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STATEMENT OF
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UNITED STATES GENERAL ACCOUNTING OFFICE
BEFORE THE
SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT
OF THE
SELECT COMMITTEE ON AGING
HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Subcommittee:

We are pleased to appear here today to present information on the effect of the Employee Retirement Income Security Act of 1974 on the termination of single employer defined benefit pension plans. The act is commonly referred to as ERISA.

The information we are presenting was developed by the General Accounting Office at the request of 116 Members of the Congress. In making the request the 116 Members expressed concern about the effects of ERISA on small businesses and emphasized the large increase in the number of defined benefit pension plans that terminated after the enactment of ERISA. The Members expressed the belief that many small businesses and their employees were being irreparably hurt by ERISA. To respond to the 116 Members' concerns, GAO undertook two separate studies.

Our first study, which our discussion will focus on today, was directed at determining the effects of ERISA on about 7,300 single employer sponsored defined benefit pension plans terminating during the 21-month period from September 2, 1974--the date of ERISA's enactment--to June 1976. Our second study is being directed at the effects of ERISA on ongoing pension plans.

BACKGROUND

ERISA, is the first Federal legislation that regulates the internal workings of private pension plans. The purpose of ERISA is to establish Federal standards for private pension plans and to protect the rights under these standards for an estimated 30 million participants in an estimated 170,000 private pension plans. Defined benefit plans account for about 20 percent of all private pension plans and about three-fourths of all pension plan participants.

ERISA does not require businesses to establish pension plans, nor does it prohibit businesses from terminating pension plans. However, with few exceptions, both continuing and new private pension plans must comply with the act's provisions.

To protect the interest of employees, ERISA established comprehensive minimum standards and requirements that specify:

--how employees become eligible to participate in pension plans (participation standards),

--how employees earn a nonforfeitable right to pension benefits (vesting standards),

--how the plans are to be funded (funding standards),

--how the plans are to be operated in the best interest of plan participants (fiduciary standards), and

--the extent to which plan information is to be reported and disclosed to the Federal Government and plan participants (reporting and disclosure requirements).

ERISA also established an insurance program for guarantying the payment of certain benefits to participants of defined benefit plans if a plan terminates without sufficient assets to provide vested benefits.

Responsibilities for carrying out and enforcing ERISA's provisions are assigned to the Department of Labor, the Internal Revenue Service, and the Pension Benefit Guaranty Corporation (PBGC).

As part of our review of defined benefit pension plan terminations, we sent a questionnaire to a random sample of 731 of the 7,300 plans terminating during the period from September 1974 to June 1976, and received 595 responses--a response rate of 81 percent. About 93 percent of the 595 responses were for plans with less than 100 participants. We also reviewed 63 plans where the act, according to plan sponsors, was a major reason for termination.

NON-ERISA FACTORS CONTRIBUTED SIGNIFICANTLY TO PENSION PLAN TERMINATIONS

Of the 595 responses to our questionnaire, about 35 percent noted both ERISA and non-ERISA factors as major reasons for plan terminations. However, non-ERISA factors were noted by about 44 percent of the responses as the only major reason for plan termination whereas ERISA was noted as the only major reason by about 17 percent of the responses.

Therefore, 473 or almost 80 percent of the 595 questionnaire responses noted non-ERISA factors as major reasons for plan termination and 313 or about 53 percent noted ERISA as a major reason.

Based on the sample results, we estimate that non-ERISA factors played a major role in the decision to terminate 5,811 of the 7,310 defined benefit plans terminating during the 21-month period from September 1974 to June 1976. ERISA played a major role in the decision to terminate 3,845 of the plans during this period.

The 473 respondents that indicated non-ERISA factors as a major reason for plan termination most often noted adverse business conditions, costs of the plans, and the plans' unsuitability for meeting employee or employer needs.

IMPACT OF ERISA ON DECISIONS TO TERMINATE PENSION PLANS

The 313 respondents that identified ERISA as a major reason for plan termination indicated that the cost and administrative burden to begin and continue to meet ERISA requirements, the lack of clarifying regulations on what was required, and the potential penalties for not meeting the requirements were major factors in decisions to terminate plans. Another major factor was the objection in principle to Federal regulation of private pension plans voluntarily established and funded by employers.

ERISA Costs

Of the 313 respondents who said ERISA was a major factor in terminating the pension plans, 246 indicated that anticipated increased costs due to ERISA had a major effect on the decision to terminate the plan. Of the 246 respondents, 173 indicated that these anticipated cost increases were unacceptable.

Generally, the three types of increased costs associated with ERISA are (1) benefit costs, (2) initial costs to amend the plans to meet ERISA standards, and (3) costs to administer the plan.

Benefit costs

The amount of annual employer benefit contributions required by ERISA tund pension plans can vary greatly depending on plan provisions. Revising plans to meet the minimum participation and vesting standards could increase the number of employees participating in pension plans and the amount of benefits to which these participants have a nonforfeitable right, even if they terminate employment. ERISA provides minimum funding standards to make sure that plans have sufficient money to pay promised benefits.

Of the 246 respondents who indicated ERISA costs were a major reason for termination, 177 considered anticipated benefit costs to be significant and 131 considered benefit costs to be unacceptable. The 65 respondents who provided us with benefit cost information indicated that ERISA would have increased annual benefit costs by 96 percent from an average of $22,832 to an average of $44,815,

Initial costs

Many plan sponsors anticipated significant costs to revise their plans to meet ERISA requirements. These costs, especially for smaller businesses and plans, could include legal, actuarial, and other consultant fees.

Of the 246 respondents who indicated that increased costs were a major reason for termination, 170 considered initial costs as a major cost element and 124 considered initial costs to be unacceptable. According to 79 respondents, who provided us with estimates of anticipated initial costs, their average cost to revise the terminating plans to meet ERISA requirements would have been $3,515.

Administrative costs

Many plan sponsors anticipated substantial increases in annual costs to administer their pension plans. Additional administrative expenses could, for example, result from changes in recordkeeping practices, reporting and providing information to Government agencies and plan participants, and consulting fees for services and advice.

Of the 246 respondents who considered costs to meet ERISA as a major reason for termination, 202 expected a major increase in administrative costs and 137 considered the anticipated increase in administrative cost to be unacceptable. The 74 plan sponsors who provided us with information on administrative costs indicated that average annual administrative costs would have increased by about 114 percent from an average of $2,110 to $4,525.

The most frequently noted factors anticipated to increase administrative costs were consulting fees to actuaries, or legal advisors; and the cost of meeting ERISA's reporting and disclosure requirements.

Reporting and Disclosure Requirements

ERISA requires pension plan administrators to report and disclose extensive information about pension plan operations and financial conditions to the Department of Labor, the Internal Revenue Service, the Pension Benefit Guaranty Corporation, and to plan participants and beneficiaries. According to many sponsors of terminated pension plans, this burden was a major reason for plan termination.

Of the 313 respondents who indicated that ERISA was a major reason for plan termination, 235 indicated that ERISA reporting and disclosure requirements had a major effect on their decisions to terminate their plans.

Of the numerous reporting and disclosure requirements, the annual report, and plan description requirements were frequently noted as having a major effect on plan termination decisions.

<u>Other</u>

Of the 313 respondents who indicated that ERISA was a major reason for plan termination, 271 noted other ERISA factors as major contributors to terminations.

A lack of clarifying regulations by Labor and IRS was cited by 201 respondents as a major reason for termination. Two previous GAO studies support this contention. In a July 6, 1977, report to the Senate Committee on Human Resources, we pointed out that although Labor had identified 53 areas needing regulations to implement and clarify ERISA, only 15 regulations had been issued and another 10 proposed as of March 10, 1977. In a October 21, 1976, report to Congressman Alan Steelman, we pointed out that Labor generally showed a lack of timely response to public inquiries on ERISA requirements.

About 77 percent of the 271 respondents indicated that a major reason for termination was an objection in principle to Federal regulation of pension plans established and funded by employers. In addition, a significant number of respondents indicated that ERISA provisions directed at responsible management of pension plans such as potential penalties for not complying with the act's requirements were also major reasons for termination.

Agency Actions

The Department of Labor, IRS, and PBGC have made some progress in clarifying ERISA requirements, and have lessened the reporting and disclosure burden through consolidation of reports and reduction in information required to be reported.

For example, as of September 30, 1976, the number of final, temporary, and proposed regulations issued by the three agencies totaled 73. As of December 31, 1977, the total was 111. Further, beginning with the 1977 annual report, which plan sponsors have to file in 1978, only one annual report will be required to be filed. It will be filed with IRS rather than individual reports to Labor, IRS, and PBGC. In addition, each of the three agencies have established advisory groups and initiated studies to identify and determine how plan administrators' problems and concerns can be further alleviated.

INDICATED ADVERSE EFFECT OF TERMINATIONS ON PARTICIPANTS MISLEADING

We believe that the adverse impact of ERISA on American workers as indicated by the large number of plan terminations was not as great as it appeared because of the following factors.

--Where ERISA was noted as a major reason for plan terminations, the terminating plans generally did not meet ERISA's minimum participation and vesting requirements.

--Participants of terminated plans generally had received or were to receive almost all of their vested benefits promised by plan provisions.

--About 41 percent of the sponsors of terminated pension plans continued pension coverage for their employees through new or other existing pension plans.

Most Terminating Plans Did Not Meet Standards

ERISA established minimum participation and vesting standards so that employees do not have to work an unreasonable number of years before participating in and benefiting from a private pension plan. The further the terminating plans were from meeting these ERISA standards, the less adverse impact the termination had on plan participants and employees of plan sponsors.

Of the 595 responses to our questionnaire, 313 noted that ERISA was a major reason for plan termination. We compared the plan provisions of 63 of the 313 plans with the ERISA minimum participation and vesting requirements, and found that 60 plans did not meet one or both requirements.

Participation standards

Generally, ERISA provides that employees must be allowed to participate in a plan after they are 25 years old and have completed 1 year of service. These two requirements are referred to as the minimum age and service participation requirements.

Further, older employees may be excluded from participating in defined benefit pension plans if their age at the time of commencing employment is within 5 years of the plan's normal retirement age. This requirement is referred to as the maximum age participation requirement. For example, if a plan's normal retirement age is 65, an employee hired before age 60 must be allowed to participate in the plan. However, an employee hired at age 60 or older may be denied participation.

Both the minimum age and service and the maximum age requirements have to be met before a plan meets ERISA's minimum participation standards. Our review of the 63 plans showed that, 57 plans did not meet the minimum age and service requirements and 32 did not meet the maximum age requirement. The 32 plans that did not meet the maximum age requirement required that older workers, to participate, begin employment an average of 9-1/2 years before reaching the plans' normal retirement age rather than the 5 years required by ERISA.

Of the 57 plans that did not meet the minimum age and service requirements, 15 did not meet the age requirement and 57 did not meet the years of service requirement. The age required by the plans that did not meet the minimum age requirement ranged from age 26 to 35 and averaged age 30. Twelve of the 15 plans required employees to be at least age 30 before being eligible to participate. The 57 plans that did not meet the years of service requirement required employees to work from 2 to 6 years before participating. About 74 percent of the plans required an employee to work 3 years or more before being allowed to participate as contrasted to 1 year required by ERISA.

Because of the lack of available data, we could not determine the extent to which the restrictive participation provisions of the 57 plans would have kept employees from becoming plan participants in the long-run. Based on infomation provided by sponsors of 15 of the 57 plans, however, revising the plans to meet ERISA's minimum participation standards would have increased the number of employees participating by from 35 to 4,000 percent.

As an example at the extreme, one plan sponsor operated a chain of fast food restaurants and employed about 1,400 full-time employees. The plan was considered tax qualified by IRS and required employees to be at least 30 years of age, have a minimum of 5 years of service, and a salary greater than $550 per month to be eligible to participate in the plan. The plan sponsor stated that only 25 employees met these qualifications mainly because his business experienced a high employee turnover rate. The sponsor believed that revising the plan's participation provisions to meet ERISA standards would permit about 1,000 additional employees to participate for a 4,000 percent increase.

Another plan sponsor operated a small retail business employing 15 people of which 5 participated in the plan. The plan required employees to be at least 30 years of age and work for 5 years before becoming a plan participant. The sponsor told us that revising the plan to meet ERISA minimum participation standards would have required him to provide all of his 15 employees coverage under the plan.

Vesting standards

ERISA provides that participants of defined benefit plans have a vested right to retirement benefits upon reaching the plans' normal retirement age. ERISA in general provides three minimum vesting schedules which are governed by years of service. Under any of the schedules, participants must be at least 50 percent vested in their accrued benefits after 10 years of service and 100 percent vested after 15 years of service.

To ascertain the degree to which terminating plans met ERISA's minimum vesting requirements, we compared the ERISA requirements with the length of time required for 50 and 100 percent vesting under the provisions of the 63 plans we reviewed. In making the comparison, we took into consideration the ERISA general requirement that all years of service after age 22 be counted in determining vesting rights.

Our comparison showed that 35 of the 63 plans did not meet the vesting requirements. Of the 35 plans, 33 had vesting schedules. These schedules required participants to have an average of about 19 years of service before becoming 100 percent vested or 4 years more than required by ERISA.

Nine of the 33 plans that had vesting schedules and the 2 plans that did not have vesting schedules required participants to meet a minimum age requirement before becoming vested at all. The minimum age required by these 11 plans for vesting ranged from age 40 to 65 and averaged age 52. Participants in these plans could lose benefits regardless of their years of service by terminating employment before reaching the specified age. For example, four plans required participants to be 50 years old before becoming vested in any part of their accrued benefits. A participant starting to work for the sponsors of these plans at age 22 could work for 28 years for the sponsor before having a vested right to any benefits.

Terminating Plan Participants Received Vested Benefits

One of the principal purposes of ERISA was the creation of an insurance program to make sure that participants of single employer defined benefit pension plans receive promised benefits. The insurance program is administered by PBGC and guarantees, within certain limits, participants' accrued benefits that are vested under plan provisions at the time of termination. During calendar year 1977, the maximum monthly benefits guaranteed by PBGC to each participant of a terminating plan was generally limited to $937.50.

According to PBGC, 9,627 single employer defined benefit pension plans having about 214,000 participants gave notification of intent to terminate during the 25-month period from September 1974 through September 1976. According to PBGC, most participants had received or were to receive benefits that had become vested under the terminating plans' provisions.

PBGC estimated that 227 or about 2 percent of the 9,627 plans giving notice of termination during the 25-month period had insufficient assets to pay guaranteed vested benefits. Presumably, the remaining 9,400 terminating plans had sufficient assets to pay guaranteed benefits. The 227 insufficient plans had about 19,000 participants with guaranteed vested benefits totaling about $144.5 million but had assets valued at only about $55.2 million. PBGC was to guarantee the remaining $89.3 million in vested benefits.

Continuing Pension Coverage

The large increase in terminating single employer defined benefit pension plans after passage of ERISA indicated that the act may be the cause of hundreds of thousands of plan participants not having continuing private pension coverage and an unknown number of workers not having the opportunity to participate and benefit from a private pension plan.

Of the 595 responses to our questionnaire, 524 indicated whether participants of terminating pension plans would have continuing pension coverage. Of the 524 respondents, 216 or 41 percent indicated that their employees would continue to have private pension coverage through new or existing pension plans.

Employees who were not provided continuing pension coverage by employers had an opportunity to continue pension coverage through individual retirement accounts. An individual retirement account is a retirement savings plan which allows employees not covered by a tax qualified private pension plan to set aside part of their earnings for which Federal taxes are deferred until benefits are received from the plan.

CONCLUSIONS

In conclusion, ERISA did contribute significantly to single employer sponsored defined benefit pension plan terminations. However, economic and other non-ERISA factors played a more significant role in decisions by plan sponsors to terminate defined benefit pension plans.

Also, the adverse effect on American workers indicated by the number o terminations was misleading. The adverse impact was not as great as it appeared because plans terminating in whole or in part because of ERISA generally required employees to work longer and/or be older than required by ERISA to participate in and benefit from the plan. Participants of terminating plans were to receive almost all of their vested benefits, and about 41 percent of the sponsors of terminating plans continued pension coverage for their employees under other pension plans.

Overall, the minimum participation, vesting, and funding standards and other provisions of ERISA should enhance responsible management of new and continuing plans and give tens of millions of workers a better chance to earn and receive vested benefits without having to work an unreasonable number of years an[illegible]h an unreasonable age.

According to plan sponsor[illegible] increas[illegible] cost of providing benefits, and revising [illegible]ring plans; the burden of meeting reporting and [illegible]e requirements; the need for clarifying regulations; [illegible] concern about penalties for not [illegible]ting requi[illegible] major ERISA factors contributi[illegible] to pla[illegible] [illegible] should be noted, however, tha[illegible] most of th[illegible] [illegible] a direct result of efforts to make sure [illegible] have an equitable opport[illegible]ity to particip[illegible] pension plans and that partici[illegible] receive earned pension benefits.

We believe that the lack of regulations clarifying ERISA's complex provisions resulted in confusion about how ERISA requirements were to be met and concern about penalties for not meeting requirements. F[illegible]ther, ERISA reporting and disclosure requirements were burdensome and costly to plan sponsors. The Department of Labor, the Internal Revenue Service, and the Pension Benefit Guaranty Corporation, however, have made progress in providing pension plan sponsors and administrators with guidelines for meeting ERISA requirements and have somewhat lessened the reporting and disclosure burden through consolidation of reports and reduction in information required to be reported.

We believe that the clarification of ERISA requirements and the reduction of burdens on plan administrators should be a continuing goal of the three agencies. However, reduction in administrative burden should not be accomplished by compromising participant protection.

Mr. Chairman, this concludes our prepared statement. We will be pleased to respond to any questions that you or other members of the Subcommittee may have.