of these motives, together with the tax incentives for maximizing plan investment in employer stock, exacerbate management's conflict between its fiduciary duties to the company's shareholders and its fiduciary duties to the plan participants. Because of these realities, many employees who have the right to diversify do not do so, even if they receive adequate information and advice regarding the importance of investment diversification. The playing field between employer stock and more diversified investments is not level. That being the case, the question is whether the law should incorporate measures to affirmatively lead to greater diversification. We believe it should.

There is a legitimate and substantial public policy interest in ensuring that the assets of ERISA-governed, trusteed, tax-qualified retirement plans are invested in a prudent, diversified manner, so as to minimize the risk that the tax advantages accorded to those assets will fail to achieve their intended purpose of providing additional economic security in retirement. The tax expenditure for qualified plans is the largest single federal tax expenditure. The tax system subsidizes qualified employer-sponsored retirement plans in an amount estimated to exceed $90 billion a year. See Joint Committee on Taxation, Estimates of Federal Tax Expenditures for Fiscal Years 2002-2006, JCS-1-02 (Jan. 17, 2002). The high tax subsidy for the pension system is for the purpose of providing adequate savings for retirement. It is therefore appropriate for the law to include measures that will achieve this purpose.

In the case of personal, non-plan funds, individuals are free to invest in any way they choose. But the law should provide for the assets of trusteed, tax-qualified retirement plans to be invested in a prudent, diversified manner, in order to accomplish their intended purposes.

We believe that any approach to reducing the excessive concentration of plan investments in company stock should be appropriately sensitive to the voluntary nature of our private pension system. Workers' retirement security should be protected while seeking to minimize any disincentive for the employer to contribute to the plan. One way to achieve this may be to afford plan sponsors choices by which to achieve the public policy goal of protecting participants from the financial risk associated with high concentrations in employer stock.

Some have proposed placing caps or percentage limits on the amount of company stock a plan participant can hold in a 401(k) account. Others have recommended prohibiting a plan sponsor from using company stock to make matching contributions to the plan. We agree with the ultimate goal of these proposals – that of improving diversification by reducing the over-concentration of stock in the hands of employees. We believe, however, that there are other approaches. We believe a preferable approach should avoid placing a disincentive on the employer's own contributions to their employees, while at the same time recognizing that the combination of employer-provided stock and employee elective purchases of company stock are what ultimately create such high concentrations. In fact, studies show that where an employer provides stock as a matching contribution, employees are even more likely to elect employer stock as an investment option with their own elective contributions.

One option that would increase diversification without providing a disincentive to the employer is to provide the employer with the choice: the employer can continue to make matching or non-matching contributions in stock, or the employer can include employer stock as an option for employee elective deferrals in the plan. Under this approach, we can continue to allow employers – without limit – to make matching or non-matching contributions with company stock. However, in such cases, the employer would not be permitted to provide company stock as an investment option for elective contributions. Where the employer did not provide stock directly to the employees, the employer could continue to offer employer stock as an investment option in the plan. This approach would result in a greater degree of diversification over time without discouraging businesses from establishing new plans or contributing employer stock directly to employees. This approach is also consistent with employees' ability to self-direct their investments among the limited menu of investment options that employers provide under the plan.

Investment Advice and Education

Most 401(k) plan participants have little experience in, or understanding of, investment fundamentals. While almost half of all households now have some money in equities or mutual funds – up over 50 percent in the past decade – many of these are new investors. In addition, many have no other investments aside from their retirement plan. This is particularly true for those households below the median income, who are far less likely to have any money in an equity fund. Even for those who have entered the investment marketplace, too few have the time, or have taken the time, to learn the basics of investing.

A recent survey conducted for AARP ("Consumer Behavior, Experience and Attitudes: A Comparison By Age Groups," conducted by Princeton Survey Research Associates, March 1999) sought to provide a snapshot of the public's basic investment knowledge by asking four questions:

> Whether the FDIC covers losses from mutual funds purchased at banks,
>
> Whether no-load mutual funds involve sales charges or other fees,
>
> Whether diversification increases or decreases the risk of the investments, and
>
> Whether full-service brokers and financial planners are compensated on the quality of their advice or on the amount and type of investments they sell to clients?

The unfortunate findings are that not many Americans are knowledgeable about financial investments. Only 11 percent of respondents answered all questions correctly, while only 25 percent correctly answered three of four and less than half (46 percent) answered two questions correctly. Perhaps most significantly for the issues at stake today, just over one-third could correctly answer whether diversification reduces risk.

Lack of information is not necessarily the problem; the amount of financial information available today is greater than ever before. Magazines, newspapers, daily financial news programs, on-line services, and various types of software make available more information than most individuals could want or need. In addition, the plan itself often makes available many different forms of information, including videos, seminars and booklets on plan options and hypothetical investment portfolios. What the individual investor often lacks, however, is the ability to sort through the information. As noted, too many investors or would-be investors lack both the time and the knowledge to determine which information is important, accurate and appropriate for their own individual situation. These issues are especially true in the case of self-directed plans.

The Department of Labor, through Interpretive Bulletin 96-1, provided a helpful step by encouraging greater investment education for plan participants. The guidance provides examples of "safe harbors," -- such as asset allocation models based on hypothetical individuals with different time horizons and risk profiles -- that do not rise to the level of specific advice and thus do not trigger fiduciary liability under ERISA. These asset allocation examples and model portfolios, permissible under current law, already provide individuals who take the time to sift through the information with a good roadmap to the investment alternatives under their plan.

However, this information continues to be insufficient, and often still too complex, for many participants. Many participants simply want to be told more specifically where to invest their plan funds. As a result, some employers and plan service providers have sought to provide more specific and individualized investment advice to plan participants. AARP agrees that such individualized advice can be helpful, but such advice must be subject to ERISA's fiduciary rules, based on sound investment principles, and protected from conflicts of interest.

ERISA Rightly Prohibits Advice Subject to Conflict of Interest

Participants deserve to have access to quality investment advice, and that advice should be free from financial conflicts of interest. ERISA has long recognized that financial conflicts of interest give rise to divided loyalties, and thus pose the risk that actions will not be taken in the sole interest of plan participants. Advice providers who also stand to benefit financially depending on the type of advice that is given face just such a conflict. Preserving ERISA's ban on such conflict of interest transactions is necessary to ensure that the advice provider is acting for the "exclusive benefit" of plan participants.

The *Retirement Security Advice Act, H.R. 2269,* passed by the House last year, would replace ERISA's prohibition on such conflicts of interest with a disclosure requirement, and would allow investment advice where a conflict exists so long as such conflicts are disclosed. AARP believes disclosure alone is not sufficient protection, nor is it the best approach in today's marketplace.

As noted, too many participants are already overwhelmed with the investment information they are currently receiving. Disclosing yet more information, which the individual would have to both understand and properly weigh, will be least helpful to the unsophisticated investor. Even with the disclosure of potential conflicts, the participant is not left with much real choice. The individual either chooses to accept advice that is subject to a conflict, or the individual can choose no advice at all. Providing pension participants with qualified advice is simply not the best approach.

In fact, the Committee on Compensation Practices – also known as the "Tully Commission" (named for its Chairman, Daniel Tully of Merrill Lynch) – which was formed by the SEC to review conflicts of interest in the brokerage industry, reported in 1995 that "the prevailing commission-based compensation system inevitably leads to conflicts of interest among the parties involved." The report further stated that "...conflicts of interest persist and have been underscored by some widely publicized incidents in which the actions of certain brokerage firms and their representatives clearly damaged the interests of their clients." This is not to suggest that all advice that may entail conflict is inevitably bad advice. However, such advice, given by an advisor with a financial stake in the recommended product, needlessly subjects that advice to potential bias and interests other than the sole interest of the participant. In addition, participants must understand and weigh yet another factor in determining whether to follow that investment advice.

Congress held hearings last year on yet another example of the problematic influence of conflict in the financial markets. The hearings followed on the heels of press coverage of the conflicts in Wall Street firms between analysts' ratings on companies and the firms' own financial interests in promoting their investment banking business. Indeed, despite the recent market downturn from an over-inflated market, only one percent of analysts' reports had "sell" ratings. In fact, one study concluded that "the recommendations by underwriter analysts show significant evidence of bias." The New York Times noted the need for regulations to "protect investors from conflicted advice that undermines the integrity of the nation's financial markets."

ERISA Permits Independent Advice

If advice subject to conflict were the only avenue available, then such an alternative would deserve greater attention. However, plans currently have other options to provide investment advice. Financial institutions and other firms may provide advice to participants on products in which they do not have a financial interest, and plans may choose to make such advice available. In fact, a recent 401(k) benchmarking survey indicated that the number of firms using Web-based investment advice is growing rapidly. The survey indicates the service is now available to about one out of every five plans. In addition, the number of large financial service providers who have developed alliances with an independent investment advisor is also growing, and most of the large 401(k) providers now have an independent investment advisor available. (The use of independent advisors is not the only available alternative under current law. In addition, the Department of Labor may grant exemptive relief, as it has done in some instances, provided that certain conditions are included to protect plan participants.)

In light of these other alternatives, it is premature to weaken ERISA's longstanding conflict of interest rules that have served both participants and pension plans well. As we have noted, the application of individualized investment advice to plan participants is in its early stages. As a result, Congress should first encourage the growth of and greater competition among independent and non-conflicted advice providers. Indeed, Congress can further encourage employers to provide such advice by clarifying that the employer would not be liable for specific investment advice so long as the employer undertook due diligence in selecting and monitoring the advice provider. A recently introduced bipartisan Senate bill, S. 1677, takes just that approach.

In Interpretive Bulletin 96-1, the Department of Labor indicated that the designation of an investment advisor to plan participants would not, in and of itself, give rise to fiduciary liability that is the result of the individual's exercise of control. However, as with any service provider, the plan fiduciary would be responsible for the prudent selection and periodic monitoring of the advisor. Currently, the rules applicable to an advisor should be similar to that of any plan service provider. The Department of Labor has indicated the plan fiduciary must engage in an objective process to obtain information to adequately assess the qualifications of the provider, the quality of the services offered, and the reasonableness of the fees. In addition the Department has indicated such process should avoid self-dealing, conflicts of interest, or other improper influence.

The Department has stated that as applied to the selection of an investment advisor, a fiduciary should take into account the qualifications of the advisor, including registration under any applicable federal and state securities laws, the extent to which the advisor acknowledges its fiduciary status under ERISA to participants, and the extent to which the advisor can provide informed, unbiased, and appropriate investment advice to participants. An employer would also be required to periodically review the performance and qualifications of the advisor, including any comments or complaints about the services.

AARP believes we should encourage employers to provide advice under these basic fiduciary standards, and thus permit employers to offer investment advice without significant risk of liability. Encouraging independent unbiased investment advice will better enable employees to improve their long-term retirement security while minimizing the potential for employee dissatisfaction and possible litigation. We believe it is in the best interest of both the plan and plan participants to pursue these avenues prior to carving out an exemption to one of ERISA's basic prohibitions and opening the door to the potential for conflicted advice.

Remedies

Another glaring problem of the ERISA framework is the inability of employees to properly enforce their pension rights to make whole their losses as a result of wrongdoing. Under the current federal pension law, employees have limited, if any, remedies to make whole their losses for any fiduciary violations by their employer and for the improper actions of other parties involved in these violations. As a result, there can also be no deterrent message sent to other violators.

Current law permits individuals to sue fiduciaries for breaches of fiduciary duty under two sections of ERISA. Under Section 502(a)(2), a participant may sue for "appropriate relief under section 409." Section 409 provides for relief only to the plan itself for losses caused by or profits made by the fiduciary, and other equitable relief such as removal of the fiduciary. In *Massachusetts Mutual Life Insurance Co. v. Russell*, the Supreme Court held that compensatory and punitive damages were not available under Section 502(a)(2). Accordingly, under Section 502(a)(2), only persons acting as a fiduciary may be sued; and they may be sued only for losses to the plan or profits made by the fiduciary. For example, in Enron, neither Mr. Lay nor Arthur Anderson may be found to be fiduciaries. And, only direct losses caused to the plan as an entity or profits made by the fiduciary based on its actions may be compensated.

Section 502(a)(3) acts as a "catch-all" provision for injunctive or "other appropriate equitable relief." Unlike Section 502(a)(2), Section 502(a)(3) permits individuals to sue for relief. *Varity Corp. v. Howe*, 516 U.S. 489 (1996). And, Section 502(a)(3) may provide for relief against non-fiduciaries (such as Mr. Lay or Arthur Anderson) if they knowingly participate in a breach of fiduciary duty. *Harris Trust & Savings Bank v. Salomon Smith Barney*, 530 U.S. 238 (2000). However, the relief available under section 502(a)(3) is limited to equitable relief. The Supreme Court has narrowly interpreted equitable relief to be limited to the forms of relief that were traditionally available in equity such as restitution, mandamus and injunctions. *Mertens v. Hewitt Associates*, 508 U.S. 248 (1993). In *Great-West Life and Insurance Annuity Co. v. Knudson*, 122 S.Ct. 708 (2002), the Supreme Court recently reaffirmed its interpretation of ERISA that equitable relief does not provide make-whole relief and does not provide monetary relief, unless an individual can trace the property taken from the individual.

Thus, under section 502(a)(3), Enron participants who sue on behalf of themselves may be left with no remedy against Mr. Lay and no remedy against Arthur Anderson because even though the value of the funds dropped enormously, no money was actually stolen from their accounts. The plan participants may have no remedy under ERISA for any deliberately misleading information or other misdeeds because a remedy based on the difference between the value of their Enron stock today and the value of some other investment or series of investments is legal damages, not equitable relief.

This is not a new problem and this is not unique to Enron. Current pension law, as interpreted by the courts, has developed so participants and beneficiaries have rights without remedies, which of course are no rights at all. For example, in *Farr v. U.S. West Communications, Inc.*, 151 F.3d 908 (9th Cir. 1998), the court held that it was a breach of fiduciary duty where the fiduciaries knew that participants would incur potential adverse tax consequences of a benefit election and the fiduciaries consciously decided to withhold that information from the participants. The court held that the participants had no remedy because the amount of additional taxes the participants had to pay due to the conscious failure to disclose this material information was damages -- a legal remedy. Similarly, in *Kerr v. Vatterott and Co.*, 184 F.3d 938 (8th Cir. 1999), the court held that the difference between what the participant could have earned in his 401(k) account and what was actually earned is not equitable relief, but legal damages, and thus not recoverable.

It is ironic, and crying for amendment, that the federal law that was designed to protect the retirement security of participants and beneficiaries may provide no protections at all in a situation like Enron. The pension law has been interpreted to provide fewer protections than many other federal and state laws. Even if there is outright fraud, or you are caught with your hand in the cookie jar, there's no effective way to send a message that wrongdoing is not tolerated with the American public's retirement monies. Given the large numbers of plans in existence today, the Department of Labor simply does not have the resources to do the type of effective job needed for enforcement. It is therefore critical that employees' self-enforcement rights are improved. In fact, it should also be made clear that an employer's failure to disclose material information is a breach of fiduciary duty. Unfortunately, the Department has not taken the position that there is an affirmative duty to disclose material information.

As part of any pension reform effort, it is therefore essential that we allow employees to actually recover losses due to fraud and other violations of the law. Without the tools to protect their own retirement funds, other changes in the law may have little value.

Conclusion

In conclusion, we urge Congress to act this year to enact changes that will better protect workers' pensions. The President in his State of the Union address called for "new safeguards for 401(k) and pension plans." He also stated that: "Employees who have worked hard and saved all their lives should not have to risk losing everything if their company fails." AARP agrees and believes we should act now to improve disclosure, improve diversification and reduce risk, and improve remedies for those who are harmed. While the President has already offered a number of useful steps on disclosure and limiting restrictions on diversification, we must go further to address the fundamental problems created by the high concentrations of employer stock in some plans. Only with more comprehensive changes can we ensure greater retirement security for workers in today's pension environment.

APPENDIX E - WRITTEN STATEMENT OF JOHN H. WARNER, JR., CORPORATE EXECUTIVE VICE PRESIDENT, SCIENCE APPLICATIONS INTERNATIONAL CORPORATION, SAN DIEGO, CA, TESTIFYING ON BEHALF OF PROFIT SHARING COUNCIL OF AMERICA

Testimony of Dr. John Warner, Corporate Executive Vice President

Science Applications International Corporation

Testifying on behalf of PSCA

February 27, 2002

PSCA shares the concern of Congress and the Administration about the Enron collapse, particularly the plight of the Enron employees who were heavily invested in Enron stock. The allegations of financial and auditing misconduct by Enron management and its auditors have resulted in a crisis in confidence in the American equity-trading system. It is essential that Congress and the executive branch quickly and thoroughly investigate all aspects of the Enron collapse and, if warranted, insure that the full weight of the law be brought to bear against any and all responsible parties.

PSCA is concerned about the speed in which the Administration and members of Congress have introduced measures in response to the Enron incident to change pension plans that, for the most part, have been working very well and have created wealth for millions of employees. That said, PSCA supports the decision by Chairmen Boehner and Johnson to introduce HR 3762, the Pension Security Act of 2002, which embodies the Administration's proposals in this area. It is critically important that this Subcommittee assert its rightful role in any effort to change our country's voluntary, employer-provided retirement system.

We thank Chairman Boehner for conducting hearings by the full Committee that have helped determine what happened at Enron. However, PSCA does not believe that the dozens of hearings held to date by various committees have clearly determined what happened at Enron. So far, there is a strong suggestion of corporate malfeasance and --only perhaps -- violations of existing laws controlling retirement plans. But until the facts are established, one cannot determine if present laws are inadequate. It is critical to address this issue before considering any new laws. PSCA has consistently urged Washington policy makers to wait until the facts have been determined before recommending any changes to the voluntary employer-provided retirement system, and we do so again now.

Many of the bills introduced are well intended, and they do contain some ideas that should be further developed. Certainly HR 3762 is in this category. Others, frankly, seem to be designed to pursue an agenda of dissuading employers from offering a defined contribution retirement plan or from using employer securities as part of the funding strategies for such plans. Regardless of the sponsors' intent, all the bills introduced so far share one unfortunate characteristic to varying degrees: they may well result in fewer American workers being offered plans. Furthermore, by drastically changing the ability of employers to continue a successful, decades-old policy of making employees long-term owners of the company that employees them, the bills could result in less-generous employer contributions to these plans. One has only to look at the defined benefit system to see the results of overzealous government regulation of a voluntary employer benefit program.

Defined contribution plans have transformed American workers into owners of capital -- a world that until recently was available only to economically advantaged Americans. While defined contribution plans have existed for nearly 100 years, the 401(k) plan arrangement has been available on a widespread basis for only 20 years. These plans have already demonstrated that they are a very effective means to accumulate wealth that will provide substantial retirement income. In the strong majority of America's largest and most successful corporations -- and in many small businesses as well -- employer stock in defined contribution plans is providing substantial retirement wealth for millions of American workers.

Employers will continue to provide meaningful retirement benefit programs only so long as they have the flexibility to design and fund plans that take into account their unique business strategy and the specific needs of their workforce. In some plans, including SAIC's, company stock is a key component not only in terms of the retirement benefits provided to employees, but also in helping a company maintain its structure as an employee-owned company.

Following are comments on proposals found in many of the bills introduced in response to the Enron collapse:

> **CAPS:** Imposing limits on the amount of employer stock in an employee's account is a major government intervention into private financial decisions by workers. The decision of how much company stock an individual holds in their 401(k) account is dependent on many individual factors, including other assets, other retirement plan benefits, coordination with a spouse's assets, and personal risk tolerance. Government should not inject itself in this process. A cap could result in forcing an employee to sell company stock merely because it has risen in value, forcing a worker to invest in less attractive options.
>
> **EDUCATION, ADVICE, AND NOTICES:** Employees have a critical role in managing their investments in a participant-directed plan. There is an ongoing need to educate all employees in the basics of investing. Congress should work with employers to encourage financial education for employees and identify and remove barriers that deter many employers from making professional investment advice available to workers. The advice

> provision in HR 3762 will help some plan sponsors, as will a provision in HR 3669, cosponsored by Reps. Portman and Cardin, that will allow workers to purchase financial advice with pre-tax dollars. However, a requirement to provide a quarterly benefits statement that includes a discussion about diversification will unnecessarily increase plan costs, often borne by participants. An annual notice may be more appropriate given that almost all participants already receive account updates regularly or can access their accounts at any time electronically.
>
> **DIVERSIFICATION RIGHTS:** Employee ownership is a long-term process. By definition, it is about holding stock -- not having employers simply making contributions in stock that an employee can quickly convert to other assets. The majority of employers that make contributions in employer stock impose restrictions that limit a participant's ability to diversify. Employers use the flexibility provided in today's system to custom design employee-ownership plans that uniquely fit their business. If major changes are enacted, employers might well reexamine their plans and some will replace stock contributions with less-generous cash contributions. Limiting the ability to restrict diversification from employer-provided company stock could also result in severe damage to investors if employees were to sell large quantities of company stock in response to a sharp but brief drop in stock value.

A pivotal question for this Subcommittee is whether or not employee ownership should be an element in 401(k) and other defined contribution plans. PSCA feels strongly that the answer is "yes."

And now I would like to turn to the example of my own company, SAIC. SAIC is the largest employee-owned research and engineering firm in the nation with over 40,000 employees and with offices in more than 150 cities worldwide. The proposed changes to diversification rights – and other proposed regulations that would curtail sponsors' ability to design flexible plans -- could seriously jeopardize SAIC's employee ownership programs.

Employee ownership fuels the entrepreneurial spirit in SAIC's employee-owners. It rewards outstanding performance, enables SAIC to better perform for its customers, and helps attract and retain talented people. This culture encourages SAIC to take initiative, suggest ways to solve problems, and find creative ways to better serve its customers. Current employees, directors, their families, and participants in SAIC's retirement plans own approximately 85% of SAIC stock either directly or through SAIC retirement plans. SAIC's founder and CEO currently owns less than 1.5

percent of SAIC's shares, making the ownership very broad-based. As its business grows, SAIC's employee shareholders benefit from the company's financial success. That's how SAIC has continued to grow in a very competitive environment.

This has translated into more than 30 years of increasing SAIC stock values. In the past five years, SAIC's stock price averaged 38% annual growth, and the ten-year annualized return is 28%. Founder and CEO, Dr. J. Robert Beyster, recently noted, "I can't tell you where we would be without employee ownership, but I am convinced that we would not be where we are today. Shared ownership and shared responsibility have created an effective entrepreneurial environment throughout SAIC, with not just one or two on the top, but thousands."

To summarize, the use of company stock in defined contribution plans has been extremely successful. More restrictive policies may well reduce the number of companies offering retirement plans and reduce the company contributions to some existing plans. PSCA advocates that no action be taken that would restrict either the amount of contributions employees may invest in company stock or change the current limitations employers may apply to the diversification of employer contributions in company stock. Thank you for this opportunity to share our views.

APPENDIX F - WRITTEN STATEMENT OF RICHARD FERLAUTO, DIRECTOR OF PENSIONS AND BENEFITS, AMERICAN FEDERATION OF STATE, COUNTY, AND MUNICIPAL EMPLOYEES (AFSCME), WASHINGTON, D.C., TESTIFYING ON BEHALF OF THE AFL-CIO

Testimony of Richard Ferlauto
Director of Pension and Benefit Policy
Department of Field Services (AFSCME),
on behalf of the AFL-CIO

Subcommittee on Employer-Employee Relations
Committee on Education and the Workforce

February 26, 2002

Good morning, Chairman Boehner, Ranking Member Miller, members of the Committee. My name is Richard Ferlauto, and I am the director of Pension and Benefit Policy for the American Federation of State, County and Municipal Employees (AFSCME). I am testifying here today on behalf of AFSCME and the American Federation of Labor and Congress of Industrial Organizations. On behalf of AFSCME's 1.3 million members, the 65 unions of the AFL-CIO and their 13 million members, I would like to thank the Committee for the opportunity to address the issue of governance—401(k) plan corporate governance, money manager governance and 401-k plan governance, and the extremely serious issues of retirement security raised by the collapse of Enron.

Let me begin by defining for you what the labor movement believes is the central theme that defines what went wrong at Enron—both at Enron the public corporation and at Enron the ERISA plan sponsor. Workers invested their retirement savings in Enron, and the people whose legal duty it was to see that money was managed in workers' interest instead in a variety of complex ways used it for their own benefit.

We view conflict of interest as the problem. And we view governance—fund governance and corporate governance -- as a large part of the solution.

The place governance reform has to start is within worker funds. As Enron workers painfully discovered, employers have interests that conflict with sound retirement policy. Fundamentally, employers too often want workers to bear risks workers cannot afford to bear on their own, and employers cannot resist the temptation to view worker funds as a financing source for employers.

The labor movement feels very strongly that retirement security is best financed by a three-layered pyramid. For most, at the base is Social Security—a guaranteed social insurance program that covers nearly all working Americans. The next layer should be defined benefit plan—plans that provide a guaranteed benefit financed by professionally managed funds, behind which stands either the guarantee of the sponsoring state or local government or the Pension Benefit Guaranty Corporation, and ultimately the United States Treasury. And the top layer is personal savings—most importantly in the form of tax-favored defined contribution benefit plans like

401-k's—savings that varies based on employees' surplus income and that is at risk in the markets but that still needs to be managed based on sound investment practices and protected against employer manipulation.

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

Unfortunately, over the last twenty years, employers and policy makers have together worked to collapse the three layers of retirement security. As a result many workers have to rely only Social Security and their personal savings, savings that are fully at risk in the capital markets. And as we all know, the President has asked his Social Security Commission to propose ways to transform Social Security into a system of individual accounts that would put all of workers' retirement income at risk in the capital markets. Had any of these proposals been in place this fall, the collapse of Enron would have affected most Americans' Social Security benefits.

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

In the public sector, state and municipal governments sometime seek to imprudently tap public plan assets. Equally troubling, now some governors and state legislatures would like public employees to convert their defined benefit plans to defined contribution plans, plans where money managers would get higher administrative fees but public sector workers would find in many cases their entire retirement income at risk in the capital markets.

In the states where public plans do not participate in Social Security, public employees retirement income would be completely at risk if they converted to DC plans.

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

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

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

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

Companies that do not try to protect their own workers' retirement security by giving them an adequate defined benefit pension should be given a choice with regard to company stock. If the employer does the right thing and provides its employees with a good enough defined benefit plan, in addition to a 401 (k) plan, the employer should be allowed to make its contribution in company stock and offer company stock as an option for employees to invest their contribution. But if an employer insists on having a 401(k) plan as the only retirement security vehicle, then the employer should have to choose between making its matching contribution in company stock and offering company stock as an investment option under the plan, but it cannot do both.

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

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

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

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

Now I would like to turn to the governance issues raised as workers' money moves from the plan into the corporate economy. When workers put money in a 401-k plan, if it is not put in company stock it is generally invested in a mutual fund. Mutual funds have been extremely resistant to the basic transparency requirements for good governance. Although the funds control the proxy voting authority for investors, all but a very few funds do not disclose to their investors how they vote their proxies, nor do they disclose their proxy voting policies. Effectively this means that 401-k participants who invest in mutual funds have no ability to hold mutual fund managers accountable for how they manage workers' corporate governance assets.

When workers invest in their own employer stock through the company 401-k plan, the corporate governance rights they should have as shareholders in their company are now held by the 401-k plan itself. This includes the right to vote the proxy and the right to sponsor shareholder proposals. This is wrong. Employees invested in their own company stock accounts should be treated like a brokerage account and individual worker shareholders should have full governance rights and not be treated as second class corporate citizens, by being able to vote their own proxies.

Finally, I would like to turn to the actual governance of the corporations worker retirement money ultimately is invested in. These issues affect nearly all worker retirement money—whether in the form of public worker benefit funds, union or employer defined benefit funds, 401-k's, ESOP's or other defined contribution plans. Most of this money ends up being invested in the securities of publicly traded companies. As investors in these companies, workers rely on corporate governance mechanisms to ensure that the people making decisions about their money from day to day are doing so in the interests of the firms they are managing and not in their self-interest.

Effective corporate governance requires accurate, timely disclosure (including accounting statements) and it requires mechanisms to hold company directors and officers accountable. The collapse of Enron shows that there is a serious need to enact reforms in these areas.

The AFL-CIO has submitted rulemaking proposals to the Securities and Exchange Commission regarding auditor independence and director independence. We have urged that Congress act to create a public oversight board to supervise the accounting industry, a board with full investigative powers and independent funding. We have urged that the regulators act to separate the investment analysis and investment banking functions within the large financial houses. And we have called for tightening both FASB's and the SEC's treatment of executive stock options and insider trading. Finally, we have called for repealing the provisions in our securities laws that give auditors like Arthur Andersen immunity from aiding and abetting liability and protection from being held jointly and severally liable when they help their clients commit securities fraud. Copies of our rulemaking petitions are attached.

I wish I could report that in general the regulatory agencies with authority here are proposing appropriately substantive solutions. But with the exception of the disclosure area, where the SEC has recently announced several positive initiatives, both the SEC and the stock exchanges have proposed inadequate solutions to the problems of auditor oversight and analyst independence, and have been simply silent on the issues of auditor independence and director independence the AFL-CIO raised in its rulemaking.

At AFSCME, our members largely are participants in public employee pension funds. We have worked closely together with those funds to challenge bad corporate governance practices – excessive executive compensation, auditor conflicts, corporate boards that are in the pockets of the managers they are supposed to oversee. But the effort is a difficult owe because shareholders currently have limited power to challenge entrenched mangagers and insulated boards. We need help from Congress in the face of an inadequate response from the regulators, and non-responsive SROS.

I will just close by giving you one example of what's wrong with corporate governance today. Shortly the Motorola Corporation is going to announce the directors the board will be renominating. The AFL-CIO has written to Motorola and asked that the company not renominate Ronnie Chan, who was until very recently a member of Enron's Audit Committee, and serves on Motorola's board, unless Mr. Chan can show he took meaningful steps at Enron to protect investors. Motorola has not responded to our request. We have every reason to believe Motorola intends to renominate Mr. Chan and send out to investors a proxy solicitation that does not inform them that Mr. Chan participated in what the Powers Report referred to as "inexcusable" decisions in his capacity as an Enron director.

Once Motorola does this, union and public pension funds, with billions of dollars invested in Motorola, will have to run at our own considerable expense a "vote no" campaign, fighting against a company campaign in favor of Mr. Chan that will be financed with our money. That's not right, and that's why worker benefit plans need access to the director nominating process, access to the company proxy, to hold directors accountable.

I want to close by saying that while these corporate governance matters have not been a central concern of this Committee, I hope you can appreciate in the aftermath of Enron how they directly affect the retirement security of America's working families through the trillions of dollars invested in public companies for workers' benefit. AFSCME and the AFL-CIO are ready to work with this Committee to take up the challenge of governance reform presented by the Enron fiasco – plan governance, money manager governance, and corporate governance. I thank you for the opportunity to testify today.

APPENDIX G - WRITTEN STATEMENT OF JOHN M. VINE, ESQ., PARTNER, COVINGTON & BURLING, WASHINGTON, D.C., TESTIFYING ON BEHALF OF THE ERISA INDUSTRY COMMITTEE

Testimony of Mr. John Vine, Partner

Covington & Burlington

Testifying on Behalf of ERIC

February 27, 2002

Good morning, Mr. Chairman. I very much appreciate the opportunity to speak with you and the Subcommittee today about investment and fiduciary responsibility issues.

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

I am a partner in the law firm of Covington & Burling. I have concentrated on employee benefit matters since the enactment of ERISA in 1974, and I have served as ERIC's legal counsel since 1984.

I have been asked to focus today on how ERISA's standards of fiduciary responsibility apply to investments in employer stock by individual account plans, such as § 401(k) plans and employee stock ownership plans.

Initial Comments on Pending Bills

Initially, however, I would like to make five points regarding the pending bills that would impose new restrictions on individual account plans -- largely in response to the Enron bankruptcy.

First, Congress should observe the old adage: "Do no harm." Voluntary employer-sponsored retirement plans, including plans that invest in employer stock, have been enormously successful in providing retirement benefits to employees. As of the end of 2000, approximately 42 million employees had accounts in § 401(k) plans, representing $1.8 trillion in assets. If Congress responds excessively to the risks associated with stock-based plans by imposing restrictions that prevent these plans from meeting employers' business needs, Congress will have addressed one risk by creating other, more dangerous risks: that millions of employees will be unable to share in their employers' success and that employers will curtail their commitments to their plans and reduce employees' retirement savings.

Second, Congress should not prohibit employees from making their own investment decisions. Many plans allow employees to direct how their accounts are invested. Congress should not restrict an employee's ability to allocate his or her account among the plan's investment options, including employer stock.

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

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

Fifth, before imposing new restrictions on individual account plans, Congress should carefully consider what the consequences are likely to be. Increasingly onerous regulation of defined benefit plans during the 1980's had devastating effects on the willingness of employers to maintain those plans. Before imposing new restrictions on individual account plans, Congress should consider how employers are likely to respond.

ERISA's Fiduciary Standards

Turning now to ERISA's fiduciary standards, I would emphasize that the fiduciaries of *all* ERISA-governed plans, *including* stock-based plans, are subject to rigorous fiduciary duties under ERISA. These standards are enforceable by plan participants and beneficiaries, by other plan fiduciaries, by the Secretary of Labor, and, in some cases, by the Internal Revenue Service.

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

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

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

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

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

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

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

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

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

Co-fiduciary Liability

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

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

- if the first fiduciary participates knowingly in, or knowingly undertakes to conceal, an act or omission of the second fiduciary, knowing that the second fiduciary is violating his fiduciary duties;

- if the first fiduciary's failure to discharge his or her own fiduciary duties enables the second fiduciary to commit a breach; or

- if the first fiduciary knows of a breach by the second fiduciary and fails to make reasonable efforts to remedy the breach.

Proposed Expansion of ERISA

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

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

ERISA § 404(c)

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

There is considerable misunderstanding about § 404(c). In general, it provides that when an individual account plan allows a participant to exercise control over assets in his account and the participant actually exercises control,

- the participant is not deemed a fiduciary by reason of having control, and

- no plan fiduciary is liable for any loss resulting from the participant's exercise of control.

A plan qualifies under § 404(c) only if it meets a series of rigorous requirements set forth in Labor Department regulations. The regulations require a § 404(c) plan to give a participant a reasonable opportunity to give investment instructions and sufficient information to make informed decisions.

Under the regulations, a § 404(c) plan may impose reasonable restrictions on the frequency with which participants may give investment instructions. The frequency must be appropriate in light of reasonably expected market volatility. In addition, at least three of the plan's core investment options must allow participants to give instructions at least once every three months.

Section 404(c) does not absolve the plan's fiduciaries of all responsibility. The fiduciaries who select the plan's investment funds remain responsible for selecting (and for periodically reevaluating) those funds in accordance with ERISA's fiduciary standards, including the duties of loyalty and prudence. There is no doubt that ERISA's duty of loyalty forbids the fiduciaries of a § 404(c) plan from making misrepresentations about the plan's investment options, including any employer stock fund that the plan offers.

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

Section 404(c) plans have been enormously successful in encouraging employees to save. Employees appear to be more likely to choose to save if they have some control over how their savings are invested.

We are concerned that any narrowing of § 404(c) could cause employers to respond by curtailing their plans' participant-direction features. This is likely to make these plans less attractive to employees and to dampen their enthusiasm for retirement savings.

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

One of the most important challenges facing Congress is how to expand pension coverage. Section 404(c) has been an extremely effective tool in this effort. Because it has given employees the ability to direct the investment of their retirement savings, it has made saving for retirement more attractive to them and has helped to increase retirement savings. Congress should not cut back on one of the most effective tools in the effort to increase pension coverage and retirement savings.

APPENDIX H – SUBMITTED FOR THE RECORD, LETTER FROM CHAIRMAN JOHN A. BOEHNER, COMMITTEE ON EDUCATION AND THE WORKFORCE, TO CONGRESSMAN HAROLD E. FORD, JR., COMMITTEE ON EDUCATION AND THE WORKFORCE, APRIL 5, 2002

COMMITTEE ON EDUCATION AND THE WORKFORCE

U.S. HOUSE OF REPRESENTATIVES
2181 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–6100

MAJORITY—(202) 225–4527
(TTY)—(202) 226-3372
MINORITY—(202) 225–3725
(TTY)—(202) 226-3116

April 5, 2002

The Honorable Harold E. Ford
U.S. House of Representatives
1641 Longworth HOB
Washington, D.C. 20515

Dear Mr. Ford:

Thank you for your letter of March 12, 2002 regarding the forum you held in your congressional district on retirement security. I thank you for sharing with me the views you received. Pursuant to your request, I will include these submissions as part of the permanent Committee hearing record.

Again, I very much appreciate your letter and look forward to working with you in the future.

Sincerely,

John Boehner

JOHN BOEHNER
Chairman

JAB/jms

APPENDIX I – SUBMITTED FOR THE RECORD, LETTER FROM CONGRESSMAN HAROLD E. FORD, JR., COMMITTEE ON EDUCATION AND THE WORKFORCE, TO CHAIRMAN JOHN A. BOEHNER, COMMITTEE ON EDUCATION AND THE WORKFORCE, MARCH 12, 2002

HAROLD E. FORD, JR.
9TH DISTRICT, TENNESSEE

COMMITTEES:
EDUCATION
AND THE WORKFORCE
SUBCOMMITTEES:
EDUCATION REFORM
EMPLOYER-EMPLOYEE RELATIONS

FINANCIAL SERVICES
SUBCOMMITTEES:
CAPITAL MARKETS, INSURANCE, AND
GOVERNMENT-SPONSORED ENTERPRISES
FINANCIAL INSTITUTIONS AND
CONSUMER CREDIT

Congress of the United States
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March 12, 2002

The Honorable John Boehner
Chairman
House Committee on Education and the Workforce
2181 Rayburn House Office Building
Washington, DC 20515-6100

Dear Chairman Boehner:

On February 21, 2002, I held a forum in my congressional office on retirement security. The forum participants included benefits managers, investment professionals, and labor representatives from the Ninth District of Tennessee.

At the forum, we discussed a multitude of issues raised by the collapse of Enron. The consensus was that Congress should proceed deliberately in examining our pension laws. The proper solution will center around empowering workers to make decisions about their own retirement savings based on unbiased information. To this end, the important elements of reform will be accounting, accountability, and investor education.

At the close of our discussion I asked participants to convey their views to be in writing. I wish to submit several of these views for the hearing record for the Employer-Employee Relations Subcommittee Hearing on February 27, entitled "Enron and Beyond: Legislative Solutions." As Congress proceeds, we will be wise to listen carefully to the professionals in the field of retirement savings and investments. Please accept these views of several such professionals in the Ninth District of Tennessee.

Sincerely,

HAROLD FORD, JR.
Member of Congress

APPENDIX J – SUBMITTED FOR THE RECORD, LETTER FROM WILLIAM E. THOMPSON, INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS, MEMPHIS, TN, TO CONGRESSMAN HAROLD E. FORD, JR., COMMITTEE ON EDUCATION AND THE WORKFORCE, FEBRUARY 25, 2002

INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS
LOCAL UNION 1288
4000 CLEARPOOL CIRCLE • MEMPHIS, TENNESSEE 38118
PHONE (901) 363-1563 • FAX (901) 363-3289

IBEW

February 25, 2002

The Honorable Harold E. Ford, Jr.
United States House of Representatives
325 Cannon House Office Building
Washington, D.C. 20515-4209

Dear Congressman Ford:

RE: Pension Plans and Stock Options

Thank you for the invitation to attend the February 21, 2002 discussion on "Protecting Workers' Retirement Savings." IBEW Local 1288 is submitting the following comments for your consideration.

You mentioned that Congress is having difficulty and confusion with Vesting vs. Stock Restrictions.

"Vested" means an employee owns 100% of his retirement contributions

- contributions made by the employee.
- contributions made by the Company in behalf of the employee
- all earnings on both contributions

"Vesting Period" The number of years an employee has to contribute to the Pension Plan before he is vested.

- We support the minimization of the vesting period.
- If this is truly a benefit of employment, then there is no reason to make the vesting period any longer than practical.

Several Employer Representative Groups were opposed to decreasing the vesting period, saying that it would hurt employee retention. Employees say, many companies hire during good times and lay off at the first sign of trouble. Why should these employees not own the retirement benefits promised them at employment; especially when an employee leaves the company for reasons outside of his or her control. (lay off, job relocation of a spouse, medical, etc.)

"Stock Restrictions" is a completely different matter. Companies may have some valid business reasons for restricting employee-owned stock, given by the company.

- We recommend that you insure that restrictions for employee-owned stock and;
- Restrictions for Company Executives and other Shareholders are the same degree of equitableness.

"ERISA Exemption" -

- Propose or support the removal of ERISA Exemption for state and local government, or;

- Propose or support the removal of ERISA Exemption for state and local government-owned utilities, who must compete in a deregulated market with the likes of Enron.

If neither option is politically viable, at an absolute minimum, please require that all government entities comply with the vesting requirements of ERISA.

We disagree with the employers' concept of "Re-evaluating Funding Requirements under more aggressive modes." This concept would leave companies like Enron with cash that they can divert for other purposes. WLOK Radio station reported that Enron had approached the Mayor of Memphis and Memphis Light, Gas & Water Division about selling the Utility to them. Companies like Enron are interested in MLGW and similar utilities because the Pension Funds are generally well funded and conservatively valued.

Your decision not to allow Congress to "turn the world upside down," as an overreaction to the Enron problems was a wise decision. Promoting this change has extended your national recognition. A relatively large proportion of organized labor and minorities are within government owned utilities, and are traditionally Democratic supporters.

Once again, thank you for allowing IBEW Local 1288 to have input in this process.

Sincerely,

William E. Thompson

William E. Thompson
Business Manager

WET/gw
opeiu 367 afl cio

cc: J. D. Cox

APPENDIX K – SUBMITTED FOR THE RECORD, LETTER FROM NOEL, DAVID, WADDELL & REED FINANCIAL SERVICES, MEMPHIS, TN, TO CONGRESSMAN HAROLD E. FORD, JR., COMMITTEE ON EDUCATION AND THE WORKFORCE, FEBRUARY 22, 2002

Noel David, District Manager
Waddell & Reed Financial Services,
8001 Centerview Pkwy (Ste 103), Memphis, TN38018

02/22/2002

CONGRESSMAN HAROLD FORD Jr.

Thank you for the invitation to be a part of the group of financial professionals who met last Thursday to discuss the future of Defined Contribution Plans and possible legislative changes in the light of the Enron debacle.

I could not participate verbally in the lively discussion that day as I was suffering from laryngitis. Therefore I appreciate this opportunity to share my opinions on the subject.

This may sound very simplistic, but the main issue of the Enron situation was not a result of inadequate or inefficient legislation or structure of the current Defined Contribution Plan. The problem was in the execution or implementation of those rules. Some unscrupulous persons chose to abuse the influence and position they had. it's as simple as that.

Additional legislation & reporting requirements:
Any further restriction or reporting requirement will hurt the overall purpose of the D.C.Plan more than the additional safety it will provide. Therefore this should be examined very carefully and cautiously.

Vesting:
This is a mechanism of the D.C.Plan that only comes into play at the time of termination of employment, and only applies to the employer's portion of the contribution. It is a powerful tool to attract and retain good employees and should not be changed.

Restriction on sale of corporate stock:
This is the subject that has been a source of misunderstanding. Companies use this tool to protect their stock prices from being artificially lowered by indiscriminate selling of stock by staff. This practice does not seem to have too many negative issues in the private sector. However it may be examined further.

Full and timely disclosure:
All executive staff who administer DC Plans or have the potential to influence lower staff's stock holdings should be required to make all buying and selling of stock public through an independent agency as soon after the transactions as is practical and consistent. This could possibly be the most important legislative addition through the SEC.

(Page 2 of Noel David's opinion on the legislative changes for the D. B. Plan)

I am going to address the following three issues together, since they are integrally connected.

Before I do, allow me to share a story with you. A couple made an appointment to seek my help with their money. They were both in their mid 50's. The gentleman had just been laid off and wanted to know what to do with his 401k money. He had no idea how his money was invested; in fact the couple confessed that they (and most of the man's co-workers) had been using their 401k accounts almost like a Christmas club account! For the last 15 years, in the month of November, the man (and most of his co-workers) would request withdrawals from their 401k accounts to enjoy Christmas! They signed "a form" without any knowledge or understanding of the consequences.

Diversification, Investor Participation, Financial Education:
In my opinion, this is the real issue and also the answer to most of the problems surrounding the D C.Plan. If financial education provided by approved Financial Institutions became mandatory in the workplace, it would build a new worker who was more interested in his financial future, understand the advantage of diversification and therefore be more aware and involved in his retirement funding.

Technically this is currently a fiduciary responsibility of the Human Resources/ Benefits Manager/ Department. Unfortunately many HR people are not aware of this, and obviously the staff is oblivious too. The 401k plan is loosely referred to as a financial plan or even purported to be all the retirement planning that the worker needs. We know that this is simply not true and is not fair to the workers. There is much room for greater participation in the 401k plan so that we can fight to reduce the number of people who become wards of the state in retirement. With the progress of medical science, people are living much longer. Most actuaries will corroborate this statement. Just a 401k plan may not be the answer to the worker's retirement needs. There are so many other options that are available to everyone. We financial professionals need to share this with the American work force, to empower them to take control of their own financial future. Information is power, and we can make it available to them.

Most HR people do not have the background or training to advise or guide the employees adequately. Many fall short of their fiduciary responsibility and yet neither they nor the staff are aware of this. Sometimes a person's ego may stop him admitting his inadequacy, and the ignorant worker suffers! I am sure good financial education will help.

The only caution I would raise would be to ensure that the legislation insists that all financial education be provided by appropriately licensed and trained representatives of approved financial institutions. Also all such information/ teaching is generic in its content and no direct sales if any were made in the workplace.

Once again I thank you for this forum. I hope this opinion helps in the overall result.

APPENDIX L – SUBMITTED FOR THE RECORD, LETTER FROM PAUL SHAFFER, ASSISTANT BUSINESS MANAGER, ELECTRICAL WORKERS LOCAL UNION NO. 474, MEMPHIS, TN, TO CONGRESSMAN HAROLD E. FORD, JR., COMMITTEE ON EDUCATION AND THE WORKFORCE, FEBRUARY 21, 2002

ELECTRICAL WORKERS
LOCAL UNION NO. 474
OF THE INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS • AFL - CIO
ELECTRICAL WORKERS HALL • 1870 MADISON AVENUE • MEMPHIS, TENNESSEE 38104-2695
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JACK A. GATLIN
BUSINESS MANAGER &
FINANCIAL SECRETARY

GLENN GREENWELL
PRESIDENT

February 21, 2002

The Honorable Harold Ford, Jr.
167 N. Main, #369
Memphis, TN. 38103

Dear Representative Ford:

This is in reference to the topic that seemed to be of the most concern at the meeting yesterday, which I took to be the requirement of some 401k plans that any employer contributed stock be held until a certain age and how this relates to vesting. The understanding I have of vesting is that it is the time at which you have 100% ownership of the "employer contributed" assets in a pension plan and the apparent area of concern is that even though you own the assets you still do not have control of them until you have reached the age limit in a plan such as Enron's.

I, as purely a layman in this field, think that it is totally unfair that you do not have control over assets that you supposedly have ownership of at the time that you become 100% vested in the plan and a purely simplistic solution to this would be to lift any employer restrictions on how an employee manages their 401k plan assets at the time they become 100% vested, whether it be in one year, three years or five years. The only reason I would have reservations about such a change would be the possibility that it could cause employers to change to non-matching plans or discourage employers from establishing new plans. Although I do not think that it would have a large negative impact I would have to defer to the experts on those matters, but still think that an employee should have control over their assets and would have to see hard evidence against making a change to remove employer restrictions that continue past the date of vesting.

On another related topic I would like to address some of my concerns about Presidents Bush's so called Social Security reforms. The Enron mess and the fact that so many of their employees were chasing the specter of high profits with their retirement funds when the company failed should be a strong argument against Bush's proposal to allow self direction of individual accounts in the Social Security system. Where would these employees from Enron be if they had been able to invest their Social Security assets in Enron stock along with their 401k funds? We should be slow to tinker with a program that was designed to be a safety net by allowing the potentially risky practice of self direction of retirement assets by ill informed and misdirected investors. I shudder to think of the impact that the crash of a major corporation or the stock market itself would have on the public assistance network, both private and governmental, should a substantial portion of Social Security participants lose their plan assets through risky investments. For this reason, I would encourage you to resist Bush's so called reforms and pursue other avenues to shore up the Social Security program so that it will be there for future retirees.

I would like to thank you for including us and other representatives of organized labor in this important meeting. If we can be of assistance at any other time please feel free to call upon us without hesitation.

Sincerely,

Paul Shaffer

Paul Shaffer
Assistant business Manager

APPENDIX M – SUBMITTED FOR THE RECORD, LETTER FROM CAROL LEE ROYER, WADDELL & ASSOCIATES, INC., MEMPHIS, TN, TO CONGRESSMAN HAROLD E. FORD, JR., COMMITTEE ON EDUCATION AND THE WORKFORCE, FEBRUARY 21, 2002

WADDELL & ASSOCIATES, INC
Investment and Financial Counsel
Carol Lee Royer, CFP, CFA

February 21, 2002

The Honorable Harold E. Ford, Jr
Member of Congress
167 N. Main St., Ste 369
Memphis, TN 38103

Dear Congressman Ford,

It was a pleasure attending the discussion this morning on "Protecting Workers' Retirement Savings." I found your determination to listen, ask questions and understand more than just the media headline issues very refreshing and hopeful to all retirement plan participants.

As Chairman of the Financial Planning Associates of the Mid-South (the local chapter of CFP professionals who are members of the national FPA organization), I know that all of us in the financial planning community are advocates for providing the best retirement savings opportunities for working Americans. The defined contribution plan with the 401(k) option has provided such an opportunity, allowing millions of workers to save regularly in a tax-favored manner while accumulating substantial retirement assets.

In light of the Enron collapse and loss of employee retirement savings funds, I would encourage Congress and the SEC to address the following 3 major areas:

1. Promote employee financial literacy – Private and public sector efforts to promote more and better quality employee education is crucial. Financial literacy programs should cover the concept of personal financial planning, the definition and value of diversification, the risk associated with a high concentration in employer stock (if employer stock is an investment option in the plan), the definition and risk/return characteristics of investment options and how to go about determining an asset allocation. HR2269 seems to address an important aspect of promoting better employee education since it allows employers to provide professional investment advice to employees. This ability should be available to all employees (not just upper management) with all potential conflicts fully disclosed.
2. Require more timely disclosure of insider buy/sell activity – Employees as well as all investors should have more instantaneous access to insider transactions. While insiders almost always explain sell activity as being unrelated to their opinions about the firm's prospects, employees and investors who own the stock should know about these transactions so they can form their own conclusions. In searching the SEC website, I read that such a proposal addressing corporate disclosure rules was announced on 2/13/02 (see Press Release #2002-22).
3. Auditing reforms to ensure accurate information about a corporation's financial condition - I am not an accountant, but it is obvious that the conflicts of interests were rampant and abusive inside Enron's management and Board and among its paid consultants, auditors, attorneys and investment bankers. It is crucial for investors to have accurate, reliable information regarding the true state of a company's financial condition to ensure fair, transparent financial markets. Perhaps the introduction of the "Corporate and Auditing Accountability,

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Responsibility, and Transparency Act" by Oxley and Baker (see SEC Press Release #2002-24) is a step in the right direction here, though I have not had time to read its provisions.

Other questions more specific to 401(k) plans were discussed in today's meeting. Some comments on topics mentioned:

- Vesting – As discussed, vesting refers to how much of their retirement account an employee owns when they terminate employment. All employee salary deferrals or contributions (and their earnings) are 100% vested or owned. Only employer contributions (whether in cash or employer stock) can be subject to a vesting schedule. Employees, of course, would like all employer contributions to be 100% vested and some employers choose to do this. However, there are probably more retirement plans with generous employer contributions in existence today because of the vesting option. Employers see this as a way to reward and encourage long term employees rather than seeing short term employees stay just long enough to take the money and go elsewhere. *Since what went wrong at Enron has nothing to do with vesting provisions and current vesting rules work well, I would recommend no changes in this area.*
- Switching investment options – 401(k) plans have different provisions about how often employees can change their investments within the plan. More restrictive provisions can be applied to employer contributions of company stock. Apparently, one problem for employees at Enron was their inability to sell Enron stock that they received as a matching contribution until age 50. There were no restrictions on switching out of Enron stock they had accumulated with their own contributions. While I understand that companies may want to encourage some minimal level of employee ownership of company stock, I think restrictions on selling employer stock in the plan should be loosened. *I would support legislation or rules that would reduce or eliminate the amount of time before employees could switch out of company stock into another investment option in the plan.* If company contributed shares are subject to a vesting schedule, then employees should be able to sell whatever shares are fully vested. (Shares in the plan that are not vested, or owned by the employee, would not be distributed to the employee if they terminated employment anyway).
- Plan "lockdowns" – I do not know much about lockdowns and what could be done to shorten these blackout periods caused by administrative changes. It seems that technology solutions and thorough planning could reduce the length of lockdowns just as computer system "downtime" has been reduced over the years. *I do agree with proposals that would limit the ability of corporate executives and directors to sell company stock if employees are restricted from selling stock in their plans during "lockdowns."*

I hope these comments are helpful. Please feel free to contact me if you have more specific questions or need clarification.

Sincerely,

Carol Lee Royer

Carol Lee Royer, CFP, CFA
Vice President, Finance

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Waddell & Associates, Inc. is a registered investment adviser

APPENDIX N – SUBMITTED FOR THE RECORD, LETTER FROM ROBERT C. BURLEIGH, BURLEIGH CONSULTING GROUP, MEMPHIS, TN, TO CONGRESSMAN HAROLD E. FORD, JR., COMMITTEE ON EDUCATION AND THE WORKFORCE, FEBRUARY 22, 2002

BURLEIGH CONSULTING GROUP

RETIREMENT PLAN CONSULTANTS AND ADMINISTRATORS

February 22, 2002

Congressman Harold Ford
167 North Main, Suite 369
Memphis, TN 38103

Re: Follow Up To The 401(K) Plan Discussion Held Yesterday

Dear Congressman Ford:

Thank you for the opportunity to express our comments yesterday. The purpose of this letter is to clarify the confusion you mentioned about how vesting and the right to diversify out of company stock contributed by the company are "tied-together". After re-reading some of the pending legislative proposals, I now understand the basis for the confusion.

Under current law with 401(K) plans that contain company stock, employees can sell or diversify the stock purchased with their own contributions at anytime with the proceeds re-invested into one of the other investment choices offered by the plan. However, on the company stock contributed by the company as a matching contribution, the company can preclude these shares being sold and diversified until age 55 for example.

Several of the legislative proposals would allow the employees to sell and diversify the shares contributed by the company after a short period of time – i.e. 90 days, 3 years, etc. Frankly, I would be in favor of such changes. Apparently, however, the sponsors of these legislative proposals seem to believe that a participant would need to be 100% vested in the matching contribution before being permitted to diversify the company's contribution, and hence they also are suggesting a faster vesting schedule. These are separate items. There is no legal requirement that states that the right to diversify one's investments can only be allowed when one is 100% vested.

Vesting merely means what percent of the employees account balance derived from company contributions are owed to the employee when the employee terminates. As you know, the pension reform legislation enacted last year made changes to the vesting requirements for matching contributions.

If there are reasons to re-consider the vesting requirements for all 401(K) plans in the country, this should be done after thoughtful consideration, and not

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in response to the Enron situation. All of our clients which consist primarily of 401(K) plans of smaller companies in Memphis, have just gone through the cost of having their plans re-drafted to meet the recent pension legislative changes. This includes the new vesting rules. Could we not state that any shorter vesting requirements would only apply to 401(K) plans that contain company stock?

A second concern that would be extremely detrimental to many of our Memphis clients is the requirement that all plans containing 401(K) provisions must provide quarterly benefit statements. It is my belief, that this proposal is based on several misconceptions as follows:

(1.) The misconception that all 401(K) plans are designed where the employees make the investment decisions among a menu of investment choices.

(2.) The misconception that of those plans that do permit the employees to make the investment decisions that they will make better diversified investment decisions if they can make changes more frequently during each year – i.e. quarterly vs semi-annually; daily vs quarterly, etc.

In our practice, which consist primarily of small businesses, only about one-third are set-up where the employee's are responsible for making the investment decisions. In approximately two-thirds of the cases, the company has engaged an investment manager to diversify all of the plan's assets among many investments with annual reporting to all employees. Naturally in these cases, the employer knows that the company is assuming the role of a fiduciary in making these decisions. However, they believe their employee's well being at retirement by appointing investment professionals to manage the entire assets in a diversified manner is important enough to assume this responsibility.

Under President Bush's proposal, these companies would be required to pay for more frequent reporting and account reconciliation which would substantially increase their administrative costs without any purpose being served.

How would this proposed change have prevented the Enron problem? The Enron employees were allowed to change the investment mix of their own contributions at anytime.

Can we not limit this quarterly reporting requirement to only plans that contain employer stock? Why extend it to <u>all</u> 401(K) plans?

Finally, based on my experience, most independent financial advice recommends that employees make a diversified asset allocation and "stick with it" through different market cycles. This advise almost always warns employees not to try to "time the market" and move their investments to what has performed best recently. The concept that more frequent reporting and more frequent investment changes assures better investment results is contrary to actual experience.

Thank you again for the opportunity to express my opinion. I would be happy to answer any questions or to make available any other information we can provide. Terry Dunger of Acuff and Dunger, a consultant that also services many 401(K) plans in Memphis, concurs in these opinions.

Sincerely yours,

Robert Burleigh

Robert C. Burleigh

Cc: Terry Dunger

APPENDIX O – SUBMITTED FOR THE RECORD, STATEMENT OF THE PENSION REFORM ACTION COMMITTEE, WASHINGTON, D.C., FEBRUARY 27, 2002

PRIVATE COMPANIES AND THEIR EMPLOYEES' RETIREMENT SAVINGS FACE UNIQUE CONCERNS IN PENSION REFORM

- Thousands of non-public companies across America are employee-owned. These companies, the vast majority of which are small- and medium-sized and/or family businesses, are a hallmark of American entrepreneurship. Through their growth, they have helped fuel the national economy by providing increasing numbers of jobs for millions of workers in fields ranging from trucking to tourism, from manufacturing to management consulting.

- Private, employee-owned companies also have unique concerns that must be considered in the context of the current debate over proposed pension reforms. In particular, as described below, proposals to change existing diversification rules for non-publicly traded stock would harm, not enhance, the retirement savings of the employee-owners of these companies.

- Two particular features distinguish private from public business: First, the stock of a private business cannot be sold on the public market. Thus, when company stock is sold, the only purchaser of the shares is the company itself. Any change to current law that facilitates substantial sales of private company stock will place an enormous strain on the capital of the company-buyer, potentially forcing up leverage ratios and reducing the company's ability to fund ongoing operations/growth.

- The second, related distinction is that a private company's stock value does not derive from the public markets, but rather from a private valuation of the company's assets, liabilities and cash flow. Any change to current law that facilitates the sale by employees of large amounts of private company stock – regardless of whether the employees choose to divest of these shares – creates a massive contingent liability for the company-buyer. The automatic result of this liability is that the company's stock value will fall, **resulting in a devaluation of the employees' stock accounts.**

- It is also important to understand that among private, employee-owned companies there is a standard culture of entrepreneurship and personal economic empowerment. Private employee-owned companies are typically "open book" companies, where employees are informed investors in the company. Furthermore, in the vast majority of cases, these employees reap enormous benefits from their piece of the rock in their company – setting aside more retirement savings in their ESOP accounts, for example, than they could ever amass in a 401k plan or other retirement program.

- In summary, private companies are uniquely vulnerable to proposals that would alter existing pension laws on mandatory diversification, and any such changes would impair the retirement savings of employee-owners of these businesses.

- To date, only one pension reform bill that has been introduced – the Portman/Cardin bill – to exempt private companies from new mandatory diversification rules. It is critical to the viability of these companies, and the health of the retirement savings of their employees, that in any new pension reforms, this distinction survive.

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