Misuse of Public Pension Assets: White Collar Crimes and Other Offenses

Ridgeley A. Scott*

Introduction

Shortly after beginning his first term in office, President Eisenhower read several newspaper stories about theft of pension assets. He found there was no federal law protecting the interests of workers, and began a campaign for legislation.[1] The Welfare and Pension Plan Disclosure Act (Disclosure Act)[2] became law in 1958, and was replaced in 1974 by the Employee Retirement Income Security Act (ERISA).[3]

Notice was the main feature of the Disclosure Act. Workers who were aware of problems could sue to prevent further abuse.[4] The laissez-faire approach did not work.

ERISA is a much more ambitious arrangement.[5] ERISA contains general standards for fiduciary conduct and rules limiting or prohibiting specified practices.[6] Those with standing to sue include beneficiaries, employers, trustees, and the Labor Department.[7]

Government plans were exempted from ERISA.[8] Congress did not want to be liable for the uncertain cost of compliance. Arrangements like Social Security and the Federal Civil Service plan complied with the general spirit of the statute. State and local plans were given the

---

* Professor of Law, Widener University. J.D., 1967, Memphis State University; L.L.M. in Taxation, 1978, New York University.

1. *E.g.*, President's Special Message to Congress on Labor-Management Relations, 1954 Pub. Papers 40 (Jan. 11, 1954).

2. Welfare and Pension Plans Disclosure Act, Pub. L. No. 85-836, 72 Stat. 997 (repealed 1974).

3. Employee Retirement Income Security Act, 29 U.S.C. §§ 1001-1461 (1988).

4. *See, e.g.,* International Bhd. of Teamsters, Chauffeurs, Warehousemen & Helpers v. Daniel, 439 U.S. 551 (1979); Moyer v. Kirkpatrick, 265 F. Supp. 348 (E.D. Pa. 1967), *aff'd*, 387 F.2d 955 (3d Cir. 1968); S. Rep. No. 127, 93d Cong., 1st Sess. 4 (1973), *reprinted in* 1974-3 (Supp.) C.B. 4; Seth E. Herbert, *Investment Regulation and Conflicts of Interest in Employer-Managed Pension Plans*, 17 B.C. Indus. & Com. L. Rev. 127, 128-29, 149-51 (1976); William J. Isaacson, *Employee Welfare and Pension Plans: Regulation and Protection of Employee Rights*, 59 Colum. L. Rev. 96, 121 (1959).

5. Herbert, *supra* note 4, at 129.

6. 29 U.S.C. §§ 1104(a), 1106(a)(1)(B) (1988).

7. *Id.* § 1132(a).

8. *Id.* § 1003(b)(1).

same treatment for similar reasons. Committees were directed to deliver studies on the cost of compliance by the end of 1976.[9]

Public Employee Retirement Income Security Act (PERISA) proposals were introduced and hearings were held in every year from 1978 through 1984. The proposed bills would have subjected state and local plans to various regulations, including express fiduciary standards. Horrified by the prospect of minimal requirements and the possibility that additional rules might be added later, state and local governments mounted an intense lobbying effort. A parade of witnesses opposed each bill on the ground of increased costs.[10] None of the bills passed either house of Congress.[11] No bills were introduced after 1984.[12]

The cost argument is suspect. The principal cost for pension plans subject to ERISA relates to compliance with a number of antidiscrimination rules.[13] Although opponents complained about costs at great length during ERISA hearings, private plans satisfying ERISA requirements have grown at a steady, substantial rate since ERISA's enactment. Because the PERISA requirements are minimal compared with those of ERISA, it seems clear that there is little or no merit to the cost argument under PERISA. Opponents argued that the cost of compliance was too high because there was no other apparent way to avoid regulation.[14]

Failure to enact PERISA leaves government plans in the same situation private plans were in before enactment of the Disclosure Act in 1958. Executive and legislative officials frequently seek to avoid pension obligations as a means of easing budget problems.[15]

Several general rules are available to deal with the misuse of pension assets. Relief is also available under laws governing breach of employment contracts, including failure to comply with a promise of deferred compensation. Both current and former employees have a cause of action if a government fails to make scheduled contributions

---

9. H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 360-61 (1974), *reprinted in* 1974-3 C.B. 521-22.

10. *Public Employee Pension Benefit Plan: Hearings Before the Ways & Means Comm.*, 98th Cong., 1st Sess. (1983); H.R. Rep. No. 1138, 98th Cong., 2d Sess. (1984); H.R. Doc. No. 6525, 96th Cong., 1st Sess. (1980); H.R. Doc No. 14138, 95th Cong., 2d Sess. (1978).

11. *See supra* note 10.

12. *Id.*

13. *Id.*

14. *See, e.g.*, *Hearings and Markups on H.R. 2465 and H.R. 6536 Before the Subcomm. on Fiscal & Gov't Affairs Comm.*, 95th Cong., 1st Sess. 7 (1977) (statement of former Rep. Thomas M. Rees).

15. *Id.*

to a pension plan or uses employee contributions for an unauthorized purpose.[16]

Government pension plans are trusts and those with discretion to handle trust affairs are trustees. Trustees of pension plans have three categories of duties: (1) timely collection of employer and employee contributions in full from the government, (2) proper investment of plan assets, and (3) limiting distributions to those approved by the plan. The trustees have a duty to see that funds are collected properly. If the government proposes elimination, reduction, or postponement of contributions due to the plan, and negotiation does not produce timely payment in full, the trustees have a duty to sue to collect.[17] Although a lawsuit may be very disagreeable to those trustees who are friendly with or owe political favors to executive or legislative officials, it is their legal duty to bring suit under these circumstances.

Raiding pension plan assets is another method of relieving budget pressures. Although a trustee's acquiescence in such conduct may preserve friendships and political alliances, civil liability and criminal penalties may be imposed when a trustee facilitates or permits an improper removal of assets.

Trustees also have a duty to obtain reasonable returns from prudent investments.[18] This duty is often disregarded by trustees who allow governments that are unable to borrow from other lenders for a reasonable rate of interest to borrow from government pension plans. Loans of this type are improper under the prudent investor rule, because the amount of interest paid on tax-exempt bonds and similar securities is inadequate under the reasonable return requirement.[19]

Although Congress initially requested a cost study of federal plans, the issue was never addressed. Hence one is forced to conclude that Congress did not really want information about operations like Social Security.[20] While one might infer that there were no problems, it is

---

16. *E.g.*, Aikens v. Alexander, 397 N.E.2d 319 (Ind. Ct. App. 1979); *see also* Board of Trustees of the Employees' Retirement Sys. v. Mayor of Baltimore, 562 A.2d 720, 727-29 (Md. 1989); Dadisman v. Moore, 384 S.E.2d 816, 826-28 (W. Va. 1988).

17. *Board of Trustees*, 562 A.2d at 734-37; *See* RESTATEMENT (SECOND) OF TRUSTS § 170(1) (1959); GEORGE G. BOGERT & GEORGE T. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 541 (rev. 2d ed. 1978); AUSTIN W. SCOTT & WILLIAM F. FRATCHER, THE LAW OF TRUSTS § 187 (4th ed. 1988).

18. *See, e.g.*, Dadisman v. Moore, 384 S.E.2d 816, 829-32 (W. Va. 1988).

19. Wilkes v. Teachers' Retirement Sys., 447 F. Supp. 1248, 1254-55 (S.D.N.Y. 1978), *aff'd*, 595 F.2d 1210 (2d Cir. 1979); *Hearings and Markups on H.R. 2465 and H.R. 6536 Before the Subcomm. on Fiscal and Gov't Affairs, 95th Cong.*, 1st Sess. 47-48 (1977) (statement of Roy O. Shotland, Georgetown University law professor).

20. *Compare* H.R. CONF. REP. No. 1280, 93rd Cong., 2d Sess. 360-61 (1979), *reprinted in* 1974-3 C.B. 521-22, *with* PENSION TASK FORCE, 95TH CONG., 2D SESS., REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS (Comm. Print 1978).

much more likely that Congress did not want to absorb the cost of requiring compliance with the new rules and did not want to compile evidence that could be used as the basis for a reform campaign.

The cost of complying with express fiduciary standards is clearly outweighed by its potential benefits. Consider the losses suffered by Social Security due to the wrongful actions or omissions of its trustees. Secretary of the Treasury Henry Morgenthau, Jr., was the managing trustee when he used an incorrect rate of interest to make more money available for other government programs.[21] The discrepancy cost Social Security several billion dollars of interest income between 1939 and 1960.[22]

Public discussion of the problem of protecting Social Security has not been satisfactory. Trustees and advisory councils did not face up to the issue before it was raised in the 1949 Ways and Means Committee report.[23] Although the Ways and Means Committee did discuss the problem in general terms, there was no mention of the cause of the problem and no recommendation for change.[24] These Finance and Conference Committees wanted to bury the topic, so it was omitted from both reports.

Reports during the early and mid-1950s did not address the Social Security problem. Finally, the 1959 Advisory Council recommended that Social Security receive the average rate of interest of all federal obligations,[25] and Congress agreed in 1960.[26] Since the 1960 action caused Social Security to start receiving the rate of interest it had been entitled to since 1939, one question is why did this action take twenty-one years? Another issue is why the government was not sued for several billion dollars of unpaid interest?

The Social Security Administration prepared estimates of future events based on actuarial computations. In every year from its inception through 1957, Social Security had income in excess of expenses. After a loss in 1958, changes were made promptly to eliminate the problem. Over the next twenty-four years, a series of changes in taxation and

---

21. *See* S. Rep. No. 1856, 86th Cong., 2d Sess. 28-9 (1960), *reprinted in* 1960 U.S.C.C.A.N. 3636-37.

22. S. Rep. No. 1856, 86th Cong., 2d Sess. 28-29 (1960), *reprinted in* 1960 U.S.C.C.A.N. 3636-37, 3641-42; Advisory Council Report, H.R. Doc. No. 181, 86th Cong., 2d Sess. 72 (1959).

23. *Id.*

24. S. Rep. No. 1699, 81st Cong., 2d Sess. (1950); H.R. Conf. Rep. No. 2771, 81st Cong., 2d Sess. (1950); H.R. Rep. No. 1300, 81st Cong., 2d Sess. 33, 37 (1949), *all reprinted in* 116 U.S. Revenue Acts 1909-50 (B. Reams ed. 1950).

25. Advisory Council Report, H.R. Doc. No. 181, 86th Cong., 1st Sess. 71 (1959).

26. S. Rep. No. 1856, 86th Cong., 2d Sess. 28-29 (1960), *reprinted in* 1960 U.S.C.C.A.N. 3636-37.

benefits were designed, in part, to eliminate recurring losses. Although there were some ups, Social Security lost all of its reserves between 1958 and 1983.[27]

Several Advisory Council reports endorsed the methodology used by the Social Security actuaries, and one report even praised their professional competency.[28] Trustees' reports were similar to those of the Advisory Council's.[29] Since the trustees have a statutory duty to report to Congress whenever there is a problem with fund reserves, one can only speculate why the trustees did not obtain an independent second opinion on the Social Security computations. The trustees are personally liable for losses attributable to breach of their fiduciary duty.[30] Therefore, they should have been sued for failure to properly evaluate Social Security's actuarial estimates.

Burned by the insolvency of the Social Security system in 1983, Congress enacted tax rates that produced extra revenue. A precipitous increase in reserves led to charges in 1989 that Congress was using loans from the Social Security trust fund to conceal the true size of the federal deficit. In 1991, Congress refused to enact more reasonable tax rates by a lopsided vote.[31]

Because experience under the Disclosure Act established that people are unlikely to seek redress for wrongful acts,[32] there clearly is a need for a PERISA enforcement provision applicable to all government plans as well as an agency responsible for enforcement. Enforcement could be placed in the hands of an existing department that has a substantial interest in pension matters and is relatively unlikely to bow to political pressure. Labor has not shown much interest in ERISA enforcement problems. The Internal Revenue Service (IRS), which is relatively non-political and has put substantial effort into ERISA enforcement, would be a wiser choice.

We should all keep a particularly watchful eye on regulators of federal pension plans. Representative interest groups such as the American Association of Retired Persons (AARP) and labor unions—as well as private individuals—should have access to an established procedure

---

27. H.R. Rep. No. 25, 98th Cong., 1st Sess. 1-2 (1983), *reprinted in* 1983 U.S.C.C.A.N. 219-20; S. Rep. No. 2388, 85th Cong., 2d Sess. 2-3 (1958), *reprinted in* 1958 U.S.C.C.A.N. 4219-20.

28. *E.g.*, Advisory Council Report, H.R. Doc. No. 75, 94th Cong., 1st Sess. 45-51 (1975).

29. Bd. of Trustees, 37th Annual Report, H.R. Doc. No. 150, 95th Cong. 1st Sess. 41-45, 257-63 (1977).

30. *See supra* note 18 and accompanying text.

31. Jeffrey Birnbaum, *Senate Rejects Payroll Tax Cut by Big Margin*, Wall St. J., April 25, 1991, at A2.

32. *See* Herbert, *supra* note 4.

for registering complaints. If this does not produce a satisfactory result, they should have a right to sue.[33] When successful, they should be entitled to recover attorney fees and other legal expenses, and the court should have discretion to award punitive damages against the regulators.

This Article will examine the misuse of assets belonging to federal, state, and local pension plans and the remedies presently available. Since there is an obvious need for express rules and aggressive enforcement, this Article suggests the steps necessary to obtain them. Standards for state and local plans will probably be enacted if representative groups do a good job of lobbying their congressional delegations. Resistance to standards for federal plans makes enactment more uncertain.

I. State and Local Plans

Statutes creating pension funds for government employees typically call for contributions based on quantities of covered employment. Each time a person performs a quantity of covered work, the government must make a fixed contribution to the fund. Many statutes also require additional contributions to sustain the actuarial soundness of the fund. Because both types of payments have been promised as additional compensation for services, timely payment in full is an obligation of the government.[34]

Consider the West Virginia pension plan, enacted in 1961, which established three sources of revenue. Employees contributed a fixed amount of money per unit of covered service, and the employer agency matched those contributions. Any additional amount necessary to maintain actuarial soundness was appropriated by the state from general funds.[35]

The amount necessary to maintain actuarial soundness was computed by the trustees of the program and certified to the governor, who then included the necessary amount in his appropriation bill. The system operated according to plan through fiscal year 1984-85. For that fiscal year, the trustees certified that the fund needed $12 million. The governor requested and the legislature appropriated $12.56 million to the fund.[36]

---

33. *Cf.* 29 U.S.C. § 1132(a) (1988 and Supp. II 1990).

34. *E.g.*, Dadisman v. Moore, 384 S.E.2d 816, 821, 826-28 (W. Va. 1989); *In re* State Employee's Pension Plan, 364 A.2d 1228, 1234-35 (Del. 1976); *see generally* Rubin G. Cohn, *Public Employee Retirement Plans—The Nature of the Employees' Rights*, 1968 U. Ill. L. F. 32; Note, *Contractual Aspects of Pension Plan Modification*, 56 Colum. L. Rev. 251 (1956); Note, *Public Employee Pensions in Times of Distress*, 90 Harv. L. Rev. 992, 998-1005 (1977).

35. W. Va. Code §§ 5-10-1, 5-10-13, 5-10-19, 5-10-22, 5-10-29(a)-(b), 5-10-31, 5-10-32 (1987); Dadisman v. Moore, 384 S.E.2d 816 (W. Va. 1989).

36. *Dadisman*, 384 S.E.2d at 821-22.

Contributions from general funds deteriorated after the 1984-85 fiscal year, as illustrated by the following chart:

Year	Trustees	Governor	Appropriated from General Funds	Reverted to General Funds	Received by Plan
1985-86	13,800,000	12,561,966	12,561,966	12,561,966	-0-
1986-87	16,203,000	12,561,966	-0-*	-0-	-0-*
1987-88	13,639,555	-0-	7,544,667	7,544,667	-0-
1988-89	14,250,000	-0-	-0-	-0-	-0-

* Money from certain special funds was to be paid to the plan.[37]

The West Virginia legislature gained confidence after the 1985-86 fiscal year and began taking funds from employer agencies and employees. The 1985-86 budget legislation directed the state highway department to use its contribution money to pay for paving roads. The 1988-89 budget legislation was even more ambitious, putting all contributions from all employer agencies into the general fund and paying part of the health insurance premiums for retirees from employee contributions to the pension plan.[38]

One angry West Virginia retiree sued the governor, legislature, trustees, and various other officials, alleging that the pension trust was not properly funded and was actuarially unsound. Most of the defendants' answers were dilatory, and the plaintiff was upheld on all counts. West Virginia state law had established contractually based property rights in all pension participants who earned contributions from their employers.[39] Hence, the employer contributions wrongfully withheld or diverted were a public debt.[40]

As a substitute for having health insurance premiums for retirees paid from the budgets of the former employer agencies, the legislature provided that retirees' premiums could be paid from pension contri-

---

37. *Id.* at 822-23. *Cf.* Weaver v. Evans, 495 P.2d 639, 641-48 (Wash. 1972).

38. *Dadisman*, 384 S.E.2d at 823.

39. *Id.* at 820, 826-29.

40. *Id.* at 832-33; *see also* United States Trust Co. v. New Jersey, 431 U.S. 1 (1977); Valdes v. Corey, 189 Cal. Rptr. 212 (3d Dist. Ct. App. 1983); Dombrowski v. City of Philadelphia, 245 A.2d 238, 244-51 (Pa. 1968); Weaver v. Evans, 495 P.2d 639, 648-50 (Wash 1972).

butions made by employees. This was another violation of the retirement contracts and created another public debt.[41]

Any violation of the funding requirements should support a successful suit. Lowering pension costs was part of the plan to eliminate the 1990 New York budget crisis. Realizing that state pension contributions could not be simply eliminated or modified, the legislature altered the funding formula to reduce the state's 1991 pension fund contribution by approximately $800 million. The change was improper, because the pension plan provided that only the controller could make formula alterations.[42]

States may impair their contractual obligations under limited circumstances. An essential attribute of sovereign power is the ability to alter contract terms. However, when a change is substantial, there should be a careful examination of the nature and purpose of the legislation. One case involved California's refusal to transfer almost $187 million to the state pension fund in an effort to balance the state budget. Loss of $187 million plus long-term investment earnings was substantial, and there was no corresponding benefit to the pension fund. Hence, the impairment was illegal.[43]

Another way to avoid or evade an obligation is to follow the practices of Charles Ponzi.[44] Mr. Ponzi borrowed from many people by telling an amazing story and promising a fabulous rate of interest. Funds from more recent loans were used by Ponzi to cover payments on older loans as they came due. The scheme unraveled when Ponzi could pay only a few cents on the dollar as the number of his loans grew to an unmanageable size. By comparison, some governments provide little or no current funding for pension promises which are so generous that taxes could not be increased enough to pay them.[45]

---

41. *Dadisman*, 384 S.E.2d at 829-33; State Teacher's Retirement Bd. v. Giessel, 106 N.W.2d 301, 305 (Wis. 1960).

42. McDermott v. Regan, 587 N.Y.S.2d 532 (N.Y. Sup. Ct. 1992); Barbara Franklin, *Pension Fund Reform*, N.Y.L.J., May 17, 1990, at 5; *Lawmakers Tap Public Pension Funds for $1.2 Billion to Ease Budget Crunch*, BNA PENSION REP., June 4, 1990, at 981; *New York Loses Round on Pension Contributions*, WALL ST. J., Aug. 11, 1992, at A11; Sam Verhovek, *States Are Finding Pension Funds Can Be a Bonanza Hard to Resist*, N.Y. TIMES, April 22, 1990, at § 4 at 8.

43. Valdes v. Corey, 189 Cal. Rptr. 212, 224-26 (3d Dist. Cal. Ct. App. 1983). *See generally* Allied Structural Steel Co. v. Spannaus, 438 U.S. 234 (1978); United States Trust Co. v. New Jersey, 431 U.S. 1, 26-37 (1977).

44. DONALD H. DUNN, PONZI!: THE BOSTON SWINDLER (1975).

45. Cunningham v. Brown, 265 U.S. 1, 7-9 (1924); *Hearings & Markups on H.R. 2465 and H.R. 6536 Before the Fiscal & Gov't Affairs Comm.*, 95th Cong., 1st Sess. 6 (1977) (statement of former Rep. Thomas M. Rees); H.R. REP. No. 779, 93d Cong., 2d Sess. 163 (1974). *See generally* DUNN, *supra* note 44.

The main difference between the fraudulent schemes is that the legislators probably will not be indicted.

A trust can be defined as a holding of title to property for the purpose of conserving and protecting it for other persons.[46] An express trust usually involves a formal writing. However, if there is no writing, or the writing does not create an express trust, a trust may be inferred or may result from the circumstances of the particular case.[47] Even if legislation creating a pension fund carefully avoided trust language, the pension fund would still be treated as a trust.

When a contribution is received by a plan, it becomes the property of the trust. Legal title to trust assets is held by the trust, while the beneficiaries hold equitable title. Use of trust property is generally limited to the express purposes set forth in the trust instrument. If the statute creating the pension fund limits it to providing pension benefits for a specified class of people, it is improper to use the assets for any other purpose. Therefore, payment of pension benefits to ineligible persons or payment of health insurance premiums is illegal.[48]

Removing assets for any nonqualified purpose is improper. Public officials who are desperate for money will take anything they think they can get away with. During the 1991 California budget crisis, the enormous state pension plan reserves received great attention. The only question on the legislators' minds seemed to be how to obtain part of the pension fund reserves.[49] There was no apparent concern about the legality of taking property belonging to others. The main difference between robbing a bank at gun point and a legislative raid on a pension fund is that the raid is more likely to have a substantial effect on the lives of a large number of widows and orphans.

There may be different levels of legislative raids. Some states, including West Virginia, seized pension fund assets without any obligation to repay.[50] The California legislative action was not quite as outrageous. In exchange for $1.6 billion, the state offered future benefit increases of equal value. This transaction would have constituted a loan, if there had been an enforceable promise. On the other hand,

---

46. Treas. Reg. § 301.7701-4(a) (1986); *see also* Social Security Act of 1935 § 201(a), 49 Stat. 622 (1935); W. Va. Code § 5-10-3 (1987).

47. Bogert & Bogert, *supra* note 17, § 1; Scott & Fratcher, *supra* note 17, § 462.1.

48. Bogert & Bogert, *supra* note 17, § 1; Scott & Fratcher, *supra* note 17, § 462.1; *see also In re* State Employee's Pension Plan, 364 A.2d 1228, 1236-37 (Del. 1976); Dadisman v. Moore, 384 S.E.2d 816, 825-26, 830 (W. Va. 1989).

49. *Budget Plans Will Hit PERS*, Sacramento Bee, June 25, 1991, at F1; *California, Pension Fund to Aid State, Hoping to Stall Governor's Control Bid*, Wall St. J., June 18, 1991, at A3; *U.S. Probe of Wilson's Pension Fight*, S.F. Chron., June 20, 1991, at A1.

50. Dadisman v. Moore, 384 S.E.2d 816 (W. Va. 1989).

if the offer was a suggestion that legislation[51] would be enacted at a subsequent time, there is no apparent way to distinguish the transactions from a legislative raid.

The payment of interest to pension plans is another important factor. New York required insurance companies to contribute to a reserve fund, and the state promptly began borrowing from the fund without promising to pay interest. Two lower courts found the action of the state to be legal.[52] However, the Court of Appeals held the practice illegal.[53] Because it was improper for the state to borrow trust assets without promising to pay adequate interest, the state was ordered to pay interest.[54]

Trust assets must be exclusively devoted to approved purposes, which are frequently limited to providing pension benefits. It is a breach of trust for a trustee to pay an unqualified benefit or person. Paying health insurance premiums or pension benefits to unqualified people are examples of improper actions by trustees. It is also a breach of trust for the trustee to foster or allow withdrawals from the pension fund by a legislative body for unapproved purposes, such as dealing with state budget problems.[55]

Trustees are required to resist political pressure. When West Virginia withdrew money to pay health insurance premiums, the trustees were cooperative. The court described their actions in language that makes one think the trustees were co-conspirators in a crime.[56] When Governor Wilson sought to withdraw $1.6 billion in exchange for future benefits of equal value, the trustees initially refused. Threats to take control of the pension board led the trustees to agree to the transfer.[57] There is no apparent justification for the action of the California trustees.

Investment policy and practice are additional duties of trustees. Assets may be placed in many different types of investments. One limitation on private plans is the fiduciary standard of ERISA. Under ERISA, fiduciaries must: (1) diversify investments to reduce the risk of large losses, (2) satisfy the prudent investor rule, and (3) act solely

---

51. *Assembly Passes Big Tax Package*, S.F. CHRON., June 29, 1991, at A1; *California Budget Talks Continue on Accord to Close Huge Deficit*, WALL ST. J., July 1, 1991, at A10; *Pension Legislation Approved*, L.A. TIMES, June 25, 1991, at A1.

52. *E.g.*, Alliance of Am. Ins. v. Chu, 551 N.Y.S.2d 979 (App. Div. 1990).

53. Alliance of Am. Ins. v. Chu, 571 N.E.2d 672, 681 (N.Y. 1991).

54. *Id.*

55. *In re* State Employees' Pension Plan, 364 A.2d 1228, 1235-36 (Del. 1976); Dadisman v. Moore, 384 S.E.2d 384, 829-31 (W. Va. 1989).

56. *Dadisman*, 384 S.E.2d at 826.

57. *California Pension Fund to Aid State, Hoping to Stall Governor's Control Bid*, WALL ST. J., June 18, 1991, at A3; U.S. Probe of Wilson's Pension Fight, S.F. CHRON., June 20, 1991, at A1.

in the interest of the participants and beneficiaries. Because state and local government plans are exempt from ERISA,[58] their investment practices are governed by the law of trusts.

ERISA requirements are similar to those of the law of trusts. Diversification has always been required at some point. Fiduciaries are required to exercise a reasonable amount of care and judgment. Leading textbooks and some organized groups, such as the American Law Institute, have spent a considerable amount of time evaluating exactly what is required or permitted by those rules.[59]

The duty of loyalty requires trustees to act solely in the interest of the beneficiaries.[60] Therefore, the fiduciary cannot directly or indirectly profit from his or her position. Leading textbooks extensively examine various types of improper conduct.[61] The duty of loyalty is not limited to prohibiting monetary gain from the trustee position. Even where there is no potential for improper profit, several authorities hold that pension trustees must act solely in the interest of the beneficiaries.[62] Expectations and results are frequently quite different.[63]

Consider the approach of the Kansas trustees. In an effort to boost the economy, the trustees instituted local investment programs in 1973. By the mid-1980s, about $200 million, or ten percent of fund was invested in Kansas real estate, and another ten percent was invested in Kansas companies. The trustees made those investments despite not having any in-house experts on those types of investments.[64]

The standard for business loans was conservative. Borrowers had to be "relatively substantial, seasoned, and in sound financial condition" in order to obtain a loan.[65] Pressure from Governor Carlin led to the easing of the loan restrictions in 1985. Loans were thereafter

---

58. 29 U.S.C. §§ 1104(a), 1003(b)(1), 1002(32) (1992). *See generally* Note, *Fiduciary Standards and the Prudent Man Rule Under the Employment Retirement Income Security Act of 1974*, 88 HARV. L. REV. 960 (1975).

59. BOGERT & BOGERT, *supra* note 17, §§ 612-13, 671, 706; SCOTT & FRATCHER, *supra* note 17, §§ 174-174.1, 228-228.1, 230.3; *see also* RESTATEMENT (THIRD) OF TRUSTS §§ 227-29 (1992).

60. BOGERT & BOGERT, *supra* note 17, §§ 543-543V; SCOTT & FRATCHER, *supra* note 17, §§ 170-170.25.

61. BOGERT & BOGERT, *supra* note 17, §§ 543-543V; SCOTT & FRATCHER, *supra* note 17, §§ 170-170.25.

62. BOGERT & BOGERT, *supra* note 17, §§ 543-543V; SCOTT & FRATCHER, *supra* note 17, §§ 170-170.25.

63. BOGERT & BOGERT, *supra* note 17, §§ 543-543V; SCOTT & FRATCHER, *supra* note 17, §§ 170-170.25.

64. *Picking Losers, Back-Yard Investing Causes Losses, Rocks Kansas Pension Plan, But Idea Still Has Appeal*, WALL ST. J., Aug. 21, 1991, at A1 [hereinafter *Picking Losers*].

65. *Id.*

made to new and expanding Kansas businesses unable to obtain credit elsewhere. Similar investments were made outside Kansas in an effort to entice companies to move operations into the state. Money was lent to ventures which included a steel mill, a savings and loan institution, a video store chain, a high technology company and a food distributor.[66]

A newspaper article entitled "Picking Losers" was published. During a legislative investigation, Ronald Peyton, president of Callan Associates, the chief investment adviser to the fund, stated that "the . . . underlying theme at the time was rah-rah, gung-ho, we're going to help Kansas."[67] When asked why he did not do more to curb risky investments, Mr. Peyton replied that when "the locomotive is coming down the track, you don't throw yourself in front of the train."[68] In another newspaper article entitled "The Land of Oz,"[69] the chairman of the legislative investigation stated that the "thing that boggles the mind is the extent to which there was failure after failure after failure of the system."[70]

The courts will be busy for years with claims of civil and criminal mismanagement of the Kansas pension fund. Already, one criminal complaint alleged that a defendant committed seven counts of securities fraud during placement of a loan. More proceedings are in the works.[71] The trustees have hired a team of investigators and lawyers.[72] Suit has been filed against an investment firm and more lawsuits will likely follow.[73] Apparently, there will be many claims against professionals, such as lawyers and bankers.[74]

Some of the problems in the Kansas plan involved more than mere mismanagement. The biggest single loss was $65 million, which resulted from the collapse of Home Savings Association. Loans to Home Savings Association were made at the urging of Michael Russell, who was appointed as Chairman of the Board of Trustees by Governor Carlin. Chairman Russell subsequently received a $40 million business loan from Frank Morgan, who controlled Home Savings. Russell and Morgan

---

66. *Id.*

67. *Id.*

68. *Id.*

69. *Land of Oz: Kansas Pension Scandal Like Bad Dream*, St. Louis Post Dispatch, Oct. 7, 1991, at 23 [hereinafter *Land of Oz*].

70. *Id.*

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.; see also Scandal Rocks Kansas State Employee's Pension Fund*, Charlotte Observer, Oct. 13, 1991, at 10B; *SEC Insider Trading Change*, Wichita Bus. J., July 2, 1990, at § 1, p. 3; *see generally* Mertens v. Hewitt Associates, 948 F.2d 607 (9th Cir. 1991), *on remand sub nom*, Mertens v. Kaiser Steel Retirement Plan, 1992 U.S. Dist. LEXIS, 10770 (N.D. Cal.), *cert. granted*, 113 S. Ct. 49 (1992).

denied any connection between the two loans. Charges that Robert Stephen, attorney general under Governor Carlin, delayed an inquiry into pension fund activities led to the appointment of a special prosecutor.[75] Ironically, the acronym for the name of the Kansas plan is CAPERS.[76]

Other pension funds suffered losses from direct placement of funds in targeted investments. A 1989 survey by the Institute for Fiduciary Education included questionnaires to the 126 largest public funds. Of the ninety-nine public systems responding, forty-one reported having made economically targeted investments.[77]

Another approach of desperate politicians is to borrow money from a plan when the government is not credit-worthy. For example, after emerging from the Great Depression, New York City enjoyed several years of relative financial health. The city established a rainy day fund and made substantial contributions to the fund for several years. However, in 1965, New York City Mayor Robert Wagner could not balance the city's budget, despite the use of several suspect accounting practices.[78]

In 1966, Wagner was replaced by John Lindsay, who thereafter sought state approval for city tax increases. Mayor Lindsay greatly appealed to voters, but he did not understand the politics of doing business with state and city officials or with constituents such as municipal labor unions. This administration suffered when the mayor advocated a tax increase and failed to close deals with various other people.[79]

Because NY state law required a balanced budget, budget gimmicks multiplied. Devices included suspending contributions to the city's rainy-day fund, spending the existing balance in the rainy-day fund, and delaying contributions to several municipal pension plans. Political pressures and a weak mayor led to overestimation of future revenue

---

75. *Land of Oz, supra* note 69; *Picking Losers, supra* note 64.

76. *Id.*

77. *Joint Economic Committee Hearing*, 94th Cong., 2d Sess. 134 (1976) (statement of Edward M. Kirshner); INST. FOR FIDUCIARY EDUC., ECONOMICALLY TARGETED INVESTMENTS: A REFERENCE FOR PUBLIC PENSION FUNDS 1 (1989); *see generally Doing Homework Closer to Home*, L.A. TIMES, Sept. 11, 1989, § 2, at 4; Virginia Ellis, *Firms Pick Up Tab for State Pension Officials*, L.A. TIMES, Sept. 8, 1989, at 1; *Institute Gets $35,000 for Fund Survey, Pensions & Investment Age*, L.A. TIMES, April 3, 1989, at 19.

78. CHARLES R. MORRIS, THE COST OF GOOD INTENTIONS: NEW YORK CITY ON THE LIBERAL EXPERIMENT, 1960-1975 22, 136-37 (1980).

79. *Id.* at 26, 28-29. *See generally* WALLACE S. SAYRE & HERBERT KAUFMAN, GOVERNING NEW YORK CITY: POLITICS IN THE METROPOLIS (1965); WALLACE S. SAYRE, NEW YORK CITY AND THE STATE IN PROCEEDINGS OF THE ACADEMY OF POLITICAL SCIENCE (1967).

and underestimation of spending. The series of incorrect budget projections created a budget problem too large to be ignored.[80]

In 1974, Abraham Beame replaced Lindsay. Beame, a former budget director and controller for a number of years, may have understood city finances better than any previous incoming mayor. However, the financial problems were so great that Beame was unable to save the city from practical bankruptcy. Financial institutions, investors and federal, state and city officials did not want the city to go through bankruptcy proceedings, so they created several devices to deal with New York's problems.[81]

Part of the recovery plan included additional investments by several municipal pension plans. In the early 1960s most of these plans ceased investing in city bonds for financial reasons. By late 1975, the New York teachers' plan had about seventeen percent of its assets in city bonds. As the city's financial crisis intensified, the trustees faced substantial political pressure to increase the investment. The trustees were opposed, because they knew that the bonds were unmarketable and prospects for financial recovery by the city were dim. President Ford opposed federal aid because New York did not know what it was doing with its money. Trustees for pension plans outside of the city felt that it was improper for their funds to invest in city bonds for the same reason.[82]

An independent investigation led the trustees to conclude that the city probably would be forced into bankruptcy without assistance from the teachers' fund, and that event would threaten the solvency of the fund. Contributions from the city were the teachers' fund largest source of revenue, and they would cease if all city revenue were devoted to essential services and bondholders. Faced with this dilemma, the trustees refused to invest further until they obtained approval of various provisions designed to secure maximum protection of the beneficiaries. The teachers' fund invested $860 million in city bonds, thereby increasing its holdings to thirty-seven percent of plan assets by the middle of 1978.[83]

---

80. MORRIS, *supra* note 78, at 131-32. *See also* Malcolm S. Forbes, Jr., *New York City's Dire Financial Straits*, FORBES, Nov. 1, 1974, at 23.

81. ROBERT W. BAILEY, THE CRISES REGIME: THE MAC, THE EFCB, AND THE POLITICAL IMPACT OF THE NEW YORK CITY FINANCIAL CRISES 3, 16-46, 74-75 (1984); *New York's Last Gasp?*, NEWSWEEK, Aug. 4, 1975, at 18.

82. Wilkes v. Teachers' Retirement Sys., 447 F. Supp. 1248, 1255 (S.D.N.Y. 1978), *aff'd*, 595 F.2d 1210 (2d Cir. 1979); BAILEY, supra note 81, at 68; *New York's Last Gasp?*, NEWSWEEK, Aug. 4, 1975, at 18; *Why New York City Won't Make It Financially*, BUS. WK., Aug. 18, 1975, at 94.

83. *Wilkes*, 447 F. Supp. at 1251-55, 1258.

Several beneficiaries sued alleging that the purchase of such a large quantity of unmarketable and highly speculative bonds violated the prudent investor rule and the duties of diversification and undivided loyalty. The court indicated that the purchase would have been improper if the city's potential bankruptcy had not been a factor. The purchase of the bonds by the teachers' fund was approved because the trustees had properly concluded it was the only means of maintaining the solvency of the fund. The decision was limited to the unique circumstances and has been described as a political decision.[84]

Philadelphia suffered a similar fate. Years of fiscal irresponsibility were capped off by the administration of Mayor Wilson Goode, who led the city to the brink of bankruptcy. Unable to borrow in the marketplace, the city turned to the fire and policemen's pension fund. The trustees grudgingly agreed to cooperate. An attempt to enjoin the purchase of city bonds by the pension fund was rejected on the ground that there was no breach of fiduciary duty.[85]

Suggestions that cases of this sort present unique circumstances unlikely to occur again are difficult to accept. Whenever politicians are desperate for money, they will take it from any source. Hence loans from pension funds will continue if trustees of governmental plans feel they will not be penalized. The New York and Philadelphia decisions tend to encourage this type of conduct.[86]

Low-interest loans are another gimmick. Trustees are obligated to obtain a reasonable rate of return on trust assets. One commentator has observed that although tax-exempt bonds may be great for investors in high tax brackets, their low interest rate makes them a disaster for tax-exempt plans. Hence, the only apparent reason for buying tax-exempt bonds is to benefit the issuer, and placing an investment in tax-exempt bonds is a breach of the trustee's duty of loyalty.[87]

II. Interest Rates and Social Security

After World War I, the federal government was embarrassed by its wealth. There were record surpluses, and tax rates were reduced

---

84. *Id.* at 1255-56, 1259; Marc Gertner, *Fiduciary Responsibility of Public Employee and Employer Representatives*, 6 J. of Pension Plan. & Compliance 83, at 94 (1980). *Cf.* Sgaglione v. Levitt, 337 N.E.2d 592, 375 N.Y.S.2d 79 (N.Y. 1975).

85. Philadelphia Lodge No. 5, Fraternal Ord. of Police v. Philadelphia Bd. of Pensions and Retirement, No. 5224 slip op. at 9 (Dec. Term, 1990) (Phila. Common Pleas 1991), *appeal dismissed* 606 A.2d 603 (Pa. Commw. Ct. 1992).

86. *Hearings and Markups on H.R. 2456 and H.R. 6536 Before the Subcommittee on Fiscal and Gov't Affairs*, 95th Cong., 1st Sess. 47-48 (1977) (statement of Roy O. Shotland, Georgetown law professor). *See generally* Note, *Public Employee Pensions in Times of Fiscal Distress*, 90 Harv. L. Rev. 992 (1977).

87. *Hearings*, *supra* note 86, at 47-48; Bogert & Bogert, *supra* note 17, § 824; Scott & Fratcher, *supra* note 17, § 240.

four times during the 1920s. Unfortunately, the Great Depression ended that. Revenues declined as tax rates increased, and increasing deficits forced Congress to search for additional means of raising money to combat the Depression. Anti-tax avoidance hearings were held in 1933, while Congress borrowed additional funds to cover shortfalls.[88]

President Roosevelt wanted to increase government spending. Unemployment relief was one of his early goals, so he asked Congress for additional federal employment, a broad public works program, and grants to the states. Studies developed in connection with grants accentuated the scope of the problem in terms of people who needed help and the cost of providing it.[89]

In Roosevelt's 1934 State of the Union address, he pledged continued unemployment relief. In another message that June, he called for security for individuals and families, and an Economic Security Committee was created to suggest methods for dealing with misfortunes. A report in January of 1935 recommended various measures including mandatory old age annuities, and offered a draft bill.[90]

The original program was not ambitious. Half of all workers in the nation were not covered due to various exclusions. The original program was financed by taxes on employers and employees. The maximum annual contribution was $60 per employee. Because the tax was scheduled to start in 1937 but benefits would not begin until 1942, a substantial reserve was to be created.[91]

The original financing plan would not have produced enough revenue. Relatively few people would retire in the early years of the system and the original plan called for Federal Insurance Contribution Act (FICA) tax revenue to be considerably greater than disbursements during

---

88. *E.g.*, Ways & Means Subcomm. on Methods of Preventing the Avoidance & Evasion of the Internal Revenue Laws, Preliminary Report, 73d Cong., 2d Sess. (1933), *reprinted in* 100 U.S. Revenue Acts 1909-1950 (B. Reams ed. 1979); Annual Report of the Secretary of the Treasury on the State of the Finances for the Year Ended June 30, 1928, H.R. Doc. No. 137, 71st Cong., 2d Sess. 32 (1929).

89. Three Essentials for Unemployment Relief, 1933 Pub. Papers 80 (March 21, 1933). *See generally id.* at 107, 183, 202, 237, 246, 249, 308, 361, 454, 533.

90. Report of the Committee on Economic Security, H.R. Doc. No. 81, 74th Cong., 1st Sess. 38-46 (1935); Annual Message to the Congress Reviewing the Broad Objectives and Accomplishments of the Administration, 73d Cong., 2nd Sess. at 7 (Jan. 3, 1934); *see generally* S. Rep. No. 628, 74th Cong., 1st Sess. 2-3 (1935), *reprinted in* 101 U.S. Revenue Acts 1909-1950 (B. Reams ed. 1979); J. Douglas Brown, An American Philosophy of Social Security 3-24 (1972).

91. H.R. Doc. No. 4120, 74th Cong., 1st Sess. §§ 301-02, 7 (4-6), 404-05 (1935); S. Rep. No. 628, 74th Cong., 1st Sess. 9, 25-27, 31 (1935), *reprinted in* 101 U.S. Revenue Acts 1909-1950 (B. Reams ed. 1979).

the first twenty years. The Old Age fund would have been in a deficit position by 1965, followed by large and increasing deficits until 1980. Hence, a portion of the benefits due after 1965 would have to be paid out of general revenue.[92]

President Roosevelt insisted on a program which would be entirely self-supporting until 1980. A new rate schedule was developed to meet this goal. One result of this change was the creation of a much larger surplus in the first twenty years. Appropriations equal to the amount required to fund future social security payments were added to the Old Age Reserve Account. By the middle of 1939, the account had a balance of $1.18 billion.[93]

Money not required for current withdrawals was invested in securities issued or guaranteed by the government. Government obligations could be acquired on original issue at par or by purchase for the market price. Paper issued to the unemployment trust fund had to bear interest at the average rate for all government obligations issued in the previous month. Investments purchased had to have a rate of return at least equal to the average. When the average was not equal to one-eighth of one percent, it was to be rounded to the next lower eighth. Debt issued to the Old Age Reserve Account was to bear a three percent interest rate, and investments purchased had to yield at least that rate. The fixed minimum facilitated actuarial computations which were based on tables bearing three percent interest compounded annually.[94]

Use of the funds was suspect. Although one goal was to avoid loss of principal, another was to obtain the use of a large quantity of cash to finance general operations of the government. The reserve could have been invested to obtain a much better return from other sources without undue risk.[95]

Republicans distrusted most of President Roosevelt's programs, and their 1936 presidential platform complained about the size and handling

---

92. Edwin E. Witte, The Development of the Social Security Act 146-49 (1962). *See generally* A. Altmeyer, The Formative Years of Social Security (1968); Roy Lubove, The Struggle for Social Security 1900-1935 (2d ed. 1986).

93. Witte, *supra* note 92, at 149-52; Fourth Annual Report of the Social Security Board, 1939, H.R. Doc. No. 610, 76th Cong., 3d Sess. 210 (1940). *Cf.*, Comm. on Econ. Security, Report, H.R. Doc. No. 81, 74th Cong., 1st Sess (1935). *See generally* Brown, *supra* note 90, at 179-93.

94. Social Security Act of 1935 §§ 201(b), 904(b), 49 Stat. 622, 641 (1935) (current version at 42 U.S.C. § 401 (1992)); H.R. Rep. No. 615, 74th Cong., 1st Sess. 9, 19, 35 (1935), Comm. on Econ. Security, Report, H.R. Doc. No. 81, 74th Cong., 1st Sess. 16 (1935).

95. *See generally* Bond and Stock Yields: 1857-1970, Historical Statistics of the United States, H.R. Doc. No. 78, 93d Cong., 1st Sess., pt. 2, at 1003 (1974).

of reserves. A Republican congressional group studied the issues. Finance responded by establishing an Advisory Counsel consisting of representatives of employers, labor, and the public. The report was prepared late in 1938 when the nation was still in the grips of the Depression, and many of the proposals were designed to boost public confidence in the system.[96]

Appropriations to the reserve were equal to the amount needed for full funding under accepted actuarial principles. The goal was to obtain enough money in the fund at any given time to pay all of the liabilities accrued to that time. Full funding was desirable for private plans, because they might terminate at any time. Since a government plan presumably would continue forever, a reserve adequate to avoid the need for emergency taxes was considered sufficient. Republicans approved of a reserve that was adequate to cover expenses for a few years. This change resulted in the abandonment of scheduled tax increases and the rejection of a Democratic plan for the government to bear an equal part in the cost of benefits.[97]

Originally, the Treasury Department held FICA collections as part of general revenue. Appropriation of all or part of general revenue required Congressional action. The Advisory Council recommended a permanent appropriation so that all receipts would automatically be credited to the Old Age fund. Congress adopted this proposal.[98]

Republicans were not satisfied with the Treasury account and argued for a separate trust fund. The Advisory Council members thought that a trust fund should be dedicated exclusively to the payment of benefits

---

96. H.R. Rep. No. 728, 76th Cong., 1st Sess. 113-14 (1939) (supplemental views of the Republican minority), *reprinted in* 105 U.S. Revenue Acts 1909-1950 (B. Reams ed. 1979); Advisory Council, Final Report, S. Doc. No. 4, 76th Cong., 1st Sess. 1-2 (1939). *See generally* Comm. on Econ. Sec., Report, H.R. Doc. No. 110, 76th Cong., 1st Sess. 11-12 (1939), *reprinted in* 105 U.S. Revenue Acts 1909-1950 (B. Reams ed. 1979); *Republican Platform, Plank 4*, *reprinted in* N.Y. Times, June 12, 1936, at 1; Representatives Jenkins and Reed, Senators Townsend and Vandenberg, Joint Statement of Explanation (1937), *reprinted in* Reserves Under Federal Old-Age Benefit Plan - Social Security Act: Finance Comm. Hearing, 75th Cong., 1st Sess. 15-19 (1937); Brown, *supra* note 90.

97. *Compare* S. Rep. No. 628, 74th Cong., 1st Sess. 31 (1935), *reprinted in* 101 U.S. Revenue Acts 1909-1950 (B. Reams ed. 1979) *with* S. Rep. No. 734, 76th Cong., 1st Sess. 15 (1939). *See generally* H.R. Rep. No. 728, 76th Cong., 1st Sess. 113 (1939) (supplemental views of Republican minority), *all three reprinted in* 105 U.S. Revenue Acts 1909-1950 (B. Reams ed. 1979); Advisory Council, Final Report, S. Doc. No. 4, 76th Cong., 1st Sess. 24-25 (1939); Comm. on Econ. Sec., Report, H.R. Doc. No. 110, 76th Cong., 1st Sess. 12 (1938).

98. Social Security Act of 1935 § 201(a), 49 Stat 622 (1935) (current version at 42 U.S.C. § 401 (1992)); S. Rep. No. 734, 76th Cong., 1st Sess. 16, 41 (1939), *reprinted in* 105 U.S. Revenue Acts 1909-1950 (B. Reams ed. 1939); Advisory Council, Final Report, S. Doc. No. 4, 76th Cong., 1st Sess. 6 (1939).

and that the trustees should act solely for the beneficiaries. Congress created a trust fund with the Secretary of the Treasury serving as the managing trustee. The trustee's general investment duties were limited to supervision of the fund and making reports to Congress.[99]

Congress modified the investment practices of the Old Age fund. The three percent rule was dropped in favor of an average approach, because there was no need to compute a full funding contribution. Unlike the unemployment trust fund where the statute was silent, the Old Age Trust could not invest in average obligations unless the managing trustee found that purchasing general obligations would be contrary to the public interest. Republicans argued that the managing trustee would favor the government when making investment decisions, because his investment duties were not limited to protecting the interests of beneficiaries and because the managing trustee was also the chief financial officer of the government.[100]

Some Republican concerns were justified. Interest on average obligations was supposed to have been the average rate of interest on all federal obligations. However, Henry Morgenthau, Jr., Secretary of the Treasury and managing trustee, fixed the interest rate at the average rate of interest for federal coupon obligations, which was typically more than one percent less than the average rate of interest on all federal obligations.[101] The lower rate of interest was used to allow the government to spend more on other programs.

Several 1950 modifications illustrate the lack of congressional respect for the Old Age Trust. In 1944, advocates of government contributions won a minor victory when the statute was amended to authorize appropriations from general revenue funds to finance benefits. This change was not mentioned during congressional hearings or in House and Senate reports, and the Conference Committee report merely stated that general revenue funds could be contributed to the trust. No appropriation was ever made under the general revenue provision before it was repealed in 1950 on the ground that FICA revenue and interest on the reserve should entirely support the trust.[102]

---

99. H.R. Rep. No. 728, 76th Cong., 1st Sess. 33-34 (1939), *reprinted in* 105 U.S. Revenue Acts 1909-1950 (B. Reams ed. 1979); Advisory Council, Final Report, S. Doc. No. 4, 76th Cong., 1st Sess. 6-7, 26 (1939); Social Security Act of 1939, § 201(a)-(b), 53 Stat. 1362 (1939) (current version at 42 U.S.C. § 403 (1992)).

100. H.R. Rep. No. 728, 76th Cong., 1st Sess. 15, 34 (1939), *id.* at 113 (supplemental views of the Republican minority), *both reprinted in* 105 U.S. Revenue Acts 1909-1950 (B. Reams ed. 1979). *Compare* Social Security Act of 1935, § 904(b), 49 Stat. 642 *with* Social Security Act of 1939 § 201(c), 53 Stat. 1363.

101. Social Security Act of 1939 § 201(c), 53 Stat. 1363. *E.g.*, S. Rep. No. 1856, 86th Cong., 2d Sess. 28-29 (1960), *reprinted in* 1960 U.S.C.C.A.N. 3636-37.

102. Revenue Act of 1943 § 902 (1944), H.R. Conf. Rep. No. 1079, 78th Cong.,

Appropriations to the trust fund included all FICA taxes, interest, and penalties, which required IRS accounting for collections. Beginning in 1951, the amount payable was calculated by applying the tax rates to taxable wages reported by employers. Finance observed that the change would help reduce administrative costs. The Conference Committee instructed Treasury to pass the savings on to the Social Security system. Unfortunately, any benefit in the form of lower administrative expenses may have been more than offset by the reduction in revenue.[103]

By the end of 1949, the fund's reserve had grown to $11.2 billion, and Ways and Means began responding to complaints about investments. Some Committee members complained that it was improper for the government to spend the money for general government purposes. This argument was rejected based upon an analogy to investments by insurance companies. Others thought people would be taxed twice for a single benefit. The report denied the claim by applying the argument to a single year in which benefit payments exceeded FICA revenue by $100 million. If the trust held government bonds, interest financed by taxes would cover all or a portion of any shortfall. If the trust did not hold government bonds, $100 million of revenue would be needed to cover the shortfall and another $100 million would be needed to pay interest to the bondholders.[104]

The last answer is suspect because it assumes either that there is no surplus FICA revenue or that any surplus would be nonproductive. The absence of surplus revenue is unlikely because Congress demanded a surplus large enough to cover estimated expenses for a few years. It is equally improbable that several billion dollars would not generate any earnings. Strangely enough, no one complained about the 2 1/8% rate of return on average obligations. During the same period other government insurance programs, including the civil service retirement system, earned three percent to four percent interest on loans to the government.[105] One can only speculate why Social Security received a

---

2d Sess. 89 (1944), *both reprinted in* 110 U.S. Revenue Acts 1909-50 (B. Reams ed. 1979); S. Rep. No. 1669, 81st Cong., 2d Sess. 4, 34-34 (1950), *reprinted in* 116 U.S. Revenue Acts 1909-1950 (B. Reams ed. 1979). *Contra*, Advisory Council, Report, S. Doc. No. 149, 80th Cong., 2d Sess. 13, 45-46 (1948). *See generally* Brown, *supra* note 90.

103. S. Rep. No. 1669, 81st Cong., 2d Sess. 121-23 (1950), H.R. Conf. Rep. No. 2771, 81st Cong., 2d Sess. 111 (1950), *both reprinted in* 116 U.S. Revenue Acts 1909-1950 (B. Reams ed. 1979).

104. H.R. Rep. No. 1300, 81st Cong., 1st Sess. 36-37 (1949), *reprinted in* 116 U.S. Revenue Acts 1909-1950 (B. Reams ed. 1979). *Cf.* Advisory Council, Report, S. Doc. No. 149, 80th Cong., 2d Sess. 45-46 (1948).

105. H.R. Rep. No. 1300, 81st Cong., 1st Sess. 33, 37 (1949), *reprinted in* 116

much lower rate of interest on government loans and why no one objected to the different treatment. Social Security presumably could have received at least a four percent rate of return on other investments without undue risk.

Major legislation had always begun with an administration bill, and there were significant changes in 1950, 1952, and 1954. Complaints about investments began to increase again, and the 1955 trustees report added a new point to the 1949 arguments. The trust should not purchase obligations issued by competitive business because such obligations are not proper investments for government. The administration did not offer a bill, and the Chairman of Ways and Means developed a secret bill which was passed by the House seven days after it was introduced.[106]

This secret bill proposed an Advisory Council to oversee the financial progress of Social Security. It also provided for the Secretary of Health, Education, and Welfare to appoint a group of twelve people to represent workers, employers and the public before each scheduled tax increase. The group would review the financing of the Old Age Trust funds in relation to long-term commitments of the program. The report of the Council would be included in the trustee's annual report to Congress[107]

One member of Ways and Means Committee was not satisfied. A few weeks after the secret bill was passed, Congressman Bill Jenkins introduced a bill with more provisions regulating investment practices. An express authorization to issue obligations to the trust fund was designed to emphasize that these obligations were as much a part of the public debt as other federal undertakings. This point was reinforced by changing the designation of the obligations from special obligations to public debt obligations. The existing law did not mention maturities. Purchases had been periods of five years or less. The bill called for maturities fixed with due regard for the needs of the trust. The managing trustee interpreted the "due regard" language to require a maturity date of five years or more.[108]

U.S. Revenue Acts 1909-1950 (B. Reams ed. 1979); H.R. Rep. No. 728, 76th Cong., 1st Sess. 14-15 (1939), *reprinted in* 105 U.S. Revenue Acts 1909-1950 (B. Reams ed. 1979). *See generally* Bond and Stock Yields: 1857-1970, Historical Statistics of the United States, H.R. Doc. No. 78, 93d Cong., 1st Sess., pt. 2, at 1003 (1974).

106. Bd. of Trustees, 15th Annual Report, S. Doc. No. 39, 84th Cong., 1st Sess. 7-8 (1955); Letter from Secretary Hobby to Chairman Cooper (June 22, 1955), H.R. Rep. No. 1189, 84th Cong., 1st Sess. 58-62 (1955); H.R. 7225, 84th Cong., 1st Sess. (1955).

107. H.R. Rep. No. 1189, 84th Cong., 1st Sess. 10-11, 35-36 (1955). *See generally* Bd. of Trustees, 19th Annual Report, H.R. Doc. No. 181, 86th Cong., 1st Sess. 31-34 (1959).

108. Advisory Council Report, H.R. Doc. No. 181, 86th Cong., 1st Sess. 70 (1959); H.R. Doc. No. 7770, 84th Cong., 1st Sess. § 101(a) (1955).

Other changes were more substantial. Congressman Jenkins was a member of Ways and Means in 1949, and he remembered the low interest rate on average obligations. Interest rates were based on the average interest rate of all marketable federal securities. To reflect the fact that Social Security was a long-term investor, obligations due or callable in five years or less were excluded from the average computation. If the average was not a multiple of one-eighth of one percent, it was rounded to the next lower multiple. The new approach was to round to the nearest multiple. Excluding short term obligations from rate calculations increased revenue by approximately $80 million dollars per year. Nothing was said about the consequence of modifying the method of rounding.[109]

Average obligations could be purchased only when marketable securities were not in the public interest. The managing trustee interpreted this to mean that marketable securities should be purchased only when they would produce a higher yield.[110] Ways and Means did not take any action on the Jenkins bill. The Eisenhower Administration approved of the contents of the Jenkins bill during Finance Committee hearings, and it was incorporated into the Senate version of the secret bill.[111] All of the proposals were enacted in 1956.

By the end of 1959, the reserve had grown to $20.5 billion. Comparative investment returns on the fund did not change significantly between 1949 and 1959. During 1959, about ninety percent of the fund's assets were invested in average obligations, at interest rates of 2 1/2% and 2 5/8%.[112] The average interest rate was based upon the average interest rate for coupon bonds, which was frequently was more than one percent less than the rate for all marketable government securities.[113] The only apparent reason for using the lower interest rate was to reduce the government's interest expense.

---

109. *Social Security Amendments of 1955: Hearings Before the Senate Finance Comm.*, 84th Cong., 2d Sess. 1239 (1956) (statement of Marion B. Folsom, Secretary of Health, Education, and Welfare); H.R. Doc. No. 7770, 84th Cong., 1st Sess. § 101(a) (1955).

110. *Social Security Amendments of 1955: Hearings Before the Senate Finance Comm.*, 84th Cong., 2d Sess. 1230-34 (1956) (statement of Marion B. Folsom, Secretary of Health, Education, and Welfare); ADVISORY COUNCIL REPORT, H.R. DOC. No. 181, 86th Cong., 1st Sess. 72 (1959); S. REP. No. 2133, 84th Cong., 2d Sess. 14-15, 49 (1956), *reprinted in* 1956 U.S.C.C.A.N. 3891-92, 3926; H.R. Doc. No. 7770, 84th Cong., 1st Sess. § 101(a) (1955).

111. *Social Security Amendments of 1955: Hearings Before the Senate Finance Committee*, 84th Cong., 2d Sess. 1230-34 (1956).

112. ADVISORY COUNCIL REPORT, H.R. DOC. No. 181, 86th Cong., 1st Sess. 70-71 (1959); *see also* BD. OF TRUSTEES, 20TH ANNUAL REPORT, H.R. DOC. No. 352, 86th Cong., 2d Sess. 13 (1960).

113. S. REP. No. 1856, 86th Cong., 2d Sess. 28-29 (1960), *reprinted in* 1960 U.S.C.C.A.N. 3636-37.

Three considerations suggest that the lower interest rate constituted improper management of Social Security funds. First, other federal programs, such as the Railroad Retirement fund were guaranteed at least a three percent interest rate on their average government investments.[114] Second, marketable government securities were paying up to a four percent interest rate.[115] Third, a return of more than four percent could have been obtained without undue risk.[116]

Altering the interest rate paid on investments leads to some remarkable figures. For example, increasing the interest rate from 2 5/8% to 3% on the entire fund in 1959 would have produced about $77 million in additional interest income annually; from 2 5/8% to 3 5/8% would have yielded $205 million, and from 2 5/8% to 5% would have generated $486 million. The $486 million increase would have been more than 54% of the total 1959 FICA revenue of $895 million.[117] Although using the coupon rate in 1959 saved the government $205 million in interest expense, the possible loss to Social Security from government investments was far greater. If the entire Social Security fund had been invested in private issues at 5%, the increase in 1959 interest income would have been $486 million.

Complaints about investment practices continued to escalate. The 1959 Advisory Council report supported limiting investments to government securities, and added two new points to the 1955 arguments. Purchasing obligations of competitive businesses might lead to unfortunate financial or political consequences for the Social Security system, and investing in obligations of state and local governments would unnecessarily involve the funds in affairs entirely apart from Social Security.[118]

The major complaint was that the rate of return was not satisfactory. In early 1959, the average coupon rate was 1 3/8% less than the average return for all long term marketable government securities. The Advisory Council argued that the rate received by Social Security should be "as nearly as possible equal"[119] to that received by long

---

114. *See, e.g.*, Bd. of Trustees, Annual Report, Railroad Retirement Board, 1959, H.R. Doc. No. 267, 86th Cong., 2d Sess. 8 (1960).

115. S. Rep. No. 1856, 86th Cong., 2d Sess. 28-29 (1960), *reprinted in* 1960 U.S.C.C.A.N. 3636-37.

116. *See* H.R. Rep. No. 961, 87th Cong., 1st Sess. 2-3 (1961); Bd. of Trustees, 20th Annual Report, H.R. Doc. No. 352, 86th Cong., 2d Sess. 13 (1960); Advisory Council Report, H.R. Doc. No. 181, 86th Cong., 1st Sess. 70-71 (1959).

117. Bd. of Trustees, 20th Annual Report, H.R. Doc. No. 352, 86th Cong., 2d Sess. 15 (1960).

118. Advisory Council Report, H.R. Doc. No. 181, 86th Cong., 1st Sess. 68-70 (1959).

119. *Id.* at 71.

term investors, and recommended that the average required return be based on quotations for all marketable securities maturing more than five years after the date of issuance.[120]

Conflict of interest charges were side-stepped by the Advisory Council. When the statute first authorized an average in 1939, some Republicans complained that the Secretary of the Treasury might favor the government over the trust fund. Although the statute called for an average interest rate based on all marketable government securities, Secretary Morgenthau used the much lower average interest rate for coupon bonds. As a result, Social Security made low-interest loans to the government for twenty-one years, although congressional opponents continually complained about improper investments by a series of Treasury Secretaries.[121]

The Social Security system incurred substantial losses due to investments made at low interest rates. A total of $5 billion in interest income was received between 1937 and 1959.[122] However, the trust would have made an additional substantial additional income if it had received the proper rate of interest.

The Advisory Council recommended that the average rate of interest for most obligations be based on an investment period of more than five years. The Council suggested a lower rate of interest for short term investments. However, the board of trustees thought two different averages would be an unnecessary burden and proposed a single three year investment period. Ways and Means recommended a single interest rate with a four-year investment period.[123]

Rules for deciding what to purchase were modified. The 1956 statute required purchasing marketable securities unless they were not in the public interest. The Secretary interpreted this to mean that the trusts could purchase marketable securities only if they provided a higher rate of return. The 1959 Advisory Council thought that obtaining a higher rate of return should be a statutory duty and recommended that the average be required on all trust investments unless marketable

---

120. S. Rep. No. 1856, 86th Cong., 2d Sess. 28-29 (1960), *reprinted in* 1960 U.S.C.C.A.N. 3636-37; Advisory Council Report on Social Security Financing, H.R. Doc. No. 181, 86th Cong., 1st Sess. 71 (1959).

121. Advisory Council Report, H.R. Doc. No. 181, 86th Cong., 1st Sess. 70 (1959); H.R. Rep. No. 728, 76th Cong., 1st Sess. 113-14 (1939) (supplemental views of the Republican minority), *reprinted in* 105 U.S. Revenue Acts 1909-1950 (B. Reams ed., 1979); Social Security Act of 1939 § 201(c), 53 Stat. 1363 (1939) (current version at 42 U.S.C. § 403 (1992)).

122. Advisory Council Report, H.R. Doc. No. 181, 86th Cong., 1st Sess. 58 (1959).

123. H.R. Rep. No. 1799, 86th Cong., 2d Sess. 27 (1960); Bd. of Trustees, 19th Annual Report, H.R. Doc. No. 181, 86th Cong., 1st Sess. 32-33 (1959).

was both in the public interest and resulted in no loss of income.[124]

Investment policy was to be subject to regular oversight. Although the experience and position of the Secretary of the Treasury made him the best person to be managing trustee, the Advisory Council thought that the board should be responsible for reviewing general policies and recommending changes. The Board was scheduled to meet at least once every six months. Advisory Councils were scheduled to meet every three years.[125] Ways and Means thought this was unnecessary in light of the expanded duties of the Board, so it proposed a Council meeting every five years beginning in 1966. With the exception of the average investment period, Congress enacted the changes recommended by the Advisory Council.[126]

III. Actuarial Problems and Social Security

Actuarial criteria were developed for Social Security. Information was evaluated under standards established and regularly revised by the Social Security Administration. When expenses exceeded income, a small negative figure was not considered significant because of "certain elements of conservatism" and the variability of long range estimates. Congress adopted 0.25% as an acceptable variance of actuarial balance. Thus, if expenses did not exceed revenue by more than 0.25% of taxable payroll, the system was considered in actuarial balance.[127]

Results were acceptable from 1937 through 1957 when revenue always exceeded disbursements. Hence, things like economic conditions and lack of actuarial balance did not cause any problems. However, 1958 disbursements exceeded revenue by 0.25%, and Ways and Means and Finance both projected that disbursements would continue to exceed revenue in each year through 1965. The committees proposed a package of increased benefits, earnings base, and tax rates to stop this trend.[128]

---

124. Advisory Council Report, H.R. Doc. No. 181, 86th Cong., 1st Sess. 71-72 (1959).

125. S. Rep. No. 1856, 86th Cong., 2d Sess. 28-29, 33-34 (1960), *reprinted in* 1960 U.S.C.C.A.N. 3636-37, 3641-42.

126. Advisory Council Report, H.R. Doc. No. 181, 86th Cong., 1st Sess. 72 (1959); *see also* S. Rep. No. 1856, 86th Cong., 2d Sess 28-29, 33-34, (1960), *reprinted in* 1960 U.S.C.C.A.N. 3636-37, 3641-42.

127. *E.g.*, S. Rep. No. 409, 89th Cong., 1st Sess. 123 (1965), *reprinted in* 1965 U.S.C.C.A.N. 2066; Bd. of Trustees, 24th Annual Report, H.R. Doc. No. 236, 88th Cong., 2d Sess. 51-53 (1964); Social Sec. Admin. Actuarial Study No. 53 (1961); *see generally* Social Sec. Admin., Economic Assumptions Underlying the Medium-Range Projections of the Federal Old Age and Survivor's Insurance and Disability Insurance Trust Funds 1966-1975 (1961).

128. S. Rep. No. 2388, 85th Cong., 2d Sess. 2-3, 5-8 (1958), *reprinted in* 1958 U.S.C.C.A.N. 4219-20, 4222-25. *See generally* S. Rep. No. 1856, 86th Cong., 2d Sess. 37 (1960), *reprinted in* 1960 U.S.C.C.A.N. 3645.

The actuarial situation was approved by the 1959 Advisory Council. It studied demographic and other assumptions and the basic techniques used in estimating short- and long-range costs. The Advisory Council concluded that the assumptions provided a reasonable basis for making forecasts and that the estimating techniques were sound. Because expenses exceeded income by only 0.25%, the 1958 program was in close actuarial balance. The Advisory Council concluded by recommending there should be no change in the contribution schedule.[129]

The actuarial system had broken down. The 1958 loss of $216 million was followed by 1959 and 1960 losses of $1.271 billion[130] and $713 million,[131] respectively. Politics moved to the center stage during the 1960 presidential campaign. Even though there was every reason to believe that the program would continue to produce substantial losses, Congress and the President agreed to increase benefits without increasing taxes. The actuarial deficiency decreased slightly from 0.25% to 0.24%,[132] probably due to an increase in the interest received by the fund. After the election, the new Congress promptly prepared a bill to increase benefits and revenues. Expenses under the 1961 program were expected to exceed income by 0.24%.[133]

Results varied under the 1961 program. The years 1961, 1964, and 1965 produced gains of $72 million, $760 million, and $482 million, while 1962 and 1963 produced losses of $1.274 billion and $687 million, respectively. In sum, the fund lost a total of $2.849 billion during the period from 1958 through 1965. The Board was unsure of the situation, and repeatedly emphasized that the system was in actuarial balance under the 0.25% standard.[134]

---

129. ADVISORY COUNCIL REPORT, H.R. DOC. No. 181, 86th Cong., 1st Sess. 60-61, 73 (1959).

130. BD. OF TRUSTEES, 20TH ANNUAL REPORT, H.R. DOC. No. 352, 86th Cong., 1st Sess. (1959).

131. BD. OF TRUSTEES, 21ST ANNUAL REPORT, H.R. DOC. No. 60, 87th Cong., 1st Sess. 1 (1961).

132. S. REP. No. 425, 87th Cong., 1st Sess. 11 (1961).

133. S. REP. No. 404, 89th Cong., 2d Sess. 128 (1965), *reprinted in* 1965 U.S.C.C.A.N. 2071; S. REP. No. 425, 87th Cong., 1st Sess. 11 (1961), *reprinted in* 1961 U.S.C.C.A.N. 1866; BD. OF TRUSTEES, 21ST ANNUAL REPORT, H.R. DOC. No. 60, 87th Cong., 1st Sess. 1 (1961); BD. OF TRUSTEES, 20TH ANNUAL REPORT, H.R. DOC. No. 352, 86th Cong., 2d Sess. 8 (1960); BD. OF TRUSTEES, 19TH ANNUAL REPORT, H.R. DOC. No. 181, 86th Cong., 1st Sess. 10 (1959).

134. BD. OF TRUSTEES, 26TH ANNUAL REPORT, H.R. DOC. No. 392, 89th Cong., 2d Sess. 1 (1966); BD. OF TRUSTEES, 25TH ANNUAL REPORT, H.R. DOC. No. 100, 89th Cong., 1st Sess. 1, 29 (1965); BD. OF TRUSTEES, 24TH ANNUAL REPORT, H.R. DOC. No. 236, 88th Cong., 2d Sess. 1, 51-53 (1964); BD. OF TRUSTEES, 23RD ANNUAL REPORT, H.R. DOC. No. 80, 88th Cong., 1st Sess. 1, 30-31 (1963); BD. OF TRUSTEES, 22ND ANNUAL REPORT, H.R. DOC. No. 346, 87th Cong., 2d Sess. 1 (1962).

After a detailed examination, the 1965 Advisory Council approved of the actuarial situation. The only significant change suggested was modification of the period for estimating long range costs. The period had been forever, and seventy-five years was considered a more realistic time. The seventy-five year rule made a closer actuarial balance desirable, but the Council did not offer a specific limit. The 1965 Act increased benefits and revenue and adopted a new standard for excess expenses. The system would be considered in actuarial balance if expenses did not exceed income by more than 0.1% of taxable payroll.[135]

Things improved during the next several years. The 1966 loss of $308 million was followed by a 1967 gain of $3.643 billion. Several noteworthy changes were introduced in the 1967 Act. Although Advisory Councils had reported only on financial conditions, future Councils were to review all aspects of Social Security. Reports were due every four years beginning in 1971. Benefits and revenue increased and expenses exceeded income by only 0.05%. Hence, the system was considered to be in actuarial balance, and Finance estimated the fund would increase by $36.158 billion during the 1968-72 period. Although there was an actual gain in each year, the $12.884 billion increase for the entire period was only about one-third of the estimate.[136]

Substantial differences between estimates and actual results led to several changes. The 1971 Advisory Council appointed a panel of actuaries and economists to examine the assumptions and methods used by Social Security. Previous estimates had assumed level earnings. Since earnings in fact go up, the panel felt that the estimates should conform with reality. The panel also recommended that benefits keep pace with changes in prices. Hence, benefits and the contribution and benefit base should automatically increase with the cost of living.[137]

---

135. Advisory Council Report, H.R. Doc. No. 100, 89th Cong., 1st Sess. 66-68 (1965); S. Rep. No. 404, 89th Cong., 1st Sess. 132 (1965), *reprinted in* 1965 U.S.C.C.A.N. 2075. *Compare* Bd. of Trustees, 25th Annual Report, H.R. Doc. No. 100, 89th Cong., 1st Sess. 29-30 (1965) *with* 26th Annual Report, H.R. Doc. No. 392, 89th Cong., 2d Sess. 37 (1966).

136. 33d Annual Report, H.R. Doc. No. 130, 93d Cong., 1st Sess. 5 (1973). The 1967 estimate does not seem to have been materially altered by legislation in 1969 and 1971. H.R. Conf. Rep. No. 42, 92d Cong., 1st Sess. 3 (1971), *reprinted in* 1971 U.S.C.C.A.N. 976; H.R. Conf. Rep. No. 782, 91st Cong., 1st Sess. 344 (1969), *reprinted in* 1969 U.S.C.C.A.N. 2460; H.R. Rep. No. 700, 91st Cong., 1st Sess. 4 (1969); 28th Annual Report, H.R. Doc. No. 288, 90th Cong., 2d Sess. 12 (1968); Bd. of Trustees, 27th Annual Report, H.R. Doc. No. 65, 90th Cong., 1st Sess. 12 (1967); S. Rep. No. 744, 90th Cong., 1st Sess. 103, 9, 26, 39-42 (1967), *reprinted in* 1967 U.S.C.C.A.N. 2937, 43, 60, 73-76.

137. Advisory Council Report, H.R. Doc. No. 80, 92d Cong., 1st Sess. 90, 95-103 (1971).

Prior estimates were an average of high and low estimates. The panel concluded that a best estimate derived from a single set of assumptions would produce results closer to actual experience. In addition, the panel suggested using a series of varying situations in order to show how the best estimate would be affected if experience differed from the major assumptions. The goal of the estimates was to produce enough revenue to cover actual expenses and maintain a fund approximately equal to one year of benefit payments. The panel called for substantial reductions in short-term tax rates if the changes were adopted.

The Advisory Council accepted the recommendations of the panel,[138] and the panel's recommended changes were enacted in 1972. The 1972 Act increased benefits and the contribution and benefit base, and both could be increased automatically to account for changes in the cost of living. Short-term estimates assumed a gradual increase in earnings, while long-range projections continued to be based on level earnings.[139]

This new arrangement made actuaries even more uncertain. The 1973 trustees' report repeatedly emphasized the imponderables of estimating future events and the likelihood that 1974 expenses would exceed income by 0.32%. Nonetheless, the trustees did not propose any financing changes.[140] Several months later, Ways and Means expressed concern and concluded that a basic review of financing was overdue. The Committee directed early creation of the next Advisory Council and ordered an independent review by the Ways and Means staff.[141]

The 1974 trustees' report created even more concern. Remarks about imponderables were repeated and the size of the deficit increased dramatically to 2.98%. Although some change in income or expenses was needed, the 1974 trustees' report declined to offer specific recommendations until the Advisory Council completed its work.[142] The 1975 Council report stated that the alternative to a substantial tax increase

---

138. Advisory Council Report, H.R. Doc. No. 80, 92d Cong., 1st Sess. 65-67, 72-73, 95-103 (1971).

139. Public Debt Limit-Extension, Pub. L. No. 92-336, §§ 201-2, 86 Stat. 408-15 (1972); *see* H.R. Conf. Rep. No. 1215, 92d Cong., 2d Sess. 2 (1972); S. Rep. No. 1230, 92d Cong., 2d Sess. 135, 339-44 (1972), *reprinted in* 48 U.S. Revenue Acts 1953-72 (B. Reams ed. 1985); Fin. & Ways & Means Comm., 92d Cong., 2d Sess. Summary of Social Security Amendments of 1972, 34-35 (Comm. Print 1972).

140. Bd. of Trustees, 33d Annual Report, H.R. Doc. No. 130, 93d Cong., 1st Sess. 16, 32-33 (1973).

141. H.R. Rep. No. 627, 93d Cong., 1st Sess. 5-6 (1973), *reprinted in* 1973 U.S.C.C.A.N. 3181-82; *see also* S. Rep. No. 553, 93d Cong., 1st Sess. 73 (1973).

142. Bd. of Trustees, 34th Annual Report, H.R. Doc. No. 313, 93d Cong., 2d Sess. 34-38 (1974).

in 1976 was a decline in fund revenues of several billion dollars per year.[143] The 1975 trustees' report noted that the deficit increased dramatically to 5.32%, leading the trustees to endorse the Council's recommendations.[144]

Congress was skeptical about the need for a substantial tax increase. Ways and Means began the process of investigating the issue by directing the Subcommittee on Social Security to hold the first public hearings on financing the system. Several hundred pages of testimony was received in the spring of 1975.[145] While Congress considered the situation, the trustees became even more concerned. The trustees' 1976 report described the problem in considerable detail and stated that the fund would be exhausted by 1984 under the intermediate estimate.[146] The 1977 report included a similar description and advanced the exhaustion date to 1983.[147]

Results for the period illustrate the degree of actuarial inefficiency. Finance found in 1972 that income would exceed expenses by 0.01%, but Congress estimated that the fund would grow by $16.03 billion during the next five years.[148] Although there were gains in the first three years, losses during the last two years produced a $102 million net loss for the five-year period. This loss was intentionally understated. Since the closing figure for 1976 was $925 million more than the opening figure for 1977, actual net loss was $1.027 billion.[149] Even though there were several warnings about the need for a quick increase in income,[150] Congress did not act until 1977.

143. ADVISORY COUNCIL REPORT, H.R. DOC. No. 75, 94th Cong., 1st Sess. 47-51, 57-63 (1975).

144. BD. OF TRUSTEES, 35TH ANNUAL REPORT, H.R. DOC. No. 135, 94th Cong., 1st Sess. 36, 41-45 (1975).

145. *Financing the Social Security System: Hearings Before the Ways and Means Subcommittee on Social Security*, 94th Cong., 1st Sess. 1 (1975).

146. BD. OF TRUSTEES, 36TH ANNUAL REPORT, H.R. DOC. No. 505, 94th Cong., 2d Sess. 21-59 (1976).

147. BD. OF TRUSTEE, 37TH ANNUAL REPORT, H.R. DOC. No. 150, 95th Cong., 1st Sess. 1-4, 42-60 (1977).

148. FIN. & WAYS & MEANS COMM., 92D CONG., 2D SESS., SUMMARY OF SOCIAL SECURITY AMENDMENTS OF 1972, 34-35 (Comm. Print 1972); S. REP. No. 1230, 92d Cong., 2d Sess. 344 (1972), *reprinted in* 48 U.S. REVENUE ACTS 1953-72 (B. Reams ed. 1985).

149. *E.g.*, BD. OF TRUSTEES, 33D ANNUAL REPORT, H.R. DOC. No. 130, 93d Cong., 1st Sess. 5 (1973); *compare* 37TH ANNUAL REPORT, H.R. DOC. No. 150, 95th Cong., 1st Sess. 8 (1977) *with* 38TH ANNUAL REPORT, H.R. DOC. No. 336, 95th Cong., 2d Sess. 9 (1978). The 1973 legislation did not materially affect the actuarial situation. H.R. REP. No. 627, 93d Cong., 1st Sess. 12, 17 (1973), *reprinted in* 1973 U.S.C.C.A.N. 3188, 3193.

150. *E.g.*, BD. OF TRUSTEES, 37TH ANNUAL REPORT, H.R. DOC. No. 150, 95th Cong., 2d Sess. 9 (1977).

Ways and Means found that the method of computing automatic increases in benefits and the contribution and benefit base accounted for half of the deficit. The remainder resulted from a combination of factors, including higher-than-estimated inflation and unemployment and lower-than-estimated fertility and real growth. Changes were designed to "restore financial soundness . . . by eliminating the actuarial deficit . . . through the first decade of the next century."[151] It is doubtful that Ways and Means believed that. The medium-range estimate was for income to exceed expenses by 0.84%, but the long-term figure was a negative 1.33%. The Committee also adopted a provision authorizing Social Security to borrow from general revenue if the fund fell below a certain level.[152]

The plan was not accepted. The Social Security Administration felt a slight positive actuarial balance was preferable, and Finance designed a package under which income would always exceed expenses. The medium-range number was 0.84%, and the long range figure was 0.04%. The Committee estimated that there would be losses in 1978 and 1979, followed by gains in the years 1980 through 1983, and the net growth of the fund for the six-year period was estimated at $12.2 billion. Because there was no need for the authority to borrow from general revenue, the provision was deleted.[153]

Conference preferred the Ways and Means approach. The medium-range estimate was for income to exceed expenses by 0.79% and a long-range number was a of negative 1.26%, and the fund would be exhausted in 2029. This result and the fact that the committees wanted a National Commission to study Social Security financing suggests that neither Ways and Means nor the Conference believed the projections.[154]

The period from 1977 through 1983 was remarkably similar to the period from 1972 through 1977. The 1978 Board of Trustee's report observed that the 1977 amendments would eliminate the short- and medium-range annual deficits beginning in 1981 and that income would exceed expenses by 1.02% for the medium range. However, there would be a long-range deficit of 1.4%. The report concluded that the amendments had restored "financial soundness . . . throughout the remainder

---

151. H.R. Rep. No. 702, 95th Cong., 1st Sess. 2, 6-7, 17, 57 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4155, 4159.

152. H.R. Rep. No. 702, 95th Cong., 1st Sess. 2, 6-7, 17, 57 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4159, 4163-64, 4174, 4214.

153. S. Rep. No. 372, 95th Cong., 1st Sess. 51, 55-57 (1977).

154. Bd. of Trustees, 38th Annual Report, H.R. Doc. No. 336, 95th Cong., 2d Sess. 46-47 (1978); H.R. Conf. Rep. No. 837, 95th Cong., 1st Sess. 74 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4320.

of this century."[155] There was no material difference in the 1979 report.[156]

The 1979 Advisory Council may have been more cautious. The fund declined from seventy-three percent of annual outlays in 1974 to twenty-nine percent in 1979, and the report carefully examined the actuarial situation. The Council found that the underlying assumptions were reasonable and that the methodology used to make financial projections was sound. Although the arrangements were generally approved, there remained a need for a more systematic approach to known relationships between the assumptions. The Council concluded that the intermediate and long-range projections in the 1979 Board report were sound[157]

Although the medium- and long-range outlooks in 1980 had not changed materially from those of 1978 and 1979, the short-range picture was different. Under one approach, the fund would be insolvent and unable to pay benefits in late 1981 or early 1982. After the short-term deficits there would be substantial surpluses. The report also stated that revised projections would probably be necessary when data reflecting the 1980 recession became available.[158]

The National Commission on Social Security identified a basic problem with the actuarial assumptions. Since about 1900, wages had regularly increased at a rate greater than benefits. Social Security estimates assumed that this relationship would continue. Consequently, benefits were automatically adjusted upward for changes in the Consumer Price Index, but wages were in fact rising more slowly than prices. The Board's 1981 final report called for higher revenue and suggested that the fund maintain a balance equal to approximately one year's expenses.[159]

A few months later, the 1981 Board report did a nearly complete reversal. The discussion of actuarial status was more detailed and included a pair of intermediate estimates. The medium-range figures were a surplus of 0.30% and a deficit of 0.31%. The long-range numbers were deficits of 1.61% and 2.44%. The short-term situation was critical. Every alternative approach predicted that the fund would run out of

---

155. Bd. of Trustees, 38th Annual Report, H.R. Doc. No. 336, 95th Cong., 2d Sess. 2-3 (1978).

156. Board of Trustees, 39th Annual Report, H.R. Doc. No. 101, 96th Cong., 1st Sess. 3 (1979).

157. Advisory Council Report, Ways and Means Comm. Pt. No. 45, 96th Cong., 1st Sess. 31, 45, 48 (Comm. Print 1980).

158. Bd. of Trustees, 40th Annual Report, H.R. Doc. No. 332, 96th Cong., 2d Sess. 3-4 (1980).

159. Nat'l Comm'n on Social Sec., Final Report 55-56, 65 (1981).

money in the latter half of 1982 and that expenses would continue to exceed income until at least 1985. Prompt legislative action was needed to strengthen short-term financing.[160] Congress responded by giving the fund the authority to borrow until the end of 1982.[161]

Lack of actuarial efficiency is illustrated by the decline in the fund. During the period from 1937 through 1957, the balance increased every year, because income exceeded disbursements each year. The fund grew steadily from a zero balance to more than $23 billion in 1957. There were various ups and downs between 1957 and 1983. The fund reached almost $40 billion by the middle of 1975, but it was exhausted by the end of 1982. Thus, the fund had to use its authority to borrow money in order to pay current benefits in 1983. In addition to not receiving interest on reasonable balances, the fund had to pay interest on borrowed money.[162]

Congress dealt with these problems early in 1983. Funds for payment of current benefits were assured by continuation of the authority to borrow, and the deficit was to be eliminated by a tax increase and by limiting benefit increases.[163] This solution was effective, and the fund steadily grew from 1984 through 1990 when the balance exceeded $203 billion.[164]

The existence of a large and growing fund gave rise to a movement to reduce the Social Security tax. Senator Daniel Patrick Moynihan complained that the money loaned to the government was being used for general expenses. Congress used the fund as a device to conceal the true size of the federal deficit. He argued that if Congress wants to spend more, it should finance additional expenditures with revenue from other sources or additional taxes.[165]

---

160. Bd. of Trustees, 41st Annual Report, H.R. Doc. No. 66, 97th Cong., 1st Sess. 2, 57-71 (1981).

161. H.R. Conf. Rep. No. 409, 97th Cong., 1st Sess. 9-11 (1981), *reprinted in* 1981 U.S.C.C.A.N. 2681-83.

162. H.R. Rep. No. 25, 98th Cong., 1st Sess. 1 (1983), *reprinted in* 1983 U.S.C.C.A.N. 219; 37th Annual Report, H.R. Doc. No. 150, 95th Cong., 1st Sess. 8-9 (1977); Bd. of Trustees, 19th Annual Report, H.R. Doc. No. 181, 86th Cong., 1st Sess. 19 (1959).

163. H.R. Rep. No. 25, 98th Cong., 1st Sess. 65-66 (1983), H.R. Conf. Rep. No. 47, 98th Cong., 1st Sess. 132-33 (1983), *both reprinted in* 1983 U.S.C.C.A.N. 284-85, 422.

164. Bd. of Trustees, 51st Annual Report, H.R. Doc. No. 88, 102d Cong., 1st Sess. 24 (1991).

165. Michael Arndt, *Effort to Trim Social Security Tax Gaining*, Chi. Trib., Jan. 16, 1991 at 1; Dale Russakoff, *Say It Again, Pat*, Wash. Post, Jan. 18, 1990, at A21; *The Payroll Tax Hoax*, San Diego Union, April 2, 1991, at B-6; George F. Will, *The Social Security Surplus Scam*, Wash. Post, Jan. 11, 1990, at A23.

Senator Moynihan also noted a need to stimulate the economy. Lowering the tax on employees would put more spending money in the hands of consumers. Slashing the tax on employers would reduce the cost of goods and services. These events would create more jobs and stimulate other benefits. Both the economy and Social Security would have been winners under the reduction plan. Revenue from a million new jobs would have increased Social Security income by more than $2 billion a year.[166]

Social Security was removed from deficit computations in 1990,[167] and opponents of the Moynihan plan argued that reducing the tax would increase the deficit.[168] Even if a debt is not included in deficit computations, it will still have to be paid sooner or later. Thus, the only reason for removing Social Security from deficit calculations must have been to minimize the figures announced to the people who were unaware of the dishonest method of accounting.

Opponents suggested that reducing contributions would weaken the financial integrity of the Social Security system.[169] President Bush even argued that the change might result in bankruptcy.[170] These complaints have no apparent connection to reality. No one seriously suggested a need for reserves exceeding expenses of the current year, and even if they had, the reserve was equal to disbursements of one and one-half years in 1991.[171] So long as the reduced rates maintained a reserve at least as great as the expenses for one year, there should not be a

---

166. The lowest rates under the proposal were 5.2% on employers and employees for 1996-2009. If the new workers averaged $20,000 a year under the 1996 rates, the fund would receive $2,04 million from them and their employers. 137 CONG. REC. 5579-82 (daily ed. Jan. 14, 1991) (statement of Sen. Moynihan); Alex Prud'homme, *The Common Man's Tax Cut*, TIME, April 1, 1991, at 28; Paul Roberts, *Worker's bondage to the tax collector*, WASH. TIMES, April 18, 1991, at G3.

167. Omnibus Budget Reconciliation Act of 1990 § 13,301, 104 Stat. (1990); H.R. CONF. REP. NO. 964, 101st Cong., 2d Sess. 1160-61 (1990), *reprinted in* 1990 U.S.C.C.A.N. 2865-66.

168. Donald Lambro, *Social Security More Likely To Be Cut*, WASH. TIMES, Feb. 1, 1991, at A4; Tom Wicker, *The Party of April 15*? N.Y. TIMES, April 17, 1991, at A23. *See generally Budgetary Treatment of Federal Trust Funds: Hearing Before the Legislation and Nat'l Security Subcomm. of the Gov't. Operations Comm.*, 101st Cong., 1st Sess. 27-33 (1989) (statement of Rep. Butler Derrick); *id.* at 33-51 (statement of Rep. William Alexander); *id.* at 90-104 (statement of Isabel V. Sawhill, Senior Fellow, Urban Institute); *id.* at 104-16 (statement of Carolyn L. Weaver, Dir., Social Security & Pension Project, American Enterprise Inst. for Public Policy Research).

169. Jeffrey Birnbaum, *Sen. Mitchell Proposes Cut in Payroll Tax*, WALL ST. J., Feb. 7, 1991, at A6.

170. President's Letter to congressional Leaders on Social Security, 27 WEEKLY COMP. PRES. DOC. 492 (April 23, 1991).

171. BD. OF TRUSTEES, 51ST ANNUAL REPORT, H.R. DOC. NO. 88, 102d Cong., 1st Sess. 24 (1991).

short-term financial crisis. The highest rates allowed under current law are 6.2% for 1990 and all subsequent years.[172] The reduction plan had several higher rates for later years, including 8.1% beginning in 2050. Therefore, the reduction plan was a better bet to provide long-term stability.[173]

Regardless of the merits of the reduction plan, the Senate rejected it by a lopsided vote in April of 1991. Senator Moynihan said that he felt unable to push the plan again in 1991, and the reduction plan has not been resurrected to date.

IV. The Public Employee Retirement Income Security Act (PERISA)

Assets of public plans may be misused by legislators, trustees, or the two acting in concert. Many legislators and trustees seem to be unaware of the legal status of public plans and the potential consequences of misusing assets.[174] Because remedies for misconduct are primarily based on common law and equitable principles,[175] there may be substantial differences from one jurisdiction to another. A uniform set of express rules would ameliorate the problems caused by rules which are indefinite or inconsistent.

When ERISA was being considered early drafts included government plans. Federal funds, including Civil Service and Social Security, and funds of state and local governments would have been covered. Suggestions that compliance would be very expensive led to an exemption for government plans and a study of the cost.[176] Subsequent proposals to regulate state and local plans were called PERISA.

The original version of PERISA was rudimentary in comparison to ERISA.[177] Many duties applicable to private arrangements were not imposed on state and local government plans. Horrified at the prospect

---

172. I.R.C. §§ 3101(a), 3111(a) (West Supp. 1991); 137 Cong. Rec. 5579-82 (daily ed. Jan. 14, 1991) (statement of Sen. Moynihan). *See generally Read His Lips*, New Republic, Feb. 12, 1990, at 7.

173. Jeffrey H. Birnbaum, *Senate Rejects Payroll Tax Cut by Big Margin*, Wall St. J., April 25, 1991, at A2.

174. *E.g.*, *Picking Losers, supra* note 64; Joyce Terhaar, *Budget Plans Will Hit PERS*, Sacramento Bee, June 5, 1991, at § F, p. 1.

175. H.R. Rep. No. 533, 93d Cong., 1st Sess. 4-5 (1973), *reprinted in* 1974-73 C.B. 213-14.

176. *Compare* H.R. Rep. No. 533, 93d Cong., 2d Sess. 18 (1973), *reprinted in* 1974-3 C.B. 227 (1974) *with* 29 U.S.C. §§ 1002(32), 1003(b)(1) (Supp. II 1990). *See generally* H.R. Rep. No. 779, 93d Cong., 2d Sess. 17, 163 (1974), *reprinted in* 1974-3 C.B. 260, 406; H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 360 (1974), *reprinted in* 1974-3 C.B. 521.

177. H.R. Doc. No. 6525, 96th Cong., 1st Sess. (1980); H.R. Doc. No. 14138, 95th Cong., 2d Sess. (1978).

of minimal requirements and the specter of additional rules which might be added at later times, state and local governments mounted an intensive lobbying effort.[178]

Several witnesses testified during hearings on the original proposal. Most were representatives of state and local governments who argued that PERISA would unnecessarily increase pension costs. Like the ERISA opponents, opponents to PERISA preferred being able to do whatever they wanted without interference.[179]

Proposals were introduced and hearings were held in every year from 1978 through 1984. Each time, a parade of witnesses opposed the bill for reasons which had no apparent merit except for a desire to maintain the status quo. None of the bills were passed by either House of Congress, and no bill was introduced after 1984.[180]

There are two likely reasons for the success of the opposition. First, Congress may never have been particularly interested in regulating governmental plans. Second, Congress may have yielded to pressure from state and local political colleagues. These two possibilities suggest that state and local employee groups did not express adequate interest in PERISA to their Congressional delegations.

Suggestions that potential costs would have outweighed prospective benefits requires examination.[181] The principal cost for plans under ERISA is compliance with the anti-discrimination rules. Without the specific requirements for things like participation, accrual of benefits, and vesting, and the general requirement that contributions or benefits be non-discriminatory, the cost of compliance with ERISA would be minimal. Although opponents complained about the cost of compliance at great length during ERISA hearings private pension plans under ERISA have actually continued to grow at a substantial rate. Because PERISA requirements are minimal in comparison to those of ERISA,[182] one should suspect that there is little or no merit to the cost arguments.

---

178. *E.g.*, *Hearings on Public Employee Retirement Income Security Act of 1980: House Comm. on Ed. & Labor*, 96th Cong., 2d Sess. 159-73 (1980) (statement of James Krivitz, representing Nat'l Assn. of Counties).

179. *E.g.*, *id.* at 141 (statement of Robert J. Egan, Ill. State Senator, and Chairman of Ill. Public Employees Commission).

180. *E.g.*, *Hearings on Public Employee Retirement Income Security Act of 1982: House Comm. on Ed. & Labor*, 97th Cong., 2d Sess. 351 (1982) (statement of James Clark, Jr., President of Md. State Senate & Chairman of Pensions Comm. of Nat'l Conference of State Legislators, representing Nat'l Governors Assoc.).

181. *E.g.*, *Hearings & Markups on H.R. 2456 and H.R. 6536 Before the Fiscal & Gov't Affairs Comm.*, 95th Cong., 1st Sess. 6-7 (1977) (statement of former Rep. Thomas M. Rees).

182. *E.g.*, *Hearings on Public Employee Retirement Income Security Act of 1980: House Comm. on Ed. & Labor*, 96th Cong., 2d Sess. (1980) (text of bill).

In fact, cost was probably argued because there was no other way to avoid regulation. One can only speculate why Congress accepted the argument.

Congress has never been interested in regulating Social Security. Although Congress ordered a study on the cost of compliance, no study has actually dealt with the issue.[183] While there have been several proposals to regulate state and local plans, no one has introduced a bill covering Social Security or other federal plans. Congress believes that federal plans comply with the general spirit of ERISA, and it does not want to finance any costs of complying with specific rules.

The need for regulation of all government plans has been discussed. This Article has examined the affirmative acts and omissions of the Secretary of the Treasury and other trustees of the Social Security system and the misconduct of legislators and trustees of state and local plans.[184] There is no question that there is a need for regulation and that the potential good stemming from regulation far outweighs the costs.

Many of the subjects that might be covered by PERISA are beyond the scope of this Article. Topics such as discrimination and vesting have nothing to do with the misuse of assets. However, other matters such as fiduciary conduct and funding are relevant.[185]

As an illustration of the deficiencies in private retirement plans, consider the experience of the Studebaker Motors Co. In many important respects—including participation, accrual of benefits, and vesting—the Studebaker plan was very favorable to employees. However, when Studebaker went out of business, many unsuspecting employees discovered that their dreams of a secure retirement were lost because the Studebaker plan had little or no money to pay benefits.[186] The purpose of a funding rule is to force employers to contribute money for benefits as they are earned. Even if the employer becomes unwilling or unable to continue the plan, there will be substantial funding for benefits earned under the plan.

Opponents believe that there is no need for a funding rule in government plans. They argue that since governments do not go out

---

183. Pension Task Force, 95th Cong., 2d Sess., Report on Public Employee Retirement Systems (Comm. Print 1978).

184. *See, e.g., Hearings and Markups on H.R. 2456 and H.R. 6536 Before the Fiscal & Gov't Affairs Comm.*, 95th Cong., 1st Sess. 6-7 (1977) (statement of former Rep. Thomas M. Rees); H.R. Rep. No. 779, 93d Cong., 2d Sess. 163 (1974), *reprinted in* 1974-3 C.B. 406; *Picking Losers, supra* note 64.

185. I.R.C. §§ 401(a)(4), 411(a), 412(a) (1986); 29 U.S.C. § 1104 (Supp. II 1990).

186. Seth Earl Herbert, *Investment Regulation and Conflicts of Interest in Employer-Managed Pension Plans*, 17 B.C. Indus. & Com. L. Rev. 127 (1976).

of business, the taxing power is always available to provide funding on a pay-as-you-go basis. Although this line of reasoning is fine for governments that do not overspend, a funding requirement is the only adequate response to a Ponzi-type approach to funding.[187]

Certain transactions should be prohibited or restricted. ERISA forbids loans to the employer and limits investments in employer property to 10% of plan assets.[188] Those measures are designed to reduce the risk of loss, and there is no substantial difference between private and public plans. Governments usually do not attempt to borrow from a plan unless they are unable to borrow from anyone else. Investments in properties such as bonds and other securities should be limited to encourage diversification. An exception could be made for federal plans such as Social Security, whose investments have always been limited to federal obligations.[189]

Fiduciary conduct should be subject to several express duties. The statute should require undivided loyalty to the beneficiaries, as well as compliance with the prudent investor rule and diversification principles. The prudent investor principal should be expanded to identify the viewpoint to be used when working with cases. ERISA defines the prudent investor as a person in the business of being a fiduciary.[190] Thus, the conduct of the Secretary of the Treasury and the Board of Social Security Trustees would be judged by the actions of entities such as the Chase Manhattan Bank and the Bank of America.

Enforcement of regulations may be the biggest problem. Experience under the Disclosure Act demonstrated that beneficiaries and others with notice are unlikely to pursue remedies. One reason was that the cost of suing without any chance of a direct financial recovery is prohibitive. Another was a reluctance to upset the employer. As a solution to these enforcement problems, ERISA give administrative agencies the authority to use judicial and other remedies to enforce the plan and ERISA.[191]

ERISA permits just about everyone to sue just about anybody. For example, beneficiaries, the IRS, and the Labor Department can

---

187. Cunningham v. Brown, 265 U.S. 1, 7-9 (1924); *Hearings & Markups on H.R. 2456 and H.R. 6536 Before the Fiscal & Gov't Affairs Comm.*, 95th Cong., 1st Sess. 6 (1977) (statement of former Rep. Thomas M. Rees); H.R. Rep. No. 779, 93d Cong., 2d Sess. 163 (1974), *reprinted in* 1974-3 C.B. 406.

188. 29 U.S.C. §§ 1106(a)(1)(B) (1988), 1107(a)(2) (Supp. II 1990).

189. *E.g.*, Social Security Act of 1935 § 201, 49 Stat. 713 (1935) (current version at 42 U.S.C. § 401 (1992)).

190. *See* 29 U.S.C. § 1104(a)(1) (Supp. II 1990).

191. *E.g.*, Tax Treatment of Survivor Benefit Plans of the Uninformed Services, H.R. Rep. No. 298, 93d Cong., 1st Sess. (1973), *reprinted in* 1974-3 C.B. 213.

sue the trustees and the employer, and the trustees likewise can sue the employer. Federal and state courts have concurrent jurisdiction to hear suits to enforce the plan and ERISA, but federal courts have exclusive jurisdiction over criminal prosecutions.[192]

Identifying the agency responsible for enforcement is another issue. There is no apparent reason for creating a new agency, since two existing bodies work with the types of issues which PERISA covers. Granting substantial duties to two agencies has not worked well under ERISA, so that approach should not be adopted under PERISA.[193] The probability of political influence is a major concern in deciding how to regulate governmental plans. Labor has not demonstrated substantial interest in ERISA enforcement. On the other hand, IRS is less susceptible to political pressure, and has expended much effort on ERISA enforcement in areas such as funding.

Whenever there is doubt about whether officers will faithfully perform their duties, oversight is one response. Beneficiaries and representative groups including unions should be encouraged to report any irregularities to the enforcement agency. If these complaints do not produce satisfactory results, then those persons should be able to sue the enforcement agency.[194] A successful plaintiff should have the right to recover attorney fees and other litigation costs, and the court should have discretion to award punitive damages against the enforcement agency.

V. Conclusion

Politicians who are desperate for money will take it from anyone, including widows and orphans. Beneficiaries have a contractually based property interest in government pension plans and are entitled to sue if the terms of the plan are not observed. For example, retired and employed beneficiaries of the West Virginia pension plan could sue the state for refusing to comply with its duty to contribute to the plan and could sue the trustees for permitting unauthorized withdrawals.[195]

Misuse of assets is the Watergate of government pension plans. The attitude of many officials is illustrated by the remarks of one investment advisor. When asked why he did not do more to stop risky

---

192. 29 U.S.C. § 1132(a) (Supp. II 1990).

193. *E.g.*, 29 U.S.C. § 1204 (1992); Beverly M. Klimkowski & Ian D. Lanoff, *ERISA Enforcement: Mandate for a Single Agency*, 19 U. Mich. J.L. Ref. 89 (1985).

194. *See* I.R.C. § 7430(a) (1986).

195. *E.g.*, Aikens v. Alexander, 397 N.E.2d 319 (Ind. Ct. App. 1979); Board of Trustees v. City of Baltimore, 562 A.2d 720 (Md. 1989); Dadisman v. Moore, 384 S.E.2d 816 (W. Va. 1988).

investments by the Kansas pension plan, he said, "[W]hen the locomotive is coming down the track, you don't throw yourself in front of the train."[196] But, in fact, it was his fiduciary duty as a trustee to throw himself on the rails in front of the oncoming locomotive. The only question is why an experienced and apparently responsible official failed to comply with the duties of his office.

Regardless of the words used, government pension plans are trusts under state law. Those who have discretion to manage trust affairs are trustees. The duty to manage plan assets can be divided into three categories: (1) timely collection of employer and employee contributions in full from the government, (2) proper investment of plan assets, and (3) limiting distributions to those approved by the plan.[197]

There remains a need for additional regulation of pension funds. Although most of the topics that might be covered by PERISA are beyond the scope of this Article, the need for explicit fiduciary standards and active administrative oversight and enforcement was highlighted by recent events.[198] Federal statutes should make clear that government pension arrangements are always trusts and that those in charge of their management are always trustees.

All government plans should be covered by PERISA. So long as the plan is primarily for government employees, it should not matter whether it is run by the government, an agency, or instrumentality, such as a school board or a labor union. Plans primarily for other persons such as Social Security should also be covered.

The fiduciary standards under PERISA generally ought to be the same as those of ERISA. The statute should expressly: (1) impose a duty of timely collection of contributions in full, (2) mandate a strict and comprehensive prudent investor rule, (3) call for an adequate return on investments, (4) include a list of prohibited transactions, (5) limit disbursements to purposes identified by the plan, and (6) require undivided loyalty to the beneficiaries.[199]

The prudent investor rule should cover several subtopics. Since a prudent investor would be concerned about whether he is likely to get his money back, he would carefully make reasonably safe investments and would diversify his portfolio to eliminate undue risks in order to reduce the possibility of large losses. Loans to employers would be

---

196. *Picking Losers, supra* note 64; *see generally* Mertens v. Hewitt Assocs., 948 F.2d 607 (9th Cir. 1991), *on remand sub nom*, Mertens v. Kaiser Steel Retirement Plan, 1992 U.S. Dist. LEXIS, 10770 (N.D. Cal. 1992), *cert. granted*, 1992 U.S. LEXIS 5544.

197. *E.g.*, Dadisman v. Moore, 384 S.E.2d 816 (W. Va. 1988).

198. *Id.* at 821-22.

199. 29 U.S.C. §§ 1104(a) (Supp. II 1990), 1106(a) (1988).

prohibited, since they tend to be unnecessarily risky. Holdings of employer property should be limited to 10% of plan assets for the same reason.[200]

Jurisdiction should be similar to ERISA. Federal and state courts should have concurrent jurisdiction to hear lawsuits brought by interested persons such as beneficiaries, governments and trustees. Courts should be authorized to grant legal and equitable relief against beneficiaries, governments and trustees. There should be concurrent jurisdiction to hear criminal prosecutions against trustees for intentional impropriety.[201]

Enforcement may be the major problem. The Disclosure Act did not work because beneficiaries and representative groups, such as unions, were frequently unwilling to pursue claims.[202] There is a need for an aggressive body that is responsible for enforcement. Because creating a new agency seems unnecessary, the problem lies in identifying the existing agency best able to manage pension fund issues. Labor is not a good choice because it is relatively political and has not demonstrated substantial interest in dealing with ERISA problems. IRS is much less political and has exerted considerable effort in ERISA matters, so it may be the best choice.

Congress does not like the idea of reasonable regulation of government plans. Congress demanded annual reports when Social Security was on the brink of bankruptcy, deciding it was prudent to oversee the financial operations of other plans. Although the statute used most of the ERISA definition of annual reports, it rejected the clause which would have required that the reports be made available to beneficiaries.[203] Thus, beneficiaries do not have a legal right to the annual reports and can get them only through the cooperation of members of Congress. There has been no proposal to regulate other aspects of federal plans.

Congress has the same general attitude towards regulating state and local plans. In 1978, the results of an ambitious, extensive Congressional study of those plans were published. Although the study indicated the need for regulation and although bills were introduced

---

200. 29 U.S.C. §§ 1104(a)(1)(C) (Supp. II 1990), 1107(a)(2) (Supp. II 1990).

201. 29 U.S.C. §§ 1131, 1132 (Supp. II 1990).

202. H.R. Rep. No. 533, 93d Cong., 1st Sess. 4 (1973), *reprinted in* 1974-3 C.B. 213; Scott Earl Herbert, *Investment Regulation and Conflict of Interest in Employer-Managed Pension Plans*, 17 B.C. Indus. & Com. L. Rev. 127 (1976); Robert Tilove, Public Employee Pension Funds 217 (vol. 1 1976).

203. 31 U.S.C. §§ 9501-04 (1992); H.R. Rep. No. 1678, 95th Cong., 2d Sess. (1978), *reprinted in* 1978 U.S.C.C.A.N. 5772.

in every year from 1978 through 1984,[204] not one bill passed either House of Congress. Proponents admitted defeat and abandoned the cause. No bill has been introduced since 1984.

Reasonable programs will not be enacted unless proponents and representative groups actively pursue the matter. State and local legislators who naturally oppose directives will certainly lobby hard to defeat any PERISA proposal. Regulation of federal plans is even more unlikely, since Congress does not want to pay the cost of compliance. This strong opposition to PERISA must be countered by public outcry insisting on universal employee retirement regulation. It is only when the public voice is heard that participants will gain the protection that private employees currently enjoy under ERISA.

---

204. Pension Task Force, 95th Cong., 2d Sess., Report on Pub. Employee Retirement Systems (Comm. Print 1978); *see, e.g.*, *Pub. Retirement Income Security Act of 1978; House Comm. on Ed. & Labor*, 95th Cong., 2d Sess. (1978); H.R. Rep. No. 1138, 98th Cong., 2d Sess. (1984).