U.S. Pension Plans and Retirement Systems

An Honor Thesis (ID 499)

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The provision of economic security for those aged 65 and over has been developing economically, socially, and politically since the beginning of this century. From 1920 to 1970, the number of people in the United States has doubled, and the number of people over age 65 has quadrupled. Over the last fifty years, those aged 65 and older have increased from 4.6% of the population in 1920 to 9.8% of the population in 1970. It is estimated that the number of aged people will total 40.3 million by the year 2020. This assumption is based on a decline in birthrate, an increase in life expectancy, and a reduction in immigration.

In 1890, the aged comprised 3.9% of the labor force. Now the number has more than doubled in size although they still total approximately 3.5% of the labor force. Because of society's transition from an agrarian to an industrial economy, businesses are finding it necessary to provide for the retired employee. With the acceptance of retirement at age 65 and with the increase in longevity, industries realized a need for an improvement in social insurance and pensions.\(^1\)

There are other reasons for the development of pensions. First of all, people in general find it difficult to save or invest for their future.

High-pressured advertising and liberal extension of installment credit have conspired to tie up the worker's income even before it is earned. As a result, systematic provision for old age has become a secondary consideration in the budget calculations of the majority of families.\(^2\)
Secondly, the rise in income taxes has made it virtually impossible to accumulate an estate. A third factor is the influence of inflation, which especially impairs the saving plans of those with fixed incomes. Also, many reaching retirement age now experienced the depression of the 30's which completely devastated their savings and eliminated their opportunity to accumulate funds. Lastly, the geographical mobility of recent generations has changed society. Where the elderly used to reside with their families who cared for and supported them, the old now depend upon their employers or the government.
The first public employee retirement system in the United States was introduced in 1859. The plan covered the New York City policemen. For the next fifty years, more and more municipal plans (including teachers) were established. Then Massachusetts was the first state to cover its general state employees. During the 1900's, public pension plans have grown tremendously and now cover 90% of state, provincial, and local employees in the United States and Canada.\(^3\)

The federal Old-Age, Survivors, and Disability Insurance (OASDI) created by the Social Security Act of 1935 was the most comprehensive and important undertaking in constructing a foundation for public pension plans. Through this legislation, coverage is not based on encompassing the entire population but on including those in the labor force. Therefore, as a whole, all gainfully employed, and even the self-employed, were to assume responsibility for the support of the old-aged after retirement.

Retirement, disability, and survivorship are provided for by OASDI benefits. The benefit is in the form of a life income payable after age 65, or proportionately reduced between ages 62 and 65. Under survivorship, the wife of the insured is entitled to fifteen percent of the primary insurance amount if over 65.
Then in 1958, the restriction on minimum age was eliminated. The amount of the benefit is calculated by the insured's "covered earnings" which is actually an average monthly wage computed for a certain number of years (after 1950) in which earnings were the highest. This usually applies to the years between ages 26 and 62, and covers at least 5 years.

Another type of public pension plan is the Federal Staff Retirement Plan, which covers federal employees not included in OASDI funds. In 1920, the Civil Service Retirement System was established. It is the largest single-employer pension plan for retirement, disability, and survivorship. Initially the plan made coverage compulsory for 2.7 million employees. Other federal public pensions are provided through the Armed forces, foreign service, Federal Reserve Banks, Tennessee Valley Authority, and members of the federal judiciary. In coordination with OASDI is the Railroad Retirement System established by legislation in 1937. Underwritten by the federal government, this plan was to enable private employees to restore financial stability to railroads.

Public pensions are also provided through state and local retirement systems. Policemen, firemen, teachers, and those who serve the community are usually covered by a public pension plan. The first plans generally developed were for policemen and firemen because of the hazardous work they performed. After a brief number of years, usually twenty, a benefit is then issued at a young age.

The Old-Age Assistance (OAA) plan, financed by general
revenues, came into existence along with the Social Security Act. For those not qualified for OASDI and over age 65, they may be eligible to receive OAA benefits. One could also be included if the benefits provided by OASDI were inadequate. Recently, OAA was replaced by the Supplemental Security Income plan (SSI). Coverage extends to the needy and the blind. Under this "guaranteed income plan", a single person could receive $146 per month or a married person could receive $219 per month by 1975 standards. One other important source of income is the Veterans Administration who provide benefits for the old.

In *Retirement Systems for Public Employees*, Thomas P. Bleakney gives an analogy of a public pension plan.

The state needs a new, large office building. It will be a multi-million dollar project. The money required to build will be expended over two years. Instead of trying to cover costs in such a short time, the state will borrow the cost. Interest charges and bond retirement payments will spread the cost over the years the building is used.

Public pensions work just the opposite way. The time of pension payments to an employee come after years of using his service.

The principle is if the building is to be paid for by the generation of taxpayers who gain utility from its existence, so also should the pension of a public employee be paid for by the generation of taxpayers who use his services.
Private Pension Plans

Private pension plans originated from the employer's need to recognize an employee's long and faithful service. In the beginning, however, the employer had the right to terminate a benefit at any time. Today, the employer must follow stricter guidelines set forth by laws governing pension plans which guarantee the rights of the employee. Two theories, the Human Depreciation concept and the Deferred Wage concept, explain the purpose of private pension plans.

The Human Depreciation concept was first used by the United Mine Workers in the 1920's and then by the steel industry in 1949. Their arguments could have been similar to the following quote.

"We think that all industry, in the absence of adequate government programs, owes an obligation to workers to provide for maintenance of the human body in the form of medical and similar benefits and full depreciation in the form of old-age retirement--in the same way as it does now for plant and machinery."

Arguments for and against the Human Depreciation theory are plentiful. The main reasons against this theory are (1) an employee ages from employment, but this is a physiological process, (2) it places the responsibility of support upon the last employer, and (3) the cost of replacing a human does not equal the cost of replacing a machine. The replacement of a human involves the cost of retraining, whereas the replacement of a machine involves accumulating funds to the new purchase price.

Points in favor of the theory are (1) maintaining the human
resource during and after working years should be a cost of production, (2) depreciation is made for machinery which is not always replaced, (3) an employer should be obligated to support the retirement needs of an employee who has served him for an extended period of time, and (4) social pressures stress for the accumulation of funds to support a retired employee.

The theory behind the Deferred Wage concept is stated as an employee group has the prerogative of choosing between an immediate wage increase and a pension plan, and having chosen the latter, is entitled to regard the benefits as deferred wages. Actually, the plan guarantees that a payment at the time of retirement will be paid in one form or another. However, the amount the insured receives as a benefit is only approximately equal to the amount he forgoes in wages.

In either concept, the pension rewards the employee who has served the employer for a certain number of years. Generally, the reward is paid in the form of a benefit at retirement age. Some pension plans issue payments to the insured if an employee becomes disabled or to the insured's beneficiary in the form of a death benefit.

By knowing one will eventually receive benefits, it has been discovered that employees will preserve the folklore of the industry, foster loyalty to the firm and its traditions, and transmit skills from the old to the young.

Once it was established that companies should provide financial security to its retired employees, several factors contributed to the growth of formal pension plans. First of
all, employers were concerned with the number of employees still working beyond a normal retirement age. If a company discharged an employee without some form of benefit, it would surely face public censure. Or, if a superannuated employee remained on the payroll at a reduced pay, the employee performed with less ability and energy. Not only would a pension resolve these concerns, but it would mitigate the anxiety over old-age security, reduce turnover and the cost of training replacements, and provide means whereby executives and supervisors retire at their peak opening channels for promotion.

Before legislation, contributions to a trust fund for an employee's pension were tax deductible from the employer's gross income if the pension was an ordinary and necessary business expense and if it provided reasonable compensation. However, income from the trust was still taxable until the Revenue Act of 1921 which made income from trusts exempt from taxes if it was used as a stock bonus or in a profit-sharing plan. Not until the Revenue Act of 1926 was income from trusts exempt from taxes if used for pensions.

Legislation of a series of acts provided the employer additional incentives to maintain a pension plan. The Revenue Act of 1928 allowed the employer tax "reductions for reasonable amounts paid in to a qualified trust in excess of amounts required to fund current liabilities". In 1938, the Non-Diversion Rule made it impossible at any time for part of the trust to be used for any other purpose than that for the exclusive benefit of the employee. Because too many plans favored only a few select employees, the
Revenue Act of 1942 tightened up the qualifications for a pension plan. Current taxes are based on the Revenue Code of 1954. If a plan meets the code's requirements, it is considered "qualified".* Such a plan is prized and sought by the employer.

Pressure from organized labor was another factor influencing the growth of pension plans. During the 1940's and 50's, labor unions were basically opposed to pension plans although in 1949 one organized labor union demanded pension plans instead of increased wages. Controversy arose between Inland Steel and the National Labor Board as to whether provisions of pension plans were within the scope of collective bargaining. The Federal court ruled that they were. Since 1949, organized labor has been an important force in the establishment of pension plans which have brought economic security to millions.

Lastly, social pressure has significantly contributed to the growth of pension plans. The early 30's depression caused feelings of insecurity throughout the country. The inability (or unwillingness) of the individual to accumulate funds on his own has increased pressure upon the employer to share the burden. If an employer does not provide for superannuated employees through a pension plan, he must compensate in some way. Most have found pension plans to be the economical way.

*In order for a pension plan to be qualified, it must meet requirements under these categories: (1) written document, (2) permanency, (3) segregation of plan assets, (4) percentage of employees covered, (5) nondiscrimination in contributions or benefits, (6) participation and vesting requirements, and (7) definitely determinable benefits.
Nearly one-half of all workers in commerce and industry in the U.S. and three-fourths of all government civilian personnel are now enrolled in retirement plans other than OASDI (Social Security). This included those enrolled in profit-sharing plans which provide for an income at retirement. The number of participants is estimated to be close to 50 million.\footnote{12}

It is often difficult to determine the number of "covered" workers and/or beneficiaries under a pension plan. Future benefits under a pension plan are based on the employee's attained age, length of service, and the financial soundness of the plan. Dependents and survivors are not counted until they actually receive any benefits. Also, an individual may be covered by several plans if he or she has met the vesting requirements under each one. One may have coverage through his own employer and also be covered as the spouse under another employer's plan.
### Number of Persons Covered by Major Pension and Retirement Programs in the United States

\[ (000,000\text{ Omitted}) \]

<table>
<thead>
<tr>
<th>Year</th>
<th>Private Plans</th>
<th>Government-Administered Plans</th>
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<tbody>
<tr>
<td></td>
<td>With Life Insurance Companies</td>
<td>Other Private Plans</td>
</tr>
<tr>
<td>1930</td>
<td>100</td>
<td>2,700</td>
</tr>
<tr>
<td>1935</td>
<td>285</td>
<td>2,525</td>
</tr>
<tr>
<td>1940</td>
<td>695</td>
<td>3,565</td>
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<tr>
<td>1945</td>
<td>1,470</td>
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<tr>
<td>1950</td>
<td>2,755</td>
<td>7,500</td>
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<tr>
<td>1955</td>
<td>4,105</td>
<td>12,290</td>
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<tr>
<td>1960</td>
<td>5,475</td>
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<td>1961</td>
<td>5,635</td>
<td>18,440</td>
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<td>5,770</td>
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<tr>
<td>1965</td>
<td>7,040</td>
<td>21,060</td>
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<tr>
<td>1966</td>
<td>7,835</td>
<td>21,710</td>
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<tr>
<td>1967</td>
<td>8,700</td>
<td>22,330</td>
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<td>1968</td>
<td>9,155</td>
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<td>1970</td>
<td>10,480</td>
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<td>1971</td>
<td>10,880</td>
<td>26,580</td>
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<td>1972</td>
<td>11,545</td>
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<td>1973</td>
<td>12,485</td>
<td>28,700</td>
</tr>
<tr>
<td>1974</td>
<td>13,335</td>
<td>29,240</td>
</tr>
<tr>
<td>1975</td>
<td>15,195</td>
<td>30,300(^3)</td>
</tr>
</tbody>
</table>

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1. Includes members of the U.S. Civil Service Retirement System, the Tennessee Valley Retirement System, the Foreign Service Retirement System of the Federal Reserve Banks, which includes the Bank Plan and the Board of Governors' Plan.

2. Includes persons employed with coverage in effect at year-end including the self-employed, workers retired for age or disability, dependents of retired workers, and survivors of deceased workers, who are receiving periodic benefits.

3. Estimated

Source: Compiled by the American Council of Life Insurance
Qualified Pension Plans

Before 1974, nothing substantial governed the operation of pension plans. The laws presented by the Internal Revenue Code or the Federal Welfare and Pension Plan Disclosure were limited and ineffectual. The Labor-Management Relations Act of 1947 (Taft-Hartley Act) ruled over plans administered by both labor and management. Plans under insurance companies, assets of funds through banks and trust companies, and assets of state-regulated institutions all had their own specific laws. An individual had no protection against corrupt administrators and no guarantee of benefit rights. Nothing assured the actuarial soundness of a plan; all that could happen was a company losing its "qualified" status.

The Employment Retirement Income Security Act (ERISA) became the one single law established to cover all pension plans. Its origins began with a Report of Commission on Money and Credit which defined pension plans, the firm, and the participant's interest. In 1962, the economic report of President Kennedy reviewed the rules of pension plans and tax privileges, thereby establishing the President's Commission on Corporate Pension Funds. This commission developed a "provisional report" which was referred to the Advisory Commission on Labor Management Policy near November, 1962. They in turn reported to President Johnson in late December of 1963. Then in President Johnson's release of January 1965, he listed recommendations to protect the public interest.
Subsequently, the Interagency Task Force was appointed to study the public's reaction and to develop appropriate legislation. As a result, the Pension Benefit Security Act (PBSA) was introduced to Congress in 1968; however, this was dropped by the Nixon administration. Many disputes between the executive branches continued. After further battling ensued, mainly between four legislative committees, the Senate finally adopted a pension reform bill in September 1973, and likewise, the House of Representatives adopted one in March 1974. By August of 1974, a compromise was reached between the houses. President Ford signed ERISA into law on Labor Day, September 2, 1974.

Since ERISA had to satisfy four legislative committees, it is very complex, and it is composed of several hundred pages. The major compromise involved jurisdiction over pension plans. Jurisdiction by the Department of Labor and the Treasury Department is either exclusive, joint, or overlapping. The Treasury Department primarily rules over vesting, funding, and participation; whereas, the Department of Labor mainly rules over reporting, disclosure, and fiduciary matters.

Because of its length and complexity, ERISA is divided into sections or titles. Title I guarantees employees protection of benefit rights. Title IV pertains to plan termination and participant's vesting rights. Title II is concerned with tax matters, particularly of qualified pension plans. This is the first time the IRS enforced the actuarial soundness of a pension plan.
The actuarial reports required under law must be signed by persons called "enrolled" actuaries, who have met these standards. The actuary must certify annually that the actuarial assumptions and methods used to determine the costs and funding requirements of the plan are, in the aggregate, reasonable and reflect the actuary's best estimate of anticipated experience under the plan.14

Two other provisions relate to tax matters. The first is referred to as the Keogh or HR-10 plans which are for self-employed individuals. Secondly, individuals not covered by a qualified pension plan can establish their own retirement savings plans. The Individual Retirement Account or the Individual Retirement Annuity, a special bond issued by the U.S. Treasury, are two possible choices.
Installation and Operation

There are numerous reasons for installing a pension plan. Recently management's concern about providing for an employee's long years of service have found pension plans as a solution to this problem. Also, the government offers sizeable tax deductions to employers who meet the specified requirements. In addition, organized labor has influenced the development of benefit plans. Funding agencies, such as insurance companies and banks, have been the pension plan's chief protagonists.

Initially, a pension plan must arouse the buyer's interest. An employer must contemplate advantages of providing pension benefits or the consequences of not doing so. Unions judge a plan on how well it supplements OASDI benefits. Meeting the general objectives of the individual and often defining special services are functions of an efficient pension plan. A final consideration is the cost. If prepared by an insurance company, the expense is included in premiums; otherwise, there is a specific fee varying according to the amount of work involved.

Deciding upon the terms of a plan involves the cooperation of both employer and the bargaining unit. Agreement upon who is covered, what kind of benefits issued, the amount of the benefit, conditions under which benefits are provided, and how benefits are financed must be met. Competition from the same kind of industry within the same area may also be a factor in determining pension benefits. A major consideration of any plan is "How much can an employer contribute to maintain a satisfactory plan?"
Employees may or may not contribute funds depending on whether provided benefits are adequate.

Contributions to a plan are made either monthly, quarterly, or annually. If payments are made by the employer and the employee, the plan is termed contributory; whereas, a plan in which only the employer makes payments into a fund is termed noncontributory.

The amount an employee contributes is based on a percentage of current compensation and the employer contributes at the same rate (i.e. 5% of current compensation) or sometimes a higher or a lower rate. Some plans provide that an employee may make additional voluntary contributions in order to increase their benefits at retirement. These contributions and their interest would be nonforfeitable and could be withdrawn at any time. Since contributions are not subject to taxes, IRS restricts voluntary contributions to less than 10 percent of current compensation.¹⁵

Reasons favoring a contributory plan are that (1) it furnishes a larger benefit to the employee, (2) sometimes an employer cannot cover the entire cost alone, and (3) members appreciate a plan more if they pay part of the cost. On the other hand, noncontributory plans are viewed as a deferred wage concept in that an employer pays for the total cost. Advantages of a noncontributory plan include (1) less complicated administration, (2) all employees are covered, (3) more flexible investments and funding are possible, and (4) the employer's contributions are
usually tax deductible. Judgement as to the types of benefits provided should coincide with allowable contributions and the objectives of the firm.

Although an employee could devise his own pension plan, consultants are usually involved in the drafting of a trust agreement. In either case, an actuary's assistance is required to verify all calculations. Before a plan is ever implemented, a company must decide which funding agency, either an insurance company or trust company, will control its pension funds. This decision would affect the forms and documents used for reporting.

Formal and legal documents are comprised of:

1. persons eligible to participate, including any requirements that must be met
2. types and levels of benefits to be provided
3. form and manner in which benefits provided
4. method of determining employer's contribution and employee's contribution
5. rights of participants on termination of employment
6. protection of employer's interest, include the right to alter or terminate plan and right to discontinue
7. rights of participants on termination of plan

Once the details are incorporated into a company's trust agreement, the document requires the approval of its board of directors.

Whether pension funds are accumulated by an insurance company or a trust company, IRS approval is a vital feature of the plan. Request for acceptability of a plan is submitted to a district office and includes copies of the plan along with all related materials compiled either by the insurance company or by a consulting actuary. If all requirements have been met, then
the IRS issues a favorable, so-called, determination letter. If not, the employer meets in conference to discuss revisions or is subject to reapproval if an agreement is made to meet stated requirements. If it is believed all requirements have been met, the employer may request a review by the National Office of the IRS and then, if necessary, take court action.

According to ERISA, the employer must supply each participant a copy of the plan in understandable language upon request. It must be furnished 120 days after the plan is established or 90 days after an individual becomes a participant. Any other material associated with the plan should also be available. Normally this is issued in booklet form when a participant enters the plan or upon revision. Also, the employer should cultivate the employee's interest and appreciation of the plan through posters, displays, interviews, meetings, and the like.

Each pension plan must establish records of all employees to determine benefits and to calculate costs and liabilities. Obtained by an application, individual information includes age, sex, birthdate, date of employment, present compensation, and beneficiaries. For a contributory plan, applications are mandatory. If the employee is contributing to the cost, then his/her participation is voluntary and an application indicates willingness for employer to deduct contributions from wages. Even though coverage in a noncontributory plan is automatic, some sort of form has to be signed by the employee to show the plan was read and explained and is binding. In addition to the given information in a con-
tributory plan, records of the amount each employee has contributed are kept. Through this method, the proper amount is awarded at retirement.

A governing board or the administration will determine whether all requirements for an individual benefit have been met and agree to the amount based upon minimum age and years of participation. If a benefit is refused, a written explanation must be given along with an opportunity for a hearing in a federal court. Depending on the funding agency, money is set aside each year and collected through premiums or deductions from weekly payroll. The amount of deduction could be set through management and labor negotiations as a percentage of salary. Estimates are often obtained through past experience and by the judgement of an actuary as to the future.

Investment of assets may be accomplished through a bank, a trust company, an insurance company, or investment advisor. Decisions are made in conjunction with a plan advisor who has the responsibility of monitoring the asset manager's services. Through contract agreement, the asset manager must guarantee benefits to the extent that they are funded.
Reporting Requirements

The Employee Retirement Income Security Act requires annual reports made to the Department of Labor and to each plan participant. Along with certifying the assumptions and methods used, the plan actuary furnishes data on the accrued liability of the plan, the normal or annual cost, contributions needed, and other actuarial information. The authenticity of all financial statements requires an independent accountant's examination.

Included in the report is a financial statement, a statement of plan assets and liabilities, a statement of receipts and disbursements, a schedule of investments, and a schedule of transactions. Besides the financial reporting, the name and address of each fiduciary must be listed along with any change in trustee, accountant, enrolled actuary, investment manager, custodian, or administrator. An explanation for the changes must also be given.

If an insurance company disburses the plan benefits, then they must disclose the premiums paid, the benefits paid, the number of people per class, administrative expenses, commissions, and dividends credited. The trustee or investment manager must approve investment transactions, investment income, and asset values and their distribution.

Both qualified public accountants and enrolled actuaries must serve in evaluating a pension plan under ERISA laws. An accountant is allowed to rely upon the correctness of any actuarial matter certified by an enrolled actuary, and vice-versa, an enrolled actuary may rely upon the correctness of a matter
examined by a certified public accountant.

The term enrolled actuary is defined in ERISA as an actuary enrolled by a Joint Board for the Enrollment of Actuaries (established jointly by the Secretary of Labor and the Secretary of the Treasury under ERISA's requirement for such establishment). The Board shall establish reasonable standards and qualifications for persons performing actuarial services with respect to plans to which ERISA applies, and upon application by an individual shall enroll such individual if the Joint Board finds such individual satisfies such standards and qualifications.17

Different standards are specified for persons applying for enrollment before January 1, 1976, and on or after January 1, 1976. For an individual applying before January 1, 1976, proposed regulations require:

(1) qualifying experience within the prior 15 years of
   (a) at least 36 months of "reasonable pension actuarial experience" (as defined), or
   (b) at least 60 months of "total responsible actuarial experience" (as defined) including at least 18 months of reasonable pension actuarial experience, and
(2) other qualifications
   (a) specified educational degree, or
   (b) specified organizational qualifications, or
   (c) satisfactory completion of examination prescribed by the Joint Board18

By ERISA funding requirements, an enrolled actuary must prepare an actuarial statement that states among other things:

(1) the number of participants and beneficiaries covered by the plan
(2) the normal cost for the year
(3) the accrued liabilities of the last valuation date
(4) the minimum contribution required for the year
(5) the current value of plan assets
(6) the accrued liability for nonforfeitable pension plans, allocated by termination priority categories (may be waived by some plans)
(7) the actuarial assumptions and methods used to determine plan costs and liabilities
(8) a certification of the contribution necessary to reduce the accumulated funding deficiency to zero

The actuary's report is part of the complete annual report.
Fiduciary Responsibility

Almost every person connected with the plan has some fiduciary responsibility. A named fiduciary stated in the plan document has authority to control and manage the operation and administration of the plan. Assets must be held in trust by either an individual, or corporate trustee, or a life insurance company, unless the plan is authorized to keep an account without one.

Since a trustee is awarded exclusive control, they are fully responsible. However, if they follow the advice of other fiduciaries they are not legally liable. In the case where a named fiduciary appoints a qualified investment manager to control plan assets, the trustee is not legally responsible. Co-trustees are allowed; but individual duties should be written and each is responsible for the other's actions. If a fiduciary specifically designates several trustees for various business reasons, then each is not responsible for the others. If a plan employs a life insurance company, it is a fiduciary and must follow ERISA standards.

To protect the rights of the participant and his/her benefits, it is illegal to divert plan assets for any other purpose than as a benefit to the participant or a named beneficiary. Even after an employee is provided for, plan contributions are still irrevocable. Only under certain circumstances may the employer recover any part of the contributions.

Besides the management of plan assets, a fiduciary must
act in the interest of the participant or beneficiary. This means they should periodically review the plan and see to the proper allocation and surveillance of delegated duties. In all actions, the fiduciary must observe the "prudent man standard", defined by law.

Unless the fiduciary can prove it wise not to diversify plan assets, they must do so to minimize the risk of large losses. (Diversification Requirement). With exceptions that are established business practices, ERISA prohibits any business or investment transaction between the plan and parties-in-interest. Fiduciaries who breach contract requirements are liable for any losses as a result of the breach. Penalties for those who participate in prohibited actions are stated under ERISA.
Coverage

Coverage refers to the class or classes of employees who are participants of the plan. This coverage depends upon whether the plan operates as multiemployer or single-employer. Under multiemployer, the plan covers employees of more than one firm which are not financially related. Therefore, funds are usually accumulated by pooling contributions of equal rates of each firm, and then uniform benefits are paid.

The multiemployer plan offers economic security and is usually, but not always, a product of collective bargaining and has emerged principally in industries characterized by skilled craftsmen, numerous small employers, intense competition, and high rate of business failure. ... Ten plans, each with over 100,000 participants, cover a third of all participants in multiemployer plans. Plans covering fewer than 1000 participants account for about three-fifths of the plans but only six percent of the participants.

The most common pension plan is that of the single-employer. They comprise the most in the number of plans and in the number of employees covered.

The IRS rules against discrimination in favor of officers, stockholders, or highly-compensated employees called the "prohibited group". This is usually avoided by covering a certain percentage of all employees. The practice is referred to as the Arbitrary Rule. The Arbitrary Rule states that 70% of all employees must be eligible for coverage, but only 80% of those eligible must participate. Employees who are excluded are those who work less than 1000 hours per year. Those who have not met age or service requirements may also be ineligible. A plan
cannot exclude an individual because of a maximum age limit or cannot exclude nonresident aliens with no income in the United States.

Example: A corporation has 500 employees.

\[
(500 \times .70) = 350 \quad \text{must be eligible for coverage}
\]
\[
(350 \times .80) = 280 \quad \text{must participate in the plan}
\]

Thus, it is possible only 56% of all employees are covered.

\[
(500 \times .56) = 280
\]

Because of stipulated exclusions, a plan may not meet the necessary percentage. In this instance, the Commissioner of Internal Revenue may still approve the plan as long as it does not discriminate in favor of the prohibited group. A plan is not discriminatory just because it is limited to salaried or clerical employees. Those employees excluded from participation in one plan may be covered by another similar plan.
Participation

Used in reference to an individual employee, participation defines the class of employees that must meet certain conditions before they are eligible to be covered by the plan. Participation does not necessarily include all employees, and separate plans may apply to different age groups. Depending upon the plan, participation commences either when the company begins records for an employee, or when he/she meets the requirements to accrue benefits, and then is measured after that point or in addition to previous years of employment.

The two requirements for eligibility are age and service. The reason for the service requirement is to reduce the administrative expense of covering those recently hired who may leave shortly thereafter. Turnover is higher among recently hired employees than those who have spent some time with a particular company. A minimum age is also to exclude those employees with higher turnover. Employees with younger ages tend to leave a company more readily than older employees. Besides, those at younger ages may not be interested in a pension plan, and therefore, would not wish to contribute to its cost.

ERISA dictates that the minimum age cannot be greater than 25. The service requirement cannot exceed one year if the employee is at least 25. However, plans with full and immediate vesting may require three years of service as a prerequisite to plan entry. Once eligible, an employee must be allowed into the plan at the beginning of the next plan year (date on which plan
commenced) or within six months, whichever is earlier.

According to the law, there cannot be a maximum age limit. Originally, the restriction intended to cut the cost of the plan because cost increases with age. It also intended to benefit those who had served a certain number of years before retirement. Now pension plans define participation requirements to exclude an employee who is within five years of retirement age when hired. By stating retirement age as the later of age 65 or 10 years service, most plans circumvent this requirement.

Some plans are noncontributory and do not have age and service requirements. Usually benefits are uniformly issued based on years of service. A "year of service" is defined as a twelve-month period in which an employee worked at least 1000 hours (or as defined by the Secretary of Labor for certain companies) beginning with the date on which the employee was hired. Years of service are for the purpose of accruing benefits; therefore, a plan must accrue benefits even if an employee works less than full time, but they can be issued on a pro rata basis. Each plan specifies its own terms for years of service in accruing benefits, but they must be consistent and applicable.

To maximize participation by all eligible employees is an objective of the company. In a noncontributory plan, all are automatically included. Most contributory plans grant the employee an opportunity for participation. Nevertheless, some plans impose restrictions upon the employee, such as the continuation of participation throughout employment; or if one
discontinues participation, reentry is not permissable; and/or benefits cannot be withdrawn until termination of service.

Example:  2,000 hours = full service ➞ full benefit
         An employee works 1,500 hours
         1,500 hours = 75% full service ➞ 75% full benefit

According to ERISA, a "break-in-service" occurs when an employee works less than 500 hours per accrual period, usually one year. At this time, no benefit accrues. If pre-break accruals are fully-vested, then they are uneffected and available to the employee. If accruals are partially vested, then they are preserved until the employee returns to service plus works during a one-year waiting period. With no vesting, all benefits are forfeited unless an employee returns before his break-in-service exceeds his service. Then the pre-break service is still used to calculate vesting privileges.
Retirement Benefit

The purpose of a retirement income is to provide for the retired employee and his dependents so they may live as close to the standard of living they had immediately before retirement. Most people do not have adequate savings, and Social Security benefits alone do not provide enough support.

It can be demonstrated that a total retirement income of 60 to 70 percent of an individual's gross earnings at the time of retirement will enable him to enjoy a standard of living that is reasonably commensurate with that which he enjoyed the later stages of his employment.21

In other words, the spendable income after retirement would equal the pension and Social Security payments. This approximates the spendable income before retirement which equaled gross wages with deductions for income tax, social security tax, contributions to a pension plan, and other expenses. Except for medical and sometimes travel costs, most expenses are eliminated after retirement. Also, a change in the tax bracket increases savings.

When developing a pension plan, the employer must consider the effect of Social Security benefits, realizing the formula favors those in the lower wage bracket, and other circumstances of each employee. One example is whether to account for the Social Security benefits of one's spouse. A plan that only accounts for the employee's spouse discriminates against an employee without a spouse. Another consideration is that the income of a lower wage earner may greatly exceed his earnings
prior to retirement. Including a provision for the cost of living is sometimes necessary. Recently, organized labor has pressurized companies to adjust benefits based on changes in the Consumer Price Index.

In contributory plans, an employer may contribute to the cost in either of two ways, the defined contribution plan or the defined benefit plan. With a defined contribution plan, both the employer and employee contribute an amount fixed by a formula, and therefore, the benefit varies. Two types of defined contribution plans are the money-purchase arrangement and the negotiated contribution plan. With a defined benefit plan, the size of the contributions vary.

To have a participant set aside a predetermined amount each period is the purpose of a money-purchase arrangement. Usually, the amount is a defined percentage of current salary and then the employer contributes at the same rate, at a lower rate, or sometimes a higher rate. Contributions are then handled by either a life insurance company or deposited in a trust fund.

Advantages of this arrangement are (1) it is simple and flexible, (2) the employer's pension cost is fully paid to date and the future cost is a percentage of payroll, (3) it is not subject to plan termination insurance and not subject to contingent liabilities, (4) the employees contributions are accumulated in an individual account, (5) there is a wide choice of disposition of funds in case of termination, (6) the vested portion of an employer's account is not frozen at the point of termination as in defined benefit plans.
Disadvantages are (1) the payment of benefits depends upon account balances and uniform contribution rates cannot be obtained to coincide with entry ages, (2) females' benefits are smaller than males' benefits because actuarial factors consider the fact that a females' life expectancy is longer, (3) greater weight is placed upon the lower wages in earlier years than the higher wages of later years of service, (4) during a period of inflation, the benefit would prove inadequate because early contributions would accumulate at lower rates of interest and could not compete with higher wages in later years, (5) employees are unsatisfied if investment management is poor, and (6) future benefits are indeterminable because they are based on future salary levels and interest rates.

Money-purchase arrangements are more popular with public employee retirement systems, nonprofit organizations, self-employed persons, or individual retirement accounts. They are not generally used by business firms.

The negotiated contribution plan originated from recent developments in collective bargaining. Generally, this plan covers several companies in which only the employers contribute to the cost. However, benefits are administered by a board of trustees in which the employees and unions are represented. According to a scale based on years of service, benefits are paid out of a pooled fund. Conflict between unions and management create problems in deciding upon an appropriate scale or contribution rate, and then adjustments are often needed.
With the other type of plan, the defined benefit, fixed benefits are more common than variable benefits and are either in the form of a unit benefit or flat benefit. In granting a unit benefit, credit is given for each year of service along with a percentage of compensation, or a fixed amount.

Example: An employee hired three years ago earns $10,000 a year. The benefit formula is $1\%$ of current compensation after one year of service. Since he meets the service requirement, he is entitled to a $150 ((1\% \times 10,000)$ annual benefit at retirement.

The percentage of compensation varies with the level of earnings. Often a "career average formula" applies in which the benefit is based on average earnings over a specified number of years service. Modification of this formula stipulates a certain number of consecutive years of past service (i.e. 3, 5, or 10) in which to calculate the average compensation.

Example: An employee who has met the minimum service requirement has earned the following wages in the last three years: $11,500; $12,000; $12,500. The average to which a benefit rate would apply is $12,000. 

\[
(11,500 + 12,000 + 12,500)/3
\]

In general, years of service utilized in determining benefits may exclude (1) years of service before a certain age, (2) the first few years of service, or (3) all service for a maximum number of years (i.e. 10, 20, or 25), or (4) before a certain date.

Before an employee is entitled to a flat benefit, a certain number of years service may be required. However, the years of service are usually not used in deriving the amount of the benefit. Normally, it is an average earning of a certain period of minimum service. Or ignoring both compensation and years of service, the
benefit formula could just set a certain dollar amount.

Example: All employees who have served the company at least 25 years can receive a $100 per month benefit at retirement.

This type of benefit was typical in earlier times, but recently many employers have amended their plans in order to change the benefit formula.
Retirement Dates

The normal retirement age (NRA) is the earliest age at which an eligible participant is permitted to retire with full benefits. However, many plans allow retirement over a range of ages usually with reductions in the benefit. Employees are expected to retire at NRA, and in some plans NRA marks the point of compulsory retirement, sometimes referred to as automatic retirement or mandatory retirement. For a particular company, this is the age beyond which further employment would be theoretically uneconomical. For the individual, NRA would depend upon physical strength versus mental agility, the type of class he or she is in, and individual characteristics. Therefore, a NRA applicable to the majority of employees must be found. By ERISA, the NRA may not exceed age 65, or if later, the tenth anniversary of a participant's entry into the plan. Exceptions are made for employees already past a specific age after a plan was adopted. (If employees were aged 55 to 60 when the plan became effective, then they work ten years or until age 70 whichever is first.)

One method of computing normal retirement age is to state an age along with a certain number of years service.

Example: Normal retirement age is 60 with 20 years service. If hired after age 40, then NRA would be greater than 60. For instance, an employee hired at age 45 would have a NRA of 65 to obtain 20 years of service.

Another method may be by the "Rule of 90" in which both the sum of a participant's age and service must be greater than 90.
Example: An employee age 55 would have to have 35 years of service \((55 + 35 = 90)\) in order to receive a benefit.

To receive a benefit before NRA, restrictions are placed upon years of service and age of entry into the plan. This may or may not require an employer's consent, and the accrued benefit will only equal the portion vested. Some companies may only permit early retirement if an employee is disabled.

The benefit for early retirement age is actuarially reduced because interest will have accumulated for a shorter period of time, payments begin earlier and last longer, and the number of years service is reduced. Retirement earlier than 10 years before NRA is not usually permitted. The amount of reduction in most cases depends upon interest and mortality rates. The greater the rates the greater the reduction.

Example: Early retirement benefit is reduced 10% from the normal retirement benefit of $100 per month for each year prior to the NRA of 65.

<table>
<thead>
<tr>
<th>Retirement Age</th>
<th>Benefit</th>
</tr>
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<tbody>
<tr>
<td>64</td>
<td>$90.00</td>
</tr>
<tr>
<td>63</td>
<td>81.00</td>
</tr>
<tr>
<td>62</td>
<td>72.90</td>
</tr>
<tr>
<td>61</td>
<td>65.61</td>
</tr>
<tr>
<td>60</td>
<td>69.05</td>
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<tr>
<td>59</td>
<td>53.14</td>
</tr>
<tr>
<td>58</td>
<td>47.83</td>
</tr>
<tr>
<td>57</td>
<td>43.05</td>
</tr>
<tr>
<td>56</td>
<td>38.74</td>
</tr>
<tr>
<td>55</td>
<td>34.87</td>
</tr>
</tbody>
</table>

For instances in which an employee wishes to work beyond normal retirement age, there is the deferred retirement benefit. To work beyond NRA usually requires an employer's consent and then an individual may only work to a compulsory retirement age (i.e. 70).
Among the reasons for continuing employment are to earn more benefit credits, to increase the salary base, to spread assets over a shorter period as to increase amount of payments, or to continue salary. In most cases, the benefit is held until the actual retirement date, but then a difference in opinion occurs as to whether the benefit should remain the same dollar amount, or whether the benefit should be actuarially equivalent to what would have been paid at NRA. There are numerous approaches in between these two extremes.

Example: Computing the benefit as if the actual retirement date was really one's NRA. Two men aged 45 and 50 were hired at the same time with the same salary. Each retiring at ages 65 and 70 respectively would receive equal benefits for the same number of years service.

It is not necessary to provide equal amounts of benefits for the number of years service. Yet, since this may lead to backloading (providing higher scale of benefits for later years of service), Congress has imposed three different tests for defined benefit plans. These tests are the 3% rule, the 133 1/3% rule, and the fractional rule.23

To protect employees, a minimum benefit must be included in a plan and stated as a certain dollar amount. A plan could formulate an annual benefit equal to 1½% of compensation and the minimum annual benefit should not be less than $90. Since 1974, an upper limit for benefits has also been established by the Internal Revenue Code. The largest benefit defined in the form of a straight life annuity is the lesser of
(a) $75,000, or
(b) 100% of an employee's average compensation during the last three consecutive years of the highest pay. These limits may change according to the cost of living and require actuarial adjustments if the benefit is not in the form of a straight life annuity. For a defined contribution plan, the maximum addition to an employee's account is the lesser of $25,000 or 25% of compensation. If an employer has two or more plans and a participant is included in more than one of them, then the total benefit or contribution must meet the limitations as if it were one plan.
Annuities

Payments made to an employee upon retirement to provide a life income which is disbursed either through an insurance company or a trust fund are called annuities. They are either life or joint-life. Both in turn may be either pure or refund types. Various options are listed below.

**Life Annuity (straight life annuity)** periodically payable to one person continually as long as he/she lives and terminates upon death; least expensive

**Life Annuity Certain and Continuous** a certain number of payments are guaranteed whether the annuitant lives or dies, and payments are continued after this point if the annuitant is living

**Refund Annuity** returns a portion of the purchase price in one form or another

**Installment Annuity** if annuitant dies before receiving monthly benefits equal to the purchase price, then annuity pays beneficiary until full cost is reached

**Cash Refund Annuity** payment equal to remaining contributions returned to beneficiary in a lump sum upon annuitant's death; "modified" means contributions with interest; not favored by employer, but adds flexibility

**Joint and Survivor Annuity** provides payments as long as either annuitant or beneficiary shall live; most expensive; income to spouse may be reduced by 1/3 or 1/2, or by other forms

**Social Security Adjustment Option** benefit from the pension plan and social security remains at the same level throughout retirement, realizing social security does not commence until age 65

Pension plans define the "normal annuity form" as the straight life annuity which sometimes includes a period certain. Each participant must be given the opportunity and an adequate amount
of time before retirement to elect a different form of annuity normally offered by the plan. Since most plans have failed to support an annuitant's spouse, ERISA has decreed

that all qualified pension plans must provide that retirement benefits payable to an employee married to his current wife for at least one year will be automatically paid in the form of a qualified joint and survivor annuity unless the participant elects otherwise.\(^{25}\)

A qualified joint and survivor annuity provides the spouse an income in the amount at least one half of the amount paid when both were alive. Soon, the joint and survivor annuity may become the "normal" benefit of a pension plan because more and more organized labor groups are demanding it.
Vesting

A participant who terminates from the service of an employer for reasons other than death or disability still has certain benefit rights. Regulations instruct plans to return all contributions made by the participant in one form or another even if the employee does not remain with the employer until early or normal retirement. It is still questionable whether to refund contributions with or without interest. Some provide no interest while others may refund at a lower rate.

In the past, if a participant withdrew his contributions, he/she then forfeited the right to accrued pension benefits from the employer's contributions even though he/she would have had vested interest in them. Also, the withdrawal of pensions presented a problem in that the younger employees' contributions are greater than the cost of accruing benefits. Despite this fact, Congress sided with the employees and restricted employers from denying vested benefits unless the employee was less than fifty percent vested.

Vesting can either be immediate or deferred. The deferred form generally requires meeting a number of years of service and reaching a certain age.

Example: Vesting deferred: To become fully vested (100%) an employee must have 20 years of service at the attained age of 45.

The rate of vesting is either full or graded. With full vesting, all conditions are satisfied and benefits to that date are 100% vested and all benefits accrued are also vested in full. Graded
vesting means only a percentage of accrued benefits are vested. Full vesting depends upon fulfilling certain requirements usually according to a scale in which vesting increases until 100% is reached.

Example: Graded Vesting Scale

An individual is 25% vested after 5 years of service with 5% additional vesting for each year for 5 more years, and 10% additional vesting for the remaining 5 years.

<table>
<thead>
<tr>
<th>Year of Service</th>
<th>Percent Vested</th>
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<tbody>
<tr>
<td>5</td>
<td>25%</td>
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<tr>
<td>6</td>
<td>30</td>
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<tr>
<td>7</td>
<td>35</td>
</tr>
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<td>8</td>
<td>40</td>
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<td>9</td>
<td>45</td>
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<td>10</td>
<td>50</td>
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<td>11</td>
<td>60</td>
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<td>12</td>
<td>70</td>
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<tr>
<td>13</td>
<td>80</td>
</tr>
<tr>
<td>14</td>
<td>90</td>
</tr>
<tr>
<td>15</td>
<td>100</td>
</tr>
</tbody>
</table>

Therefore, 100% vesting is obtained after 15 years of service.

The disadvantage to this process is that it is difficult to explain and to administer, although it prevents employees from retiring immediately after becoming fully vested.

Depending upon the manner of funding, vested benefits are issued in several forms. With a trust company, the plan requires the trustee to purchase a deferred life annuity from an insurance company. If with an insurance company, vested benefits may be a paid-up insurance, an annuity contract, or a deferred claim against the plan. In any case the employer must provide the employee a statement as to the amount of the vested benefit, the form of annuity, and when it is payable.
A terminated employee may take the vested benefit as a lump sum and deposit it in an individual retirement account (IRA) where it would remain tax free if transferred within sixty days. Then an individual may transfer this to a pension plan with another employer. Nevertheless, if any individual returns to the employer's service and rejoins the pension plan, he may reacquire his previously vested benefits by repaying the money he received plus 5 percent interest compounded annually.

Because plans were accommodating participants vesting demands rather slowly, Congress passed legislation for all qualified pension plans.

Vesting of accrued benefits is necessary (1) to assure equitable treatment of all participants, (2) to remove artificial barriers to changes of employment, hence enhancing mobility of labor, and (3) to assume that private pension plans fulfill their social role of supplementing for a broad segment of the labor force the old-age insurance benefits provided under the Social Security System.

Many believed these laws infringed upon the rights of labor and management to determine their own objectives. Therefore, Congress spent years trying to devise a reasonable approach to vesting standards. Finally, the decision made requires one of three minimum standards be met in order that a pension plan be qualified:

1. full vesting of all accrued benefits if participant has contributed 10 years of service without respect to attained age; no vesting before 10 years
2. 5-15 year standard: 25% vested after 5 years, an additional 5% for each of the next 5 years, and an additional 10% for each of the remaining 5 years; fully vested in 15 years; without respect to attained age (see page 41)
(3) point system: with 5 years service, participant is 50% vested whenever his/her attained age and years of service total 45 (Rule of 45), and then 10% added for each year thereafter until fully vested; also applies to 50% vesting after 10 years of service without respect to attained age, and 10% added each year thereafter.

These are only standards and each plan may modify them based on their definition of year of service. Overall, all three are similar in cost and provide the same amount of vesting.
Death Benefits

Death benefits are easier to understand if viewed from two points, before retirement and after retirement. Pre-retirement death benefits are of two kinds, (1) a refund of employee contributions paid in a lump sum to a designated beneficiary or the estate of the deceased participant, and (2) an explicit benefit formula specified in the plan either as a lump sum or as income payments.

Under a lump sum method, benefits are provided by a life insurance annuity or through a trust fund. Group annuities are usually just a refund of employee contributions. Individual insurance contracts provide a death benefit greater than the face amount of the contract or reserve (i.e. a retirement income policy). In a money-purchase plan, an employer may use trust funds to purchase ordinary life insurance contracts under a profit sharing plan.

Initially, employers found it necessary to protect a wife's interest in her husband's pension, so survivors' income benefits were included in more and more pension plans. Since the time survivor income benefits were first devised, they have undergone several changes. One ruling stating that a benefit was payable only to a "surviving widow" was in discrimination on the basis of sex, and now the plan must change the term "widow" to "spouse". Also, a spouse's benefit is payable as long as he/she lives, but subject to termination in the event of remarriage prior to a certain age, such as, 60.
Congress has ordered that a plan must provide a participant the option of electing a joint and survivor annuity from the time the participant is eligible for early retirement. The benefit for the spouse must be at least 50 percent of the benefit which would normally be paid if both were living at the date of death or based on the accrued value of the pension benefit. Related to the pension of the deceased, the spouse's benefit is sometimes adjusted for the number of years difference in age.

Example: If an employee dies at age 55, 75% of the deceased's compensation is paid to the spouse who has at least attained age 50; no reduction for the age difference.

or

If an employee dies at age 55, the value of the benefit is projected to NRA, then the spouse is awarded 50% of the benefit ordinarily paid at NRA.

The principle purpose of a pension plan is to provide regular payments of a predetermined amount to the participant over a period of years, usually a lifetime. Therefore, death benefits must be "incidental" to the purpose of the plan. Because the actuarial value of benefits for those at younger ages are greater than of older ages and this amount could even be five or six times the amount of a participant's salary, the IRS has devised a table to impose limits upon accrued and projected benefits.

Death benefits issued after NRA are in either of two forms, lump sum or income benefits. A lump sum benefit is usually awarded to cover the cost of funeral expenses of the deceased. It is incidental if the amount is within a $1000 to $3000 range.
Many plans do not even provide post-retirement death benefits.

An income benefit issues payment in annuity form. Originally, noncontributory plans did not provide a benefit to survivors and contributory plans only returned an amount equal to contributions. As presently provided by the law, a plan must provide a joint and survivorship annuity retirement benefit in which the surviving spouse would receive an income at least one half that payable during their joint lives. However, this tends to be rather expensive, and since the cost is covered by the participant, he or she may elect not to receive such an annuity and elect a different type of death benefit.
Disability Benefits

All pension plans provide for the protection of benefits during temporary disability, but problems arise for cases of permanent disability. The plan is entitled to vest the accrued benefit of a permanently disabled employee without regard to normal requirements. If an employee has reached early retirement age, he may receive an immediate annuity without a reduction for age. Death benefits may be derived from a percentage of an employee's current compensation or as a percentage of his accrued or projected pension benefits.

In choosing among the various alternatives, the employer has to consider several factors pertaining primarily to the spouse's benefit and to participants disabled at young ages. First of all, benefits are subject to adverse selection by an employee who knows he is afflicted with a health impairment. Thus, employers may

1. require a physical examination for plan entry, or
2. withhold protection for a period of years (i.e. 3-5 years), or
3. exclude disability payments for pre-existing conditions that manifest within 1-2 years after entry, or
4. permanently exclude coverage for a pre-existing condition.

Even all these precautions do not totally solve the problem. Secondly, there is the question whether or not payments should continue throughout an individual's retirement age. A distinction should be made in the relationship between a disability benefit and an early retirement benefit. Lastly, the total benefits
received by an employee must be less than what he could earn if he were not disabled. This means the employer must take into account social security, workman's compensation, and veteran's legislation.
Termination

In terminating a pension plan, certain IRS rulings must be followed. These rules prevent discrimination in favor of the prohibited group, which is the shareholders, officers, super­visors, and highly-paid employees. If a plan terminates within ten years from when it was installed for any reason other than a "business necessity", it is not a bona fide program, and is subject to tax penalties. Bankruptcy, insolvency, change of ownership, change of management, and financial inability to continue contributions constitute a business necessity.

According to the Non-Diversion Rule, an employer is forbidden to divert any portion of the principal or income of the trust or any other funding medium to purposes other than the exclusive benefit of his employees or their beneficiaries. Under a life insurance company, there are no unallocated funds because all contributions are used to purchase deferred annuities for the participants. For other plans with unallocated funds, stipulations directing their allocation must be contained within the plan. These funds may be allocated either on a pro rata basis or based on classifications of participants in a stated order.

On a pro rata basis, each participant receives a proportionate share which is equal to the ratio of the actuarial value of his accrued benefit to the actuarial value of all accrued benefits given a certain set of actuarial assumptions. Allocations on a classification basis provide benefits to several divisions in descending order of priority. First the participants of the
highest rank are fully satisfied before allocations are made to the next class. Then if funds are inadequate for a particular class, they are applied on a pro rata basis. Ranking of classes depends upon the employer, but are usually as follows:

(1) retired participants and their beneficiaries  
(2) active participants beyond normal retirement age  
(3) active participants eligible for early retirement but not normal retirement  
(4) active and terminated participants who have satisfied the plan requirements for vesting  
(5) all other participants  

Depending on whether plan assets are with a life insurance company or with a trust, funds are disbursed as either a deferred paid-up annuity, cash, or a paid-up annuity. Distributions can be made at the time of termination or over a period of years, termed a "delayed priority allocation".

Through the establishment of a federal insurance facility, the Pension Benefit Guaranty Corporation (PBGC), participants are guaranteed vested benefits with certain limitations. These limitations authorize the PBGC to recapture from a retired participant all payments in excess of $10,000 (or greater, the amount he would have received as a monthly benefit under a life annuity commencing at age 65 if he had elected at the beginning of the three-year period to receive his interest in the plan in the form of such an annuity) made during any twelve-month period within three years prior to plan termination.

Yet, the PBGC cannot recover amounts paid for death or disability, and they can waive any recovery that would cause economic hardship.

After satisfaction of all claims have been made against the plan, an employer is entitled to any remaining assets. This occurs
only if accrued benefit claims are less than those projected with reasonable actuarial assumptions.
Problems and the Future

Jurisdiction over the administration of pension plans has been a problem ever since ERISA became the law. Agencies in control are the U.S. Department of Labor and the Internal Revenue Service. Now the Pension Benefit Guaranty Corporation (PBGC) is yet another agency gaining status in ruling over pension plans.

Set up under ERISA, the PBGC watches over more than 100,000 of the nation's private pension plans which cover over 33 million participants backed by about $200 billion assets.\(^{32}\) It mainly supports retirement plans unable to meet payments because companies either go broke, close down, or drop their pension program. Besides collecting over a total of $70 million in premiums by a one dollar contribution from each covered employee per year, the PBGC has kept a separate account of $11 million dollars. This was received from cash and securities of inadequate retirement plans. The investment of this fund has cause much controversy. The Treasury Department believes the money should to to government-backed income securities, while the PBGC wants to invest in corporate stocks and bonds.

Other fiduciary problems exist, mainly that costs of pension benefits threaten to become greater than contributions made. Dan McGill at the Wharton School of the University of Pennsylvania explains. . .

There is a distinct possibly that the economy of the future will not be able to support all of the retirement benefits which are being promised. It is possible to promise too much. You may just be putting too heavy a burden on the working population.\(^{33}\)
In private pension plans, improvements will not be seen until enough money is accumulated to cover deficits. Many plans are presently in the hole. However, increasing premiums causes friction with labor unions who do not like to see their raises disappear in pension plans.\(^{34}\)

Since the passage of ERISA, plans have additional paperwork which has increased costs approximately five to seven percent. Funds also suffer from the rise in normal costs. Both the recession and reporting laws are to blame for the 5,035 terminations in 1975.\(^{35}\) All this places a heavy burden especially upon small plans; thus, a larger number of these plans terminate. The cost of pension plans have unfortunately deterred many companies from starting new ones.

The PBGC is studying methods to insure against companies' risk of losing a large percentage of their net worth upon termination. Perhaps legislation may be the only solution. Guidelines are needed for the investment of plan assets; however, too many strict rules may be counterproductive.

State and local systems find underfunding to be the biggest problem for government-funded pension plans. Taxes never seem adequate to cover projected payments. Some states and certain large cities have billions of unfunded liabilities. Both are looking for ways to reduce costs and avoid overburdening the taxpayers. Some have attempted to rewrite costly benefits, but this has resulted in the courts' disapproval. Therefore, future benefits of new employees will have to be less liberal, and employees
will probably contribute more from their payroll.

Also facing a growing pattern of unfunded liabilities are the federal pension plans.

Social Security faces a string of near-term deficits which threaten to exhaust the system's 44.3 billion dollars of reserve sometime after 1982. Tax increases to support Social Security seem inevitable. Yet, this usually faces opposition in Congress.

Currently, another problem being debated is the justification of higher pension rates for women. Both sides of this issue were presented in an article in "Family Weekly" on April 16, 1978. According to Alan E. Lazarescu, assistant general counselor, Metropolitan Life, . . .

A fundamental principle employed by life insurers is to place persons into a class with other persons having similar characteristics. This principle is equitable because each person with the same life expectancy pays the same premium for the same benefit. Most people agree that based on life expectancy, a person 35 should not have to pay the same life insurance premium as a person 65. Women have a longer life expectancy than men. This is the reason women pay lower life-insurance premiums. As for annuities (pensions), women generally receive payments for a longer period than men, so the cost to fund such payments for women is greater.

On the other hand, Michael Evan Gold, assistant professor of Industrial and Labor Relations, Cornell University, states . . .

Men and women deserve equal pay for equal work. Equal pay means that an employee should provide male and female counterparts with the same take-home pay and the same pension pay. Congress shares this view. All the retirement funds it has created for Federal employees as well as the Social Security System follow this principle. Counterparts are charged the same contributions during their working
years, and they are paid the same monthly benefits during retirement. Only one woman in six outlives her counterpart. Because no one’s date of death can be predicted, the only fair system is to treat employees not as male or female but as persons.37

Of great importance is that the population of those over age 65 continues to rise due to a longer life expectancy. This in turn means an increase in people nearing retiring age concerned about their future incomes. Already the number of employees retiring before age 65 is increasing. Currently, 70 percent of the people receiving Social Security are retired before age 65 although they are receiving reduced payments.38 By the twenty-first century, the birthrate will have declined and the percentage of old-age people in this country will jump sky high. To meet demands, industries are finding it necessary to incorporate cost-of-living escalators and early vesting into their plans. The table on the next page estimates the future population in the U.S. over age 65.

One solution for inflationary purposes may be that a benefit could pattern itself accordingly while still keeping the initial benefit related to a fixed percentage of final pay. Another idea may be to increase the retirement age which would increase the number of working to the number of retired. A recent article in the "Muncie Star" reveals that the Senate passed a bill which raises mandatory retirement age from 65 to 70 and prohibits a company from retiring an employee before 70 strictly because of his or her age. (see page 58)

Coordinating Social Security benefits with pension benefits is another approach. If this is not done, eventually some people
### PROJECTED NUMBER OF PERSONS AGE 65 AND OVER IN THE UNITED STATES

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Persons Age 65 and over</th>
<th>Percent of Total Population</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976</td>
<td>22.9 million</td>
<td>10.7%</td>
</tr>
<tr>
<td>2000</td>
<td>31.8 million</td>
<td>11.3% to 12.9%</td>
</tr>
<tr>
<td>2030</td>
<td>55.0 million</td>
<td>14.0% to 22.0%</td>
</tr>
</tbody>
</table>

Source: U.S. Bureau of Census. Percentages for years 2000 and 2030 depend on fertility levels used in population projections.
WASHINGTON (AP) — The Senate Thursday approved 12-38 and sent to President Carter legislation that will allow millions of Americans to work longer into old age by raising the mandatory retirement age.

The bill raises from 65 to 70 the mandatory retirement age under private employee benefit plans for most workers and will not apply to employees of federal, state or local governments.

The bill has hurdles for the Senate, in private employee benefit plans for most workers and will not apply to employees of federal, state or local governments.

The bill was introduced by Sen. Bill Thomas, D-Calif., and signed by President Carter on Thursday.

The bill would phase in increases in the mandatory retirement age for most workers, starting at 65 in 1980 and increasing by one year every two years until达到70 in 1985.

In cases where mandatory retirement is part of a collective bargaining agreement, it would be optional for workers to retire at age 65 or retire at age 66 with no penalty.

The bill was part of a broader effort to raise the retirement age for most workers, starting at 65 in 1980 and increasing by one year every two years until达到70 in 1985.

The bill was introduced by Sen. Bill Thomas, D-Calif., and signed by President Carter on Thursday.
will receive combined benefits greater than their salaries before retirement. This puts a strain on corporation profits and taxpayers. Besides, some persons would rather have higher wages during their working years than at retirement. Experts suggest to make Social Security a requirement for all workers and pension plans would only supplement these benefits. Yet, unions do not like seeing their already-promised benefits lowered.

Nevertheless, private pension plans are becoming more standardized since the passing of ERISA. For instance, a tendency toward the 10-year vesting rule and toward the one-year, age 25 participation rule have been increasingly observed. Whatever changes are necessary for the future of pension plans will change slowly.
Historic Dates of U.S. Pension and Retirement Plans

1859 New York City established a pension fund to cover its policemen, the first pension plan covering state or local government employees.

1875 First pension plan established in U.S. industry by the American Express Company. Financed solely by the employer.

1880 First formal plan supported jointly by employer and employee contributions, by Baltimore and Ohio Railroad Company.

1892 First private college retirement plan. Columbia University adopted a pension plan for its professors, at age 65 with a minimum of 15 years service.

1893 First pension plan for public school teachers established in Chicago.

1901 Carnegie Steel Company established first enduring plan in a manufacturing company. This plan, with some modifications, was taken over by United States Steel in 1911.

1903 Standard Oil Company of New Jersey plan for pensions went into effect and was one of the more important in this early period. Its terms were informal but were the basis of 26 later plans and, in operation, appears to have been the same as if it were a formal plan.

1905 First trade union plan which actually functioned was established by the Granite Cutters. Earlier trade union plans, Pattern Makers (1900) and National Association of Letter Carriers (1902), never paid any benefits before dissolution.

1905 Carnegie Foundation for the Advancement of Teaching was founded, one of the primary purposes being to help provide retirement income for teachers in institutions of higher learning. Within a few years most private colleges and universities had qualified, and later, publicly-administered educational institutions also qualified through amendments in the Foundation.

1907 The first of the large international unions, the International Typographical Union, adopted a formal pension plan for its members.

1920 The Federal Civil Service Retirement and Disability Fund was created by Congress. The U.S. Civil Service Commission, as early as 1899, had recommended the adoption of a Federal
civil service employee retirement system to be funded in whole or in part by employee's contributions.

1921 First group annuity contract in the U.S. issued by Metropolitan Life Insurance Company.

1935 Railroad Retirement System established and amended in 1937, to create a unified system for the industry. The system is the only social insurance system administered by the federal government which covers a single private industry.

1935 Social Security Act adopted. Subsequently amended to include survivors and dependents, disabled workers and their dependents, coverage for additional fields of employment; to lower minimum retirement age; to raise benefit levels; to revise contribution schedules; to increase earnings base; and in 1965, to establish "Medicare", a broad program of health insurance for people 65 or older.

1949 The U.S. Supreme Court determined that employers are required to bargain on pensions, giving impetus to the drive by trade unions for negotiated pension plans.

1949 The Steel Industry Fact Finding Board held that employers were obliged to provide workers with pensions and other welfare benefits for temporary and permanent depreciation of human machinery.

1952 College Retirement Equities Fund (CREF) was established as the first variable annuity fund. In 1854, the Participating Annuity Life Insurance Company offered the first variable annuity contracts to the general public.

1957 Federal Welfare and Pension Plans Disclosure Act became effective, providing for detailed reporting to the federal government regarding the operation and administration of welfare and pension plans. This law was repealed under ERISA (see 1974), except that it continues to apply to conduct and events which occur before the effective dates in ERISA.

1959 Life Insurance Company Income Tax Act passed by Congress excluding from taxation the investment income attributable to insured pension reserves, thus enabling life insurance companies to compete more effectively with other pension providers.

1962 H.R. 10 adopted (officially the Self-Employed Individual Retirement Act) and subsequently liberalized by amendment; this made available qualified pension planning for self-employed persons, unincorporated small businesses, farmers, professional people and their employees. (Also referred to
as the Keogh Act.

Early 1960s Most states which did not already permit life insurance companies to maintain separate accounts passed laws specifically allowing them, thus freeing such pension fund investments from some limitations applicable to the companies' general accounts.

1963-1964 The SEC ruled that separate account acquisitions are an issuance of securities subject to regulation under the Securities Act, but tax-qualified group pension plans (including variable annuities) were exempted from registration and prospectus requirement of the Securities Act.

1965 The President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs issued its report, "Public Policy and Private Pension Programs". This was the forerunner of ERISA.

1974 The Employee Retirement Income Security Act of 1974 (ERISA) was signed into law on September 2, 1974. This legislation is designed to protect participants in private plans on job changes and plan terminations, and to give individual pension incentives to self-employed persons and those whose employers have no pension plan.

1975 Major new provisions of the Employee Retirement Income Security Act of 1974 became effective, including Individual Retirement Accounts (IRAs), increased limits under H.R. 10 plans; established the Pension Benefit Guaranty Corporation.

1976 The Tax Reform Act of 1976 included a section allowing an individual who is eligible to establish an IRA for his or her nonworking spouse, with specified maximums.
Footnote Page


2 Ibid., p. 5.


4 McGill, p. 10.

5 Ibid., p. 14.

6 Ibid., p. 16.

7 Bleakney, pp. 4-5.

8 McGill, p. 17.

9 Ibid., p. 19.

10 Ibid., p. 20.

11 Ibid., p. 24.


13 Ibid., p. 21.

14 McGill, p. 38.

15 Ibid., pp. 157-58.

16 Ibid., p. 63.

17 Ibid., p. 69.

18 Ibid., p. 70.

19 Ibid., p. 48.

20 Ibid., p. 78.

21 Ibid., p. 89.

22 Ibid., pp. 93-96.

23 Ibid., pp. 105-6.
24Ibid., p. 108.
25Ibid., p. 121.
26Ibid., p. 134.
27Ibid., p. 135.
28Ibid., pp. 136-37.
29Ibid., p. 152.
30Ibid., p. 163.
31Ibid., p. 165.
34Ibid., p. 78.
35"Pension Benefit Guaranty Corporation", p. 28.
36"Why Bigger Pensions Will be Harder to Come By", p. 79.
39Ibid., p. 17.
40Ibid., pp. 47-50.
Bibliography


