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TESTIMONY

OF

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SUN COMPANY, INC.

BEFORE

SUBCOMMITTEE ON OVERSIGHT AND SUBCOMMITTEE ON SOCIAL SECURITY

COMMITTEE ON WAYS AND MEANS

JOINT HEARING

RETIREMENT INCOME SECURITY IN THE UNITED STATES

September 6, 1985

Chairman Jones and Chairman Pickle, it is a pleasure to appear before you today representing the views of the Sun Company. Your efforts to look at public sector and private sector programs are very important. As I hope to make clear to you today, I believe that the U.S. retirement income system has been a remarkable success. But the system could nonetheless be improved if there were better coordination of our various retirement income policies, and for that reason, I commend you for your endeavors in this area.

Previous witnesses, in particular Mr. Dallas Salisbury of the Employee Benefit Research Institute (EBRI), have presented you with the relevant national data. EBRI's research on this subject is the very best that exists, and I hope you will give it your careful attention.

I would like to answer the four major questions you posed in the press release announcing this hearing, with reference to the experience at the Sun Company, where I have worked since the 1950s as Director of Special Projects, Director of Human Resources, Vice President, and Director of Compensation and Benefits.

What Is Retirement?

Retirement is the completion of an employee's tour of duty with an organization, and the time when the individual turns his or her attention to other activities.

Currently, the Sun Company has approximately 12,500 active employees and approximately 10,400 retired workers and survivors of retired workers.

I would say that our retirees, as a group, are very satisfied with the standard of living that they have in retirement, based upon their careers with the Sun Company. In July 1984, for example, one of our retirees testified before the Senate Finance Committee. John W. Kriebel, then age 77, testified how his retirement benefits allowed him to successfully overcome a year-long battle with cancer at the Sloan-Kettering Hospital in New York. And he compared the administration of his benefits at Sun with the unfavorable experiences he had with the publicly administered Medicare program. "The private sector can adminster these programs beautifully," he said. And I quote: "They do a wonderful job. And in the private sector you are eyeball to eyeball with the administrator of the program. If you have a problem you can go to them; they know who you are. You are not a number. And it has just been a wonderful experience to be with Sun and be retired." That is what our retirees think, and as I say, it's a matter of public record.

The average age of our retirees has held steady at about 60.5. About one in five does some volunteer work and about one quarter do some work for pay, although only 15 percent have regular jobs. Only 43 percent don't work and don't want to work. Money is not the prime motivator among people who work or want to work. The main motivations, we learned in a recent survey of Sun Company retirees, are the pleasure of the work itself, the feeling of making a contribution, and the enjoyment of being with others. Financial necessity or money for extras are secondary reasons for working. These findings for Sun Company retirees accord with results from a nationwide survey conducted for the National Council on Aging. As health and longevity continue to improve, it would not surprise me if more of our retirees in the future won't want to engage in some paid work after retirement.

As far as the company itself goes, Sun has evolved a basic philosophy with respect to employee benefits. It believes that benefits are part of total compensation and that in the aggregate, this compensation should be competitive in our industry and in our geographic areas. Sun believes that these benefit programs should include plans for retirement, capital accumulation, premature death, medical care, disability income, paid time-off, etc. Sun also believes that its benefit programs should encourage employees to plan and save for their own economic security. The federal government, likewise, has an important role to play in ensuring basic economic security through programs like Social Security and Medicare, and through reasonable tax incentives to stimulate additional necessary benefits.

In our benefit planning, postretirement employment is not a factor that we give consideration to, except in the very broadest terms, when we are looking at special early retirement arrangements. In other words, we plan for our employees to have adequate retirement incomes based on Social Security, the Sun Company pension plan, and their own savings for retirement.

<u>What are the major sources of retirement income today?</u>

Sun maintains a carefully designed retirement program for career employees, which is intended to meet their income replacement needs. This program is made up of two plans.

One is a defined benefit pension plan, the Sun Company, Inc. Retirement Plan, which provides fixed retirement income and serves as the primary source of retirement benefits. Our philosophy is that a retirement plan should provide a stream of income in retirement. Therefore, the Sun Company plan does not allow lump-sum distributions from its defined benefit plan.

The other plan is a defined contribution capital accumulation plan, which is called "SunCAP". This plan combines a cash or deferred arrangement 401(k) with a thrift plan feature which together provide for pre-tax employee contributions, the first 5 percent of which are matched dollar for dollar by Sun Company contributions. Upon termination or retirement, an employee's account balance is available in the form of a lump sum. Sun Company has an arangement with a major insurer, which allows employees to convert their lump sum to an annuity at a favorable interest rate.

Although Sun does not subscribe to the principle of automatic indexation, it has granted approximately 10 ad hoc increases to retiree pensions since 1960. Today we have a system called ORBIT where employees may choose to use part of their SunCAP account to purchase an annuity which will provide inflation protection. Sun matches employee contributions dollar for dollar to purchase the annuity at retirement. This provides a total of 15 annual retirement increases. Your Committee could help American industry provide some inflation protection for retirees if you would approve legislation (H.R. 3179) that is before you, sponsored by Rep. Kennelly, Chairmen Pickle, Rep. Archer, and others. H.R. 3179 would encourage the spread of this type of postretirement benefit adjustment to offset inflation. Attached to my statement is a fact sheet that more fully explains the benefits of this legislation.

Sun also provides health insurance to retirees and a modest amount of life insurance. After retirement, there is an automatic 50 percent spouse's pension provided.

The amount of money that Sun spends for its retirement benefits is substantial. In 1984, for example, for an average of 13,350 active employees, Sun paid $29.7 million in F.I.C.A. contributions. Our defined benefit pension expense was $32.8 million. The company's contributions to the defined contribution plan was $18.4 million, while employees themselves contributed an additional $50 million to the defined contribution plan. The Sun Company's annual spending for medical benefits was $36 million, of which $22 million was for active employees and $14 million for retirees. We also spend another $5 million on long-term disability and over $4 million in death benefits. Altogether, then, the Sun Company's expenditure for the combination of retirement security programs amounted to nearly $95 million. Let me emphasize that the $95 million total excludes roughly $60 million in pension payments to annuitants, excludes the health insurance contribution for active employees as well as spending for disability and death benefits, and it excludes the employees' contributions to the defined contribution capital accumulation plan.

F.I.C.A. contributions made up about 31 percent of the total, defined benefit pension expense about 34 percent, defined contribution plan contributions comprised 19 percent, and health insurance for retirees about 15 percent of the $95 million total.

How can we define "adequate" retirement income security?

As we see it, adequate retirement income is a shared responsibility of the federal government, employers, and the individuals themselves.

The Sun Company believes its career employees should be provided enough income to support a comfortable basic lifestyle and that the employees' own savings should provide the additional amenities of life. In designing our retirement benefits, Sun aims to replace 50-55 percent of preretirement income for the higher paid, and 65-75 percent for the lower paid. These targets have been set with the needs of a retired couple in mind. And we have achieved these replacement targets through a combination of defined benefit pension plan benefits integrated with Social Security. The following table illustrates precisely how we achieve those targets at various income levels -- and how much of retirement income comes from Social Security and how much comes from the Sun Company Retirement Plan.

These replacement targets do not include monies saved through the SunCAP program. The employer matching contribution for this program is designed to encourage individuals to save. And most of them do. But if an individual wants more than the target replacement rates, they have to save money for that purpose.

At Sun, we are concerned about the changing composition of our work force and of our society, and we are reviewing our retirement income plans with these

APPROXIMATE RETIREMENT BENEFITS AS A PERCENTAGE OF EARNINGS AT RETIREMENT

Earnings at Retirement	Percentage of Employee Population at Earnings Level	Percentages of Earnings at Retirement		
		Sun Company, Inc. Retirement Plan Benefit Payable at age 65	Social Security Benefit Payable at age 65	Total Retirement Income
$10,000 - $19,999	8.2%	26%	44%	70%
20,000 - 29,999	51.7	32	32	64
30,000 - 39,999	12.2	36	24	60
40,000 - 49,999	12.5	39	19	58
50,000 - 59,999	7.5	40	15	55
60,000 - 69,999	3.0	41	13	54
70,000 - 79,999	3.0	42	11	53
80,000 - 89,999	0.9	43	10	53
90,000 - 99,999	0.5	43	9	52
$100,000+	0.7	44	8	52

Notes

1. Retirement in 1984 at age 65 with 35 years of service.

2. Historical salary increases of 6%/year.

changes in mind. For one thing, we are experiencing more mobile employees, who change jobs more frequently than the traditional career employee we have attracted in the past. We are asking ourselves whether we need to provide a retirement arrangement that will permit a more rapid pension accrual for these mobile workers. We are also trying to understand what the implications of more second careers, and more two earner couples mean for the target replacement rates we have set.

The point is, your Committee is not alone in asking these important questions. Companies like Sun are analyzing changes in work habits and trying to consider the adjustments that are appropriate to accomodate those changes.

What role does federal tax policy play in retirement income security?

I think an important first step in answering this question is to understand why employers provide benefits to begin with. Many policymakers appear to be shocked by how much of an employee's total compensation is in benefits. For medical benefits alone, the bill is enormous.

Employee benefits have an important social purpose. Benefits are designed to address the basic needs that arise from aging, death, illness, disability and so forth. People also need to be able to cope with inflation after retirement, so I would add to that list of basic needs the need to accumulate capital for retirement. In other words, benefits provide economic security. Sometimes we become so enmeshed in the technical details that we lose sight of the basic purpose of benefits, which is to provide economic security. This is especially true of retirement benefits.

These programs have evolved over the years for a number of reasons. At one time or another they have been provided by enlightened management, and at other times, no doubt, companies have been pushed along by strong unions, federal legislation, socioeconomic factors, and employees' expectations. Today, the United States has an excellent system of employer-provided benefits as a result.

It is psychologically unsound to assume that human beings, if left to their own devices, would provide for themselves with logical, sound, cost-effective, integrated benefits. It is therefore very important for an employer or some central source -- it can be a union -- to provide structure and leadership, as well as economies of scale and time.

In meeting this social purpose, employers provided benefits in the context of the then-current tax code. Today each industry has evolved to a level of retirement and other benefits that meets each industry's different needs. Tax policy has had very little to do with the reasons for <u>creating</u> those benefits, but it plays a really key role in determining their shape and their future levels.

In talking about the effects of tax policy on employer provision of benefits, I would say that you have to distinguish between the short-term and the long-term impacts.

In the short-term, the main effect of tax policy is on the way plans are designed.

In the long-term, however, adverse tax legislation can affect not only the design of a pension plan but also the type of program and even the very existence of a program. In other words, the decisions made by this Committee could have very serious long-term implications for the future of American society.

Overall, the current body of tax code provisions are achieving their social goals. In the Sun Company's opinion, Congress has contributed to what is an absolutely brilliant success story-- with the private sector now complementing the Social Security and Medicare efforts by providing comprehensive retirement and other benefit programs for millions of workers, retirees and their families. These benefits are broadly distributed across people of different income levels. In the oil-related activity of our company, for example, all of our regular employees -- 100 percent -- are covered by the pension plan.

If you are reexamining these tax incentives with respect to basic tax reform, I would recommend that you view benefits in two tiers. There are the first tier of benefits, the basic benefits that are just the basic needs of humanity associated with aging, disability, illness and death. And there are some newer forms of benefits, like 401(k), which work very well in this context by promoting capital accumulation that can be used, for example, to buy inflation protection for retirees.

The second tier of benefits may be somewhat "exotic," that is, benefits that aren't absolutely necessary for the provision of economic security.

In the future, I think we shall see a return of emphasis by employers and by employees to the basic economic security benefits. If Congress is determined to change the tax incentives for employee benefits in connection with tax reform, then I don't disagree with your making changes in some of these benefits which aren't absolutely necessary.

But in the process of tax reform, don't undercut the tax incentives that support the basic core of employer-provided retirement and welfare plan benefits, which have been truly succesful. If you do cut tax incentives for those basic benefits, then tax reform will end up hurting American workers, retirees, and their families -- instead of helping them.

Sun Company's retirement and welfare programs are designed to provide financial security and independence for employees, which are long-standing national policy goals. Without the current tax incentives, Sun Company would be less inclined to develop new programs and would likely reduce existing benefits to coincide with new limitations, providing employees and retirees with a lowered level of economic security. To the extent that these tax incentives are "rolled-back" by Congress as part of tax reform, financial independence of workers and retirees would be replaced by greater dependence on the public programs. The public programs, as this Committee certainly knows, have serious long-term problems of their own.

I hope these remarks have been helpful to the Committee and would be happy to respond to any questions you may have.

COST OF LIVING ADJUSTMENTS THROUGH TAX QUALIFIED PLANS
SUMMARY OF LEGISLATIVE NEEDS

Overall Problem

Many employers' pension programs base retirement income on pay levels achieved just prior to retirement. This ensures that initial pension benefits will be adequate; however, even modest levels of inflation can quickly erode a pensioner's purchasing power after retirement. Some employers have addressed this problem by providing "ad hoc" adjustments in retirement benefits; however, this solution is costly, inefficient and inflationary.

Proposed Solution: Supplemental Retirement Benefits

Many employees accumulate funds for retirement in defined contribution plans but do not actually use those funds for retirement purposes. As an alternative to employers providing ad hoc increases, it is suggested that employers and employees jointly fund supplemental pension benefits through an employer's existing tax qualified plan or plans using employer contributions and employee accumulations in company savings type programs (technically called defined contribution plans). This permits a more planned approach to retirement income protection while encouraging employees to use defined contribution plan funds to fund retirement benefits--the purpose for which they were intended.

Legislative Solution

The Internal Revenue Code should be amended to permit inclusion of supplemental retirement benefit provisions in current tax-qualified retirement programs. Amendments should allow:

- Employer/employee cost sharing in providing supplemental retirement benefits.
- An employer to condition its contribution for supplemental retirement benefits on the employee's agreement to share a portion of the cost.
- Assurance that the employer's contribution to provide supplemental benefits will not result in taxable income to the employee until benefits are received.
- An employer to fund its contribution for supplemental retirement benefits over the employee's career.
- Benefits to be subject to the joint and survivor protections of current law.

Tax Reform

The Treasury's recent tax reform proposals and most other similar approaches implicitly recognize the need to encourage defined benefit plans. The supplemental retirement income proposals described above are designed to strengthen retirement plans which provide lifetime income (technically called defined benefit plans) by addressing the impact of inflation on fixed income provided under this type of plan at nominal revenue costs.

QUESTIONS AND ANSWERS REGARDING SUPPLEMENTAL RETIREMENT BENEFITS

QUESTION:

Why is a Supplemental Retirement Benefit Program ("SRB") important?

ANSWER:

Inflation erodes benefits accrued by retirees during their careers. A supplemental retirement benefit is intended to preserve the relative buying power of pension payments. At the same time, an employee has no incentive to devote a portion of his/her account balance under employer sponsored savings plans towards retirement income. An SRB provides inflation protection as well as an incentive for a participant in a tax qualified savings plan to dedicate a portion of his/her account balance towards retirement.

QUESTION:

Why don't employers simply increase benefits payable under their defined benefit pension plan?

ANSWER:

Most companies' defined benefit plans (i.e., a plan which promises a specific benefit at retirement, such as $100 per month) calculate the benefits payable to an employee at retirement as a percentage of final or final average earnings. Provided an employer's salaries keep pace with inflation, the initial pension is generally adequate to meet a retiree's needs. However, once the pension is payable, its purchasing power can be rapidly eroded by even a modest rate of inflation. To simply raise the benefits payable at retirement in anticipation of cost-of-living increases or to index defined benefit pensions to inflation is itself inflationary and too expensive for most employers.

QUESTION:

How have employers dealt with inflation on fixed retirement income in the past?

ANSWER:

Most large employers coped with this problem by increasing the pensions payable to retirees (as opposed to those who were entitled to vested terminated benefits) through "ad hoc" adjustments, payable out of general corporate assets. Traditionally, these "ad hoc" payments had to be renewed on a year-to-year basis and were increasingly expensive and administratively burdensome. From a retiree's viewpoint, ad hoc payments were also unsatisfactory. Given the contingent nature of the payment, the retiree could not rely on either the increments granted to his pension in previous years or the employer's decision to increase his or her pension in response to current inflation.

QUESTION:

In spite of these drawbacks, why can't employers continue to increase basic pensions using ad hoc payments?

ANSWER:

Current law requires essentially that these gratuitous ad hoc payments be treated as retirement payments which must be funded, prior to retirement, through a tax-qualified retirement plan which not be forfeited if an employee fails to make a required contribution at retirement. In 1980 Congress amended ERISA to allow for nonretirement supplemental payments. However, neither the statute nor the supplemental payment regulations issued by the Department of Labor permit a sustained annuity purchase program comparable to the SRB proposal.

QUESTION:

How does an SRB program work?

ANSWER:

A participant in both a defined benefit pension plan and a defined contribution plan (i.e., a plan which provides a retirement benefit equal to amounts contributed to a participant's account, plus earnings) maintained by the same employer will be allowed to elect to dedicate a portion of his/her account balance in the defined contribution plan (or from other sources, including personal savings) toward the purchase of an SRB annuity. A participant with only a vested pension in a defined benefit plan may elect to purchase SRB protection by reducing his/her benefit. The annuity will provide an escalating percentage increase in the pension payable under his employer's defined benefit pension plan. The cost of the annuity will be shared by the employer. Under the proposed legislation, the employer's contribution must be accrued and funded during the employee's career, but need not paid until the employee makes an election to purchase the annuity at retirement. If the employee does not elect to purchase the SRB, the company's contribution may be forfeited under the proposed legislation.

QUESTION:

What are the advantages to an employee of providing an SRB through a tax-qualified retirement plan?

ANSWER:

Employer annuities purchased outside a tax-qualified plan on behalf of an employee result in immediate taxation, to the employee, equal to the cash value of the annuity. In contrast, an employer may contribute towards the purchase of annuities on behalf of a participant through a tax-qualified plan without causing the participant to recognize tax on the distribution until the employee begins to receive payments under the annuity, and then only to the extent employer-derived amounts are actually received in a given tax year. At the same time, the employer contribution at retirement under the SRB programs provides the employee with an incentive to devote account balances built up during an employee's career for retirement income. Finally, the use of a tax-qualified plan as a vehicle to provide supplemental retirement benefits assures employees that the benefits will be distributed equitably and that past and current increases in pension benefits will be continued.

QUESTION:

Why can't a supplemental retirement benefit be provided under current law?

ANSWER:

The overall limitations on amounts allocated to a participant's account in a defined contribution plan is limited to 25% of compensation, up to a maximum dollar amount. Since the cost of purchasing an SRB annuity is high (ranging from approximately 70% to 120% of final pay), employer contributions to fund an SRB will in most cases exceed the current applicable limits, if the plan were to be provided under a defined contribution plan. At the same time, the provision of employer contributions at retirement to purchase an SRB benefit which have been accrued under a defined benefit plan may not ordinarily be forfeited if an employee fails to devote his/her account balance to a specific plan option, such as an SRB benefit.

QUESTION:

Who is eligible to receive the benefit?

ANSWER:

Any employee who terminates service with a vested pension under a defined benefit must be entitled to purchase the SRB benefit, no earlier than the time he/she separates from service.

QUESTION:

How is the contribution to the SRB funded?

ANSWER:

During employment, the employer contribution must be funded, subject to certain limitations, through a defined benefit plan. The employee may fund his/her portion of the annuity through the companies' defined benefit plan (by electing to reduce his/her pension) or an account balance in a defined contribution plan maintained by the same employer or from other personal savings from outside the plan and contributed at the time of retirement. The employer portion of the SRB could also be provided through a defined benefit plan in conjunction with an insured benefit.

QUESTION:

How is the employee who purchased an SRB annuity protected?

ANSWER:

Since the employer's portion of the contribution is funded through a defined benefit plan, the benefit is subject to existing funding requirements and guaranteed by PBGC, employees who participate in such a program will be fully protected. At the same time, even if the benefit is discontinued, the employee will still be entitled to the pro rata portion of the benefit accrued during the time the benefit was in effect.

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