

# PRIVATE PENSION PLANS

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HEARINGS  
BEFORE THE  
SUBCOMMITTEE ON FISCAL POLICY  
OF THE  
JOINT ECONOMIC COMMITTEE  
CONGRESS OF THE UNITED STATES  
EIGHTY-NINTH CONGRESS  
SECOND SESSION

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PART 2

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MAY 3, 9, 11, 16, AND 20, 1966



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## PRIVATE PENSION PLANS

TUESDAY, MAY 3, 1966

CONGRESS OF THE UNITED STATES,  
SUBCOMMITTEE ON FISCAL POLICY  
OF THE JOINT ECONOMIC COMMITTEE,  
*Washington, D.C.*

The subcommittee met, pursuant to recess, at 10 a.m., in room S-407, the Capitol, Hon. Martha Griffiths (chairman of the subcommittee) presiding.

Present: Representative Griffiths.

Also present: John R. Stark, deputy director; Nelson D. McClung, economist; Hamilton D. Gewehr, administrative clerk; and Douglas C. Frechtling, minority staff research assistant.

Representative GRIFFITHS. Gentlemen, I would like to thank you for being here this morning.

I think I might as well tell you gentlemen from Sears that while I do not have any personal theory on your profit-sharing plan, I do have a theory for foreign aid. My theory is that if you give everybody in the world \$5 and a Sears, Roebuck catalog I think we would soon get all the money back.

I have some questions which have been raised about your plan; so as you read, I hope you will be able to answer these.

I do not quite understand this telegram sent to me:

Husband in Sears plan 25 years. Fifty-three when died. Got profit-sharing but refused pension. Stock yield low, tax heavy on sales. Need \* \* \* law to retrieve pension rights for support of family.

I presume this is someone who made a mistake.

Then I would like you to answer how one can borrow on his rights. A man has raised objection that he was forced to borrow because his mother was ill and when she died and he needed money for the funeral, he couldn't get it because no more withdrawals for any reason were permitted—including tax. I don't quite understand that.

With that, I would be pleased to have you proceed.

### **STATEMENT OF LAWRENCE L. O'CONNOR, VICE PRESIDENT AND GENERAL COUNSEL OF SEARS, ROEBUCK & CO.; ACCOMPANIED BY THEODORE BOWER, ATTORNEY**

Mr. O'CONNOR. We will be pleased to address ourselves to both of the problems.

Allow me to introduce my colleague, Theodore Bower, a member of the bar of Illinois and an employee of Sears, Roebuck & Co. as attorney.

My name is Lawrence L. O'Connor. I am vice president and general counsel of Sears, Roebuck & Co. Sears operates a general merchandise business through catalog order and retail stores. It does business in all the States of the United States, the District of Columbia, and in a number of foreign countries.

Sears appears here today at the invitation of your subcommittee to discuss the Sears profit-sharing fund and to explain how it works. We are pleased to be able to assist this subcommittee in its consideration of private pension and profit-sharing plans.

Before entering into a specific discussion of the Sears profit-sharing fund, I would first like to set out the major differences between a profit-sharing plan, such as ours, and a pension plan.

Madam Chairman, I notice from your agenda, you have been listening to representatives of various pension plans.

Representative GRIFFITHS. That's right.

Mr. O'CONNOR. Basically a pension plan is intended to provide retirement security for employees through a program of definite and regular payments during their retirement years. This is after they leave the employment.

Under a typical pension plan all the employee has is a promise to pay him a pension at some future time. He will receive this pension provided he meets all the requirements of the plan and there is enough money in the plan to pay his pension when he retires.

A profit-sharing plan, on the other hand, gives the employee an interest in the success of his employer's business by allowing him to share in the profits. The employer contributes a portion of its profit each year to the plan which is set aside for the benefit of employees. These contributions are then invested, and when an employee retires he is given his proportionate share in the assets of the fund. However, there is no guarantee that he will receive a specific amount on retirement. If the employer's business has been profitable and the fund's investments turn out well, he may receive a substantial amount. If not, the amount he receives will be less.

Now, I would like to discuss the Sears profit-sharing fund.

#### HISTORY OF THE FUND

On July 1, 1916, Julius Rosenwald, then president of Sears, announced the creation of "The Savings and Profit-Sharing Pension Fund of Sears, Roebuck & Co. Employees."

Its purpose—to permit employees to share in the profits of the business, to encourage the habit of saving—mind you, the habit of saving—and to allow employees to accumulate a sum sufficient to provide for them in retirement. This purpose has remained unchanged and continues as the guiding philosophy of the profit-sharing fund to this day.

Another fundamental principle established in 1916 was the policy of investing in Sears' stock. The first rules of the fund stated—and I am talking about 50 years ago:

It is intended that so far as practicable and advisable the fund will be invested in shares of stock of Sears, Roebuck & Co., to the end that depositors may, in the largest measure possible, share in the earnings of the company.

This provision has remained unchanged from 1916 to the present day.

Business historians—and Sears employees—have long since taken note of Julius Rosenwald's action in setting up the Sears profit-sharing fund. Today the Sears fund, started 20 years before Federal social security laws were enacted, is one of the oldest and best known profit-sharing plans in the country. More important, it has been—and continues to be—one of the foundations upon which literally thousands of Sears families build their financial security for the years ahead.

Sears profit-sharing plan started with some 6,000 employees—the number of employees who signed up as members in 1916. In the years since then, the fund has grown substantially. At the end of calendar year 1965, it had over 172,000 members—more than 98 percent of all employees eligible to join.

Representative GRIFFITHS. Who is not eligible to join?

Mr. O'CONNOR. The people who elect not to join. Every full-time employee that we have, after 1 year of service, is eligible.

Representative GRIFFITHS. The president of the company is eligible?

Mr. O'CONNOR. Yes; and incidentally our chief executive officer is the chairman. But everyone is entitled to join and the 98 percent that I just quoted to you are people who elected to join.

Representative GRIFFITHS. I see.

Mr. O'CONNOR. The fund in the first year purchased 2,473 shares of Sears common stock, worth a little more than \$500,000. At the end of last year, the fund had more than \$2,650 million in assets of all kinds. It held in trust for its members more than 35 million shares of Sears stock. These shares represent about 23 percent of Sears outstanding stock and 88 percent of the fund's total assets. The remaining 12 percent of the fund's assets were invested in other securities.

Representative GRIFFITHS. May I ask what other securities.

Mr. O'CONNOR. It is a balanced portfolio, Madam Chairman, quite similar to what might be selected by any trust company or banking institution. In the prospectus that you have before you at the present time, we have it defined.

Representative GRIFFITHS. Thank you very much. Proceed.  
(The following is the document referred to:)

**THE SAVINGS AND PROFIT SHARING PENSION FUND OF SEARS, ROEBUCK & CO.  
EMPLOYEES, CHICAGO, ILL.**

**FUND MEMBERSHIPS**

Every regular employe of Sears, Roebuck & Co. ("Company") or of any of the participating employers named below, who completes one year of continuous service, may become a member The Savings and Profit Sharing Pension Fund of Sears, Roebuck and Co. Employes ("Fund"). It is estimated that not more than 30,000 such employes will become eligible for membership in the next twelve months. Membership is voluntary. Each member shall deposit in the Fund 5% of his compensation, but not more than \$500 in any year. The participating employers at the present time are:

Sears, Roebuck and Co., 925 South Homan Avenue, Chicago, Illinois 60607.  
Allstate Enterprises, Inc., 7435 Skokie Boulevard, Skokie, Illinois 60078.  
Allstate Insurance Company, 7447 Skokie Boulevard, Skokie, Illinois 60078.  
Homart Development Co., 925 South Homan Avenue, Chicago, Illinois 60607.

Schirmer Engineering Corporation, 2447 West Peterson Avenue, Chicago, Illinois 60645.<sup>1</sup>  
 Sears Roebuck Acceptance Corp., 100 West 10th Street, Wilmington, Delaware 19899.  
 Sears, Roebuck de Puerto Rico, Inc., 106 Coll y Toste, Hato Rey, Puerto Rico 00919.  
 Sears, Roebuck Overseas, Inc., 925 South Homan Avenue, Chicago, Illinois 60607.  
 Service Review, Inc., 7770 Frontage Road, Skokie, Illinois 60076.  
 Terminal Freight Handling Company, 1012 South Spaulding Avenue, Chicago, Illinois 60624.

## COMMON SHARES

The deposits of Fund members, the contributions of the Company and of the other participating employers, and other moneys received by the Fund will be utilized, in part, to purchase, from time to time, at private sales or through the facilities of national securities exchanges, outstanding common shares of the Company at not more than the market price at the time of purchase. It is not anticipated that in the ensuing 12 months the aggregate amount of members' deposits will exceed \$48,000,000 or that the Fund will purchase more than 3,000,000 shares of the Company's common shares.

These Securities Have Not Been Approved or Disapproved by the Securities and Exchange Commission Nor Has the Commission Passed Upon the Accuracy or Adequacy of This Prospectus. Any Representation to the Contrary is a Criminal Offense.

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## GENERAL INFORMATION

*History and purpose*

The Fund was established by the Company's execution of a written instrument dated July 1, 1916 containing the Rules of the Fund. The Rules have since been amended from time to time. It is the Fund's three-fold purpose (i) to permit eligible employes to share in profits, (ii) to encourage the habit of saving, and (iii) to furnish a means for such employes to accumulate their own savings, the employers' profit sharing contributions, and the earnings thereon, to provide themselves with retirement income.

*Eligibility*

Every regular employe of the Company or of any wholly owned subsidiary designated as a participating employer who has completed one year of continuous service is eligible for membership and may become a Fund member upon executing and filing the prescribed form of application. At December 31, 1964 there were 158,500 members.

<sup>1</sup> Effective Jan. 1, 1965.



*Administration*

The Fund is managed by the following persons :

Name	Offices and Positions With the Fund	Principal Occupation, Relationship with the Company, and Address
Charles H. Kellstadt.....	Trustee, Chairman of the Board of Trustees, and member of the investment Committee	Chairman of the Board of Directors of General Development Corporation; director and member of the Executive and the Nominating and Proxy Committees and former Chairman of the Board of Directors of the Company—925 South Homan Avenue, Chicago, Illinois 60607
James M. Barker.....	Trustee and Chairman of the Investment Committee	Director and former officer of the Company—c/o Allstate Insurance Company, 7447 Skokie Boulevard, Skokie, Illinois 60078
Edward P. Brooks.....	Trustee.....	Dean Emeritus of School of Industrial Management, Massachusetts Institute of Technology, Cambridge, Massachusetts, former director and officer of the Company—352 Beacon Street, Boston, Massachusetts 02116
Lou R. Crandall.....	do.....	Chairman of the Board of Directors of George A. Fuller Company, and former director of the Company—597 Madison Avenue, New York, New York 10022
Austin T. Cushman.....	do.....	Chairman of the Board of Directors and Chief Executive Officer of the Company; Chairman of the Executive and Nominating and Proxy Committees of the Company and member of the Finance Committee of the Company—925 South Homan Avenue, Chicago, Illinois 60607
Claire Giannini Hoffman.....	do.....	Member of the Board of Directors and of the Executive Committee of the Bank of America National Trust and Savings Association, and a director of the Company—20 El Cerrito Avenue, San Mateo, California 94402
David M. Kennedy.....	do.....	Chairman of the Board of Directors of Continental Illinois National Bank and Trust Company of Chicago—231 South La Salle Street, Chicago, Illinois 60604
William F. McCurdy.....	Trustee and Executive Director.	Employee of the Company—925 South Homan Avenue, Chicago, Illinois 60607
J. Roscoe Miller.....	Trustee.....	President of Northwestern University, Evanston, Illinois, and a director of the Company—619 Clark Street, Evanston, Illinois 60201
Lysle R. Cahoon.....	Controller.....	Employee of the Company—925 South Homan Avenue, Chicago, Illinois 60607
William G. Casterline.....	Treasurer	Do
George Allen Mason.....	Secretary and Fund Attorney	Do

Each trustee is appointed by the Board of Directors of the Company for a three year term but may be removed at any time by the Board with or without cause. The officers of the Fund are appointed by and serve at the pleasure of the Board of Trustees. In addition, the Advisory Council, which consists of 27 members of the Fund representing various divisions, subsidiaries, groups or units who are elected annually as delegates to the Council for a term of one year by their fellow employees, meets from time to time with the Board of Trustees and the Executive Director to make recommendations concerning administration, procedure, rights and obligations of members, total and partial withdrawals, amendment of the Rules, and such other matters as the Board of Trustees refers to the Council for consideration. No director, officer or supervisory employee of the Company may under existing regulations and policies be a member of the Council, and Council members are not eligible for re-election.

The Fund reimburses the Company for certain expenses paid by the latter in connection with the administration of the Fund, including salaries and social security taxes with respect to such salaries, stationery and supplies, printing, telephone, telegraph and postal charges. These and other expenses paid directly by the Fund plus the trustees' fees of \$85,383 amounted to \$449,000 in 1964. In addition, the Fund reimburses Allstate Insurance Company for the expenses incurred by the latter in connection with the investment advisory services rendered to the Fund by Allstate's investment department which amounted to \$192,353 in 1964.

#### *Investment management*

The Rules provide that the Fund is to be invested so far as practicable and advisable in common shares of the Company. As of December 31, 1964 the Fund held 18,076,093 shares of common stock (before the two-for-one split on February 11, 1965) of the Company, representing 23.75% of the outstanding shares.<sup>2</sup> The Trustees may, however, in their discretion, invest and reinvest assets of the Fund in other securities or properties, whether or not designated by law as suitable for investment of trust funds. It is the policy of the Board of Trustees to invest as much as feasible of the Fund's cash in Sears common shares, but from time to time in recent years it has been difficult to so invest the available cash without increasing the market price of such shares, especially in view of the large number of shares withdrawn by Fund members upon retirement. As a consequence, a portion of the cash receipts has been invested in other securities. As of December 31, 1964, the Fund had total assets of \$2,654,827,565, of which \$2,336,335,020 represented the investment in common shares of the Company and \$10,372,019 represented investments in notes and bonds secured by liens on properties leased to Simpson-Sears Limited. The estimated amount of the Employers' annual contribution is paid to the Fund on December 31st in each year thereby effecting temporarily a manifold increase in the Fund's usual working bank balance of approximately \$2,000,000. For additional information with respect to the portfolio of the Fund, see the Statement of Financial Position and Statements of Changes in Members' Equity appearing elsewhere in this prospectus.

Investments are made, under the supervision of the Board of Trustees, by the Investment Committee, whose members are appointed by and serve at the pleasure of the trustees. At present the Investment Committee consists of the following persons:

Name:	<i>Principal Occupation and Relationship with the Company</i>
Crowdus Baker-----	President, director, member of the executive committee and chairman of finance committee of the company and member of Finance Committee of Allstate Insurance Company.
James M. Barker-----	Chairman of the investment committee of the fund; director and former officer of the company.
Charles H. Kellstadt---	Chairman of the Board of Directors of General Development Corporation; chairman of the board of trustees of the fund and director and member of the executive and nominating and proxy committees of the company and former officer of the company.
Howard A. Dentham----	Vice president, comptroller, director and member of the executive and finance committees of the company.
Robert B. Pelton-----	Vice president, treasurer, director and member of Finance Committee of Allstate Insurance Co.

#### DEPOSITS AND CONTRIBUTIONS

Each member, by payroll deductions, deposits with the Fund 5% of his compensation but not more than \$500 in any year. The employers contribute each year to the Fund an amount, known as the "Employers' Contribution", equal to

<sup>2</sup> Apart from the Fund, Sears knows of no person who owns of record or beneficially 10% or more of its outstanding common shares.

a percentage of consolidated net income of the Company and its wholly owned domestic subsidiaries for the year, computed prior to provision for federal income taxes, dividends and contributions to any profit sharing or pension fund. No contribution is made unless such "consolidated net income" equals \$50,000,000. Thereafter, the percentage of such "consolidated net income" to be contributed increases as indicated below to a maximum of 10%.

Percentage	"Consolidated net income" range	Percentage	"Consolidated net income" range
5 percent.....	\$50,000,000 to \$99,999,999.	8 percent.....	\$175,000,000 to \$199,999,999.
6 percent.....	\$100,000,000 to \$149,999,999.	9 percent.....	\$200,000,000 to \$249,999,999.
7 percent.....	\$150,000,000 to \$174,999,999.	10 percent.....	\$250,000,000 or more.

The share of each employer in the Employers' Contribution for the fiscal year equals the sum to be credited out of said Contribution to the accounts of all members employed by that employer. If an employer's net profits for any fiscal year (or its accumulated net profits to the end of such year) amount to less than its share of the Employer's Contribution, such employer (called a "partial participating employer") contributes only that part of its share which is equal to its net profits for such year or its accumulated net profits to the end of said year, whichever are larger. The Employers' Contribution, nevertheless, is computed as specified above and is paid by the remaining employers (except that in the case of any employer, the total of its share of the Employers' Contribution and an additional amount attributable to the reduced payments by the partial participating employers may not exceed its net profits for the year or its accumulated net profits to the end of the year, whichever are greater) and credited to the accounts of all members of the Fund.

Each member of the Fund is furnished annually with a statement showing the credits to his account on December 31.

#### COMMON SHARES OF THE COMPANY

##### *Description of Certain Provisions*

Each holder of common shares (the Company's only authorized class of shares) is entitled to one vote per share, to vote cumulatively for the election of directors, to receive dividends declared by the Board of Directors, and upon liquidation to share in the assets of the Company pro rata in accordance with his holdings after payment of all liabilities and obligations. There are no restrictions on the pre-emptive subscription rights of shareholders or on repurchases or redemption of shares by the Company which do not impair its capital. Common shares to be purchased by the Fund will be validly issued, fully paid and nonassessable.

##### *Market Prices*

The high and low prices (after adjustment to the next lower eighth for the two-for-one stock split effective February 11, 1965) at which reported transactions were effected in the Company's common shares on the New York Stock Exchange were as follows:

	Year ended Jan. 31—				
	1961	1962	1963	1964	1965
High.....	\$29.50	\$47.38	\$42.38	\$53.13	\$67.88
Low.....	22.25	27.00	29.50	37.63	50.13

#### RULES OF THE FUND

The rights and obligations of members are set forth in the Rules of the Fund as in effect from time to time. The Rules relate not only to the matters described above under the captions "General Information", and "Deposits and Contributions", but also to certain other matters indicated below. The text of the Rules, as amended through August 3, 1964, is set forth in Exhibit 1 to the Registration

Statement. Reference is hereby made to the exhibits for a complete statement of the Rules, and the following is qualified in its entirety by such reference.

#### *Allocation of employers' contributions*

For the purpose of determining participation in contributions made by the employers, the Fund members are divided into four groups in accordance with length of service and also according to age where there is at least fifteen years of service: (i) Group A—members with less than five years of continuous service; (ii) Group B—members with five years and less than ten years of continuous service; (iii) Group C—members with ten or more years of continuous service excluding those over fifty or more years of age with fifteen or more years of continuous service; and (iv) Group D—members of fifty or more years of age with fifteen or more years of continuous service. The Employer's Contribution for the year is credited to each member's account pro rata on the basis of one, two, three or four times the amount of his deposits during the calendar year, depending on whether he is in Group A, B, C or D. Members on military leave of absence continue to participate during such leave, but not beyond four years after the commencement of such leave, in the allocation of such contributions on the basis of their rates of compensation immediately prior to the commencement of such leave.

#### *Termination of membership*

Membership in the Fund ceases upon (i) total withdrawal, (ii) termination of employment and compensation, (iii) failure to make regular deposits unless on approved leave of absence, (iv) death, (v) total and permanent disability, or (vi) retirement.

#### *Total withdrawal*

A member with less than five years of continuous service may withdraw only the amount which he has deposited plus simple interest at the rate of 5% per annum on his deposits, unless the withdrawal is due to total and permanent disability in which event he may withdraw an amount equal to the cash and securities credited to his account as of the preceding December 31 (adjusted for his subsequent deposits, changes in market value of securities held by the Fund, income on investments, and gains or losses on the sale or purchase of securities by the Fund). In the event a depositor's membership terminates after completing five years of continuous service and also in the event of his death, regardless of his length of service, the members or his beneficiaries may withdraw an amount equal to the cash and securities credited to his account as of the preceding December 31 (adjusted in the manner indicated above) plus, if such termination or death occurs on or after November 15 and on or prior to December 30, an amount equal to the trustees' estimate of the amount that would have been credited to the depositor's account at the end of said year out of the Employers' Contribution for such year had the depositor continued to be a member of the Fund. If such termination or death occurs on December 31 the amount which may be withdrawn will be equal to the cash and securities credited to the depositor's account as of such December 31, and, accordingly, such amount will reflect his deposits for the year, changes in the year in the market value of securities held by the Fund, income on investments, gains or losses on the sale or purchase of securities by the Fund during the year, the Sears shares acquired for his account during the year, and his proportionate share of the Employers' Contribution for the year. Except in the case of persons who withdraw as a result of termination of employment and who thereafter again qualify subsequent to re-employment, a member who makes a total withdrawal cannot re-enter the Fund.

#### *Partial withdrawal*

Any partial withdrawal permitted under the Rules will not terminate membership, but misstatement of the purpose of any such withdrawal may cause an applicant's expulsion from membership. A member for ten or more consecutive calendar years may withdraw one-half of the credits added to his account beginning with the credits for the tenth consecutive calendar year of membership, less all previous withdrawals, if in the judgment of the trustees such withdrawal will be used to further his retirement security (if the member is in Group D such

partial withdrawal may be in excess of one-half of such credits). A member for 15 or more consecutive calendar years may apply for a withdrawal of one-half of the credits added to his account beginning with the credits for the 15th consecutive calendar year of membership, but the application may be denied if the proposed withdrawal plus all previous withdrawals will aggregate more than the total of his deposits.

In the event of death or serious illness in a member's family, partial withdrawal not otherwise allowed may be permitted, but members with less than five years of continuous service may not withdraw in excess of their own deposits. In any Group B, C or D member is within one year of his retirement date, established in accordance with the Company's personnel policy, he may with the consent of the trustees make a partial withdrawal not otherwise permitted under the Rules prior to such retirement date.

#### *Retirement*

If a depositor in Group B, C or D retires in accordance with the Company's personnel policy during the period commencing July 31 and ending November 14 of any year, then in addition to the moneys and securities to the credit of his account in the Fund, he shall be entitled to withdraw a sum equal to the portion, determined on the basis of the number of months of his continuous service in the year of retirement, of the trustees' estimate of the amount that would have been credited to his account at the end of said year, out of the Employers' Contribution for such year, had he continued to be a member of the Fund.

#### *Payment of withdrawals*

Upon partial or total withdrawal or retirement by a member (except a Group A member withdrawing for reasons other than total and permanent disability) or in the event of his death, payment may be made, in the discretion of the Board of Trustees, wholly or partially in kind or in cash or, if so requested by the member (or by his beneficiary in case of the member's death), in the form of a single premium annuity contract in accordance with such request. Cash and investments (other than common shares of the Company) are carried in the "General Investments Account." Securities carried in this account in practice are, in the case of withdrawal or retirement, paid and accounted for only in cash. In the exercise of their discretion as to the manner of payment, the trustees are not obligated to accede to the requests of members or beneficiaries. The portion of the amount to the credit of the account of a Group A member for which he is not entitled to payment upon total withdrawal (designated in the Rules as a "lapse") is subsequently credited to the accounts of the remaining members.

#### *Assignment*

Apart from the withdrawal and retirement privileges described above, no member is entitled to withdraw, transfer, assign or hypothecate any of the moneys or securities credited to his account in the Fund.

#### *Designation of beneficiary*

A member by executing and filing an appropriate form provided by the Fund may designate beneficiaries to receive his interest in the Fund in the event of his death. Any such designation may be revoked or changed at any time. Any marriage or divorce of a member shall be deemed to revoke any prior designation of beneficiary with respect to a member's Fund credits not disbursed prior to receipt by the Fund's Executive Director of written notice of such marriage or divorce.

#### *Amendments and interpretations*

All questions of interpretation of the Rules of the Fund including those relating to accounting, values, profits, or other matters are determined solely by the trustees and their decision is final and conclusive upon all members. Except as noted below, the trustees may amend the Rules and adopt rules and policies of administration. The provisions of the Rules relating to (i) the making, changing or discontinuance of Employers' Contributions, (ii) discontinuance of participating subsidiaries, (iii) the number, qualifications and compensation of trustees, and (iv) the liabilities and responsibilities of members of the Board of Trustees and employers may be amended only by the Company's Board of Directors.

*Voting of company shares held by fund*

Group B, C or D members are entitled to give voting instructions to a committee of Fund trustees (consisting of those trustees who are not directors, officers, or nominees for election as directors of the Company) with respect to the common shares of the Company credited to their accounts in the Fund. To provide secrecy with respect to each individual's voting instructions, the members mail their instructions directly to an independent accounting firm for tabulation and certification of the results. The shares to the credit of those members who forward voting instructions are voted in accordance with their instructions. All other common shares of the Company held by the Fund are voted in accordance with the best judgment of said committee.

*Personal liability*

Each person who serves as a trustee, officer or member of the Investment Committee of the Fund and each person who serves at the request of the Fund as a director or officer of a corporation of which the Fund is a creditor or shareholder is entitled to indemnification for expenses (including attorneys' fees and amounts paid in settlement) incurred in connection with certain litigation except where such person is adjudged liable for dereliction or misconduct in the performance of his duties as trustee, officer or director. The trustees shall not be personally liable to any person for any obligation or liability incurred on behalf of the Fund or for any loss on Fund investments or for any act or failure to act on their part.

*Termination of the fund*

The Company's Board of Directors may at any time change or discontinue the Employers' Contribution to the Fund. Such action, however, shall not without the trustees' consent be effective for the fiscal year of the Company in which taken, unless written notice has been given by the Company to the trustees prior to July 1 of such year. After announcement of such discontinuance, no new members may join the Fund and the assets of the Fund shall be distributed among the existing members.

If any employer (other than the Company) whose employes are Fund members discontinues business or ceases to be a wholly owned subsidiary or a division of the Company, the assets of the Fund then to the credit of employees of such employer who do not become employees of the Company or of any other wholly owned subsidiary shall be paid for their respective accounts to a profit sharing or pension trust, if any, maintained or established by such employer or the purchaser or transferee of such employer or, if no such trust is established within six months or such additional time as the trustees shall allow, then such assets shall be paid to such employees in installments over a five year period or at one time, as the trustees determine.

## LEGALITY

The legality of the Fund, of the memberships herein, and of the common shares of the Company has been passed upon by Kahn, Adsit, Arnstein, Gluck, Weitzenfeld & Minow, 120 South LaSalle Street, Chicago, Illinois, 60603, counsel for the Fund and for the Company.

## FINANCIAL STATEMENTS

The financial statements of Sears, Roebuck and Co. and consolidated subsidiaries set forth in the Company's annual report to shareholders for the fiscal year ended January 31, 1965 are incorporated herein by reference. Included herein are (i) a statement of consolidated earnings of the Company and its consolidated subsidiaries for the five fiscal years ended January 31, 1961 to 1965, and (ii) financial statements of the Fund as of and for the year ended December 31, 1964.

## SEARS, ROEBUCK &amp; Co. AND CONSOLIDATED SUBSIDIARIES

## Statement of consolidated earnings

	Fiscal year ended Jan. 31—				
	1961	1962	1963	1964	1965
Net sales .....	\$4, 134, 319, 550. 00	\$4, 267, 677, 903. 00	\$4, 603, 318, 710. 00	\$5, 115, 706, 591. 00	\$5, 740, 034, 700. 00
Other income:					
Dividends (principally from unconsolidated subsidiaries).....	27, 085, 006. 00	30, 001, 121. 00	32, 637, 639. 00	32, 937, 420. 00	36, 419, 533. 00
Miscellaneous income.....	3, 670, 997. 00	21, 620, 321. 00	4, 284, 881. 00	2, 714, 119. 00	7, 052, 081. 00
Total income.....	4, 165, 075, 553. 00	4, 319, 299, 345. 00	4, 640, 241, 236. 00	5, 151, 418, 130. 00	5, 783, 506, 314. 00
Deduct:					
Cost of sales, buying, and occupancy expenses.....	2, 670, 413, 223. 00	2, 716, 898, 619. 00	2, 892, 378, 745. 00	3, 199, 415, 326. 00	3, 539, 218, 701. 00
Selling, administrative, and general expenses.....	1, 014, 887, 370. 00	1, 064, 939, 726. 00	1, 186, 832, 604. 00	1, 345, 378, 053. 00	1, 545, 304, 211. 00
Provision for doubtful accounts and increase in allowance for collection expenses.....	14, 309, 977. 00	15, 414, 666. 00	20, 513, 737. 00	30, 997, 580. 00	38, 826, 837. 00
Interest expense.....	43, 030, 584. 00	52, 547, 735. 00	36, 164, 219. 00	37, 743, 485. 00	49, 577, 109. 00
Contribution to the savings and profit sharing pension fund.....	42, 807, 963. 00	46, 944, 186. 00	49, 831, 911. 00	53, 559, 771. 00	59, 335, 749. 00
Total.....	3, 785, 449, 117. 00	3, 896, 744, 932. 00	4, 185, 721, 216. 00	4, 667, 094, 215. 00	5, 232, 262, 607. 00
Income before provision for Federal income taxes.....	379, 626, 436. 00	422, 554, 413. 00	454, 520, 014. 00	484, 323, 915. 00	551, 243, 707. 00
Provision for Federal income taxes (note).....	182, 833, 298. 00	198, 659, 552. 00	219, 929, 654. 00	223, 300, 000. 00	247, 150, 000. 00
Net income for the year.....	196, 793, 138. 00	223, 894, 861. 00	234, 590, 360. 00	261, 023, 915. 00	304, 093, 707. 00
Net income per share (calculated on number of shares outstanding at end of year):					
Before 2-for-1 stock split.....	2. 61	2. 96	3. 10	3. 44	4. 00
After 2-for-1 stock split.....	1. 31	1. 48	1. 55	1. 72	2. 00
Cash dividends paid per share:					
Before 2-for-1 stock split.....	1. 40	1. 50	1. 65	1. 75	2. 00
After 2-for-1 stock split.....	. 70	. 75	. 83	. 88	1. 00
Company's equity in undistributed income of its unconsolidated subsidiaries and Simpsons-Sears Ltd.....	26, 524, 525. 00	27, 753, 896. 00	28, 349, 968. 00	32, 564, 748. 00	33, 728, 018. 00

NOTE.—For income tax purposes, the company uses the installment method of reporting its income. Under this method, the tax on profits from installment sales is payable when the profit is realized by collection from customers or through the sale of accounts. However, the company prepares its consolidated financial statements on the accrual basis wherein the profit on installment sales is included in income at the time of the sales,

and the provision for Federal income taxes is charged against income concurrently. The amounts of Federal income taxes deferred to future years in each of the fiscal years as reported above is as follows: 1962, \$178,450,000; 1963, \$96,423,884; 1964, \$67,705,346; 1965, \$88,151,873.

THE SAVINGS AND PROFIT SHARING PENSION FUND OF SEARS, ROEBUCK & Co.  
EMPLOYEES

*Statement of financial position, Dec. 31, 1964*

General investments:

Cash in banks, less accounts payable of \$3,337,835-----	\$41,766,929
Time deposits and savings accounts-----	39,006,606
Dividend receivable on Sears, Roebuck & Co. stock-----	14,437,208
Other dividends and interest receivable-----	494,330
Simpsons-Sears, Ltd., 1st mortgage bonds—at cost-----	490,000
Notes receivable secured by mortgages or other liens on prop- erties leased to Simpsons-Sears, Ltd-----	10,372,019
Other notes receivable-----	1,300,000
Convertible debentures, at market (cost, \$8,347,250)-----	11,102,107
Convertible preferred stocks, at market (cost, \$831,040)-----	1,012,830
Common stocks, at market (cost \$131,189,557, note B)-----	198,510,516
<b>Total general investments-----</b>	<b>318,492,545</b>
Sears, Roebuck & Co. stock: 18,076,093 shares (before 2-for-1 stock split) at quoted market price (average cost as shown by fund records, \$679,139,819)-----	2,336,335,020
<b>Members' equity-----</b>	<b>2,654,827,565</b>

See notes to financial statements.

*Statement of fund earnings and changes in members' equity in general  
investments, year ended Dec. 31, 1964*

Members' equity in general investments, Jan. 1, 1964-----	\$298,598,363
Add credits to members' accounts in 1964:	
Members' deposits (note C)-----	\$43,709,516
Employers' contributions (note C)-----	65,784,534
Fund earnings:	
Dividends on stock of Sears, Roebuck & Co-----	\$36,621,261
Other dividends-----	4,336,253
Interest-----	2,770,629
Fund office and investment expenses-----	(641,353)
	43,086,790
Lapses credited to accounts of members remaining in fund at Dec. 31, 1964:	
General investments account lapses-----	751,640
Stock account lapses (see p. 13)-----	2,619,545
<b>Total-----</b>	<b>3,371,185</b>
Less deposits and interest thereon refunded to with- drawing members not enti- tled to full credits-----	(2,163,811)
	1,207,374
Market adjustment:	
Adjustment of general in- vestments to market values at Dec. 31, 1964---	8,357,111
Net gain on sales of general investments (note D)---	6,839,438
	15,196,549
Cash credits arising from con- version of accounts of mem- bers approaching retirement (including interest of \$185,624 on retirement reserve ac- counts)-----	7,228,568
	176,213,331
<b>Total-----</b>	<b>474,811,694</b>



*Statement of fund earnings and changes in members' equity in general investments, year ended Dec. 31, 1964—Continued*

Deduct:

Cost of 975,851 shares (before 2-for-1 stock split) of Sears, Roebuck & Co. stock credited to members' stock accounts in 1964 (see p. 13)-----	\$111,348,523		
Withdrawals and lapsed accounts:			
Cash withdrawn by members entitled to full credits-----	\$37,679,131		
Cash withdrawn from retirement reserve accounts-----	6,539,855		
General investments balances in lapsed accounts--	751,640		
		44,970,626	
			156,319,149
Members' equity in general investments, Dec. 31, 1964-----			318,492,545

See notes to financial statements.

*Statement of changes in members' equity in stock of Sears, Roebuck & Co., year ended Dec. 31, 1964*

	Number of shares (before 2-for-1 stock split)	Average cost (see footnote)		Quoted market	
		Per share	Amount	Per share	Amount
Balance, Jan. 1, 1964-----	18,905,584	\$33.30	\$629,442,293	\$97.88	\$1,850,384,034
Add purchases and lapses credited to members' accounts in 1964:					
Stock purchased on market-----	174,400	125.88	21,953,702	125.88	21,953,702
Stock purchased from individuals and estates-----	464,253	112.56	52,255,073	112.56	52,255,073
Stock purchased from withdrawing members-----	243,075	113.04	27,477,259	113.04	27,477,259
Stock purchased from members approaching retirement-----	61,497	114.53	7,042,944	114.53	7,042,944
Stock lapses-----	32,626	80.29	2,619,545	115.27	3,760,799
Subtotal, additions-----	975,851	114.10	111,348,523	115.27	112,489,777
Deduct withdrawals and lapsed accounts:					
Stock withdrawn by members-----	1,468,144	33.30	48,889,195	111.60	163,848,477
Stock sold to fund by withdrawing members-----	243,075	33.30	8,094,416	113.04	27,477,259
Stock converted into cash credits for members approaching retirement-----	61,497	33.30	2,047,841	114.53	7,042,944
Stock in lapsed accounts-----	32,626	80.29	2,619,545	115.27	3,760,799
Subtotal, deductions-----	1,805,342	34.15	61,650,997	111.96	202,129,479
Add adjustment of shares owned to quoted market price at Dec. 31, 1964-----					575,590,688
Balance, Dec. 31, 1964-----	18,076,093	37.57	679,139,819	129.25	2,336,335,020

Members' individual stock accounts are maintained in number of shares only. For financial statement purposes, the average cost per share of stock withdrawals (other than lapses) is stated at the average cost of all shares held by the fund at the beginning of the year.

See notes to financial statements.

## PRIVATE PENSION PLANS

NOTES TO FINANCIAL STATEMENTS, YEAR ENDED DEC. 31, 1964

NOTE A.—The amounts by which the aggregate quoted market prices (or current values as determined by the trustees) of the fund's investments exceed the cost as shown by the fund's records are as follows:

	General investments	Sears, Roebuck & Co. stock	Total
At Dec. 31, 1964.....	\$70,257,606	\$1,657,195,201	\$1,727,452,807
At Jan. 1, 1964.....	61,900,495	1,220,941,741	1,282,842,236
Increase in 1964.....	8,357,111	436,253,460	444,610,571

Inasmuch as it is qualified as an exempt trust in accordance with the provisions of the Internal Revenue Code, the Fund itself is not subject to income taxes upon the realization of any part of the foregoing appreciation. Each member is subject to income taxes at the time of his withdrawal upon that portion of the cash (including cash distributed in lieu of stock) and the market value of the stock withdrawn by him which is in excess of the amounts attributed and not previously withdrawn by him, except that with respect to total withdrawals in one taxable year of the member on account of separation from the employer's service, the unrealized appreciation attributable to that part of the total withdrawal which consists of stock of Sears, Roebuck and Co. is not subject to tax unless and until it is realized through sale or taxable exchange of stock by the member, and except that in any case unrealized appreciation on stock of Sears, Roebuck and Co. attributable to the member's contribution is not subject to tax unless and until it is realized through sale or taxable exchange of stock by the member.

NOTE B.—Investments in common stocks of unaffiliated issuers:

Description	Number of issues	Cost	Market value
Aerospace.....	1	\$1,995,590	\$1,764,475
Banks.....	3	2,166,149	3,078,520
Building and construction.....	3	1,375,089	1,747,393
Chemical and rubber.....	6	9,977,034	13,175,622
Drugs and cosmetics.....	8	14,043,794	31,472,161
Education and publishing.....	4	4,289,496	3,918,656
Electronic and office equipment.....	12	16,687,831	24,703,876
Finance.....	1	1,057,208	1,818,600
Food distributors and processors.....	3	2,993,089	4,317,566
Household equipment.....	1	793,988	3,473,874
Industrial and electrical equipment.....	4	4,685,229	5,682,775
Insurance.....	8	6,715,787	13,574,416
Leisure time.....	2	2,241,140	2,543,225
Metals.....	2	2,036,374	2,182,950
Petroleum and natural gas.....	10	17,749,850	25,579,247
Pulp, paper, and containers.....	2	3,287,318	3,384,342
Savings and loan associations.....	4	6,727,260	5,434,246
Transportation.....	2	5,412,423	7,094,495
Utilities.....	16	15,807,021	30,548,202
Vending.....	1	207,955	423,988
Miscellaneous.....	15	10,949,932	12,591,887
Total common stocks.....	108	131,189,557	198,510,516

NOTE.—Included in the foregoing common stocks are 17 issues which paid no cash dividends in 1964. The aggregate cost of such stocks was \$16,956,223 and the aggregate market value at Dec. 31, 1964, was \$13,945,323.

## NOTE C.—Members' deposits and employers' contributions:

Participating employer	Deposits	Contributions
Sears, Roebuck & Co.....	\$37,800,558	\$58,649,576
Sears Roebuck Acceptance Corp.....	2,937	3,446
Sears, Roebuck Overseas, Inc.....	9,925	19,635
Sears, Roebuck de Puerto Rico, Inc.....	142,754	135,681
The Newark Ohio Co.....	269,283	384,747
Terminal Freight Handling Co.....	86,928	142,664
Total Sears, Roebuck & Co. and consolidated subsidiaries.....	38,312,385	59,335,749
Allstate Insurance Co.....	5,335,790	6,401,384
Allstate Enterprises, Inc.....	29,778	25,125
Service Review, Inc.....	24,096	17,072
Homart Development Co.....	7,467	5,204
Total.....	43,709,516	65,784,534

Effective July 1, 1964, The Newark Ohio Co. ceased to be a participating employer of the fund.

## NOTE D.—Realized net gain on sales of general investments:

Aggregate proceeds.....	\$27,347,323
Aggregate cost (on basis of average cost).....	20,507,885
Net gain.....	6,839,438

## REPORTS OF CERTIFIED PUBLIC ACCOUNTANTS

*To the Shareholders and Board of Directors of Sears, Roebuck & Co.:*

We have examined the accompanying statement of consolidated earnings of Sears, Roebuck & Co. and consolidated subsidiaries for the five fiscal years ended January 31, 1965. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statement referred to above presents fairly the net earnings and other data shown therein of Sears, Roebuck and Co. and consolidated subsidiaries for the five fiscal years ended January 31, 1965, in conformity with generally accepted accounting principles applied on a consistent basis.

TOUCHE, ROSS, BAILEY & SMART.

CHICAGO, ILL., March 29, 1965.

*To the Board of Trustees of the Savings and Profit Sharing Pension Fund of Sears, Roebuck & Co. Employees:*

We have examined the accompanying statement of financial position of The Savings and Profit Sharing Pension Fund of Sears, Roebuck and Co. Employees as of December 31, 1964, and the related statements of members' equity for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of The Savings and Profit Sharing Pension Fund of Sears, Roebuck and Co. Employees at December 31, 1964, and the results of its operations for the year then ended, in accordance with the rules and regulations of the Fund, and in conformity with generally accepted accounting principles applied on the basis consistent with that of the preceding year.

TOUCHE, ROSS, BAILEY & SMART.

CHICAGO, ILL., April 16, 1965.

Mr. O'CONNOR. I might also indicate to you that there are short-term investments in order to create and hold the flow of cash. Annual income in 1965 was about \$166 million including members' deposits, the company's contribution, and income from investments. Administrative expenses, that is, the cost of office expenses, investment expenses, and the like, amounted to \$702,641 or about four-tenths of 1 percent of the income.

The assets of the Sears profit-sharing fund have grown to their present size in part because of contributions of employees—mind you, it is a savings plan—but mostly because of contributions of the company, the growth in value of Sears stock, and the investment of fund income.

AMOUNT OF BENEFITS TO FUND MEMBERS

The success of the Sears fund in meeting its responsibility of providing retirement security for its members can be seen by looking at the actual results of its operations. Naturally, the retirement benefit varies from individual to individual, depending mainly on length of service. To give you some examples, those employees who retired in 1965 with from 20 to 24 years' service took out an average of \$68,415 in stock and cash of which only about \$4,200 represented their own deposits. Those employees with 25 to 29 years' service withdrew an average of \$142,229 in stock and cash, of which only about \$5,900 represented their own deposits.

Representative GRIFFITHS. How many employees retired in 1965 with \$68,415?

Mr. O'CONNOR. 316 in this group.

Representative GRIFFITHS. How many with \$142,229?

Mr. O'CONNOR. 192 in this group.

Representative GRIFFITHS. Thank you. You may proceed.

Mr. O'CONNOR. While some long-service employees retired with larger accounts than this, other employees' accounts were, of course, smaller. Through profit sharing, many thousands of former Sears employees today are spending their retirement years with living standards comparable to those they enjoyed during their working careers.

Representative GRIFFITHS. Have you ever done a study on what these people do with the money after they retire?

Mr. O'CONNOR. We have never done a study in that. The best way to answer you, Madam Chairman, is to observe the stock transfers. We have approximately 250,000 share owners, of which a considerable number are retirees. We can observe the deaths that take place among our retirees. We get the transfers through the executor, the administrator, and the beneficiaries. And at least, now I am expressing my own opinion, it is startling, the number of retirees that retain their stock during their lifetime after retirement.

Representative GRIFFITHS. I would be interested in knowing how many do. If you could supply the information for the record, I think we would like it.

Mr. O'CONNOR. I will try to supply such information.

Representative GRIFFITHS. All right, proceed.

(The material referred to, later supplied, follows:)

*Record of retention of Sears stock by retirees*

Retirement date	Number of retirees	Shares withdrawn	Shares owned of record on Feb. 16, 1966	Percentage of shares owned on Feb. 16, 1966, to total withdrawn
Prior to July 1, 1956.....	53	89,327	50,586	56.6
July 1, 1956, to June 30, 1961.....	146	213,494	148,905	69.7
After June 30, 1961.....	303	356,760	298,746	83.7
Total.....	502	659,581	498,237	75.5

The shares withdrawn were calculated on the basis of the actual number of shares originally withdrawn from the Fund by the retirees, adjusted to reflect stock dividends and stock splits since their retirement date. The total of shares owned of record on February 16, 1966, would not necessarily reflect the total shares owned by these retirees, since many of them may own shares which are held in trust or held in the names of nominees.

Mr. O'CONNOR. I will attempt to explain how the Sears fund works.

All full-time employees of the company and its designated wholly owned subsidiaries—whether salaried or hourly paid employees—are eligible to join the profit-sharing fund after they have been with Sears for 1 year. Joining is a voluntary act.

We just discussed that a few minutes ago, and this is a reiteration of the principle.

Representative GRIFFITHS. Yes.

Mr. O'CONNOR. Employee-members contribute, out of their own tax-paid savings, a straight 5 percent of their salary, up to a maximum of \$500 per year. The \$500 ceiling prevents higher salaried employees from getting too great a share of the fund benefits by limiting their participation to their first \$10,000 in earnings from Sears.

Sears contributions are figured on a sliding scale based on the company's consolidated net income before Federal income taxes and dividends to shareholders.

To put it another way, before anybody else takes a cut at our profits, including the Federal Government or the shareholders, the first ones to receive a share are the employees. If net income in a year is less than \$50 million, the company makes no contribution. But if net income is between \$50 million and \$100 million the company contributes 5 percent of its net. The percentage rises to a maximum of 10 percent on net income of \$250 million or more. In actual practice, the full 10-percent maximum has been contributed by Sears for many years.

Company contributions in 1950 amounted to more than \$31 million; in 1955 to more than \$40 million, and in 1965, to more than \$70 million. All told, company contributions from 1916 through 1965 has amounted to over \$870 million.

These company contributions are allocated each year among the individual fund members based on a formula which takes into account each employee's contribution, his years of service, and his nearness to retirement.

Each fund member has a separate profit-sharing account. It is his. Once a year he receives a statement of his account—and you have a copy of that before you. It is this yellow sheet, Madam Chairman, that is in the folder before you at the present time. Once a year the member receives this. To assist you in understanding this statement, in the sample that you have is this explanation of his deposits, company contributions, credits and how he can actually figure out his account.

Is this clear?

Representative GRIFFITHS. Yes. Proceed.

(A copy of the form referred to is included in the record at this point.)

**1965 THE SAVINGS AND PROFIT SHARING PENSION FUND OF SEARS, ROEBUCK AND CO. EMPLOYEES 1965**  
 STATEMENT OF YOUR PROFIT SHARING ACCOUNT DECEMBER 31, 1965

**FACTORS WHICH DETERMINE YOUR CREDITS THIS YEAR**

ITEM 3 COMPANY CONTRIBUTION BY GROUPS FOR EACH DOLLAR DEPOSITED BY MEMBER:			
A	B	C	D
FUND EARNINGS			ITEM 8 AND 9 PURCHASE COST
ITEM 4A RATE OF RETURN FROM GENERAL INVESTMENTS	PERCENT ON COL. 10A	ITEM 4B DIVIDENDS AND LAPSES PER SHARE OF SEARS STOCK (COL. 11A)	PER SHARE OF SEARS STOCK

NAME \_\_\_\_\_ SOC. SEC. NO. \_\_\_\_\_  
 STORE OR UNIT \_\_\_\_\_ DATE OF BIRTH \_\_\_\_\_  
 YEAR JOINED FUND \_\_\_\_\_ SERVICE DATE \_\_\_\_\_

YOUR NET INVESTMENT BALANCE *		
GENERAL INVESTMENTS 10A	SHARES SEARS STOCK 11A .1000	1000
YOUR BALANCE ON 12-31-64		
WITHDRAWAL IF ANY IN 1965		
BALANCE BEFORE 1965 CREDITS		

**YOUR 1965 CREDITS**

GP	YOUR 1965 DEPOSITS 2	COMPANY CONTRIBUTION 3	FUND EARNINGS 4	TOTAL CREDITS 5
			A	
			B	

MARKET ADJUSTMENT	6	SEARS STOCK PURCHASED IN 1965		
		COST 8	SHARES SEARS STOCK 9	
DISTRIBUTION OF 1965 TOTAL CREDITS	7			

**YOUR TOTAL DEPOSITS TO DATE**

13	
12	

GROSS DEPOSITS  
 NET AFTER WITHDRAWALS

} THIS IS THE AMOUNT YOU HAVE DEPOSITED FROM YOUR EARNINGS

GENERAL INVESTMENTS 10B	SEARS STOCK		
	AVERAGE COST	SHARES 11B	.1000

THIS IS THE BALANCE OF YOUR ACCOUNT 12-31-65  
 IT CONSISTS OF: 1. GENERAL INVESTMENTS IN DOLLARS  
 2. SEARS STOCK IN SHARES

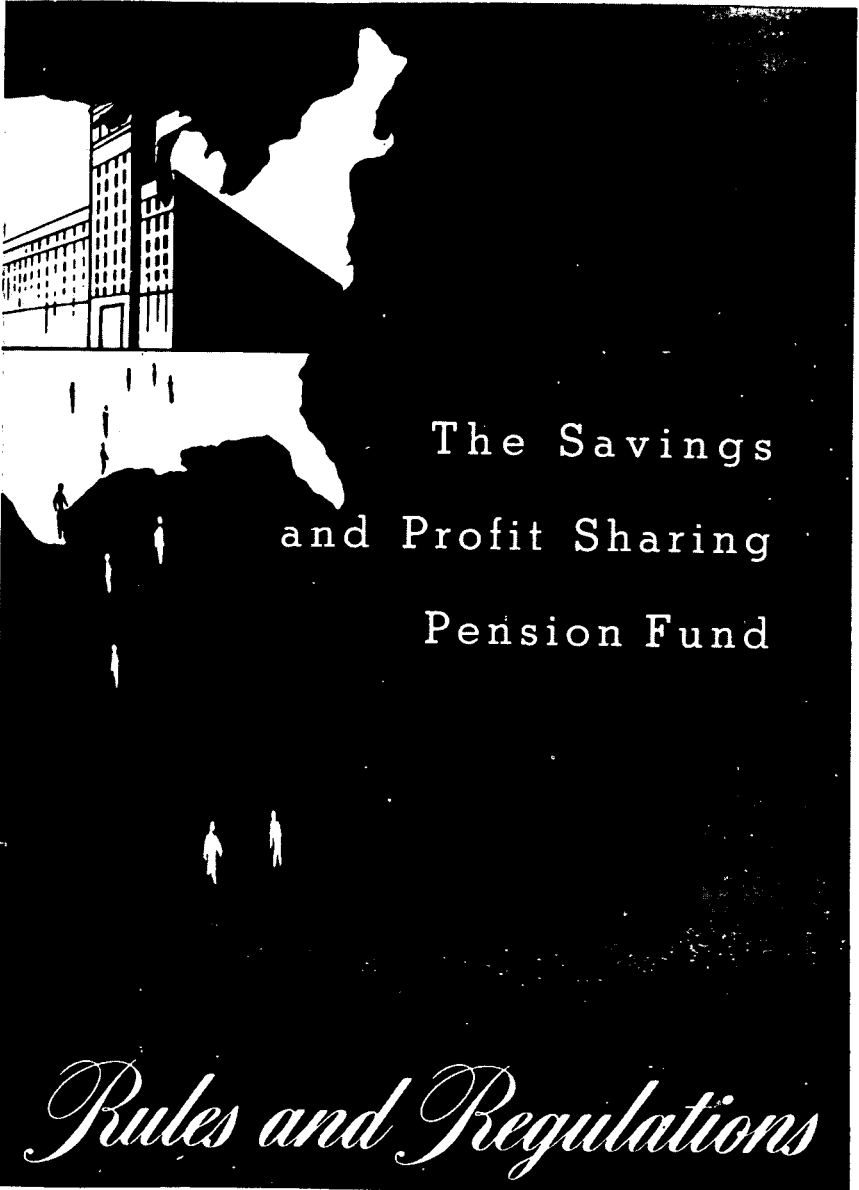
P.S.P.F. 13746 C (REV. 12/65)

\*ADJUSTED TO REFLECT TWO FOR ONE STOCK SPLIT.

Mr. O'CONNOR. They receive that once a year. Now, this statement also shows the total number of shares of Sears stock which have accumulated in his account over the years and the total value of other fund investments which have been made for him.

Besides his annual statement, the employee is kept informed about his interest in the fund in a variety of ways. When he joins the fund, he receives a copy of the rules and regulations and you have that in the folder.

(The rules and regulations of Sears' savings and profit-sharing fund are included in the record at this point:)



The Savings  
and Profit Sharing  
Pension Fund

*Rules and Regulations*



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# The Savings and Profit Sharing Pension Fund

OF SEARS, ROEBUCK AND CO. EMPLOYES

In Effect Since July 1, 1916

RULES AND REGULATIONS

Amended and Revised to August 4, 1964

## ARTICLE I

### ○ PURPOSE

The purpose of this Fund is three-fold:

- ① To permit eligible employes of the Company and its subsidiaries to share in the profits thereof;
- ② To encourage the habit of saving;
- ③ To provide a plan through which each eligible employe may accumulate his own savings, his portion of the Employers' Contributions, and the earnings on his accumulations as a means of providing an income for himself at the close of his active business career.

It is intended that the Fund will furnish to those depositors who remain in the employ of the Company or its subsidiaries until they reach the age when they retire from active service, a sum to provide for them in part thereafter; and that even those who do not remain until retirement will have accumulated a substantial sum. In order to carry out this important purpose of the Fund, withdrawals prior to retirement have

always been restricted, and, as is logical, will continue to be restricted.

### ● DEFINITIONS

Whenever the following terms are used in these Rules and Regulations they shall have the meaning specified below unless the context clearly indicates to the contrary.

- (a) The "Fund" shall mean The Savings and Profit Sharing Pension Fund of Sears, Roebuck and Co. Employees.
- (b) The "Company" shall mean Sears, Roebuck and Co., a New York corporation.
- (c) "Employers" shall mean the Company and the corporations subsidiary to or affiliated with the Company, whose employes are eligible to participate in the Fund. "Employer" shall mean either the Company or any of said subsidiary or affiliated corporations.
- (d) A "regular employe" shall mean any employe of any such employer who is qualified as "regular" by the Company's personnel policy.
- (e) "Continuous service" shall have the meaning imparted to it by the Company's personnel policy.
- (f) "Mandatory retirement date" shall mean the date set by the Company's personnel policy for the retirement of the particular class and type of employe concerned.
- (g) "Compensation" of an employe for any calendar year shall mean the total cash compensation paid such employe for such year for services rendered to an employer, including salary, wages, overwrites, commissions, bonuses, vacation pay and illness allowances, but excluding any severance allowance, any retirement or profit sharing benefit, any prizes or awards, any retainer, or any payment for temporary employment.

- (h) "Effective Valuation Date" shall mean the date to be used in computing the cash value of Company stock and General Investments then standing to the credit of a depositor's account for the purpose of determining the value and amount of a partial or complete withdrawal or determining the amount to be credited to his Retirement Reserve Account or applied to the purchase of an annuity. In the case of a complete withdrawal in connection with a depositor's death, the date of death shall be the effective valuation date. In the case of a complete withdrawal upon separation of a depositor from service, the effective valuation date shall be the latest of (1) the date of termination of employment as fixed by the Company's personnel policy, or (2) the date a depositor is removed from payroll while on an approved leave of absence, or (3) the last day worked if a depositor returns from an approved leave of absence within the specified time limit but does not thereafter continue in active service for at least six months. In the case of an application for complete withdrawal by a depositor remaining on payroll, or in the case of an application for partial withdrawal, or in the case of applications for crediting all or part of a depositor's account to his Retirement Reserve or applying all or part of an account to the payment of the premium for an annuity, the effective valuation date shall be the date certified by an authorized representative of the employer as the date on which such application was signed by the applicant. In the case of a complete withdrawal upon termination of a depositor's membership by action of the Trustees, with or without the receipt of a withdrawal application, the effective valuation date shall be the date of such action by the Trustees or such other date as may be fixed by the Trustees.

**ARTICLE II****ELIGIBILITY**

Participation will be entirely voluntary.

Every regular employe of the Company employed in any of its operations in the United States, every regular employe of the Company employed in such of its operations outside the United States as the Company designates, and every regular employe of such of its wholly owned subsidiaries as the Company designates, regardless of position, who has completed one year of continuous service, shall be eligible to participate in the Fund so long as he remains a regular employe, subject, however, to these Rules and Regulations.

Regular employes of any partially owned subsidiary or affiliate of the Company working in any merchandising establishment of the Company under the supervision and control of the Company's management in such establishment may, if the Trustees in their discretion so decide, be made eligible to membership and participation in the Fund upon the provisions and conditions contained in these Rules and Regulations and upon such additional provisions and conditions, if any, as the Trustees shall prescribe in writing.

The Trustees shall permit any depositor who, at an employer's request, is assigned, in accordance with the Company's personnel policy, to a subsidiary or affiliate not wholly owned or designated by the Company as aforesaid, to remain a depositor in the Fund.

**ARTICLE III****DEPOSITS AND CONTRIBUTIONS**

Sec. 1. An employe in order to participate must deposit in the Fund 5% of his compensation; provided that no

employe may deposit more than 5% thereof and in no case more than \$500 per annum, this limit being deemed advisable so that the higher salaried employes may not too largely participate in the Fund.

Sec. 2. The employers will each fiscal year contribute to the Fund a sum (herein referred to as the "Employers' Contribution") equal to the percentage of the consolidated net income for such year which is applicable according to the following provisions, namely: 5%, if the consolidated net income amounts to \$50,000,000 or more but less than \$100,000,000; 6%, if the consolidated net income amounts to \$100,000,000 or more but less than \$150,000,000; 7%, if the consolidated net income amounts to \$150,000,000 or more but less than \$175,000,000; 8%, if the consolidated net income amounts to \$175,000,000 or more but less than \$200,000,000; 9%, if the consolidated net income amounts to \$200,000,000 or more but less than \$250,000,000; and 10%, if the consolidated net income amounts to \$250,000,000 or more. The share of each employer in the Employers' Contribution for any fiscal year shall equal the total sum credited, out of said Contribution, to the accounts of all Fund members who are employes of said employer. If an employer's net profits for any fiscal year or its accumulated net profits to the end of such year, before adjustment for its share of Employers' Contribution for said year, amount to less than such employer's share of the Employers' Contribution for said year, such employer (hereinafter called a "partial participating employer") shall pay only that part of such employer's share of the Employers' Contribution for said fiscal year which is equal to its net profits for said year, or its accumulated net profits to the end of said year, whichever are larger, if any, and each employer (other than a partial participating employer), in addition to paying its own share of the Employers' Contribution, shall also pay that part of the partial participating employer's unpaid share

of such Employers' Contribution which the current and accumulated profits of each such employer (other than a partial participating employer), after adjustment for its own share of the Employers' Contribution for said fiscal year, bears to the aggregate current and accumulated profits of all such employers (other than partial participating employers), after adjustment for their respective share of the Employers' Contribution for said year, provided that the foregoing shall apply only to those employers which constitute an "affiliated group" within the meaning of the provisions of the Internal Revenue Code relating to employer deductions for contributions to profit sharing plans. If an employer is not a member of the affiliated group as herein provided, such employer's share of the Employers' Contribution for any fiscal year shall not exceed its net profits for said fiscal year, or its accumulated net profits to the end of said year, whichever are larger, nor shall the total portion of the Employers' Contribution credited to members who are employees of said employer exceed the said net profits or accumulated net profits of said employer, but the total Employers' Contribution for said year shall nevertheless be computed as above provided, and shall be paid and shared by all employers except those employers who are excluded therefrom by the foregoing provision because of the amount of their current or accumulated net profits and who are not members of the affiliated group as herein provided.

"Consolidated net income" for any fiscal year shall mean the consolidated net income of the Company and its wholly owned domestic subsidiaries for such fiscal year before deduction of any dividends, Federal income taxes, or contributions to any profit sharing or pension plan, as determined by the independent firm of accountants selected by the Company to make the annual audit of its books. Such determination of consolidated net income in the case of the Company and its wholly owned domestic subsidiaries other than insurance

subsidiaries shall be made, except as hereinbefore otherwise provided, in conformity with generally accepted accounting principles and in the case of each insurance subsidiary in conformity with accounting principles and classifications prescribed by the insurance regulatory authority of the state of incorporation of such insurance subsidiary adjusted for items which are required to be recorded directly in surplus but which, under generally accepted accounting principles, are properly considered in determining net income.

## ARTICLE IV

### ○ PARTICIPATION IN THE EMPLOYERS' CONTRIBUTIONS

The Employers' Contributions will be made annually as soon after the end of each year as an audit of the books will permit, but the Company at its option may at any time or times prior to the completion of such audit make advancements to the Fund in anticipation of the Employers' Contribution for such year. For the purpose of participation by the depositors in such contributions, the depositors are divided into four groups as follows:

- Group A—Consisting of depositors who have less than five (5) years' continuous service;
- Group B—Consisting of depositors who have five (5) years' and less than ten (10) years' continuous service;
- Group C—Consisting of depositors who have ten (10) or more years' continuous service, excluding depositors who have fifteen (15) or more years' continuous service and are over fifty (50) years of age.
- Group D—Consisting of depositors who have fifteen (15) or more years' continuous service and are over fifty (50) years of age.



Employers' Contributions when made will, subject to the provisions of Section 2 of Article III, be credited to the accounts of depositors as follows:

Depositors in Group A shall participate pro rata on the basis of their respective deposits during the preceding calendar year; depositors in Group B shall participate pro rata on the basis of two times their respective deposits during the preceding calendar year; depositors in Group C shall participate pro rata on the basis of three times their respective deposits during the preceding calendar year; depositors in Group D shall participate pro rata on the basis of four times their respective deposits during the preceding calendar year; provided that each depositor on leave of absence for military duty shall participate in the Employers' Contribution for each year that such leave is in effect (except that for the year in which such leave terminates, there shall be no participation other than as provided in (iv) or (v) of Section 6 (a) of Article V or in Section 1 of Article VI), pro rata on the basis of one, two, three or four times (as the case may be, depending upon whether such depositor is in Group A, B, C or D) the deposits such depositor would have made during such preceding calendar year had he or she continued in active service at his or her rate of compensation in effect immediately prior to the commencement of such leave.

## ARTICLE V

### WITHDRAWALS

Sec. 1 (a). Upon ceasing to be a member of the Fund, a depositor who has completed five years of continuous service will be entitled, subject to the provisions of Article VI and of Section 6 (b) of this Article V, to withdraw the moneys and securities to the credit of his account in the Fund determined as provided in Section 6 (a) of this Article V.

Sec. 1 (b). If a depositor dies before payment is received by him of all Fund credits to which he shall be entitled, then, regardless of his length of service, the depositor's Fund credits determined as provided in Section 6 (a) of this Article V shall be paid, subject to the provisions of Article VI and of Sections 6 (b) and 9 of this Article V, to his surviving beneficiary or beneficiaries designated by unrevoked written instrument executed, filed and accepted as provided in Section 9 of this Article V, or to the depositor's estate in case there is no such surviving beneficiary or unrevoked designation.

Sec. 1 (c). If, before completing five years of continuous service, a depositor's employment and compensation are terminated because of total and permanent disability upon the recommendation of a physician approved by an employer, such depositor upon ceasing to be a member of the Fund shall be entitled, subject to the provisions of Article VI and of Section 6 (b) of this Article V, to withdraw the moneys and securities to the credit of his account in the Fund determined as provided in Section 6 (a) of this Article V.

Sec. 2. Except as provided in Section 1 (c) of this Article V, a depositor who has completed less than five years of continuous service will be entitled, upon ceasing to be a member of the Fund, to withdraw only the amount he has deposited and not theretofore withdrawn, plus simple interest at 5% per annum on each month's deposits, not theretofore withdrawn, computed from the month in which made to the month of the applicable effective valuation date.

Sec. 3. A depositor shall cease to be a member of the Fund, when he totally withdraws from the Fund, when his employment and compensation terminate, or when he fails to make regular deposits, except that no depositor shall cease to be a member for failure to make regular deposits while on leave of absence approved by his employer if he returns

to the active service of his employer within the time limited by such leave and thereafter continues in active service for a period of at least 6 months. A depositor who dies while on leave of absence for illness, or who, having returned to active service of his employer within the time limited by any leave of absence, dies or becomes totally and permanently disabled within 6 months thereafter while in active service or on leave of absence, shall cease to be a member of the Fund as of the date of his death, or upon submitting medical evidence of such disability acceptable to the Trustees. A depositor who becomes totally and permanently disabled while on leave of absence for illness shall cease to be a member of the Fund upon submitting medical evidence of such disability acceptable to the Trustees.

Sec. 4. Except as described in Section 5 of this Article, and except in the case of depositors who withdraw from the Fund upon leaving their employment and who thereafter duly qualify as regular employes after being reemployed by an employer, a depositor who once withdraws cannot re-enter the Fund.

Sec. 5. The conditions under which a depositor may apply for withdrawals without affecting continued participation in the Fund, are as follows:

- (a) Applications for withdrawals under paragraphs (b), (c), (d), (e), and (f) of this Section 5 shall be addressed to the Trustees on forms specified by the Trustees. If, in any such application, the depositor misstates the purpose of the proposed withdrawal, such depositor may be expelled from membership in the Fund by action of the Trustees, whereupon he shall receive the same amount he would have been entitled to withdraw had he terminated his membership voluntarily on the date of such expulsion.
- (b) When an employe has been a depositor for ten (10) or more consecutive full calendar years, he shall have the privilege from time to time of applying to the Trustees

for withdrawal of one-half of the credits added to his account beginning with the credits for the tenth consecutive full calendar year of being a depositor, less the total of all withdrawals made prior to said withdrawal; provided that any Group D depositor may at any time or times make application for larger partial withdrawal than is permitted under the foregoing provisions of this paragraph (b). The Trustees shall, in their discretion, either approve or disapprove withdrawal applications made under this paragraph (b), and they may approve any such application if in the exercise of their judgment the proposed withdrawal is to be used to further the depositor's retirement security.

- (c) When an employe has been a depositor for fifteen (15) or more consecutive full calendar years, he shall have the privilege from time to time of applying to the Trustees for withdrawal of one-half of the credits added to his account beginning with the credits for the fifteenth consecutive full calendar year of being a depositor, less the total of all withdrawals made prior to said withdrawals; provided that any application for withdrawal under this paragraph (c) may be denied by the Trustees, in their discretion, if the proposed withdrawal plus the total of all withdrawals made prior to said withdrawal exceeds the total of his deposits in the Fund.
- (d) Any Group B or C depositor shall have the privilege of applying under this Section for a withdrawal to purchase a house in which he will live. The Trustees shall, in their discretion, either approve or disapprove withdrawal applications made under this paragraph (d), and they may approve any such application if in the exercise of their judgment the proposed withdrawal is to be used to further the depositor's retirement security; provided that any such application may be denied by the Trustees if a previous withdrawal under this paragraph (d) has been

made by the depositor, and provided further that no application shall be approved for an amount exceeding the adjusted value of General Investments standing to the credit of the depositor's account on the effective valuation date.

- (e) (i) In the event of serious illness of a Group B, C or D depositor or a dependent member of his immediate family, the Trustees may consider applications for partial withdrawal to reimburse the depositor for expenses incurred for the medical or dental care of the depositor or such member of his immediate family.
- (ii) In the event of serious illness of a depositor or death or serious illness in his immediate family, the Trustees may consider applications for partial withdrawal not otherwise permitted under this article except that depositors who have less than five (5) years' continuous service may in no instance apply for withdrawal in excess of their own deposits.
- (f) When a Group B, C or D member is within one year of his retirement date, established in accordance with the Company's personnel policy, the Trustees may consider an application of such member for a withdrawal, not otherwise permitted hereunder, prior to such retirement date.
- (g) In approving any application filed pursuant to this Section 5 for a partial withdrawal to be paid in whole or in part out of the amount in respect of the Fund's General Investments Account to the credit of a depositor's account, the Trustees shall have the right to increase or decrease the amount of the proposed withdrawal specified in the application by applying to said amount the same adjustment factor that would be applied under Section 6 (a) (iii) and Section 8 of this Article V had the application been for a complete withdrawal.

Sec. 6 (a). The moneys and securities which any depositor or his estate or designated beneficiary, as the case may be, shall be entitled to withdraw in the event of the termination of his membership or in case of his death shall, subject to the provisions of Article VI and of Sections 2 and 6 (b) of this Article V, consist of such of the following as shall not have been withdrawn prior to such withdrawal, namely: (i) the shares of Company stock to the credit of such depositor's account at the end of the calendar year next preceding such termination or death, and the dividends received by the Fund on said shares subsequent to said year and prior to such withdrawal; (ii) the deposits made by him subsequent to said preceding year and prior to such withdrawal; (iii) the amount in respect of the Fund's General Investments Account to the credit of such depositor's account at the end of the calendar year next preceding such termination or death, adjusted by the applicable adjustment factor provided for under Section 8 hereof; (iv) if such termination or death occurs on or after November 15 and on or prior to December 30 in any year, a sum equal to the Trustees' estimate of the amount that would have been credited to such depositor's account at the end of said year, out of the Employers' Contribution for such year, had such depositor continued to be a member of the Fund; (v) if such termination or death occurs on December 31 of any calendar year, the number of shares of Company stock and the amount in respect of the Fund's General Investments Account to be credited to the depositor's account for the calendar year in which such termination or death occurs. Since the shares of Company stock and amounts in respect of the Fund's General Investments Account to be credited to accounts of depositors for any calendar year cannot be determined until after the close of the Company's fiscal year, the Trustees shall have the right to make two distributions in connection with complete withdrawals when termination of membership

or death occurs on December 31 of any calendar year or on or after January 1 of the succeeding year and prior to final determination of the credits to depositors' accounts for said calendar year, the first distribution to include, subject to the provisions of Section 6 (b) of this Article V, in addition to the securities and cash previously credited and not subsequently withdrawn, the estimated number of shares of Company stock and the estimated amount in respect of the Fund's General Investments Account to be credited to the depositor's account for said calendar year, the second distribution, which may be entirely in cash, to make up any deficiency in said estimate.

Sec. 6 (b). Payment of the moneys and securities to which any depositor or his estate or designated beneficiary shall become entitled under these Rules and Regulations may, subject to the provisions of Section 2 of this Article V, be made, at the option of the Trustees, wholly or partially in kind or in cash or through the purchase and delivery of a single premium annuity contract. If and whenever, in the case of shares of Company stock, the Trustees elect to pay or account for said shares in cash rather than in kind, the amount so to be paid or accounted for, as the case may be, shall be computed at the last reported price per share of such shares on the New York Stock Exchange for the applicable effective valuation date, or if there be no such reported price for such date, then the last reported price for the day next preceding such effective valuation date on which there is a reported price for said shares on said Exchange. The securities carried in the Fund's General Investments Account shall in each instance be paid or accounted for in cash rather than in kind as provided in Section 6 (a) of this Article V unless the Trustees by express action determine otherwise. Any such depositor or beneficiary shall have the privilege of requesting the Trustees not to exercise, or to exercise in any manner he or she deems best for the purpose of his or

her retirement security, all or any of the options and powers vested in the Trustees under the provisions of this Section 6 (b); but the Trustees in their discretion and without liability may deny or disregard any such request.

Sec. 7. If and whenever, under the provisions of Section 2 of this Article V, any person ceasing to be a member of the Fund is entitled to withdraw only a portion of the moneys and securities credited to his account, the portion of such moneys and securities which he is not entitled to withdraw (herein referred to as "lapses") shall be credited, at the end of the calendar year, to the accounts of those who are then depositors in proportion to the number of shares of capital stock of the Company to the credit of their accounts at the beginning of said year and not withdrawn during said year.

Sec. 8. All cash, stocks, bonds, notes and other securities and investments (other than Company stock) shall be known and referred to as "General Investments" and carried in an account to be known and referred to as "General Investments Account," said securities and investments at values equal to the cost thereof to the Fund unless and until revalued from time to time as hereinafter provided. At the end of each month (and at such other times as the Trustees deem that circumstances warrant or make it advisable or desirable), the Trustees shall adjust to the then current market value thereof the values at which such securities and investments, or any of them, shall be carried in such Account, and shall also adjust the total net valuation of the Fund's General Investments Account at the end of the preceding calendar year to reflect (i) the net increase or decrease in the aggregate value of such securities and investments resulting from the afore-said revaluations made after said year-end to the date of such adjustment, (ii) net earnings of such Account after said year-end to such adjustment date, and (iii) purchases, sales and other dispositions of securities and investments after said



year-end to the date of such adjustment, all in accordance with procedures and schedules established by the Trustees for use in making such adjustments. Upon making any such adjustment or at the end of the calendar year in which made, as the Trustees determine, the net increase or decrease in the total net valuation of the Fund's General Investments Account (after making the accounting adjustments required therein to conform to the Rules and established procedures of the Fund) shall be credited or charged, as the case may be, to the individual accounts of those who are then Fund members, in proportion to the amounts in respect of the Fund's General Investments Account to the credit of their respective accounts at the end of said preceding year and not withdrawn in the meantime. Each such adjustment of the Fund's General Investments Account shall be computed as a percentage of the total net valuation of said Account at the end of the next preceding calendar year and not withdrawn in the meantime. The Trustees shall have the right to designate the effective dates for applying this percentage as an adjustment factor (as provided in Sections 5 (g) and 6 (a) (iii) of this Article V) to the General Investments Accounts of depositors upon application for partial or complete withdrawal of their Fund accounts. Unless otherwise designated by the Trustees, the adjustment factor to be used shall be the adjustment factor computed for the applicable effective valuation date.

Sec. 9. A depositor, by executing and filing with the Trustees a proper instrument in writing, shall have the right to designate a beneficiary or beneficiaries who, in the event of the depositor's death before payment is received by the depositor of all Fund credits to which he shall be entitled hereunder, shall, if then surviving, be entitled, upon complying with the reasonable requirements of the Trustees, to receive and give acquittance for the depositor's Fund credits determined as provided in Section 6 (a) of this Article V;

and also the further right in like manner to revoke or change any such designation; provided that the marriage or divorce of a depositor, upon receipt by the Executive Director of written notice thereof, shall be deemed to revoke any prior designation of beneficiary made by the depositor with respect to such of his Fund credits as shall not have been theretofore disbursed in accordance with such designation. The form and execution of each such written instrument of designation, revocation or change shall be subject to the Trustees' approval and the Trustees may require the same to be executed by the spouse of the depositor as well as by the depositor. No such written instrument of designation, revocation or change shall be effective unless and until filed with and accepted by the Trustees prior to the depositor's death.

Sec. 10. Except as provided in this Article V and in Article VI, no depositor shall be entitled to withdraw, transfer, assign or hypothecate the moneys and securities, or any part thereof, credited to his account in the Fund.

## ARTICLE VI

### ○ DEPOSITORS RETIRING OR APPROACHING RETIREMENT

Notwithstanding any provisions to the contrary contained in these Rules and Regulations,

Sec. 1. If a depositor in Group B, C or D retires in accordance with the Company's personnel policy during the period commencing July 31 and ending November 14 of any year he shall be entitled upon such retirement to withdraw, subject to the provisions of Section 6 (b) of Article V, the moneys and securities then to the credit of his account in the Fund determined as provided in Section 6 (a) of Article V, in addition to which he shall also be entitled upon such retirement to withdraw a sum equal to the portion,

determined on the basis of the number of months of his continuous service in said year, of the Trustees' estimate of the amount that would have been credited to his account at the end of said year, out of the Employers' Contribution for such year, had he continued to be a member of the Fund.

Sec. 2. The Trustees shall have the power and authority, in their discretion, at the written request of any depositor in Group B, C or D, at any time within the five year period prior to his mandatory retirement date or such other date as may be established for his retirement, or at the written request of the designated beneficiary of any such depositor after such depositor's death, to purchase for such depositor or designated beneficiary, as the case may be, from an insurance company and through an insurance agent of his or her selection, a single premium annuity under an individual contract on his or her life, or on the joint lives of such depositor or beneficiary and of any one or more other persons he or she shall designate, in such amount and containing such terms, provisions and conditions as he or she shall prescribe or approve; to apply to the payment of the premium for such annuity so much as may be required of the moneys and securities standing to the credit of such depositor's account on the effective valuation date; and to cause the annuity contract to name as the owner thereof, and said contract to be delivered to, such depositor or beneficiary, as the case may be.

Sec. 3. The Trustees shall have the power and authority, in their discretion, upon the application of any depositor in Group B, C or D at any time within the five year period prior to his mandatory retirement date or such earlier date as may be fixed for his retirement, to establish a Retirement Reserve for such depositor on the books of the Fund; and also the power and authority, in their discretion, upon the

request of such depositor concurrently with his application for the establishment of such Retirement Reserve or thereafter from time to time before his retirement, to convert into a credit to his Retirement Reserve as of the applicable effective valuation date (a) all or any of the shares of Company stock then standing to the credit of his account in the Fund, and (b) also all or any part of the amount then standing to the credit of his account in the Fund in respect of General Investments, determined as provided in Section 8 of Article V in the case of an application for a partial or complete withdrawal. Amounts so credited to any such depositor's Retirement Reserve Account may be retained by the Trustees wholly or partially in cash at bank or wholly or partially invested in bonds or other obligations of the United States or other securities, whether or not designated by law as suitable for the investment of trust funds; and such of said proceeds as shall be retained in cash at bank, the securities, if any, so purchased, and the income received therefrom by the Trustees shall be credited to such depositor's Retirement Reserve Account. No interest shall be paid on the amount of cash to the credit of any depositor's Retirement Reserve Account in the Fund in respect of which the Trustees receive no income.

Sec. 4. Any depositor in Group B, C or D shall have the privilege, at any time within the five year period prior to his mandatory retirement date or such other date as may be established for his retirement, of requesting the Trustees in writing not to exercise, or to exercise at any time or times in any manner he may indicate as he deems best for the purposes of his retirement security, all or any of the powers vested in the Trustees under the provisions of Sections 2 and 3 of this Article VI; but the Trustees in their discretion and without liability may deny or disregard any such request.

**ARTICLE VII****MANAGEMENT**

Sec. 1. The Fund shall be under the management of not less than five (5) nor more than nine (9) Trustees, to be determined and appointed for three year terms by the Board of Directors of the Company. The Trustees shall be officers, directors or employes of the Company, except that if the Board of Directors so determines, as many as three of the Trustees need not be officers, directors or employes of the Company. Of those Trustees who, when appointed, are officers, directors or employes of the Company, a majority shall be officers or directors of the Company.

Each Trustee who is an officer or director of the Company at the date of his appointment as such Trustee shall hold office as Trustee only so long as he continues to be an officer or director of the Company. Each Trustee who is an employe but not an officer or director of the Company at the date of his appointment as such Trustee shall hold office as Trustee only so long as he continues to be an employe but not an officer or director of the Company.

Any Trustee may be removed at any time, with or without cause, by the Board of Directors of the Company. Any Trustee shall have the right to resign at any time by giving written notice of such resignation to the other Trustees of the Fund and the Secretary of the Company. Vacancies occurring among the Trustees will be filled by appointment made by the Board of Directors of the Company.

Any person appointed as Trustee hereunder shall forthwith upon such appointment become fully vested with the rights, title, interests, powers, trusts, duties and obligations of a Trustee hereunder, without any further act, deed or conveyance of any predecessor or other Trustee, with like effect as if such person had originally been named as Trus

tee hereunder. The rights, title, interests, powers, trusts, duties and obligations of any person ceasing to be a Trustee hereunder, by reason of the expiration of his term of office or by reason of his death, resignation, removal, disability or disqualification, shall forthwith upon such cessation vest in the remaining Trustees, and their and his successors in office from time to time, without any further act, deed or conveyance on the part of such person, his personal representatives, heirs, legatees or devisees; provided, nevertheless, that such person, his personal representatives, heirs, legatees or devisees, shall at the request of the Trustees in office from time to time execute and deliver such instruments and do such other things as may reasonably be required more fully and certainly to vest and confirm all such rights, powers, trusts, duties and obligations in the Trustees in office from time to time.

Sec. 2. The Trustees shall elect a Chairman and may elect a Vice-Chairman, each of whom shall be a Trustee, and shall also elect an Executive Director, a Secretary and a Treasurer, who may but need not be Trustees. The Trustees may also elect or appoint such other officers and assistant officers as they may deem desirable. The Chairman, Vice-Chairman, Executive Director, Secretary and Treasurer, and any other officers or assistants, elected or appointed by the Trustees, shall hold office during the pleasure of the Trustees and shall have and perform such powers and duties as shall be prescribed from time to time by the Trustees.

The Trustees shall have the right to appoint an Investment Committee which shall have all the powers, authorities and discretions vested in the Trustees under the provisions of Section 3 of this Article VII, subject to such restrictions and conditions as may be prescribed from time to time by the Board of Trustees. The Committee may adopt such reasonable Rules of Procedure, not inconsistent with these Rules

and Regulations, as the Committee shall deem necessary or desirable to govern its procedures and actions and to perform the functions and exercise the powers, authorities and discretions granted to it and to amend the same from time to time, provided that such Rules of Procedure or amendments thereof shall first be submitted to and approved by the Board of Trustees. The members of the Investment Committee shall hold office during the pleasure of the Trustees, and may or may not be Trustees, and may or may not be employes of the Company or of an employer, provided that the Chairman of said Committee must be a Trustee. An Assistant Secretary of the Fund shall be designated by the Board of Trustees to act as Secretary of the Investment Committee. The Investment Committee shall submit to the Board of Trustees reports of the Committee's actions at such times and in such form and detail as the Board may require.

The Trustees shall, by resolution, specify the number of Trustees who shall be required to vote or give their written assent in order to authorize any action on behalf of the Trustees.

The Trustees may also adopt such other resolutions as they desire for the purpose of regulating themselves in the conduct and discharge of their business and duties as such Trustees. The Trustees shall have the right to determine the depositories in which the moneys and securities of the Fund shall be kept, and to hire employes of the Fund and fix their duties and compensation.

Sec. 3. It is intended that so far as practicable and advisable, the Fund will be invested in the capital stock of the Company, to the end that depositors may, in the largest measure possible, share in the earnings of the Company. The Trustees may, however, in their discretion, invest and reinvest any part of the assets of the Fund in, and buy and sell shares of capital stock of other corporations, and like-

wise debentures, bonds, stocks, mortgages, promissory notes, real estate, real estate improvements, leaseholds or any income producing properties or securities, real or personal, within or without the State of Illinois, the Trustees to have as wide latitude in the selection and making of any investments as if they, as individuals, were the absolute owners thereof, and not to be restricted to the investments for trustees as prescribed by the statutes or laws of the State of Illinois or of any other jurisdiction.

The Trustees may also make loans of the moneys and securities of the Fund, including loans to depositors of the Fund, upon such terms and conditions as the Board of Trustees shall from time to time determine. The Trustees may likewise borrow money for the purposes of the Fund and pledge or mortgage securities or other assets owned by the Fund as security for the payment thereof.

The Trustees are authorized and empowered in their discretion, but not by way of limitation, to lease, sell, exchange, convey, transfer or dispose of, improve, protect, maintain, and also to grant options with respect to, any property, whether real or personal, at any time held by them, for cash or upon credit, or partly for cash and partly upon credit, as the Trustees may deem best, and no person dealing with the Trustees shall be bound to see to the application of the purchase money or to inquire into the validity, expediency or propriety of any such sale or other disposition; to deal in and with real property held by or pledged, mortgaged or conveyed in trust to them, and all interest therein, including, but not by way of limitation, to subdivide, resubdivide and vacate any subdivision of, to dedicate for streets or any other public use, to partition, to grant, release, convey or assign easements and charges in or about, such property and to join with others in taking any such action, all for such consideration or no consideration as the Trustees may deem



best; to make such warranties, representations and indemnifications in connection with the sale or other disposition of any securities owned by the Fund, for the benefit of the issuer of such securities, the purchasers thereof, as well as underwriters and securities dealers involved in such sale or other disposition, all to the extent and under such terms and conditions as the Trustees with advice of counsel shall deem to be appropriate under the circumstances; to compromise, compound and settle any debt or obligation due to or from them as Trustees, and to reduce the rate of interest on, to extend or otherwise modify, or to foreclose upon default or otherwise enforce any such obligation; to vote in person or by proxy on any stocks, bonds or other securities held by them; to exercise any options appurtenant to any stocks, bonds or other securities for the conversion thereof into other stocks, bonds, or securities, or to exercise any rights to subscribe for additional stocks, bonds or other securities, and to make any and all necessary payments therefor; to join in, or to dissent from, and to oppose the reorganization, recapitalization, consolidation, liquidation, sale or merger of corporations or properties in which they may be interested as Trustees upon such terms and conditions as they may deem wise; and to make, execute, acknowledge and deliver or to cause to be made, executed, acknowledged and delivered on their behalf, any and all deeds, leases, assignments, proxies, powers of attorney and instruments whatsoever.

Notwithstanding the provisions contained in the foregoing paragraph, (i) the Trustees shall, before each meeting of the Company's stockholders, furnish to each Group B, C and D member a proxy statement relating to such meeting and an appropriate form on which such member may indicate to the committee of Trustees hereinafter mentioned his or her instructions for voting at the meeting the shares of Company stock credited to his or her Fund account; (ii) a committee of the Trustees, consisting of those Trustees who are not di-

rectors, officers or candidates for election as directors of the Company, shall vote said shares in accordance with such instructions; (iii) all shares of Company stock owned by the Fund which shall not have been credited to Group B, C or D members' accounts or in respect of which voting instructions shall not have been received from such members within the time specified by the Trustees shall be voted by said committee of Trustees according to the committee's best judgment; and (iv) reasonable means shall be employed to provide secrecy respecting each member's voting instructions. The means and methods for implementing and carrying out the foregoing provisions of this paragraph shall be specified and governed by resolutions adopted for that purpose from time to time by the Board of Trustees.

Sec. 4. The Board of Directors of the Company shall determine the amount of compensation to be paid to the Trustees, or any of them, and all expenses and liabilities incurred in connection with the operation and management of the business of the Fund, including expenses and any compensation of the Trustees, shall be borne by the Fund, provided that no officer of the Company shall be compensated for serving as a Trustee.

The Trustees or members of the Investment Committee shall not be personally liable to any person for any obligation or liability incurred on behalf of the Fund, but each such person shall look solely to the assets of the Fund for satisfaction of such obligations or liability. Moreover, the Trustees or members of the Investment Committee shall not be personally liable for any loss which may result by reason of any investment or loan made on behalf of the Fund or for any act or failure on their part to act.

Each person who at any time shall have served as a Trustee or officer of the Fund, or as a member of the Investment Committee, or, at the request of the Fund, as a director or offi-

cer of a corporation which is indebted to the Fund or whose shares of stock or other securities are owned by the Fund, and the heirs, legatees, devisees and personal representatives of any such person who shall be deceased, shall be indemnified by the Fund for expenses (including attorneys' fees and any amount paid in settlement) incurred by them in connection with the defense of any action, suit or proceeding (including any appeal therein) in which such person or his heirs, legatees, devisees or personal representatives is or are made a party or parties by reason of such person being or having been a Trustee or officer of the Fund or a member of the Investment Committee or a director or officer of such corporation, except in relation to matters as to which such person shall be adjudged in such action, suit or proceeding (which adjudication is final) to be liable for negligence or misconduct in the performance of his duties as such.

No employer shall have any responsibility or liability whatsoever with reference to the management or conduct of the business of the Fund or for any act or failure to act on the part of any Trustee, member of the Investment Committee, officer, employe of the Fund or of any employer.

Sec. 5. The Trustees may, from time to time, adopt rules and resolutions for carrying out the purposes of the Fund, and for and on behalf of the depositors may adopt amendments to the Fund's Rules and Regulations. All questions of interpretation of the Fund's Rules and Regulations, or rules and resolutions from time to time adopted hereunder, or in connection with any matter of accounting, values, profits, or any other matters or differences which may arise, shall be determined solely by the Trustees, and the decisions of the Trustees shall be final and conclusive upon all depositors.

Sec. 6. The entire right, title and interest to all assets of the Fund shall be held by and vested in the Trustees and their successors in office from time to time, in trust never-

theless for the uses and purposes and upon the terms, conditions and provisions set forth in the Fund's Rules and Regulations.

Certificates of stock or other assets held or owned by the Fund may be issued in the name of the Trustees of the Fund or in the name of such nominee or nominees as the Trustees may from time to time designate. Upon the death, resignation, removal or disability of any such nominee, the certificates of stock or other assets may be transferred to the Trustees of the Fund, or to any other nominee or nominees as the Trustees designate. The Board of Trustees shall from time to time by resolution designate the individuals who shall be authorized to sign, on behalf of the Trustees of the Fund, instruments of assignment or transfer for the purpose of assigning and transferring certificates of stock or other assets held in the name of the Trustees of the Fund.

The Board of Trustees shall from time to time by resolution designate the individuals who shall be authorized to sign, on behalf of the Trustees of the Fund, written orders to the nominee or nominees in whose name or names certificates of stock or other assets owned by the Fund are issued, instructing such nominee or nominees to execute instruments of assignment or transfer for the purpose of assigning or transferring such stock certificates or other assets. No stock certificates or other assets issued in the name of the Trustees of the Fund shall be assigned or transferred unless the instrument of assignment or transfer is signed on behalf of the Trustees of the Fund in accordance with the provisions of resolutions adopted by the Board of Trustees, as aforesaid. No stock certificates or other assets owned by the Fund and held in the name of any nominee or nominees, shall be assigned or transferred except pursuant to written orders signed on behalf of the Trustees in accordance with resolutions adopted by the Board of Trustees, as aforesaid; but such nominee or nominees shall in each case promptly comply with all such written orders when so signed.

**ARTICLE VIII****○ ADVISORY COUNCIL**

An Advisory Council consisting of twenty-seven delegates, each to serve for a term of one year, fifteen to be elected from and by Retail unit employes, five from and by Catalog Order Plant employes, one from and by employes of a Territorial Office, one from and by Chicago Parent Organization employes, one from and by New York Parent Organization employes, three from and by Allstate Insurance Company employes, and one from and by employes of a specified organization, branch, division, service or other unit not included in the foregoing, shall be elected (together with one or more alternates for each such delegate) by various groups or units as selected and designated by the Board of Trustees.

The qualifications of nominees for the office of delegate and alternate, as well as the dates upon which elections shall be held and the manner and methods of conducting such elections, shall be specified and governed by resolutions adopted for that purpose from time to time by the Board of Trustees. The Board may prescribe different voting methods and procedures to be followed in respect of the various groups. No officer or director of the Company shall be a member of the Council.

The Advisory Council shall meet regularly twice a year with the Board of Trustees at such times and places as shall be fixed by the Board of Trustees. Immediately prior to such regular meetings with the Board of Trustees, the Advisory Council may meet with the Executive Director who shall be the Chairman of any such preliminary meetings. Meetings of the Council may be called at other times by the Board of Trustees. The purpose of such meetings shall be to consider and discuss with the Executive Director and with the Board of Trustees and to make recommendations to the Board of Trustees in respect of questions related to administration, procedure, rights and obligations of the

members of the Fund, total and partial withdrawals, and amendments of the Rules and Regulations of the Fund, and such other matters as the Board of Trustees shall indicate from time to time as being subject to consideration by the Council.

Members of the Council and their alternates shall not receive compensation for their services as such, but expenses of attendance will be paid by the Fund for attendance at the meetings of the Council.

## ARTICLE IX

### ○ CHANGE OR DISCONTINUANCE OF EMPLOYERS' CONTRIBUTIONS

Sec. 1. The Company, by action of its Board of Directors, shall have the right at any time and from time to time to change the provisions of Section 2 of Article III, and also the right at any time to discontinue Employers' Contributions to the Fund; provided that any such change or discontinuance shall not, without the Trustees' consent, be applicable to the fiscal year of the Company in which made, unless the Company gives written notice of such change or discontinuance to the Trustees prior to July 1 of such year. In case the Company exercises its right to discontinue Employers' Contributions to the Fund as aforesaid, then after the announcement of such discontinuance, no new members shall be eligible to join the Fund, and the assets of the Fund shall be distributed among the then members according to their respective interests therein, in the most practicable manner as determined by the Trustees.

Sec. 2. If and whenever, in any year, any employer, other than the Company, shall discontinue business or cease to be a wholly owned subsidiary of the Company, or should any division of the Company or of any employer or substantially all the assets of any employer be sold or transferred to a person, firm or corporation other than an employer or the

Company (any such division or employer being hereinafter referred to as a "terminated division" or "terminated employer", as the case may be), then (a) employes of such terminated employer or division shall not thereafter be eligible to join the Fund, (b) the account of each employe of such terminated employer or division who is then a member of the Fund shall be credited with a sum equal to the portion, determined on the basis of the number of complete months of his continuous service in such year to the date of such discontinuance, cessation, sale or transfer, of the Trustees' estimate of the amount that would have been credited to his account at the end of such year, out of the Employers' Contribution for such year, had he continued to be a member of the Fund, (c) subject to the provisions of Section 2 of Article III, such terminated employer shall pay its share of the Employers' Contribution, and the Company or employer selling or transferring a division or assets as aforesaid shall pay its share of the Employers' Contribution, including in such share a sum equal to the aggregate amount credited to the accounts of employes of such terminated employer or division pursuant to subsection (b) of this Section, and (d) the assets of the Fund then to the credit of the accounts of such employes, computed according to the provisions of Section 6 (a) of Article V hereof, plus the portion of the Employers' Contribution as aforesaid, shall be paid for their respective accounts, wholly or partially in kind or in cash as the Trustees shall determine, to a profit sharing or pension trust, if any, maintained or established by such terminated employer or by the purchaser or transferee of such terminated division or of the assets of a terminated employer, or if no such trust has been established within six months after such discontinuance, cessation, sale or transfer (or within such additional time as the Trustees in their discretion may grant for obtaining necessary approvals and completing other details in the establishment of such trust), then such assets shall be paid to such employes in substantially equal install-

ments over the ensuing five-year period or, at the option of the Trustees, at one time; provided that until said Fund assets shall have been paid as aforesaid, all authorities, powers, and discretions vested in the Trustees hereunder, including those relating to withdrawals, shall continue in full effect with respect to said assets; except that the Trustees shall make no payments pursuant to applications for complete withdrawal filed by employes who are remaining in the employment of such terminated employer or division until such time as the Trustees commence payment of the accounts of all employes remaining in the employment of such terminated employer or such division as set forth in this Section 2; provided, further, that the foregoing provisions of this Section shall not be applicable to the employes of any such terminated employer or division who become employes of the Company or any other employer at or about the time such terminated employer discontinues business or ceases to be a wholly owned subsidiary of the Company or at or about the time of the sale or transfer of such division or assets.

Sec. 3. Only the Company, by action of its Board of Directors, shall have the right to amend the provisions in Section 2 of Article III, in Sections 1 and 4 of Article VII, and in this Article IX; provided that no such amendment shall vest in any employer any right, title or interest in or to the assets of the Fund or allow any part of the Fund to be used for, or diverted to, purposes other than for the exclusive benefit of members and their beneficiaries.

*Trustees*

JAMES M. BARKER	CLAIRE GIANNINI HOFFMAN
EDWARD P. BROOKS	CHARLES H. KELLSTADT
LOU R. CRANDALL	DAVID M. KENNEDY
AUSTIN T. CUSHMAN	WILLIAM F. MCCURDY

J. ROSCOE MILLER

*Executive Director, WILLIAM F. MCCURDY*



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Each year-end he also receives a special report which includes information on the profit-sharing fund's operations for the year. He also receives a copy of the company's annual report.<sup>1</sup> In addition, a notice of the annual meeting of the shareholders is sent to him. Every employee receives a copy of each document.

(The "Notice of Annual Meeting of Shareholders" follows:)

SEARS, ROEBUCK & Co., CHICAGO, ILL.

*Notice of Annual Meeting of Shareholders*

Notice is hereby given that the annual meeting of shareholders of Sears, Roebuck and Co. will be held in the Auditorium of the Prudential Building, 130 East Randolph Street, Chicago, Illinois, on Monday, May 16, 1966, at 10:00 a.m., Central Daylight Saving Time, for the following purposes:

1. To elect directors;
2. To vote on the recommendation of the Committee on Audits that Touche, Ross, Bailey & Smart be appointed auditors of the Company for the fiscal year 1966; and
3. To transact such other business as may properly come before the meeting.

By Order of the Board of Directors:

LAWRENCE L. O'CONNOR, *Secretary.*

*Proxy Statement*

This proxy statement is furnished in connection with the solicitation of proxies by the management of Sears, Roebuck and Co. for the annual meeting of shareholders to be held on May 16, 1966. Only shareholders of record at the close of business on April 1, 1966, will be entitled to notice of, and to vote at, the meeting. There were 152,519,845 common shares outstanding on February 28, 1966. Shareholders are entitled to vote cumulatively for the election of directors and to one vote per share on other matters. If the accompanying proxy form is signed and returned, the shares represented thereby will be voted, they will be voted in accordance with the specifications thereon, and it is intended that they will be voted for the nominees named herein. The shareholder may revoke the proxy at any time prior to the voting thereof. The expenses of the solicitation will be paid by the Company.

The Company's management knows of no matter to be brought before the meeting other than those referred to in Items 1 and 2 of the notice of meeting. If, however, any other matters properly come before the meeting, it is intended that the proxies in the accompanying form will be voted thereon in accordance with the judgment of the persons or person voting such proxies. The favorable vote of the holders of a majority of the common shares represented in person or by proxy at the meeting will be required for approval of the recommendation of the Committee on Audits.

ELECTION OF DIRECTORS

Twenty-three directors are to be elected to hold office until the annual meeting of shareholders in 1967 and until their respective successors shall have been elected and have qualified. All of the nominees listed below were previously elected directors by the shareholders. In case any person named herein for election as a director is not available at the time of the election, proxies in the accompanying form may be voted for a substitute as well as for the other

<sup>1</sup> Copies of both these documents are retained in the subcommittee files.

persons named herein. The Company's management expects all nominees to be available.

Name	Principal occupation, name of organization in which such occupation is carried on and offices or positions, if any, held with the company	First became a director	Approximate number of common shares of company beneficially owned at Feb. 28, 1966
Crowdus Baker.....	President of the company and chairman of the finance committee. <sup>1</sup>	1952	2 <sup>3</sup> 54,900
James M. Barker.....	Former chairman of the board of directors of Allstate Insurance Co.	1930	125,217
Howard A. Benthin.....	Vice president and comptroller of the company <sup>1,4</sup> ...	1963	2 <sup>5</sup> 20,435
Judson B. Branch.....	Chairman of the board of Allstate Insurance Co.....	1962	2 <sup>2</sup> 21,468
Edgar G. Burton.....	Chairman of the board of directors of Simpsons, Ltd. (Canadian retailer of general merchandise). <sup>5</sup>	1961	5 <sup>1</sup> 1,000
Austin T. Cushman.....	Chairman of the board of directors and chief executive officer of the company; chairman of the executive committee and of the nominating and proxy committee. <sup>4</sup>	1950	2 <sup>7</sup> 77,593
John D. deButts.....	Executive vice president of American Telephone & Telegraph Co. <sup>1,6</sup>	1964	200
Hugh K. Duffield.....	Former vice president of the company.....	1956	44,021
Calvin Fentress, Jr.....	Chairman of the finance committee of Allstate Insurance Co. <sup>4</sup>	1948	2 <sup>3</sup> 33,431
Claire Giannini Hoffman...	Director and member of executive committee of Bank of America National Trust & Savings Association.	1963	400
Charles H. Kellstadt.....	Former chairman of the board; chairman of General Development Corp. <sup>1,6,7,8</sup>	1948	49,468
Homer J. Livingston.....	Chairman of the board of directors of the First National Bank of Chicago and chairman of the salary and supplemental compensation committee of the company. <sup>4,9</sup>	1954	3,062
Gordon M. Metcalf.....	Vice president of the company, midwestern territory. <sup>1,4</sup>	1958	2 <sup>3</sup> 30,098
Charles A. Meyer.....	Vice president of the company, eastern territory....	1960	2 <sup>3</sup> 30,617
J. Roscoe Miller.....	President, Northwestern University <sup>6,7</sup> .....	1957	1,100
Lucien E. Oliver.....	Vice president of the company, southern territory..	1959	2 <sup>3</sup> 34,654
Julius Rosenwald II.....	Business consultant, chairman of the committee on audits.	1939	31,410
Edgar B. Stern, Jr.....	President, Royal Street Corp. <sup>4,6,7,10</sup> .....	1958	11 51,534
Richard L. Tayloe.....	Independent oil operator and former vice president of the company. <sup>3</sup>	1953	26,852
W. Wallace Tudor.....	Vice president of the company, personnel.....	1958	2 <sup>5</sup> 31,895
J. Huber Wetenhall.....	Chairman of the board of directors of National Dairy Products Corp. <sup>4,7</sup>	1964	400
Arthur M. Wood.....	Vice president of the company, Far West territory..	1959	2 <sup>5</sup> 34,496
Robert E. Wood.....	Former chairman of the board of directors of the company. <sup>5</sup>	1926	137,601

<sup>1</sup> Also a member of the executive committee of the company.

<sup>2</sup> Includes shares credited to his account in the profit-sharing fund at December 31, 1965.

<sup>3</sup> Includes shares held by spouse.

<sup>4</sup> Also a member of the finance committee of the company.

<sup>5</sup> Simpsons, Ltd. and Sears each own one-half of the outstanding 12 million shares of voting stock of Simpsons-Sears Ltd. Of the outstanding 1,544,435 shares of the Simpsons-Sears class A (nonvoting) stock, which is listed on the Montreal and Toronto Stock Exchanges, 750 shares are owned by Mr. Benthin, 25,000 shares by members of Mr. Burton's immediate family; 4,500 shares by Mr. Oliver; 4,500 shares by Mr. Tudor, and 4,000 shares by Mr. A. M. Wood.

<sup>6</sup> Also a member of the salary and supplemental compensation committee of the company.

<sup>7</sup> Also a member of the committee on audits of the company.

<sup>8</sup> Also a member of the nominating and proxy committee of the company.

<sup>9</sup> Sears and its subsidiaries borrow money from time to time from the First National Bank of Chicago.

<sup>10</sup> Mr. Livingston is the bank's chief executive officer.

<sup>11</sup> In 1965 Interchange Realty Co., in which Mr. Stern and members of his immediate family have indirectly a 63 percent interest, transferred to Sears at no cost 14 acres of the 50-acre Oakwood Shopping Center being developed in Jefferson Parish, La., upon the undertaking of Sears to construct a retail store on the tract and to operate it for at least 5 years and to pay its proportionate share (estimated at \$497,000) of filling, grading, paving, drainage, utilities, lighting, and landscaping the 14 acres. Payments to Interchange Realty Co. for maintenance and other services chargeable to the retail store are estimated at \$70,000 annually.

<sup>12</sup> Exclusive of an additional 107,800 shares held by Mr. Stern, as trustee, and in which he has beneficial interests.

## REMUNERATION

The following tabulation sets forth: (a) the remuneration and contributions to The Savings and Profit Sharing Pension Fund of Sears, Roebuck and Co. Employees (referred to elsewhere herein as the "Profit Sharing Fund" or the "Fund") paid by the Company and its subsidiaries for the fiscal year ended January 31, 1966, to or for the account of each of (i) the several directors, including the three highest paid officers, whose direct aggregate remuneration exceeded \$30,000, and (ii) all directors and officers as a group; and (b) the accrued interests in the Profit Sharing Fund for each such individual and to all directors and officers as a group. The annual deferred salary benefits payable after termination of employment and estimated annual retirement benefits payable under the supplemental retirement plans are shown in notes 2 and 3 below.

Name of individual or identity of group	Aggregate remuneration <sup>1</sup>	Employers' contribution to profit-sharing fund for last fiscal year	First became member of fund	Aggregate interest in profit-sharing fund as of Dec. 31, 1965 <sup>4</sup>	
				Common shares of the company	General investments (at market)
Crowdus Baker.....	\$180,000	\$1,400	1930	8,447	\$46,563
Howard A. Benthin.....	124,994	1,400	1937	4,391	36,493
Judson B. Branch.....	153,750	1,400	1936	4,788	40,427
Austin T. Cushman.....	250,000	1,400	1932	8,419	61,287
Hugh K. Duffield.....	135,000	1,400	1929	9,516	55,721
Calvin Fentress, Jr.....	105,500	1,400	1935	6,054	47,296
Gordon M. Metcalf.....	140,000	1,400	1934	5,303	43,057
Charles A. Meyer.....	135,000	1,050	1940	2,157	23,547
Lucien E. Oliver.....	135,000	1,400	1937	4,665	40,262
George H. Struthers.....	130,000	1,400	1940	2,952	29,137
W. Wallace Tudor.....	120,000	1,400	1937	3,497	32,302
Arthur M. Wood.....	135,000	1,400	1947	1,344	16,612
All directors and officers as a group (40).....	2,505,912	34,241	-----	105,762	805,264

<sup>1</sup>The capacities in which remuneration was received by the above-listed persons are shown on p. 2, except for Mr. Struthers, deceased, who was vice president of the company, merchandising, and Messrs. Branch and Fentress who served Allstate Insurance Co. in 1965 as president and chairman of the board, respectively.

<sup>2</sup>Deferred salary related to 1965 (\$20,000 for Mr. Baker, \$10,000 for Mr. Branch, \$25,000 for Mr. Cushman, \$5,000 for Mr. Metcalf, and \$5,000 for Mr. Oliver) will be paid to them in 5 equal annual installments commencing after termination of employment. On the basis of awards to date, each annual installment will amount to \$6,000 for Mr. Baker, \$4,000 for Mr. Branch, \$8,000 for Mr. Cushman, \$2,000 for Mr. Metcalf, and \$2,000 for Mr. Oliver.

<sup>3</sup>The estimated annual benefits upon retirement under the supplemental retirement plan of the company, and in the case of Messrs. Branch and Fentress under the Allstate Insurance Co. supplemental retirement plan, amount to \$35,000 for each individual (other than Mr. Benthin—\$25,417, and Mr. Duffield who retired Jan. 31, 1966) named in the above tabulation, and to \$817,360 for all directors and officers as a group, assuming that each person named or referred to above continues as an employee until normal retirement age at his current rate of compensation.

<sup>4</sup>The amounts shown for each individual under this heading include the contributions of the individual and the earnings thereon since the individual became a fund member. As of December 31, 1965, 172,393 employees of the company and certain wholly owned domestic subsidiaries were participants in the fund. For the fiscal year ended January 31, 1966, the contributions of the company and its subsidiaries to the fund amounted to \$70,419,941. The assets of the fund are invested principally in common shares of the company, and, as of Feb. 28, 1966, the fund held 35,243,588 of the company's outstanding common shares (23.11 percent).



## EMPLOYEE STOCK PLANS

During the period from February 1, 1965, to February 28, 1966, options for the purchase of 71,940 common shares were exercised by directors and officers as follows:

Name of individual or identity of group	Number of common shares purchased <sup>1</sup>	Option price <sup>1</sup>	Market value (or range) on dates of purchase <sup>1</sup>
Howard A. Benthin.....	400	\$29.38	} \$72.50
Austin T. Cushman.....	8,000	33.57	
	750	29.38	65.00
	1,600	} 29.38	65.25
Hugh K. Duffield.....	800		59.63
	12,000	} 33.57	65.25
	4,000		59.63
	2,400	} 29.38	62.88
Gordon M. Metcalf.....	4,000		33.57
	3,700	} 15.57	76.00
Charles A. Meyer.....	500		66.38
	6,000	} 29.38	64.13
W. Wallace Tudor.....	4,000		29.38
Arthur M. Wood.....	3,800	15.57	64.88
	6,090	29.38	65.75
All other directors and officers as a group.....	13,900	33.57	(?)

<sup>1</sup> Information under this heading as to number of shares, option prices, and market values has been adjusted, where appropriate, for the 2-for-1 split effective Feb. 11, 1965.

<sup>2</sup> Options were exercised by officers (other than those named above) in the 2d, 3d and 4th calendar quarters of 1965. During this period the closing price per share for the company's common shares on the New York Stock Exchange ranged from \$64.38 to \$76 in the 2d quarter, from \$63.13 to \$68.38 in the 3d quarter, and from \$62.88 to \$68 in the 4th quarter.

## AUDITORS

In accordance with the bylaws, the recommendation of the committee on audits that Touche, Ross, Bailey & Smart be appointed auditors for 1966 is being presented to shareholders for approval.

## IMPORTANT

All shareholders are cordially invited to attend the meeting in person.

If you do not expect to attend the meeting in person, it is important that your shares be represented so that the presence of a quorum may be assured. It is requested that you sign and date the enclosed proxy and mail it promptly. No postage is required if mailed in the United States.

Each fund member annually receives a copy of the fund prospectus which is prepared in connection with the filing of form S8 by the fund and the company with the SEC under the provisions of the Securities Act of 1933. This [indicating] is the prospectus. Once a year these are circulated to each and every member, 173,000 of them.

Besides this information provided directly to fund members, other important information on fund activities is a matter of public record. For example, because the fund is an owner of more than 10 percent of the outstanding Sears stock, it is required under section 16 of the Securities Exchange Act of 1934 to make a monthly report to the SEC of all its acquisitions and dispositions of Sears stock. This information, of course, is in the public domain and is published periodically by the SEC.

To put it another way, the fund appears periodically in the "Insider" report that is published by the Securities and Exchange Commission showing the amount of stock that we buy each month and what we—they say sell, but we do not sell the stock, we distribute it to our members upon retirement—but it appears in the "Insider's" report as a sale. We frequently get inquiries from shareholders who think we are selling stock and we have to straighten them out.

Representative GRIFFITHS. Do you never sell stock?

Mr. O'CONNOR. We have never sold Sears stock. We do sell stock of other corporations in the general portfolio in order to accumulate money for payouts, et cetera, or for reinvestment in securities considered more desirable. Any fund member with recommendations or criticisms of fund activities may make his thoughts known by communicating directly with the fund trustees or with his representative on the advisory council—both of which groups I will discuss in greater detail a little later on.

Every employee-member has his interest in the fund "fully vested" after 5 years service with Sears. This means that if he leaves Sears for any reason whatever, he takes with him the entire amount credited to his account. Once his account is vested, there is no way in which any part of it can be forfeited. This relatively short vesting period allows even employees who are not near retirement to take their full benefits with them when they leave Sears. We estimate that 92 percent of those who are now members will receive full benefits.

Representative GRIFFITHS. You mean that you have only an 8-percent turnover before 5 years of employment?

Mr. O'CONNOR. Yes; between 1 and 5 years. It would be after 1 year. But let us not count the first year.

Representative GRIFFITHS. Yes. Well, the first year they are not paying anything anyway; they are not eligible?

Mr. O'CONNOR. That is right.

Representative GRIFFITHS. And you are not setting anything aside for them?

Mr. O'CONNOR. We are not.

Representative GRIFFITHS. But between 1 and 5, Sears has an 8-percent turnover in members of the plan?

Mr. O'CONNOR. Yes.

Representative GRIFFITHS. How much do you set aside for that 8 percent?

Mr. O'CONNOR. They will receive from the second to the end of the fourth year their deposits back, and then what we set aside, Madam Chairman, is 5 percent on their money. So for the money that they deposited and that they will not receive full benefits for, they will receive 5 percent on the deposits.

After a member's account is vested he has the right to instruct the trustees of the fund as to how he wants them to vote the Sears stock credited to his account. Every year he sends in his voting instructions, in complete secrecy, to an independent public accounting firm that is not the auditing firm for the company or the fund. These instructions are then tabulated and the shares are voted accordingly.

Representative GRIFFITHS. Do you mean voted for the officers of the company or the trustees?

Mr. O'CONNOR. They do not vote on the officers of the company.

Representative GRIFFITHS. What are they voting on?

Mr. O'CONNOR. They vote on the directors. They act as a shareholder.

Representative GRIFFITHS. Of what?

Mr. O'CONNOR. Directors of the corporate entity, Sears, Roebuck & Co.

Representative GRIFFITHS. I see.

Mr. O'CONNOR. Let me put it another way: They are exactly the same as any stockholder who went in and bought on the New York Stock Exchange.

If an employee leaves the company before completing 5 years' service, he receives back his own deposits plus 5 percent annual interest. The balance of the credits to his account are then reallocated to the other fund members. However, if the employee dies or is forced to leave the company through disability, the entire balance of his account will be paid to him or his beneficiary even though he has not yet been with the company for the 5 years normally required for vesting.

Under certain prescribed circumstances, the member may apply for a partial withdrawal. This is part of the answer to the telegram, or I think it is the letter, that you received, but we will develop this further.

Representative GRIFFITHS. Yes, the letter.

Mr. O'CONNOR. Reasons for partial withdrawals include the purchase of a home, serious illness, and similar reasons. If an employee is given such a partial withdrawal, the balance of his account remains intact, and in future years his own and the company contributions will continue to be credited to it.

An employee whose account is vested may, at any time within 5 years of retirement age, request that the dollar value of all or a portion of his account be frozen at the then current market value. In this way he can be assured of an ascertained amount of money for his retirement and take no market risk. He may also at any time within this 5-year period request that the trustees use either part or all of the amount credited to his account to purchase an annuity for his benefit through a broker and in an insurance company of his choice.

When a member retires, dies, or leaves the company after 5 years' service, the entire balance in his account is distributed to him or his beneficiary. His account may be distributed to him in cash, Sears stock, in the form of an annuity contract, or in a combination of these. In practice, most employees take the greater portion of their Sears stock with them rather than the cash equivalent. The employee may then decide for himself when and if to sell the stock just as though he had purchased it himself over the years.

The members of the fund are the beneficial owners of their profit-sharing investments. No member is guaranteed any definite benefit upon retirement. Like any entrepreneur, he assumes the risk of gain or loss. However, no member has ever realized a loss because of his participation in the Sears fund.

#### MANAGEMENT OF THE FUND

The rules and regulations provide that the fund is to be under the management of five to nine trustees to be appointed for 3-year terms by the board of directors of Sears. At the present time, there are nine trustees.

Representative GRIFFITHS. Who set up the rules and regulations?

Mr. O'CONNOR. Julius Rosenwald in 1916.

Representative GRIFFITHS. You go back to the will?

Mr. O'CONNOR. Yes. Well, I might indicate that under the terms of the original document, there were powers given for amendments. As

this has grown, it has taken on flesh—it started with a skeleton. The advisory council has suggested changes. We have found areas that have been awkward. Mind you, we have employees in the 50 States of the United States and the District of Columbia. We have probate problems and so forth. So the result is that the document—the rules and regulations—is now quite complex.

Representative GRIFFITHS. Now, I would like to ask you: on the board of directors, are there any employees of Sears, Roebuck who would make \$5,000 or less?

Mr. O'CONNOR. The Board of Directors of Sears, Roebuck & Co., the New York corporation?

Representative GRIFFITHS. Yes.

Mr. O'CONNOR. There are no employees on the board who will make \$5,000 a year or less.

Representative GRIFFITHS. Are there any employees of Sears on the board?

Mr. O'CONNOR. There are employees of Sears on the board.

Representative GRIFFITHS. Who are those employees, and what is their position?

Mr. O'CONNOR. Mr. Austin T. Cushman is chairman of the board of directors. He is the chief executive officer of the company.

Crowdus Baker is a director of Sears and he is the president of the company.

Howard A. Benthin is a vice president and comptroller of Sears.

Calvin Fentress, Jr., is the chairman of the finance committee, and former chairman of the board of the Allstate Insurance Co., which is a wholly owned subsidiary of Sears, Roebuck. Judson B. Branch, present chairman of the board of Allstate Insurance Co.

Gordon M. Metcalf—he is the vice president of the midwestern territory; that is, the area that involves Wisconsin, Minnesota, as far west as Montana, Illinois.

Charles Meyer, Lucien Oliver, Wallace Tudor.

Representative GRIFFITHS. What is his position?

Mr. O'CONNOR. Vice president, personnel.

And Arthur M. Wood, who is the vice president of the Far West territory—that is, the west coast and Hawaii.

Representative GRIFFITHS. When the employees vote this stock for the directors, are they required to vote for 12 directors or can they pool those votes?

Mr. O'CONNOR. They can cumulate them and frequently do, or they can vote for anyone else if they do not wish to vote for the persons nominated.

This is off the record.

(Discussion off the record.)

Representative GRIFFITHS. Back on the record.

If they actually cumulated their votes, if every employee owning stock were suddenly to vote for somebody at a less than \$10,000 salary, would they have sufficient votes to elect a director?

Mr. O'CONNOR. Unequivocally, yes.

Representative GRIFFITHS. Proceed.

Mr. O'CONNOR. In fact, I think the last time I was before you, that question came up also, and they can elect a good portion of the board.

Representative GRIFFITHS. How close have they ever come?

Mr. O'CONNOR. Well, I cannot give you the exact totals, but I can indicate to you on the tally of the annual meeting of May 1965, 149,000 shares were voted against the management slate.

Representative GRIFFITHS. Thank you.

If you had 149,000 against, how many votes did the people of the slate have to win?

Mr. O'CONNOR. The employees who voted 30,118,788 shares for the slate against the 149,128 shares that I just indicated to you. The potential of the whole corporation is 153 million shares. We have 153 million shares of stock outstanding.

Representative GRIFFITHS. How many shares were voted?

Mr. O'CONNOR. At our annual meetings about 84 to 85 percent of 153 million shares owned by all shareholders are represented.

Representative GRIFFITHS. I do not see how 30 million votes, then, would ever elect anybody.

Mr. O'CONNOR. On cumulative voting, each share is worth 24 votes.

Representative GRIFFITHS. So it is 24 times 30 million?

Mr. O'CONNOR. Yes. This is a very able vehicle.

Representative GRIFFITHS. That could do it, all right. In fact, they might, under certain circumstances, elect two or three?

Mr. O'CONNOR. Yes. I tried to indicate that in my statement a little earlier. They can.

Representative GRIFFITHS. Well, they cannot come close if 149,000 is all they have so far.

Mr. O'CONNOR. Maybe they are satisfied.

Representative GRIFFITHS. Maybe they do not know. There are two interpretations. Maybe they are satisfied, but maybe they just do not know. You may not have a politician among them.

Proceed.

Mr. O'CONNOR. While we are indulging in dialectics, have you ever talked to a very sophisticated lawyer in reference to vote accumulation? It is like talking to a person who is developing a syllogism in the Aquinian fashion. You usually find out that he is possibly more confused than the interrogator.

But be that as it may, it is a recognized corporate vehicle of cumulating votes. It can be done, it has been done, and it will be done in the future, over and over again.

Representative GRIFFITHS. You talk to pretty ordinary politicians and they will be able to figure out how to get these votes in.

Mr. O'CONNOR. Politicians are very intelligent people. I indicated to you that the rules provide for five to nine trustees and at the present time we have nine trustees for the fund.

The board of trustees determines the policies of the fund and oversees their implementation. They meet approximately every other month and may hold additional meetings as the necessity arises. They have responsibility for the fund's investment program and they specifically consider the fund's investment policies and results at every meeting.

The board of trustees also is authorized to appoint an investment committee whose members hold office at the pleasure of the trustees. At the present time, this committee consists of five persons and meets regularly every month. The investment committee decides—within the requirements of the rules and regulations and under the general

supervision of the board of trustees—what the investment program of the fund will be. Also, representatives of the committee meet with the board of trustees each time the trustees meet.

The board of trustees elects an executive director, a secretary, and a treasurer of the fund. The executive director is responsible for the day-to-day operations of the fund. This includes processing new member applications, keeping records of all employees' accounts, processing applications for withdrawal, and answering questions directed to him by the members.

The advisory council which I mentioned a moment ago presently consists of 26 members. The members are nonexecutive employees who represent the various divisions of the company. They are elected by their fellow employees and meet at least twice a year with the board of trustees and the investment committee.

Each of these meetings runs for 2 days and the council is thoroughly briefed on all phases of the fund's operations. The council reflects the thinking, attitude, and wishes of fund members, and conveys their questions and suggestions to the trustees. They will meet on the 16th of May of this year in Chicago and I brought with me a copy of the directory of the advisory council. I have only one copy with me unfortunately.

Representative GRIFFITHS. That is quite all right. We do not need that for the record. You may continue.

Mr. O'CONNOR. There are other employee benefit plans.

Sears has a number of employee benefit plans in addition to the profit-sharing fund. These include illness allowance, since 1902; employee discounts, since 1907; paid vacations, since 1907; military service allowances, since 1917; group life insurance, since 1931; paid holidays, since 1932; severance allowance, since 1933; general hospitalization insurance, since 1939; health catastrophe insurance, since 1952; and travel accident insurance, since 1957.

In addition to these other benefits, Sears also has a supplemental pension plan which was established in 1944. This plan covers earnings in excess of \$10,000 per year. This plan is "integrated" with profit sharing and social security so that benefits under the pension plan cannot be greater, as a percentage of compensation, than benefits under the profit sharing fund and social security.

Representative GRIFFITHS. What do you mean, cannot be greater as a percentage of compensation? For anyone who drew \$122,000 who was making only six, I would presume that is quite a percentage of compensation. Do you mean this pension plan would pay off in that same way?

Mr. O'CONNOR. No. In fact, it has a ceiling of \$35,000. That is the most you can get out of the pension plan.

But understand that in order to get a pension, you cannot get more than what you are getting out of profit sharing, and social security. You have to integrate back. So even though you are a high-salaried executive, with a short term of office in the company, you would get very little money in the pension plan because your benefits from the profit sharing plan would be so low, that in your integration you would come out with very little money.

Representative GRIFFITHS. How much money is there in the pension fund?

Mr. O'CONNOR. Around \$95 million.

Representative GRIFFITHS. Where is the pension fund investing its money?

Mr. O'CONNOR. The pension fund is controlled by the Continental Illinois National Bank & Trust Co. of Chicago. The funds are invested in the type of "balanced portfolio" usually utilized by trusts and banks in the United States.

Representative GRIFFITHS. What does it make annually, percentage-wise?

Mr. O'CONNOR. About 3.5 in earnings, not including any appreciation in the assets.

Representative GRIFFITHS. What is the percentage growth of the profit sharing plan annually?

Mr. O'CONNOR. On our general investments, earnings about the same, 3.5, not including appreciation.

Representative GRIFFITHS. Who is entitled to draw the pensions?

Mr. O'CONNOR. Anyone who earns more than \$10,000 a year.

Representative GRIFFITHS. How long before the pensions vest?

Mr. O'CONNOR. At age 55.

Representative GRIFFITHS. How many years of work?

Mr. O'CONNOR. You have to be 30 years of age to join the fund and you vest at age 55.

Representative GRIFFITHS. Could you enter at 40 and still have a vested right at 55, or do you have to be there from 30 to 55?

Mr. O'CONNOR. You have to have 20 years of service to vest at age 55.

Representative GRIFFITHS. Twenty years of service and be 55?

Mr. O'CONNOR. Yes. However, you would be completely vested regardless of your length of service at age 60, and you could start receiving your pension at that time.

Now, to be eligible for the pension plan an employee must be with the company at least 1 full year and have attained age 30. The pension plan is noncontributory, and an employee's right to a pension does not vest until he reaches age 55. As of the close of 1965, the pension plan had about 7,600 members as compared to about 172,000 in profits sharing.

In conclusion, let me just briefly review some of the points I have touched upon here.

Our profit sharing fund is open to all Sears employees who have completed 1 year of service. Membership in the fund is voluntary.

A member's account becomes fully vested after he has been with the company 5 years, and members who are vested may vote the stock which is credited to their accounts.

The fund keeps all its members well informed about the status of their accounts. It also allows members to make partial withdrawals for a number of different reasons. And when a member does retire or leave the company for any reason after he has been employed for 5 years he takes with him the entire balance in his account.

I already told you that Sears has contributed a total of \$870 million to the fund. In addition, the members have contributed over \$575 million making a grand total of \$1,445 million. I also mentioned that the fund had assets totaling \$2,650 million as of the end of last year—assets being held in trust for its members.

What I haven't told you is the total value of the assets which already have been paid out by the fund in benefits to its members.

This figure is \$1,800 million—actually \$355 million more than the combined total contributions to the fund of both the members and the company over the past 50 years. Yet the fund today still is valued at more than \$2,650 million.

The fund stands on a record of discharging its fiduciary capacity in a most meticulous way. We are proud of its tradition of providing for the retirement security of so many Sears employees.

Representative GRIFFITHS. How many people do Sears and its subsidiaries employ?

Mr. O'CONNOR. We have a total employment of well over 250,000 workers.

The next question that you should tender, I suspect, is what is the difference between 172,000 and 250,000. The merchantile business, Madam Chairman, has become more acutely a service business. We find now that in order to compete, we have to be open—in many areas—12 hours a day, and also 6 days a week. Some of our competitors, incidentally, are also open on Sunday. We are not. But in order to stretch out the hours we have had to go into the communities where we are operating and we have had to solicit the aid of the housewife for the early morning hours, when she has the children off to school and can get back for luncheon. So we do have an ever-increasing number of extra employees. College students—at Christmas, our warehouses, our catalog order plants, are loaded with college boys and girls.

Representative GRIFFITHS. These people probably do not participate in the fund?

Mr. O'CONNOR. They do not. Their hours are irregular, and, frankly, it is a two-way street. They are being of service to us, I admit, but they work for us 15 hours a week, 12 hours a week, as much as they can spare.

Representative GRIFFITHS. If I were a participator in the fund, I would want all those people to have membership. I would assume that I would get more money.

I would like to ask you, have you ever made any estimate of what it would cost Sears, Roebuck to borrow that \$1,445 million through the years, or raise it otherwise?

Mr. O'CONNOR. No, I have not.

Representative GRIFFITHS. What is Sears' stock paying right now?

Mr. O'CONNOR. Sears' stock is paying about 2 percent on the present market.

Representative GRIFFITHS. What is the reason for this? It seems rather low.

Mr. O'CONNOR. Well, we do not control the marketplace. We are paying a dividend commensurate with our profits. Mind you, from the profits that I was talking about from which we pay our employees, we also pay a dividend and we still keep in the company a considerable amount of money. In this past year, we have spent \$200 million in building new stores, extending ourselves, and every time we spend \$1, the stock of the employees in the profit-sharing plan and of our other stockholders becomes that much more valuable.

Representative GRIFFITHS. Why do you have a maximum participation of the fund in profits? Why did you put on the ceiling?



Mr. O'CONNOR. Well, I think that this is quite logical. When the fund first started out, the percentage taken from the profits was much lower, and as the company progressed and got larger and generated more profits, they continued to increase the percentages. So it inched up until about 10 or 15 years ago—maybe 15 years ago—to 10 percent. Now it is at 10. We feel that this is an equitable division from a moral standpoint between the employees who are definitely contributing to the success of this business and the shareholders who are equally essential for us to open our doors.

You have to remember this, Madam Chairman, that we would not be here if we did not induce risk capital to come into our business originally. The shareholders who came in and invested the equity are very important.

Representative GRIFFITHS. In 1916, who owned Sears?

Mr. O'CONNOR. A multitude of shareholders. We were registered at that time, or listed, on the New York Stock Exchange, I do not know how many shareholders, but there would be a considerable number.

Representative GRIFFITHS. What was the stock paying then?

Mr. O'CONNOR. I do not know but I can get the information for you.

Representative GRIFFITHS. All right. What I would like to know is, once the plan went into effect, did the payment on the stock go up or down? Did the stock make more money or less?

Mr. O'CONNOR. You mean on the dividend?

Representative GRIFFITHS. Yes.

Mr. O'CONNOR. I would say that it made quite a bit—also, I think it had an increase in dividends. But here I am speculating. I do not know. I shall get it for you. I am annoyed that I do not have it with me.

(Information later supplied follows:)

Year:	<i>Dividend on Sears stock</i>	<i>Dividend per share</i>
1916.....		\$7.00
1917.....		7.75
1918.....		8.00

It should be noted that the corresponding annual dividend on a share of Sears stock held in 1916, taking into account stock splits and stock dividends since that date, would currently be in excess of \$222.

Representative GRIFFITHS. Of course, in 1916, when this plan went into effect, there were very light income taxes anyhow; is that not right?

So really taxation was not a consideration.

Mr. O'CONNOR. No. If you were to go back, we believed at that time, and we believe in 1966, that profit sharing is a vehicle for involving people in our business. Now, there are a number of criticisms that can be leveled at us. For instance, you should look in a stern way and say, "Mr. O'Connor, do you mean to tell me that you invest all of this money into Sears stock, and are you not placing these people in a dangerous position?"

The answer to that is that these people are owners of the business. From a sociological and economic standpoint, we have no hostility to a farmer who has all of his money in his farm or a small business entrepreneur who owns a hardware store.

Now, what is so different between that and a person who can actually control the profits of the business?

And you might say, "Tut, tut, tut, what were your sales last year, \$6,400 million?"

But you must remember that the mercantile business does not have the sophistication of automation, of other industrial pursuits. Only a few days ago, I was looking at the number of man-hours required to produce a barrel of petroleum in 1868, the day of the discovery, down to the present time, and this has gone lower and lower.

In merchandising it is entirely different. We have to have the procurers, the people who go out to procure the merchandise; this is a very personal situation.

And besides that, we have to have the people who deliver and display it and the salespeople. All of these people can control our profits.

Representative GRIFFITHS. Now, Mr. O'Connor, I am not going to say, tut, tut, tut, at all, because of course, these people do not own the business. That is ridiculous. They really do not have a voice in this business. These people have a feeling, and a correct feeling, that if Sears sells a lot and makes a lot of money, they are going to get something more out of it; undoubtedly. But if they really had a voice, they would take that maximum off. It seems to me there are a lot of things these people could do to help themselves to a better sharing in the profits.

Furthermore, I am wondering how has Montgomery Ward competed against this tax-free money all these years?

Mr. O'CONNOR. How do you mean, tax-free money?

Representative GRIFFITHS. Look at the money you have taken from these employees and that you have set aside, tax free, on your own. It seems to me that this would be part of the problem, would it not?

Mr. O'CONNOR. Are you talking about the members' deposits?

Representative GRIFFITHS. Yes.

Mr. O'CONNOR. You understand that that has never gone into the business?

Representative GRIFFITHS. Well, what do you do with it?

Mr. O'CONNOR. We have purchased stock.

Representative GRIFFITHS. What stock?

Mr. O'CONNOR. Sears stock, on the open market.

Representative GRIFFITHS. What do you mean, it has not gone into the business? If you have purchased stock with it, it has gone into the business, has it not?

Mr. O'CONNOR. But it is purchased on the marketplace.

Representative GRIFFITHS. It is in the business.

Mr. O'CONNOR. No, it is not.

I really should not say that; my apologies, Madam Chairman.

The only time you generate an equity contribution to a corporate entity is in an initial issue of the stock.

Representative GRIFFITHS. How much stock have you issued in the years since this plan began?

Mr. O'CONNOR. Right now, 153 million shares.

Representative GRIFFITHS. I would think that one of the questions you would have to answer is have you not really played the employees off against the shareholders?

Mr. O'CONNOR. No, on the contrary.

Representative GRIFFITHS. You have been careful to see to it that the employees really do not have control. They have no voice in it.

Mr. O'CONNOR. It is only a legal fiction. The people who own the corporation are the shareholders.

Representative GRIFFITHS. And you showed me and I figured out how we were going to cast all these votes and how much trouble it would be to get some directors from these people who presumably own it. But they do not really own it. They own 23 percent of the stock, do they not?

Mr. O'CONNOR. That is a very satisfactory ownership in the corporate entity.

Representative GRIFFITHS. Only if they are organized. Twenty-three percent of the stock distributed among—how many people; 200,000 people?

Mr. O'CONNOR. No; 173,000.

Representative GRIFFITHS. The same thing.

Mr. O'CONNOR. May I just bring you back to one other point? You did ask me how much stock was outstanding, and I told you 153 million shares. And I did supply you with a balance sheet, the current balance sheet, that has just been uttered. We generated out of that 153 million shares, \$228,775,412.

We also have a capital in excess of par value of \$108 million.

Now, this is all the money that we have ever been able to generate in reference to our shares. The shares of stock in the profit-sharing plan have been bought in the marketplace many, many, many years, after we got this money into the business. We have never used—do not confuse this, Madam Chairman—we have never used this money. In fact, the plan provides that we have no control over this as far as using it in the business.

And as far as competing with Montgomery Ward is concerned, we compete with Montgomery Ward and the rest of our competitors in the marketplace.

Representative GRIFFITHS. What is the average wage paid in Sears?

Mr. O'CONNOR. Around \$6,000 a year.

Representative GRIFFITHS. What is the average education?

Mr. O'CONNOR. I am not in a position to answer that.

Representative GRIFFITHS. What does a salesperson make in Sears?

Mr. O'CONNOR. I could not answer that. I could supply you with the information. It would vary geographically.

Representative GRIFFITHS. What is the average wage for people who are not part of the administration—not executive personnel? What is the average wage?

Mr. O'CONNOR. \$6,000 is the average.

Representative GRIFFITHS. \$6,000 is the average. Does that average not include the executives?

Mr. O'CONNOR. Surely; it would be right across the board.

Representative GRIFFITHS. What I would like to know is what is the average wage of those who are not in the executive group.

Mr. O'CONNOR. We will see what we can get for you.

(The information referred to, supplied later, follows:)

The average annual compensation of fund members in the nonexecutive group in 1965 was approximately \$5,500.

Representative GRIFFITHS. Does the plan hold stock just in Sears or does it hold stock in your subsidiaries?

Mr. O'CONNOR. The only such investments that the fund has, as is shown in the prospectus that is uttered each year, is \$490,000 in first mortgage bonds of Simpson's Sears, Ltd. That is our 50-percent-owned Canadian subsidiary. It also owns \$10,372,000 of first mortgages on buildings or stores in Canada and \$1,212,000 in first mortgages on real property of Universal Rundle Corp., a domestic affiliate of Sears. These investments were made many years ago. The interest rate was attractive at the time when these investments were made.

Representative GRIFFITHS. Did the employees vote it?

Mr. O'CONNOR. It is the fund's money.

Representative GRIFFITHS. The employees put it in?

Mr. O'CONNOR. They put in the amount that I told you in my presentation.

Representative GRIFFITHS. What is the average amount of stock withdrawn by a person retiring from Sears?

Mr. O'CONNOR. The average amount of stock—in the examples that I gave you—I gave you two.

Representative GRIFFITHS. Yes; you gave me some at so many years and this and that. But you must have people who retire at less than that.

Mr. O'CONNOR. Twenty to twenty-four years—this is the one I gave you.

Representative GRIFFITHS. Do you have to be there 20 years?

Mr. O'CONNOR. No. Five years.

Representative GRIFFITHS. All right, 5 years. Averaging it all, what is the average amount of stock an employee takes out on retirement?

Mr. O'CONNOR. In 1965, the average value of a retiree's account who had 5 to 9 years of service, \$5,577.

Representative GRIFFITHS. How many people retired with that?

Mr. O'CONNOR. 113.

Between 10 and 14 years of service, they would retire with an average account of \$13,833.

Representative GRIFFITHS. How many people retired with that?

Mr. O'CONNOR. 414.

Between 15 and 19 years of service, 467 employees, an average of \$37,336.

Between 20 and 24 years, 316 employees, an average of \$68,415.

Twenty-five to twenty-nine, 192, an average of \$142,229.

Now, I also have the retirees' deposits, what they deposited.

Representative GRIFFITHS. All right, what have they deposited?

Mr. O'CONNOR. Well, for the 5- to 9-year retirees, there were 113; they deposited an average of \$1,453.

Representative GRIFFITHS. They could have deposited 500 times 9, could they not, or \$4,500 in 9 years?

Mr. O'CONNOR. Yes.

Representative GRIFFITHS. But they deposited \$1,400?

Mr. O'CONNOR. \$1,453, yes.

Representative GRIFFITHS. All right, go on.

Mr. O'CONNOR. Ten to fourteen years, 414, \$2,246.

The 15 to 19, \$3,402; and the 20 to 24, \$4,202; 25 to 29, \$5,942.

Representative GRIFFITHS. With a \$5,942 deposit, what was the draw?

Mr. O'CONNOR. \$142,229.

Representative GRIFFITHS. On which they paid capital gains tax, right?

Mr. O'CONNOR. They paid capital gains on the cash withdrawn—

Representative GRIFFITHS. And they paid income tax on the \$5,942?

Mr. O'CONNOR. And the average cost to the fund of the Sears stock that they took out less their own deposits which were taxed to them when they were made. They did not pay capital gains on the unrealized appreciation.

Representative GRIFFITHS. What was the average taxpayment?

Mr. O'CONNOR. The average taxpayment? I could figure that for you.

Representative GRIFFITHS. Will you figure it for us and supply it for the record?

Mr. O'CONNOR. Surely. We certainly will.

Representative GRIFFITHS. Offhand, what would you assume it was, approximately?

Mr. O'CONNOR. In our last presentation to you before the Ways and Means Committee in 1963, we had figures that were generated for that year. We utilized an example of a total value of the account of \$141,289. We also indicated that the total of the employee's annual deposits were \$11,922 and the appreciation in the Sears stock totaled \$63,314. The distribution resulted in a tax of \$12,851.

Representative GRIFFITHS. Thank you very much.

How many profit sharing plans do you have?

Mr. O'CONNOR. We have only one profit-sharing plan. There are no profit-sharing plans in any wholly owned domestic subsidiaries.

Representative GRIFFITHS. I see.

How many employees retiring in recent years have taken the annuity option?

Mr. O'CONNOR. I can supply it.

(The information referred to, furnished later, follows:)

Annuities were purchased at the request of retirees or employes approaching retirement during the past 5 years, as follows:

Year:	<i>Number of annuities purchased</i>
1965.....	116
1964.....	144
1963.....	106
1962.....	81
1961.....	41
Total.....	488

The purchasing annuity generally represents only a portion of an employee's interest in the fund.

Representative GRIFFITHS. What is the average pension paid on retirement for those who qualify for the pension fund?

Mr. O'CONNOR. \$230.76.

Representative GRIFFITHS. A month?

Mr. O'CONNOR. A month, yes.

Representative GRIFFITHS. The staff is interested in knowing if you have the information on how many profit-sharing plans there are in existence? Do you have any idea?

Mr. O'CONNOR. It is estimated that there are between 30,000 and 40,000 plans in existence.

Representative GRIFFITHS. As a matter of fact, is not this one of the few really successful ones?

Mr. O'CONNOR. I am not in a position to answer that.

Representative GRIFFITHS. This one is a successful one. It has worked well?

Mr. O'CONNOR. We have worked on it.

Representative GRIFFITHS. And it has worked well?

Mr. O'CONNOR. When I say we have worked on it, I mean the fund has worked very hard on it, Madam Chairman.

Representative GRIFFITHS. I want to thank you very much for being here. You were very kind in giving us this information and we are very, very grateful.

Mr. O'CONNOR. I do not know about your time.

Representative GRIFFITHS. Would you like to sell something for Sears?

Mr. O'CONNOR. No, on the contrary; I have avoided the two items of correspondence and I would like to face up to them.

The first is the lady who wrote in who indicated that her husband had died and that he was 53 years of age. In the *voir dire* that we have just presented to you, Madam Chairman, we have indicated that you do not vest in the supplemental plan until age 55 and this man died before age 55, and the result is he was not eligible for a pension. But he did get—he got his group insurance, he got his profit-sharing, he got all of the other emoluments that the company offers. The only thing that I can say is that it is unfortunate.

Representative GRIFFITHS. Yes, that is true.

Mr. O'CONNOR. Would you refresh my recollection with reference to the other communication?

Representative GRIFFITHS. Let me see, this person needed money when his mother died—she was ill for some time and he drew some, and then she died, and he wanted to draw more and you would not permit him.

Mr. O'CONNOR. Yes.

Representative GRIFFITHS. There must be some type of regulation.

Mr. O'CONNOR. As I told you in the *voir dire*, the employee has the right of withdrawal. I do not know what the condition of the letter writer's account was, if there was anything left. However, generally illness is one of the reasons for which he can make a partial withdrawal. And I would like to indicate that he could completely withdraw all the money, for that matter.

Representative GRIFFITHS. Does the fund own any stock in the General Land Development Corp.?

Mr. O'CONNOR. No, we do not, nor do we own any property that might emanate from that corporate entity.

Representative GRIFFITHS. Thank you very much.

It is very kind of you to come.

We are in recess until 2 p.m.

(Thereupon, at 11:15 a.m., the hearing recessed until 2 p.m. of the same day.)

#### AFTERNOON SESSION

Representative GRIFFITHS. I would like to express my appreciation, gentlemen, for your coming here today to tell us about the Boeing pension plan. If there are no objections from you people, we will begin.

Mr. Blaker, have you a statement that you would like to present?

Mr. BLAKER. I have, Madam Chairman.

Representative GRIFFITHS. You may proceed, if that is all right with you.

#### TESTIMONY OF A. H. BLAKER, ASSISTANT TREASURER, HEAD-QUARTERS OFFICES, THE BOEING CO., SEATTLE, WASH., AND ALBERT S. EPSTEIN, ASSOCIATE DIRECTOR OF RESEARCH, INTERNATIONAL ASSOCIATION OF MACHINISTS & AEROSPACE WORKERS, AFL-CIO

##### STATEMENT OF A. H. BLAKER

Mr. BLAKER. My name is A. H. Blaker, assistant treasurer, headquarters offices, the Boeing Co., Seattle, Wash. Administration of pension, savings plans, and employee group insurance are among the functions reporting to my office. Your prime interest is in pension plans so I shall refer only briefly to other elements of the employee fringe benefit package.

The Boeing Co. has four pension plans of which three are peculiar to our Vertol Division, all having been in existence in 1960 when Vertol was acquired. A contributory plan covers the approximate 125 employees of a Canadian subsidiary. There is a contributory plan for the Philadelphia area salaried staff over age 55. This covers approximately 100 employees and again is a reminder of former administration.

The third plan peculiar to the Vertol division is a noncontributory plan for hourly rated employees in the Philadelphia area represented by United Auto Workers. There are approximately 5,000 employees in this category. This is a standard UAW plan.

All other employees at company locations, both hourly rated and salaried, are covered by the noncontributory Boeing employee retirement plan. Approximately 100,000 employees are eligible. The balance of my remarks will be addressed to the latter plan as applying to the vast majority of Boeing employees.

The Boeing Co. may have been one of the last major employers to install a pension program. The Boeing employee retirement plan was effective January 1, 1955, although it had been in preparation more than 5 years prior thereto. This plan, developed to meet our specific requirements, is of particular interest because it incorporates the variable benefit principle, possibly the first major industrial plan

to do so. It likewise, today, probably is the largest industrial plan incorporating this feature.

As an indication of size, the trust associated with our plan had assets totaling \$253,800,000 on December 31, 1965. Estimated funding for 1966 will be \$33,500,000 and when requirements for the three plans at the Vertol division are added, total company pension costs for 1966 will exceed \$35 million. Adding company contribution to the voluntary savings plan and to the various group insurance programs available to employees, the company's 1966 outlay will approach \$75 million.

I shall simplify the explanation of the retirement plan by omitting details of how employee service prior to 1955 was recognized and of plan changes incorporated since inception.

Service subsequent to January 1, 1955, is recognized both by length of tenure with the company and by base wage or salary. The basic benefit provides a monthly income of \$4.25 for each year of credited service. You recognize this as a conventional benefit based on service with the company. This basic benefit is supplemented by a monthly income of one-twelfth of 1½ percent of wage or salary in excess of the social security maximum. This is the variable benefit. In 1965, when the social security maximum was \$4,800, approximately 95 percent of eligible employees participated in the supplemental—variable—benefit. With the change to \$6,600 maximum social security, we estimate that approximately 75 percent of eligible employees will participate in this supplementary benefit.

The term "credited service" has been used. Participation requires 3 years of company employment and attainment of age 30. Credited service can be accrued to normal retirement date, age 65, so that maximum credited service is 35 years.

Let me next discuss the vesting provision, which is relatively liberal among industrial plans. At the completion of 5 years of credited service, the employee is vested in 45 percent of his accumulation. This increases 15 percent each year until, at the end of the ninth year, the employee is fully vested.

The Boeing employee retirement plan originally was targeted to provide a retirement income, including social security, of approximately 50 percent of wage or salary for the long-service employee. Because of changes in social security and integration of the supplemental future service portion of the plan, it now tends to favor the lower wage or salary employee. To state it differently the lower salaried clerk will, on normal retirement, receive a larger percentage of income than will the supervisor, assuming the same period of service for each.

A brief explanation of the concept behind the Boeing plan should be helpful. The basic benefit (\$4.25 monthly income per year of credited service) is strictly conventional. For 35 years of service it provides \$148.75 per month of income. On the other hand, the supplemental benefit is the variable portion and is based upon the actual benefit accrual each year measured by salary or wage in excess of the social security maximum. This is funded to a separate account where fluctuations in the value of trust assets accrue to the participants. For example, the value of the unit now is \$1.392 versus a nominal value of \$1. Intent, of course, is to have retirement income compensate for changes in the cost of living. To this date, it has treated our retired employees as anticipated.



You will have observed that this one pension plan covers both hourly rated, salaried, and supervisory employees. In negotiating benefits under the plan we of course deal with a number of separate bargaining units. To this time there has been no problem.

Administration is by a retirement committee, appointed by the board of directors. All members of the committee are officers of the company. There have been no problems with this type of administration, partly because the plan as originally written was very detailed in its provisions and requires or permits little in the way of interpretation. The main function of the committee seems to be approval of early retirements and funding requirements. The committee has established guidelines for early retirements and delegated to the secretary approval of requests which meet established criteria. Nine out of ten requests that reach the retirement office are so approved. And, parenthetically, I might add that in discussion with the retirement office, they tell me that I could well have said 99 out of 100, instead of 9 out of 10.

Representative GRIFFITHS. If you are not approved, to whom do you appeal?

Mr. BLAKER. There is no appeal from the retirement committee.

Representative GRIFFITHS. Are there any legal rights? Could you institute a case or suit in court?

Mr. BLAKER. I think not.

Representative GRIFFITHS. With a vested plan, you could not institute a case?

Mr. BLAKER. The employee retains his vesting. We are talking now of early retirement. The employee could then have vesting, but he would get his retirement income at age 65.

Representative GRIFFITHS. I see. Thank you.

Mr. BLAKER. I should like briefly to mention the controls which have been established for the protection of the retirement office, the company, and the employees. Obviously, a plan which has 100,000 eligible participants is beyond the scope of hand operation. Reliance must be placed on data processing procedures for maintenance of records, determination of funding requirements, and payment of benefits. Data processing tests have been developed by the actuary and are applied by the retirement office to provide assurance that results obtained from data processing are within established parameters.

The company's internal audit staff periodically audits the operations of the retirement office. This is a detailed type of audit, investigating among other things the accuracy of benefit accruals and payment to retired individuals. Their report typically covers 10 or 12 typewritten pages. An audit of the retirement office is presently in process.

Because the Boeing Co. is heavily involved in military and NASA activities, our funding and distribution of costs are subject to review by the Department of Defense.

We use an outside actuary for the development of machine procedures and determination of plan costs. The memorandum prepared by Coates, Herfurth & England, for use in connection with the company's tax return to Internal Revenue Service requires a substantial review on their part of actual operations.

The company's outside auditor, Touche, Ross, Bailey & Smart, annually reviews assets of the trust and office operations and provides appropriate certification to the board of directors and stockholders.

Our retirement plan is somewhat unique in calling for a 5-year review of actuarial assumptions. Two such reviews have been completed, the most recent in 1965, which led to a change of withdrawal rates, salary scale, and a reduction in the assumed retirement ages.

Representative GRIFFITHS. What was it before 1965 on each one of them and what afterwards?

Mr. BLAKER. The withdrawal rate, the new withdrawal rate, shows an increase in the terminations, withdrawal being termination from the employment of the company. The withdrawal rate was increased. Salary scale, we found that our salaries were growing faster than had been anticipated, so the salary scale was increased. We had assumed that people on the average would be retired at age 66. We find that they are retiring nearer to age 65, so we brought the assumed retirement age down to age 65.

Representative GRIFFITHS. What did the change in the withdrawal rates do to the funds?

Mr. BLAKER. Changes in withdrawal rates such as we instituted reduced the company's contribution, because you are assuming that more people leave before they are fully vested.

Representative GRIFFITHS. So that you reduced the total contribution?

Mr. BLAKER. Yes; but changes in other assumptions increased total funding—

Representative GRIFFITHS. It is the first time we have had anybody who reduced anything.

You may proceed.

Mr. BLAKER. Three years ago we desired to have an independent actuarial study of the validity of assumptions employed and the firm of Milliman & Robertson was retained for the purpose. Using entirely different programming, Milliman & Robertson reported that the assumptions used were sound, that the machine programs employed were adequate and produced satisfactory results.

The most recent step taken was to employ an investment counseling firm to advise the company as to results obtained by the trustee. The purpose, obviously, was to obtain a measurement of trust performance by comparison with other trusts of the same general nature.

The foregoing audits, reviews, and tests are all designed for the purpose of providing assurance that the large sums of money involved in providing pensions for employees are properly handled. These are summarized annually by a written report of the retirement committee and of the investment policy committee to the board of directors. These written reports are supplemented by a visual presentation to the board covering pensions, savings, group insurance, and security plans, and I have that to look forward to at the next board meeting.

As a final comment I point out that pensions are only one element, although a very costly one, in a total employee benefit package.

Representative GRIFFITHS. What is the cost of the fringe benefits to Boeing?

Mr. BLAKER. Our cost of fringe benefits?

Representative GRIFFITHS. As a percentage of payroll.

Mr. BLAKER. I will say 25 percent. I may be a percentage point off one way or another. Funds used to provide pensions for retired employees bear a relationship to moneys which provide benefits for the active staff. It is appropriate, therefore, to remember that pension benefits are related to the total fringe benefit package which may include savings, profit sharing, life and medical insurance, vacations, holidays, and several other elements.

As you know, present tax laws, discourage contributory pension plans because the employees' contribution is on an after-tax basis. Pension plans could be substantially improved if the employee could contribute on a pretax basis comparable to the consideration given to employer contributions. Such tax concessions would require the "locking-in" of the employees' money comparable to the philosophy applied to the employers' contribution. This well could be the most efficient way of increasing the level of benefits provided on privately supported pension plans.

Representative GRIFFITHS. I would like to thank you for your suggestions.

As a matter of fact, are not the machinists the only union that ever did at any time support a contributory plan? Did you not at one time believe that a contributory plan would be a better plan?

Mr. EPSTEIN. Well, I do not think we took a definite position. But some people have favored or thought that a contributory pension plan would be desirable. In Canada, as you know, the tax regulations permit the deduction of individual contributions to pension plans.

Representative GRIFFITHS. Maybe we could take care of professional people by this means.

What percentage of Boeing's business is with the Defense Department or NASA?

Mr. BLAKER. Approximately 35 percent, Madam Chairman.

Representative GRIFFITHS. Did Vertol have a pension plan when it was acquired?

Mr. BLAKER. Vertol had three different pension plans when it was acquired.

Representative GRIFFITHS. Did you set those pension plans up with your own? Did you mix them with your own, commingle the moneys, or did you keep them separately?

Mr. BLAKER. We did not.

Representative GRIFFITHS. In the case of any of these companies that you have bought, did you assimilate their pension plans into your pension plan?

Mr. BLAKER. We have purchased only Vertol. We have acquired only Vertol, and the salaried people at Vertol who are under age 55 are now in the Boeing retirement plan, just as I am and just as are my associates in Seattle or Wichita, or down at the cape.

Representative GRIFFITHS. Did they have a pension plan previously?

Mr. BLAKER. They had a contributory pension plan.

Representative GRIFFITHS. Was the money from that contributory plan transferred into Boeing?

Mr. BLAKER. It was not.

Representative GRIFFITHS. How did you handle the plan?

Mr. BLAKER. That being a contributory plan, all of the funds remained to the credit of those individuals. It could not come back to the company under regulations unless the employee voluntarily withdrew his own contribution.

Representative GRIFFITHS. I see.

Mr. BLAKER. So that those people—a person who was, for instance, 35 years old, will have when he gets to be 65 a pension from the old contributory Vertol plan, plus the pension from the noncontributory Boeing employee retirement plan. He will be getting two checks. The company did not derive any benefit.

Representative GRIFFITHS. How long did it take you to acquire this \$253 million?

Mr. BLAKER. Our first funding was in 1955, so that that took 11 years through 1965.

Representative GRIFFITHS. How much are you paying out annually?

Mr. BLAKER. Our estimate for this year is \$1,250,000 versus the \$33.5 million that will be paid into the trust.

Representative GRIFFITHS. And what are the earnings on this fund?

Mr. BLAKER. They averaged over this 11-year period fractionally above 6 percent.

Representative GRIFFITHS. What is the fund invested in?

Mr. BLAKER. There is investment in bonds, mortgages and equities. It is approximately 45 percent in fixed income securities, 55 percent in equities. When I quoted 6 percent, I am including the appreciation, the unrealized appreciation on the equities.

Representative GRIFFITHS. How constant is Boeing's rate of employment?

Mr. BLAKER. Like our associates in the aerospace industry, our employment is apt to fluctuate fairly widely.

Representative GRIFFITHS. Is that one of the reasons you have such a large sum in the fund and such a small draw upon it?

Mr. BLAKER. That is one reason. Appreciate also that Boeing is a relatively young company.

Representative GRIFFITHS. With young people in it?

Mr. BLAKER. Yes. We do not go back—

Representative GRIFFITHS. How much money would you have to have in this fund to fund it completely?

Mr. BLAKER. Our current requirements are completely funded. Past service requirements are almost completely funded. We have one more year to go, one more year's contribution for past service requirements and the Boeing funding for past service will have been completed. We will then have only future service.

Representative GRIFFITHS. Well, I have learned at least two things since we have started these hearings. One is that bad times are good times for a pension fund.

Mr. BLAKER. To the extent—because of increased withdrawals.

Representative GRIFFITHS. That is right. Go on.

Mr. BLAKER. May I also comment on that?

With liberal vesting, such as we have, and as I explained, at the end of 9 years' credited service, our employees are fully vested. They begin to vest 45 percent at the end of the fifth year—45 percent, then 60 percent, then 75, then 90 percent, then 100 percent—100 percent at the end of the ninth year. It is true that if real short service employees are the ones who are terminated because of cutback, then there is a chance, there is a probability that certain funds will accrue to the company and can be used to reduce future funding.

But I also explained that in our case, a person needs to be with the company 3 years and attain age 30 before he becomes a participant in

the plan. Therefore, if you assume, and generally this is correct, that it is the real short service younger employee, who may be with us for only a short time—then there is no recovery because there has been no funding for him.

Representative GRIFFITHS. The other thing that I have learned is that we need a new definition of funding. What is your definition of funding?

Mr. BLAKER. I am not an actuary. I make no pretense of being one. But to me, funding for any one year is the amount that needs to be set aside in order that benefits accrued during that period can be paid at some future date when the man gets to normal retirement.

Representative GRIFFITHS. Well, then, I think that we need some public actuaries in this country to look these pension funds over.

Will you give us the number of employees you have had annually for the last 10 years? Can you give it to us now?

Mr. BLAKER. No, that type of data I did not bring.

Representative GRIFFITHS. All right, just supply it. That will be quite all right and the record will show that we want this question answered.

(The material referred to follows:)

THE BOEING CO.

*Number of employees for whom benefits were funded*

Year:	<i>Number</i>
1955.....	40, 775
1956.....	45, 986
1957.....	48, 285
1958.....	50, 553
1959.....	59, 422
1960.....	65, 351
1961.....	65, 748
1962.....	66, 023
1963.....	68, 310
1964.....	72, 778
1965.....	74, 079

Representative GRIFFITHS. Do you have survivor rights in these pensions? Would the widow draw?

Mr. BLAKER. The employee can elect a joint and survivor annuity.

Representative GRIFFITHS. How many women do you employ at Boeing who participate in this fund?

Mr. BLAKER. Our female employment is somewhat under 20 percent, I would say, of the total population.

Representative GRIFFITHS. Do they have the same survivor rights that a man would have?

Mr. BLAKER. Yes, ma'am. If they have a spouse, they could elect to have the spouse receive a survivor benefit.

Representative GRIFFITHS. What about a dependent child for either the man or the wife?

Mr. BLAKER. No, ma'am.

Representative GRIFFITHS. Would you give us the 1965 and pre-1965 withdrawal rates for the record? Will you supply them for the record, please?

Mr. BLAKER. Very well.

(The material referred to, and later supplied follows:)

*Number of terminations in year of age per thousand employees having at least 2 years of service*

All	Male, hourly, payroll code 1		Male, general salary, payroll code 2		Male, Specia-Wea, payroll code 3		Male, technical, payroll code 5		Male, special payroll code 7		Female, all payroll codes	
	New as- sumptions	Old as- sumptions	New as- sumptions	Old as- sumptions	New as- sumptions	Old as- sumptions	New as- sumptions	Old as- sumptions	New as- sumptions	Old as- sumptions	New as- sumptions	Old as- sumptions
20-----	290	163	166	163	166	32	166	32	58	32	316	259
25-----	203	115	136	115	136	29	136	29	46	29	264	200
30-----	130	89	95	89	95	24	95	24	34	24	187	152
35-----	94	72	61	72	61	16	61	16	25	16	126	112
40-----	76	59	42	59	42	13	42	13	18	13	93	85
45-----	64	50	35	50	35	12	35	12	15	12	74	69
50-----	53	42	33	42	33	11	33	11	13	11	62	54
55-----	35	28	26	28	26	8	26	8	12	8	43	31
60-----	0	0	0	0	0	0	0	0	0	0	0	0

Explanation: New assumptions, termination rates to be used 1966 and subsequent. Old assumptions, termination rates used 1960 through 1965.

Representative GRIFFITHS. How is the supplemental benefit computed? On what factors does it depend?

Mr. BLAKER. The supplemental future service is computed on the aggregate attained age, level, contribution method. And that is a technical description of the way the funding is done. I think I can help with the understanding of it.

The person's actual salary is determined for the year 1966. From that is deducted social security maximum, \$6,600. To the residual amount then is applied the necessary computations which will result in his obtaining at retirement an income of one-twelfth of 1½ percent per month.

And in order to determine that, a table is provided in our pension plan, which shows that for males at age 30, as an example, the \$1 of monthly benefit cost \$31.80 down to age 60, for example, where the same \$1 benefit requires a funding of \$102.20.

Representative GRIFFITHS. Does the retirement committee manage the plan funds?

Mr. BLAKER. The retirement committee does not manage the plan funds.

Representative GRIFFITHS. Who does?

Mr. BLAKER. The trustee is First National City Bank, New York. That bank has full responsibility for investments.

Representative GRIFFITHS. Do they collect a fee for doing this?

Mr. BLAKER. They do.

Representative GRIFFITHS. What is the fee?

Mr. BLAKER. Our total costs last year, paid by the company, which includes their fee, and I believe I have their fee separately, expressed as a percentage of funding last year, 1.2 percent. The trustees charges included in that 1.2 percent, \$106,473. That was paid by the company, not charged to the trust.

Representative GRIFFITHS. Are any of the other administration costs paid by the company and not charged to the trust?

Mr. BLAKER. All the administration costs.

Representative GRIFFITHS. Are paid by the company?

Mr. BLAKER. Are paid by the company. Total administration costs for 1965, and I mentioned our report to the board of directors—this is my report to the board of directors—including internal administration, data processing, counseling to retired and retiring employees, audit services, trustees' fees, and actuaries fees, makes a total of \$282,404. That was paid by the company in addition to the funding requirement for this year.

Representative GRIFFITHS. What is the theory of having the company pay the administrative costs of the fund? Is it just simpler? Of course, if you are dealing with the Defense Department, they will permit you to put that in as a cost, so that you are getting something on it for profit.

Mr. BLAKER. It is a cost; yes, an overhead cost.

Representative GRIFFITHS. But if this were an expense to the fund, then, of course, you would not realize anything on it.

Mr. BLAKER. Thinking back 15 years ago, when we were developing this plan, that particular factor did not enter into our consideration. It seemed to us at that time that having the company pay the internal

costs and the cost of the trustee was the cleanest, the easiest way to do it and would protect—would make sure that the funds that were with the trust, with the trustee, were available for payment of employee benefits and not included in the cost of administering the plan.

Representative GRIFFITHS. On what principles are the funds invested and who suggests the investment? Does the bank suggest to you or do you suggest to the bank?

Mr. BLAKER. Neither, Madam Chairman.

Representative GRIFFITHS. All right, what happens?

Mr. BLAKER. The bank has sole investment authority and responsibility.

The trust department of the bank periodically comes to Seattle and meets with the investment policy committee of the board of directors, which not only has some consideration of this plan but a number of other functions as well. They tell us what they are doing, what they propose to do. They neither ask for our approval nor do we suggest. It is merely informative. The investment of trust assets is the sole responsibility of the trustee.

Representative GRIFFITHS. If they started doing something which you knew of your own knowledge was wrong, what could you do about it? Could you stop them?

Mr. BLAKER. Replace the trustee.

Representative GRIFFITHS. What is the position of the Machinists in all of this?

Mr. EPSTEIN. Well, it is not much different. On the question of investment, it depends on whether you use an insurance company or a bank. If you have a bank to invest your funds, you can develop a number of different procedures.

Representative GRIFFITHS. I would like to read some letters here to you which we have received on the space industry. One man writes in and says, "I am an engineer"—and he gives his address—"who works in the aerospace industry, Lockheed Missile & Space Co., Sunnyvale, Calif."

He points out that Lockheed has recently liberalized its pension plan so that employees with 10 years seniority will have retirement rights. Quoting from his letter:

Within the aerospace industry, it is hard to remain with one employer for long periods of time unless one is at higher management levels because of the instability of the industry. As Government contracts shift from one company to another, it follows that the pool of trained engineers follows the contracts, much as, for instance, dam builders move from site to site. When Lockheed employment drops from 30,000 to 20,000, many employees, through no fault of their own, must seek new jobs and the loss of potential retirement benefits is a crime. The idea of delayed benefit rights is to persuade employees to stay, but too often the employee has no chance.

Would you say that is true, that this presents a problem?

Mr. BLAKER. It is a problem, but there is quite a bit of it that is not true.

Representative GRIFFITHS. What is not true about it?

Mr. BLAKER. I take exception to the last statement; I take personal exception to the last statement that pension is, or any other fringe benefit should be, used to retain an employee. If an employee wishes to move and he is retained and he is held on the job because of that reason, he is not going to be a satisfactory employee in the future.



Representative GRIFFITHS. Of course, the problem of these people is they do not want to move. They do not want to leave at all, but they are forced to.

Mr. BLAKER. Yes. However, there is a great deal of movement in the engineering field that is not triggered by lack of work in the particular plant. But in any event, the solution, I think, is a reasonable vesting provision so that the person is not tied to his job. He can move if he wants to move.

Representative GRIFFITHS. Here is another letter from which I quote:

There are many, many people in the same situation that I am. I work as an engineer in the aerospace industry and every 2 or 3 years, I end up working for another company. Each time I move, I lose money on the sale of my house and I lose my retirement benefits I might accrue. In essence, I have become an itinerant defense aerospace worker. Mind you, I don't mind the changing of jobs. However, I am now 37 years old and it is almost impossible to go into some other industry.

What is your opinion of this problem?

Mr. EPSTEIN. Well, it is a real problem and a question of a good vesting provision and certain innovations in portability, and a system, perhaps a clearinghouse, for crediting service would be desirable.

Representative GRIFFITHS. In view of the fact that these are all government contracts under which these people are working, it seems that portability might be a little more reasonably agreed upon. The Federal Government is paying the whole bill anyhow.

You have been very kind to come here, Mr. Blaker, and tell us about your pension plan. I would like to say to you that everybody we called in the space industry was going to be very busy this afternoon and asked us to call Boeing. Now you negotiate with these other companies, do you not?

Mr. EPSTEIN. Yes.

Representative GRIFFITHS. Then I would like to hear, since they all had a chance to appear, what is Lockheed's plan?

Mr. EPSTEIN. I have some prepared remarks I would like to read.

Representative GRIFFITHS. All right, I would be delighted.

#### STATEMENT OF ALBERT S. EPSTEIN

Mr. EPSTEIN. My name is Albert S. Epstein. I am associate director of research for the International Association of Machinists. Part of my responsibility is to advise on the problems pertaining to pensions and group insurance.

I welcome the opportunity to appear before you. I understand that the purpose of the hearing is to develop the major policy issues in private pension plans in the context of a number of representative plans. Although I am a union trustee of the IAM Labor Management pension fund, I am here in my capacity as associate director of research of the International Association of Machinists. Since Mr. Blaker has described the Boeing retirement plan, I shall merely offer a few general observations on pensions and then submit to your questioning.

The first thing to be noted about pension plans is their rapid growth in the past 20 years. In 1930, only 2,700,000 persons were covered by private pension plans. There was no social security then, either. The latest figures available for 1964 show the following: There were 24,-

600,000 persons covered by private pension plans; employer contributions amounted to \$5,900 million; employee contributions were, in 1964, \$990 million; the number of beneficiaries was 2,490,000; the amount of benefit payments was \$1,760,000, and the reserves, \$77,200 million. All these figures come from the Social Security Bulletin, which has an annual roundup of benefit plans.

Such a vast enterprise requires the attention of the Congress of the United States. Surely, it is too serious a matter to be left exclusively in the hands of the Internal Revenue Service.

As you know, the initial spurt in the growth of pension plans developed in 1942 when high profits, high taxes, wage stabilization controls, and the exemption of pension contributions from taxation encouraged plans for deferred compensation. The next spurt came in 1950, as a result of the large number of negotiated pension plans which followed court rulings upholding an NLRB decision in April 1948 that retirement rules are within the statutory scope of collective bargaining.

Congress and several Presidents have shown their vital concern on pension development by the passage of the Welfare and Pension Plans Disclosure Act and the establishment of the Office of Labor Management and Welfare Pension Reports to administer the act. The Secretary of Labor also has the guidance of the Advisory Council on Employee Welfare and Pension Benefit Plans on which representatives from the fields of insurance, banking, management, labor, actuarial consultants, accounting, and the public serve.

I should also like to remind you of the value of a report of the President's Committee on Corporate Pension Funds and other private retirement and welfare programs entitled "Public Policy and Private Pension Programs."

An interesting fact about the document is that the representatives of all organizations split right down the middle on controversial questions. Far from deploring the absence of agreement, we should welcome it. The subject of pensions is complex and such problems are solved not by debate but by experience. It is well to remember that pension plans, unlike the Goddess Minerva, have not sprung perfectly designed and fully fashioned from the head of an actuary. Pension plans have evolved and matured over the years. They are the product of our pluralistic society, which involves differences in needs and approach among individuals and groups, public and private.

Collective bargaining has played a decisive role in the past 15 years in shaping the character of pension programs. When pension plans were first negotiated, the younger members within the union were either disinterested or opposed, but there has been a marked change in recent years. The young people favor pension plans just as much as the older workers. The influence of younger employees is reflected in the more recent pension plans. They pushed for the elimination of the age requirement for vesting. Vesting after 10 years regardless of age is now common in a number of industries. Widow's pensions are being incorporated in some plans.

However, I should point out it would be undesirable to require uniformity in all pension plans. A new pension plan should not be treated in the same way as a mature and well-seasoned plan. There have been many changes in the provisions and funding of pension plans. This has been the result of collective bargaining and the in-

genuity of the pension consultants, particularly the actuaries. Among the advances in pension designs, I want to mention the following:

A, treatment of past service; B, variety of funding methods and media; C, liberalization of early retirement; D, increases in pension benefits, including the benefit of those who have already retired, changes in benefit formulas, either by increases in the percentage that applies to earnings or relating the pension benefit to final pay; E, introduction of variable annuity, and Mr. Blaker has already mentioned that the variable annuity feature is part of the Boeing plan. However, I think, now, because of the social security base having been raised to \$6,600, as Mr. Blaker has pointed out, it has decreased the percentage of the people who will benefit from that feature. F, cost of living protection. We find such features on National Airlines and the United Aircraft. G, inclusion of options; H, development of the multiemployer pension plan, which results in a degree of portability; I, the spread of reciprocity agreements among plans.

Since the question of funding and the role of the actuary has come up, I should like to say something about it. The role of the actuary is often misunderstood. Some expect too much from him, others do not trust him at all. I believe that he plays an indispensable role, so long as we understand his limitations as well as he does himself. I should, therefore, like to cite a few sentences from the Presidential address delivered by Mr. Frank M. Redington in October 1958 to the Institute of Actuaries in London, which expresses the concept of actuarial guidance in dynamic and modern terms:

Pension schemes can, therefore, be more happily regarded as homing to a distant and moving target under the guidance of the actuarially radar tracking system. Whether a scheme will be successful or not is only in part a question where it is now; that is to say, its current degree of solvency. It is also largely a question of the power of its driving force to bring it curving on to track in due course.

The Boeing retirement plan discussed here by Mr. Blaker is an example of the single employer type of plan which covers most of the IAM members. In addition, there is the IAM labor-management pension plan and about a dozen area and regional plans of the multi-employer type. We do not have any figures as to the number covered. However, employees in such industries as aerospace and air transport are nearly all covered by pension plans. This is also true of all large plants in other industries. I estimate that about 90 percent of our members are participants in private pension plans. However, the employees on the railroads are under railroad retirement but are not covered by any private group pension plans. Numerous small employers are also still without pension plans of their own.

In my opinion, there will be a steady improvement in pension plans. Through private collective bargaining by governmental system of disclosure and free discussion, we are in a good position to develop a sound basis for the advancement of the private group pension plan system.

Representative GRIFFITHS. Thank you very much.

Do you organize all these space companies?

Mr. EPSTEIN. Yes, ma'am. The International Association of Machinists is the largest union in the aerospace field. We probably have 70 percent of all the aerospace workers who are organized.

Representative GRIFFITHS. Well, you would be in a pretty good position to make these plans portable from one company to the other; would you not?

Mr. EPSTEIN. We are only one side to that collective bargaining process. It takes both the consent of the employers and the unions to come to an agreement.

Representative GRIFFITHS. Have you raised the question?

Mr. EPSTEIN. We are raising the question in the air transport industry at the present time. We are asking the airlines to adopt the IAM labor-management pension plan.

Representative GRIFFITHS. How do you cover your union officials?

Mr. EPSTEIN. The union officials have a plan which is separate and apart.

Representative GRIFFITHS. Contributory?

Mr. EPSTEIN. Noncontributory.

Representative GRIFFITHS. Paid out of dues?

Mr. EPSTEIN. It is paid out of the regular funds of the grand lodge.

Representative GRIFFITHS. When do rights in this plan vest?

Mr. EPSTEIN. I have nothing to do with that particular plan.

Representative GRIFFITHS. Do you know? Will you supply this information? I am sure you could do it.

Mr. EPSTEIN. This is not part of my work and you would have to ask an official of the International Association of Machinists to supply such information.

Representative GRIFFITHS. Will you describe the machinists' plan for small employers?

Mr. EPSTEIN. I am a trustee of that plan. What we have is a multiemployer plan in which any employer, who has a collective bargaining agreement with the IAM and agrees to contribute to a plan, may participate. Based upon the contribution that the employer makes to the plan, the benefits are determined. Under the— at the present time, a 10-cent contribution from an employer will bring a pension benefit of \$88 a month to an employee who has 25 years of service at age 65.

Representative GRIFFITHS. Ten cents per what?

Mr. EPSTEIN. Ten cents per hour. Or usually it may be expressed in, let's say, 80 cents a day, or \$4 a week.

Representative GRIFFITHS. When the money is paid into the plan by the employer, does he ever have any chance to get any of it back?

Mr. EPSTEIN. No, once it is contributed, it is all used in behalf of the employees.

Representative GRIFFITHS. Do you have any residual rights, Mr. Blaker? Does Boeing have any rights in this fund? Could you ever, under any circumstances, get any of this money back?

Mr. BLAKER. Yes.

Representative GRIFFITHS. What are those circumstances?

Mr. BLAKER. If Boeing went out of business, if it turned out that there were more funds in the hands of the trustees than were required to pay the vested benefits then outstanding, there is the possibility that there would be a reversion to the Boeing Co. You need to postulate, however, the Boeing Co. going out of existence and that there would actually be overfunding at that time.

Representative GRIFFITHS. What if you sell to another company? What happens?

Mr. BLAKER. I cannot answer.

Representative GRIFFITHS. Mr. Blaker, have you ever considered this problem?

Mr. BLAKER. No.

Representative GRIFFITHS. Mr. Epstein, have you ever considered this problem?

Mr. EPSTEIN. What problem?

Representative GRIFFITHS. What if Boeing sells to Lockheed or vice versa, what happens to pension funds?

Mr. EPSTEIN. The pension funds, by and large, cannot be returned to the employer. In most agreements, the provision is that only if there has been an error in the actuarial calculation and an overpayment can that sum be returned to the employer who contributed.

Representative GRIFFITHS. But what if the purchaser appropriates the funds?

Mr. EPSTEIN. He cannot. It is impossible.

Representative GRIFFITHS. Why not?

Mr. EPSTEIN. The fund is set up as a trust fund, under the law, under the trust laws. That money cannot be taken by anybody.

Representative GRIFFITHS. Well, let me give you a case.

American Standard Radiator acquired Mullins Manufacturing Co., 5,000 people, \$5 million in the pension fund. American Standard Radiator merged Mullins money with their own pension funds. At this time, the Attorney General stepped in and decided that American Standard Radiator was monopolizing the field and made them divest themselves of Mullins. They kept the pension fund.

Mr. EPSTEIN. I am not familiar with it.

Representatives GRIFFITHS. You folks had better think it over. Because it could happen to you.

Well, anyhow, can you give me the vesting provisions in the plans of any of these other companies that you organize—Lockheed or any of the other companies? How long does it take for a pension right to vest?

Mr. EPSTEIN. Right now in the aerospace industry, it is 10 years in most cases, regardless of age.

Representative GRIFFITHS. Regardless of age?

Mr. EPSTEIN. Age used to be a requirement but it no longer is in pension plans like Lockheed or Douglas.

Representative GRIFFITHS. So if, after 10 years, you leave the company, you have to wait until a certain age and then you get a pension?

Mr. EPSTEIN. Vesting is a deferred pension benefit which pays you either at 65 or at early retirement, depending upon provisions of the plan.

Representative GRIFFITHS. What are other space companies and what are their vesting plans?

Mr. EPSTEIN. I would say all except General Dynamics has 10 years.

Representative GRIFFITHS. What does General Dynamics have?

Mr. EPSTEIN. Ten years and age 40. Boeing, as Mr. Blaker has said, I guess would amount to the same thing, age 40.

Representative GRIFFITHS. Yes, because employees can't begin to acquire vested rights until they are 30. I see.

Mr. EPSTEIN. Partial vesting. You have a system of gradual vesting, but complete vesting would be approximately age 40.

Representative GRIFFITHS. Do you know how large the funds are in any of the other company plans?

Mr. EPSTEIN. All the information is available in the Department of Labor. They submit financial reports just like every other company and it is very easily obtained.

Representative GRIFFITHS. I want to tell you both how much I appreciate your coming here and to commend you again, Mr. Blaker, on Boeing's plan. All of your competitors agree that is the best plan.

Thank you very much.

(Whereupon, at 2:55 p.m., the hearing adjourned.)

## PRIVATE PENSION PLANS

MONDAY, MAY 9, 1966

CONGRESS OF THE UNITED STATES,  
SUBCOMMITTEE ON FISCAL POLICY  
OF THE JOINT ECONOMIC COMMITTEE,  
*Washington, D.C.*

The subcommittee met, pursuant to recess, at 10 a.m., in room S-407, the Capitol, Hon. Martha Griffiths (chairman of the subcommittee) presiding.

Present: Representative Griffiths.

Also present: Nelson D. McClung, economist; Donald A. Webster, economist; and Hamilton D. Gewehr, administrative clerk.

Representative GRIFFITHS. This committee will be in order. I am very happy to have you here, Secretary Wirtz. I am going to begin by reading to you some of the letters that we have received over the weekend, and hope that you will reply in your testimony to some of these.

This particular letter comes from a person that I know and who I know is qualified, but I will not reveal his name. He is in a different time zone than we are and I couldn't get him this morning to ask him if I could reveal his name.

In agreeing to the need for control, here is just one unusual example. Two local unions in blank city, in the same trade and same international union, have no reciprocal agreement to cover members shuffled between the two locals. The equity of the workers is forgotten in the need to build up benefits for the "regular members."

Here is some comment on another angle. The Ford Foundation was once aptly described as "a large body of money surrounded by people who are trying to get it." This applies to the pension and welfare plans with which I am acquainted. Insurance companies, actuaries, accountants, attorneys, administrators, investment counselors, consultants and bankers, all want a piece of the action. The cost to small plans such as this is scandalous and cries out for control.

The dollars spent unnecessarily now on the above, plus plush trips to the National Foundation of Health, Welfare and Pension Plans will mean many less dollars to the working man who is lucky enough to qualify for a pension.

At least that is one person. Here is another.

I worked for Colgate Palmolive Company and I was forced to retire in 1962. I was 57 years old at that time. They gave me severance pay in the amount of \$2,300 and paid up insurance to the amount of \$5,000. I am supposed to draw \$50 a month when I reach 65 years' old. I think that these companies should be made to pay their employees when they force them to retire early. I had a rough time in getting a job with other companies.

Here is another letter:

When I signed up for my pension, I was told I would receive \$200 a month, but I only received \$135. This pension is from the Teamsters Union Local 299.

When I received my first pension check, I called the business agent to return to work, but he told me, no. I lost my house and my car.

This is an interesting letter from a woman. I don't really see how this plan would work:

MADAM: I was interested in the enclosed article in the News Sentinel in Fort Wayne. My husband worked for 42 years. Month after month he paid in \$100 or more withheld from his wages. He built up a nice retirement fund, annuity as they called it. He was only able to use two years of the same and suddenly he passed away.

Here is my problem. I was qualified for a better than average job. Because I made more than the "retirement board says I made" I am being penalized for working. Last year I received \$1,830. They withheld \$217.80 right at tax paying time. A penalty of eight percent is added to your tax if it is not paid on time.

We have one letter after another from people who haven't received their pensions, and I hope that during the course of your testimony you comment on some of these problems.

We will be pleased to have you proceed.

**STATEMENT OF HON. W. WILLARD WIRTZ, SECRETARY OF LABOR;  
ACCOMPANIED BY JAMES J. REYNOLDS, ASSISTANT SECRETARY  
OF LABOR FOR LABOR-MANAGEMENT RELATIONS; PETER HENLE,  
DEPUTY ASSOCIATE COMMISSIONER, BUREAU OF LABOR STATIS-  
TICS; AND FRANK M. KLEILER, DIRECTOR, OFFICE OF LABOR-  
MANAGEMENT AND WELFARE PENSION REPORTS, DEPARTMENT  
OF LABOR**

Secretary WIRTZ. Thank you very much. There are with me today, Mr. James J. Reynolds, Assistant Secretary of Labor; Mr. Frank M. Kleiler, Director of the Office of Labor-Management and Welfare Pension Reports, Mr. Peter Henle, Deputy Associate Commissioner of the Bureau of Labor Statistics, and I hope that as the questions come up that they may share in the answering of them.

I am filing with the subcommittee, Madam Chairman, a statement which is short and which I would propose, if it suits your purpose, to read.

Representative GRIFFITHS. We will be glad to have you do so.

Secretary WIRTZ. But to leave out parts of it which are perhaps sufficiently explanatory to be omitted but then to have the statement as a whole appear in the records. The statement will be responsive to your questions, Madam Chairman, and will include some references to the same kinds of letters to which you refer. We, too, have been receiving them. It will at the same time put these same facts in a somewhat broader perspective.

I suppose it is true that there is at any time in the development of the policies of the country a number of problems which we know we are going to have to face at some point, but which we keep putting off in one way or another. I think as almost a classic example of that (in fact I think it was in 1951 or 1952 that I first remember hearing about it) the water shortage. It is not with the present circumstances in mind that I know as a fact it was the League of Women Voters who first called attention to an imminent water shortage prospect. We didn't do very much about it. It wasn't a real crisis until very recently.



You could say that of a number of other problems we now face. I suppose the issue of population control and population expansion is another. I don't believe it exaggerates the importance of the question before this committee to put it in that same category. These facts are gradually but recently more rapidly entering the public consciousness:

Private retirement plans—including profit-sharing retirement plans—now cover over 25 million employees in the country. This number will probably increase to about 34 million by 1970, and about 42 million by 1980, if the present prospects hold up.

About 2½ million men and women are currently receiving benefit payments under these plans; and this number will increase to about 7 million by 1980. But these figures have perhaps less significance than the unknown numbers—possibly even larger—of men and women who are now covered by such plans but who will not receive benefits under them. It is that group about whom you are talking. It is that group from whom you have heard in these representative letters.

We are always impressed, perhaps very much because we can't evaluate them, with the size and dollars of some of the things going on today, but even inured as we are with large figures, we can't ignore the fact that there are \$85 billion today in these funds which we are talking about. That figure will be about \$120 billion by 1970, and it will probably go to over \$200 billion by 1980.

Another fact involved here is that the tax treatment of the money going into these funds and earned by them represents a 30-percent savings factor in their financing, so the tax implications are a very important part of it.

These facts make it plain, I think, that these private retirement plans do represent a force of substantial magnitude in the financing of the economy, in connection with the mobility of labor, and most particularly in connection with the later lives of the participants in these plans.

And yet, there has been almost no public attention to these implications. There is a very clear and unquestionable consensus that private retirement plans are a good idea, and that has led to a public indifference to the details. The notion has even been developed that public attention to it is in some way unwarranted, a mistake and unwise. I share strongly the view that they are a good idea. I do not share the view that attention to it is unwarranted. It seems to me that these hearings are most timely.

I am here today in two capacities. First, as the administrative officer with responsibility for administration of the Welfare and Pension Plan Disclosure Act; and then second, as Chairman of the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs. I should point out that this is a subject of very great interest to a number of the departments and agencies in the Government. The views that I express here are all shared, I think, by the representatives of all of these agencies. There has been a complete unanimity of approach to this problem. I should also make it clear, however, that there has not been any formal administrative position developed with respect to this matter.

We have got to start by realizing that any discussion of private pension plans has to recognize that a basic characteristic is their diversity. Each is the product of a specific industrial relations environ-

ment. Most of them have been tailored to meet the needs of the specific firm or the industry or the group of workers involved. Many of them have essentially the same basic provisions. But, there are many that differ in terms of their eligibility, formula for pension benefits, conditions under which employees obtain pension rights, method of financing, administrative arrangements, and the addition of such supplementary benefits as disability or survivors' benefits.

In their totality, these private pension plans provide an extremely valuable supplement to the public retirement system. Essentially, they have been conceived, established, and administered without Government involvement. And so it is proper to ask why it was that it was considered desirable to establish a special Presidential Committee to review the relation of these plans to public policy. The answer, it seems to me, lies in several points at which public policy becomes involved with private pension plans and I would like to enumerate those briefly.

First, it is clear that a close relation exists between private pension plans and the public retirement system. The operations and program of the Federal OASDI system are affected by changes in the private system.

Then, pension plans represent a major aggregation of capital which has to be handled, managed prudently in behalf of the employees whose employment retirement is involved. Congress has already decreed through the Welfare Plan Disclosure Act that these funds must meet certain requirements to provide information on the handling of this money.

Third, these plans affect the operation of the economy in two very important ways. First is the accumulation of large sums of money in pension funds. That raises questions about possible economic effects on the ratio of savings to investment and the money market, and so forth.

In addition to this, pension plans, especially those that do not provide adequate vesting, may also hinder the fullest development of the Nation's manpower resources by reducing the willingness of covered employees to change employment.

Fourth, although no public funds are utilized directly to finance private pensions, American taxpayers do have an important stake in their operations. Practically all private plans have met the qualifications for special tax treatment and, as a result of this, contributions to these plans by employers are not currently taxable to the employee as compensation. Rather, such taxes are deferred until the benefits are received by the employee at a time when his current income and his marginal tax rate are, with some exceptions, much lower. Moreover, the investment income of a tax-qualified plan is not taxable as earned, but only as it is later distributed in retirement benefits. As I have indicated earlier, the estimated value of these benefits is such that with their assistance, employers and workers are able to finance a given pension system with a 30 percent lower rate of contributions.

Madam Chairman, I have tried to state the tax implications in as neutral a form as I can, because there has been concern expressed at talk about "tax subsidies." This statement is an attempt to state the facts in a most restrained way. I just want to point out that it is unquestionably true that to whatever extent there are tax benefits to

a program of this kind, what that means is that the taxpayers as a whole pick up that much of the cost of these plans. This is not said in criticism of that approach. In support of it rather.

Representative GRIFFITHS. It is very kind of you to state it this way. I have stated it considerably less neutrally.

Secretary WIRTZ. Well, I feel very strongly about it, only to the point of making clear that there is so necessarily a public interest in it. It isn't that the public is expressing some interest in something in which before it has played no part. It is rather that the public is expressing a proper interest, a necessary interest in something in which it makes a very large investment.

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

Assistant Secretary Reynolds is here. It is within his particular responsibility, and Mr. Kleiler, that the present disclosure program is administered, and he will, in connection with this, be glad to go into whatever parts of that program that are of interest to the Committee. One point, however, worth special attention is the fact that as a result of this statute, this Department receives, Madam Chairman, a great many letters, just as you have, and as you have indicated in your opening statement, from plan participants complaining about denial of benefits because of plan eligibility rules, or loss of benefit rights due to circumstances beyond their control. My reaction to these letters, as I am sure yours is to those that you have received, is that there is at least a vast misunderstanding and lack of understanding, a lack of communication between the people in the organizations who administer these plans and those who are their beneficiaries. There is great frustration of hopes, there is great disappointment, there is great disillusionment on the part of a great many people who think that there have been rights built up under these plans which it turns out later there have not. And so, we have a good many protests of a kind that you have already illustrated.

Now these matters, despite their being brought to our attention, are beyond our authority and jurisdiction under the present act. There isn't a thing we can do about them except in connection with the disclosure provisions of that act, because the Welfare and Pension Plan Disclosure Act says specifically to me as Secretary that I shall not "regulate, or interfere in the management of, any employee welfare or pension benefit plan," and I have no desire to regulate or to interfere. I simply call attention to the fact that as the law now stands, there is a requirement of disclosure. There is also an assumption in the public's mind that there is an authority being exercised, which, under the statute there cannot be.

The broader questions of the relation between public policy and private pension plans was the central issue in the work of the President's Committee, to which I have already referred, the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs. This Committee was asked, and this goes back now 3 or 4 years, to conduct a broadscale review of the role and character of the private pension and other retirement systems in the eco-

conomic security system of the Nation. That task was completed, in a sense, a little more than a year ago, and the Committee's report was published last January, January 1965. There is no need for me to review here those findings, at least in any detail. Essentially, the report represents a strong vote of confidence in the operation of a private pension system and the way it has functioned. The Committee specifically rejected any proposal under which the public system should somehow "take over" the funds or the operation of private pension plans. At the same time, the Committee did recommend that public policies affecting these plans be strengthened in the following respects:

First, a reasonable measure of vesting should be included as one of the standards for tax qualification of private pension plans, in the view of all of the members of that Committee. As you know, a vesting provision allows covered employees to receive rights to retirement benefits before reaching retirement age but after meeting certain qualifications, typically regarding length of service and frequently age. Once an individual's pension rights have been vested, he is eligible to receive retirement benefits at a normal retirement age, even if at that time he has changed employment and is no longer covered by the plan. The committee felt that this recommendation was essential as a matter of equity and fair treatment to covered employees, and as an important aid to improving labor mobility throughout the economy.

I can simplify the point by a single illustration. Somebody who is covered by a plan which perhaps provides benefits at age 65, and then leaves the employment at age 61, 62, or 63, can only come with shock to the realization that by so doing, all rights in that plan have in some way been lost, and that happens too often and too frequently.

Representative GRIFFITHS. This gentleman who wrote had been fired.

Secretary WIRTZ. Well, that presents the case in perhaps one of its more acute forms, and yet I suspect the one that would hit us all as a matter of human equity is the case of somebody who loses his or her job to a machine when she is 62 years old, and loses employment because that job is no longer there, picks up a job some place else with another employer but finds that 30 years' investment, not investment because often it is not a contributory plan, but that 30 years of working, during which she had built up a reliance in her own mind upon the effects of that plan, is suddenly frustrated completely. Or the other case which presents the same problem in a different way is the case of a person who should, for one reason or another, and perhaps more in the public interest than in his own, move into some other employment, but who stays with what he is now doing, because if he moves, he will lose all rights under that plan.

And then second, there is the funding problem. The present standards for funding tax-qualified pension plans should, in our judgment, be strengthened by a number of changes designed to assure greater financial protection for the covered employees. We have suggested changes that would require funding of past service liabilities over a period of not more than 30 years, a periodic actuarial report on the finances of the fund and evaluation of pension fund assets by a qualified public accountant.

Third, we have suggested that the Welfare and Pension Plan Disclosure Act should be amended to require the disclosure of additional information relating, for example, to investment holdings and activities of private pension funds.

In addition, investments by retirement funds in the stock or obligations of the employer company should be limited to a fixed proportion. We have suggested 10 percent of the total assets.

Fourth, we have suggested that greater coverage should be assured by limiting to 3 years the maximum period of employment before a new employee can become eligible for participation in a pension plan. As of now, that permitted waiting period is up to 5 years. In addition, the option which qualified retirement plans now have to cover only salaried or clerical employees should, in our judgment, be eliminated, unless there is a showing of special circumstances.

Then, there is a fifth suggestion, and these are only the five principal suggestions among a much larger number coming from the Committee, a series of special studies should be undertaken to explore the feasibility of an insurance arrangement to protect covered employees against the risk that their plan will be terminated without being able to meet all its liabilities. A similar study was suggested to explore the possibility of a system with "portable" pensions, under which an employee could accumulate earned retirement credits as he transfers from one job to another.

Now, the Committee's report represents, I think, the most comprehensive review that any group, either public or private, has made of the private pension system. Its recommendations were designed to help private plans to better perform their function, and to provide greater assurance that the private pension promise will be fulfilled. Yet, it should be made clear that these recommendations were not meant as specific legislative proposals suggested for immediate congressional reaction. I would like to add a little more about that and to give the present posture in our thinking.

In releasing this report, President Johnson emphasized that it was designed to stimulate public reaction and further discussion. During the past year, the President's Committee has been reviewing a number of comments and proposals received as a result of the report. One major development has been our further realization that adequate information is still lacking with regard to a good many of the critical issues affecting the private pension system. And so we have undertaken a series of research projects or at least have initiated them, and we think that we will have shortly a good deal more information about them. Those present investigations or inquiries cover these points.

First, we have got to find out more about the relative importance of the reasons why retirement plans terminate, and how many plan participants do lose benefit rights owing to pension and profit-sharing plan terminations. We know it is a great many. We don't know the exact scope of it. And so the Bureau of Labor Statistics and the Internal Revenue Service are now collecting and analyzing data on about 7,000 tax-qualified retirement plans. We are taking those that were terminated between 1953 and 1965, and we are hoping that from this study we can find out a good deal more about what happens in

these cases, why it happens, when the plans terminate who is affected by them, what the reasons are for it.

Second, we have got to get more extensive data on the status of funding under the private pension plans. It appears that there is a good deal more going on than we first realized. That represents obviously an improvement. We don't mean to overstate a problem which may be in the course now of rapid improvement, and so we are trying to find out through a study financed by the Social Security Administration, a project sponsored by the Pension Research Council of the Wharton School, University of Pennsylvania. We would like to get a complete picture of the condition of the funding of all plans, with the thought that it will probably be desirable to supplement this project with certain additional studies.

For the first time, information on the characteristics of employees covered by private pension plans is being collected. We know the round number in terms of millions, but we don't have a clear profile of who it is and what the particular needs, what the particular situations are as far as this group is concerned. We are trying to find that out. These data which were obtained in January of this year as part of the monthly survey on the labor force, will be studied to find out the extent to which workers between 50 and 65 expect to receive private retirement benefits from their present or previous employment.

The BLS is also continuing its analysis of benefit provisions and other characteristics of private pension plans. These are all available to you. There are a vast number of them. We are trying to go over them now to see in more detail just what the pattern of present provisions is.

Overall data on private retirement plan coverage, beneficiaries, contributions, benefit payments and reserves are being compiled each year now by the Social Security Administration. The quality of these statistics is gradually being improved through special inquiries by the SEC and special studies of reports filed under the Welfare and Pension Plans Disclosure Act.

The SEC is also continuing to obtain annual financial data for non-insured private retirement funds. That information is available on both book and market values for different types of assets, on purchases and sales of common stock. To supplement their regular data, the SEC will shortly be issuing quarterly reports on the total common stock transactions of these funds, and on changes in broad categories of their assets.

Then in addition to that, interested Government agencies are continuing their study of other aspects of private pensions. The question of fiduciary responsibility under pension plans is receiving special attention as a result of congressional hearings and proposed legislation on this subject. During the coming months we are hoping to meet with a number of private interested groups which are knowledgeable in this field. Any suggestions for possible changes in public policy will come only after obtaining the best advice from those directly concerned with these private plans.

And so I report to you, Madam Chairman, and members of the committee, a situation which has our active attention, which excites our very real concern, and which we think is exceedingly important to bring before the public, first in terms of what the facts of the situation

actually are so that there may be developed a much stronger public realization, and I am sure a public commitment, with respect to what ought to be done in this area. It is a matter of very great concern I know, and we express the strongest gratitude, not in personal terms because it isn't that, but in official terms for the recognition that is now being given this exceedingly important problem.

(The prepared statement of Secretary Wirtz follows:)

PREPARED STATEMENT OF W. WILLARD WIRTZ, SECRETARY OF LABOR

Madam Chairman, and Members of the Subcommittee, these facts are gradually, but recently more rapidly, entering the public consciousness:

Private retirement plans (including profit-sharing retirement plans) now cover over 25 million employees in the country. This number will probably increase to about 34 million by 1970, and about 42 million by 1980.

About 2½ million men and women are currently receiving benefit payments under these plans; and this number will increase to about 7 million by 1980. But these figures have perhaps less significance than the unknown numbers—possibly even larger—of men and women who are now covered by such plans but who will not receive benefits under them.

There are presently about \$85 billion in these funds. This figure will probably go to about \$120 billion by 1970 and to over \$200 billion by 1980.

The tax treatment of the money going into these funds and earned by them represents a 30 percent savings factor in their financing.

These facts make it plain that these private retirement plans represent a force of substantial magnitude in the financing of the economy, the mobility of labor, and the later lives of the plan participants.

There has, however, been notably little public attention to these implications. The clear and unquestionable consensus that private retirement plans are a good idea has led to a public indifference about details. The notion has even developed that public attention to the subject is unwarranted.

These Hearings are most timely.

My appearance is two capacities: as the administrative officer with responsibility for administration of the Welfare and Pension Plan Disclosure Act; and as Chairman of the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs. The subject is one of very great interest, and in some respects concern, to a number of other agencies of the Government.

The views I express are shared by the representatives of those agencies. There has not been formulated on any point, however, a formal Administration position.

Any discussion of private pension plans must recognize that a basic characteristic is their diversity. Each is the product of a specific industrial relations environment. Most plans have been tailored to meet the needs of the specific firm, industry, and group of workers involved. Many plans have essentially the same basic provisions, but there are many that differ in terms of their eligibility, formula for pension benefits, conditions under which employees obtain pension rights, method of financing, administrative arrangements, and the addition of such supplementary benefits as disability or survivors benefits.

In their totality, private pension plans provide an extremely valuable supplement to the public retirement system. Essentially, they have been conceived, established, and administered without government involvement. Why then, it may be asked, was it considered desirable to establish a special Presidential Committee to review the relation of these plans to public policy? The answer, it seems to me, lies in a number of points at which public policy becomes involved with private pension plans:

A close relation exists between private pension plans and the public retirement system. Obviously, the operations and program of the Federal OASDI system are affected by changes in the private system.

Pension funds represent a major aggregation of capital which must be managed prudently in behalf of the employees whose retirement is involved. Congress has already decreed, through the Welfare and Pension Plans Disclosure Act, that these funds must meet certain disclosure requirements to provide information on the handling of this money.

These plans affect the operation of the economy in two important ways: 1) the accumulation of large sums of money in pension funds raises questions about possible economic effects on the ratio of savings to investment, on the money market, etc.; and 2) pension plans, especially those that do not provide adequate vesting, may also hinder the fullest development of the Nation's manpower resources by reducing the willingness of covered employees to change employment.

Although no public funds are utilized directly to finance private pensions, American taxpayers do have an important stake in their operations. Practically all private plans have met the qualifications for special tax treatment. As a result, contributions to these plans by employers are not currently taxable to the employee as compensation. Rather, such taxes are deferred until the benefits are received by the employee, at a time when his current income and his marginal tax rate are, with some exceptions, much lower. Moreover, the investment income of a tax-qualified plan is not taxable as earned, but only as it is later distributed in retirement benefits. As I have indicated, the estimated value of these benefits is such that with their assistance, employers and workers are able to finance a given pension system with a 30 percent lower rate of contributions.

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

Assistant Secretary Reynolds will be available after this testimony to discuss the scope and operations of the Department's responsibility under the disclosure statute. One point, however, worth special attention is the fact that as a result of this statute the Department receives many letters from plan participants complaining about denial of benefits because of plan eligibility rules or loss of benefit rights due to circumstances beyond their control. However, these are matters outside the scope of the Act which expressly provides that it shall not be construed to give the Secretary any authority "to regulate, or interfere in the management of, any employee welfare or pension benefit plan," except for the purpose of inquiry into investments and actuarial assumptions under special procedures on presumption that the Act has been violated.

The broader question of the relation between public policy and private pension plans was the central issue in the work of the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs. This Committee was asked to conduct a broad-scale review of the "role and character of the private pension and other retirement systems in the economic security system of the Nation." This task was completed a little more than a year ago and the Committee's report published in January 1965. There is no need for me here to review its findings in any detail. Essentially, the report represents a strong vote of confidence in the operation of the private pension system and the way it has functioned. The Committee specifically rejected any proposal under which the public system should somehow "take over" the funds or the operation of private pension plans. At the same time, the Committee did recommend that public policies affecting these plans be strengthened in the following respects:

A "reasonable measure of vesting" should be included as one of the standards for tax qualification of private pension plans. As you know, a vesting provision allows covered employees to receive rights to retirement benefits before reaching retirement age but after meeting certain qualifications, typically regarding length of service and frequently age. Once an individual's pension rights have been vested, he is eligible to receive retirement benefits at a normal retirement age even if at that time he has changed employment and is no longer covered by the plan. The Committee felt that this recommendation was essential as a matter of "equity and fair treatment" to covered employees and as an important aid to improving labor mobility throughout the economy.

Similarly, present standards for funding tax-qualified pension plans should be strengthened by a number of changes designed to assure greater financial protection for the covered employees. The suggested changes would require funding of past service liabilities over a period of not more than 30 years, a periodic actuarial report on the finances of the fund, and valuation of pension fund assets by a qualified public accountant.



The Welfare and Pension Plans Disclosure Act should be amended to require the disclosure of additional information relating to investment holdings and activities of private pension funds. In addition, investments by retirement funds in the stock or obligations of the employer company should be limited to a fixed proportion (perhaps 10 percent) of the total assets.

Greater coverage should be assured by limiting to three years the maximum period of employment before a new employee can become eligible for participation in a pension plan. The present provision allows a waiting period of up to five years. In addition, the option which qualified retirement plans now have to cover only salaried or clerical employees should be eliminated, unless there is a showing of special circumstances.

A series of special studies should be undertaken to explore the feasibility of an insurance arrangement to protect covered employees against the risk that their plan will be terminated without being able to meet all its liabilities. A similar study was suggested to explore the possibility of a system with "portable" pensions under which an employee could accumulate earned retirement credits as he transfers from one job to another.

The Committee's report represents the most comprehensive review that any group, either public or private, has made of the private pension system. Its recommendations were designed to help private plans to better perform their function and to provide greater assurance that the private pension promise will be fulfilled. However, it should be made clear that these recommendations were not meant as specific legislative proposals suggested for immediate Congressional enactment.

In releasing the report, President Johnson emphasized that it was designed to stimulate public reaction and further discussion. During the past year, the President's Committee has been reviewing a number of comments and proposals received as a result of the report. One major development has been further realization that adequate information is still lacking with regard to many of the critical issues affecting the private pension system. Consequently a number of research projects have been initiated to fill a few of the major information gaps:

1. To ascertain the relative importance of the reasons why retirement plans terminate and how many plan participants lose benefit rights owing to pension and profit-sharing plan terminations, the Bureau of Labor Statistics and the Internal Revenue Service are collecting and analyzing data on about 7,000 tax-qualified retirement plans that were terminated between 1953 and 1965. Such a study is a necessary part of any examination of the desirability of a system of insurance of participant pension rights, as suggested by bills currently before Congress.

2. To obtain more extensive data on the status of funding under private pension plans, the Social Security Administration is helping to finance a project sponsored by the Pension Research Council of the Wharton School at the University of Pennsylvania. To obtain a more complete picture of the funding condition of all plans, it will probably be desirable to supplement this project with certain additional studies.

3. For the first time, information on the characteristics of employees covered by private retirement plans is being collected in relation to the characteristics of all employees. These data, obtained in January 1966 as part of the monthly survey of the labor force, will indicate the extent to which workers between 50 and 65 expect to receive private retirement benefits from their present or previous employment.

4. The BLS is continuing its analysis of benefit provisions and other characteristics of private pension plans. A current study is directed toward the administrative arrangements of pension plans under collective bargaining. It will identify, for example, the individuals who make the final determination of the benefits to which a retired worker is entitled and indicate the manner in which these individuals are selected for this position.

Overall summary data on private retirement plan coverage, beneficiaries, contributions, benefit payments and reserves are compiled each year by the Social Security Administration. The quality of these statistics are gradually being improved through special inquiries by the Securities and Exchange Commission and special studies of reports filed with the Labor Department under the Welfare and Pension Plans Disclosure Act.

The SEC is continuing to obtain annual financial data for non-insured private retirement funds. Information is available on both book and market values for

different types of assets and on purchases and sales of common stock. To supplement their regular annual data, the SEC will shortly be issuing quarterly reports on the total common stock transactions of these funds and on changes in broad categories of their assets.

In addition, interested government agencies are continuing their study of other aspects of private pensions. The question of fiduciary responsibility under pension trusts is receiving special attention as a result of Congressional hearings and proposed legislation this subject. During the coming months, government agencies hope to meet with a number of private interested groups knowledgeable in this field. Any suggestions for possible changes in public policy will come only after obtaining the best advice from those directly concerned with private plans.

Representative GRIFFITHS. Thank you very much, Mr. Secretary. Will you please refresh my memory? What are the rights and duties of the Secretary of Labor under the Taft-Hartley in connection with pension plans?

Secretary WIRTZ. May I refer that question please to Mr. Reynolds.

Mr. REYNOLDS. There is really no responsibility under Taft-Hartley.

Representative GRIFFITHS. Well, then, under the Landrum-Griffin?

Mr. REYNOLDS. There is none under the Landrum-Griffin either.

Representative GRIFFITHS. What does the Disclosure Act require?

Mr. REYNOLDS. The Welfare and Pension Plans Disclosure Act is exactly what it infers by the title, namely it is a statute which reflects the intent of Congress that the terms and conditions of pension or welfare plans and their financial conditions be revealed to the participants and to all interested parties. It requires that the plan administrators file with the Secretary a detailed description of the plan, and to keep that description up to date by also filing with us all amendments to that plan within 60 days after they have been made, and it also requires the administrators to file annually with the Secretary a statement as to the financial condition of the plan. It is just that, a disclosure act. It might be of interest to you, Madam Chairman, to know that the degree to which those statements on file here with the Department of Labor are reviewed by parties can be indicated by the statement that last year in calendar 1965 we had about 1,400 visitors to the disclosure room. They looked at 25,100 plans.

Now the inquiry and the object behind these inquiries will be varied. I am sure many of these inquires and much of the reviewing came from professionals in the field who were interested in things other than merely the interests of the participants. The act, of course, also requires that copies of this material be made available to every participant, and every future beneficiary by filing in the main office of the plan the same material that they must file with us.

Representative GRIFFITHS. What are the penalties if they fail to file?

Mr. REYNOLDS. The penalties, if they fail to file, are not very severe, unless the failure to file it a willful failure to file. Frequently, we find that there are plan administrators who are delinquent in their filing requirements, and we attempt to get compliance, and usually are successful in getting such compliance. If we fail to do that, then it is referred to the Department of Justice.

Representative GRIFFITHS. How many such plans have you found that did not file?

Mr. REYNOLDS. Well, we have found a great many that have been delinquent, but after an appropriate prodding they have come into compliance.

Representative GRIFFITHS. Do you have any idea of how many?

Mr. REYNOLDS. Mr. Kleiler may be able to tell me.

Mr. KLEILER. Yes, we have a table in our report to Congress.

Mr. REYNOLDS. Here are the exact figures. Actions by the compliance and enforcement staff, from August 1962 until the end of 1965, types of possible violations—namely, failure to file—there were a number of possible violations, 138 administrators failing to file the plan descriptions. There were 102 cases where the amendments to the descriptions were not filed, and there were 1,520 situations where the annual financial report was not filed.

Representative GRIFFITHS. How did you find out that they didn't file?

Mr. REYNOLDS. Frequently, we find out from correspondence from beneficiaries. Often we find out only by a careful check of our records against corporations at large, where we know there are plans possibly that have been negotiated by unions, but, quite frankly, the means of finding violations of failure to report are not very effective in my opinion.

Representative GRIFFITHS. Why don't you find out from the head of the Internal Revenue Service?

Mr. REYNOLDS. That is a good question.

Representative GRIFFITHS. He must know.

Mr. KLEILER. We have explored that possibility, Madam Chairman. The difficulty is this, that the bulk of the plans which are qualified under the Internal Revenue Code probably involve fewer participants than are covered by this particular law. The qualification records are decentralized at Internal Revenue Service, and the cross-checking job to identify plans which are qualified under Internal Revenue and would be subject to the WPPDA and have not filed would involve a rather tremendous operation. I understand that our staff has been exploring this with the Internal Revenue Service, that Internal Revenue Service expects to computerize an index to the qualified plans sometime later this year.

Representative GRIFFITHS. Do you file these plans under A, B, C, and so forth?

Mr. KLEILER. No; they are assigned a file number.

Representative GRIFFITHS. Is the file number the same file number that the Internal Revenue Code uses?

Mr. KLEILER. No ma'am.

Representative GRIFFITHS. Why isn't it? If you had the same number I assume it would be fairly easy to cross-check.

Mr. KLEILER. It would be worth exploring.

Mr. REYNOLDS. It is certainly a thought and a suggestion worth looking into, Madam Chairman. Quite frankly, it had not occurred to us and we will look into it. This may be a very effective way to get a cross-check.

Representative GRIFFITHS. Now supposing a plan reports for 5 years and then does not report. They do have to report every year, don't they?

Mr. KLEILER. If they have more than 100 participants, yes.

Representative GRIFFITHS. On the sixth years they don't report. What do you do?

Mr. KLEILER. We enter into correspondence to ascertain why it hasn't been reported.

Representative GRIFFITHS. Supposing that you discover that the business had gone broke. Do you have any right to determine what happened to the pension money?

Mr. KLEILER. We attempt to obtain a report for its last year of operation. We have no authority to supervise the disposition of its assets.

Representative GRIFFITHS. Supposing you discovered that the company had sold out to another company. Do you have no rights then to inquire into what happened to the pension money?

Mr. KLEILER. We normally obtain a terminal report by which the terminated plan indicates that has happened to the funds. Usually they are acquired by the company with which it is merged.

Representative GRIFFITHS. Which purchased?

Mr. KLEILER. Yes. Frequently, there is consolidation.

Representative GRIFFITHS. Suppose the Attorney General told the company that did the purchasing to divest itself of the concern bought. Would you look into what happened to the pension money? Do you have any rights?

Secretary WIRTZ. We have authority to find out what has happened to the fund.

Representative GRIFFITHS. Have you ever done this?

Mr. KLEILER. No.

Secretary WIRTZ. But we do not have any authority to do anything about it, to exercise any judgment with respect to whether it was proper or improper.

Representative GRIFFITHS. But you have never as a matter of fact checked it anyhow; is that right?

Secretary WIRTZ. Would there have been any case of that kind, divestment case? I can't think of any.

Mr. KLEILER. I doubt it very much.

Secretary WIRTZ. We will supply it for the record if it is there. You can be quite content, Madam Chairman, if there are any, it is a very small number. I don't think there are any.

Representative GRIFFITHS. There is one. American Radiator acquired Mullens.

Secretary WIRTZ. All right.

Representative GRIFFITHS. They acquired \$5 million. They were told to divest, and it is my understanding that they didn't divest themselves of the pension fund which they had already commingled with their own money.

Secretary WIRTZ. All right, thank you.

Representative GRIFFITHS. Has the Cabinet Committee considered the possibility of revising the OASI system to permit employers to purchase additional credits for the employees?

Secretary WIRTZ. I don't believe it appears in the final report, does it?

Mr. REYNOLDS. No, it was not a major issue.

Secretary WIRTZ. And whether it came up in the course of the deliberations Mr. Henle would best know.

Mr. HENLE. It is one of the things that might come as a byproduct of a portability system.

Secretary WIRTZ. So, the answer would be that it did enter into discussions. It did not become sufficiently prominent that much about it appears in the report; is that right?

Mr. HENLE. There is a brief discussion of this question.

Representative GRIFFITHS. If the tax subsidy to private plans were eliminated by requiring that employee contributions be included in worker income subject to tax, wouldn't this practically require that plans provide for immediate vesting?

Secretary WIRTZ. I hope you will understand my putting your question in terms which take it, for my purposes, out of the subsidy language because I have got into so much trouble talking about subsidies that it doesn't seem worth it. I understand the question to be whether there would be in the administration of the tax provisions, the revenue provisions affecting this plan, sufficient power in effect to require their vesting if the Congress should so provide. My answer would be "Yes." If there were a change in the taxing provisions to permit these tax features to apply only if there were vesting, I assume that this change would result in the vesting of most of these funds, although I don't know whether all of them.

Representative GRIFFITHS. Would you suggest or favor giving the Labor Department authority to investigate worker complaints, such as these I have had here, and to represent them in well-founded pension claims.

Secretary WIRTZ. With respect to the investigation, yes. With respect to the representation, that would present larger questions which we always get into in this, of whether it should be on complaint or on our own initiative or whatever it may be. But if the broader question is whether I would think that it was a good idea to make something more than a filing operation of this, so that there could actually be provision, investigatory provision in individual cases, yes.

We can, of course, today, upon the request of an employee, look into the situation to provide him with the full information about it. But our authority stops there.

Representative GRIFFITHS. Do you have any authority to do anything in case you discover that the pension plan is not notifying the members as to what the plan is?

Mr. REYNOLDS. Well, if there is a failure to do so, this would be a matter that we could refer to the Department of Justice for litigation as a violation of the statute.

Representative GRIFFITHS. Have you ever done it?

Mr. REYNOLDS. There have been 44 cases involving this type of complaint. Forty-two had been disposed of by December 31. In 33 of these we found no evidence of violation and in the other 9 the administrators complied by making available the information to which participants were entitled.

Mr. KLEILER. We have received very few complaints from plan participants alleging they have been denied the information to which they were entitled under the law, and I think all of those have been cleared up with no evidence of willfulness. The participant got the information to which he was entitled.

I do want to call attention to one other section of the law, section 9(b), which provides that the individual himself may go to court if he has been denied the information to which he is entitled, and I think two private suits have been brought which are still pending in court, I believe. There is a penalty of \$50 a day upon the administrator who fails to give the participant the information to which the participant is entitled under the law.

Representative GRIFFITHS. When you have letters that complain, as the letters that I read, do you file those so that you know how many letters you have received complaining about a particular plan?

Mr. KLEILER. I don't believe we have them organized by plans. We keep a voluminous correspondence file, but frequently they don't identify the plan or the employer in stating their problem. I doubt that we could give you an inventory of the plans.

Representative GRIFFITHS. If you knew this, though, if you had 50 letters complaining against a certain plan, wouldn't it be some evidence that the plan was not informing its members properly?

Mr. KLEILER. Not necessarily. As a matter of fact, some of the most reputable plans in the country I think are still the subject of a great deal of correspondence. Basically, the letterwriters fail to avail themselves of the information as to what their rights are.

Representative GRIFFITHS. Quite frankly, don't you feel that if the plan is notifying the participants with a 50-page closely written statement as to what their rights are, that for all practical purposes they are not being notified? That isn't the way the company sells its products. In that case they say it simply and easily. Take this person, for instance, who wrote in and said, "my husband worked and paid into a plan more than \$100 a month for 35 years and died, and now I am getting my pension cut because I work"; wouldn't her right have been easy to explain to anybody? It seems to me like it would.

Secretary WIRTZ. I would agree, Madam Chairman, that there is not effective communication.

Representative GRIFFITHS. Why, of course not.

Secretary WIRTZ. Of the critical points in this situation, in a good many cases to the participants in the plan.

Representative GRIFFITHS. We have had plan after plan come in here and hand us 25-page briefs on what the plan did. That isn't really adequate notification at all.

Has the Labor Department any studies to determine how many of the 25 million workers now covered by plans are likely to qualify for pensions under their present plan or any plan?

Secretary WIRTZ. That is exactly the point that we are trying to pursue in a present study, so the answer to your question is "Yes"; we are presently, through the Bureau of Labor Statistics, developing an analysis of that situation. We do not know the answer as of today.

Representative GRIFFITHS. And I am sure you will make it available.

Mr. REYNOLDS. Yes. This question is also related to the research project on the degree of funding, because the degree of funding has a very distinct bearing upon the prospects of sufficient plan assets being available when an individual claims his benefits.

Representative GRIFFITHS. Good. Do you have a definition of funding?

Secretary WIRTZ. No.

Representative GRIFFITHS. Do you know if there is any official definition of funding?

Secretary WIRTZ. There is not.

Representative GRIFFITHS. Everybody has a different idea.

Secretary WIRTZ. That is correct, and the point is very well taken. It would be wrong to suggest that there is a single funding standard on which there ought to be a yes or no answer. It is a complicated problem. It is an involved problem. We have talked with the actuaries. They have very different theories, basically different theories about the whole funding problem, there is not a single answer. There is a problem of the extent to which there is a disappointment of expectations as far as the prospective participants in the plan are concerned. It is hard to state it more accurately than that.

Representative GRIFFITHS. Somebody ought to review what funding means in the case of a plan that has been in existence for 26 years and still isn't paying enough of the interest on the money. But there really is no official definition of funding. It would be enormously helpful to the Internal Revenue.

Mr. REYNOLDS. The Internal Revenue Service, of course, as you know, Madam Chairman, refers to the term "funding" in its qualification of plans under the Internal Revenue Act. The funding of present service liabilities together with interest on past service liabilities is the minimum required for a plan to be eligible for favorable tax treatment. But the term "funding" can mean different things to different actuaries.

Representative GRIFFITHS. We have found that out.

Mr. REYNOLDS. I am sure you did, and an actuary is in a field of a sophistication far beyond that of the average layman. He will take what is known as the "deck." That will be the employees presently employed by a firm, their ages, their life expectancies, their sex, et cetera. Utilizing this data, he will come up with how much it would cost that company to fund present service or to fund past service liability on a 10-year basis, a 20-year basis, or 30-year basis.

Now, I think the statement can be made that the most prudent manner in handling the plan is to fund past service, so that at any particular time, once that funding has been accomplished, sufficient plan assets would be available, if the plan were terminated, to pay the beneficiaries their accumulated benefits for the rest of their lives. But the question of funding is a matter subject to a great many variables.

Representative GRIFFITHS. Well, of course, there really aren't any available statistics to show exactly what you should be funding for. In the first place, if you look at the past economic development, any recession is a great boon to these plans, because workers are laid off.

Mr. REYNOLDS. Yes.

Representative GRIFFITHS. You are getting rid of people who are never going to have an opportunity to collect.

Mr. REYNOLDS. Yes; whenever there is a layoff and there is no vesting, that constitutes a windfall to the plan.

Representative GRIFFITHS. That is right. Obviously, these things aren't even being considered. There aren't any statistics so far on who is paying in and who is going to collect. So the idea that you

have to set up an amount of money that is going to pay every person within that plan is certainly getting a great big tax-free loan.

Secretary WIRTZ. A study on funding, Madam Chairman, is being financed by the Social Security Administration, and is being made at Wharton School right now and we expect a report on that, when?

Mr. HENLE. Some results are expected within 9 to 12 months.

Representative GRIFFITHS. What we really need is a public definition of funding or a public actuary.

Secretary WIRTZ. Lest I leave a misimpression of the preceding point, Madam Chairman, I am not sure that in our own thinking we would at this point come to the conclusion that there ought to be a single funding plan or standard. As we get into this, I mean we, the public, we will face some pretty hard problems of how specific we want to be in connection with particular standards, as contrasted with the possibility that there will be standards of responsibility that will be cast in more general terms.

I guess I should think for myself, but recognizing, as you have pointed out, that there still is not enough information available, I would guess that it will be questionable whether we come to a single definition of funding, and that we would want to explore rather the possibility of standards of responsibility in this area. Now, I am sorry I lost the subsequent question that you asked.

Representative GRIFFITHS. Do you think that the Labor Department should have authority to supervise the investment of pension funds?

Secretary WIRTZ. I wouldn't be prepared to say that at this point. There are involved here very, very strong interests by other agencies, and I don't mean in any bureaucratic sense. I have never seen an operation that has been conducted on an interdepartmental basis with such a complete understanding and complete responsibility as this one on private pension plans. I would at this point recognize that there are very, very strong interests on this question relating to the responsibilities of the Treasury Department, the Commerce Department, the Securities and Exchange Commission, the Social Security Administration, to name only several among a large number.

I don't know where responsibility for such supervision should vest if this matter is subsequently brought to that stage. I, frankly, don't know.

Representative GRIFFITHS. Are pension benefits taken into account in the guidelines?

Secretary WIRTZ. Yes; they are.

Mr. REYNOLDS. The cost of them is.

Secretary WIRTZ. That is right.

Mr. REYNOLDS. To clarify that, when a plan is negotiated and a particular benefit is incorporated in any particular contract year, the hourly cost of that is included in the guidelines. Now I think it is well to point out, Madam Chairman, what happens after a certain amount per hour is costed against those benefits in a negotiation with the labor organization. If that plan does not have vesting, and subsequently there is a layoff, a great many people may cease to be employed because of the drop in the fortunes of the company. In that case, actual hourly costs mean nothing, because it may very well be for that particular year or the year following no contribution at all will be required and the plan may be sufficiently funded under Internal



Revenue regulations to meet the requirements for tax qualification. Do you follow the point?

Representative GRIFFITHS. Yes; but nevertheless to permit the money to go into a pension plan for whatever reason would justify a price that covered that cost and you would have to consider the pension contribution.

Secretary WIRTZ. Yes, we would, Madam Chairman. There are two aspects of this question. This became a quite sharp, acute consideration in connection with the steel case last fall, where there was a very, very precise pension plan issue and a very precise application of the guideposts' arithmetic. You are very right. In terms of increasing consumer purchasing power as direct wage increases do, there would not be this immediate effect from a pension plan. And so it could be argued and has been, that it should not be included.

But, you are very right in suggesting that it becomes, at least if it is properly administered, a cost of doing business.

Representative GRIFFITHS. A part of the price.

Secretary WIRTZ. Therefore, it does affect costs and prices and the short answer is that we have counted it in in computing wage increases for the purpose of applying the guideposts.

Representative GRIFFITHS. If large companies doing business today at a greatly accelerated pace, make a vast amount of money, they can easily get rid of some of it by putting it into pension plans.

Secretary WIRTZ. I guess I couldn't add anything by commenting on that.

Mr. REYNOLDS. May I make a comment on that, Madam Chairman?

Representative GRIFFITHS. Surely.

Mr. REYNOLDS. If they wish to obtain a tax deduction for all their contributions, they can only put that amount in which is called for by the plan on file with Internal Revenue.

Representative GRIFFITHS. Can't they amend the plan?

Mr. REYNOLDS. Yes, indeed they could.

Representative GRIFFITHS. So that they could get rid of an awful lot of money if they wanted to.

Mr. REYNOLDS. Perhaps.

Representative GRIFFITHS. And if they have a union that is anxious to help them get rid of it that way, the rest of us are going to continue to pay the full price.

Mr. REYNOLDS. Yes; but I think it is only fair to say that that same corporation which is enjoying, let's say windfall profits in this particular period of great prosperity might at some future date not be so kindly favored by the winds of business. Therefore, they have to think prudently of a long-range plan to provide assurance that the beneficiaries will get what they are entitled to.

Representative GRIFFITHS. Do you know how many of these plans that are on file with your Department provide that under some circumstances, or any circumstances, the management can get part of the money back?

Mr. REYNOLDS. I don't think we have that, Madam Chairman.

Mr. KLEILER. It would be a tedious examination of each plan description, the documents on file. It isn't coded. We couldn't derive it by any automatic data processing system.

Mr. REYNOLDS. We have over 35,000 plans on file now, Madam Chairman. Each one of them would require going through that detailed fine print language you referred to before, to ascertain how many of them have such a provision.

Secretary WIRTZ. My impression, Madam Chairman, is that it is an exceedingly small number for that kind of determination.

Representative GRIFFITHS. Suppose the actuary makes an error, and, therefore, the fund has really a very large sum of money which is unjustified in terms of the pension promise. Why then doesn't the management have a right to recapture?

Mr. REYNOLDS. Those funds must stay inviolate until the last beneficiary has died. If you are referring to a plan, Madam Chairman, where the business terminates and there are all these assets there, they must remain there until all the pension liabilities have been met.

Representative GRIFFITHS. Is it necessary that the business terminate? You put so much money in and you decide all at once this is just too much money; the plan doesn't require this much money.

Mr. REYNOLDS. Well, it might provide a method whereby the requirement to maintain the plan on a prudent basis would not call for as heavy contributions in subsequent years.

Representative GRIFFITHS. In one case, you start with the thesis that the plan is going to pay so many people and is going to pay them so much and this is the subject of negotiation. In the other case, the negotiators bargain for a contribution rate and set aside an earmarked fund saying this is pensions. If the union will strike to get these contributions and the fund is built up too high, the end result is that employees are going to get a much larger pension than they would have gotten originally; is that not right? It seems to me that you should have some idea of where you are going when the fund is set up, and what you are going to pay out rather than just add money to a fund.

Secretary WIRTZ. I think that is the usual pattern. To the extent that the questions are as to what the rights would be, and that really means what the tax implications would be in situations of this kind, I suppose we should defer to the Treasury people who are testifying at another time.

Representative GRIFFITHS. We heard representatives of the Ladies' Garment Workers plan testify that the plan pays the union to administer the plan. Doesn't this create a conflict of interest which should not be permitted?

Secretary WIRTZ. I should not offhand think of this as a conflict-of-interest situation. I think that there would be very, very few cases and the ILGWU would not be one, where I would think of a conflict of interest between the union and the members of the union, and so I don't believe that I would think of that as a conflict-of-interest case, but I will be glad to inquire of my associates whether a technicality is involved there. Does the administration of plan by the union on the basis of reimbursement by the fund present any question under the statute? I would want to check on that. I suppose that there is a possible question under section 303 of the Taft-Hartley Act, isn't there?

Mr. KLEILER. No; it is a very common thing, Mr. Secretary, for a jointly administered fund to be administered out of the union office

with the fund reimbursing the union for the cost of administration, and I am reasonably sure it has not been suggested as a possible violation of Taft-Hartley.

Representative GRIFFITHS. I have been interested by the plans that provide that the management pay the price of operating the fund.

Secretary WIRTZ. These are the cases that occur to me under 303. I am satisfied with what Mr. Kleiler says, that there probably has been enough clarification of that, that there is not a problem, but I take it your concern is with the broader matter.

Representative GRIFFITHS. Yes.

Secretary WIRTZ. On that I should like to say that I think the interests here are such that that kind of administration does not seem to me to present a problem. We would run into arguments, disagreements with some of the unions administering these plans. But I would never be inclined to cast those in terms of any conflict of interest between them and the members. I would be inclined to raise, rather, consideration of public policy here such as the vesting and the funding requirements which are in the public interest. But I don't think that this is a case where the unions have put the members to a disadvantage.

Representative GRIFFITHS. In the situation which the gentleman wrote about, pointed out that there were two unions which could shuffle the members back and forth between them, it is quite conceivable that the pension rights of only a few will ever vest, which is what he said. It seems to me that in that case something additional should be done. What you need is vesting that vests every year.

Secretary WIRTZ. I agree.

Representative GRIFFITHS. In your judgment, what is the advantage of a contributory plan as opposed to a management paid plan?

Secretary WIRTZ. Oh, I don't know that my thoughts are clear enough yet on this to come to a single conclusion. Jim?

Mr. REYNOLDS. I think it depends on the particular circumstances of the industry and the individuals at any particular time. This leads to the suggestion that many of the decisions on these plans reside and should reside, I would expect, in the area of free decisionmaking within the framework of free collective bargaining.

For instance, although most of us would applaud the concept of vesting, because we believe it is proper and morally correct, and because we believe that it would improve the mobility of labor in this country, the fact of the matter is, Madam Chairman, that the question as to whether there is or is not vesting today frequently is a bargainable matter over the bargaining table.

Representative GRIFFITHS. But, of course, we have already interfered with the bargain.

Mr. REYNOLDS. In what respect?

Representative GRIFFITHS. We are giving the management contribution a tax break and we are not giving that same thing to the employee contribution. We are practically setting up the ground rules.

Secretary WIRTZ. Oh, if the question is whether the tax treatment should depend upon contribution or noncontribution, I would have a very clear view on that and it would be as Mr. Reynolds suggested in the negative, that it should not. I would interpret your question as being rather a matter of policy, but the distinction is a very important

one. I would be quite clear that this question is not something in our opinion that should determine tax treatment.

Representative GRIFFITHS. Is it in the public interest that pension plans encourage retirement, in your judgment?

Secretary WIRTZ. No, as far as I am concerned, and that is just a personal view, but it gets into an area of great sensitivity. I am not at all sure that we are going down the right course at this point in our history by encouraging especially early retirement. At the same time that the doctors are extending our lives, we are seemingly intent on cutting out some of the opportunities for spending these added years. Until we come up with a better theory of what people are supposed to do when they get old, some meaningful doing I mean, I am not prepared to encourage retirement at all. At the same time the doctors are extending our lives 5 to 10 years we are thinking up euphemisms about "autumn years," "senior citizens," and things like that. The social architecture, social planning, social invention is so far short of the scientific invention here. I am sorry to have taken advantage of a very small opportunity to make what is perhaps an unrelated point, but I am not at this point prepared to say that the point of life is to encourage retirement, not at all.

Representative GRIFFITHS. Should not a plan participant or his heirs receive the actuarial equivalent amount regardless of retirement age?

Secretary WIRTZ. Well, now, that is really related to the vesting question, isn't it? To the extent that this presents the general vesting point, our answer is affirmative. It again raises questions of detail. Just as there is not a single concept of funding, there is not a single concept of vesting. But to the extent your question really raises essentially the question of whether we think that vesting in one form or another is a good idea. I would say "yes" without qualification.

Representative GRIFFITHS. Did you want to add something?

Mr. REYNOLDS. Well, I would just point out that any such requirement, Madam Chairman, that the actuarial equivalent go to the heirs, for instance, would raise costs of pensions to a great extent, because every pensioner then becomes a loss certain or a burden certain on that plan. The actuarial computations take into account the whole question of life expectancy as we know; when people unfortunately pass away and cease to be a burden on that fund, it permits that fund to have a higher level of benefits at a given cost than might otherwise be the case if the heirs to that individual were entitled to the actuarial equivalent.

Now, frequently, plans do have that provision in them, but again, it is a matter of the individual bargain and the individual choice of the parties. They would prefer possibly to have a lower benefits level and yet have that requirement, so that the heirs of a particular prospective beneficiary would be protected to some degree.

Representative GRIFFITHS. Just in case you have never thought of it, in case I die right now, my husband gets back from the Federal Government what I paid in, and your widow in case you die will get the pension.

Mr. REYNOLDS. Yes.

Secretary WIRTZ. We hope there are better ways to prove this point.

Mr. REYNOLDS. But may I point out, Madam Chairman, that is under a contributory plan. You and I both contribute very liberally.

Representative GRIFFITHS. I would just as leave that you contribute to help support my husband as that I contribute to help support your wife, frankly.

I would like to thank you for being here.

Secretary WIRTZ. Thank you very much.

Representative GRIFFITHS. You have been very kind. If you are not indignant, I am indignant. I am furious that these people are paying in to pension plans for 20 and 30 years and getting nothing. I think it is really a shame that it can happen.

Wednesday afternoon at 2 o'clock Robert Ball will testify before this committee, and we are going to find out why social security doesn't do a better job.

Secretary WIRTZ. Thank you very much, Madam Chairman.

(Whereupon the committee, at 11:05 a.m., recessed until 2 p.m., Wednesday, May 11, 1966.)

## PRIVATE PENSION PLANS

WEDNESDAY, MAY 11, 1966

CONGRESS OF THE UNITED STATES,  
SUBCOMMITTEE ON FISCAL POLICY  
OF THE JOINT ECONOMIC COMMITTEE,  
*Washington, D.C.*

The subcommittee met, pursuant to recess, at 2 p.m., in room S-407, the Capitol, Hon. Martha Griffiths (chairman of the subcommittee) presiding.

Present: Representative Griffiths (presiding).

Also present: Nelson D. McClung, economist; Donald A. Webster, economist; and Hamilton D. Gewehr, administrative clerk.

Representative GRIFFITHS. I would like to welcome you here and tell you how pleased I am to see you, and ask you to begin.

### **STATEMENT OF ROBERT M. BALL, COMMISSIONER, SOCIAL SECURITY ADMINISTRATION; ACCOMPANIED BY ROBERT J. MYERS, CHIEF ACTUARY**

Mr. BALL. I thought perhaps it would be helpful to the subcommittee, Madam Chairman, if I began with some descriptive material about our existing arrangements for retirement systems, looking at them as a whole.

Representative GRIFFITHS. We have let everybody else advertise, we will be glad to let you.

Mr. BALL. There are four major types of retirement systems in the United States today:

1. Our Federal social insurance system—paying retirement benefits, survivors benefits, total disability benefits and, beginning, July 1, providing health insurance protection for older people—which now covers more than 9 out of 10 jobs and forms the foundation of future retirement security for most Americans.

2. Private retirement systems in industrial and nonprofit employment, which build on our Federal social insurance system and provide additional benefits.

The coverage is almost entirely overlapping, in the sense that a person who is covered by the private systems is himself covered by social security.

3. A number of governmental systems—Federal, State, and local—which either build on the Federal social insurance system as in the case of many State and local plans and the plan covering the Armed Forces, or are closely coordinated with it as in the case of the railroad retirement system.

4. A few governmental systems; namely, the Federal civil service retirement system and some State and local plans, which are not coordinated with our social insurance system and cover jobs which are not under social insurance.

Those are the four types of arrangements that we have.

I think these broad classes of retirement systems must be studied together for it is the combination of protection which people have and the cumulative effect of the combined arrangements which are significant. Private plans cannot reasonably be considered separately from the public program. For those who have private plan coverage, it is the combination of social insurance with the supplementary protection of the private plan which constitutes the "retirement system."

For the majority of people who get private pensions, as well as for those who do not, the major part of their retirement income will come from the social insurance system.

#### COVERAGE OF CURRENT WORKERS

The first area that I propose to discuss is the coverage of current workers, people who have not yet retired. All but about 4 percent of the people at work today are earning retirement protection for the future and many in this 4 percent will earn protection as they move to other jobs. More than 9 out of 10 are under our Federal social insurance system and most of the rest are under other Federal retirement systems or State and local retirement plans. The 4 percent not covered at any one time are in jobs which currently do not meet tests of substantial employment established under social security in connection with self-employment, and with agricultural, and domestic employment.

At the beginning of the 1966 a little over a third of those who were covered by social security were also covered by private plans designed to supplement the public system and another 6 percent were under the railroad retirement system or governmental plans designed to supplement the social insurance system. About 5 percent of all people at work were covered solely by the Federal civil service retirement system or a State and local system.

For the worker, this coverage is almost entirely compulsory. Membership in a particular plan, whether public or private, is typically an automatic accompaniment of employment in an industry or occupation covered by the plan. Under a few State and local plans, under most private contributory plans, and in nonprofit employment and certain State employment under the Federal social insurance system, those who were in covered employment at the time the plan was initiated may stay out of the plan if they wish, but those who are hired later are covered compulsorily. Other than this, coverage on an individual voluntary election basis is pretty much limited to clergymen under the Federal social insurance system.

#### THE HISTORY OF COVERAGE

The practically universal coverage of current workers under retirement systems is a recent development. Thirty years ago there were only about 6 million persons, less than 15 percent of those employed, with this protection. Employer sponsored plans, including railroads,

covered about 3.7 million workers and the special systems for Government employees about 2 million. Around 200,000 employees of non-profit institutions such as clergymen and university and college teachers also had protection, and a few workers were covered by union sponsored plans. Most employees of business and industry were protected under a retirement program for the first time in 1937 when coverage under the Social Security Act became effective. At that time about 25 million were covered under social security. As the labor force grew, the number of persons covered by the program increased until by 1950, just before the further extension of coverage, there were about 35 million under that program at one time. There are now about 68 million workers covered under social security at one time.

Most supplementary plans of private industry are of even more recent origin than the public programs, although a few are very old. The American Express Co. (now the Railway Express Agency) set up the first private pension plan in the United States in 1875, and the Consolidated Gas Co. of New York (predecessor of the Consolidated Edison Co. of New York) and the Carnegie Steel pension plan and the pension plan of the Standard Oil Co. (New Jersey) were established during the 30 years following.

Most of the early plans were noncontributory and unfunded, and they carefully avoided establishing "rights." The pension was usually discretionary and was considered a gratuity. Pensions could usually be terminated or reduced at will. Gradually the legal character of pension plans has changed until today they are generally considered a right of the employee who meets the eligibility conditions.

During the 1920's insurance companies began to sell group annuities and following the establishment of social security there was a considerable upsurge in the establishment of insured plans as supplements to the public program. The second major growth in private plans occurred during World War II because of the special conditions growing out of the war economy. Cash wages were frozen, and pensions were one of the few ways left open to employers to grant increases in compensation and to compete with each other for labor. Moreover, the establishment of pensions was made relatively inexpensive because of the operation of the excess-profits tax. For a firm in the higher brackets of the tax then in effect, money put into a pension plan actually cost the employer only about 20 cents on the dollar.

Unions have made retirement protection a major goal. As indicated, total coverage under private plans now numbers about 25 million people, although because of job movement and the lack of early vesting in some plans not all of those, by any means, who have current coverage will become eligible for pensions at the time of retirement.

#### COVERAGE OF THE PRESENT AGED

Now, to turn to the subject, not of the coverage of current workers, but of how effective those plans are in relation to people already old—the coverage of the present aged. Today 85 percent of the 19 million people 65 and over are either getting social security benefits or will be eligible for them upon retirement. If you add the number protected under civil service retirement and railroad retirement, 90 percent of the present aged have pensions that they can count on under



programs of the Federal Government, based upon their work and contributions and, of course, paid without a test of need. If we look at those who became 65 last year, instead of at all the aged, 92 percent were eligible for social security benefits and about 97 percent were protected under one of these three Federal retirement systems.

Because of their relative newness and because of in some instances the lack of early vesting provisions, most private plans are less effective in supplying benefits to the people already 65 or over than they are in covering current workers. Although about a third of the labor force are currently in jobs covered by private plans, only about 15 percent of those 65 or over are either drawing private pensions or are the wives of men drawing private pensions. Another reason for the low percentage of the aged receiving private pensions is that very few plans provide survivorship protection for widows as the public programs do. Yet widows represent about 30 percent of all persons 65 or over.

Actually then, social security is the only retirement system for more than 80 percent of social security beneficiaries, age 65 or over, and the combination of social security and a supplementary pension plan is the retirement system for the rest. Even for those whose retirement system is a combination of social security and a supplementary plan, it is important to remember that social security usually accounts for more than half of the total pension. Over the next 25 years these figures might change to 70 to 75 percent with only social security and 25 to 30 percent with a combination. There is no real likelihood in the foreseeable future that a majority of older people would become eligible for supplemental pensions. Too much of the problem of income maintenance in old age is a problem of survivors insurance for widows which is seldom covered by private pension plans; too many jobs are difficult to include in private pension plans; and very early vesting would be required to supply protection to the large number that change jobs frequently.

The problem of universal coverage under governmental systems has been just about solved. What remains is largely a matter of coordination between social security and the Federal civil service retirement system and a few State and local plans. The President has recommended a transfer-of-credit plan which would solve this problem for Federal civilian employment by guaranteeing that employment for the Federal Government would result in credits under either the civil service retirement system or social security that would be at least as great as if the employment had been covered by social security. We are also studying the possibility of whether coordination with State and local plans can be made easier, where this has not occurred, and whether any liberalization of the coverage tests in the areas of agricultural and domestic employment are administratively feasible.

#### BENEFIT LEVELS

From the standpoint of protection furnished, the level of benefits provided by present arrangements is much less satisfactory than the coverage situation. Since for most people social security benefits constitute their only income from a retirement system and since social security benefits constitute the major part of retirement income even

for most of those who have supplementary pensions, the level of social security benefits is the most important question in determining the adequacy of our retirement arrangements.

Even if one takes into account all types of retirement income, such as income from savings and investments, social security constitutes the major reliance of just about all beneficiaries and is the only regular income of about half of the beneficiaries. Yet improvements in cash benefits in recent years have not quite kept the benefits up to date in terms of purchasing power. The 7-percent increase last year fell slightly short of restoring the 1958 purchasing power of the benefits and the 1958 increase of about 7 percent also fell slightly short of restoring the 1954 level. This means that those on the social security rolls throughout this period have not shared in the rising level of living of the rest of us, and, of course, the benefits were low to begin with, even in terms of the 1954 standard of living.

It is true that for most of those who have not yet retired and who will be working under the program for a longer period of time, the recent amendments will result in a considerable increase in benefit levels. Earnings up to \$6,600 per year instead of \$4,800, are now counted for benefit purposes. Ultimately the maximum benefit for a worker will be \$168 instead of the \$135.90 maximum today. For a couple, the maximum will be \$252 a month instead of the present maximum of \$203.90.

Perhaps more important, for the man who regularly earns "average wages"—around \$5,600 a year—the benefit in the future for himself and his wife, if the pension is taken at 65, will be about \$225 a month, or about 50 percent of earnings, and for the one who earns regularly at the level of the Federal minimum wage, amounting to about \$2,600 a year, the benefit for the couple will be about \$140 a month, or about two-thirds of previous earnings.

These amounts need to be increased. It cannot be assumed that retired workers who earned only minimum wages have significant assets or income from other sources; the benefit for such retired workers is usually all they have to live on. For the worker who is under the social security program full time and who has earned only minimum or near-minimum wages, our objective should certainly be to pay amounts above the minimum standards we have been using to measure the poverty line. In our studies we have set the basic poverty level in present prices at about \$155 a month for elderly couples or about 10 percent more than the benefits payable to the steady worker and his wife earning the Federal minimum wage. Those who earn more should, of course, be paid more. Single people are somewhat worse off in relation to the poverty standard—as, also, are those who do not work regularly under the system.

President Johnson has indicated that he will propose major improvements in the social security program in time for action by the next session of Congress, and he has particularly emphasized the need for an increase in the level of benefits. He has asked us to complete our studies of alternative possibilities with this legislative timetable in mind. Thus the first order of priority is an increase in benefit levels, and I would say that increase is needed throughout the whole range of covered earnings and not just for those earning minimum amounts.

Social security beneficiaries who receive supplementary retirement pay from other plans are, of course, much better off than those who receive social security alone. In the survey of the aged conducted for us by the Bureau of the Census in 1963, it was found that about half of the couples drawing private pensions got more and half got less than \$65 a month from this source.

#### SERVICE REQUIREMENTS FOR BENEFITS

All of the retirement programs, both public and private pay benefits only after a period of work under the system. It is true that, on a temporary basis, a recent amendment to the social security program gives a special minimum benefit at age 72 to the relatively small number of persons not otherwise covered under governmental retirement systems or drawing public assistance even though they have no social security coverage, but this benefit is paid for from general revenues rather than from the regular social security system.

In the long run, a person must have been in covered employment 10 years to be eligible for a retirement benefit under social security. For the early years of the program, however, in order to make the program effective for those already near age 65, a shorter period of work is sufficient. For men reaching 65 this year,  $3\frac{3}{4}$  years of work in covered employment is sufficient, although people with this small amount of coverage receive quite low benefits. Since work in nearly all jobs counts toward social security, men now working will find the service requirements easy to meet.

Service requirements under private plans are much more difficult to fulfill because the employment must generally all be with the same employer (in some plans in the same industry). Plans frequently require as much as 10 or 15 years' service before making any payment. In some cases a worker is required to wait as long as 5 years before he may participate in the plan and start accruing pension credits. In addition, some plans do not permit new employees past a certain age, say 55 or 60, to be covered.

Those plans which require relatively long employment with the same employer or industry do not protect the worker who changes jobs after, say 45 or 50. This is one reason why it is very difficult to say just how much protection these plans afford. There are more than 25 million persons working in jobs which would provide them with benefits supplementary to social security if they stayed in those jobs long enough. But how many will?

#### VESTED RIGHTS

Some private plans require the individual to be working for the particular employer (or industry or to be on some kind of leave status) at the time of retirement in order to receive any benefit at all. Other plans give certain rights of termination of employment before retirement age. In private contributory plans, an employee whose service is terminated before retirement is always entitled to a refund of his contributions, usually with interest.

In many plans an employee who meets certain requirements with respect to length of service, age, or both is given an equity in the pension rights accumulated for him out of his employer's contribu-

tions if he does not withdraw any contributions that he himself has made. This "vesting" is usually in the form of a paid-up annuity deferred to retirement age. Thus, an employee leaving a firm at age 45, for an example, may be given a paid-up annuity maturing at age 65 for an amount purchasable by both his own and the employer's contribution. Vesting may be complete; that is, the employee is entitled to the full value of the deferred annuity to his credit, or it may be graded, in which case partial vesting is established after an initial number of years of coverage, with the proportion vested increasing gradually to full vesting after an additional number of years. A combination eligibility requirement for vesting of both a specified minimum age at termination of employment, 45 to 55, and of service, 10 to 20 years, is quite common.

The Federal programs tend to have provisions which have the effect of liberal vesting provisions. Rights to a railroad retirement system pension are established after 10 years and to a civil service retirement pension after 5 years. The right to retirement benefits under social security is established after meeting the minimum service requirements previously described.

#### FUNDING

In all pension plans, benefit expenditures are low at first and increase gradually as the pension roll builds up over the years. Some arrangements for currently setting aside amounts to cover part or all of the accruing liabilities before benefits have to be paid, that is "funding," is the common practice.

What constitutes an "actuarially sound" funding plan, however, is a matter of debate. A very strict definition of a fully funded plan would be a plan which had deposits in sufficient amounts so that if after any given cutoff date no further deposits were made, the plan could continue in operation, fully honoring all obligations based on service up to such date. Thus all those who had retired would continue to get their benefits, and those who had not yet retired would get benefits as they became eligible. This definition of actuarial soundness would require deposits to have been made for all past-service credits and to be made currently for all present service.

Relatively few workers today are covered by plans which would meet such a test of liquidation. Some plans do not contemplate ever being in this position, while others that do, by and large, have not yet accumulated the sums necessary to fund all past-service credits.

Another possible test of actuarial soundness is to fund the plan in such a way that the necessary amount has accumulated by the time of retirement to provide each participant with the contemplated life retirement income. This test can be met even though past-service credits have not been fully funded. Under this test, the continued operation of the plan may be necessary to meet the obligations to those who have not yet retired, but in the event of liquidation those already on the rolls would continue to get their benefits.

Another test, somewhat less stringent, which depends even more on the continued operation of the plan, is the test usually applied to social security and other Government plans; that is, will the scheduled income to the fund into the remote future be sufficient to meet the benefit obligations as they arise? Thus the tax schedule in the social

security program is designed to make the system entirely self-supporting over the next 75 years but does not contemplate full funding. This test can be met even though past-service credits are never funded, if in the future, instead of such funding, amounts are made available equivalent to the interest which would have been earned by deposits for past-service credits. Although appropriate for a public program whose continuance may be assumed, this test of actuarial soundness is very doubtful for private plans.

Although most plans have some sort of funding arrangement, many would not meet any of the tests of actuarial soundness suggested above.

#### THE RELATIONSHIP OF THE BASIC FEDERAL SYSTEM AND PRIVATE PENSION PLANS

There is widespread acceptance of the idea that our retirement arrangements should consist of a universal Government plan with private pensions and certain Government plans supplementing the universal system. A single approach may seem at first glance to have considerable attraction but even if social security benefits were to be considerably liberalized, as they should be, it is extremely doubtful that a generally applicable system would pay benefits high enough to satisfy management and unions in the more successful companies or industries. Moreover, in some occupations and in some industries special types of provisions, such as lower retirement ages, may be desirable. And, for those in top executive positions and for supervisory personnel many managements want to facilitate retirement or shifts to another job by paying retirement benefits much higher than will be paid by a general system.

Until recently the justification for private plans has been that they furthered the interests of a particular company, on the one hand attracting and holding good employees, and on the other, making it easier to retire those who are most likely to be unproductive. The goal of private pension plans was first to assure a particular organization a reasonable age distribution of its labor force and an aggressive leadership and to accomplish this in a way which would promote, rather than harm, public and employee relations.

Private pension plans in recent times have taken on more of a general public purpose and tend now to be justified on the ground they make an important contribution to the security of a large number of workers—providing for them in combination with social security a much higher level of living in retirement than would probably be reasonable to expect from even a substantially liberalized social security program standing alone. There is little doubt that private initiative will continue to foster plans supplementary to the broad base of the public program and it is important that they be shaped in the public interest.

Although there is widespread agreement on the desirability of supplementary private plans, there is also an awareness of their limitations and an awareness of the possible dangers which lie in certain features of some plans. Thus the emphasis has been on a universal public program, with private plans filling a subsidiary role.

The unions, management, and experts alike have pointed out the difficulties which arise in private pension planning because each plan covers only a given employer, industry, or group of employers within a locality. They have pointed out that private plans may lack the security of the public program because employers may go out of business or be forced to terminate the plan. They recognize the difficulty of funding in a way which allows for increases in benefit amount as productivity rises. Some among management have feared the nature of the long-range commitments which they must make in bargaining on private pensions and the fact that the commitments must be met in bad times as well as good, under unfavorable tax conditions as well as favorable conditions.

Perhaps the most serious charge which can be brought against private plans is that certain types of plans can bind the worker to a particular company or industry when both he and the economy might be better off if he were free to move—for with his pension at stake the worker may be afraid to change jobs.

For these reasons, it seems to many of us that it is important that the basic governmental program continue to receive major emphasis in our retirement arrangements, even though it is recognized that private pension plans are important and should be improved.

In summary there are several key features of social security that cause it to deserve primary emphasis. First is its nearly universal coverage and the complete portability of credits earned. Earnings with different employers and in different types of employment are combined and given full credit toward the computation of an individual's retirement benefits.

Second, the pension rights are secure with the capacity to finance benefits resting on the entire economy rather than on a single firm or industry.

A third key feature is the broad scope of benefit protection. In addition to retirement benefits, the program pays benefits in case of the death or disability of an insured worker thus protecting older widows and workers prematurely retired because of disability. Furthermore, as a social insurance program financed by a percentage of earnings, social security benefits can be readily adjusted in relation to rising earnings levels and to changing standards of living.

Since social security will continue to be the Nation's basic instrument for assuring reasonably adequate retirement income to workers, their widows, and dependents, the primary task of public policy in the field of retirement income, as I see it, is to assure a universal and adequate public system including an earnings base and a benefit formula that keeps pace with changes in wages and results in benefit levels that are reasonable in relation to general living standards.

Secondly, sound private plan supplementation should be encouraged. As the report of the President's Committee concluded:

\*\*\* Public policy should continue to provide appropriate incentives to private plan growth and by improving the basic soundness and equitable character of such plans, set a firmer foundation for their future development.

Representative GRIFFITHS. Thank you very much.

I believe you told me once that when the original social security tax base was set it covered 97 percent of all incomes then paid; is that right?

Mr. BALL. Ninety-seven percent of the workers—all the income of 97 percent of the workers; that is right.

Representative GRIFFITHS. If today you were to cover 97 percent of the workers, what would be the annual contribution to social security?

Mr. BALL. The comparable wage base to the \$3,000 that was in effect at the time you are speaking of, when the program started, would today be a \$15,000 maximum wage base. And the contributions for people who earned at that maximum amount would be, including the health insurance contribution, at the present time—

Mr. MYERS. On the basis of the current 4.2 percent employee rate, 4.2 percent of \$15,000 would be \$630 for the year.

Representative GRIFFITHS. And what approximately would be the total annual contribution to the fund?

Mr. MYERS. From employers and employees and the self-employed combined?

Representative GRIFFITHS. It is about \$20 billion today.

Mr. MYERS. It is about \$20 billion today. And just increasing the earnings base to that figure of \$15,000 would increase the total contributions by approximately 20 percent. So that would be roughly \$4 billion a year.

Representative GRIFFITHS. So that it would be possible to lift some of these payments if you were taxing on the same basis that we originally taxed?

Mr. BALL. Yes. That would allow for a considerable improvement in the benefit structure.

And Madam Chairman, part of it would be quite automatic, in that, counting the higher wages that people would earn between \$6,600 and \$15,000 it would result in their benefits being higher without any change in the benefit formulas as a whole, but it also would leave over some money for general improvement in benefits.

Representative GRIFFITHS. My favorite improvement would be to combine the contributions of a husband and wife and pay out on that basis. I believe you told me last year that this would cost a billion dollars more per year.

Mr. MYERS. Yes, Mrs. Griffiths, as I recall, that was about the figure.

Representative GRIFFITHS. But at the present time you are taxing the lowest paid the most heavily, and paying them the least; isn't that right? They are paying a double tax, they are both paying on their incomes, and they are receiving less.

Mr. MYERS. Yes; that is true in many instances.

Mr. BALL. You are speaking of the couple situation—

Representative GRIFFITHS. Yes. Supposing each one had made \$2,400 throughout his or her working life, they would have paid the same amount as was once the base, \$4,800.

Mr. BALL. And the man and wife getting the benefit on his own earnings, which were equal to twice that of husband and wife's earnings separately, would get a somewhat higher benefit, that is correct.

Ever since you mentioned this to us we have been in agreement that this is not an equitable result. But frankly, we have not yet designed a solution that would be one that didn't introduce a lot of other difficulties. One of the problems is how you handle the maximum wage base.

But we will continue to study that.

Representative GRIFFITHS. Have you yet had a formal application by a man for benefits at 62 years of age? He is just retiring.

Mr. BALL. Oh, yes; there have been many applications for men at 62.

Representative GRIFFITHS. The retirement age for a man is 65, isn't it?

Mr. BALL. No; they can get an actuarially reduced benefit now at 62. And substantial numbers of both men and women have been applying for benefits below 65. This is one area of considerable concern to us, because when they do apply before 65, the benefits are much lower. And yet, as I remember last year, almost half of the men and almost two-thirds of the women who applied for the retirement benefits applied for them before 65.

Representative GRIFFITHS. Are you aware that one of the problems of the Equal Opportunity Commission is that men are asking for private pensions before 65? They are asking for equal treatment. And the answer of the private concerns has been that the Federal Government will not pay you a pension at an earlier age. Now, if you are actually paying, then they are really referring to the Federal civil service pension.

Mr. BALL. Perhaps, but of course, there, too, people can receive pensions before 65.

Representative GRIFFITHS. After sufficient years of work.

Mr. BALL. Yes. It is possible that this type of criticism arose before the amendments to social security gave benefits to men on an actuarially reduced basis at 62. There was a period of time during which such benefits were payable only to women. And now it is the same for both. But there still remains an inequity in that women's benefits are computed on a wage history up to age 62, whereas men have to go all the way up to 65. And this results in an advantage for the women in benefit amounts, since she does not have to count any blank years—that is, years with low or no earnings—after 62 in computing the average wage.

Representative GRIFFITHS. What would it cost the fund if you gave men the same right that women have, not taking into account that men are not going to live as long. A woman is going to live about 3 or 4 years longer. Supposing you let the man draw at 62, and gave him the same amount of money that you would give a woman based on her life expectancy?

Mr. BALL. Making the computation on the same basis for men and women, the increase in cost is 0.1 percent of payroll. And it is, Madam Chairman, a recommendation that was made by the 1965 Advisory Council on Social Security, and is certainly one that we are giving very serious consideration to in relation to the President's request for social security improvements. It does seem difficult to defend the situation of two workers who are otherwise earning just the same, and the woman gets a higher benefit by reason of being a woman.

Representative GRIFFITHS. I agree with you. I think a man should have the same right.

To what extent, in your opinion, is the development of the private pension system a consequence of an inadequate old-age and survivor's insurance system?



Mr. BALL. Well, I believe that a considerable part of the development during the war years and immediately following was considerably influenced by the fact that the social security maximum earnings base had not been kept up to date, and that consequently the benefit amounts payable to workers in unionized industry under social security alone were just obviously inadequate. I am not able to give you a proportion. I think that private pension plans have a purpose over and beyond, and in addition to social security. But I think a considerable part of the push for having the plans apply to all workers, and on a widespread basis, was the inadequacy of social security at that time.

Representative GRIFFITHS. Do you feel that the greatest obstacle to increasing social security pensions is the method of taxation?

Mr. BALL. I think certainly the financing of the benefits is the big inhibiting factor to moving to substantial increases. And the contribution rates that are contemplated in the present law, when you add in health insurance, will ultimately be over 5 percent on the employee and on the employer. So that we have come to a place where further increases in the contribution rates run into increasing resistance. Personally, I believe that they could be somewhat higher than they are. But how much is a question. And I think the wage base could certainly be increased.

But I would like to take the opportunity of your question to say that we will also give, and are giving, serious consideration to whether the social security system might in part also have a general revenue contribution which has a generally more progressive base than the present method of financing, and perhaps a combination of present financing and general revenues would be better.

Representative GRIFFITHS. Since we now have a precedent for putting in some money out of the general fund, I think that maybe we would have a better chance of financing social security from both sources. But actually, this payroll tax is a very regressive tax, and it makes our products less competitive in the world.

How far do you think we should go in imposing a burden on the active to support the retired?

Mr. BALL. I do not think I could give you a precise answer to that, Madam Chairman. I think you can look at the social security system, or for that matter any pension system or retirement system, either in terms of active workers supporting the retired, or I think another way of looking at it is equally valid, and that is, people covered by the system by the contributions they make are building up for themselves additional protection at a time in their lives when their incomes would otherwise be lower, so in that sense it is deferred income. One of the main functions of a retirement system and social insurance, in general, is to level out the peaks and the valleys in a person's lifetime income history. I would think that we could go much further than we have and it would still be valid for the individuals concerned and for society to push some of the higher income that people have while at work over into periods when they are not at work. The worst poverty situations that we have for workers are usually while they are out of work, and not while they are earning.

Representative GRIFFITHS. Have you ever considered the possibility of amending the OASI plan to permit employers to purchase additional credits for their employees?

Mr. BALL. Yes; that has been given some consideration. And I believe it will be part of the general interdepartmental study that we will be making on the possibility of improving the portability of private pension rights that was suggested for further study by the President's Committee.

I don't know that we will necessarily decide that that particular method is a good one. If you set it up on a strict actuarial basis, which I presume you would, if it is a matter of employers purchasing the protection, or collective bargaining plans purchasing it, this can also be done by existing private arrangements. They also can sell on an actuarial basis. And it is a question, at least, whether the Government is justified in moving into that kind of direct competition with private insurers—I do not know whether we have any special advantage that a private insurer would not have for such an arrangement, except the one of portability of credits. And it is possible to work out other plans for portability without taking over the actual selling of the insurance itself.

Representative GRIFFITHS. Since you are the only people who have even tried to define funding, I would like to ask you, what disasters and what other things do you consider in the question of funding? Do you really think that anyone setting up a pension plan 15 years ago would have assumed that they could make 6 percent on the investment?

Mr. BALL. I would be glad to have Mr. Myers comment on that if he would, since he is the actuary.

Mr. MYERS. Madam Chairman, I think your question is very well posed. If anybody had said 15 years ago that they would get 5½ or 6 percent on their invested assets—

Representative GRIFFITHS. They would have been removed to some mental institution very quickly.

Mr. MYERS. I think that is very true. There are all sorts of elements of uncertainty in any type of funding, just as there are in any type of actuarial cost estimates, as to just how the experience will develop as to not only interest, but the elements of mortality, withdrawal of active employees from service, and the retirement experience; namely, whether people retire at the minimum possible age, or whether the employer or the plan permits them to go on working to an older age, and thus draw a higher salary during that time, but at the same time saving the pension fund payments.

Representative GRIFFITHS. How many depressions or recessions do you figure in a 20-year period?

Mr. MYERS. This is another element that really is, I would say, relatively unpredictable as far as actuarial cost estimates are concerned.

Of course, in funding private pension plans a common practice is to fund each particular piece of the pension as it is earned, and then if subsequently there is less employment, the past pensions will still have been paid for. Of course, this is not so readily possible under private pension plans that are based on final salary.

Representative GRIFFITHS. Now, in view of all these uncertainties, and in view further of the fact that in these noncontributory plans the employer is setting aside money which even today would be taxed at a 48-percent rate in general, wouldn't it be cheaper for the Government simply to insure these plans like a bank deposit than it is to permit them to make all these guesses on who, what, and when they are going

to pay? These guesses are terribly expensive to the tax system. When a company comes in here that has had a plan for 26 years, and has never yet paid the interest on the fund, then it seems to me that all the guesses have been in favor of the company. And it seems to me also that the Government would be further ahead if they just insured the plan for them.

Mr. BALL. We have been mentioning some of the funding factors that result in plans having more money than they originally expected.

But there is one other very strong and inherent tendency in pension plans that works in the opposite direction. And that is the fact that, although not legally, they tend to be commitments to a given level of living in relation to wages, and that this almost forces a continual liberalization of the plans in terms of dollars.

Representative GRIFFITHS. Is that what forces it, or is the fact that they have the money?

Mr. BALL. I do not think that typically they have had enough money to fully fund the additions that have been made. In terms of past service, the liability has always been running behind. And I am afraid that it would always run somewhat behind. Because every time you raise a pension you have got a tremendous accrued liability that is increased.

So that I would guess—I would like to have Mr. Myers' comment on it, but I would guess that on balance the inherent tendency, the need to liberalize in order to have the plan do what you had in mind in the light of rising prices and the level of living is probably a stronger tendency toward underfinancing than the tendency of actuaries to adopt conservative assumptions that result in having more money.

Representative GRIFFITHS. But who knows what they had in mind? Where do they produce these facts as to what they had in mind?

Mr. BALL. I was thinking not of what the actuaries had in mind, but the statement of the plan's benefit in dollars in relation to wages they are paying.

Representative GRIFFITHS. Do they tell IRS exactly what they expect to pay?

Mr. BALL. Yes, they do. But what I am saying is that wages go up a lot, and the previously promised dollars look pretty small, and then in order to do a job you come along and liberalize it, and that increases the need for more funding, and you are in a circle.

Mr. MYERS. I would agree completely with what Commissioner Ball says on that matter. In brief, any excess funds that plans may be developing now because of the favorable interest rate experience, which may or may not continue for many years in the future, will be used up in the improvements in the plan that will almost certainly result from rising earning levels. In fact, one might even say that these are not improvements so much as just keeping the plans up to date with the changing price level and standard of living level.

Representative GRIFFITHS. Of course, I have been trying to figure out exactly what is favorable to a pension plan. A good depression is really favorable, because you cut off the people who were going to draw a pension. True, you might lose some of the assets but I would think that on balance a depression is a boon to a plan.

Mr. MYERS. There are, as you have indicated, factors moving both ways.

Representative GRIFFITHS. All the time.

Mr. MYERS. If a number of active workers lose their jobs and lose any rights to deferred pensions, then in that sense the pension plan is in a sounder condition. On the other hand, as you mention, if some of the assets go sour, this is a negative element.

Still another feature is that if, with worsened business conditions, people retire early or retire promptly at the minimum retirement age of 62, this is a higher cost element than if they went on normally working for 2 or 3 years beyond the minimum age.

Representative GRIFFITHS. And now I would like to ask you, what would really be wrong with having social security actually vest at 62 or 65 or whatever, and let the worker work if he wants to?

Mr. BALL. I would say the problem is primarily, Madam Chairman, one of cost. And then add to that the idea of what do you get for your money? There is no reason, no technical reason, why the program could not be rewritten to pay benefits automatically at age 65, say, regardless of whether a person continues to work full time. It would cost eight-tenths of 1 percent of payroll to do it. This means that currently around \$2 billion of additional benefits would be paid annually.

Now, the question that has always stopped me is, who would get that \$2 billion? Well, not entirely but almost entirely it would go to people who are continuing to work after 65 at regular, full-time jobs, who have really no more need for getting a pension now than they did when they were 45 or 50 and had regular, full-time jobs. In other words, the concept of the program has been one of insurance against the loss of earned income growing out of a risk of retirement and for that reason it does not cost as much as if it were paid automatically. And it also directs the money to the places where there has been a drop in income, to people who have substantially retired.

So, although I think it is quite proper to spend a significant additional amount of money under this program, I would rather see it go to the people who have to stop work, and have suffered a significant loss of income, and are getting benefits that are too low by and large rather than the full-time workers who just happen to be over 65.

Representative GRIFFITHS. Now, I had a letter from a woman in my district, who I think was 52. Her husband had passed away. The amount that she was going to get was set, because the amounts she was earning were never going to entitle her to as much. But she was going to continue to pay into that thing as long as she worked. And, of course, she had lots of objections to it. And really, I think it is a very difficult thing to explain.

Mr. BALL. You are saying her benefits as a widow, based on her husband's earnings, would definitely be higher than what she herself would get under her own continued work?

Representative GRIFFITHS. But she was going to pay for another 10 or 13 years.

Mr. BALL. I think if the facts would bear out her description of it, it is a difficult thing. Typically current workers continue to improve their benefit amounts quite substantially, because wages rise, you know, 3 or 4 percent a year. So that a benefit based on her husband's earnings, even though her husband's earnings might have been a great deal more at the time he was earning—because they are frozen in the past are apt to be outpaced by her own earnings on into the future.

When you take into account, also, that she gets a full primary insurance amount on her earnings, as compared with 82½ percent of the primary insurance amount based on her husband's earnings, I am just not sure it would turn out the way she now thinks it would if she continued to work.

Representative GRIFFITHS. Of course, I suppose if she became disabled she could draw on her own. She did have some additional protection. But, otherwise, she was just paying.

If we are not going to let people work and draw social security, why should they be permitted to draw dividends?

Mr. BALL. Just before going directly to the question, I think it ought to be clear, Madam Chairman, for the record that people can do considerable amounts of work and still draw some social security benefits under the provision as it is now written. As you know, the retirement test has been liberalized in 1965, so that people get their full social security benefits even though they earn in a year as much as \$1,500.

But even more importantly, there is only a dollar benefit reduction for every \$2 of earnings, from \$1,500 up to \$2,700 now. So that a person with a relatively high benefit, a man and wife, can actually get some social security benefits even with earnings of as much as \$4,000 under the present test.

Now, the reason that the retirement test has been entirely limited to earnings is twofold. First, the thought has been that it was highly desirable to use social security as a base to which people would be encouraged to add other income as they were able to get it, just as it is a base for private pension plan. It is desirable for them to have savings of their own and get income on top of it. So that the system has been completely consistent with incentives for voluntary arrangements, whether they are private pension plans or whether they are individual savings. If you were to say, you don't get your social security benefit because you have saved money or because you have a private pension plan, I think the incentive is going in the wrong direction, and you tend to destroy the use of social security as a base to build on.

Another point is that income from savings are continuing. You accumulate the capital, and that income from savings is part of your level of living before age 65 and after age 65. What the program tries to insure against is the loss—the drop in income that comes from earnings either stopping or being greatly reduced as a result of retirement. The program partly makes up for that, whereas the income from investments or savings just goes right on.

It would really change the whole character of the program—it would really make it more like an assistance program with an income test if you took into account what people got from savings or private pension plans or other sources. The way it is now, the test is part of the definition of the risk—that is, loss of income due to retirement after age 65 is the risk you are insuring against. A highly paid worker who stops work gets a benefit to make up for the loss of earned income even if he has an income from savings.

Representative GRIFFITHS. What would it cost the system to eliminate the means test for husbands of women workers?

You do it now if the husband's income is less than half. Otherwise, you send out a few little busybodies to find out if he has a car, if he is buying a home, if he has any money in the bank, and if he has

any of these things, then he does not get the money. But if a man were to marry Mrs. Dodge with a million dollars tax-free money annually, she would get half his social security pension. How much would it cost to wipe out the test for the husband so that, if he did not draw in his own right, he could draw in her right?

Mr. BALL. Have you got a cost estimate on that?

Mr. MYERS. I presume, Madam Chairman, this would also apply to the widower as well as the husband, so that men and women would be on the same basis for both of these benefits.

Representative GRIFFITHS. Absolutely.

Mr. MYERS. I have not made an exact cost estimate of this, but I would think that it would be a relatively small amount, in the neighborhood of either 0.01 percent or 0.02 percent of taxable payroll, which means an annual cost of perhaps something like \$25 to \$50 million a year.

Representative GRIFFITHS. And then in the interest of fairness, I think we ought to do it.

Mr. BALL. Could I just put one thought on the record, one thought of caution, and I think it should be considered.

We still have a few uncoordinated systems, such as the Federal Civil Service Retirement System. It would seem somewhat anomalous to me to pay a male civil servant on retirement in addition to his civil service retirement a benefit of half his wife's social security, if she worked.

Representative GRIFFITHS. You do it the other way. What is so anomalous about it? Thirty percent of all women are working. What difference does it really make? You ought to treat all workers alike.

Mr. BALL. I think, though, that it is still not as typical to have a long, full career throughout a working lifetime on the part of women as on the part of men, which is the basis for the benefit computation.

Representative GRIFFITHS. It is really a new world, and I think that you ought to make the change. I think it is completely unfair to have a means test for the spouse of one worker and no means test at all for the spouse of another. Nobody ever asks a widow if she is drawing a million dollars a year, if she has a civil service pension, if she has this or that—they just pay her. All they ask a man is whether the new Mrs. X ever worked under social security and, if so, does she draw less than half of his pension, and if she does not, she gets a pension based on his.

Mr. BALL. I am sure you understand that the purpose of the test is to establish dependency. The thought has been—maybe incorrectly—that you could assume that a wife in the majority of cases would have an economic dependence on her husband to an extent.

Representative GRIFFITHS. But you don't really establish dependency, you don't ask them if they are dependent.

Mr. BALL. Economically dependent that is what the test is aimed at.

Representative GRIFFITHS. Now, you would pay the widow.

Mr. BALL. No, I meant for the man, you try to establish—

Representative GRIFFITHS. Why do you have to establish dependency there? You do not establish it in the case of a widow.

Mr. BALL. I am saying that the thought was in the case of women you could presume it.

Representative GRIFFITHS. Don't presume it again.

Mr. BALL. And in the case of the man you would have to demonstrate it.

Representative GRIFFITHS. Don't do it, pay the man, too.

How many people now draw who have less than 10 years of coverage?

Mr. BALL. Do you have a figure on that?

Mr. MYERS. As of January 1965, 57 percent of the retired workers and 73 percent of the disabled worker beneficiaries on the roll had at least 10 years of coverage.

Representative GRIFFITHS. What year do you anticipate will be the first year in which only those people with 10 years of covered employment will draw?

Mr. BALL. As far as retirement benefits are concerned?

Representative GRIFFITHS. Yes.

Mr. BALL. Because there will always be some with other benefits.

About 1990. You see, the requirements are that you need to have one quarter of coverage for each year elapsing after 1950, and up to the time you are 65 for men and 62 for women, and it will be 40 years after 1950 before you hit the 10 years.

Representative GRIFFITHS. About 1990 everyone will actually have 10 years?

Mr. BALL. As a minimum requirement for retirement benefits. At present it is 3¾ years for men, and that will just gradually increase; the requirement will be an increase of one quarter for each year, until it comes to 10 years, and then it will stabilize.

Representative GRIFFITHS. I want to thank you for being here. And I want to point out again that while I think it is a wonderful system, and it does everything you say that it does, I think it is almost impossible to describe it as a pension system, because it really does not vest: you really aren't paid on the basis of what you paid in. An employer friend of mine who went to law school with me once said that he had tried for years to figure it out. And the only way that he could figure it out was that it was just money removed from the payroll and sent to Washington with which to do good. I must say I think you are doing very well indeed.

Mr. BALL. Madam Chairman, I don't know whether you have time for some rebuttal of that last characterization.

Representative GRIFFITHS. I would be glad to hear the rebuttal.

Mr. BALL. I do not think the test of whether a system is a retirement system could really rest on whether people get back amounts that are exactly equivalent to their own contributions. It is very typical. I would say, in just about all plans, private pension plans, too, for the employer—even in contributory plans—to use his contributions in ways that are advantageous for certain workers as against others—certain weighting, particularly for people who were in the older age groups when the system went into effect, for whom he is apt to pay all of the past service credits.

So that I would not say that was the test, nor could I agree that paying an annuity at the age specified without regard to employment would be a test. Almost all systems require retirement from the

area of coverage that they deal with, that is, you don't get a pension from one of the auto plans unless you stop working for that automobile company.

So that a retirement system to me really implies that it has a test of some kind of retirement. The difference is that social security has a universal test as far as retirement is concerned.

Representative GRIFFITHS. And yet you would suspend the pension under your test in case the person went in civil service?

Mr. BALL. Yes; it applies to all employment.

Representative GRIFFITHS. The autoworkers would not necessarily do that.

Mr. BALL. That is correct. There are major differences, but they do not seem to me to be ones that distinguish a system as being a retirement system or not, but there are differences.

Representative GRIFFITHS. Thank you very much. It was very pleasant.

We will adjourn until Monday at 10 a.m.

(Whereupon, at 3:07 p.m., the subcommittee recessed to reconvene Monday, May 16, 1966, at 10 a.m.)



## PRIVATE PENSION PLANS

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MONDAY, MAY 16, 1966

CONGRESS OF THE UNITED STATES,  
SUBCOMMITTEE ON FISCAL POLICY  
OF THE JOINT ECONOMIC COMMITTEE,  
*Washington, D.C.*

The subcommittee met, pursuant to recess, at 10 a.m., in room S-407, the Capitol, Hon. Martha W. Griffiths (chairman of the joint subcommittee) presiding.

Present: Representative Griffiths; Senator Miller.

Also present: James W. Knowles, executive director; John R. Stark, deputy director; Nelson D. McClung, economist, and Hamilton D. Gewehr, administrative clerk.

Representative GRIFFITHS. The subcommittee will come to order.

Mr. Macy, I am very glad to have you and your associate here this morning. And you may proceed as you wish.

### **STATEMENT OF JOHN W. MACY, JR., CHAIRMAN OF THE U.S. CIVIL SERVICE COMMISSION; ACCOMPANIED BY ANDREW E. RUDDOCK, DIRECTOR, BUREAU OF RETIREMENT AND INSURANCE**

Mr. MACY. Thank you, Madam Chairman. I think the best procedure would be for me to read my statement. I could highlight it, but I think it would take me more time to do that than to read it.

Madam Chairman and members of the subcommittee, I appreciate your invitation to discuss retirement systems for Federal employees with the committee. Because of my limited experience with those systems which are not administered by the Civil Service Commission, I shall direct my remarks primarily to the civil service retirement plan and will refer only briefly to the others.

It is especially appropriate that the Civil Service Commission be asked to appear at this time since the President's Cabinet Committee on Federal Staff Retirement Systems has just filed its report within the last 70 days, and we recently have had an opportunity to review and evaluate this study. Members of the committee included the Director of the Bureau of the Budget who served as Chairman; the Secretaries of State, Defense, Labor, and Health, Education, and Welfare; the Postmaster General; and myself as Chairman of the Civil Service Commission.

The scope of the study included all staff retirement systems of the Federal Government but concentrated on the civil service, military service, and Foreign Service plans. Particular attention was given to the respective objectives, the overall consistency, and the financial

soundness of the three major plans and to problems of common concern to all of them.

First, the civil service retirement.

The Civil Service Retirement Act, administered by the Commission, covers all but a handful of the civilian employees of the United States and District of Columbia Governments. It provides retirement benefits based on age and length of service, disability retirement benefits and either survivor or lump-sum death benefits. Although it is geared to a career of 30 years or more of Federal service and a normal retirement age of 60, there are special, more liberal eligibility requirements for certain occupational groups covered by the system. In addition, there are several different early retirement provisions—with options available only to employees, not to Government—and two discontinued service provisions under which employees retire with less service and at a younger age. As a result, only 31 percent of the retired employees now on the annuity roll have had as much as 30 years of service. Retirement is mandatory only when the employee reaches age 70 and has 15 years of service.

The civil service plan, like most of the smaller Federal staff retirement plans for civilian employees, is a contributory system. Members of the civil service system contribute 6½ percent of their salaries toward the system's costs. Government makes a matching contribution and the receipts are deposited in a trust fund where the money is invested in Government securities currently yielding interest of 3.5 percent.

If employees leave the service before they are entitled to an immediate annuity, they may obtain a refund of their own contributions or if they have completed as much as 5 years of civilian service may, in lieu of refund, receive a deferred annuity at age 62. Interestingly, up to 80 percent of the employees separating with over 5 years of service apply for the refund and thereby forgo the deferred annuity entitlement.

Representative GRIFFITHS. Mr. Macy, what is the age of those people who take the refund?

Mr. MACY. This would cover the whole range of ages.

Representative GRIFFITHS. So you don't know the range of ages at which they are more apt to take their money back?

Mr. MACY. No, but the higher frequency would be in the younger ages, with shorter service. But I am always surprised that as many as 80 percent take the refund, because really what they are doing, in the interest of securing immediate cash in hand, is forgoing a future benefit that is of significant value to them.

Representative GRIFFITHS. Of course, I was one of those people who did that once upon a time. I was quite young and needed the money right then. And I assume that this is true of all these people.

Mr. MACY. This is true in virtually every case. There is need for immediate cash. And therefore the prospect of having this at such a distant age as 62 seems very unrealistic.

Employment covered by the Civil Service Retirement Act is excluded from social security coverage and, as a result, there are some rather serious gaps in survivor, disability, and retirement protection for large numbers of Federal employees, especially those with short service. Proposals for extending social security coverage to Federal

employment, with adjustment of the staff retirement provisions to take account of social security coverage, have always proved unacceptable in the past. The President, acting on the advice of his Cabinet Committee, recommended to the Congress, on March 7, 1966, a twofold approach for remedying these deficiencies in protection for Federal employees. In brief, the approach involves—

The transfer of credit to social security where the employee, the former employee, or his survivors are not eligible for staff system benefits, and

Where staff system benefits are payable, a guarantee that such benefits—together with any social security benefit payable—will be at least as high as if the Federal employment had been covered under social security.

The civil service system covers about 2.3 million present employees and nearly three-quarters of a million annuitants—employee and survivor; the number of annuitants is expected to level off at about 2.5 million within another 50 years.

The average employee annuitant on the roll at the end of the last fiscal year—that is June 30, 1965—was receiving annuity of about \$2,300; the average employee added to the roll during the year was retired on an annuity of about \$2,800. It is estimated that over 75 percent of the retired employees now on the rolls have some other income in addition to their civil service benefit. About 40 percent are estimated to have acquired social security coverage through other employment, with an average annual benefit of about \$750 per recipient.

The other large Federal staff retirement plan is the military retirement system covering about 2.7 million members of the armed services. It is a noncontributory system to which the serviceman makes no direct contribution. It has no vesting feature. It is geared to the concept of a 20-year career, and operating in tandem with an up-or-out promotion system and acceptance or nonacceptance of reenlistments, it provides the principal mechanism for keeping the Armed Forces young and vigorous. The retirement plan itself, offers no survivorship benefits, but widows, children, and parents of deceased servicemen may be eligible for dependency and indemnity compensation under laws administered by the Veterans' Administration.

The serviceman also has social security coverage for which he pays taxes at the same rate and from which he and his survivors receive the same benefits as do all others subject to that system.

About 16,000 civilian Government employees have coverage under two other contributory staff retirement systems. The plan for Tennessee Valley Authority employees is the larger with over 11,000 members. Members of this plan are also covered by social security. The system has the unique feature of an optional variable annuity plan. Under this plan, the annuity received by a member electing to participate is in a fixed number of units each month, the value of which may vary from month to month with the price of and income from the stocks in which the variable annuity fund is invested.

Benefits and funding arrangements under the staff retirement system for Foreign Service employees are quite similar to those of the civil service system, and employment covered by it is also excluded

from social security coverage. However, like military service retirement the system is management oriented to a greater degree than is the civil service system. It is geared to a normal working career of less than 30 years, a younger retirement age, and a selection-out procedure. About 4,500 Foreign Service officers and staff personnel are covered by the system.

Next, I would like to speak on the subject of exchange of credits.

Arrangements for the exchange of retirement service credits among the different Federal staff retirement systems are varied and highly technical, and I would not pose as an expert on these provisions. As a general rule, service performed under another Federal contributory retirement system is creditable for civil service retirement purposes if the employee is not receiving any benefits under the other system for the service involved. The employee must, however, draw a refund of his deductions under the other system and re-deposit the refund, with interest, in the civil service retirement fund. The Foreign Service system has a reciprocal arrangement for crediting service performed under the Civil Service Act but the other small systems generally do not have such a provision.

Military service is usually creditable under the civilian retirement systems if the employee is not receiving military retired pay, but there are exceptions to this general rule. Retired military pay may be waived if the employee would prefer to have the military service credited under civil service retirement.

Representative GRIFFITHS. May I ask you, cannot the military receive a pension and draw a salary under civil service at the same time?

Mr. MACY. Yes, under the Dual Compensation Act.

Representative GRIFFITHS. They can draw a military pension and a civil service pension, can they not?

Mr. MACY. Yes, if they qualify for both.

Representative GRIFFITHS. Can you draw a civil service pension and a Foreign Service pension?

Mr. MACY. No, you cannot; not for the same service.

Representative GRIFFITHS. Can you draw a civil service pension and a TVA pension?

Mr. MACY. No, you cannot for the same service.

Representative GRIFFITHS. Why the difference?

Mr. MACY. Well, the military retirement system, being based upon a noncontributory program, is more viewed as deferred compensation to provide income for the member of the armed services who has retired at an earlier age.

Representative GRIFFITHS. How many people are there today in the Pentagon drawing both a pension and a paycheck?

Mr. MACY. I would not be able to answer that.

Representative GRIFFITHS. Are you able to find out?

Mr. MACY. But I can give you a general figure.

Representative GRIFFITHS. Would you supply it for the record?

Mr. MACY. I would be happy to.

But let me add, Madam Chairman, that under the Dual Compensation Act of 1964 a formula is set up for those military retirees who are appointed to civilian positions so that they receive the full compensation for the civilian post, but only a portion of their retired

pay. It is based on their receiving \$2,500 of the retired pay plus 50 percent of the balance. This generally means that enlisted personnel will receive the entire retirement, but it tapers off as you go up the officer grade as to the percentage of the total retirement income that they receive.

Representative GRIFFITHS. But when they start drawing both pensions they draw the full pensions; do they not?

Mr. MACY. Yes.

Representative GRIFFITHS. For both services?

Mr. MACY. For both services.

Consolidation. It has been frequently suggested and was recommended in 1955 by the Committee on Retirement Policy for Federal Personnel that wherever practical, employees covered under the smaller contributory system should ultimately be brought under civil service retirement. The President's Cabinet Committee agreed that the inclusion of all regular civilian employees under one system would be a highly desirable goal. Recognizing, however, that each system is geared to special management requirements, the Committee recommended further careful exploration of the possibilities for merger by the Civil Service Commission with officials administering the smaller systems before any actual consolidation of the smaller systems was accomplished.

The Committee also believed that adoption of some of its other recommendations would move more in the direction of a consolidated system by standardizing more benefits and by merging the funds of the civil service and Foreign Service systems.

Another of the Cabinet Committee's key recommendations would provide for improved financing and funding of the civil service system. At the present time, because of inadequate financing in the past, the system has an unfunded liability amounting to more than \$43 billion. Unless something is done to meet this increasingly serious problem, the retirement fund will be depleted within 25 years and thereafter benefits will have to be paid from current revenues.

Very briefly, the remedial measures recommended by the Committee would include:

The sharing of the full normal costs of present benefits and of all future liberalizations via matching contributions by the employee and the agency. In other words, agency and employee contributions must be increased whenever the level of benefits is increased or eligibility requirements are liberalized.

Provision for payment by Government of all increases in the unfunded liability that result from liberalizing legislation enacted in the future such as general pay increases and increases in benefit levels.

Provision for pegging the retirement fund balance at a predetermined level high enough to assure an ample margin of safety.

I have some informal material in the folder that was handed out which should be helpful in understanding the civil service retirement system.\*

\*Materials referred to are retained in the files of the Subcommittee on Fiscal Policy of the Joint Economic Committee.

First, the certificate of membership which is given to all covered employees, summarizes the provisions of the system and familiarizes the employee with his retirement rights.

Second, the green pamphlet—"Your Retirement System"—poses and answers the questions that are most commonly asked about the civil service system.

Third, the Commission's report for fiscal year 1965, on the retirement, life insurance, and health insurance programs, is a compilation of statistical data on these programs.

Let me add that I find reference to this document very helpful in gaining an understanding in depth with respect to these fringe benefits programs provided for Federal employees.

Fourth, the committee print, "Survey of Income of Civil Service Annuitants," is a report of an income study of some 40,000 employee annuitants. The study was made to obtain better information for reporting on annuity increase legislation pending before Congress last spring.

House Document No. 402 includes part I of the Cabinet Committee's report. Part II will include much more detailed analysis, background papers, and tables of statistical data.

The table attached to my statement compares some of the features of the larger Federal staff retirement systems. Part II of the Cabinet Committee's report, which should be printed within a few weeks, includes tables with much more detailed comparisons of the benefit provisions of the several plans.

Mr. Ruddock and I shall now be pleased to answer any questions you may have with respect to this testimony or the Federal Government's retirement systems.

Representative GRIFFITHS. Thank you very much.

Address your attention first to financing. If we funded Federal pensions today, and you needed \$43 billion, I assume that would mean between an \$800 and \$900 tax increase per taxpayer in the United States.

Mr. MACY. If it were to be totally funded.

Representative GRIFFITHS. Yes, today.

Mr. MACY. Yes, it would call for an appropriation of roughly \$43 billion. And the only way this could be funded would be through increased taxes or through a heavy borrowing program which would increase the national debt.

Representative GRIFFITHS. Now, in view of the fact that you are only making 3.5, and there are other funds that are making much more money than that, I would assume that the taxpayers would be better off if they used their own money, made what they could on it, and paid for these pensions as they became due.

Mr. MACY. The fund is limited to investment in Federal securities, and the interest rate of 3½ percent is as a result of recent legislation. Prior to that time it was substantially lower. If the fund were invested in equities as are private funds, the income would be greater. But this is a matter of public financial policy that has been set in these terms since the enactment of the Retirement Act of 1920.

Representative GRIFFITHS. In your judgment would it help if the funds were invested otherwise than in Government bonds?

MR. MACY. This would be a question which I think is beyond my competence.

Representative GRIFFITHS. Doesn't the Cabinet report suggest investment in non-Federal securities?

MR. MACY. No. The Cabinet report suggested this three-way funding change, which I fully support. By that action there would be a sharing of the normal cost on a continuing basis at a percentage of payroll on the part of the Government and a percentage of salary on the part of the employee.

This would cover the continuing cost.

Now, it has only been since 1956 that the Government has matched the employee contribution on a regular basis. The funded liability is attributable in part to the fact that the Government through the 36 years prior to that was very sporadic in making its contribution. In many years there was no contribution whatsoever.

The Cabinet Committee proposal would continue agency contributions, but probably with an increase in the amount, because even now we are running somewhat in excess of the accruing cost of 13 percent at the normal level.

The second provision would assure that with liberalization, either in the form of increased salaries for active employees, which has a significant impact on the retirement cost, or in the liberalization of benefits, that the new cost, the increase in unfunded liability, would be amortized over an appropriate period of time. For example, on a salary increase the cost would be amortized over a 30-year period, so that you would not increase the unfunded liability by that liberalization.

Then the third provision would be to arrive at a pegged level for the fund which Congress would not permit to fall below, probably setting the peg at the equity of employees in the fund. This would avert the situation that you posed to me a moment ago of financing the entire unfunded liability, which would clearly be unrealistic. The \$43 billion is on the basis of actuarial computations. If you were to peg it it would mean that you would have a working fund at a held level, the held level being maintained by appropriations from time to time. And you would not face the situation where you would have to make a heavy appropriation for the fund at some point in the future. That point in the future is not too far off. There has been a tendency to feel that it was so far off that we didn't need to bother about it now. But our estimates are that the expenditures line from the fund will cross the income line—what is it this morning, about 1984—I keep remembering 1984, that is the Orswellian year—but in the 1970's.

MR. RUDDOCK. Less than 10 years.

MR. MACY. So that there is need to look upon this problem.

Also there is need frankly for some discipline on liberalization, recognizing that at some future date all liberalization is going to have to be paid out in benefits. This system is based upon a computation where the annuity is figured on the high 5 years of salary. And with increases in salary the annuity rises very substantially over the level of salary that the individual had for the bulk of his career. So that the amount of the annuity is substantially increased over a period of time.

Representative GRIFFITHS. How many people draw more than one Federal pension?

Mr. MACY. Do you recall that, Mr. Ruddock?

This would exclude social security, more than one staff retirement.

Representative GRIFFITHS. More than one Federal pension.

Mr. RUDDOCK. Page 1 of the committee print, "Survey of Income of Civil Service Annuitants," shows that in this study as of 1964 40 percent of our annuitants also drew social security, 2.8 percent also drew military retired pay, 21.3 percent drew veterans pension and compensation. That was the extent of that information.

Representative GRIFFITHS. Of course, I think it really is inexcusable for anybody to be permitted to pile one of these pensions on the other. In reality these pensions are being paid by the taxpayers of this country, who are themselves not getting anything like this in pension. No matter what can be said about the Federal Government, the real value of working for the Federal Government is the pension. You are sure you are going to get it. And that pension is much higher than other pensions. The problem is not confined to the Federal Government. Every person in this Congress must know many people working at a local level, either for the State or for a county or for a city, who are piling one pension on another.

Now, it seems to me that if the Federal Government really wants to have portability in these pension plans, the place to begin is right at home. It should stop this business of people piling one pension upon another. There is no reason why the Federal Government as an employer doesn't pay into social security just as every other employer is required to do. But under any circumstance for a Federal Government employee to draw all of these pensions is, I think, very reprehensible.

Mr. MACY. Respecting your view, let me just point out that in the instances where there is more than one—and as you see, it is a relatively small percentage—it is because the individual has performed certain services under different plans and has earned the benefits for retirement. The retirement is looked upon as a deferred right.

We also see that many who have vested rights in the civil service system when they leave that system withdraw their money, even though they have a perfect right to draw a deferred annuity later—at a later date, based on their service.

So I do not feel that the problem is a critical one in the sense of their being dual coverage. It is a matter of there being a number of different pensions because of a number of different employments for which pension credits were gained.

In this matter of portability, particularly with other public jurisdictions, our view has been that if there were more vesting in the other systems at an earlier point in time, that this would permit the movement without loss of retirement benefits, but it would result in there being multiple pension checks at the point of retirement. But I cannot see anything basically wrong with that if the creditable service has been performed and the eligibility established under pension plans.

Representative GRIFFITHS. That would be quite right. But the Federal Government would not have any problem in sending one



check by putting all these pension plans, including social security, into one system.

Mr. MACY. The background of the Federal Government's exemption or noncoverage under social security goes back over the years. Actually, this is one of the few retirement systems actually in being at the time the Social Security Act was passed. Consequently, it is different from the private pension plans that were largely developed from the social security base. There have been a number of efforts to achieve coordination between the two plans going back into the period of the late 1930's. They have been opposed by the employee groups even though they have been supported by various administrations in the past, the opposition being a preference to have comparable benefits included in the Civil Service Retirement Act, with the result that there are survivorship and disability benefits under the civil service retirement system, that, if they were added to the total social security system, would be prohibitively costly, and would probably provide dual benefits.

The position of the Administration is that there should be a provision whereby the Federal Government permits a transfer of credit for those short-term employees who do not establish eligibility or vesting under the Federal plan, so that they will be covered by social security, and have the advantage of—particularly the survivorship benefits—on the basis of relatively short service.

The other provision was that there be a floor established, a benefit floor established which would be equivalent to the minimum benefits of social security.

Representative GRIFFITHS. Why don't you establish a ceiling for pensions that are drawn from the Federal Government; this much and no more?

Mr. MACY. Well, there is, there is a ceiling of 80 percent of average salary under the formula in the Civil Service Retirement Act.

Representative GRIFFITHS. A ceiling on the total amount which you could draw under all plans.

Mr. MACY. Again, you get back to the basic point, do you place a ceiling on other systems when there was a creditable earning, through service, for a pension. And I believe you are primarily addressing yourself to the military pension.

Representative GRIFFITHS. Why should somebody unfit for military service after 30 years be given veterans preference for civil service employment?

Mr. MACY. Well, this opens the whole question of veterans preference. And the Congress has decided and reaffirmed as recently as this year that it feels that a part of national policy is to provide preference for those who have served in the military service in peacetime as well as in wartime.

Representative GRIFFITHS. But this particular question probably was not even considered when Congress made its decision.

Mr. MACY. Well, I am unaware of any consideration. But it seems to me—

Representative GRIFFITHS. It is ridiculous on the face of it.

Mr. MACY. This raises the whole question of veterans preference. And this has been national policy for a long time.

Representative GRIFFITHS. How many people can draw at less than 65 years of age now? Does every pension plan permit them to draw actuarially reduced amounts or not?

Mr. MACY. No. Reduced amounts can be drawn at age 55 with 30 years' service, with a reduction of 1 percent a year for each year under age 60. That is the present provision. The House has passed a bill which is now under consideration in the Senate committee which would eliminate the actuarial reduction, so that there could be retirement drawn at age 55 with 30 years' service without any reduction.

Representative GRIFFITHS. I would like you to address yourself to the survivor annuity. I notice that a widow, having been married for at least 2 years to the employee preceding his death, or the mother of a child, draws 55 percent of the annuity at the employee's death. But in the case of a woman employee you ask if her husband has received more than one-half of his support from her. Well, under those circumstances, Mr. Macy, I would like to reduce the amount I am paying into the system to agree with what I am going to get out of it, because my survivor's right is not as good as yours. Presently, I am paying the same price for a survivor's right as you are.

Mr. MACY. This has been a topic of consideration a number of times. It has been preserved as it is at the present time based upon the general assumption in our society that the male, unless disabled, will exercise responsibility for his family.

Representative GRIFFITHS. In view of the fact that almost one-third of the work force today is women, do you not think that it is time to do away with that supposition? In the case of college-educated women, 81 percent of them work outside their home.

Mr. MACY. That is right. I used that figure myself.

Representative GRIFFITHS. You are saying, that, for instance, Senator Phil Hart of Michigan, is the principal support for Mrs. Hart, who is one of the wealthiest women in the world?

Mr. MACY. No, we do not have any means test.

Representative GRIFFITHS. No, you do not, not there, but when it comes to a husband you have a means test. Why have a means test for a husband?

Mr. MACY. We have a disability requirement.

Representative GRIFFITHS. And a means test. You even go further. If once you have given him the pension, you then decide that he can support himself, you remove the pension.

Mr. MACY. That is correct.

Representative GRIFFITHS. Why?

Mr. MACY. Because he is in a position to provide income for himself.

Representative GRIFFITHS. But actually there is no other pension plan that has appeared that has this type of survivor's right. A worker is a worker and the survivor should have exactly the same right whether the survivor is a husband or the survivor is a wife. And in all other plans that have appeared here, if they had survivor's rights, they had an equal right.

Mr. MACY. Without any distinction at all?

Representative GRIFFITHS. Yes. In fact, you cannot even explain this to most companies. They think it is ridiculous. And I agree with them. Because you are really collecting the money from women who work to pay pensions for widows. But when the woman worker dies do you give her husband her money back? You do not give him anything, unless he is incapable of self-support. How can you explain a difference like that between workers? Why am I paying more for less rights than you are?

Of course, I don't think it can be explained except that the system was set up 30 years ago, and at that time we were still living in the days of chivalry, and it was assumed that women didn't work. Now, women do work. They are a large part of the work force. Therefore, this should be changed. And I do not think it should wait any longer. I think it should be changed right now, either charge me less or give me the same rights.

Mr. MACY. You feel this is a major factor in coverage for you as—

Representative GRIFFITHS. Certainly. Why should I be paying to support your widow unless you want to be paying to support my husband? I do not mind helping you support her, but I do insist that you help me. And if you are not going to have a means test for wives, there is no need having a means test for husbands. It is a right that I am paying for. And I want exactly the same amount for my money that you get for yours.

Mr. MACY. You make a strong case for it.

Representative GRIFFITHS. Well, I am going to make it stronger.

Mr. MACY. Good.

Representative GRIFFITHS. Because I think it is incredible that the Federal Government which has an Equal Employment Opportunity Act, that advertises that it is trying to be fair to everybody and treat all workers alike, has this type of provision in a pension system.

I made these statements one night in Detroit, and half the companies in Detroit called up, and said, "You do not mean to tell me that that is in the Federal pension system?"

Mr. MACY. You are correct, it is in there.

Representative GRIFFITHS. It is not in any industry system and it should not be in this system.

Mr. MACY. You feel that the benefit pattern ought to be just the same?

Representative GRIFFITHS. Absolutely. How can you possibly explain this?

Mr. MACY. Should there be an option for the woman employee upon retirement as to whether she provides this or not?

Representative GRIFFITHS. Certainly, the same provision as the husband has.

Mr. MACY. The same provision as the husband has.

Representative GRIFFITHS. How many widows today are drawing a pension on a husband who worked in the Federal Government and are also drawing their own pension from the Federal Government? There must be quite a few.

Mr. MACY. There probably are.

I do not believe we have figures on it, do we?

Mr. RUDDOCK. No.

Representative GRIFFITHS. You probably never worried about it or even thought about it. But it is not working the other way. No husband is drawing on his wife's pension.

Mr. MACY. And you feel he should?

Representative GRIFFITHS. Of course, he should.

Mr. MACY. Even if he is working?

Representative GRIFFITHS. Of course, he should, unless you are going to go around and ask of all of the widows of men who have worked, do you have some money, do you have a pension?

The thing that I think is inexcusable is that in the first place you aren't paying women the same amount as you are paying men. They are not being permitted to move into the better jobs, as you are well aware. And the women who are getting less in the first place are then paying into a system that gives them less, but they are paying exactly the same amount of money.

Now, I remember that even on the health program, if you will recall, it came as a great shock one day to the Ways and Means Committee when I pointed out that I paid \$2.50 more for my husband and myself than a man paid for a wife and two small children. In other words, I was really supporting one of those children.

Mr. MACY. But that has been changed.

Representative GRIFFITHS. Now, I am paying the same amount that he is paying for a wife and two small children, isn't that right?

Mr. MACY. That is right.

Representative GRIFFITHS. I am still supporting one of the two small children. At least it should be acknowledged that the Federal Government is doing this sort of thing, and there should be set up some sort of a depreciation schedule for women that work.

Mr. MACY. Let me get to your point about unequal salaries. I just can't let that stand, because since 1923 women have been receiving equal pay for equal work with men. And there is no—if there are cases that you are aware of where that is not so, why certainly we want to remove that.

Representative GRIFFITHS. It is too late to correct it, but when I was in Ordnance during World War II, I was moved from one job to another, because I did the job well. I was given most of the work in the whole department. And I drew at two levels lower than any man doing the same job, and I practically had to go to the President to get an increase in pay.

Mr. MACY. I am afraid it is too late to correct that.

Representative GRIFFITHS. It is too late to correct that.

Mr. MACY. But if you are aware of any current cases—

Representative GRIFFITHS. I am sure there are a number of current cases. And I know you are not promoting them on the same basis as you are promoting men.

Mr. MACY. Anyplace where that judgment is confirmed, I would like to hear about it.

Representative GRIFFITHS. You are going to hear about it. I want to know why they are not being promoted.

Mr. MACY. Let's have some specific cases. Let's not generalize on it.

Representative GRIFFITHS. As quick as I get back to the office I will send you one.

Mr. MACY. Fine. I will go with you to get it because the Federal Government is determined that the Federal Government does provide equal opportunity for women. We have made a very specific and determined effort to do this, and if it is failing in some place or other, we want to know about it.

Representative GRIFFITHS. In this pension system it is failing.

Mr. MACY. I was referring to promotion.

Representative GRIFFITHS. In the health system it is failing. You are charging women as much and giving them less. I suggest you correct it.

I asked you this before, and you pointed out that Federal pension funds are not placed in corporate shares and mortgages because of the statutory limitations.

Mr. MACY. That is right.

Representative GRIFFITHS. We have had a little trouble in Michigan. I see that the State pension funds have just lost heavily on poor mortgages. So that perhaps there is some real reason for saying that at least you are guaranteeing that we are going to get something on the money that has been invested.

Mr. MACY. That is right. As it is entirely then a matter of Federal judgment with respect to investment in Federal securities. And this is a matter that the Treasury handles as a part of its regular trust fund operation.

Representative GRIFFITHS. It really provides them with a good market for their debt, doesn't it?

Mr. MACY. Yes.

Representative GRIFFITHS. Our staff economist asks, does it serve any other purpose. And frankly, I don't think it does.

Mr. MACY. It provides some advance financing for annuities. You could depart from this and go on a completely pay-as-you-go basis, but this would mean that you would have no funds built up at all.

Representative GRIFFITHS. As far as the Federal Government's share is concerned, you are practically on a pay-as-you-go basis, aren't you?

Mr. MACY. Well, the Federal Government is meeting current obligations for the 6½-percent contribution. There still is the rising unfunded liability. We are not even restraining that from further increase.

Representative GRIFFITHS. I want to thank you for appearing here. It is very kind of you.

Mr. MACY. Thank you. Your comments have been very helpful to me.

Representative GRIFFITHS. I hope that you begin with the correction of the Federal pension system that I mentioned, and I hope that you come up with a plan that does not have one person drawing under several plans.

This committee is adjourned until 2 o'clock today to hear Stanley Surrey and Sheldon Cohen.

(Whereupon, at 10:45 a.m., the committee adjourned, to reconvene at 2 p.m., the same day.)

## AFTERNOON SESSION

Representative GRIFFITHS. The committee will be in order.

Gentlemen, I am not only pleased to see you here, I have waited anxiously for you. Throughout these hearings I have been waiting anxiously to talk to a few people. I am delighted that you are here. You may proceed to read your statements in whichever manner you choose.

**STATEMENT OF HON. STANLEY S. SURREY, ASSISTANT SECRETARY OF THE TREASURY; ACCOMPANIED BY WILLIAM T. GIBB, ASSOCIATE TAX LEGISLATIVE COUNSEL, AND GERARD M. BRANNON, DIRECTOR, OFFICE OF TAX ANALYSIS**

Mr. SURREY. Madam Chairman and members of the subcommittee, I will read my statement first, if that is all right with you, and then Commissioner Cohen will follow me.

I am pleased to respond to your request to describe generally the tax provisions with regard to pension and profit-sharing plans and to discuss the extent to which these provisions are favorable to employers and employees. Despite public consciousness of the enormous growth and the importance of private pensions, there is relatively little knowledge and understanding of the role that tax policy plays in influencing pension growth and design. Your subcommittee is to be congratulated for bringing the workings of the private pension system to greater public knowledge.

A pension or profit-sharing plan is a part of the employment contract. Often the plan terms are negotiated in collective bargaining. Whether or not negotiated, they clearly affect the wage rate. From the employer's standpoint, this is part of the labor cost. From the standpoint of the employee, pension or profit-sharing benefits are an element in comparing total compensation between different employments.

The development of pension and profit-sharing plans has without question been aided by favorable tax treatment, which has the effect of lowering the tax liability when compensation is paid in this manner. The tax advantage given to these plans is the basis of the provisions in present law imposing certain qualifying conditions on a pension or profit-sharing plan. Since the provisions applicable to pension and profit-sharing plans are substantially similar, I shall simply refer to pension plans.

The legislative history provides ample evidence that Congress as a matter of public policy has used the tax system as a means both to encourage the growth of private pensions and to prescribe standards for equitable and sound pension design. For example:

In 1926 the Congress decided to favor private pensions by exempting investment income of pension trusts.

To protect the funds set aside for employees, the Congress enacted nondiversory standards in the Revenue Act of 1938 to guarantee that funds were used for the exclusive benefit of employees and that pension trusts should be irrevocable. Prior to the 1938 act, pension trusts were established by some during periods of high corporate

earnings which were ultimately revoked and the earnings recaptured by the employers during lean years.

In 1942 the Congress enacted what are now the current standards for qualification. They are intended to protect the benefits of employees and to prevent discrimination as to coverage and benefits. These provisions were modified only in some details by the Internal Revenue Code of 1954, so that essentially our present rules are those established a quarter of a century ago.

#### FAVORABLE TAX TREATMENT OF THE EMPLOYEE

Under qualified employer-financial plans, the employees are not currently taxable either on the amounts contributed by employers to the plans or on the investment income of the pension fund. The employee's tax liability for these amounts is deferred until he retires and receives benefits from the plan, at which time his effective tax rates are apt to be lower.

In the case of plans to which the employee contributes, the employee may not deduct his contribution currently. The amount of the employee's contribution, however, is not taxed when he receives his pension.

If an employer-financed plan does not qualify but the employee has irrevocable rights to benefits, the tax deferral feature is not applicable; the employer's contribution is taxable to the employee as current income when he acquires a vested right to it, and his benefits are not taxable upon retirement—to the extent that they reflect a recovery of this tax-paid amount. However, if the employer's contribution is not vested in an employee, then the employer's contribution is not taxable to the employee until he actually receives the benefits, even in a nonqualified plan.

Since the employer's contributions and investment income are not taxable as current income to the employee under qualified plans, even where the pension rights are vested, tax deferment represents tax savings to employees. It creates opportunities to obtain more liberal pensions than if the employees received equivalent wages in lieu of contributions and had to finance their own pensions.

The Cabinet Committee on Corporate Pension Funds measured the size of a monthly pension that \$100 of annual employer's contributions can buy under present tax treatment and compared it with a monthly pension obtained from an equivalent \$100 of annual wages which, after tax, is invested by the employee himself. The pension fund case resulted in a \$74 monthly pension as compared to a \$52 monthly pension in the case of the employee investing his wages after tax and paying tax on his investment income.

#### FAVORABLE TAX TREATMENT OF THE EMPLOYER

Under a qualified pension plan, an employer may deduct the amount of his contributions to the plan, subject to limitations on overfunding. As noted above, the investment income of the fund is tax free.

If a nonqualified plan does not have immediate full vesting, the law does not permit deductibility of current contributions. If the

nonqualified plan has such vesting, then current contributions are deductible.

Through the deductibility of contributions of a qualified plan and the tax exemption of investment income, the Government is sharing pension costs with the employer. Consequently, the employer is able to provide a given level of benefits at about half the cost of a nonqualified, nonvested plan.

#### TOTAL VALUE OF FAVORED TAX TREATMENT

It has been argued at times that under the existing pension plan provisions the Federal Government really provides no tax benefit. While there are, of course, specific provisions in the tax law relating to employer pension plans, the argument is that the outcome of these provisions is substantially the same as the general principles of tax law; and, consequently, no special benefits are extended to qualified plans. The argument, stated broadly, is that a contribution to a pension plan is "of course" a cost to an employer and ought to be deducted and that a contribution on behalf of an employee to a pension plan is not income to him until he gets the money.

Under these two contentions, it is argued that tax deferral would be just the normal treatment for pension plan contributions, and no special tax benefit would be involved.

I want to make clear that qualified pension plans do get a special tax treatment and that deferral would not automatically follow as a matter of the application of the general principles of tax law.

With regard to the employer's deduction, the general rule is that an amount is deductible under the tax law when there is a fixed liability on the employer to make a fixed payment to a definite person. If the employer is on an accrual basis, he may take a deduction even though he does not have to make the payment immediately, but the liability for payment must still be fixed.

With regard to an employer's contribution to a pension plan where the employee's benefits are not vested, all that is involved for the employer is the possibility that he may have to make a pension payment to some employee in the future. This possibility of future payment is not sufficient under the general principles of tax law to permit an accrual of the deduction.

With regard to the employee, it would seem clear that if the pension contribution is not vested in the employee, there is no basis for taxing the employee currently at the time that the employer's contribution is made. This is the particular case where, as I pointed out, deductibility to the employer constitutes a particular benefit granted under the present tax law.

Where the contribution by the employer is vested at the time made, or where it becomes vested at a later point before the employee receives the pension, the general principles of tax law would suggest that the employee should be taxable at that time. It is not controlling that the employee receives no cash money at that time.

If I do a piece of work for you and my payment for the job is a paid-up insurance policy that will provide a life annuity beginning when I am 65 years old, I have clearly gotten something of value for this work. Under general principles of tax law, I am required to include in my income the value of the insurance policy that I have



received. The special benefit provided for employees under qualified pension plans is that when they receive something of value in the form of a vested benefit to a pension the tax on this amount is deferred until they get the cash.

Finally, it is clear that the investment income of a pension trust would be taxable under general principles of tax law except for the benefits extended to qualified plans.

If the total amount contributed by employers to qualified pension plans and the investment income of the funds were taxable at the corporate rate, tax liabilities would rise at current levels by about \$3.8 billion per year. If the amounts were taxable at individual rates, the revenues would rise by about \$1.4 billion a year. The appropriate rate, as I have indicated, depends on whether or not the benefits were vested. Therefore, the cost in revenue of the Federal Government because of the existing pension plan provisions falls somewhere between the two limits of \$3.8 billion and \$1.4 billion. (These estimates take into account the current tax being paid on benefits.) Since there is some degree of vesting, we may put this cost very roundly at about \$3 billion.

The annual revenue loss depends on the growth of pension reserves since this is the amount of income which has not paid tax. Pension reserves have grown by increasing amounts each year. They will continue to grow as long as the number of covered employees grow or so long as benefits grow.

Given the current rate of growth of private pension coverage, it is likely that the annual revenue loss will persist for many years and even continue to grow. Given its annual revenue requirements, the Government must seek revenues annually from other sources to make up the difference between taxes deferred on employer's contributions and investment income and taxes currently collected from the pension benefits currently paid.

The Cabinet Committee report submitted some estimates of the revenue cost of the pension provisions. We have updated these to 1966 levels, and for the information of your subcommittee, I am submitting this material for the record.

#### STANDARDS FOR QUALIFICATION

In general, for a pension fund to attain qualified status, a plan must meet several tests. Briefly, some of the major tests are:

The plan must be permanent and must be made known to the employees.

Monies in the fund may not be diverted but must be used for the exclusive benefit of the employees, until all liabilities have been met.

The plan must be "nondiscriminatory" with respect to coverage and contributions or benefits. The plan must cover either a prescribed percentage of employees or all employees in an approved classification group which does not favor stockholders, managerial, or other highly paid employees. The contributions or benefits also must not favor stockholders, managerial, or other highly paid employees.

Commissioner Sheldon Cohen is present with me to discuss the administration of these qualification requirements and other tax administrative matters.

President Johnson has often emphasized the importance of cost efficiency in Government programs. In his 1966 Economic Report, the President stated:

Benefits that the Government extends through direct expenditures are periodically reviewed and often altered in the budget appropriation process, but too little attention is given to reviewing particular tax benefits. These benefits, like all other activities of Government, must stand up to the tests of efficiency and fairness.

The work of the Cabinet Committee on Corporate Pension Funds, to which Secretary Wirtz referred, represents this kind of review of tax benefits.

The report has singled out a number of problem areas and has set forth suggestions which can be used as a basis for further discussion of specific revision of the present law. Broadly, the objective of the Cabinet Committee report recommendations is to extend coverage of private plans to a wider range of employees; to provide greater assurance that a worker will get his pension benefits; to reduce impediments to a freely mobile labor force; to assure better administration of pension funds; and to eliminate particular tax preferences which do not meet the tests of efficiency and fairness.

The tax rules governing the development of private pension plans have not changed materially since 1942. Basic issues as the vesting of benefits, the funding of benefits, the portability of benefits, and the coverage of employees need to be reexamined in the light of developments since the basic rules were laid down a quarter of a century ago.

Out of this reexamination can come a highly important reevaluation of the way private pension plans should operate if they are to fulfill a major role in providing retirement security to the labor force.

(Attachment to statement follows:)

*Range of estimates of net revenue loss attributable to special tax treatment of private retirement plans, 1966*

[In millions of dollars]

Item	Based on individual income tax	Based on corporate income tax
1. Revenue gain from benefits subject to individual income tax.....	+325	+325
2. Revenue loss from tax-free income of pension and annuity funds.....	-550	-1,350
3. Revenue loss from present tax treatment of employer's contributions.....	-1,150	-2,850
4. Net revenue loss.....	-1,375	-3,875

NOTES

Item 1: Under present law, benefits are taxed to the extent they exceed the employee's contributions. Of an estimated \$3,300,000,000 in private pension benefits in 1966, it is estimated that 36 percent appear on nontaxable returns or are excluded as a return of contributions. The remainder would be taxed, under the Revenue Act of 1964, at a marginal rate of about 20 percent (based on the income distribution of pension and annuity income), but about  $\frac{1}{4}$  of the tax would be offset by the retirement income credit. Thus, approximately \$325,000,000 is now obtained by taxing benefits.

Item 2: Total investment income of private pension funds and annuity plans is estimated at \$3,000,000,000 in calendar year 1966. This would yield tax revenue of \$550,000,000 at individual rates and about \$1,350,000,000 if taxed at corporate rates.

Item 3: At 1966 income levels, corporate contributions to private pension and profit sharing plans are estimated at about \$6,300,000,000. Under the Revenue Act of 1964, the marginal rate on salaries and wages is estimated at 18.4 percent, including nontaxable returns. If corporate contributions were treated as being vested in the employees and taxed to them, their liabilities would rise by \$1,150,000,000.

The marginal tax rate on corporation deductions under the 1964 act is about 45 percent. Therefore, if in lieu of employer's contributions these amounts were included in corporate profits and were made taxable to the employer, corporate tax liabilities would rise \$2,850,000,000.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

Representative GRIFFITHS. Thank you, Mr. Surrey.  
Mr. Cohen.

**STATEMENT OF HON. SHELDON S. COHEN, COMMISSIONER OF INTERNAL REVENUE; ACCOMPANIED BY HAROLD T. SWARTZ, ASSISTANT COMMISSIONER, AND ISIDORE GOODMAN, CHIEF, PENSION FUND BRANCH**

Mr. COHEN. Madam Chairman and gentlemen of the committee, with your approval I would like to make a short statement on the tax situation applicable to the subject of these hearings. Then, with the assistance of my associates here present, Mr. Harold T. Swartz, Assistant Commissioner, and Mr. Isidore Goodman, Chief of our Pension Trust Branch, I shall endeavor to answer such questions as I can.

Some of this might be slightly repetitious of Mr. Surrey, but I think in context it might be just as well to go through it.

Favorable tax treatment is provided an employer and his employees under a pension, profit-sharing, or stock-bonus plan which satisfies the requirements for qualification set forth in the Internal Revenue Code. The employer is allowed to deduct from his gross income, within prescribed limits, contributions made under such plan. The contributions are accumulated tax free in a trust, or by an insurance company, until distributions are made to employees or their beneficiaries. The distributions are then taxable, but usually at a lower rate as they generally constitute about all of the income of the recipient, who may at that time also qualify for extra exemptions and the retirement income credit.

Furthermore, if a lump-sum distribution is made on account of the employee's severance of employment, or death during or after employment, it would be taxed as a long-term capital gain. There are also death benefit and gift and estate tax exclusions for distributions under qualified plans.

In order to qualify, a plan must be established by an employer, for the exclusive benefit of his employees or their beneficiaries, for the purpose of distributing to such employees or their beneficiaries the corpus and income of the fund accumulated in accordance with the plan. If the plan is trustee, the trust must be irrevocable, except that in the case of a pension trust provision may be made for recovery of a balance remaining on termination of the trust, arising from an actuarial error, after satisfying all liabilities to employees or their beneficiaries. In such event, the recovery is includible in the gross income of the employer.

Furthermore, the plan must meet the coverage requirements for qualification. This may be satisfied in either of two ways.

One is to cover at least 70 percent of all employees, or 80 percent or more of all eligible employees, if at least 70 percent are eligible, excluding employees who have been employed for a minimum period not exceeding 5 years, and casual, part-time, and seasonal employees.

In the alternative, the employer may set up a classification of employees, provided that we find it not to be discriminatory in favor of employees who are officers, shareholders, supervisors, or highly compensated.

Also, there must be no discrimination in contributions or benefits in favor of employees who are officers, shareholders, supervisors, or highly compensated.

In addition, upon termination of a plan, or complete discontinuance of contributions, the rights of all employees to benefits accrued to the date of such termination or discontinuance, to the extent then funded, or to the amounts credited to the employees' accounts, must be nonforfeitable.

As for nonforfeitable rights, it may be observed that in the case of a plan covering self-employed individuals and common-law employees, the rights of the common-law employees must be nonforfeitable if any of the self-employed individuals are owner-employees.

Forfeitures arising under a qualified pension plan must not be applied to increase the benefits any employee would otherwise receive under the plan since, if they were so applied, the benefits would then not be definitely determinable. The forfeitures are used instead to reduce employer contributions.

There are also two administrative requirements for nonforfeitable, or vested rights, under a qualified plan. When an employee reaches the normal retirement age and has satisfied the service requirement, his rights to benefits or contributions under the plan must be vested.

Furthermore, a qualified plan must be maintained on a permanent basis. In the case of a profit-sharing plan, if the employer reserves the right to discontinue contributions without terminating the trust, he must also provide that the employees will have fully vested rights in the event that this should materialize.

In the case of a pension plan, however, a suspension of contributions may not necessarily result in a discontinuance if the plan has previously been funded to the extent of assuring that the benefits will not be adversely affected by this situation. It is required that at least the normal cost for each year, and the interest on the unfunded past service cost, be met. If these conditions are not met, the employees' rights must then become vested.

Consistent with the requirement that a plan be maintained for the exclusive benefit of employees, investment of trust funds must meet certain criteria. These are—

- (1) The cost of an investment must not exceed its fair market value at time of purchase;
- (2) A fair return commensurate with the prevailing rate must be provided;
- (3) Sufficient liquidity is to be maintained so as to permit distributions in accordance with the terms of the plan; and
- (4) The safeguards and diversity that a prudent investor would adhere to must be present.

Furthermore, a trust may lose its exemption if it engages in a prohibited transaction in dealings with the employer, or related or controlled interests. These consist of—

- (1) Loans of trust funds without the receipt of adequate security and a reasonable rate of interest;
- (2) Payment of compensation in excess of a reasonable allowance for personal services;
- (3) Making any part of its services available on a preferential basis;

- (4) Buying securities or any other property at a price in excess of fair market value;
- (5) Selling securities or other property at a price below fair market value; and
- (6) Engaging in any other transaction which results in a substantial diversion of trust income or corpus.

An exempt trust is required to file an annual information return, form 990-P, reporting its financial transactions and furnishing a statement of receipts and disbursements and a balance sheet.

Furthermore, if it had unrelated business taxable income, it is required to file a tax return, form 990-T, and pay the applicable tax. These returns are subject to examination in accordance with our audit procedures.

A taxpayer may request an advance determination letter from his district director of Internal Revenue as to the status for qualification of his plan and exemption of the related trust by filing copies of the plan and related documents, and furnishing supporting information. The material is examined by revenue agents in the local office and if everything is found to be in order, a determination letter is issued.

On the other hand, if defects appear, these are pointed out and the taxpayer is afforded an opportunity to amend and obtain a favorable determination.

A determination letter may also be obtained as to the effect of an amendment of a plan previously held to be qualified, on the effect of a curtailment or termination of a plan, and on the effect of an investment of trust funds in the stock or securities of employers.

During 1965, a total of 13,532 plans, exclusive of plans including self-employed individuals, were held qualified, and 1,036 determination letters were issued on terminated plans, resulting in a net increase of 12,496 plans for the year. This brought the total number of plans passed on through December 31, 1965, to 123,596, of which 8,604 were terminated, resulting in a net of close to 115,000. Over 93 percent of the total applications result in favorable determinations. Out of a total of 98,312 applications processed during the 10-year period ended December 31, 1965, 91,838, or 93.41 percent, resulted in favorable determinations; 1,136, or 1.16 percent, resulted in adverse determinations, and 5,338, or 5.43 percent, were withdrawn or abandoned.

Not only must a plan satisfy the requirements for qualification at the time it is established, but it must also continue so in operation. Tax returns on which employers claim deductions for contributions under plans are examined in accordance with established audit procedures. Such returns, together with the forms 990-P and 990-T, constitute the basis for periodic verification of the status of the plan. Deduction during the fiscal year ending June 30, 1964, for employer contributions under qualified plans exceeded \$5,400 million.

A pension plan is fully funded at any given time if the cost of benefits which have accrued to that time has been paid. If the total contributions for all years through the end of the taxable year in which this occurs, and the increments on such contributions, are sufficient to provide the benefits accrued to that time, no further deductions are allowable for additional contributions. Such additional contributions would overfund the plan and would not constitute ordinary and necessary business expenses.

On the other hand, underfunding, to the extent that the normal cost and the interest on the unfunded past service cost have not been met, would require full vesting in participants. It should be observed, however, that such minimum funding merely satisfies the vesting requirement, but does not assure the sufficiency of the fund to pay the contemplated benefits.

What I have presented here is but a brief summary of our activities in the pension area. I shall, however, be glad to answer such questions as I can.

Thank you for your kind indulgence.

Representative GRIFFITHS. Thank you very much, Mr. Cohen.

May I ask in these annual reviews, how many times have you disallowed the contribution?

Mr. COHEN. We do not make any tabulations exactly that way, but we have a number of figures here.

During this fiscal year there were 24 proposed revocations as of March 31.

Representative GRIFFITHS. What was the basis?

Mr. COHEN. Assorted reasons. I do not have the reasons here, but there were examinations. There were about 83,000 forms filed, from which selected returns were examined for one reason or another.

Representative GRIFFITHS. If you had only 24 disallowances, would you mind supplying the reasons for each of them?

Mr. COHEN. We can give you the assorted reasons.

Representative GRIFFITHS. Yes; please do so.

(The information follows:)

The reasons for the recommended revocations are as follows:

Prohibited transactions.....	19
Discrimination.....	3
Inurement of income.....	1
Other (unidentified).....	1

Representative GRIFFITHS. When these plans are qualified, do you give them a number?

Mr. COHEN. No.

Representative GRIFFITHS. Why do you not give them a number, make that the Federal number, and give that number to Secretary Wirtz.

Mr. COHEN. All the identification numbers are handled on the basis of the employer identification number, which is issued for their social security purposes.

Representative GRIFFITHS. But you could give them a Federal number, so that the Secretary of Labor would know whether or not they made an annual report?

He should know at least as much about the plan as you know about the plan.

Mr. COHEN. I am forbidden by statute from revealing much of the information we have.

Representative GRIFFITHS. You do not have to violate the statute but you could give them a number, so that he knows whether or not that plan had reported.

Mr. COHEN. He does.

Mr. Goodman informs me he does know which plans have qualified.

Representative GRIFFITHS. Mr. Wirtz told us he did not.

Mr. COHEN. He has access.

Representative GRIFFITHS. He knows which plans have reported, but he does not know that he has all the plans reporting.

Mr. COHEN. We certainly can look into whatever problem the Secretary may have.

Representative GRIFFITHS. Now secondly, if you give them a Federal number, then why do you not require that the Federal number of the pension plan in which the person participates appear on his income tax return? If you did that, at the end of 10 years we would really have some statistics. You would know whether these pension plans pay out or not.

If you had this information available in place of just guessing or making some sort of an actuarial estimate, there would be some real knowledge of who does not get paid by a pension plan, and to how many pension plans contributions have been made during the life of a working individual.

Mr. COHEN. I am sorry, you are talking about each individual?

Representative GRIFFITHS. Now secondly, you require that the employer notify the employee about the plan. How do you know that they notify him?

Mr. COHEN. We were supplied with the information, the typical copies of the material submitted.

Representative GRIFFITHS. Did you ever check with the employees to find out what they knew about the plan?

Mr. COHEN. The requirement is that the employer notify the employees. The requirement is not that the employees understand what they have been told.

Representative GRIFFITHS. That is right, but you might find out they have never been told anything.

Mr. COHEN. Under normal circumstances, of course, the union, in the union-negotiated plans, there is no real problem since the union would fully disseminate the information.

Representative GRIFFITHS. You are placing quite a lot of reliance upon unions. I have had quite a lot of objections come into my office about unions; people thought they were paying into a plan on which they were going to draw, and when it came time to draw they did not get a cent.

Mr. COHEN. Of course, one of the problems that we have, Madam Chairman, is that we are not responsible, the code does not make us responsible for the actuarial soundness of a plan. This is not one of the things we are required to administer, nor are we capable of administering, under the present law.

Representative GRIFFITHS. But it seems to me that with a very modest amount of effort on your side, doing things that you are quite competent to do, we could come to have some real knowledge about pension plans.

If you gave them a Federal number; if the Federal number were passed on to the Labor Department and all other Federal agencies; if you required that everybody making out an income tax return put that Federal number on the tax return; you would come to have a lot of information about who was covered and who was not and you would have it quite shortly.

Mr. COHEN. It would be interesting for informational purposes, but it serves no purpose under the Internal Revenue Code at the moment,

and therefore we do not feel we have the authority to require this sort of thing. We do get a lot of flack right now when we ask for the informational number which we are required to ask for.

Representative GRIFFITHS. This is deferred income; is it not?

Mr. COHEN. For example, if an employee receives any part of these funds, we do receive a notification from the fund with his number on it, with his social security number, which makes us able to trace, to see whether he has reported the income. So for our purposes of administering the income tax, we do have the available resources to check whether he has reported his income, and that is what we are charged with doing right now.

Representative GRIFFITHS. You point out that when an employee reaches the normal retirement age and has satisfied the service requirement, his rights to benefits or contributions under the plan must be vested. Now this is under a qualified plan?

Mr. COHEN. This is right.

Representative GRIFFITHS. Some plans have conditions subsequent, which remove the vesting; do you disqualify those plans then? For instance, I have already heard of a good many plans which say that the employee can draw the pension as long as he does not work in certain areas. He cannot work for competitors. He cannot work in a supervisory capacity for the same employer. Do you disqualify such plans?

Mr. GOODMAN. No.

Representative GRIFFITHS. Do you not have that authority?

Mr. GOODMAN. No. This is rather a technical construction of the word "vesting." The employee is vested in rights specified in the plan. Those rights cannot be taken away from him. However, there are plans which provide for vesting subject to divestiture.

Now this may seem to be rather a contorted term, vesting subject to divestiture, but divestiture is based on commission of a certain act. For example, divulging trade secrets to a competitor. There the employee knows in advance that if he will go to a competitor and divulge trade secrets, or go to work for a competitor, or commit other specified acts which must be stated in the plan, then from that point on his benefits will cease. Other than that, his benefits must continue.

Representative GRIFFITHS. Now in our tax treatment of employee benefits, are we not promoting, as you have pointed out, the development of forms of compensation alternate to money wages?

Mr. COHEN. I think we both agree to that.

Representative GRIFFITHS. What are the limits in existing law to how far companies and their employee can go in negotiating compensation in forms other than current money wages?

Mr. SURREY. That is quite a broad question, Madam Chairman. For example, we have discussed the rules with respect to the pension area. Beyond that, for example, you can have various insurance arrangements, group term insurance and the like.

Congress recently fixed a limit of \$50,000 on the amount of group term insurance which can be provided to employees tax free. You can have other fringe benefits, working conditions and the like. Your question covers the whole gamut of the fringe benefits that an employer can provide for an employee, and each particular type of fringe benefit generally has its own tax rule to go with it. So it would be difficult



to give a detailed answer, unless you considered each fringe benefit itself.

Representative GRIFFITHS. Thank you.

Senator MILLER?

Senator MILLER. Thank you, Madam Chairman.

Mr. Cohen, you have testified that there were close to 115,000 outstanding pension plans at the end of last year.

Mr. COHEN. Yes.

Senator MILLER. How many of those will be audited over a period of 3 years?

Mr. COHEN. It is a little hard to estimate, because we do this in two different ways. We audit the pension plan per se, and in auditing the corporation that makes the contributions, we will audit the corporation's contribution which requires a look to see that the pension plan is operating in a proper fashion, so that since it happens in both ways, it is hard to put your finger on an exact figure.

Senator MILLER. Do you not have any tabulations?

Mr. COHEN. We can tell you how many of the pension plans per se, but we cannot tell you how many are looked at from this peripheral view.

Senator MILLER. It would not be too difficult for you to get the statistics on how many are audited from the peripheral point of view, would it?

Mr. COHEN. Yes, sir.

Senator MILLER. Why?

Mr. COHEN. Because there is no report made specifically on the item when the agent audits the corporation, unless there is some problem that arises. In other words, if he finds that the deduction is perfectly properly computed, and there appears to be no problem with the pension fund, then he need not comment on it, so that we do not have reports coming in that he looked at his pension fund this particular year and found it to be perfectly proper. On the other hand, if he discovers a potential problem he pursues it and this will be reflected in his report.

Senator MILLER. It would not be too difficult for his audit report to indicate whether or not there was a plan and whether or not it was examined.

Mr. COHEN. The audit reports do, but we do not tabulate them that way, sir.

Senator MILLER. Would it be very difficult to have them tabulated over a year's time?

Mr. COHEN. It means we would have to go back and examine each one of them, sir.

Senator MILLER. Well, I did not intend for you to go back and examine each one of them, but I thought that at the end of next year you might be able to tell us how many of these peripheral examinations you make.

Mr. COHEN. I think we could if we started today, forward.

Senator MILLER. Yes.

Mr. COHEN. Oh, yes; in doing it for some past year we would have to go back and retabulate in a fashion different than we have done before.

Senator MILLER. How many of these 115,000 were given a direct examination during the last 3 years?

Can you give us some figures on that?

Mr. COHEN. About a thousand a year. That does not mean that we only look at a thousand a year. That is how many we examine. In other words, there is a survey for the purpose of determining which ones appear to deserve further examination, and a thousand were detailed examinations.

Senator MILLER. How many would you say were surveyed then?

Mr. COHEN. Usually it runs anywhere from 5 to 10 times that many. I am just giving you a gage. I can give you a better figure perhaps for the record if we have it back in the office.

(Information from Mr. Cohen's office follows:)

Regarding the number of returns of exempt trusts which were surveyed in selecting returns for examination, there are no additional statistics available. Our reporting system does not presently furnish a breakdown on the number of returns surveyed for this purpose.

Senator MILLER. Roughly 10,000 a year would be surveyed, 1,000 a year have a detailed audit.

Mr. COHEN. That would be within a range.

Senator MILLER. Now, in the President's Committee on Corporate Pension Funds, there is a conclusion on page XII which says:

Present laws permit many serious inequities in qualified retirement plans, and in the tax treatment of benefits distributed by such plans.

Do you agree, Mr. Surrey?

Mr. SURREY. I would agree generally that the items mentioned are those which should be reexamined to see whether present law in these areas should be changed or not.

In other words, I would agree that these are matters worthy of examination.

Senator MILLER. But you would not necessarily agree that pending the examination, that there are many serious inequities in the qualified retirement plans and in the tax treatment of benefits? You would not reach that conclusion without an examination?

Mr. SURREY. Well, I would say that there are a number of these recommendations that seem to me to be prima facie valid. Some of these we have recommended in the past to the Congress, but the Congress has not adopted our recommendations. I would not want to say that I would stand in back of each and every one of these recommendations, but I would say that there are many which we have discussed in the past.

Senator MILLER. In the past, though, have you premised your discussion on the fact that these are inequities?

Mr. SURREY. I do not know whether you and I have a different meaning for the term. If by inequities one means tax preferences that are not appropriate, and therefore give an inappropriate tax advantage to the particular beneficiary, that is the way we could apply the term.

Senator MILLER. What would be an example?

Mr. SURREY. Well, I think an example that we were concerned about in the past with respect to this area is the capital gain treatment to lump-sum distributions of pension plans.

It is a difficult matter because the capital gain treatment was intended as a rough equivalent of averaging the income rather than subjecting the entire lump-sum distribution in 1 year to the graduated rates.

We felt, however, that in many cases capital gains treatment worked out to be unduly beneficial as compared to what averaging would have produced, and that there is a case where there was an inappropriate advantage, an inequity.

Another would be the question of whether the transfer of interests in qualified retirement plans should or should not be subject to the gift and estate taxes. Presently under certain conditions they are not subject to the gift and estate taxes and the question is raised why this particular form of transfer of benefits should be relieved of such taxes. These are some of the matters we would be interested in.

Senator MILLER. Would those two items which you just referred to be such that you would recommend that they be considered for special changes applicable only to pension and profit-sharing trusts, or would it be your thought that they ought to be taken into account as an overall change in the tax law relating to the estate taxes and capital gains taxes?

Mr. SURREY. I think the two matters that I made reference to are cases in which the present rules have these distinct exceptions just for pension plan benefits, and consequently it would be a matter of focusing on these two exceptions.

Senator MILLER. Now on page 6 of this same report, there is an estimate that total reserves will grow to about \$225 billion by 1980. Do you have any ideas as to whether or not there ought to be greater limitations on the way these reserves can be invested, or whether there should be any change in the tax treatment of them?

Mr. SURREY. With respect to investment, Senator, this report, as you know, went into the question of investment, and considered whether there should be additional rules imposed. It came to the conclusion that under present circumstances, given the desire for flexibility of investment, it would probably not be necessary at this time to impose restrictions other than restrictions regarding investment in the securities or stocks of the employer, but that this was a matter that would require a continuing examination, because the funds are very large.

For example, I suppose the SEC would constantly study the matter and see whether any changes were necessary. But this report stated that at the present time additional restrictions were not thought desirable, with the exception that I noted of employer stocks and securities.

Senator MILLER. Do you have any personal ideas on this?

Mr. SURREY. No, I do not have any personal ideas, apart from the discussion in this report.

Senator MILLER. Can either of you tell me whether or not the contributions or increased contributions to a pension system or to a new pension system come within the 3.2 percent wage guidelines?

Mr. COHEN. I do not know.

Mr. SURREY. I am informed that they do.

Senator MILLER. I have no further questions.

Representative GRIFFITHS. Thank you, Senator Miller. We have made a suggestion in these hearings that the Federal Government reinsure these pension funds. In view of the fact that I believe you testified contributions to plans are costing the Government now \$3 billion a year in taxes, would it not be cheaper to reinsure them, and therefore reduce funding requirements?

Mr. SURREY. The question of reinsurance is one that is currently under consideration, Madam Chairman. It is a complex question, because the desirability of reinsurance and the costs of reinsurance are in a sense wrapped up with funding, and one tends to go round in a circle I think in trying to answer the matter. It would be hard to say that reinsurance would be a substitute for funding until one really knew the dimensions of the reinsurance scheme and could see whether the reinsurance itself is a provision for reserves that is the equivalent of funding. But I think that it is important to study the question of reinsurance.

A study is going on in that regard, in connection with Senator Hartke's bill on reinsurance which we understand is likely to be the subject of hearings in the Senate Finance Committee.

I would not want to express an opinion on the matter now, because it is currently under study within the executive branch.

Representative GRIFFITHS. Now when a plan comes in to you, Mr. Cohen, supposing the employer says, "This year I am putting away \$2 billion, we expect to pay our employees \$75 a month, and we expect to make 3.3 percent on this investment." You can take one look at the plan and know positively that every employee he now has would have to live to be 120 to use up the funds. Do you then say, "You cannot take the \$2 billion. You are taxable on part of it"?

Mr. COHEN. We would not allow the deduction. We have actuaries and we attempt to make a determination as to the reasonableness of the amount.

Representative GRIFFITHS. How do you determine when these plans are overfunded after they have been set up?

Mr. COHEN. There is an examination. There is a study of the assets, of the liabilities, of the persons who are entitled to benefit, what the percentages run, and if necessary we provide actuarial help to our field agents from Washington and to determine from the facts of the given cases is it likely that this fund can meet its liabilities.

Representatives GRIFFITHS. Do you consider that a public utility should have less funding or more funding than any other concern, or do you consider it on exactly the same basis?

Mr. COHEN. We consider it on exactly the same basis. We have no leeway under the code to treat one taxpayer differently than another. The economics of the situation may be different, but that is not within our purview.

Representative GRIFFITHS. But do you have a right to determine what the funding requirement is or do you not? What is proper funding in one case may be different from proper funding in another case.

Mr. COHEN. We do not really determine the funding. We only determine the deduction. If the deduction is reasonable and applies a reasonable funding—

Representative GRIFFITHS. How do you determine whether it is reasonable?

Mr. COHEN. In terms of the funding that is available for the liability.

Representative GRIFFITHS. Yes.

Mr. COHEN. And it does not make any difference in our determination whether the employer is in a risky business or a stable business. It is just a question of what funds are available there for the payout of the liabilities as the activities of the plan go on.

Representative GRIFFITHS. Frankly, I think you are wrong. I think this is the problem of funding: whether or not it is reasonable.

How in the world did you let A.T. & T. accumulate \$5 billion?

Mr. COHEN. On the basis of the liabilities incurred by them.

Representative GRIFFITHS. But they have never even paid out the interest on the fund in any one year. How can you let one of these funds be set up that never pays out the interest on the fund?

Are you assuming that there is never going to be another contribution made?

Mr. COHEN. We do this on the accounting principles and under the code as established.

If you would like to change—and I do not quarrel with your concepts of desiring to change the rules, I am merely saying that the rules as currently established provide for us to determine the liability.

Representative GRIFFITHS. I do not think there is a rule which states how you are to determine funding. We have been struggling to find out what funding is and if there were a Federal definition. There is not a funding rule that enables you to determine what is funding and what is not funding. Yet, that must be the basis on which you disallow contributions to the funds.

Now I would like to know on what basis you make the determination. What is your idea of funding? What is your definition?

Mr. GOODMAN. Might I answer that?

Mr. COHEN. Let Mr. Goodman try.

Mr. GOODMAN. A taxpayer may set up any funding method he desires. You might at this particular time conclude that there are about a half dozen funding methods. However, through the complexities of actuarial determinations, another actuary might come up with additional funding methods. The mere fact that a new funding method has been introduced, that in and of itself does not necessarily mean that it is bad. We have limits on deductions, not on a funding method.

With respect to a particular funding method, you have a number of factors.

One is life expectancy. Assuming that you have an individual who is already at retirement age, what is his expected life expectancy, so that you will know how much to pay in order to give him a pension of  $x$  dollars?

No. 2, since in most cases funding is done before the individual reaches retirement age, there are various factors. No. 1, what are the probabilities of an individual dying between his present age and retirement age?

Representative GRIFFITHS. Now let me ask you when a plan comes in, do they say to you, "We have so many people, this is their age, this is the amount of money we are going to put in, this is the anticipated

return on the fund, and this is the anticipated pension that we intend to pay"?

Is this what they say to you?

Mr. GOODMAN. No.

Representative GRIFFITHS. What do they say to you?

Mr. GOODMAN. They give us a copy of the plan, which in most cases does not spell out a funding method. It does not say that here is a census data of employees showing each individual by age and sex and compensation. They gave us a document which sets forth the benefits, the requirements for obtaining the benefits.

Representative GRIFFITHS. All right, the benefits. They tell you that the benefits will be \$75 when the person is 65 years and has worked the last 20 years or the last 25. Now what else do they tell you?

Mr. GOODMAN. They give us all items which pertain to the plan itself, who is eligible, how long the man has to work or the woman has to work, how the funds will be accumulated, either in a trust or through an insurance company and so on. But in very few cases is any information furnished with respect to the funding method. That takes place at the time the employer claims a deduction.

Representative GRIFFITHS. And then how do you disallow the deduction?

Mr. GOODMAN. On examination of his tax return, every employer who claims a deduction is required to file a statement in support of his deductions. This is an Internal Revenue Form 2950, which must be attached to the employer's tax return. On this form and related information also attached, the employer spells out the various factors which go into establishing his deduction. If at that time that is, let's say we are examining 1963 now, we have an employer on a calendar year basis, at the end of 1963 what is the total assets in his fund? \$5 billion? Well, \$5 billion might be excessive, it might not.

What is the accrued liability to December 31, 1963? If the accrued liability is \$7 billion, we are not at all perturbed about assets of \$5 billion.

Representative GRIFFITHS. All right, now let me ask you: He has accrued \$5 billion and you think that is quite all right. He was making 3.3 percent on the investment. Now he is making 6.1 percent. So when he comes back the next year, do you suspend the contributions?

Mr. GOODMAN. We limit the interest assumption to what is reasonable in line with the other factors.

Representative GRIFFITHS. But not in relation to reality?

Mr. GOODMAN. Yes. We do hold that at the present time that you will not be permitted a deduction on contributions based to some minimum amount such as 2.5 percent.

On the other hand, we will permit 3.5 percent although we do know that at the present time you can get good investments at 5 percent. But you do not go out every year and cash in your old investments. You have a 20-year bond which might have been acquired 10 years ago when the rate was 3 percent, and true, you could get probably a bond just as secure today paying 5 percent.

Representative Griffiths. But I am not asking you about the situation where they are not reinvesting. You are not requiring them to reinvest?

Mr. GOODMAN. No.

Representative GRIFFITHS. I am asking you about the situation where they have reinvested, and from 3.3 they are now making 6.1 percent.

Mr. GOODMAN. That must be taken into account.

Representative GRIFFITHS. All right. Then do you reduce the contributions?

Mr. GOODMAN. We reduce the deduction.

Representative GRIFFITHS. And how many cases like that have you?

Mr. GOODMAN. We have no statistics on this.

Mr. COHEN. This is part of the normal audit pattern and we do not keep our statistics by this method.

Representative GRIFFITHS. Now, as Senator Miller was asking his questions, we figured out it is entirely possible that some of these plans could be operating for 40 years without being investigated; is that right?

Mr. COHEN. No; that is not right.

Representative GRIFFITHS. All right, how frequently do you audit them?

Are you auditing every plan every year?

Mr. COHEN. No.

Representative GRIFFITHS. How many times would a plan be audited in 20 years?

Mr. COHEN. It would fall in our normal pattern of selection. We might audit one five times in a row if it deserved auditing five times in a row, and not audit another because there appeared there was no problem with it.

Representative GRIFFITHS. I would examine them all to see if there were problems.

Mr. COHEN. I wish you would speak to the Appropriations Committee for me.

Representative GRIFFITHS. The Ladies Garment Workers came in here with a plan that paid 3 percent of the plan's income to the union to administer the plan. Have you ever considered whether or not the union should be taxed on unrelated business income?

Mr. COHEN. It might be an academic question if the cost of the administration were 3 percent. I do not know the particular case so I cannot answer it except from an academic standpoint.

Representative GRIFFITHS. But it is possible to consider this?

Mr. COHEN. It is possible to consider this.

Representative GRIFFITHS. Now A.T. & T. came in and announced that they did not charge the plan anything for administration. They charged this expense to the business. Why do you let them do this?

Mr. COHEN. I am not aware of the specific case, and I cannot talk about specific cases in any event.

Representative GRIFFITHS. Evidently there are situations where the business is permitted to administer the fund. Why should the business be permitted to administer the fund? The fund should administer the fund.

Mr. COHEN. It is only a question of reasonableness of contribution. If the contribution is reasonable and the administrative costs are not out of line, then there is no problem. But whether it comes out of one pocket or the other; the costs must be met. The employer is meeting the cost.

I think it becomes an academic question so long as the costs are reasonable.

Representative GRIFFITHS. Since the Sears profit-sharing plan permits an employee to take his equity in Sears stock at the time of retirement, why is this plan qualified?

Mr. COHEN. As I recall it, it is a profit-sharing plan. It is not a pension plan, and the code so provides is the only answer I can give you. I do not give you a theoretical answer. This is just a very practical answer.

Representative GRIFFITHS. How do you determine whether a plan adequately informs the members of their rights? Do you just look at what they say they send out?

Mr. GOODMAN. The employer is required to submit a statement together with his request for a determination letter showing that the plan has been communicated. Information submitted to a Government agency is subject to penalties for perjury. If the employer wishes to perjure himself, he is taking a risk. Assuming a particular employee should write in and tell us that he has not been given the benefits that he thought he was to get under his plan, and we found that the plan has not been communicated, that goes, of course, to audit and the regular mechanics go into operation. But ordinarily, if an employer makes a statement, we take his word for it.

Representative GRIFFITHS. Now I would like to ask you, Mr. Surrey, if you are satisfied with the workings now of H.R. 10?

Mr. SURREY. My mind had been so much on this Cabinet Committee report that it had not gotten around to H.R. 10.

Representative GRIFFITHS. I believe you sent us a report the other day.

Mr. SURREY. Yes.

Representative GRIFFITHS. Your report showed that 38,000 people had taken advantage of this provision. Why are we penalizing the self-employed?

Why are you permitting savings through pension plans and not the savings of the self-employed to be deducted?

Mr. SURREY. I suppose that is one of the questions that has hovered over and haunted this whole question of pension plans for the self-employed for a number of years. You have the whole gamut of savings. That is, you can have the savings of individuals who are not employees. Then you can have the savings of people who are self-employed. And then you can have the savings of people in employment who are not covered by pension plans, and on down to the separate savings of those who one would say are rather inadequately covered by pension plans.

Now, in this whole range of savings for retirement, what should be the attitude of the Federal Government?

I think in the past the Congress has taken the position that the primary method of saving for security on retirement has to be through the social security system, and that that is the comprehensive basis for our society.

Representative GRIFFITHS. Well, why does not the Cabinet Committee take the position that anybody who contributes to a pension plan, either an employer or an employee, gets to deduct his contribution from income subject to tax?



Mr. SURREY. We do not even permit people who contribute to social security to deduct that amount. In other words, social security is a method of saving for retirement, one might say a mandatory method to make sure people have some basic security. The payment of social security taxes is not reflected within the individual's income tax. The income tax is not to be considered a tax only on expenditure and not on savings. We do not exempt savings generally.

Now the Congress felt that this broad-based social security system should be supplemented by a broad-based private pension system, under which employers should be encouraged to provide supplementary benefits for their employees over and above social security. And largely keeping in mind the general run of workers, I would say, Congress established the general rule that these plans must be non-discriminatory in benefits and coverage. Beyond that we do not generally make any special provisions for the savings of individuals. The self-employed stand on the borderline. In one part they are somewhat like employees and in another part they are like just any individual saving on his own account.

Representative GRIFFITHS. What real excuse is there for saying that we are going to add these pensions to the cost of the product? Why not let every individual save his own money and let him deduct it but put a limit on how much he could save.

Mr. SURREY. Well, I think again that you do start back with the philosophy of the social security system. We do put on the cost of our goods today the costs of social security. The payroll taxes on employers presumably get injected into the price structure in our society, because we believe that many people either can not or will not provide for their security, and just as a social policy it should be done this way.

I think the same answer is made with respect to pension plans generally.

Now the question which you raise is an interesting and difficult question. Are we adequately handling the funding of these plans, which I think is the main point that you want to get at.

Mr. SURREY. And you have the feeling, I gather, this should be on more of a pay-as-you-go basis, whereas others can take the approach that the present consumers should be bearing the cost of providing future pensions for present workers turning out these goods.

I think you can properly ask are our rules respecting funding well thought out and intelligently considered. Now in that regard the Cabinet Committee thought that this whole question of funding should be reexamined to see if more actuarial guides can be provided, to see if the various pension plans cannot at the very outset state their funding methods and their actuarial assumptions.

Representative GRIFFITHS. That is right, how many people they expect to cover. What they expect to pay them. And if 5 years later they come in and are making 6 percent although they were planning on making 3 percent, you should stop the contributions.

Mr. SURREY. Now that, I think, is the thrust of the recommendation in the Cabinet report on funding. It indicates that this has to be discussed with the actuarial profession to see if they are equipped to handle all these plans, to look over their assumptions, so that, so to

speaking, you can have certified actuarial reports just as you have certified public accountants reports.

Now, this is a matter that the Cabinet Committee report indicates should be looked into, should be considered with the actuarial profession, and, as you have pointed out and we would agree, is a matter that deserves important consideration.

Senator MILLER. Then would I understand Mr. Surrey to say that, if there is objection raised to the company that has a retirement fund—which currently is not even paying out the interest that it is receiving through its investments for retirement purposes, that the rationale for this situation is that the payments into the fund—which are deductible now and perhaps also show up in a little increased cost of the product, mean that the present generation will be paying for the future retirement of present generation, and when the future generations come along they will not be picking up the cost of that.

Mr. COHEN. It is a question of how fast the liability accrues. If the liability is accruing as fast as the income, then there should not be any problem. This is just really a question of fact.

Senator MILLER. That would be evident?

Mr. SURREY. Yes.

Senator MILLER. But where you have a large retirement fund drawing interest, and in the present state of affairs not even the interest having to be paid out to meet the pension requirements, I can understand how some people might want to take a second look at that. But the rationale is as Mr. Surrey has stated it.

And may I say I think I agree with that particular rationale.

Now Mr. Cohen, you do not have the figures on the peripheral examinations of these pension plans. You only have the figures on direct examination?

Mr. COHEN. Yes, sir.

Senator MILLER. And I understand you to say that roughly 10,000 a year are looked at and then 1,000 a year are selected for audit.

Mr. COHEN. I would have to get the exact figure on that 10. That is just a rule-of-thumb, but we do know that about a thousand are looked at in detail each year.

Senator MILLER. That turns out to roughly 30,000 in a year<sup>1</sup> period, and if my calculations are correct, it comes down to this: that about 1 in 4 have a chance of being looked at just for the purpose of being selected, and that out of each 1 of those 4, only 1 in 10 will actually be audited, so that there is about 1 chance in 40 over a 3-year period of time of one of these pension plans being audited.

Mr. COHEN. Subject to getting my audit division to give me a more exact figure on the survey, your arithmetic is correct.

Senator MILLER. I would recognize that you are giving me a rule-of-thumb.

Mr. COHEN. It may be in this area that they look at more, 20 for every 1 that they select. I am just not sure of the figures.

Senator MILLER. Let's take these 1,000 a year that are looked at. What is the revenue outcome of those audits?

How much revenue has been picked up as a result of disallowances?

<sup>1</sup> This evidently has reference to a 3-year period.

Mr. COHEN. About \$600,000, a little over \$600,000 proposed deficiencies to the trusts, and a little over 17, almost \$17.5 million on the related individuals.

Senator MILLER. On how many audits?

Mr. COHEN. A thousand audits.

Senator MILLER. How does that measure up with respect to the additional revenue you assess on a thousand audits of corporate returns?

Mr. COHEN. It depends on the size of the corporation.

Senator MILLER. I know, but just on an average?

Mr. COHEN. I do not have the figures in mind.

Senator MILLER. What I am wondering is whether or not the auditing of these pension plans is a particularly productive sources of revenue.

Now, were those direct audits?

Mr. COHEN. Those are only direct audits I am talking about.

Senator MILLER. I am wondering if one reason why you have had a relatively low number of direct audits of these pension plans and trusts is because your revenue agents can be more productively turned on to the corporate returns themselves?

Mr. COHEN. On the whole that is a general rule, because as you see from our acceptance rate, 93 and a fraction are accepted, that 93 percent of the plans put forth were entirely proper within the rules of the code and its interpretations, and that the average company, most of the companies try to live within the rules, and we do not have substantial deviations.

As a general rule I would say that that generalization is right. That our manpower is better spent on large corporation audits.

Senator MILLER. I can understand that, and if this is so, perhaps the answer is not more appropriations to the Internal Revenue Service. Why have more revenue agents to be put on this relatively unproductive activity? Maybe the answer is to have some kind of a pension auditing staff over in the Department of Labor which looks at plans not from the standpoint of revenue but from the standpoint of proper administration. Of course, if they find something that appears to be out of line, they could refer those cases over to the Internal Revenue Service.

Have you given any thought to that?

Mr. COHEN. That is a possible alternative, and it does present interesting possibility of a specialized group being able to handle a greater volume with more dispatch, but we have not given any detailed consideration to anything like that.

Senator MILLER. Could I suggest that you probe that with the Secretary of Labor and with the Secretary of the Treasury, because I for one would not want to be a party to having your staff, which is highly productive, turned into relatively unproductive activity, but at the same time I am troubled by the fact on these direct audits 1 in 40 in 3 years; has a chance of being given a real close scrutiny.

Mr. COHEN. I think that the percentages on the other side would be quite a bit greater, Senator, because of the number of corporations audited, which is fairly substantial.

Senator MILLER. One further question of Mr. Surrey.

For my information, would you mind telling the committee whether or not you have any position on whether social security tax payments and self-employment tax payments ought to be deductible and social security receipts includible in income?

Mr. SURREY. I do not think that the Treasury has taken any public position on this in the past. I know it has not recommended the current deductibility of social security payments. It has not recommended that.

Senator MILLER. I would not propose that, either.

Mr. SURREY. Current deductibility of social security taxes?

Senator MILLER. I would only throw this out to you to consider together, deductibility of the taxes, includibility of the payments.

Mr. SURREY. Yes.

Senator MILLER. To my knowledge Treasury has not taken a position on this, but I would like to get your opinion on it.

Mr. SURREY. I would say that the two are not necessarily intertwined. In other words, I would certainly agree that you could not have deductibility without taxation of the benefits. However, the benefits can be treated as taxable without necessarily having deductibility, which would be comparable treatment to private pension plans, were the employee contributions are not deductible but when computing the tax on the private pensions on payment after retirement, then account is taken of the contributions previously made.

We have in the past, in connection with the 1963 Revenue Act, indicated to the Ways and Means Committee and the Congress that we thought the present general treatment of the aged insofar as the tax laws are concerned deserves some reconsideration by the Congress. It has become, I would say, hopelessly complicated. The retirement income credit takes a whole page on the tax return, and I think this is so detailed and so complex that many people really are not getting their full benefits under it. This whole question is one that could profitably be reexamined by the Congress at some time, to see if we could have a simpler and fairer method of dealing with people over 65 that did not get into the present discriminations that exist, depending on how you earn the income and the like. That whole area is one that could be reexamined.

The Congress did not desire to go into it in 1963, but may desire to go into it in some future time in connection with increased benefits under social security or the like.

Senator MILLER. Are you satisfied with the present state of the law on the taxability and deductibility of these items?

Mr. SURREY. I would say that overall we are not satisfied with the present treatment. As I have said; for example, it is unduly complex. I am talking about the whole treatment of people over 65.

I would not want at this moment to talk about any particular part of it. I say the whole treatment is unduly complex, and discriminatory. Tax benefits are being allowed to people who do not need them, and sufficient benefits may not be accorded to people who do need them.

Senator MILLER. One way of reducing that inequity, of course, would be to make the benefits taxable.

Mr. SURREY. That is right.

Senator MILLER. On the other hand, there would be the offset of the deductibility by higher taxpayers, so it would seem to me it would be a fair treatment both ways.

MR. SURREY. As you say, the subject is one that deserves exploration in the context of the entire tax treatment of the aged, and in the context of the benefit structure under our social security system.

Senator MILLER. Thank you very much, gentlemen.

Thank you, Madam Chairman.

Representative GRIFFITHS. Now you do not know when these people come in and set up a plan exactly what they are going to make, exactly how much money everybody is going to receive, and so forth and so on. And many of these plans are negotiated under circumstances in which the management does not make this contribution in too happy or voluntary a manner, I would assume. It seems to me that if this is permitted to continue that you are going to build up through tax deductions a favored group of people who are going to retire with large incomes that all the rest of us have helped pay for. So it seems to me that there is a real question of the public interest.

Mr. COHEN. We certainly would agree the code now provides this system. Whether this system is the best system is something that we constantly ought to reexamine.

Representative GRIFFITHS. Well, could you under the code as it stands now, ask them how much they are planning on making, what they intend to pay the employees, and how many employees they have?

Mr. COHEN. Those figures are generally available to us.

Representative GRIFFITHS. Well, why do you not ask them?

Mr. COHEN. I would like to give you the forms here. The forms provide for most of that material.

Representative GRIFFITHS. You should be able to determine whether or not there is too much money in there or there is not.

Mr. COHEN. On the average, our people find that very seldom do you run into an overfunded plan. Most of your funds are under, just as a generalization.

Representative GRIFFITHS. We have not run into a single plan that is paying out the interest on the funds.

Mr. COHEN. That is not necessarily determinative whether it is overfunded.

Representative GRIFFITHS. But it should raise a question. No matter what people thought originally, what their imaginations conceived, the fact is that you should come now to look at reality, that in fact many of these plans, after many years of existence, never have paid out the interest on the money for any single year.

Now if we were to require early vesting as a condition for tax qualification, as recommended by the Cabinet Committee report, do we not institutionalize the existing multiplicity of plans?

Mr. SURREY. That is a factor that would have to be taken account of in this sense: That people who moved around in their employment would have benefits under different plans. Now whether that in turn would lead to multiemployer plans, or lead to some system of portability of pensions, is a matter that I think is hard to say at this time.

Representative GRIFFITHS. Is not the cost of administering any plan really a considerable cost?

Some of these plans are paying 3 percent, some of them are paying 6 percent. There is a good living paid out in the management of these plans. So that the administrative cost at least could be reduced if you

had, instead of these many plans, a comprehensive plan, some plan that took in everybody.

Mr. SURREY. If the standards as to vesting became more uniform in the various plans, then I think that might lead to considerations of the kind that you are talking about and they would have to be examined. How do you handle the portability of various benefits? Do you get to multiemployer plans so as to decrease the cost of administration and the like? I think matters of this kind would evolve in connection with more adequate vesting than exists today.

Representative GRIFFITHS. Thank you very much.

Senator MILLER. May I ask another question?

Representative GRIFFITHS. Yes.

Senator MILLER. I am wondering if there is not another equity that ought to be taken into account here. Some of these plans indeed are not even paying out the interest to meet their requirements, but because of the present tax laws, are building up funds so that when the present generation retires, there will be no burden on the younger generation that is coming along. This is an equitable consideration for the younger people who are already paying in far more social security taxes than they probably can ever hope to receive in benefits when they retire. Therefore, the present system reflects a consideration for these young people who otherwise would have a stronger burden on a pay-as-you-go private pension system to compound what they are going to have to be paying in social security taxes.

Do you agree that there is an equitable consideration here?

Mr. SURREY. This gets back to I think the chairman's question of the range of considerations that exist with respect to funding.

I gather that you are saying overfunding can be inequitable, an inequitable burden on the present generation, as I understand your question.

Senator MILLER. I am not taking the part for overfunding. I am taking the part against underfunding, to the extent that you end up with a pay-as-you-go system.

Mr. SURREY. As I was going to say, you have underfunding which is dangerous and overfunding which is dangerous, and both have to be guarded against.

Senator MILLER. Yes, but I would suggest that underfunding would shift the burden on to future generations and that future generations should not have that burden shifted on them because of the present situation on social security taxes.

Mr. SURREY. That is right.

Mr. COHEN. I would like to think, Senator, I will live long enough to collect my social security taxes. I started paying at a young age.

Senator MILLER. May I say that you will probably collect, but you will not collect what you would get if you could buy a similar annuity from a private insurance company, Mr. Cohen. That is the reason why there is concern on the part of many people about the tremendous unfunded liability of the social security system.

I do not have any figures nor have the figures been computed as a result of the passage last year of the medicare bill, but my recollection is that they are just about at the point now where, quite apart from medicare, they are going to be paying more taxes in than they can ever hope to get in benefits when they retire, and you are not

even taking into account the interest added on during the 40 or 45 years that they will be working.

So I would suggest that you check with an insurance man and he will tell you that you can more profitably put your money into his company than into the social security system, although I am afraid you are going to have to put it into social security.

Thank you.

Representative GRIFFITHS. Thank you very much, gentlemen.

This committee will adjourn until 10 o'clock on Friday, May 20, in room S-407, this room.

(Whereupon, at 3:25 p.m., the committee adjourned, to reconvene at 10 a.m., Friday, May 20, 1966.)

# PRIVATE PENSION PLANS

FRIDAY, MAY 20, 1966

CONGRESS OF THE UNITED STATES,  
SUBCOMMITTEE ON FISCAL POLICY  
OF THE JOINT ECONOMIC COMMITTEE,  
*Washington, D.C.*

The hearings scheduled for May 20 were subsequently postponed. The prepared statement of the witnesses who were to appear follow:

## PREPARED STATEMENT OF FRANK WILLE, SUPERINTENDENT OF BANKS OF THE STATE OF NEW YORK

At the request of the Subcommittee on Fiscal Policy of the Joint Economic Committee of the Congress of the United States, I am submitting the following statement with respect to the regulation of private welfare and pension plans by the New York State Banking Department.

### LEGISLATION

The Employee Welfare Fund Act of 1966 brought under New York State supervision and regulation a limited class of private employee benefit funds. The act applies only to those funds that are jointly "established or maintained" by one or more employers and one or more labor organizations. The act covers even joint plans where the employer has his principal office outside the State if at least 20 employees are employed in New York State. Funds unilaterally established or managed by employers or by labor organizations are not within the purview of the statute.

Administration of the act is the responsibility of the New York State Banking Department in those cases where overall management of a fund rests in a corporate trustee which is subject to supervision by the superintendent of banks of this or any other State or is a member of the Federal Reserve System.

All other bilateral funds that come within the act are subject to the jurisdiction of the superintendent of insurance.

The basic provisions of the act are as follows:

- (1) Funds are required to register with the superintendent within 3 months of commencing to do business (sec. 62\*).
- (2) The superintendent is authorized to examine registered funds as often as necessary but at least once in each 5 years (sec. 63). Direct

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\*All statutory references are to the New York State banking law. Copies of the relevant provisions of the banking law and the regulations of the superintendent of banks thereunder have been attached to this statement.



expenses of such examinations are borne by the fund examined (sec. 65).

(3) Each registered fund is required to file an annual statement and report with the superintendent not later than 5 months after the end of the fund's fiscal year (secs. 66 and 68). The superintendent may require the filing of special statements where deemed necessary (sec. 67).

(4) A copy of the annual report filed with the superintendent is required to be made available to interested parties (sec. 68 and sec. 62.1 of the regulations of the superintendent of banks).

(5) In section 71 the trustees of a fund are made responsible in a fiduciary capacity for the overall management of its affairs. It further prohibits "kickbacks" and any other form of consideration, directly and indirectly, between employers, labor organizations, employees, trustees, and other officials, while permitting trustees, officers, or employees of a fund to receive reasonable compensation for necessary services and for expenses incurred in connection with official duties. Also, prohibitions against certain transactions may be waived by the superintendent of banks upon a finding that the transaction will promote the best interests of the relevant employee welfare funds and will not adversely affect the interests of the covered employees.

(6) The superintendent may impose a penalty of \$2,500 on any officer or employee of a fund who willfully fails to comply with the act, or he may remove such officer or employee from office. Such action is subject to judicial review (sec. 71).

(7) The superintendent may initiate a proceeding to recover property of a fund that has been depleted by the wrongful or negligent act of any person (sec. 71.6).

(8) The following are declared to be misdemeanors (sec. 71.7) :

(a) willful violation of the act or the regulations;

(b) false representation of a material fact; and

(c) the making of a false entry in any book or record, report or statement with intent to injure or defraud or to deceive an examiner.

(9) The superintendent is empowered to obtain an injunction to restrain violations of the act (sec. 72).

(10) The superintendent is given power to promulgate regulations to carry out the express provisions of the act (sec. 73). There are three such regulations (regulations 62.1, 62.2, and 62.3) :

(a) prescribing the method of distributing annual reports to interested parties;

(b) requiring that notice of changes affecting the fund be given to the banking department; and

(c) requiring that the estimated cost of a final examination be set aside when a fund is liquidated.

#### REGISTRATION

As of May 1, 1966, 176 funds were registered with the department. Of these, 166 were pension funds, 9 were welfare funds, and 1 was profit sharing.

As of December 31, 1964, the date of the most recent compilation, funds registered with the department had a book value of \$626 million, and contributions for the year amounted to \$125 million.

## ANNUAL REPORTS AND STATEMENTS

Registered funds are required to file annual reports and statements on forms supplied by the superintendent, copies of which have been attached hereto. These disclose a fund's financial condition, including income and expenses, and indicate whether applicable laws and regulations are being observed. The reports are subjected to an office audit in accordance with established procedures: financial condition is analyzed, expenses are reviewed, and investments are rated for quality and diversification. When any unusual and unexplained transactions appear in the reports, clarification and explanation are obtained. The review of these reports has provided a good indication of the quality of a fund's management and the fund's progress.

Figures abstracted from the annual reports are included in the annual report of the superintendent of banks.

## STATEWIDE SURVEYS

Each year, all banks in the State are requested to furnish information on employee benefit trusts administered by them. When these figures are compiled they form the basis for the statistics in the annual report of the superintendent.

## EXAMINATIONS

Each registered fund is examined once in each 5-year period. When deemed necessary, more frequent examinations are held. The examinations are conducted by bank examiners assigned by the chief examiner.

The objective of field examinations is to ascertain that a fund is being administered in such manner as to protect the rights, interests, and benefits of its members, that its records and accounts are being maintained in conformance with generally accepted principles, that the applicable laws and regulations are being observed, and that the fund is being administered within the intent and purposes stated in the governing instruments. The annual reports and statements filed with the department between examinations are verified to the fund's records and to reports prepared by accountants, actuaries, and corporate trustees.

Reports of examinations are reviewed and processed by an office staff of the State banking department and a copy is sent to the fund office with notice of mailing to each trustee. The transmittal letter sent with the copy of the report may emphasize certain points in the examiner's report and request that corrective action be taken. When necessary, followup letters are sent to the funds.

As a general rule, fund administrators are receptive to suggestions from the examiner and the department.

In the course of the department's supervision of registered funds, considerable progress has been made in the correction of weaknesses in the management and operation of the funds. A few of the areas in which the New York State Banking Department has been particularly successful are—

1. Trustees are much more cognizant of their fiduciary responsibilities in the management of funds.

2. Administrators are more aware of the necessity to adhere strictly to the terms of the trust agreement and related documents.
3. The books and records are being standardized to meet acceptable accounting standards and office practices.
4. Adequate audit controls, safeguards, and procedures are being installed, and the need for fidelity coverage is recognized.
5. More effective procedures for the collection of contributions and selective payroll audits have been encouraged.
6. A closer control on expenditures has been evident and the liberalization of benefits without a supporting actuarial study has been discouraged.
7. Trustees are cautious not to delegate their authority, and recognize the need for active participation in the fund's management.
8. Investments are being closely scrutinized with the results that substandard, speculative, or ineligible investments are being held to a minimum.
9. The condition of the funds is being properly disclosed to all interested parties pursuant to the requirements of the statute and regulations and the department is kept informed of all changes affecting the funds.

#### COMPLAINTS

From time to time complaints are filed with the New York State Banking Department by retired individuals whose pension applications have been denied, and in several cases by groups of individuals who have lost all claims against a fund because their employer becomes bankrupt or otherwise ceases to do business in an area, or because of a realignment of union affiliations.

The complaints are processed to determine whether the denial of benefits is in accordance with the terms of the plan and its rules and regulations. Frequently, it is found that retirees are of the mistaken impression that all amounts paid into a fund in their behalf become their property upon retirement; they fail to realize that the moneys are to be invested and held merely to pay out the benefits provided by the plan. In addition, they are unfamiliar with the requirements as to the years of service required for benefits and with the allowances for a break in service which may be permissible under the plan.

Frequently, a plan contains provisions which are inconsistent and ambiguous to the extent that an unfair denial of benefits may result. In such cases, the department has recommended clarification of the plan's eligibility rules.

When an employer becomes bankrupt or moves out of an area, the department has very limited authority to protect the interests of the membership in a pension or welfare plan. If the fund is of the multi-employer variety, the employees of the former contributor must seek employment from the remaining participating employers in order to protect accumulated credits. There is usually no provision for partial distribution of assets nor for the vesting of displaced employees' benefits. Where the fund is the single employer type, the assets are often distributed according to the term of the trust document or may be used to purchase annuities for the members. In these

cases, older employees are provided for to the extent of the available assets and often there is nothing remaining for newer, short-term employees. Before a registered fund is liquidated, the department is required to be notified, and an examiner is assigned to determine that the proposed distribution is according to the terms of the plan and that all assets are properly accounted for.

#### PROHIBITED TRANSACTIONS

Under section 71 of the banking law certain transactions by an employee welfare fund are prohibited, but may be authorized by the superintendent "upon his finding that the transaction \* \* \* will promote the best interests of the relevant employee welfare funds \* \* \*"

The most frequent requests for the superintendent's authorization concern the payment of rent to an affiliated union. Such applications are required to be supported by sufficient information to permit the superintendent to determine whether the proposed transaction will promote the best interests of the fund. Usually, the department's real estate appraisers are requested to express an opinion on the reasonableness of the proposed rent. Occasionally, requests are submitted for approval of investments and payments prohibited by statute.

#### EXPERIENCE IN ADMINISTERING THE ACT

During the 10 years since the enactment of the Employee Welfare Fund Act, it has been found that the great majority of funds registered with the New York State Banking Department have been administered in a manner consistent with good business practice and have been fulfilling the purposes for which they were established.

There has been no known instance of misapplication or diversion of the assets of a registered fund during the 10 year period. In a small number of cases, administrative expenses have exceeded acceptable proportions and in such cases the trustees are reminded of their fiduciary responsibility to conserve fund assets for the benefit of the members.

All of the funds registered with the New York State Banking Department have designated banks to act as corporate trustee, and there has been a minimum of difficulty with investment of assets. In one or two cases, individual trustees of a fund have removed small amounts of assets from the control of the corporate trustee and made imprudent investments. In these cases, the individual trustees appear to have been motivated by the high yield on speculative investments. In one instance, a loss of \$250,000 was incurred. However, it is estimated that more than 99 percent of the investments of registered funds are regarded as of investment grade.

There has been no instance where the New York superintendent of banks has found it necessary to impose a fine or to obtain an injunction.

#### PREPARED STATEMENT OF HENRY ROOT STERN, JR., SUPERINTENDENT OF INSURANCE OF THE STATE OF NEW YORK

In New York, detailed supervision of welfare and pension funds began in 1956 with the passage of the Employee Welfare Fund Act. This legislation was the result of investigations by the New York In-

insurance Department over a period of several years. Two comprehensive reports were made disclosing the findings of the investigations: "Whose Welfare" issued in December 1954 and "Private Employee Benefit Plans—A Public Trust" issued in February 1956.

Because most of the abuses uncovered by the investigations concerned operations of jointly administered welfare and pension funds, that is, funds managed jointly by representatives of management and unions, the laws as enacted encompassed only those funds.

As of December 31, 1965, a total of 781 welfare funds, 599 pension funds and 1 profit-sharing plan, had registered under article IIIA of the insurance law and article IIA of the banking law.

As of the end of 1965 the welfare fund bureau of the insurance department had under its supervision 1,205 registered funds consisting of 772 welfare funds and 433 pension funds with assets of \$1,738 million and which covered nearly 2,300,000 employees. Since organization, the welfare fund bureau has completed or commenced 1,548 examinations. The banking department had 176 registered funds, consisting of 9 welfare funds, 166 pension funds, and 1 profit-sharing plan, with total assets in excess of \$626 million and which covered 520,000 employees.

The New York Employee Welfare Fund Act divides supervision between the insurance department and the banking department. The funds supervised by the banking department are those for which a bank acts as investment manager for the fund trustees. In addition, there are a substantial number of unilaterally administered plans not subject to regulation by either the insurance department or the banking department. At present the welfare fund of the insurance department is staffed with 41 insurance examiners and supervising personnel, and 17 clerical personnel.

Each fund is required under the act of file with the bureau a completed registration form upon initial registration, and an annual statement at the end of each fiscal year. The annual statement requires details of assets and liabilities, income and outgo, and insurance information. The supplemental statement requires a detailed list of investments. Each filed annual statement is subject to desk audit.

Regular field examinations are made of each fund registered under the New York act as often as deemed necessary and at least once in every 5 years. The examinations are carried out by permanent civil service examiners. Each fund is billed for the examination on the basis of the cost to the department, with a limitation on examination charges depending on the amount of annual contribution to the fund.

Field examinations are comprehensive and the report on examination contains sections on fund history, organization, member benefits, income and outgo, assets and liabilities, and a final section on "Conclusions and Recommendations." The examination report is not intended to be a historical or chronological summary of fund information but a critical analysis with emphasis placed on areas of fund operation in need of improvement or correction.

Subsequent to the filing of a report on examination, an examiner revisits the fund to determine the degree to which the trustees have remedied the shortcomings indicated in the report on examination. A report on compliance covering these items is then prepared. Most of the deficiencies are rectified by the time the compliance examinations

are made. Where satisfactory compliance is not effected, the matters are referred to the legal section of the welfare fund bureau for further action.

The superintendent may enjoin violation of the statute. He may after notice and hearing remove fund trustees, officers, agents, or fund employees and/or fine them up to \$2,500 for violations of the law. Where the superintendent finds that a fund has been depleted by reason of any wrongful or negligent act or omission of a trustee or any other person, he may refer his findings to the State's attorney general for recovery of the amount of the depletion. Knowingly false statements or concealment of material facts in fund registration, examination, statements, or reports, and false entries in fund records are punishable as misdemeanors, as are all willful violations of the act.

It must be appreciated, however, that the insurance department's responsibility under the Welfare Fund Act is to hold the trustees of pension funds accountable in a fiduciary capacity for all funds coming into their hands. It has no specific statutory authority to require funding or valuation of assets.<sup>1</sup>

For example, while an insurance company issuing group-deferred annuity contracts is subject to rather detailed and restrictive reserve requirements, self-insured pension funds, including those funded through deposit administration and similar arrangements, are not subject to such statutory reserve requirements.

To put the problem in proper focus it must be recognized that the self-insured pension funds under our jurisdiction are not pension funds in the accepted sense, but rather funds to provide benefits in the nature of a pension, if the moneys are available.

However, because the subjects of funding and reserves and the fairness of plan provisions are recognized as particularly important in a pension fund, the regulatory supervision in New York State has attempted to encompass these areas, within the framework of the statutory language and legislative intent. Thus, through the annual statement, and the field examination, we seek to obtain information dealing with actuarial matters. In the New York Insurance Department, such information is reviewed by examiners as part of each statutory examination and each office audit. Where the funding of a pension plan is deficient, or the standards used are clearly inappropriate or the actuarial valuation is outdated, or where the fund has failed to obtain an actuarial report, the examiner criticizes the fund trustees and recommends corrective action. Such criticism by the examiners usually results in remedial action.

Furthermore, the current annual statement filed by New York funds requires that where a fund has retained the services of an actuary, a copy of the latest actuarial valuation be submitted to this department. The current annual statement also requires that for deposit administration and similar contracts, a copy of any actuarial report made to the fund by the insurance carrier be submitted to this department. On May 27, 1966, there will be a meeting in New York of a subcommittee of the National Association of Insurance Com-

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<sup>1</sup> Nor has the department specific statutory jurisdiction over investments except as provided in section 21 of the personal property law, a general law limiting investments by a fiduciary; the trustees, however, are not bound thereby if the trust instrument so provides, and practically all plans contain such a provision.

missioners for the purpose of considering a revision of the annual statement form. The new form, if adopted, will become effective as of December 31, 1966, and will require expanded actuarial information, including actuarial data for insured and self-insured pension funds.

Four States in addition to New York regulate employee welfare and pension funds. All of these States require registration and annual statement filings. The States of Wisconsin and Washington make regular field examinations. The laws in the States of Connecticut and Massachusetts make provision for field examinations only in special cases.

The New York Insurance Department is keenly aware of the need for adequate funding and for fairness and nondiscrimination in plan provisions. If, as a result of our continuing examination and investigation in this field, it is decided that the New York law should be expanded to include specific requirements dealing with pension plan funding and reserves, appropriate legislation will be considered.

In any event the feasibility of legislation which would mandate full funding and precise actuarial standards for pension plans is open to serious question. These plans result from collective-bargaining agreements between employer and union and both the duration and the benefits are determined by such agreement. While such agreements are usually renewed upon expiration such renewal is not a foregone conclusion. Funding would usually require higher contributions by employers or reduced employee benefits and might invade the right of management and labor to freely negotiate their own contract. These are just some of the matters which must be considered in evaluating the desirability of funding by pension plans.

Aside from the pension funds supervised under the Welfare Fund Act, the New York Insurance Department also regulates and supervises private retirement systems formed under section 200 of the insurance law. These are nonprofit corporations or trusts formed by the employees, officers, and agents of any person, firm or corporation or of one or more corporations having business interests in common.

As a condition to licensing by the superintendent, it must be established that the rates of contributions are adequate and that the plan is sound and equitable. The plans must create and maintain reserves calculated to be adequate to cover liabilities on account of benefits. They are limited in their investments to such as are available under the insurance law to life insurance companies. Furthermore, their contracts must be filed and approved as to form. After licensing, they must file detailed annual statements, which are reviewed by the department's actuarial, auditing, and examining bureaus and they are subject to examination at least once in every 5 years.

#### **PREPARED STATEMENT OF FREDERIC SOLOMON, DIRECTOR, DIVISION OF EXAMINATIONS, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**

All State member banks of the Federal Reserve System are examined by examiners who are appointed by the Reserve banks and approved by the Board of Governors. It is the policy to make at least one regular examination of each State member bank and its trust depart-

ment each calendar year with such additional examinations of any particular bank as may be desirable. These examinations frequently are made jointly with State banking authorities. While examinations are comprehensive in scope, they necessarily include testing and sampling techniques.

The immediate objectives of Federal Reserve examinations are to ascertain the financial condition and soundness of each institution, the adequacy of its capital structure, to appraise its operating policies and practices, to determine compliance with applicable laws and regulations, and to appraise the capabilities and performance of its management. During such examinations the safeguards and internal controls maintained by the bank, the audit programs, and the blanket bond, fidelity, and other forms of surety coverage are analyzed and weighed to determine if they are adequate and suitable. During an examination of the fiduciary activities of each State member bank, conformity of administrative performance with sound fiduciary principles, applicable laws and regulations, and controlling provisions of instruments creating trust and agency relationships is determined. The fiduciary examination activity extends, of course, to the bank's administration of employee benefit trusts and agencies.

#### DEVELOPMENT OF SUPERVISORY EXAMINATIONS OF BANK TRUST DEPARTMENTS

Against that background, I would first like to review some aspects in the development of supervisory examinations of bank trust departments. During the 1929-33 financial crisis, some unfavorable publicity arose from maladministration of trust accounts which resulted in sizable losses to some banks. Two immediate results were—

(1) Adoption by the Trust Division of the American Bankers Association of "A Statement of Principles of Trust Institutions" (attached as exhibit I) to serve as a standard to which all trust departments might adhere. This statement notes, among other things, that trust institutions are governed by the cardinal principle of fidelity that is common to all fiduciary relationships. It is further stated that "policies predicated upon this principle have for their objectives its expression in terms of safety, good management, and personal service. Practices developed under these policies are designed to promote efficiency in administration and operation." The Board of Governors subscribes to the substance of the stated objectives and commends this statement of principles to banks operating trust departments.

(2) The institution of more comprehensive trust examinations by bank supervisors, in which the areas of management, policies, systems, and functions were reviewed and evaluated. The primary purpose of such examinations was, and still is, determination of sources of actual and potential liability which might have a vital bearing on a bank's capital and solvency. These examinations were initiated on a regular basis by Federal and State bank supervisory authorities, and appropriate examination reports were adopted. These examinations may provide collateral results such as the protection of the rights of trust settlers, beneficiaries, and other interested persons, and improved quality of trust service



offered to the public. This service requires not only faithful performance by the trustee institution with applicable laws, regulations, and governing instruments, but also the exercise of reasonable prudence. To carry out this more comprehensive examination scope, it has also been necessary for bank supervisors to build staffs of trust examining specialists and to give them appropriately designed training.

By way of contrast, the concept of the present-day trust examination process is not intended to embody an audit of accounts and transactions because actual auditing and maintenance of accounting records are proper duties and functions of bank management. But the examiner does make necessary test checks of trust account administration, pending or threatened litigation and lack of asset diversification, as well as any assets requiring special scrutiny. Other general areas examined and evaluated are trust department organization, operating methods, and policies in the light of accepted principles and practices in the trust industry. By reason of wide exposure to many trust departments, trust examiners are in a unique position to make constructive suggestions and recommendations to trust management.

#### MAGNITUDE AND GROWTH TREND IN TRUST BUSINESS

Banks in the United States today administer a tremendous total volume of trust business. A bank's responsibility as trustee is determined by the instrument under which it operates with such responsibility ranging all the way from total with full investment authority to instances where the bank has virtually no responsibility acting essentially as custodian.

The Comptroller of the Currency, in his June 1965 quarterly, "The National Banking Review," estimated that, on a market-value basis, all commercial bank trust departments had investment responsibility for trust assets of about \$155 billion, including approximately \$50 billion held in employee benefit accounts. National bank trust assets reported to be included in these totals were \$75.2 billion and \$20.8 billion, respectively. The Board of Governors has not published data on the total volume of trust assets handled by State member banks; nor has it had occasion to reach any conclusion as to the reasonableness of the Comptroller's estimate of the total trust volume handled by all banks. However, information contained in examination reports for State member banks reveals that State member banks hold a large volume of trust business and supports the view that over the next few decades a further growth in volume, particularly in the employee benefit area, is very likely. A steadily rising trend in such assets is indicated also by a statistical series published by the U.S. Securities and Exchange Commission. This survey for 1964 shows assets of private noninsured pension and deferred profit-sharing funds (without distinction between bank- and non-bank-administered funds) with total book value and market value of \$51.9 and \$63.3 billion, respectively.

#### SPECIAL FEATURES IN EXAMINATION OF EMPLOYEE BENEFIT ACCOUNTS

Due to the increasing volume and complexity of employee benefit accounts administered by State member banks, the Board of Governors in 1951 expanded its trust department report of examination to include

this specific question to be answered by the examiner: "If the institution is administering any pension or profit-sharing trusts, comment on administrative practices and, if significant, submit information as to the kind and volume of such business."

Subsequently, in 1955, the Board added a new report page, which was devoted entirely to employee benefit accounts. It required the reporting of data on the volume and nature of such accounts administered by a bank's trust department and also requested information as to the adequacy of administrative practices and policies.

The System's entire trust report form was substantially revised in January 1965. However, it still contains a separate page designed to show the volume of all employee benefit trust accounts being administered as well as appropriate comments made by the examiner on any aspects of account administration and operations requiring consideration and attention of bank management. Further, the System's commercial examination report form contains a separate page, which provides for the reporting of additional information regarding trusts established by a bank for its own employees. This includes a description of any holdings involving possible conflicts of interest and any self-dealing transactions between the bank and such trusts, regardless of whether they are authorized by the governing trust instruments. (Attached as exhibits II and III are the report pages referred to in this paragraph.)

The analysis of employee benefit accounts is, of course, routinely a part of the examiner's overall review of trust operations. In addition to determining the adequacy of audit coverage, internal controls, and safeguards, the examiner has an interest and concern with the following specific areas of employee benefit account administration:

1. Nature of the bank's selectivity in its new business policies and procedures.
2. Administrative phases, including trust instrument exculpatory and other protective provisions, and compliance with applicable laws and regulations.
3. Investment policies and practices, with emphasis on unusual holdings, prohibited transactions, conflicts of interest, and the general exercise of investment discretion.

In the administration of such accounts, any observed departure from sound principles of fiduciary account management, violations of instrument provisions, laws, or regulations would be subject to critical comment in the examiner's report of examination. In that connection, the examiner would be particularly alert to any investments and procedures which might jeopardize the tax-exempt status of an account and result in possible liability to the bank as well.

#### EXHIBIT I

#### A STATEMENT OF PRINCIPLES OF TRUST INSTITUTIONS

This statement was adopted by the Executive Committee of the Trust Division, American Bankers Association on April 10, 1933, and approved by the Executive Council of the American Bankers Association on April 11, 1933. (Article V was amended June 8, 1956.)

#### FOREWORD

This statement of Principles has been formulated in order that the fundamental principles of institutions engaged in trust business may be restated and thereby become better understood and recognized by the public, as well

as by trust institutions, themselves, and in order that it may serve as a guide for trust institutions.

In the conduct of their business trust institutions are governed by the cardinal principle that is common to all fiduciary relationships—namely, fidelity. Policies predicated upon this principle have for their objectives its expression in terms of safety, good management, and personal service. Practices developed under these policies are designed to promote efficiency in administration and operation.

The fact that the services performed by trust institutions have become an integral part of the social and economic structure of the United States makes the principles of such institutions a matter of public interest.

#### ARTICLE I. DEFINITION OF TERMS

**Section 1. Trust Institutions.**—Trust institutions are corporations engaged in trust business under authority of law. They embrace not only trust companies that are engaged in trust business exclusively but also trust departments of other corporations.

**Section 2. Trust Business.**—Trust business is the business of settling estates, administering trusts and performing agencies in all appropriate cases for individuals; partnerships; associations; business corporations; public, educational, social, recreational, and charitable institutions; and units of government. It is advisable that a trust institution should limit the functions of its trust department to such services.

#### ARTICLE II. ACCEPTANCE OF TRUST BUSINESS

A trust institution is under no obligation, either moral or legal, to accept all business that is offered.

**Section 1. Personal Trust Business.**—With respect to the acceptance of personal trust business the two determining factors are these: Is trust service needed, and can the service be rendered properly? In personal trusts and agencies, the relationship is private, and the trust institution is responsible to those only who have or may have a financial interest in the account.

**Section 2. Corporate Trust Business.**—In considering the acceptance of a corporate trust or agency the trust institution should be satisfied that the company concerned is in good standing and that the enterprise is of a proper nature.

#### ARTICLE III. ADMINISTRATION OF TRUST BUSINESS

**Section 1. Personal Trusts.**—In the administration of its personal trust business, a trust institution should strive at all times to render unexceptionable business and financial service, but it should also be careful to render equally good personal service to beneficiaries. The first duty of a trust institution is to carry out the wishes of the creator of a trust as expressed in the trust instrument. Sympathetic, tactful, personal relationships with immediate beneficiaries are essential to the performance of this duty, keeping in mind also the interest of ultimate beneficiaries. It should be the policy of trust institutions that all personal trusts should be under the direct supervision of and that beneficiaries should be brought into direct contact with the administrative or senior officers of the trust department.

**Section 2. Confidential Relationships.**—Personal trust service is of a confidential nature and the confidences reposed in a trust department by a customer should never be revealed except when required by law.

**Section 3. Fundamental Duties of Trustees.**—It is the duty of a trustee to administer a trust solely in the interest of the beneficiaries without permitting the intrusion of interests of the trustee or third parties that may in any way conflict with the interests of the trust; to keep and render accurate accounts with respect to the administration of the trust; to acquaint the beneficiaries with all material facts in connection with the trust; and, in administering the trust, to exercise the care a prudent man familiar with such matters would exercise as trustee of the property of others, adhering to the rule that the trustee is primarily a conservator.

**Section 4. Corporate Trust Business.**—In the administration of corporate trusts and agencies the trust institution should render the same fine quality of service as it renders in the administration of personal trusts and agencies. Promptness, accuracy, and protection are fundamental requirements of effi-

cient corporate trust service. The terms of the trust instrument should be carried out with scrupulous care and with particular attention to the duties imposed therein upon the trustee for the protection of the security-holders.

#### ARTICLE IV. OPERATION OF TRUST DEPARTMENTS

Section 1. Separation of Trust Properties.—The properties of each trust should be kept separate from those of all other trusts and separate also from the properties of the trust institution itself.

Section 2. Investment of Trust Funds.—The investment function of a trustee is care and management of property, not mere safekeeping at one extreme or speculation at the other. A trust institution should devote to its trust investments all the care and skill that it has or can reasonably acquire. The responsibility for the investment of trust funds should not be reposed in an individual officer or employee of a trust department. All investments should be made, retained or sold only upon the authority of an investment committee composed of capable and experienced officers or directors of the institution.

When the trust instrument definitely states the investment powers of the trustee, the terms of the instrument must be followed faithfully. If it should become unlawful or impossible or against public policy to follow literally the terms of the trust instrument, the trustee should promptly seek the guidance of the court about varying or interpreting the terms of the instrument and should not act on its own responsibility in this respect except in the face of an emergency, when the guidance of the court beforehand could not be obtained. If the trust instrument is silent about trust investments or if it expressly leaves the selection and retention of trust investments to the judgment and discretion of the trustee, the latter should be governed by considerations of the safety of principal and dependability of income and not by hope or expectation of unusual gain through speculation. However, a trustee should not be content with safety of principal alone to the disregard of the reasonable income requirements of the beneficiaries.

It is a fundamental principle that a trustee should not have any personal financial interest, direct or indirect, in the trust investments, bought for or sold to the trusts of which it is trustee, and that it should not purchase for itself any securities or other property from any of its trusts. Accordingly, it follows that a trust institution should not buy for or sell to its estates or trusts any securities or other property in which it, or its affiliate, has any personal financial interest, and should not purchase for itself, or its affiliate, any securities or other property from its estates or trusts.

#### ARTICLE V. COMPENSATION FOR TRUST SERVICE

Section 1.—A trust institution is entitled to reasonable compensation for its services. Compensation should be determined on the basis of the cost of the service rendered and the responsibilities assumed. Minimum fees for trust services should be applied uniformly and impartially to all its customers alike. (As amended June 8, 1956.)

#### ARTICLE VI. PROMOTIONAL EFFORT

Section 1. Advertising.—A trust institution has the same right as any other business enterprise to advertise its trust services in appropriate ways. Its advertisements should be dignified and not overstate or overemphasize the qualifications of the trust institutions. There should be no implication that legal services will be rendered. There should be no reflection, expressed or implied, upon other trust institutions or individuals, and the advertisements of all trust institutions should be mutually helpful.

Section 2. Personal Representation.—The propriety of having personal representatives of trust departments is based upon the same principle as that of advertising. Trust business is so individual and distinctive that the customer cannot always obtain from printed matter all he wishes to know about the protection and management the trust institution will give his estate and the services it will render his beneficiaries.

Section 3. New Trust Department.—A corporation should not enter the trust field except with a full appreciation of the responsibilities involved. A new trust department should be established only if there is enough potential trust

business within the trade area of the institution to justify the proper personnel and equipment.

Section 4. Entering Corporate Trust Field.—Since the need for trust and agency services to corporations, outside of the centers of population, is much more limited than is that of trust and agency services to individuals, a trust institution should hesitate to enter the corporate trust or agency field unless an actual demand for such services is evident, and the institution is specially equipped to render such service.

#### ARTICLE VII. RELATIONSHIPS

Section 1. With Public.—Although a trust department is a distinctly private institution in its relations with its customers, it is affected with a public interest in its relations with the community. In its relations with the public a trust institution should be ready and willing to give full information about its own financial responsibility, its staff and equipment, and the safeguards thrown around trust business.

Section 2. With Bar.—Attorneys-at-law constitute a professional group that perform essential functions in relation to trust business, and have a community of interest with trust institutions in the common end of service to the public. The maintenance of harmonious relations between trust institutions and members of the bar is in the best interests of both, and of the public as well. It is a fundamental principle of this relationship that trust institutions should not engage in the practice of law.

Section 3. With Life Underwriters.—Life underwriters also constitute a group having a community of interest with trust institutions in the common purpose of public service. Cooperation between trust institutions and life underwriters is productive of the best mutual service to the public. It is a principle of this cooperation that trust institutions should not engage in the business of selling life insurance.

EXHIBIT II

Transit Number \_\_\_\_\_

EMPLOYEE BENEFIT TRUSTS  
(Cents omitted from all dollar figures)

<u>TYPE OF TRUST</u>	<u>HELD AS TRUSTEE</u>		<u>HELD AS AGENT</u> for trustees		<u>TOTALS</u>	
	No.	Carrying Value	No.	Carrying Value	No.	Carrying Value
Pension						
Profit Sharing						
Others (Total)						
<b>Totals</b>						
Fully Insured Plans		. . . .		. . . .		. . . .

Included above: \_\_\_\_\_ account(s) for the benefit of employees of this bank, with assets at carrying value of \$ \_\_\_\_\_ and market value of \$ \_\_\_\_\_. (See Page 19(a) of commercial report for additional information concerning such fund(s).)

Estimated market value (if readily available) of assets held as trustee \$.....

COMMENTS

(Administrative features, including acceptance of accounts—investment holdings and related policies and procedures—documents—legal opinions—conformity with laws and regulations as to disclosure, filing, prohibited transactions or other applicable provisions.)



(New York State Employee Welfare Act of 1956 (as amended to July 1, 1964) follows:)

## STATE OF NEW YORK



### EMPLOYEE WELFARE FUND ACT OF 1956 (As Amended to July 1, 1964)

Insurance Department  
123 William Street  
New York, N. Y. 10038  
HENRY ROOT STERN, JR.  
Superintendent of Insurance

Banking Department  
100 Church Street  
New York, N. Y. 10007  
FRANK WILLE  
Superintendent of Banks



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### Preface

The laws relating to the registration, examination and supervision of employee welfare funds are contained in Article III-A of the Insurance Law and Article II-A of the Banking Law. The former relates to funds required to be registered with the Insurance Department and the latter to funds required to be registered with the Banking Department. The laws were originally enacted in 1956 (L. 1956, ch. 774, effective September 1, 1956) and they were amended in 1957, 1958, 1959, 1960, 1961, 1962 and 1964.

(L. 1957, ch. 808, effective April 22, 1957;  
 L. 1958, ch. 857, effective April 19, 1958;  
 L. 1959, ch. 645, effective April 21, 1959;  
 L. 1960, ch. 454, effective April 12, 1960;  
 L. 1960, ch. 301, effective January 1, 1961;  
 L. 1961, ch. 392, effective April 11, 1961;  
 L. 1962, ch. 310, effective September 1, 1963;  
 L. 1964, ch. 37, effective July 1, 1964).

On the following pages are the texts of the laws as so amended.

**INSURANCE LAW—ARTICLE III-A\*****Employee Welfare Funds**

- Section 37. Declaration of policy.
- 37-a. Definitions.
  - 37-b. Registration.
  - 37-c. Examinations; authorization and requirement.
  - 37-d. Examinations; conduct.
  - 37-e. Examinations; publication.
  - 37-f. Examinations; expenses.
  - 37-g. Annual statement to superintendent.
  - 37-h. Special statements to superintendent.
  - 37-i. Annual reports to employers and employees.
  - 37-j. Annual statements by insurance companies, service plans and corporate trustees and agents.
  - 37-k. Regulation under other laws.
  - 37-l. Compliance and enforcement.
  - 37-m. Injunctions.
  - 37-n. Supplementary regulations; extensions of time.
  - 37-o. Loans for educational purposes.
  - 37-p. Construction.
  - 37-q. Separability.

**§ 37. Declaration of policy.**

It is hereby declared to be the policy of the state that employee welfare funds are of great benefit to employees and their families and that their growth should be encouraged; that the establishment and management of such funds vitally affect the well-being of millions of people and are in the public interest; and that such funds should be supervised by the state to the extent necessary to protect the rights of employees and their families, without imposing burdens upon such funds which might discourage their orderly growth and without duplicating the supervisory responsibilities presently vested in any state agencies.

**§ 37-a. Definitions.**

1. Employee welfare funds. The term "employee welfare fund", as used in this article, shall mean any trust fund or other fund established or maintained jointly by one or more employers together with one or more labor organizations, whether directly or through trustees, to provide employee benefits, by the purchase of insurance or annuity contracts or otherwise, and to which is paid or contracted to be paid anything, other than income from investments of such fund for the benefit of employees employed in this state, and, if the principal office of the employer is located outside of the

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\* Article III-A added L. 1956, ch. 744, eff. Sept. 1, 1956

state, for at least twenty such employees; provided, however, that such term, as used in this article, shall not include any such fund where its over-all management is vested, alone or jointly with other trustees, in a corporate trustee which is subject to supervision by the superintendent of banks of this state or any other state or is a member of the federal reserve system.

(Am'd L. 1957, ch. 808, eff. Apr. 22, 1957.)

2. **Employee benefits.** The term "employee benefits", as used in this article, shall mean one or more benefits or services for employees or their families or dependents, or for both, including, but not limited to, medical, surgical or hospital care or benefits, benefits in the event of sickness, accident, disability or death, benefits in the event of unemployment, or retirement benefits.

3. **Trustees.** The term "trustee" as used in this article, shall mean the person or group of persons who or which is charged with or has the general power of administration over an employee welfare fund and may include a pension board or committee, a board of individual trustees, a board of administration or the like; provided, however, such term shall not include a corporate trustee which is subject to supervision by the superintendent of banks of this state or any other state or is a member of the federal reserve system; nor shall such term include any insurer licensed under the laws of this state or authorized to do business herein.

(Am'd L. 1958, ch. 857, eff. Apr. 19, 1958.)

4. **Superintendent.** The term "superintendent", as used in this article, shall mean the superintendent of insurance.

(Added L. 1957, ch. 808, eff. Apr. 22, 1957.)

5. **Employed in this state.** The term "employed in this state", as used in this article, shall mean employed at a place of business maintained by the employer in the state of New York.

(Added L. 1957, ch. 808, eff. Apr. 22, 1957.)

6. **Employer.** The term "employer", as used in this article, shall mean all persons part or all of whose employees or members are covered by an employee welfare fund.

(Added L. 1957, ch. 808, eff. Apr. 22, 1957.)

7. **Person.** The term "person", as used in this article, shall mean all individuals (acting alone or in representative capacities), partnerships, associations, corporations, labor unions and other entities.

(Added L. 1957, ch. 808, eff. Apr. 22, 1957.)

8. **Labor organization.** The term "labor organization", as used in this article, shall mean any labor union or any organization of any kind, or any agency or employee representation committee, association, group or plan, in which employees participate and which exists for the purpose, in whole or in part, of dealing with employers concerning grievances, labor disputes, wages, rates of pay, hours of employment or conditions of work.

(Added L. 1958, ch. 857, eff. Apr. 19, 1958.)

Revised 1964

**§ 37-b. Registration.**

1. The trustees of every employee welfare fund shall register such fund with the superintendent within three months after the effective date of this article, and the trustees of every employee welfare fund commencing to do business in this state after the effective date of this article shall register such fund with the superintendent within three months after so commencing. Such registration shall be in such form and shall contain such information relating to the organization, operations and affairs of such fund as may be prescribed by the superintendent.

2. If it is found that the conditions which originally required registration with the superintendent of insurance have ceased to exist and that new conditions exist which would not require the registration of an employee welfare fund with either the superintendent of banks or the superintendent of insurance, then the superintendent of insurance may, on application of the trustees or on his own motion, cancel the registration of such fund.

(Added L. 1957, ch. 808, eff. Apr. 22, 1957.)

**§ 37-c. Examinations; authorization and requirement.**

1. The superintendent may examine into the affairs of any employee welfare fund as often as he deems it necessary, and he shall do so at least once in every five years.

2. The trustees of every employee welfare fund shall be responsible for the maintenance of accurate records of its books and accounts in conformance with generally accepted accounting principles and with any regulations prescribed with regard thereto.

(Am'd L. 1957, ch. 808, eff. Apr. 22, 1957.)

**§ 37-d. Examinations; conduct.**

1. Whenever, pursuant to this article, the superintendent shall determine to examine the affairs of any employee welfare fund he shall make an order indicating the scope of the examination and may appoint as examiners one or more competent persons not employed by the trustees of such fund or interested in such fund. A copy of such order shall, upon demand and before the examination begins, be exhibited to the trustees of the employee welfare fund whose affairs are to be examined. Any examiner authorized by the superintendent shall have convenient access at all reasonable hours to the books, records, files, assets, securities, and other documents of such employee welfare fund, including those of any affiliated or subsidiary fund thereof, which are relevant to the examination, and shall have power to administer oaths and to examine under oath the trustees of such fund and their officers, agents and employees and any other persons having custody or control of such books, records, files, assets, securities or other documents, regarding any matter relevant to the examination.

2. The examiner or examiners in charge of such examination shall make a true report of every examination made by him, verified under oath, which shall comprise only facts appearing upon the

books, records or other documents of the trustees of such fund or as ascertained from the sworn testimony of its trustees, or their officers, agents or employees, or other persons examined concerning its affairs, and such conclusions and recommendations as may reasonably be warranted from such facts.

3. In connection with any such examination, the superintendent may appoint one or more competent persons as appraisers with authority to appraise any real property or any interest therein which, as security or otherwise, may constitute a part of the assets of any employee welfare fund. The report of such appraiser shall be a supplement to the report of the examiner or examiners in charge.

**§ 37-e. Examinations; publication.**

1. All reports of examinations and investigations, including any duly authenticated copy or copies thereof in the possession of any employee welfare fund, shall be confidential communications, shall not be subject to subpoena and shall not be made public unless, in the judgment of the superintendent, the ends of justice and the public advantage will be subserved by the publication thereof, in which event he may publish a copy of any such report or any part thereof in such manner as he may deem proper.

2. In any action or proceeding against the trustees of any employee welfare fund, or against their officers, agents, or employees, such report, or any part thereof, if published by the superintendent, shall be admissible in evidence and shall be presumptive evidence of the facts stated therein.

3. The superintendent may assemble and file for public inspection such information covering forms of trust indentures in use, commission and fee schedules adopted by insurers and compensation paid to trustees of employee welfare funds and such other matters affecting the establishment and administration of such funds as, in his opinion, are in the public interest.

**§ 37-f. Examinations; expenses.**

The expenses of every examination of the affairs of any employee welfare fund, including any appraisal of real property, made pursuant to the authority conferred by any provision of this chapter, shall be borne and paid by the employee welfare fund so examined. For any such examination by the superintendent or a deputy superintendent personally, the charge made shall be only for necessary travelling expenses and other actual expenses. In all other cases the expenses of examination shall also include reimbursement for the compensation paid for the services of persons employed by the superintendent or by his authority to make such examination or appraisal; provided, however, that (1) for funds with contributions of less than thirty thousand dollars, as reported in the annual statement filed with the superintendent for the latest fiscal year covered by the examination, the charge shall not exceed three hun-

dred dollars, (2) for funds with contributions between thirty thousand dollars and one hundred fifty thousand dollars the charge shall not exceed one percent of such contributions, and (3) the superintendent, with the approval of the comptroller, may in his discretion for good cause shown remit or reduce such charges. All charges, including necessary travelling and other actual expenses, as audited by the comptroller and paid on his warrant in the usual manner by the comptroller to the person or persons making the examination or appraisal, shall be presented to the trustees of the employee welfare fund in the form of a copy of the itemized bill therefor as certified and approved by the superintendent or a deputy superintendent. Upon receiving such certified copy such trustees shall pay the amount thereof to the superintendent, to be paid by him into the state treasury.

(Am'd L. 1959, ch. 645, eff. Apr. 21, 1959.)

**§ 37-g. Annual statement to superintendent.**

The trustees of every employee welfare fund shall file in the office of the superintendent, annually within five months after the close of the fiscal year used in maintaining the records of such fund, a statement, to be known as the annual statement of such fund, executed in duplicate, verified by the oath of its trustee or, if there is more than one trustee, then by the oaths of at least two of such trustees, showing its condition and affairs during such fiscal year. Such fiscal year shall not be changed without the consent of the superintendent. Such statement shall be in such form and contain such substantiation by vouchers and otherwise and such other information as the superintendent shall from time to time prescribe. The superintendent shall cause to be prepared and furnished to the trustees of every employee welfare fund required by law to report to him printed forms of the statements and schedules required by him.

(Am'd L. 1957, ch. 808, eff. Apr. 22, 1957.)

**§ 37-h. Special statements to superintendent.**

In addition to any other statements or reports required by this article, the superintendent may also address to the trustees of any employee welfare fund or to any of its other officers, agents or employees or to any employer or labor organization representing any employees eligible for employee benefits thereunder any inquiry in relation to the transactions or condition of the fund or any matter connected therewith. Every person so addressed shall reply in writing to such inquiry promptly and truthfully, and such reply shall be verified, if required by the superintendent, by such individual or individuals as he shall designate.

(Am'd L. 1958, ch. 857, eff. Apr. 19, 1958.)

**§ 37-i. Annual reports to employers and employees.**

The trustees of every employee welfare fund shall, annually, within five months after the close of the fiscal year used in maintaining the records of such fund, file a report with the superintendent to be

known as the annual report of such fund, verified by the oath of its trustee, or if there is more than one trustee, then by the oaths of at least two of such trustees, showing its condition and affairs during such fiscal year. Such report shall be in such form and contain such matters as the superintendent shall from time to time prescribe. Such annual report shall be kept on file with the superintendent and at the principal office of the trustees and such report, or such portion thereof as the superintendent shall deem appropriate and relevant, shall be made available by the superintendent or by the trustees, or both, for inspection by any employer contributing to such fund, by any labor organization which is a party to an agreement establishing such fund, or by any employee covered by such fund. In addition and to such extent that he deems it to be in the public interest, the superintendent may require the trustees to mail such report, or such portions thereof as the superintendent shall deem appropriate and relevant, to employees covered by the fund, to contributing employers or to any labor organization which is a party to an agreement establishing such fund, or to any or all of such parties.

(Am'd L. 1957, ch. 808, eff. Apr. 22, 1957.)

**§ 37-j. Annual statements by insurance companies, service plans and corporate trustees and agents.**

Any insurance company, hospital, surgical or medical service plan providing benefits under an employee welfare fund, and any corporate trustee or agent holding or administering all or any part of an employee welfare fund shall, within four months after the end of each policy or fiscal year, furnish to the trustees of the fund a statement of account setting forth such information relating to the fund as the trustees of the fund may need from it in order to comply with the requirements of this article.

(Am'd L. 1957, ch. 808, eff. Apr. 22, 1957.)

**§ 37-k. Regulation under other laws.**

Where the trustees of any employee welfare fund are subject to and comply with the requirements of any law of this state other than this article or the law of any other state or of the United States with respect to registration, filing, examination, statements or reports, such requirements of this article or any of them may be waived by the superintendent with respect to any such fund or trustees to the extent that they are included in such other laws. Application for such a waiver shall be made in writing to the superintendent on such forms as he may require and any waiver issued by him hereunder shall be in writing and shall be filed in his office. The superintendent may, at any time, revoke any such waiver if, in his opinion, such other laws fail to accomplish adequately the purposes of this article. The action of the superintendent pursuant to this section shall be subject to judicial review.

(Am'd L. 1958, ch. 857, eff. Apr. 19, 1958.)

**§ 37-l. Compliance and enforcement.**

1. The trustees of every employee welfare fund shall be respon-

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sible in a fiduciary capacity for all money, property, or other assets received, managed or disbursed by them, or under their authority, on behalf of such fund.

2. (a) No employee welfare fund and no employer or labor organization representing any employees eligible for employee benefits thereunder, and no trustee or other officer or employee or\* any such fund, employer or labor organization shall receive, directly or indirectly, any payment, commission, loan or other thing of value from any insurance company, insurance agent, insurance broker or any hospital, surgical, dental or medical service plan, in connection with the solicitation, sale, service or administration of a contract providing employee benefits for such fund; and no such employer, labor organization, trustee, officer or employee shall receive any payment, commission, loan, service or any other thing of value from such fund, or which is charged against such fund or would otherwise be payable to such fund, either directly or indirectly, except that any such person may receive any employee benefits to which he is otherwise entitled, and any such trustee or other officer or employee of a fund, may receive from such fund reasonable compensation for necessary services and expenses rendered or incurred by him in connection with his official duties as such; provided, however, that nothing in this subdivision shall affect the payment of any dividend or rate credit or other adjustment due under the terms of any insurance or annuity contract. (Par. (a) am'd L. 1958, ch. 857, eff. Apr. 19, 1958; L. 1964, ch. 37, eff. July 1, 1964.)

(b) No insurance company, insurance agent or insurance broker and no hospital, surgical, dental or medical service plan, shall either directly or indirectly, pay any commission, make any loan or give any other payment or thing of value to any employee welfare fund or to any employer or labor organization representing any employees eligible for employee benefits thereunder or to any trustee or other officer or employee of any such fund, employer or labor organization, in connection with the solicitation, sale, service or administration of a contract providing employee benefits for such fund.

(Par. (b) added L. 1957, ch. 808, eff. Apr. 22, 1957; am'd L. 1958, ch. 857, eff. Apr. 19, 1958; L. 1964, ch. 37, eff. July 1, 1964.)

(c) The superintendent may, after notice and a hearing, prohibit the trustees of an employee welfare fund from employing or retaining or continuing to employ or retain any person upon finding that such employment or retention involves a conflict of interest which is not in the best interests of the fund or adversely affects the interests of covered employees. Any such finding by the superintendent shall be subject to judicial review.

(Former par. (c) relettered par. (d) and new (c) added L. 1958, ch. 857, eff. Apr. 19, 1958.)

\* So in originals; should be "of". See Banking Law § 71(2a).



(d) The superintendent may, by regulation or order, and upon such terms and conditions as he may require, authorize or approve any transaction or transactions otherwise prohibited by this subdivision upon his finding that the transaction or transactions promote or will promote the best interests of the relevant employee welfare funds, and do not or will not adversely affect the interests of the covered employees.

(Added L. 1957, ch. 808, eff. Apr. 22, 1957; formerly par. (c) relettered (d) L. 1958, ch. 857, eff. Apr. 19, 1958.)

3. (a) No insurance company shall pay any dividend or retrospective rate credit on any covering policy except by check payable to the affected employee welfare fund or by credit memo forwarded to such fund.

(Added L. 1957, ch. 808, eff. Apr. 22, 1957.)

(b) No employee welfare fund shall pay any premium on a covering policy except by check payable to the insurance company directly.

(Added L. 1957, ch. 808, eff. Apr. 22, 1957. Former subd. 3 renumbered 4.)

4. No political contributions shall be made directly or indirectly by or from any employee welfare fund.

(Subd. 4, formerly 3, renumbered 4 by L. 1957, ch. 808, eff. Apr. 22, 1957. Former subd. 4 renumbered 5.)

5. The superintendent may impose a penalty of not to exceed twenty-five hundred dollars upon any trustee or other officer, agent or employee of any employee welfare fund subject to this article or may remove such trustee, officer, agent or employee from office or employment, or both such penalty and removal, if after notice and a hearing he shall find that he has wilfully failed to comply with the requirements of this article. Any such action of the superintendent under this subdivision shall be subject to judicial review.

(Subd. 5, formerly 4, renumbered 5 and am'd by L. 1957, ch. 808, eff. Apr. 22, 1957; L. 1958, ch. 857, eff. Apr. 19, 1958. Former subd. 5 renumbered 6.)

6. In any case where, after notice and a hearing, the superintendent finds that any employee welfare fund has been depleted by reason of any wrongful or negligent act or omission of a trustee or of any other person, he may transmit a copy of his findings to the attorney general, who may bring an action in the name of the people of the state, or intervene in an action brought by or on behalf of an employee, for the recovery of such fund for the benefit of the employees and such other persons as may have an interest in the fund.

(Subd. 6, formerly 5, renumbered 6 by L. 1957, ch. 808, eff. Apr. 22, 1957.)

7. (a) Any person who wilfully violates or causes or induces the violation of any provision of this article or any regulation hereunder shall be guilty of a misdemeanor.

(Added L. 1957, ch. 808, eff. Apr. 22, 1957; par. lettered par. (a) L. 1958, ch. 857, eff. Apr. 19, 1958.)

(b) Any person who makes a false statement or representation of a material fact, knowing it to be false, or who knowingly fails to

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disclose a material fact in any registration, examination, statement or report required under this article or the regulations thereunder shall be guilty of a misdemeanor.

(Added L. 1958, ch. 857, eff. Apr. 19, 1958.)

(c) Any person who makes a false entry in any book, record, report, or statement required by this article or any regulation thereunder to be kept by him for any employee welfare fund, with intent to injure or defraud such fund or any beneficiary thereunder, or to deceive any one authorized or entitled to examine the affairs of such fund shall be guilty of a misdemeanor.

(Added L. 1958, ch. 857, eff. Apr. 19, 1958.)

(d) Nothing in paragraphs (b) or (c) of this subdivision shall be construed in any manner to limit the effect of paragraph (a).

(Added L. 1958, ch. 857, eff. Apr. 19, 1958.)

### § 37-m. Injunctions.

The superintendent may maintain and prosecute in the name of the people of the state an action against any trustee or any other person or persons subject to the provisions of this article, for the purpose of obtaining an injunction restraining such person or persons from doing any acts in violation of the provisions of this article. In such action if the court finds that a defendant is threatening or is likely to do any act or acts in violation of this article, and that such violation will cause irreparable injury to the interests of the people of this state or the beneficiaries of the employee welfare fund involved, the court may grant an injunction restraining such violation. The court may, on motion and affidavits, grant a preliminary injunction *ex parte* and an interlocutory injunction, upon such terms as may be just; but the people of the state shall not be required to give security before the issuance of any such injunction.

### § 37-n. Supplementary regulations; extensions of time.

1. The superintendent may from time to time promulgate appropriate supplementary rules and regulations designed to carry out the express provisions and purposes of this article.

2. For good cause shown, the superintendent may grant reasonable extensions of time for doing any act required by this article.

3. (a) The trustees of any employee welfare fund which has its principal place of business without the state, shall within ten days after registering a fund with the superintendent, file with the secretary of state a designation, duly acknowledged, irrevocably appointing the secretary of state as their agent upon whom may be served any summons, subpoena, subpoena duces tecum or other process directed to such trustees, in any action or proceeding brought under the provisions of this article arising out of or in connection with any transaction, matter or thing relating to such fund. If the trustees shall fail to make such designation in the manner and within the period above set forth, or, in case of a fund which was registered with the superintendent on the effective date

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of this act, within six months after such effective date, such trustees shall be deemed to have irrevocably appointed the secretary of state as such agent upon whom service of such process may be made.

(b) Service of such process shall be made by serving the secretary of state with a copy thereof and such service shall be sufficient provided that notice thereof and a copy of the process are sent within ten days thereafter by the moving party to the trustees at the office address of the fund by registered mail with return receipt requested. In any examination or hearing instituted by the superintendent, service of such process shall be complete ten days after the receipt by the superintendent of a return receipt purporting to be signed by the trustees or their agent or agents in accordance with the rules and customs of the post office department, or, if acceptance was refused by the trustees or their agents, the original envelope bearing a notation by the postal authorities that receipt was refused. In any action or proceeding instituted in any court in this state having jurisdiction of the subject matter, the moving party shall file with the clerk of the court in which such action or proceeding is pending, or with the judge or justice of such court, in case there be no clerk, an affidavit of compliance herewith, a copy of the process, and either the return receipt or the original envelope bearing a notation of refusal, as the case may be. Such affidavit and other papers shall be filed within thirty days after the return receipt or original envelope is received by the moving party, at which time service of process shall be complete. Service of any process made in accordance with this subdivision shall be deemed to have been made personally within the state and, in the case of a court action or proceeding, within the territorial jurisdiction of the court from which such process issued.

(Subd. 3 added L. 1958, ch. 857, eff. Apr. 19, 1958; am'd L. 1962, ch. 310, eff. Sept. 1, 1963.)

4. The trustees of every employee welfare fund shall preserve all its records of final entry and all reports and statements required by this article and the regulations thereunder for a period of at least six years from the date of making the same; provided, however, that preservation of photographic reproduction thereof or records in photographic form shall constitute compliance with the requirements of this section.

(Subd. 4 added L. 1958, ch. 857, eff. Apr. 19, 1958.)

(Former § 37-n renumbered 37-o; new 37-n added L. 1957, ch. 808, eff. Apr. 22, 1957.)

#### § 37 c. Loans for educational purposes.

Subject to the restrictions contained in this article, any employee welfare fund may lend money to any employees covered by such fund or their children, who are attending or planning to attend colleges in this state or elsewhere, to assist them in meeting their expenses of higher education, where such loans are made by such employee welfare fund and guaranteed by the New York higher education assistance corporation in accordance with the provisions

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of article fourteen of the education law, and in such cases no further security for the repayment of such loans shall be required of the borrowers by such employee welfare fund.

(Added L. 1961, ch. 392, eff. Apr. 11, 1961.)

(Former § 37-o renumbered 37-p.)

**§ 37-p. Construction.**

Nothing in this article shall be construed to relieve the trustees of any employee welfare fund from compliance with any other provision of this chapter or any other applicable laws of this state.

(Formerly § 37-n, renumbered 37-o, L. 1957, ch. 808, eff. Apr. 22, 1957; renumbered 37-p, L. 1961, ch. 392, eff. Apr. 11, 1961.)

**§ 37-q. Separability.**

If any provision of this article or the application of such provision to any person or circumstance shall be held invalid, the remainder of this article and the application of such provision to persons or circumstances other than those as to which it is held invalid shall not be affected thereby.

(Formerly § 37-p, added L. 1957, ch. 808, eff. Apr. 22, 1957; renumbered 37-q, L. 1961, ch. 392, eff. Apr. 11, 1961.)

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**BANKING LAW—ARTICLE II-A\*****Employee Welfare Funds****Section 60. Declaration of policy.**

61. Definitions.
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**§ 60. Declaration of policy.**

It is hereby declared to be the policy of the state that employee welfare funds are of great benefit to employees and their families and that their growth should be encouraged; that the establishment and management of such funds vitally affect the well-being of millions of people and are in the public interest; and that such funds should be supervised by the state to the extent necessary to protect the rights of employees and their families, without imposing burdens upon such funds which might discourage their orderly growth and without duplicating the supervisory responsibilities presently vested in any state agencies.

**§ 61. Definitions.**

1. Employee welfare funds. The term "employee welfare fund", as used in this article, shall mean any trust fund or other fund established or maintained by or on behalf of one or more employers together with one or more labor organizations to provide employee benefits, by the purchase of insurance or annuity contracts or otherwise, with the over-all management of such fund vested, alone or jointly with other trustees, in a corporate trustee which is subject to supervision by the superintendent of banks of this state or any other state or is a member of the federal reserve system, and to which fund is paid or contracted to be paid anything, other than income from investments of such fund, for the benefit of employees employed in this state, and, if the principal office of the employer is located outside of the state, for at least twenty such employees.

(Am'd L. 1957, ch. 808, eff. Apr. 22, 1957.)

2. Employee benefits. The term "employee benefits", as used in this article, shall mean one or more benefits or services for employees

\* Article II-A added L. 1956, ch. 744, eff. Sept. 1, 1956.

or their families or dependents, or for both, including, but not limited to, medical, surgical or hospital care or benefits, benefits in the event of sickness, accident, disability or death, benefits in the event of unemployment, or retirement benefits.

3. Trustees. The term "trustee", as used in this article, shall mean the person or group of persons who or which is charged with or has the general power of administration over an employee welfare fund and may include a pension board or committee, a board of individual trustees, a board of administration or the like; provided, however, such term shall not include a corporate trustee which is subject to supervision by the superintendent of banks of this state or any other state or is a member of the federal reserve system; nor shall such term include any insurer licensed under the laws of this state or authorized to do business herein.

(Am'd L. 1958, ch. 857, eff. Apr. 19, 1958.)

4. Superintendent. The term "superintendent", as used in this article, shall mean the superintendent of banks.

5. Employed in this state. The term "employed in this state", as used in this article, shall mean employed at a place of business maintained by the employer in the state of New York.

(Added L. 1957, ch. 808, eff. Apr. 22, 1957.)

6. Employer. The term "employer", as used in this article, shall mean all persons part or all of whose employees or members are covered by an employee welfare fund.

(Added L. 1957, ch. 808, eff. Apr. 22, 1957.)

7. Person. The term "person", as used in this article, shall mean all individuals (acting alone or in representative capacities), partnerships, associations, corporations, labor unions and other entities.

(Added L. 1957, ch. 808, eff. Apr. 22, 1957.)

8. Labor organization. The term "labor organization", as used in this article, shall mean any labor union or any organization of any kind, or any agency or employee representation committee, association, group or plan, in which employees participate and which exists for the purpose, in whole or in part, of dealing with employers concerning grievances, labor disputes, wages, rates of pay, hours of employment or conditions of work.

(Added L. 1958, ch. 857, eff. Apr. 19, 1958.)

## § 62. Registration.

1. The trustees of every employee welfare fund shall register such fund with the superintendent within three months after the effective date of this article, and the trustees of every employee welfare fund commencing to do business in this state after the effective date of this article shall register such fund with the superintendent within three months after so commencing. Such registration shall be in such form and shall contain such information relating to the organization, operations and affairs of such fund as may be prescribed by the superintendent.

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2. If it is found that the conditions which originally required registration with the superintendent of banks have ceased to exist and that new conditions exist which would not require the registration of an employee welfare fund with either the superintendent of banks or the superintendent of insurance, then the superintendent of banks may, on application of the trustees or on his own motion, cancel the registration of such fund.

(Added L. 1957, ch. 808, eff. Apr. 22, 1957.)

**§ 63. Examinations; authorization and requirement.**

1. The superintendent may examine into the affairs of any employee welfare fund as often as he deems it necessary, and he shall do so at least once in every five years.

2. The trustees of every employee welfare fund shall be responsible for the maintenance of accurate records of its books and accounts in conformance with generally accepted accounting principles and with any regulations prescribed with regard thereto.

(Am'd L. 1957, ch. 808, eff. Apr. 22, 1957.)

**§ 64. Examinations; publication.**

1. All reports of examinations and investigations, special reports rendered to the superintendent pursuant to section sixty-seven of this article, or correspondence and memoranda concerning or arising out of such examinations or investigations, including any duly authenticated copy or copies thereof in the possession of any employee welfare fund or the banking department, shall be confidential communications, shall not be subject to subpoena and shall not be made public unless, in the judgment of the superintendent, the ends of justice and the public advantage will be subserved by the publication thereof, in which event he may publish or authorize the publication of a copy of any such report or other material referred to in this subdivision one, or any part thereof, in such manner as he may deem proper.

(Am'd L. 1960, ch. 454, eff. Apr. 12, 1960.)

2. In any action or proceeding against the trustees of any employee welfare fund, or against their officers, agents or employees, report of examination or investigation, or any part thereof, if published or authorized to be published by the superintendent, shall be admissible in evidence and shall be presumptive evidence of the facts stated therein.

(Am'd L. 1960, ch. 454, eff. Apr. 12, 1960.)

3. The superintendent may assemble and file for public inspection such information covering forms of trust indentures in use and compensation paid to trustees of employee welfare funds and such other matters affecting the establishment and administration of such funds as, in his opinion, are in the public interest.

**§ 65. Examinations; expenses.**

The expenses of every examination of the affairs of any employee welfare fund, including any appraisal of real property, made pur-

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suant to the authority conferred by any provision of this chapter, shall be borne and paid by the employee welfare fund so examined, but the superintendent, with the approval of the comptroller, may in his discretion for good cause shown remit such charges. For any such examination by the superintendent or a deputy superintendent personally, the charge made shall be only for necessary travelling expenses and other actual expenses. In all other cases the expenses of examination shall also include reimbursement for the compensation paid for the services of persons employed by the superintendent or by his authority to make such examination or appraisal. All charges, including necessary travelling and other actual expenses, as audited by the comptroller and paid on his warrant in the usual manner by the comptroller to the person or persons making the examination or appraisal, shall be presented to the trustees of the employee welfare fund in the form of a copy of the itemized bill therefor as certified and approved by the superintendent or a deputy superintendent. Upon receiving such certified copy such trustees shall pay the amount thereof to the superintendent, to be paid by him into the state treasury.

**§ 66. Annual statement to superintendent.**

The trustees of every employee welfare fund shall file in the office of the superintendent, annually within five months after the close of the fiscal year used in maintaining the records of such fund, a statement, to be known as the annual statement of such fund, executed in duplicate, verified by the oath of its trustee or, if there is more than one trustee, then by the oaths of at least two of such trustees, showing its condition and affairs during such fiscal year. Such fiscal year shall not be changed without the consent of the superintendent. Such statement shall be in such form and contain such substantiation by vouchers and otherwise and such other information as the superintendent shall from time to time prescribe. The superintendent shall cause to be prepared and furnished to the trustees of every employee welfare fund required by law to report to him printed forms of the statements and schedules required by him.

Every employee welfare fund shall, at the time of filing the annual statement, pay to the superintendent the sum of fifty dollars as a fee for reviewing such annual statement, provided, however, for funds with annual contributions of less than thirty thousand dollars, as reported in such annual statement, the fee shall be twenty-five dollars .

(Am'd L. 1957, ch. 808; L. 1960, ch. 301, eff. Jan. 1, 1961.)

**§ 67. Special statements to superintendent.**

In addition to any other statements or reports required by this article, the superintendent may also address to the trustees of any employee welfare fund or to any of its other officers, agents or employees or to any employer or labor organization representing any employees eligible for employee benefits thereunder any inquiry



in relation to the transactions or condition of the fund or any matter connected therewith. Every person so addressed shall reply in writing to such inquiry promptly and truthfully, and such reply shall be verified, if required by the superintendent, by such individual or individuals as he shall designate.

(Am'd L. 1958, ch. 857, eff. Apr. 19, 1958.)

**§ 68. Annual reports to employers and employees.**

The trustees of every employee welfare fund shall, annually, within five months after the close of the fiscal year used in maintaining the records of such fund, file a report with the superintendent to be known as the annual report of such fund, verified by the oath of its trustee, or if there is more than one trustee, then by the oaths of at least two of such trustees, showing its conditions and affairs during such fiscal year. Such report shall be in such form and contain such matters as the superintendent shall from time to time prescribe. Such annual report shall be kept on file with the superintendent and at the principal office of the trustees and such report, or such portion thereof as the superintendent shall deem appropriate and relevant, shall be made available by the superintendent or by the trustees, or both, for inspection by any employer contributing to such fund, by any labor organization which is a party to an agreement establishing such fund, or by any employee covered by such fund. In addition and to such extent that he deems it to be in the public interest, the superintendent may require the trustees to mail such report, or such portions thereof as the superintendent shall deem appropriate and relevant, to employees covered by the fund, to contributing employers or to any labor organization which is a party to an agreement establishing such fund, or to any or all of such parties.

(Am'd L. 1957, ch. 808, eff. Apr. 22, 1957.)

**§ 69. Annual statements by corporate trustees and agents, insurance companies and service plans.**

Any corporate trustee or agent holding or administering all or any part of an employee welfare fund, and any insurance company or hospital, surgical or medical service plan providing benefits under an employee welfare fund shall, within four months after the end of each policy or fiscal year, furnish to the trustees of the fund a statement of account setting forth such information relating to the fund as the trustees of the fund may need from it in order to comply with the requirements of this article.

(Am'd L. 1957, ch. 808, eff. Apr. 22, 1957.)

**§ 70. Regulation under other laws.**

Where the trustees of any employee welfare fund are subject to and comply with the requirements of any law of this state other than this article or the law of any other state or of the United States with respect to registration, filing, examination, statements or reports, such requirements of this article or any of them may be

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waived by the superintendent with respect to any such fund or trustees to the extent that they are included in such other laws. Application for such a waiver shall be made in writing to the superintendent on such forms as he may require and any waiver issued by him hereunder shall be in writing and shall be filed in his office. The superintendent may, at any time, revoke any such waiver if, in his opinion, such other laws fail to accomplish adequately the purposes of this article. The action of the superintendent pursuant to this section shall be subject to judicial review.

(Am'd L. 1958, ch. 857, eff. Apr. 19, 1958.)

### § 71. Compliance and enforcement.

1. The trustees of every employee welfare fund shall be responsible in a fiduciary capacity for all money, property, or other assets received, managed or disbursed by them, or under their authority, on behalf of such fund.

2. (a) No employee welfare fund and no employer or labor organization representing any employees eligible for employee benefits thereunder, and no trustee or other officer or employee of any such fund, employer or labor organization shall receive, directly or indirectly, any payment, commission, loan or other thing of value from any insurance company, insurance agent, insurance broker or any hospital, surgical or medical service plan, in connection with the solicitation, sale, service or administration of a contract providing employee benefits for such fund; and no such employer, labor organization, trustee, officer or employee shall receive any payment, commission, loan, service or any other thing of value from such fund, or which is charged against such fund or would otherwise be payable to such fund, either directly or indirectly, except that any such person may receive any employee benefits to which he is otherwise entitled, and any such trustee or other officer or employee of a fund, may receive from such fund reasonable compensation for necessary services and expenses rendered or incurred by him in connection with his official duties as such; provided, however, that nothing in this subdivision shall affect the payment of any dividend or rate credit or other adjustment due under the terms of any insurance or annuity contract.

(Am'd L. 1958, ch. 857, eff. Apr. 19, 1958.)

(b) No insurance company, insurance agent or insurance broker and no hospital, surgical or medical service plan, shall either directly or indirectly, pay any commission, make any loan or give any other payment or thing of value to any employee welfare fund or to any employer or labor organization representing any employees eligible for employee benefits thereunder or to any trustee or other officer or employee of any such fund, employer or labor organization, in connection with the solicitation, sale, service or administration of a contract providing employee benefits for such fund.

(Am'd L. 1958, ch. 857, eff. Apr. 19, 1958.)

(c) The superintendent may, after notice and a hearing, pro-

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hibit the trustees of an employee welfare fund from employing or retaining or continuing to employ or retain any person upon finding that such employment or retention involves a conflict of interest which is not in the best interests of the fund or adversely affects the interests of covered employees. Any such finding by the superintendent shall be subject to judicial review.

(Added L. 1958, ch. 857, eff. Apr. 19, 1958.)

(d) The superintendent may, by regulation or order, and upon such terms and conditions as he may require, authorize or approve any transaction or transactions otherwise prohibited by this subdivision upon his finding that the transaction or transactions promote or will promote the best interests of the relevant employee welfare funds, and do not or will not adversely affect the interests of the covered employees.

(Added L. 1957, ch. 808, eff. Apr. 22, 1957; formerly par. (c) relettered par. (d) by L. 1958, ch. 857, eff. Apr. 19, 1958.)

3. (a) No insurance company shall pay any dividend or retrospective rate credit on any covering policy except by check payable to the affected employee welfare fund or by credit memo forwarded to such fund.

(b) No employee welfare fund shall pay any premium on a covering policy except by check payable to the insurance company directly.

(Added L. 1957, ch. 808, eff. Apr. 22, 1957.)

4. No political contributions shall be made directly or indirectly by or from any employee welfare fund.

(Formerly subd. 3; renumbered subd. 4, by L. 1957, ch. 808, eff. Apr. 22, 1957.)

5. The superintendent may impose a penalty of not to exceed twenty-five hundred dollars upon any trustee or other officer, agent or employee of any employee welfare fund subject to this article or may remove such trustee, officer, agent or employee from office or employment, or both such penalty and removal, if after notice and a hearing he shall find that he has wilfully failed to comply with the requirements of this article. Any such action of the superintendent under this subdivision shall be subject to judicial review.

(Formerly subd. 4; renumbered and am'd L. 1957, ch. 808, eff. Apr. 22, 1957; L. 1958, ch. 857, eff. Apr. 19, 1958.)

6. In any case where, after notice and a hearing, the superintendent finds that any employee welfare fund has been depleted by reason of any wrongful or negligent act or omission of a trustee or of any other person, he may transmit a copy of his findings to the attorney general, who may bring an action in the name of the people of the state, or intervene in an action brought by or on behalf of an employee, for the recovery of such fund for the benefit of the employees and such other persons as may have an interest in the fund.

(Formerly subd. 5, renumbered subd. 6 by L. 1957, ch. 808, eff. Apr. 22, 1957.)

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7. (a) Any person who wilfully violates or causes or induces the violation of any provision of this article or any regulation hereunder shall be guilty of a misdemeanor.

(Added L. 1957, ch. 808, eff. Apr. 22, 1957; lettered par. (a) by L. 1958, ch. 857, eff. Apr. 19, 1958.)

(b) Any person who makes a false statement or representation of a material fact, knowing it to be false, or who knowingly fails to disclose a material fact in any registration, examination, statement or report required under this article or the regulations thereunder shall be guilty of a misdemeanor.

(Added L. 1958, ch. 857, eff. Apr. 19, 1958.)

(c) Any person who makes a false entry in any book, record, report or statement required by this article or any regulation thereunder to be kept by him for any employee welfare fund, with intent to injure or defraud such fund or any beneficiary thereunder, or to deceive any one authorized or entitled to examine the affairs of such fund shall be guilty of a misdemeanor.

(Added L. 1958, ch. 857, eff. Apr. 19, 1958.)

(d) Nothing in paragraphs (b) or (c) of this subdivision shall be construed in any manner to limit the effect of paragraph (a).

(Added L. 1958, ch. 857, eff. Apr. 19, 1958.)

## § 72. Injunctions.

The superintendent may maintain and prosecute in the name of the people of the state an action against any trustee or any other person or persons subject to the provisions of this article, for the purpose of obtaining an injunction restraining such person or persons from doing any acts in violation of the provisions of this article. In such action if the court finds that a defendant is threatening or is likely to do any act or acts in violation of this article, and that such violation will cause irreparable injury to the interests of the people of this state or the beneficiaries of the employee welfare fund involved, the court may grant an injunction restraining such violation. The court may, on motion and affidavits, grant a preliminary injunction ex parte and an interlocutory injunction, upon such terms as may be just; but the people of the state shall not be required to give security before the issuance of any such injunction.

## § 73. Supplementary regulations; extensions of time.

1. The superintendent may from time to time promulgate appropriate supplementary rules and regulations designed to carry out the express provisions and purposes of this article.

2. For good cause shown, the superintendent may grant reasonable extensions of time for doing any act required by this article.

3. (a) The trustees of any employee welfare fund which has its principal place of business without the state, shall, within ten days after registering a fund with the superintendent, file with the secretary of state a designation, duly acknowledged, irrevocably

appointing the secretary of state as their agent upon whom may be served any summons, subpoena, subpoena duces tecum or other process directed to such trustees, in any action or proceeding brought under the provisions of this article arising out of or in connection with any transaction, matter or thing relating to such fund. If the trustees shall fail to make such designation in the manner and within the period above set forth, or, in the case of a fund which was registered with the superintendent on the effective date of this act, within six months after such effective date, such trustees shall be deemed to have irrevocably appointed the secretary of state as such agent upon whom service of such process may be made.

(Added L. 1958, ch. 857, eff. Apr. 19, 1958.)

(b) Service of such process shall be made by serving the secretary of state with a copy thereof and such service shall be sufficient provided that notice thereof and a copy of the process are sent within ten days thereafter by the moving party to the trustees at the office address of the fund by registered mail with return receipt requested. In any examination or hearing instituted by the superintendent, service of such process shall be complete ten days after the receipt by the superintendent of a return receipt purporting to be signed by the trustees or their agent or agents in accordance with the rules and customs of the post office department, or, if acceptance was refused by the trustees or their agents, the original envelope bearing a notation by the postal authorities that receipt was refused. In any action or proceeding instituted in any court in this state having jurisdiction of the subject matter, the moving party shall file with the clerk of the court in which such action or proceeding is pending, or with the judge or justice of such court, in case there be no clerk, an affidavit of compliance herewith, a copy of the process, and either the return receipt or the original envelope bearing a notation of refusal, as the case may be. Such affidavit and other papers shall be filed within thirty days after the return receipt or original envelope is received by the moving party, and service of process shall be complete ten days thereafter. Service of any process made in accordance with this subdivision shall be deemed to have been made personally within the state and, in the case of a court action or proceeding, within the territorial jurisdiction of the court from which such process issued.

(Added L. 1958, ch. 857, eff. Apr. 19, 1958.)

4. The trustees of every employee welfare fund shall preserve all of its records of final entry and all reports and statements required by this article and the regulations thereunder for a period of at least six years from the date of making the same; provided, however, that preservation of photographic reproduction thereof or records in photographic form shall constitute compliance with the requirements of this section.

(Added L. 1958, ch. 857, eff. Apr. 19, 1958.)

(Former § 73 renumbered § 74; new § 73 added L. 1957, ch. 808, eff. Apr. 22, 1957.)

Revised 1964

**§ 74. Construction.**

Nothing in this article shall be construed to relieve the trustees of any employee welfare fund from compliance with any other provision of this chapter or any other applicable laws of this state.  
(Formerly § 73, renumbered § 74 by L. 1957, ch. 808, eff. Apr. 22, 1957.)

**§ 75. Separability.**

If any provision of this article or the application of such provision to any person or circumstance shall be held invalid, the remainder of this article and the application of such provision to persons or circumstances other than those as to which it is held invalid shall not be affected thereby.

(Added L. 1957, ch. 808, eff. Apr. 22, 1957.)

(Additional New York State forms and regulations pertaining to employee welfare supplied by Messrs. Frank Wille and Henry Root Stern, Jr., follow:)

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**INSTRUCTIONS FOR COMPLETING THE  
ANNUAL STATEMENT BLANK**

**(EMPLOYEE WELFARE FUNDS)**

**SUPERINTENDENT OF BANKS**

**of the**

**STATE OF NEW YORK**

Attention is called to the Note on page 5 of the Annual Statement, providing for optional filing of a copy of U. S. Department of Labor Form D-2 in lieu of pages 6 to 14 inclusive of the Annual Statement. When such optional filing is made, the instructions herein numbered 9 to 16 inclusive are inapplicable.

**INSTRUCTIONS FOR COMPLETING THE  
ANNUAL STATEMENT BLANK**

**(Employee Welfare Funds)**

**GENERAL**

(1) **Date of filing:** The statement is required to be filed, in duplicate, within five months after the close of the fiscal year used in maintaining the records of the fund. Address replies to New York State Banking Department, Employee Welfare Fund Division, 100 Church Street, New York 7, New York.

(2) The statement must cover either the calendar year or the fiscal year used in maintaining the records of the fund.

(3) A separate statement must be filed for each "employee welfare fund" for which the trustees act.

(4) The statement may be handwritten—in ink—or typewritten. The sheets have been designed for ready insertion in any standard typewriter.

(5) Blank schedules will not be accepted. If no entries are to be made, write "None" or "Nothing" across the schedule in question.

(6) Check marks will not be accepted as answers to interrogatories.

(7) Where there is insufficient space in the blank to answer a question, attach a sheet to the blank, taking care that the name of the fund and the year is stamped or plainly written at the top of each such sheet.

(8) The statement must be executed by two members of the Board of Individual Trustees, Pension Board, Committee or other similar body. If the board or committee is composed of both employer and labor representatives, the annual statement must be signed by one from each group.

**LIABILITIES**

(9) Lines 11 and 12:—These lines are for the showing of reserves applicable to benefits. The amounts thereof should conform to generally accepted accounting and actuarial practice.

(10) Line 19:—Balance of Fund should equal the excess of assets over liabilities.



SUMMARY OF OPERATIONS

(11) Lines 1 and 2—Employer and Employee Contributions:—These lines may be reported on either a cash or accrual basis. When a cash basis is used, the amounts to be entered are the contributions actually received during the fiscal year. When the accrual basis is used, the amounts should be prepared as follows:

- a) Contributions actually received during the year . . . . . \$.....
- b) Add contributions due and unpaid as of end of current year (carry at Lines 7-9 of Page 6—Assets) . . . . .
- c) Less contributions due and unpaid as of end of previous year . . . . .
- d) Add contributions received in advance as of end of previous year . . . . .
- e) Less contributions received in advance as of end of current year (carry at Lines 15-17 of Page 6—Liabilities) . . . . .
- f) Net (enter at Lines 1 and 2 of Summary of Operations) . . . . . \$.....

(12) Line 6—Dividends and Experience Rating Refunds from Insurance Carriers in Connection with Member Benefits:—Include such amounts actually received, plus amounts receivable as of the end of the current year less amounts receivable as of the end of previous year.

(13) Line 11—Premiums and Annuity Considerations to Insurance Carriers for Member Benefits:—This item should comprise the following:

- a) Premiums actually paid during the current year . . . . .
- b) Less prepaid premiums as of the end of the current year . . . . .
- c) Add prepaid premiums as of the end of previous year . . . . .
- d) Add premiums due to insurance companies as of the end of the current year (Line 13, Page 6) . . . . .
- e) Less premiums due to insurance companies as of the end of the previous year . . . . .
- f) Net (enter at Line 11) . . . . .

Schedule 8—The premiums and dividends and experience rating refunds on this schedule are on a policy-year basis and normally will not agree with Lines 6 and 11 of Page 7. Each insurance company with which

the fund does business is required to furnish the information required for Schedule 8 and should be requested to do so in time for convenient reporting in the Annual Statement.

(14) Line 12 and Schedule 2—Benefits Directly Provided to Members:—This line (and Schedule 2) is applicable only to benefits not insured.

(15) Line 13 and Schedules 3, 4 and 5—General Expenses:—The kinds of expenses included in each of the expense classifications on Schedule 3 should conform to the fund's own system of expense classification during the year covered by the statement—provided such system was in accordance with generally accepted accounting practice.

Exclude: Real estate expenses (deduct from real estate income).

Schedules 4 and 5:—The totals must agree with the appropriate expense classifications on Schedule 3.

(16) Line 21:—Enter on this line the change in amounts carried at Lines 11 and 12 on Page 6.

#### GENERAL INTERROGATORIES

(17) As used in the General Interrogatories", the following terms have the following meanings:

- a) "Participating labor organization" refers to a labor organization which has participated in an agreement affecting the employee welfare fund.
- b) "Associated or affiliated fund" means an Employee Welfare Fund which provides employee benefits for the same or substantially the same group of employees, or which is administered by the same, or substantially the same, Board of Individual Trustees, Pension Board, Committee or other similar body.

#### PENALTY FOR FAILURE TO FILE THE ANNUAL STATEMENT

(18) The Superintendent may impose a penalty of not to exceed \$2,500, upon any trustee of an Employee Welfare Fund covered by Article II-A of the Banking Law, or may remove such trustee from office, or both, if after notice and hearing the Superintendent finds that the Trustee has wilfully failed to file the Annual Statement.

# ANNUAL STATEMENT

of the

.....  
(Name of Fund)

.....  
(Address of Fund)

to the

## SUPERINTENDENT OF BANKS

of the

## STATE OF NEW YORK

For the fiscal year ended....., 19.....

Attention is called to the NOTE on page 5 providing for optional filing of a copy of U. S. Department of Labor Form D2 in lieu of pages 6 to 14 incl. of this statement.

ANNUAL STATEMENT

For the fiscal year ended....., 19.....

(Name of Welfare Fund)

(Address of Fund)

to the
SUPERINTENDENT OF BANKS
of the
STATE OF NEW YORK

STATE OF..... }
COUNTY OF..... } ss.

and.....

Trustees of the Fund, and.....
being duly sworn, each for himself deposes and says that this Annual Statement is true to the best of his informa-
tion, knowledge and belief.

Employer trustees:

.....
.....
.....

Employee trustees:

.....
.....
.....

Others (Indicate titles):

.....
.....
.....

Subscribed and sworn to before me this.....
day of....., 19.....



ANNUAL STATEMENT OF THE

GENERAL INTERROGATORIES

(If more space is needed, attach additional sheets)

1. Give the names and addresses of the participating labor organizations for whose members the fund is operated.....

2. Give the names and addresses of associated or affiliated funds.....

3. Complete the following table as of the end of the current year:

	Number in:		
	State	Elsewhere	Total
a) Approximate number of employee members.....	_____	_____	_____
b) Approximate number of participating employers.....	_____	_____	_____
c) Approximate number of retired employees.....	_____	_____	_____

4. a) On what dates during the past year did the Board of Trustees (or similar body) meet?.....

b) Are minutes kept of such meetings?.....

5. Have any amendments or other changes been made during the current fiscal year in (a) the types and amounts of benefits provided by the fund, (b) the terms of trust indentures, (c) pertinent provisions of collective bargaining agreements, and (d) any descriptive booklets or other similar written material given or made available to employee-members?.....

If so, have copies of all such amendments or other changes been filed with this Department?..... (If not, attach copies to this Annual Statement.)

6. Is a written description of the benefits and eligibility requirements made available to members?.....

7. How often are the fund accounts audited by an independent accountant? .....

Submit a copy of the last annual accountant's report.

.....

**GENERAL INTERROGATORIES (Continued)**

8. Were any of the recipients of commission and allowances, or of compensation for professional services shown on the accompanying schedules related through blood or marriage or associated in any business endeavor, profession or other occupation with any fund trustee, administrator, officer, or union official? \_\_\_\_\_ . If so, give details \_\_\_\_\_  
\_\_\_\_\_
9. Were any of the recipients of salaries, fees, allowances and travel shown on the accompanying schedules related through blood or marriage or associated in any business endeavor, profession or other occupation with any other fund trustee, administrator, officer, or union official? \_\_\_\_\_ . If so, give details \_\_\_\_\_  
\_\_\_\_\_
10. In whose possession are all stocks, bonds and other assets of the fund? \_\_\_\_\_  
In whose name are they registered? \_\_\_\_\_  
\_\_\_\_\_
11. Were any of the stocks, bonds or other assets of the fund loaned during the year covered by this statement? \_\_\_\_\_ . If so, explain fully \_\_\_\_\_  
\_\_\_\_\_
12. Were any of the fund's investments purchased from or sold to any of the contributing employers, participating labor organizations, their officers and employees, or any of the trustees, officers and employees of the Welfare Fund? \_\_\_\_\_ . If so, explain \_\_\_\_\_  
\_\_\_\_\_
13. Were any of the investments listed on Schedules 10, 11, 12, 13 and 14 purchased or sold on behalf of the fund by anyone other than a bank acting as trustee or agent? \_\_\_\_\_  
If the answer is yes, attach a list of the securities so purchased or sold and a statement of the circumstances thereof.
14. Were any of the securities listed on Schedules 10, 11 and 14 purchased or sold through a broker or dealer who is not registered with the Securities Exchange Commission? \_\_\_\_\_  
If the answer is yes, attach a list of the securities so purchased or sold and a statement of the circumstances thereof.
15. Is any paid employee of the fund also employed by a participating labor organization or a contributing employer? \_\_\_\_\_  
\_\_\_\_\_

## ANNUAL STATEMENT OF THE

Page 5

## GENERAL INTERROGATORIES (Continued)

16. Contributions outstanding.
- a) Number of contributing employers more than six months in arrears at close of fiscal year \_\_\_\_\_
- b) Number of employee-members of such employers \_\_\_\_\_
- c) Amount of contributions more than six months in arrears \_\_\_\_\_  
 Note: Lines (b) and (c) may be carefully estimated.
- d) What steps are being taken to enforce collections? \_\_\_\_\_
17. Does your employee welfare fund currently hire or retain the services of an actuary? \_\_\_\_\_
- If so, give the name and business address of the actuary: \_\_\_\_\_
- Submit a copy of the last actuarial valuation.
18. If any benefit is insured, has there been a change in Carrier within this past fiscal year? \_\_\_\_\_
- If so, name the carriers and give reasons for change: \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
19. Submit a copy of the Annual Accounting of the Bank Trustee or Agent.
20. Explain how the "Annual Report" filed concurrently with this Annual Statement will be made available to employee-members, contributing employers and participating labor organizations \_\_\_\_\_
- \_\_\_\_\_
21. a) How many signatures are required on fund checks? \_\_\_\_\_
- b) Is it required that a trustee designated by the union (or employees) and a trustee designated by the employers both sign fund checks? \_\_\_\_\_

## NOTE

If fund has filed Form D-2 with the U. S. Department of Labor under the Welfare and Pension Plans Disclosure Act this Department will accept a copy of such form in lieu of pages 6 to 14 inclusive of this statement.

22. Is such copy of Form D-2 submitted herewith and made a part of this statement? \_\_\_\_\_



ANNUAL STATEMENT OF THE

ASSETS<sup>1</sup>

1. Cash:	
a. On interest . . . . .	\$.....
b. Not on interest . . . . .	.....
c. In office . . . . .	\$.....
2. Bonds:	
a. Government obligations . . . . .	\$.....
b. Other obligations . . . . .	.....
3. Stocks:	
a. Preferred . . . . .	\$.....
b. Common . . . . .	.....
4. Mortgage loans on real estate . . . . .	
5. Real estate, less \$..... encumbrances and less \$.....	
allowance for depreciation . . . . .	
6. Interest and other investment income due and accrued . . . . .	
Other assets (List each separately):	
7. ....	
8. ....	
9. ....	
10. Total Assets . . . . .	<u>\$.....</u>

LIABILITIES

11. Outstanding benefit claims not covered by insurance carriers . . . . .	
12. Other amounts set aside for payment of benefits . . . . .	
13. Premiums and annuity considerations due to insurance carriers for member benefits. ....	
14. General expenses due or accrued . . . . .	
Other liabilities (List each separately):	
15. ....	
16. ....	
17. ....	
18. Total Liabilities . . . . .	.....
19. Balance of Fund . . . . .	
20. Total . . . . .	\$.....

<sup>1</sup>The assets listed in this statement must be valued on the basis regularly used in valuing investments held in the fund and reported to the U. S. Treasury Department, or shall be valued at their aggregate cost or present value, whichever is lower, if such a statement is not so required to be filed with the U. S. Treasury Department.

ANNUAL STATEMENT OF THE

SUMMARY OF OPERATIONS

1.	Contributions from employers	\$.....
2.	Contributions from employee-members	.....
3.	Interest, dividends and real estate net income (Sch. 1)	.....
4.	Profit on disposal of investments	.....
5.	Increase by adjustment in asset values of investments	.....
6.	Dividends and experience rating refunds from insurance carriers in connection with member benefits	.....
	Other income:	
7.	.....	.....
8.	.....	.....
9.	.....	.....
10.	Total	\$.....

DEDUCT:

11.	Premiums and annuity considerations to insurance carriers for member benefits	\$.....
12.	Benefits directly provided to members (Sch. 2)	.....
13.	General expenses (Sch. 3)	.....
14.	Loss on disposal of investments	.....
15.	Decrease by adjustment in asset values of investments	.....
	Other:	
16.	.....	.....
17.	.....	.....
18.	.....	.....
19.	Total (Lines 11-18 incl.)	\$.....
20.	Increase or decrease (Line 10 less Line 19)	\$.....
21.	Net change from previous year in amounts set aside for payment of benefits (See Instruction No. 16)	.....
22.	Net increase or decrease (Line 20 plus or minus Line 21)	<u>\$.....</u>

BALANCE OF FUND

23.	Balance of Fund at beginning of year	\$.....
24.	Net increase or decrease from Item 22 above	.....
	Other charges or credits (itemize):	
25.	.....	.....
26.	.....	.....
27.	.....	.....
28.	Balance of Fund at end of year (Line 19, Page 6)	<u>\$.....</u>

SCHEDULE 1

Interest, Dividends and Real Estate Net Income

Received during year:

- 1. Interest on cash in banks . . . . . \$ .....
  - 2. Interest on bonds . . . . . .....
  - 3. Dividends on stocks . . . . . .....
  - 4. Interest on mortgage loans . . . . . .....
  - 5. Real estate net income . . . . . .....
- Other investment income (itemize):
- 6. ....
  - 7. ....
  - 8. ....
  - 9. ....
  - 10. Total . . . . . \$ .....
  - 11. Add interest and other investment income due and accrued end of current year  
(Line 6, Page 6) . . . . . .....
  - 12. Total . . . . . \$ .....
  - 13. Deduct interest and other investment income due and accrued end of previous year. ....
  - 14. Total (Line 3, Page 7) . . . . . \$ .....

SCHEDULE 2

Benefits Directly Provided to Members—Line 12, Page 7

(Include payments to medical, dental, optical and other practitioners for member benefits; and expenses of health centers. Do not include any amounts paid under any workmen's compensation laws.)

Payments made for benefits should be classified by type, or a brief explanation given as to the reason such showing cannot be made.

Type of Benefit	Claims Paid	Type of Benefit	Claims Paid	Type of Benefit	Claims Paid
Death . . . . .	\$ .....	Surgical . . . . .	\$ .....	Vacation . . . . .	\$ .....
Acc. Death and Disemb. . . . .	.....	Medical . . . . .	.....	Retirement . . . . .	.....
Disability . . . . .	.....	Unemployment . . . . .	.....	Profit Sharing . . . . .	.....
Hospitaliza- tion . . . . .	.....	Optical . . . . .	.....	Other . . . . .	.....
		Dental . . . . .	.....	<b>TOTAL . . . . .</b>	<b>.....</b>









## ANNUAL STATEMENT OF THE

Page 13

## SCHEDULE 8

## STATEMENT OF EXPERIENCE UNDER INSURANCE CONTRACTS

(Information Furnished by Insurance Carriers)

Each insurance carrier with which the fund does business is required to furnish this statement to the fund in sufficient time to permit its filing by the fund as a part of the Annual Statement.

**General Instructions**

- A. A separate statement is to be completed for each group contract.  
A pension trust or other mass sale or servicing of individual contracts may be treated as a unit.
- B. "Allowances" should include administration fees, service fees, or any other form of allowance, reimbursement of expenses, or compensation (other than commission) paid by the insurer to agents or brokers, applicants or policyholders, or to other individuals and firms. Do not include medical fees paid for the usual examination of applicants or inspection report fees paid by the insurance carrier to a regular credit reporting agency.
- C. This statement should cover the latest completed policy year.
- D. The amounts shown on this statement are on a policy year basis and normally will not agree with amounts reported in the Annual Statement on the Summary of Operations.
- E. Actual benefits to Members as reported at Line 12 should include only payments and adjustments in reserves for member benefits, and should not include payments or reserves for other purposes. Accordingly, there should be *excluded* assessments under disability benefits laws for administrative expenses or sick unemployed, claim adjustment expenses, adjustments in claim fluctuation reserves, catastrophe or epidemic reserves, or other similar payments, expenses or reserve adjustments.
- F. Where the insurer's standard practices for determination of dividends or experience rating refunds do not produce final data by the normal time for the rendering of reports, the insurer should furnish the Welfare Fund with a preliminary report based on latest data available and then submit a final report when the final data is available.
- G. If the insurer deems that there are unusual circumstances affecting the financial results which are not disclosed by the report, an explanatory footnote may be added for inclusion in the Welfare Fund's annual statement.
- H. If this is a report on a pension, annuity or retirement contract, attach additional sheets giving the following information:
  - (A) the type and basis of funding, actuarial assumptions used in determining the payments under the contract, and the number of employees, both retired and nonretired, covered by the contract; and
  - (B) except for benefits completely guaranteed by the carrier, the amount of current and past service liabilities, based on those assumptions, and the amount of all reserves accumulated under the plan.
- I. The premium rate information called for at Line 5 may be furnished by attachment of appropriate schedules of premium rates or by a statement as to the basis of the premium rates.



ANNUAL STATEMENT OF THE

1. Name of insurer .....
2. Name of policyholder .....
3. Type of contract and benefits provided .....
4. Policy year ending.....
5. Premium rate.....
6. Amount of gross premiums or annuity considerations.....
7. Approximate number of persons covered by each class of benefits.....

8. Names and addresses of recipients of commissions and allowances (show separately the names and addresses of general agents, other agents and brokers, and the amounts of commission and allowances applicable to each).	Commissions		Allowances, Fees and other Specific Acquisition Costs		Purpose for Which Paid
	Amount	% of prem. (Line 6)	Amount	% of prem. (Line 6)	

9. State whether all of the recipients of commission and allowances were licensed as insurance agents or insurance brokers.....  
 If "no," state occupation of the recipient and nature of services performed on behalf of the insurer .....
10. a) Amount of dividends and experience rating refunds \$.....  
 b) How were such amounts paid, credited, or applied?.....
11. If amounts reported at Line 10 were not paid or credited to the account of the fund, give name and address of recipient and his connection, if any, with the fund, employer, or labor organization.....
12. Amount of actual benefits to members, other than retirement benefits,  
 Paid \$..... Incurred \$.....  
 Note: See Instruction E on previous Page.
13. Amounts held to provide benefits after retirement \$.....
14. Gross premiums less amounts reported at lines 8, 10 and 12 \$.....
15. Are the additional sheets called for in Instruction H attached hereto?.....
16. Name and title of officer of insurance company under whose supervision the information on this page was prepared.....

# ANNUAL REPORT

For the fiscal year ended....., 19.....

.....  
(Name of Welfare Fund)

.....  
(Address of Fund)

to the  
**SUPERINTENDENT OF BANKS**  
of the  
**STATE OF NEW YORK**

- NOTES: (1) All data in the Annual Report is to be copied from the Annual Statement. Where a copy of U. S. Department of Labor Form D-2, has been filed in lieu of pages 6 to 14 of the New York Annual Statement, the Summary Statement of Assets and Liabilities (Exhibit B-1) and the Summary Statement of Receipts and Disbursements (Exhibit B-2) of form D-2 may be substituted for Pages 2 and 3 herein.
- (2) The Annual Report is required to be filed, *in duplicate*, within five months after the close of the fiscal year used in maintaining the records of the fund. Address replies to New York State Banking Department, Employee Welfare Fund Division, 100 Church Street, New York 7, N. Y.
- (3) The data contained herein is for the purpose of providing general information as to the condition and affairs of the fund. The presentation is necessarily abbreviated. For a more comprehensive treatment, refer to the Annual Statement, copies of which may be inspected at the office of the fund, or at the New York State Banking Department, Employee Welfare Fund Division, 100 Church Street, New York 7, N. Y.

ASSETS<sup>1</sup>

- 1. Cash:
  - a. On interest . . . . . \$.....
  - b. Not on interest . . . . .
  - c. In office . . . . . \$.....
- 2. Bonds:
  - a. Government obligations . . . . . \$.....
  - b. Other obligations . . . . .
- 3. Stocks:
  - a. Preferred . . . . . \$.....
  - b. Common . . . . .
- 4. Mortgage loans on real estate . . . . .
- 5. Real estate, less \$..... encumbrances and less \$..... allowance for depreciation . . . . .
- 6. Interest and other investment income due and accrued . . . . .
- Other Assets (List each separately):
- 7. ....
- 8. ....
- 9. ....
- 10. Total assets . . . . . \$.....

LIABILITIES

- 11. Outstanding benefit claims not covered by insurance carriers . . . . . \$.....
- 12. Other amounts set aside for payment of benefits . . . . .
- 13. Premiums and annuity considerations due to insurance carriers for member benefits. . . . .
- 14. General expenses due or accrued . . . . .
- Other liabilities (List each separately):
- 15. ....
- 16. ....
- 17. ....
- 18. Total Liabilities . . . . .
- 19. Balance of Fund . . . . .
- 20. Total . . . . . \$.....

<sup>1</sup>The assets listed in this statement must be valued on the basis regularly used in valuing investments held in the fund and reported to the U. S. Treasury Department, or shall be valued at their aggregate cost or present value, whichever is lower, if such a statement is not so required to be filed with the U. S. Treasury Department.

ANNUAL REPORT OF THE

SUMMARY OF OPERATIONS

1.	Contributions from employers	\$.....
2.	Contributions from employee-members	.....
3.	Interest, dividends and real estate net income	.....
4.	Profit on disposal of investments	.....
5.	Increase by adjustment in asset values of investments	.....
6.	Dividends and experience rating refunds from insurance carriers in connection with member benefits	.....
	Other income:	
7.	.....	
8.	.....	
9.	.....	
10.	Total	\$.....

DEDUCT:

11.	Premiums and annuity considerations to insurance carriers for member benefits	\$.....
12.	Benefits directly provided to members	.....
13.	General expenses	.....
14.	Loss on disposal of investments	.....
15.	Decrease by adjustment in asset values of investments	.....
	Other:	
16.	.....	
17.	.....	
18.	.....	
19.	Total (Lines 11-18 incl.)	\$.....
20.	Increase or decrease (Line 10 less Line 19)	\$.....
21.	Net change from previous year in amounts set aside for payment of benefits	.....
22.	Net increase or decrease (Line 20 plus or minus Line 21)	\$.....

BALANCE OF FUND

23.	Balance of Fund at beginning of year	\$.....
24.	Net increase or decrease from Item 22 above	.....
	Other charges or credits (itemize):	
25.	.....	
26.	.....	
27.	.....	
28.	Balance of Fund at end of year (Line 19, Page 2)	\$.....

Page 4

ANNUAL REPORT OF THE

.....

STATE OF..... }  
 COUNTY OF..... } ss.

.....and.....

Trustees of the Fund and.....  
being duly sworn, each for himself deposes and says that this Annual Report is true to the best of his information, knowledge and belief.

Employer trustee:  
.....  
.....  
.....

Employee trustee:  
.....  
.....  
.....

Others (Indicate titles):  
.....  
.....  
.....

Subscribed and sworn to before me this  
.....day of.....  
19.....

**SUPPLEMENT**  
to the  
**ANNUAL STATEMENT**

.....  
(Name of Fund)

.....  
(Address of Fund)

to the  
**SUPERINTENDENT OF BANKS**  
of the  
**STATE OF NEW YORK**

For the fiscal year ended....., 19.....

**NOTE**

This Supplement must be filed by all funds whether or not a copy of the Federal D-2 form is submitted in lieu of Pages 6 to 14 of the Annual Statement.









**SCHEDULE 12**

**Mortgage Loans**

Location and Description of Mortgaged Property	(1) Amount Unpaid—End of Current Year	INTEREST	
		(2) Rate of	(3) Amount Past Due more than 90 days -- End of Current Year
	\$		\$
<b>TOTALS</b>	\$		\$

Are all of the mortgages first liens? .....

Note: The total of column (1) should agree with the amount reported on the statement of assets and liabilities.

**SCHEDULE 13**

**Real Estate Owned**

Description of Real Estate and Nature of Encumbrances, if any	(1) Date Acquired	(2) Amount of Encumbrances	(3) Actual Cost	(4) Allowance for Depreciation	(5) Value Carried in Assets*	NET INCOME	
						(6) Previous Year	(7) Current Year
		\$	\$	\$	\$	\$	\$
<b>TOTALS</b>		\$	\$	\$	\$	\$	\$

\*State basis on which this value was determined .....

NOTE: The total of column (5) should agree with the amount reported on the statement of assets and liabilities.

ANNUAL STATEMENT OF THE

Page 5

PRIVATE PENSION PLANS

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STATE OF NEW YORK  
OFFICIAL COMPILATION OF CODES, RULES, AND REGULATIONS

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## TITLE 3

## BANKING DEPARTMENT

## CHAPTER III

## REGULATIONS OF THE SUPERINTENDENT OF BANKS

## Part 62

## EMPLOYEE WELFARE FUND

(Statutory authority: Banking Law, §§65, 67, 68, 73)

## Secs.

- 62.1 Annual Report
- 62.2 Notice of changes affecting employee welfare funds
- 62.3 Setting aside of expenses of final examination

Section 62.1 Annual report. The trustees of every employee welfare fund shall make available for inspection and shall distribute or publish copies of the Annual Report filed with the superintendent pursuant to section 68 of the Banking Law, in the following manner:

(a) A copy of such report shall at all times be kept on file at the principal office of the trustees and shall be available for inspection during reasonable business hours by any employee-member, contributing employer or participating labor organization; and

(b) (1) A copy of such report shall be mailed or delivered personally to each employee-member, contributing employer and participating labor organization not later than 30 days after it is required to be filed with the superintendent.

(2) Publication of such report within such 30 day period in a periodical mailed or delivered to all employee-members, contributing employers and participating labor organizations shall be deemed compliance with paragraph (1) of subdivision (b) hereof, provided that attention is directed to such publication on the first page or the cover of the periodical, in type not less than 18 point.

(3) Anything in paragraphs (1) and (2) hereof to the contrary notwithstanding, the mailing, delivery or publication of reports heretofore filed with the superintendent or which are required to be filed with him prior to May 1, 1957, may be effected at any time prior to June 1, 1957.

The superintendent reserves the right to prescribe in specific cases the method to be followed in distributing and publicizing the report.

62.2 Notice of changes affecting employee welfare funds. The trustees of every employee welfare fund shall give written notice to the Banking Department of:

(a) Any of the following changes, within 10 days after it shall have occurred:

(1) any change in the address of the fund;

(2) any amendment to, substitute for, or other change in (i) the plan, (ii) the trust indenture, (iii) any separate trust indenture or other instrument appointing a banking organization to act as trustee or agent for the fund, (iv) any insurance contract providing benefits to covered employees, (v) the provision or provisions of any collective bargaining agreement relating to the fund, and (vi) any other agreement, regulation, rule, order or by-law pursuant to which the fund is operated;

(3) any change in the method of funding (e.g., from insured to uninsured, etc.), and

(4) any change in the membership of the board of trustees or other like group having the overall management of a fund, or in its administrator or other person charged with the administration of the fund under the direction of such board of trustees or other like group, and

(b) Any proposed merger, consolidation, liquidation or dissolution of the fund, within 30 days prior to its proposed effective date.

Every notice required to be given by this section shall be addressed to the New York State Banking Department, Employee Welfare Fund Division, 100 Church Street, New York 7, N.Y., and shall include a copy or copies of all pertinent agreements and other writings or documents referred to therein.

Section 62.3 Setting aside of expenses of final examination. In the event any merger, consolidation, liquidation, or dissolution of the fund is proposed, the trustees of such fund shall set aside out of the assets of the fund, prior to the proposed effective date of such transaction, the sum estimated by the Superintendent of Banks to be required to cover the expenses of a final examination of the fund by the Superintendent, or by the persons employed by him or by his authority to make such examination, pursuant to Section 65 of the Banking Law. The Superintendent shall advise the trustees of the fund in writing, prior to the proposed effective date of such merger, consolidation, liquidation, or dissolution, of the sum estimated by him to be required to cover the expenses of such final examination.

THE ADMINISTRATOR OF NATIONAL BANKS,  
*Washington, May 26, 1966.*

HON. MARTHA W. GRIFFITHS,  
*Chairman, Subcommittee on Fiscal Policy, Joint Economic Committee, House of Representatives, Washington, D.C.*

DEAR MADAM CHAIRMAN: In connection with the hearings being held by your Subcommittee on private pension plans, you have requested this Office to explain the duties of the Comptroller of the Currency in the supervision of bank administered pension funds. You also have asked for any comments which we might care to make on State practice in the examination of bank trust departments. We are submitting the following information in response to your requests.

Under the provisions of 12 U.S.C. 92a, the Comptroller of the Currency is authorized to grant to national banks by special permit, when not in contravention of state or local law, the right to act in any fiduciary capacity in which state banks, trust companies or other corporations which come into competition with national banks are permitted to act under the laws of the state in which the national bank is located. The Comptroller is authorized to issue such regulations as he may deem necessary for the proper exercise of these powers. Pursuant to this authority the Comptroller has published regulations governing the exercise of fiduciary powers by national banks, commonly referred to as Regulation 9, in 12 CFR 9. A copy of the Regulation is enclosed.

The Comptroller of the Currency is also charged with the supervision and examination of the national banks of our country. This includes, of course, the examination of their trust departments. Of the 4,814 national banks presently in business, 1,867 are currently authorized to exercise fiduciary powers.

The examination of trust departments of national banks is carried out by a division of the Office under the direction of a Deputy Comptroller for Trusts who reports directly to the Comptroller. The actual examinations of trust departments are conducted by persons who devote their whole time to this area of activity. Currently there are 100 such examiners operating in the 14 National Bank Regions. These examinations of national bank trust departments are conducted independently of the examination of their commercial banking operations. A separate fee is charged each bank for the examination of its trust department, based upon the time required to complete the examination.

In the pursuance of their fiduciary authority, national banks act as trustee or as agent for employee benefit plans. At the end of 1964 national bank trust departments acted as trustee for employee benefit accounts holding a combined total of \$20 billion in assets. It was estimated by our Office that at that time state banks held assets of such accounts totaling \$29 billion. It should perhaps be observed at this point that our Office does not regulate or supervise state bank trust departments. Such departments are under the authority of the appropriate state bank supervisory authority. In addition, the trust department of state banks are examined by the Board of Governors of the Federal Reserve System if the bank is a member of the System; or if the bank is not a member of the Federal Reserve but its deposits

are insured by the Federal Deposit Insurance Corporation, its trust department will be examined by the agency.

In an examination of an employee benefit trust, the representatives of our Office for the most part view the trust similarly to any other fiduciary account which they find in a trust department. The examiner's interest is in protecting the bank from possible surcharge liability for breach of fiduciary duty. His job is to detect acts or omissions which violate the rules of fiduciary law, and to obtain correction thereof. In so doing, he checks the keeping of books and records by the bank. He examines the assets of each account. Where he finds assets of a substandard nature, which are not authorized by the terms of the appropriate governing instrument, he criticizes such holdings in his report of examination. Where he finds such investments which involve an unauthorized conflict of interest or bear overtones of self-dealing, he similarly makes criticism. Such criticism is followed by this Office until correction is obtained.

In determining whether the bank being examined may have committed a breach of fiduciary duty, the examiner looks to the law of trusts. In most cases this will be primarily found in the common law, and supplemented by statutory provisions of the local legislatures. Among the duties of the trustee which have special relevance here are the duty to make the trust productive, consistent with its purposes, and the duty of undivided loyalty.

While, as noted, the representatives of this Office for the most part view all trust department accounts similarly, certain specific matters are asked in the examination with respect to employee benefit accounts. For example, the examiner is required to ensure that annual returns regarding employee benefit trusts are filed with the Internal Revenue Service as required by section 6033 of the Internal Revenue Code of 1954. In addition, he must ascertain that the forms required by the Welfare and Pension Plans Disclosure Act are filed with the Department of Labor. Also, he is required to determine whether any investments administered under employee benefits accounts appear to be prohibited by the provisions of section 503(c) of the Internal Revenue Code of 1954 or by regulations implementing that section. Finally, the specific question is asked whether any fiduciary accounts, including employee benefit trusts, contain investments made on the direction or at the behest of a third party which might otherwise be considered improper investments for fiduciary funds.

Special consideration is given to employee benefit accounts when they are commingled for collective investment in a group trust, pursuant to Revenue Ruling 56-267. For regulatory purposes, such group trusts are regarded as collective investment funds and required to conform to most of the specific requirements pertaining thereto which are set forth in Regulation 9. Among other things, this requires that the plans and annual financial reports for these funds be filed with this Office. In addition, attention is given to whether the group trust qualifies for tax-exempt status under the Revenue Ruling. In these as in all other areas, matters of criticism which are developed are followed until this Office is satisfied.

We trust the foregoing information will be of assistance to the Subcommittee.

Sincerely,

JAMES J. SAXON,  
*Comptroller of the Currency.*



(Regulation 9 follows:)

FIDUCIARY POWERS OF NATIONAL BANKS AND COLLECTIVE INVESTMENT FUNDS

REGULATION 9

(Effective as of April 5, 1963—Amended February 5, 1964)

(United States Treasury, Comptroller of the Currency)

TITLE 12—BANKS AND BANKING

Chapter I—Bureau of the Comptroller of the Currency, Department of the Treasury

PART 9—FIDUCIARY POWERS OF NATIONAL BANKS AND COLLECTIVE INVESTMENT FUNDS

Sec.

- 9.1 Definitions.
- 9.2 Applications.
- 9.3 Consideration of applications.
- 9.4 Consolidation or merger of two or more national banks.
- 9.5 Conversion, consolidation or merger involving State bank.
- 9.6 Change of name.
- 9.7 Administration of fiduciary powers.
- 9.8 Books and accounts.
- 9.9 Audit of trust department.
- 9.10 Funds awaiting investment or distribution.
- 9.11 Investment of funds held as fiduciary.
- 9.12 Self-dealing.
- 9.13 Custody of investments.
- 9.14 Deposit of securities with State authorities.
- 9.15 Compensation of bank.
- 9.16 Receivership or voluntary liquidation of bank.
- 9.17 Surrender of fiduciary powers.
- 9.18 Collective investment.
- 9.19 Forms.

AUTHORITY: §§ 9.1 to 9.19 issued under sec. 1(j) of the Act of September 28, 1962, 76 Stat. 668, 12 U.S.C. 92a.

§ 9.1 Definitions.

For the purposes of this Regulation, the term:

(a) "Account" means the trust, estate or other fiduciary relationship which has been established with a bank;

(b) "Fiduciary" means a bank undertaking to act alone or jointly with others primarily for the benefit of another in all matters connected with its undertaking and includes trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, managing agent and any other similar capacity;

(c) "Fiduciary powers" means the power to act in any fiduciary capacity authorized by the Act of September 28, 1962, 76 Stat. 668, 12 U.S.C. 92a. Under that Act, a national bank may be authorized to act, both at its principal office and at any branch when not in contravention of local law, as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, managing agent or in any other fiduciary capacity which state banks, trust companies, or other institutions coming into competition with the national bank may exercise under local law;

(d) "Fiduciary records" means all matters which are written, transcribed, recorded, received or otherwise come into the possession of a bank and are necessary to preserve information concerning the acts and events relevant to the fiduciary activities of a bank;

(e) "Guardian" means the guardian or committee, by whatever name employed by local law, of the estate of an infant, an incompetent individual, an absent individual, or a competent individual over whose estate a court has taken jurisdiction, other than under bankruptcy or insolvency laws;

(f) "Local law" means the law of the State or other jurisdiction governing the fiduciary relationship;

(g) "Managing agent" means the fiduciary relationship assumed by a bank upon the creation of an account so entitled which confers investment discretion on the bank and imposes upon it the fiduciary responsibilities imposed upon trustees under will or deed;

(h) "State bank" means any bank, trust company, savings bank, or other banking institution, which is not a national bank and the principal office of which is located in the District of Columbia, any State, commonwealth, or territorial possession of the United States;

(i) "Trust department" means that department of the bank designated by the board of directors to perform fiduciary responsibilities.

### § 9.2 Applications.

(a) A national bank desiring to exercise fiduciary powers shall apply to the Comptroller of the Currency for a special permit to exercise such powers. Such application shall be made on Form TA-1.

(b) In the case of the organization of a new national bank, the conversion of a State bank into a national bank, or the consolidation or merger of two or more national banks, or the consolidation or merger of a State bank or banks with a national bank or banks under the charter of a national bank, when none of the national banks involved in such consolidation or merger is authorized to exercise fiduciary powers, application for such a permit may be made in advance on behalf of the new, converted, or resulting national bank, and the permit may be issued simultaneously with the consummation of such organization, conversion, consolidation or merger. Such application may be made by the organizers in the case of a new national bank, by the State bank in the case of a conversion, and by the national bank under the charter of which the consolidation or merger is being effected in the case of a consolidation or merger.

(c) Each application made under the provisions of this section shall be executed and forwarded in duplicate, together with duplicate copies of documents containing any information submitted with the application, to the Regional Chief National Bank Examiner of the Region in which the applying bank is located.

### § 9.3 Consideration of applications.

In passing upon an application to exercise fiduciary powers, the Comptroller of the Currency will give consideration to the following matters and to any other facts and circumstances that seem to him proper:

(a) Whether the bank has sufficient capital and surplus to exercise the fiduciary powers applied for, which capital and surplus in no case shall be less than that required by State law of State banks, or other institutions exercising such powers;

(b) The needs of the community for fiduciary services and the probable volume of such fiduciary business available to the bank;

(c) The general condition of the bank, including the adequacy of its capital and surplus in relation to the character and condition of its assets and to its deposit liabilities and other corporate responsibilities, including the exercise of fiduciary powers;

(d) The general character and ability of the management of the bank;

(e) The nature of the supervision to be given to the fiduciary activities, including the qualifications, experience and character of the proposed officer or officers of the trust department;

(f) Whether the bank has available legal counsel to advise and pass upon fiduciary matters wherever necessary.

### § 9.4 Consolidation or merger of two or more national banks.

Where two or more national banks consolidate or merge, and any one of such banks has, prior to such consolidation or merger, received a permit from the Board of Governors of the Federal Reserve System or the Comptroller of the Currency to exercise fiduciary powers which is in force at the time of the consolidation or merger, the rights existing under such permit pass to the resulting bank, and the resulting bank may exercise such fiduciary powers in the same manner and to the same extent as the bank to which such permit was originally issued; and no new application to continue to exercise such powers is necessary. However, where the name or charter number of the resulting bank differs from that of the bank to which the right to exercise fiduciary powers was originally granted, in order that the records of the resulting bank may be complete and that it have convenient evidence of its right to exercise fiduciary powers, the Comptroller of the Currency will issue a certificate to that bank showing its right to exercise the fiduciary powers theretofore granted to any of the national banks participating in the consolidation or merger.

**§ 9.5 Conversion, consolidation or merger involving State bank.**

Where a State bank converts into a national bank or one or more State banks consolidate or merge with one or more national banks, the converted or resulting national bank shall to the full extent permitted by local law succeed to the specific fiduciary appointments, designations and nominations of each State bank at the time of the conversion, consolidation or merger. It is not necessary for the converted or resulting national bank to have a permit from the Board of Governors of the Federal Reserve System or the Comptroller of the Currency in order to administer the specific accounts to which the bank has succeeded as a result of the conversion, consolidation or merger, but the converted or resulting national bank may not act generally in fiduciary capacities or accept or undertake any additional accounts unless it shall have such a permit from the Board or the Comptroller which is in force.

**§ 9.6 Change of name.**

If a national bank has a permit to exercise fiduciary powers which is in force, and changes its name, it is not necessary that a new application be made to continue to exercise such fiduciary powers. However, in order that the records of the bank may be complete and that it have convenient evidence of its right to exercise fiduciary powers under its new name, the Comptroller of the Currency will issue a certificate to it under such new name evidencing its right to exercise the fiduciary powers previously granted to it under its old name.

**§ 9.7 Administration of fiduciary powers.**

(a) (1) The board of directors is responsible for the proper exercise of fiduciary powers by the bank. All matters pertinent thereto, including the determination of policies, the investment and disposition of property held in a fiduciary capacity, and the direction and review of the actions of all officers, employees, and committees utilized by the bank in the exercise of its fiduciary powers, are the responsibility of the board. In discharging this responsibility, the board of directors may assign, by action duly entered in the minutes, the administration of such of the bank's fiduciary powers as it may consider proper to assign to such director(s), officer(s), employee(s) or committee(s) as it may designate.

(2) No fiduciary account shall be accepted without the prior approval of the board, or of the director(s), officer(s) or committee(s) to whom the board may have designated the performance of that responsibility. A written record shall be made of such acceptances and of the relinquishment or closing out of all fiduciary accounts. Upon the acceptance of an account for which the bank has investment responsibilities a prompt review of the assets shall be made. The board shall also ensure that at least once during every calendar year thereafter, and within 15 months of the last review, all the assets held in or for each fiduciary account where the bank has investment responsibilities are reviewed to determine the advisability of retaining or disposing of such assets.

(b) All officers and employees taking part in the operation of the trust department shall be adequately bonded.

(c) Every national bank exercising fiduciary powers shall designate, employ or retain legal counsel who shall be readily available to pass upon fiduciary matters and to advise the bank and its trust department.

(d) The trust department may utilize personnel and facilities of other departments of the bank, and other departments of the bank may utilize the personnel and facilities of the trust department, as long as the separate identity of the trust department is preserved.

**§ 9.8 Books and accounts.**

(a) Every national bank exercising fiduciary powers shall keep its fiduciary records separate and distinct from other records of the bank. All fiduciary records shall be so kept and retained for such time as to enable the bank to furnish such information or reports with respect thereto as may be required by the Comptroller of the Currency. The fiduciary records shall contain full information relative to each account.

(b) Every such national bank shall keep an adequate record of all pending litigation to which it is a party in connection with its exercise of fiduciary powers.

### § 9.9 Audit of trust department.

A committee of directors, exclusive of any active officers of the bank, shall at least once during each calendar year and within 15 months of the last such audit, make suitable audits of the trust department or cause suitable audits to be made by auditors responsible only to the board of directors, and at such time shall ascertain whether the department has been administered in accordance with law, this Regulation and sound fiduciary principles. The board of directors may elect, in lieu of such periodic audits, to adopt an adequate continuous audit system. A report of the audits and examination required under this section, together with the action taken thereon, shall be noted in the minutes of the board of directors.

### § 9.10 Funds awaiting investment or distribution.

(a) Funds held in a fiduciary capacity by a national bank awaiting investment or distribution shall not be held uninvested or undistributed any longer than is reasonable for the proper management of the account.

(b) Funds held in trust by a national bank, including managing agency accounts, awaiting investment or distribution may, unless prohibited by the instrument creating the trust or by local law, be deposited in the commercial or savings or other department of the bank, provided that it shall first set aside under control of the trust department as collateral security:

(1) Direct obligations of the United States, or other obligations fully guaranteed by the United States as to principal and interest; or

(2) Readily marketable securities of the classes in which state banks exercising fiduciary powers are authorized or permitted to invest trust funds under the laws of the state in which such national bank is located; or

(3) Other readily marketable securities that qualify as investment securities pursuant to the Investment Securities Regulation of the Comptroller of the Currency, 12 CFR, Chapter I, Part 1.

The securities so deposited or securities substituted therefor as collateral shall at all times be at least equal in face value to the amount of trust funds so deposited, but such securities shall not be required to the extent that the funds so deposited are insured by the Federal Deposit Insurance Corporation. The requirements of this section are met when qualifying assets of the bank are pledged to secure a deposit in compliance with local law, and no duplicate pledge shall be required in such case.

### § 9.11 Investment of funds held as fiduciary.

(a) Funds held by a national bank in a fiduciary capacity shall be invested in accordance with the instrument establishing the fiduciary relationship and local law. When such instrument does not specify the character or class of investments to be made and does not vest in the bank, its directors or its officers a discretion in the matter, funds held pursuant to such instrument shall be invested in any investment in which corporate fiduciaries may invest under local law.

(b) If, under local law, corporate fiduciaries appointed by a court are permitted to exercise a discretion in investments, or if a national bank acting as fiduciary under appointment by a court is vested with a discretion in investments by an order of such court, funds of such accounts may be invested in any investments which are permitted by local law. Otherwise, a national bank acting as fiduciary under appointment by a court must make all investments of funds in such accounts under an order of that court. Such orders in either case shall be preserved with the fiduciary records of the bank.

(c) The collective investment of funds received or held by a national bank as fiduciary is governed by § 9.18.

(d) As a part of each examination of the trust department of a national bank and as provided by the *Manual of Instructions for Representatives in Trusts*, the Comptroller of the Currency will examine the investments held by such bank as fiduciary, including the investment of funds under the provisions of § 9.18, in order to determine whether such investments are in accordance with law, this Regulation and sound fiduciary principles.

### § 9.12 Self-dealing.

(a) Unless lawfully authorized by the instrument creating the relationship, or by court order or by local law, funds held by a national bank as fiduciary shall not be invested in stock or obligations of, or property acquired from, the bank or its directors, officers, or employees, or individuals with whom there exists

such a connection, or organizations in which there exists such an interest, as might affect the exercise of the best judgment of the bank in acquiring the property, or in stock or obligations of, or property acquired from, affiliates of the bank or their directors, officers or employees.

(b) Property held by a national bank as fiduciary shall not be sold or transferred, by loan or otherwise, to the bank or its directors, officers, or employees, or to individuals with whom there exists such a connection, or organizations in which there exists such an interest, as might affect the exercise of the best judgment of the bank in selling or transferring such property, or to affiliates of the bank or their directors, officers or employees, except:

(1) Where lawfully authorized by the instrument creating the relationship or by court order or by local law;

(2) In cases in which the bank has been advised by its counsel in writing that it has incurred as fiduciary a contingent or potential liability and desires to relieve itself from such liability, in which case such a sale or transfer may be made with the approval of the board of directors, provided that in all such cases the bank, upon the consummation of the sale or transfer, shall make reimbursement in cash at no loss to the account;

(3) As is provided in § 9.18 (b) (8) (ii):

(c) Except as provided in § 9.10 (b), funds held by a national bank as fiduciary shall not be invested by the purchase of stock or obligations of the bank or its affiliates unless authorized by the instrument creating the relationship or by court order or by local law: *Provided*, That if the retention of stock or obligations of the bank or its affiliates is authorized by the instrument creating the relationship or by court order or by local law, it may exercise rights to purchase its own stock or securities convertible into its own stock when offered pro rata to stockholders, unless such exercise is forbidden by local law. When the exercise of rights or receipt of a stock dividend results in fractional share holdings, additional fractional shares may be purchased to complement the fractional shares so acquired.

(d) A national bank may sell assets held by it as fiduciary in one account to itself as fiduciary in another account if the transaction is fair to both accounts and if such transaction is not prohibited by the terms of any governing instrument or by local law.

(e) A national bank may make a loan to an account from the funds belonging to another such account, when the making of such loans to a designated account is authorized by the instrument creating the account from which such loans are made, and is not prohibited by local law.

(f) A national bank may make a loan to an account and make take as security thereof assets of the account, provided such transaction is fair to such account and is not prohibited by local law.

### § 9.13 Custody of investments.

(a) The investments of each account shall be kept separate from the assets of the bank, and shall be placed in the joint custody or control of not less than two of the officers or employees of the bank designated for that purpose by the board of directors of the bank; and all such officers and employees shall be adequately bonded.

(b) The investments of each account shall be either:

(1) Kept separate from those of all other accounts, except as provided in § 9.18, or

(2) Adequately identified as the property of the relevant account.

### § 9.14 Deposit of securities with state authorities.

Whenever the local law requires corporations acting as fiduciary to deposit securities with the state authorities for the protection of private or court trusts, every national bank in that state authorized to exercise fiduciary powers shall, before undertaking to act in any fiduciary capacity, make a similar deposit with the state authorities. If the state authorities refuse to accept such a deposit, the securities shall be deposited with the Federal Reserve Bank of the district in which such national bank is located, and such securities shall be held for the protection of private or court trusts with like effect as though the securities had been deposited with the state authorities.

### § 9.15 Compensation of bank.

(a) If the amount of the compensation for acting in a fiduciary capacity is not regulated by local law or provided for in the instrument creating the fiduciary

relationship or otherwise agreed to by the parties, a national bank acting in such capacity may charge or deduct a reasonable compensation for its services. When the bank is acting in a fiduciary capacity under appointment by a court, it shall receive such compensation as may be allowed or approved by that court or by local law.

(b) No national bank shall, except with the specific approval of its board of directors, permit any of its officers or employees while serving as such, to retain any compensation for acting as a co-fiduciary with the bank in the administration of any account undertaken by it.

#### § 9.16 Receivership or voluntary liquidation of bank.

(a) Whenever a receiver is appointed for a national bank by the Comptroller of the Currency, such receiver shall, pursuant to the instructions of the Comptroller and to the orders of the court having jurisdiction, proceed to close such accounts as can be closed promptly and transfer all other accounts to substitute fiduciaries.

(b) Whenever a national bank exercising fiduciary powers is placed in voluntary liquidation, the liquidating agent shall, in accordance with the local law, proceed at once to liquidate the affairs of the trust department as follows:

(1) All trusts and estates over which a court is exercising jurisdiction shall be closed or disposed of as soon as practicable in accordance with the orders or instructions of such court;

(2) All other accounts which can be closed promptly shall be closed as soon as practicable and final accounting made therefor, and all remaining accounts shall be transferred by appropriate legal proceedings to substitute fiduciaries.

#### § 9.17 Surrender of fiduciary powers.

Any national bank which has been granted the right to exercise fiduciary powers and which desires to surrender such right shall file with the Comptroller of the Currency a certified copy of the resolution of its Board of Directors signifying such desire. Upon receipt of such resolution, the Comptroller shall make an investigation and if he is satisfied that the bank has been discharged from all fiduciary duties which it has undertaken, he shall issue a certificate to such bank certifying that it is no longer authorized to exercise fiduciary powers.

#### § 9.18 Collective investment.

(a) Where not in contravention of local law, funds held by a national bank as fiduciary may be invested collectively:

(1) In a common trust fund maintained by the bank exclusively for the collective investment and reinvestment of monies contributed thereto by the bank in its capacity as executor administrator, guardian or trustee under a will or deed;

(2) In a fund consisting solely of assets of retirement, pension, profit sharing, stock bonus, or other trusts which are exempt from Federal income taxation under the Internal Revenue Code;

(3) In a common trust fund, maintained by the bank exclusively for the collective investment and reinvestment of monies contributed thereto by the bank in its capacity as managing agent under a managing agency agreement expressly providing that such monies are received by the bank in trust;

(b) Collective investments of funds or other property by national banks under paragraph (a) of this section (referred to in this paragraph as "collective investment funds") shall be administered as follows:

(1) Each collective investment fund shall be established and maintained in accordance with a written plan (referred to herein as the Plan) which shall be approved by a resolution of the bank's board of directors and filed with the Comptroller of the Currency. The Plan shall contain appropriate provisions not inconsistent with the rules and regulations of the Comptroller of the Currency as to the manner in which the fund is to be operated, including provisions relating to the investment powers of the bank with respect to the fund, the allocation of income, profits and losses, the terms and conditions governing the admission or withdrawal of participations in the fund, the auditing of accounts of the bank with respect to the fund, the basis and method of valuing assets in the fund, the minimum frequency for valuation of assets of the fund, the period following each such valuation date during which the valuation may be made, the basis upon which the fund may be terminated, and such other matters as may be necessary to define clearly the rights of participants in the fund: *Provided*, That Plans which have been established in conformance with prior regulations of the Board of Governors of the Federal Reserve System or the Comptroller of the Currency

may continue to conform to such regulations rather than the requirements of this paragraph, for a reasonable period. A copy of the Plan shall be available at the principal office of the bank for inspection during all banking hours, and upon request a copy of the Plan shall be furnished, to any person.

(2) Monies held by the bank in its capacity as managing agent shall not be invested in collective investment funds established under the provisions of paragraph (a) (1) or (2) of this section. Property held by the bank in its capacity as trustee of retirement, pension, profit sharing, stock bonus or other trusts which are exempt from Federal income taxation under the Internal Revenue Code may be invested in collective investment funds established under the provisions of paragraph (a) (1) or (2) of this section, subject to the provisions herein contained pertaining to such funds. Assets of retirement, pension, profit sharing, stock bonus or other trusts which are exempt from Federal income taxation under the Internal Revenue Code and held by the bank, in whatever capacity, may be invested in collective investment funds established under the provisions of paragraph (a) (2) of this section.

(3) All participations in the collective investment fund shall be on the basis of a proportionate interest in all of the assets. In order to determine whether the investment of funds received or held by the bank as fiduciary in a participation in a collective investment fund is proper, the bank may consider the collective investment fund as a whole and shall not, for example, be prohibited from making such investment because any particular asset is non-income producing.

(4) Not less frequently than once during each period of three months a bank administering a collective investment fund shall determine the value of the assets in the fund as of the dates set for the valuation of assets. No participation shall be admitted to or withdrawn from the fund except (i) on the basis of such valuation and (ii) as of such valuation date. No participation shall be admitted to or withdrawn from the fund unless a written request for or notice of intention of taking such action shall have been entered on or before the valuation date in the fiduciary records of the bank and approved in such manner as the board of directors shall prescribe. No such request or notice may be cancelled or countermanded after the valuation date.

(5) (i) A bank administering a collective investment fund shall at least once during each period of 12 months cause an adequate audit to be made of the collective investment fund by auditors responsible only to the board of directors of the bank. In the event such audit is performed by independent public accountants, the reasonable expenses of such audit may be charged to the collective investment fund.

(ii) A bank administering a collective investment fund shall at least once during each period of 12 months prepare a financial report of the fund which shall be filed with the Comptroller of the Currency. This report, based upon the above audit, shall contain a list of the investments in the fund showing the current market value of each investment a statement for the period since the last report showing purchases, sales and any other investment changes, income and disbursements, and an appropriate notation as to any investment in default.

(iii) The financial report may include a description of the fund's value on previous dates as well as its income and disbursements during previous accounting periods. The report shall make no reference to the performance of funds other than those administered by the bank, and no predictions or representations as to future results.

(iv) A copy of the financial report shall be furnished, or notice shall be given that a copy of such report is available and will be furnished without charge upon request, to each person to whom a regular periodic accounting would ordinarily be rendered with respect to each participating account. The report, in such summarized form as prescribed by the Comptroller of the Currency, shall be published in a newspaper of general circulation in the place where the principal office of the bank is located. In addition, a full report shall be furnished upon request to any person, and the fact of the availability of such material may be given publicity solely in connection with the promotion of the fiduciary services of the bank. Except as herein provided, the bank shall not advertise or publicize its collective investment fund(s). The cost of printing, publication and distribution of the report shall be borne by the bank.

(6) When participations are withdrawn from a collective investment fund, distributions may be made in cash or ratably in kind, or partly in cash and partly in kind, provided that all distributions as of any one valuation date shall be made on the same basis.

(7) If for any reason an investment is withdrawn in kind from a collective investment fund for the benefit of all participants in the fund at the time of such withdrawal and such investment is not distributed ratably in kind, it shall be segregated and administered or realized upon for the benefit ratably of all participants in the collective investment fund at the time of withdrawal.

(8) (i) A bank administering a collective investment fund shall not (a) have any interest in such fund other than in its fiduciary capacity (funds held by a bank as fiduciary as described under paragraph (a) (1) or (2) of this section for its own employees may be invested in such a fund) or (b) make any loans on the security of a participation in such fund. If because of a creditor relationship or otherwise the bank acquires an interest in a participation in such fund, the participation shall be withdrawn on the first date on which such withdrawal can be effected. However, in no case shall an unsecured advance to an account holding a participation until the time of the next withdrawal be deemed to constitute the acquisition of an interest by the bank.

(ii) The bank may purchase for its own account from a collective investment fund any defaulted mortgage held by such fund, if in the judgment of the board of directors the cost of segregation of such mortgage would be greater than the difference between its market value and its principal amount plus interest and penalty charges due. If the bank elects to so purchase the mortgage it must do so at its market value or at the sum of principal, interest and penalty charges, whichever is greater.

(9) Except in the case of collective investment funds described in paragraph (a) (2) of this section:

(i) No funds or other property shall be invested in a participation in a collective investment fund if as a result of such investment the participant would have an interest aggregating in excess of ten per cent of the then market value of the fund: *Provided*, That in applying this limitation if two or more accounts are created by the same person or persons and as much as one-half of the income or principal of each account is payable or applicable to the use of the same person or persons, such accounts shall be considered as one;

(ii) No investment for a collective investment fund shall be made in stocks, bonds or other obligations of any one person, firm or corporation if as a result of such investment the total amount invested in stocks, bonds or other obligations issued or guaranteed by such person, firm or corporation would aggregate in excess of ten percent of the then market value of the fund: *Provided*, That this limitation shall not apply to investments in direct obligations of the United States or other obligations fully guaranteed by the United States as to principal and interest;

(iii) Any bank administering a collective investment fund shall have the responsibility of maintaining in cash and readily marketable investments such part of the assets of the fund as shall be deemed to be necessary to provide adequately for the needs of participants and to prevent inequities between such participants, and if prior to any admissions to or withdrawals from a fund the bank shall determine that after effecting the admissions and withdrawals which are to be made less than 40 percent of the value of the remaining assets of the collective investment fund would be composed of cash and readily marketable investments, no admissions to or withdrawals from the fund shall be permitted as of the valuation date upon which such determination is made: *Provided*, That ratable distribution upon all participations shall not be so prohibited in any case.

(10) The reasonable expenses incurred in servicing mortgages held by a collective investment fund may be charged against the income account of the fund and paid to servicing agents, including the bank administering the fund.

(11) (i) A bank may (but shall not be required to) transfer up to five percent of the net income derived by a collective investment fund from mortgages held by such fund during any regular accounting period to a reserve account: *Provided*, That no such transfers shall be made which would cause the amount in such account to exceed one percent of the outstanding principal amount of all mortgages held in the fund. The amount of such reserve account, if established, shall be deducted from the assets of the fund in determining the fair market value of the fund for the purposes of admissions and withdrawals.

(ii) At the end of each accounting period, all interest payments which are due but unpaid with respect to mortgages in the fund shall be charged against such reserve account to the extent available and credited to income distributed



to participants. In the event of subsequent recovery of such interest payments by the fund, the reserve account shall be credited with that amount so recovered.

(iii) Notwithstanding anything herein contained to the contrary, Mortgage Investment Funds presently being operated pursuant to the provisions of section 17(d) of prior regulations of the Comptroller of the Currency or the Board of Governors of the Federal Reserve System may continue to be operated in accordance with such prior regulations for a reasonable time. However, after April 5, 1963, no such funds shall be established.

(12) A national bank administering a collective investment fund shall have the exclusive management thereof. The bank may charge a fee for the management of the collective investment fund provided that the fractional part of such fee proportionate to the interest of each participant shall not, when added to any other compensations charged by the bank to the participant, exceed the total amount of compensations which would have been charged to said participant if no assets of said participant had been invested in participations in the fund. The bank shall absorb the costs of establishing or reorganizing a collective investment fund.

(13) No bank administering a collective investment fund shall issue any certificate or other document evidencing a direct or indirect interest in such fund in any form.

(14) No mistake made in good faith and in the exercise of due care in connection with the administration of a collective investment fund shall be deemed to be a violation of this part if promptly after the discovery of the mistake the bank takes whatever action may be practicable in the circumstances to remedy the mistake.

(c) In addition to the investments permitted under paragraph (a) of this section, funds or other property received or held by a national bank as fiduciary may be invested collectively, to the extent not prohibited by local law, as follows:

(1) In shares of a mutual trust investment company, organized and operated pursuant to a statute that specifically authorizes the organization of such companies exclusively for the investment of funds held by corporate fiduciaries, commonly referred to as a "bank fiduciary fund".

(2) In a single real estate loan or a direct obligation of the United States, or an obligation fully guaranteed by the United States, if the bank owns no participation in the loan or obligation and has no interest therein except in its capacity as fiduciary.

(3) In a common trust fund maintained by the bank for the collective investment of cash balances received or held by a bank in its capacity as trustee, executor, administrator or guardian, which the bank considers to be individually too small to be invested separately to advantage, and the total investment in which on the part of any one account does not exceed \$10,000: *Provided*, That in applying this limitation if two or more accounts are created by the same person or persons and as much as one-half of the income or principal of each account is payable or applicable to the use of the same person or persons, such account shall be considered as one; and *Provided*, That no fund shall be established or operated under this subparagraph for the purpose of avoiding the provisions of paragraph (b) of this section.

(4) In any investment specifically authorized by court order or authorized by the instrument creating the fiduciary relationship: *Provided*, That such investment is not made under this paragraph for the purpose of avoiding the provisions of paragraph (b) of this section.

(5) In such other manner as shall be approved in writing by the Comptroller of the Currency.

#### § 9.19 Forms.

All forms referred to in this Regulation and all such forms as amended from time to time shall be a part of this Regulation.