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THE WHITE HOUSE

FACT SHEET

EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 (H.R. 2) (PENSION REFORM BILL)

The President has today signed into law H.R. 2, the Employee Retirement Income Security Act of 1974. H.R. 2 establishes standards governing private pension plans, including reporting, disclosure, participation, vesting, funding, and fiduciary responsibilities, and authorizes a Pension Benefit Guaranty Corporation.

BACKGROUND

The private pension system has played an increasingly important role in providing retirement income to Americans. Benefits paid out by the private pension system increased from $1.7 billion in 1960 to almost $7.4 billion in 1970. During this same period, private pension coverage increased from 21.2 million employees (36 percent of the private work force) to approximately 30 million workers (48 percent of the private work force.) Plan assest increased from $52 billion to $138 billion and are increasing at a rate of $12-$15 billion a year. It will not be long before such assets become the Nation's largest source of capital in the economy, and one which is largely unregulated.

BUDGET IMPACT

Since insurance claims for the first and future years of operation are indeterminate, it is not possible to estimate the direct budget impact of H.R. 2.

MAJOR PROVISIONS

While not requiring the establishment of pension plans, H.R. 2 would set up major new standards to govern the private pension area, with the goal of increasing the assurance that a worker will receive upon retirement the benefits he expects from a private pension plan.

New protections and guarantees for employees covered by private pension and welfare plans for their beneficiaries are provided in the Employee Retirement Income Security Act of 1974 just enacted. Specifically the bill would:

-- extend the coverage of the existing private pension system to more workers by requiring earlier participation in plans

-- strengthen the pension obligations of employers by requiring earlier vesting and more adequate funding

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-- require that plan assets be managed prudently and in the interests of plan participants

-- insure that reasonable pension obligations will be met in the event that an employer sustains unexpected economic hardship or where there is a sharp decline in a plan's assets

-- assure that plan participants are fully informed of their rights and benefits

-- increase the fairness of the tax laws relating to qualified retirement plans by providing greater equality of treatment under plans for different taxpayers.

Other basic provisions of the new law are:

Eligibility to Participate -- In general, the new law provides that:

-- a person must be eligible to participate in a pension plan after that person is 25 years old and has worked for the employer for one year; however

-- certain plans may exclude from participation a person who starts a job within 5 years of normal retirement age.

Vesting -- Once an employee has achieved vesting, that individual has a nonforfeitable right to receive benefits at retirement age, wherever he or she may be working at the time. The new law requires that pension plans provide vesting that meets one of three minimum alternative standards.

-- a 5 to 15-year graded standard, under which partial vesting would result immediately after 5 years, rising gradually to full 100 percent vesting after 15 years service

-- a 10-year/100 percent standard which would provide full and immediate vesting after 10 years of covered service

-- a "rule of 45" standard which would provide vesting based upon both an employee's age and covered service.

These new standards would be in addition to the requirements of present law that an employee be 100 percent vested upon reaching normal retirement age.

Funding -- Funding is the process by which employers contribute to pension plans in order to assure that sufficient funds will be available to pay employees their earned benefits upon retirement. While present law requires employers to fund "normal costs" (costs attributable to current service) it does not require employers to fund the total cost of pension credits for prior service. Such unfunded "past service liabilities" may result in a loss of benefits to employees if the plan should fail. The new law requires that employers fund their past service obligations over a specified period of time in accordance with mandatory formulas.

Fiduciary standards -- In general, funds set aside to provide benefits to employees must be held in trust and used only to provide benefits and pay the necessary costs of running the plan. To protect against the mismanagement of plan funds, the new law sets standards for the conduct of the "fiduciaries" who manage plan assets.

-- the bill requires fiduciaries to perform their duties solely in the interest of those covered by the plan "with the care, skill, prudence and diligence... that a prudent man... would use."

-- fiduciaries would be required to diversify plan assets to minimize the risk of large losses, except where it is clearly not prudent to do so

-- the bill would prohibit fiduciaries and parties-in- interest from engaging in a number of prohibited transactions, generally involving self-dealing with plan assets.

Reporting and Disclosure -- Protection of the interests of plan participants and their beneficiaries requires that participants be informed of plan management and of their rights and benefits. The new law strengthens the reporting and disclosure requirements of existing law by:

-- requiring that plans file an annual report with the Secretary of Labor, available for public inspection, containing detailed certified information on the financial transactions and status of the plan

-- requiring plan to furnish each participant with a summary plan description written in an easy to understand fashion

-- requiring plans to provide individuals who have terminated employment with a statement of their vested benefits in the plan.

Plan Termination Insurance -- The new law establishes a federally chartered insurance corporation within the Department of Labor, to be known as the Pension Benefit Guaranty Program. Under the basic insurance program provided by the corporation:

-- vested benefits in defined benefit plans which terminate would be insured up to a limit of 100 percent of high-5 consecutive year wages or $750 per month, whichever is less

-- costs of the program would be paid, in part, by mandatory premiums levied on plans

-- an employer would be liable for the amount of insured benefits not covered by plan assets up to 30 percent of his net worth.

This basic program will go a long way towards assuring employees that they will receive their earned pension benefits, no matter what hardships may have befallen their employer or their pension plan.

Individual Retirement Accounts -- Any individual not covered by a private or public retirement plan can establish an individual retirement account (IRA) and contribute up to $1,500 annually. Moreover, the individual retirement account may be established by the employer or by the employee's union. Contributions are tax deductible and earnings are tax-free. The amount in the individual retirement account may be set aside in a special trusteed or custodial account with a bank, savings and loan, or credit union, and includes the investment in an annuity contract, or qualified retirement bonds.

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Portability -- If an employer distributes benefits immediately to a terminated employee, the employee may transfer his benefits into an individual retirement account to be held for his retirement. Moreover, if the employee later is employed by another employer maintaining a plan he is permitted to contribute the amount in his individual retirement account into the new employer's retirement plan.

Limits on Contributions and Benefits for Self-Employed and Shareholder-Employees -- The maximum annual deduction to a plan for self-employed individual or a shareholder-employee is increased from the lesser of 10 percent or earned income to $2,500 to the lesser of 15 percent of earned income or $7,500.

Limits on Contributions and Benefits -- To be entitled to tax benefits a defined benefit pension plan (a plan which pays a specific benefit) may not pay an annual pension of more than 100 percent of salary or $75,000 per annum. Defined contribution plans, e.g. profit sharing plans, are limited to annual contributions no greater than 25 percent of salary or $25,000. The $75,000 and $25,000 figures are subject to a cost of living adjustment.

Enforcement -- The Department of Labor has principal enforcement responsibilities in the areas of reporting and disclosure and fiduciary standards. Civil penalties are authorized for violations in either area, and, in addition, criminal penalties are available for violations of the reporting and disclosure requirements. The Internal Revenue Service has principal enforcement responsibilities concerning the vesting, funding, participation standards and other tax related matters. The denial of special tax benefits under the Internal Revenue Code is the principal enforcement task. To assure that the tax treatment of retirement plans is uniform, the Service will establish an Office of Employee Plans and Exempt Organizations, headed by an Assistant Commissioner of Internal Revenue.

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