Pensions
(1956 folder)

PENSION CONFERENCE
OF CALIFORNIA STATE FEDERATION OF LABOR
APRIL 15TH TO 20TH, 1956
MONTEREY CALIFORNIA

Summary of Comments by

Martin E. Segal—Pension and Welfare Consultant

[San Francisco, 1956]

A leading weekly publication recently predicted that the national population will increase by 68,000,000 persons in the next 20 years to 228,000,000.

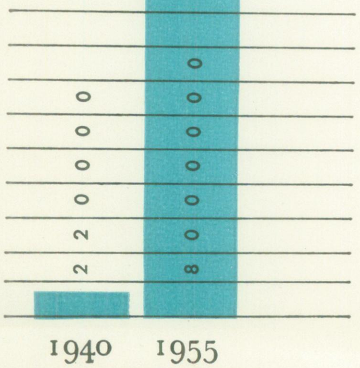
Wide open spaces will disappear; there will be new centers of population, new markets, new opportunities — and new problems.

It's predicted that the State of California, now the second state in population, will be first by 1975. Specifically, it is estimated that this state will have a population of 26,000,000 as compared to the present estimate of approximately 13,032,000.

Incidentally, as you may know, California's population growth is greater, monthly, than any other state in the Union.

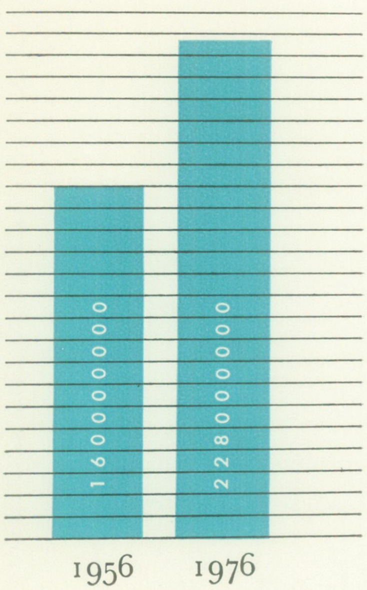
With the rise in population is an even greater rise in the percentage of older workers. The number of older workers is due first to the general increase in the total population and secondly, to the increasing life expectancy of men and women in the United States, due to the wonders of modern medical science.

The increasing population and the increasing number of



Retired Workers and Dependents receiving Benefits via Social Security

National Population



older workers presents a formidable problem; and all of these are related to what has to be done about enabling those older workers to retire on decent incomes, for three reasons, among others:

1. To enable the older employee to enjoy the fruits of his productive years by eliminating the need to work in the advanced years;

2. To provide job opportunities for younger employees (and this is particularly important in view of the technological changes, such as automation); and

3. To enable the older and retired employee to meet his everyday needs, in a self-sufficient, dignified and scientifically planned manner, rather than to become a burden of relief or dole for the community or a weight on the shoulders of the employee's children or his employer.

Collectively-bargained pension plans may not be applicable in all situations. And, certainly, whether or not there are to be such plans is entirely a matter to be determined by the employers and unions involved.

It's interesting, however, to note that today there are more than 8,000,000 employees covered by collectively-bargained pension plans, and the number continues to grow each year, depending on the financial ability of employers to finance these plans and on the way in which this type of benefit may be negotiated.

The basic foundation for security in old age can be found in Federal Social Security. Certainly increased Social Security benefits are needed for many, many employees, and this has been found to be the most practical and efficient way of providing for the employees' old age. The relative importance of Social Security benefits can perhaps be demonstrated by the fact that at the end of 1940 there were 220,000 retired workers and their wives and survivors who were receiving one kind of benefit or another, via Social Security, in a monthly sum of $4,100,000. By 1955, the number of retired workers and their dependents had increased to almost 8,000,000 receiving $412,500,000 per month in benefits.

In the sessions that follow, I do not plan to discuss whether or not a pension program should be negotiated as part of any particular collective bargaining agreement. As previously indicated, this is a matter to be determined by the employers and the unions involved. However, what will be presented is that which may be considered fundamental in the development of a pension program, if one or more employers or one or more local unions *do* decide to proceed with a pension program as part of a collective bargaining agreement.

So that you can have a general idea of the order in which various aspects of this subject will be discussed, the following is an outline of the main topics I plan to review:

I. ***Factors to Consider in Negotiating for a Pension Plan***

II. ***Establishment of a Pension Plan***

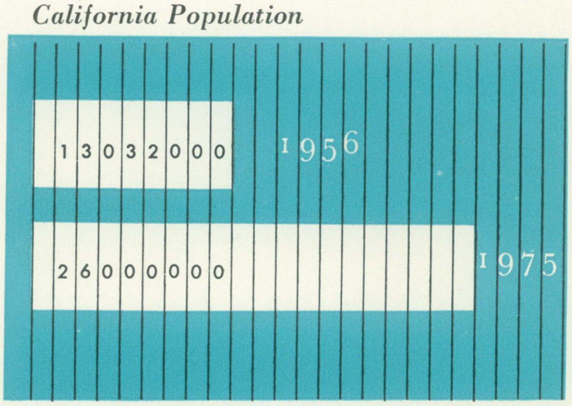
III. ***Factors That Affect the Amount of Pension Benefits***

IV. ***Administration of a Pension Plan***

V. ***Some General Problems***

VI. ***Summary***

California Population



I.

Factors to consider in negotiating for a Pension Plan

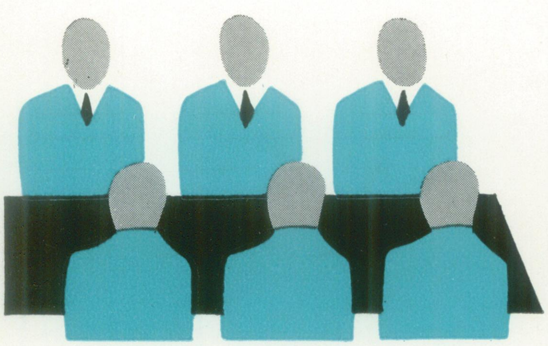
We have been asked to consider the situation that confronts many organizations in collective bargaining for pensions, namely, that they have collective bargaining agreements with more than one employer and are, therefore, concerned with obtaining a uniform pension plan for all employees represented by the union for the purpose of collective bargaining. Accordingly, it may be that many of my remarks are not fully applicable in instances where a union represents the employees of just one plant or one employer.

In our experience as consultants to more than 100 multi-employer, collectively bargained pension plans, we have found that most employers and unions agree that the "multi-employer" plan is the most effective vehicle for providing pension benefits for the employees represented by the union. A brief examination of how such a plan operates, from a cost and benefit point of view, should give you a better idea of why such plans are so enthusiastically supported by both management and labor. In the typical multi-employer, collectively bargained pension plan, the union reaches a uniform agreement on pensions with the various employers with whom it negotiates whereby the employers agree to contribute "x" cents per hour or per day, or "x" dollars per month to a pension trust fund. The contributions are based on the number of hours or days for which pay is received by the employees of the employer represented by the union. Accordingly, each employer with whom the union negotiates thereby incurs the same cost obligation in terms of cost per employee; most employers find this important from the standpoint of all employers dealing with the union maintaining the same competitive position in terms of labor cost. In addition, the employers appreciate that by many employers contributing to one central fund, economies can be effected in establishing and administering the pension fund which can be translated into higher benefits for the employees; in this respect they appreciate their contributions are being used to best advantage, from an economic standpoint.

Most unions recognize that these advantages to the employers are also advantages to the unions and to the employees to be covered. In addition, by the use of a multi-employer plan with a uniform rate of contributions, the union will be assured that all employees represented by the union for the purpose of collective bargaining will be provided with the same plan of benefits.

In industries where the nature of employment is such that an employee may be changing jobs frequently (like the construction and other industries, where employment may be with many employers over the years), such plans offer the additional advantage of the employee being able to receive pension credits for employment with all employers, whereas if each individual employer had a pension plan based on length of service with the one employer, it is doubtful that such employees would ever be eligible for pension benefits. In other industries, normal changes in employment conditions due to changes in production schedules, plant relocations, etc., are also taken care of in a multi-employer plan because the employees are able to obtain employment with other employers in the same industry and continue accumulation of pension credits. When an employee reaches the retirement age set forth in the pension plan, he may have an accumulation of pension credits based on years of service with many different employers.

Assuming that agreement has been reached on the principle that there shall be a "multi-employer, jointly administered" pension plan, the next question is the amount of employer contribution. Clearly, this item comes under the "give and take" phase of negotiations—the higher the contribution, the higher the ultimate pension benefits. As the final settlement might be anywhere from a range of $2 a week to $5 a week, it would appear best that the parties bargain this item out as they would any other wage increase, leaving to a later date the discussion of the amount of pension benefits that can be purchased for a given rate of contribution or the details of the pension plan that will be provided.



One reason for this suggestion is that we know it takes many months of study and discussion to solve the final pension plan after agreement has been reached on the amount of employer contribution. After negotiations are concluded, detailed actuarial studies are made of the data on the employees to be covered (their ages, length of service, patterns of employment, etc., are all taken into consideration). To do all this work before or during negotiations may cause considerable delay, confuse the issues, and, most likely, as a practical matter, may not affect the amount finally agreed to as the employer contribution. Short cuts to such studies to produce "approximate" results for a given contribution often do more harm than good in that most conservative estimates must be made to compensate for the "short cut" procedure with the consequence that it may appear that a higher amount of employer contribution is required to support a particular plan of benefits, or, stated another way, that the employees will have to give up more of a wage increase than is necessary to obtain a particular level of benefits. There are exceptions, of course, and in some selective situations a preliminary actuarial study may be valuable.

Both the employers and unions can properly assume that the amount of contributions agreed to in collective bargaining will be used in the most effective manner possible to provide the very best plan of pension benefits consistent with the amount contributed and the age and employment data of the employees to be covered.

In summary, it would appear best for negotiators to agree on whether there should be a "multi-employer, jointly administered" pension fund and then on the amount of employer contribution. It would also appear best, in most situations, not to confuse or delay negotiations with discussions of the level of the ultimate pension benefit or the details of the plan, but instead to agree that such matters be left for decision by a joint board of union and employer trustees.

II.

Establishment of a Pension Plan

After negotiations have been concluded, the union and employers should designate representatives to meet for the purpose of adopting the legal structure for the pension fund. In this connection, the employer and union representatives will want to use legal counsel as there are many legal matters that require careful consideration. Such meetings generally result in the preparation of a document called an "Agreement and Declaration of Trust" which is entered into by the union and employers. This Trust Agreement sets forth the general purpose of the pension fund being created, provides for the designation of union and employer trustees who will be responsible for the establishment and administration of the pension plan, and sets forth their rights, duties and obligations as trustees. In addition, there are many miscellaneous problems covered in the Trust Agreement. However, it should be noted that the Trust Agreement *does not* set forth the plan of benefits or the eligibility rules of the pension fund; instead, it essentially gives the trustees the authority to adopt an appropriate pension plan after having the necessary actuarial studies made. After this legal document has been signed by the union, the contributing employers and the persons designated as trustees, copies are generally furnished to each contributing employer for his records.

It is then necessary for the trustees to meet and start on the work that will lead to the ultimate adoption of the pension plan. The first item for consideration is usually retaining a pension consultant to advise the trustees on the technical aspects of their work and to do the necessary actuarial calculations.

Having selected a pension consultant, perhaps the first job will be the preparation of an appropriate form of "census card" which can be used to obtain basic information as to the employees' ages, length of service, and other characteristics of employment. This type of card should be designed from the long-range point of view of its serving not only as the source of the initial information required for the actuarial study, but also so that it can serve as a permanent record card in the administration of the pension fund. Having a card of this nature serves a multi-purpose and eliminates administration work and delays at a later stage of administration of the pension plan. The census cards are then distributed for completion to the employees to be covered by the pension fund and returned to the pension consultant so that the actuarial studies can be started.

It is often necessary to obtain still additional information concerning the nature of employment in the industry, particularly the rate of turnover. This involves a study of employment patterns in the past so that an evaluation can be made of the number of new employees expected to come into the industry in the future, how long they can be expected to stay in the industry, and their ages when they enter and leave the industry. This information can be obtained in a variety of ways; a qualified pension consultant will be able to work out an appropriate system for obtaining the information based on the records available in a particular situation.

When the actuarial studies have been completed, detailed written reports are generally submitted to the trustees summarizing the results and presented in such a way that all cost factors can be clearly understood by the trustees. This is an important point because the technical aspects of this subject seriously affect the ultimate plan of benefits and if the trustees do not have this explained to them in sufficient detail they may not appreciate the ultimate impact of their decisions.

Simultaneously with a review of the actuarial calculations, the trustees consider alternate types of benefits that can be provided in a pension plan. For example, they may be considering not only a normal pension benefit amount to be provided for employees who reach 65 years of age with 25 years of service, but they may also be considering providing a reduced pension benefit amount for employees who are 65 but have fewer years of service, or disability pension benefits for employees who become totally and permanently disabled at a younger age after a minimum number of years of service in the industry. In addition, they may wish to consider early retirement benefits for employees who have long years of service in the industry but who have not yet reached retirement age.

There are related questions, such as vested rights, various options that can be provided for members who are retiring, provisions for guaranteeing payments for a minimum number of years, etc. Most items of detail in a pension plan are related to cost, and, accordingly, are considered at the same time the trustees discuss the normal pension benefit to be provided.

After preliminary discussion, it is then necessary to translate the decisions of the trustees into a proposed form of rules and regulations for the pension plan. In addition to setting forth the benefit amounts of the various types of benefits to be provided, the rules and regulations also cover such items of detail as the manner in which employees are to be granted credit for their years of service in the industry, how they are to be given credit for or during periods of disability, military service, periods of unemployment, and changing of employment from one employer to another. The rules and regulations also cover the definition of total and permanent disability, if disability pensions are to be provided, the type of future employment, if any, that is prohibited for members retiring under the plan, procedures for submitting applications for pension benefits and proof of age and service, etc.

Time does not permit a detailed review of each of these items now, though in the question and answer period each point will be discussed at some length.

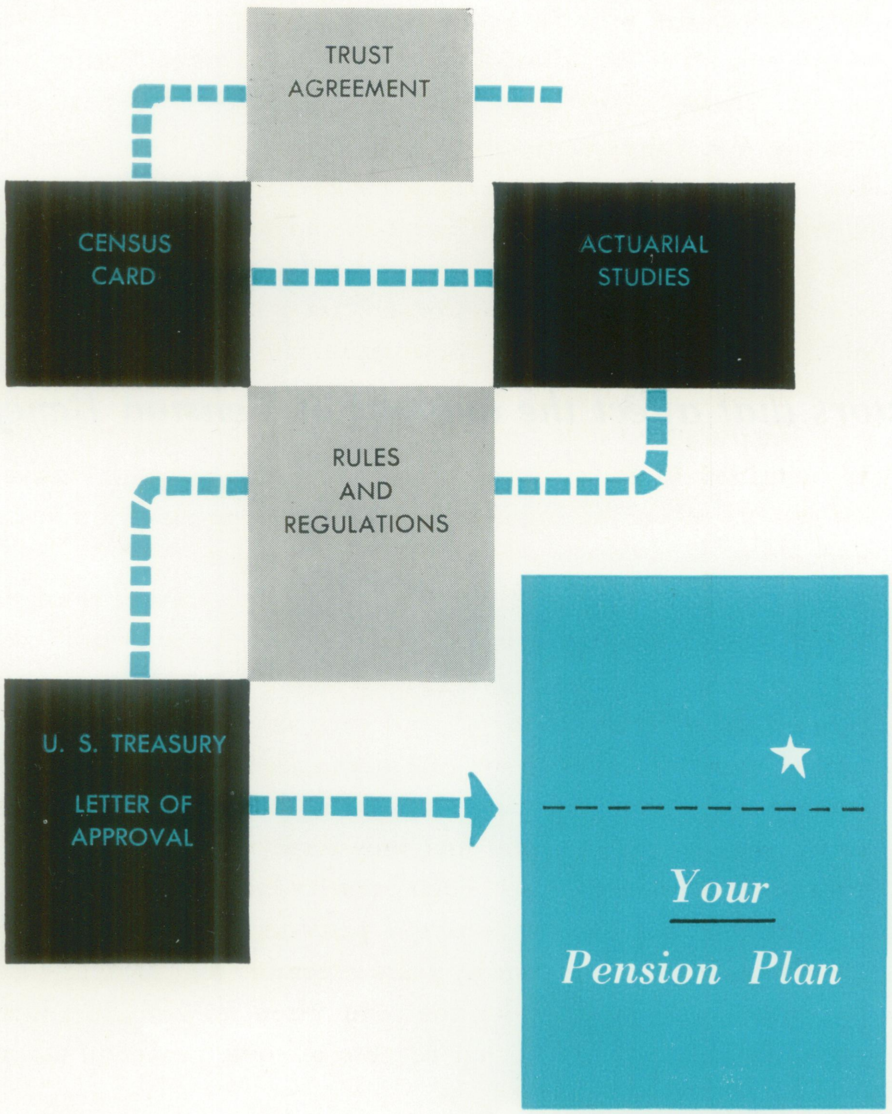
It has been my purpose to give you a general idea of the subjects considered by the trustees and the approximate order in which they are generally taken up.

Based on the discussions of the trustees, the final set of rules and regulations for the pension fund is then adopted. Such plan is incorporated in a written instrument. The rules and regulations, together with the actuarial certifications, the trust agreement, collective bargaining clause and list of contributing employers are then incorporated in a set of documents for submission to the Internal Revenue Service of the U.S. Treasury Department with a request for a ruling that the pension plan qualify as an approved plan under the applicable provisions of the Internal Revenue Code. It may be that minor amendments will have to be adopted by the trustees before final approval of the plan is received from the Internal Revenue Service of the U. S. Treasury Department.

When approval is received, a copy of the approval letter is furnished to each contributing employer so that it can be referred to when the employer wishes to sustain his income tax deductions for contributions to the pension fund.

The final pension plan should then be incorporated in booklet form together with questions and answers and other material which review the main provisions of the pension plan in simple non-technical terms so that each covered member fully understands his rights under the plan. This is most important because many members make long-range plans for their retirement based on the benefits that they hope to receive from the pension plan and under the Social Security Law. It is unfortunate to come across situations where a pension plan has not been clearly explained and for many years a member may have thought he would be covered under the plan when he reached retirement age only to find out that because of some provision of the pension plan, of which he was not aware, he does not qualify.

In the course of discussing the pension plan, the trustees will also want to give consideration to whether the plan will be on an insured or self-insured basis. This general subject will be discussed shortly under the heading of "General Problems".



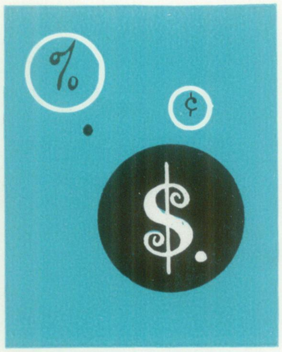
III.

Factors that affect the amount of Pension Benefits

The amount of pension benefits to be provided for a given employer contribution will depend primarily on the ages and length of service of the members to be covered, the type of pension benefits to be provided, and the eligibility conditions under which they are payable. Most every provision of a pension plan involves some cost consideration. For example, a provision for "vesting" pension benefits can be very costly. (This involves giving the employee a right to receive payments from the pension plan when he terminates employment in the industry without regard to his age or length of service, but based on the amount of contributions made to the fund on behalf of his employment.)

However, in this section of my discussion, I plan to discuss certain actuarial assumptions taken into account by the pension consultant in calculating the ultimate plan of benefits that can be provided. Such assumptions are generally discussed with the trustees so that they can determine just which assumptions should be ultimately used in the pension calculations.

1. ***Interest Assumption:*** In the basic financing of the pension fund, large amounts of monies accumulate for the payment of benefits to members who are expected to retire. Such monies are invested and earn interest. The interest factor is an important consideration in projecting the income to the fund over the course of future years and, therefore, the assumed interest rate materially affects the amount of final pension benefits that can be provided. If it is assumed that the reserves will earn interest at 2¾% per annum, the pension benefits will be roughly 5% higher than if it is assumed that the reserves will earn interest at the



rate of 2½% per annum. Generally, for each one-quarter of one percent difference in investment yield there is approximately a 5% difference in the amount of benefits that can be provided. Accordingly, a most careful discussion of this subject is warranted before the trustees reach a decision.

2. ***Mortality Rate:*** There are various mortality tables which an actuary can use for the purpose of predicting how long people will live. If an ultra-conservative table is used which predicts that the members will live for a very long period, more money will be required to pay pension benefits to such employees than if a table is used which predicts a somewhat shorter life-span; the reason being that the anticipated number of retired employees and of pension payments after retirement will be greater if the man is expected to live longer. This entire subject must be discussed by the trustees so that the pros and cons of the various mortality tables can be considered and so that the projected mortality rate used will be conservative and appropriate for the employees in their industry.

3. ***Assumed Retirement Age:*** Although you may have a pension plan which provides a given benefit for an employee who has attained the age of 65, experience proves that not all employees retire when they reach the eligible retirement age; some prefer to continue to work for a few years beyond the established retirement age. This is perhaps more understandable when you consider the fact that not all employees reaching the age of 65 are in the same physical condition nor are they all equally emotionally adjusted to retiring.

In addition, it is often found that certain employees in this category have financial problems, which may require their continued employment. In most pension plans it is found that in the absence of a provision that there be automatic retirement at age 65, the employees tend to retire on the average at an age slightly in excess of 65. The assumption as to the actual retirement age of the members is another very important cost factor. For example, if it is assumed that the employee will retire at age 66 rather than at age 65, the pension benefit can be approximately 10% higher.

4. ***Rate of Turnover:*** In practically all industries it is generally found that a certain percentage of the employees stop working in the industry before they reach retirement age or are eligible for pension benefits under "early retirement" or other sections of the pension plan. When this occurs, there is a "savings" to the pension fund because contributions have been made on behalf of such employees, yet no benefits are provided for them. These "savings" can then be used to provide higher benefits for employees who remain in the industry until they become eligible for pension benefits. It is important to study the employment patterns in the industry and determine an appropriate, but conservative, rate of turnover that can be assumed in the pension calculations.

5. ***System of Funding:*** The question of how the pension fund should be "funded" is, perhaps, the most complicated actuarial assumption discussed with the board of trustees by the pension consultant. In general, this involves a determination by the trus-

tees as to how reserves in the pension fund are to be established from the employer contributions so as to meet the liability the pension fund will have to provide pension benefits for employees who reach retirement age. If a too conservative system of funding is used, the rapid accumulation of reserves will require a lower amount of immediate pension benefits. If an overly liberal system of funding is employed, which, in the last analysis, does not even amount to "funding", the pension fund may be embarking on a problem which can lead to ultimate bankruptcy or reduction in benefits. Rather than burden you with a full discussion of this matter now, I thought it best simply to mention the subject as one that does materially affect pension costs so that you will have some idea of the problem that will be considered by the trustees and upon which they receive technical advice from the pension consultant.

If you will consider for a moment the more technical aspects of the actuarial assumptions discussed above, you can most likely appreciate why it would be so difficult to negotiate, effectively, a level of benefits plan whereby the employer would agree to provide a particular plan of benefits regardless of cost. The parties in collective bargaining will undoubtedly want to fix a cost value to the employers' obligation to provide such benefits so that the members can evaluate the amount of wage increase being sacrificed for the pension plan and so that the employer can determine his unit labor cost. To do this the parties in collective bargaining would, of necessity, have to discuss all of these actuarial assumptions. It is an understatement to say that this complicates collective bargaining and can produce inequitable results. This is not the kind of subject which lends itself well to the "give and take" of a collective bargaining session.

I think it appropriate that I stress at this point that I have not discussed all the details of the cost factors that affect the ultimate pension plan or pension benefits, but rather that I have treated the subject in a general way so that you can have some appreciation of the problems involved in pension planning.

cost factors

Interest — Mortality — Retirement Age — Turnover — Funding

IV.

Administration of the Pension Plan

When a large group of employees is to be covered by a plan, it is generally advisable for the trustees to set up a separate office for administration. (With smaller groups it is sometimes advisable to establish the office in the most convenient location, such as the union office, the employer association office, or whatever other place is generally agreeable to both sides.)

The functions of the administration office are briefly as follows:

Collection of Employer Contributions: Forms and procedures have to be established to regularly collect the employer contributions required by the collective bargaining agreement. Careful and experienced planning will permit a simplified and effective method which will not be costly either in terms of administration or in terms of the employers preparing reports of employment and submitting contributions. All contributions must be properly recorded in the fund office and deposited in the bank account for the fund. In addition, it is the employer's remittance report which generally serves as the basis for crediting employees with service credits for the purpose of their eligibility under the pension plan. This is but another example of the many "multi-purpose" forms used by the pension fund which save time and expense in the administration of the fund. Procedures are generally also established for furnishing the employers and employees with a statement of the amount of contributions made in a particular year so that a continued check of accuracy is maintained on all contributions.

Procedures for Processing Pension Applications: A simple yet effective form of pension application must be designed so that it can be made available to any person applying for benefits from the pension plan. Clear-cut instructions are most important so that the members can furnish all necessary information the first time. Clearly, such forms must be tailor-made to the particular type of pension plan and eligibility rules. In addition, account must be taken of the nature of employment in the industry, and the type and form of proofs of employment, age, military service, periods of disability, etc. When the pension application form is returned to the fund office, information submitted by the members must be verified. It is here that the pension records maintained by the fund office on a regular basis will control whether this is going to be a simple or time-consuming job. Systems must be set up to verify properly the pertinent aspects of an employee's entitlement to pension benefits because mistakes in this connection can be most costly. Generally, the person in charge of the administration office of the pension fund prepares a "Pension Analysis Form" which is then submitted to the board of trustees. This form analyzes all phases of the pension application and the verification of pertinent facts so that the trustees can pass on the final eligibility of the applicant. Many form letters are used in connection with the processing of pension applications as well as in the payment of benefits. When a pensioner is approved for pension benefits, he is generally provided with a Certificate of Award signed by the trustees which serves as his tangible evidence of approval and entitlement to benefits. A regular system is then instituted for the payment of pension checks and verifying that the member is receiving the checks. The members are also assisted in filing for their Social Security benefits and in receiving information concerning their entitlement to such benefits. In cases of disability pensions there is the problem of obtaining proper proofs of disability; this frequently involves the member being examined by a doctor selected by the pension fund office.

If the plan is on a self-insured basis, the pension fund office also is involved with the mechanics of the investment of pension fund reserves and transfer of such reserves to the investment accounts and working with the bank or other investment advisor on reports of the status of the pension fund's investments. Arrangements are also made for periodic audit reports of the pension fund accounts.

Records are also maintained in the pension fund office which permit periodic reviews of the entire pension plan by the pension consultants and the board of trustees.

V.

Some General Problems

I now plan to discuss certain special problems which often come up during the course of establishment of a pension plan. The subjects to be considered are:

1. Self-Insured vs Insured Pension Plans
2. The Roles of Banks or Trust Companies in Connection with Pension Plans
3. Employee Contributions to a Pension Plan
4. Automatic or Compulsory Retirement
5. Vesting of Benefits
6. Benefits Tied in or Related to Social Security
7. Guaranteed Periods of Benefit Payments
8. Life Insurance, Hospitalization, Surgical and Medical Insurance for Retired Employees and/or Their Dependents

The time allocated for this phase of the discussion will permit only some brief statements on the above problems and a few general observations. It is important to bear in mind that each subject warrants careful and detailed consideration by the parties concerned in the establishment and administration of a pension plan.

1. ***Self-Insured vs Insured Pension Plans:*** When the trustees consider the plan of benefits to be provided and review the actuarial calculations used in determining the ultimate benefits to be provided, they also consider whether the plan should be on an insured or self-insured basis.

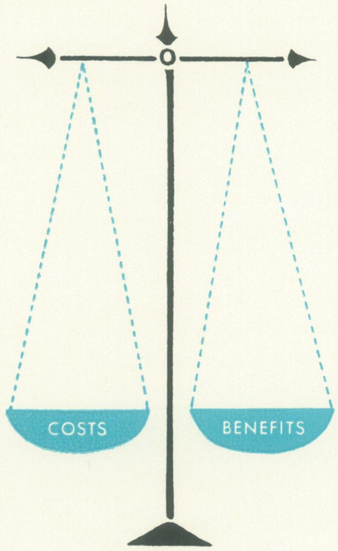
Our experience in the establishment of more than 100 collectively bargained pension plans has indicated that by and large self-insured pension plans are better, particularly for groups of more than 500 employees. By "better" we mean that higher benefits can be provided when a pension plan is on a self-insured basis for the simple reason that the insurance company charges and expenses are eliminated from the cost considerations.

At the outset, it should be borne in mind that the element of "risk" in a pension plan is considerably different than it is in other types of situations where you are providing life insurance, sickness benefits, hospitalization benefits or even such benefits as fire insurance or automobile insurance. In a pension plan the only important "risk" is how long employees who retire can be expected to live beyond retirement and how many employees will live to a retirement age.

If you are dealing with a small group of employees, such as 50 or 100, the possibility of variations from normal mortality experience is clearly far greater than if you are dealing, as you are in a multi-employer situation, with generally 500 or more employees. Mortality statistics have been so thoroughly studied and developed in this country that it is extremely unlikely that for any large group of employees such experience will vary materially from the assumed mortality rate in a self-insured pension plan. (We assume, of course, that the pension consultant and the trustees have used a reasonably conservative mortality table in preparing the benefit plan.) And even if there should be a variation, it is something that develops very slowly over the course of years and permits corrective action to be taken by the trustees in future years.

In other words, there can be no "catastrophe" such as multiple deaths or epidemics, floods, etc. which could hurt the pension plan or for which insurance protection is required. To the contrary, although it may sound odd, the actuarial facts of life develop that such catastrophes help the pension plan (though obviously only in monetary terms) in the sense that if retired employees are involved in such catastrophes, pension benefits are provided for a shorter period of time, or, if members gaining eligibility for pensions are in such catastrophes, fewer persons than anticipated attain eligibility.

In any event, the trustees must weigh the various types of



insurance contracts available for providing pension benefits and must evaluate the guarantee offered by the insurance company against the risk and against the additional costs that will be involved if an insurance company is used. In the past few years the variety of insurance contracts available for pension plans has increased considerably and it may be that some insurance companies will evolve a type of insurance contract suitable to collectively bargained pension plans, which will warrant a general reconsideration of the approach to be taken on this problem.

For the trustees of a pension plan to be completely satisfied with this problem, it is often advisable for them to ask a number of major insurance carriers to submit competitive bids in which they offer proposals for underwriting the pension plan. Careful and impartial analysis of such bids should be helpful to the trustees in understanding the relevant merits of insurance.

(Incidentally, in competitive bidding the trustees will undoubtedly be interested in noting the wide differences in insurance company charges. Also, a proper and detailed analysis of the insurance company bids will appraise reserve factors, termination charges, and a number of other technical items that are of great importance in money and benefit terms, but can easily escape the untrained eye.

(Those of you who have had experience in welfare plans may remember how insurance company retention charges vary and how careful an examination must be made each year of their claim charges, reserves, and of each item of their retention. Recently, our firm had two very interesting experiences here in the State of California. We were retained by the Trustees of these Funds to prepare detailed analyses of welfare funds that had been established some time ago. As a result of our analyses, the insurance company charges in those two Funds were reduced by more than $145,000, the retentions for future years are also to be reduced, and substantial administrative savings were effected. These are but only two examples indicating what careful study can accomplish—and the same kind of thing is also possible when dealing with insured pension plans.)

Under some types of insurance contracts for pension plans, the trustees are relieved of the responsibility for investing the reserves of the pension plan since, in effect, such reserves are turned over to the insurance company for investment. This is one of the advantages of an insured plan which is weighed by the trustees when they determine the question of whether the plan should be on an insured or self-insured basis, though it should be pointed out that in a self-insured pension plan the trustees can get excellent investment advice and assistance from banks and professional investment counselors.

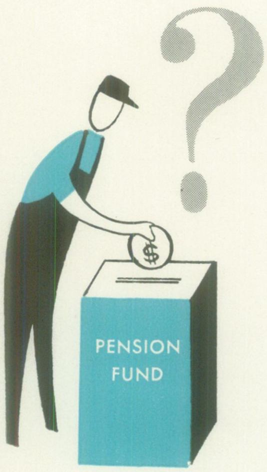
In summary, this is the type of subject on which the trustees do require competent and impartial advice by a pension consultant familiar with the operation of multi-employer, collectively bargained pension plans. But, as we said at the outset, our experience has indicated that self-insured pension plans are generally better—especially for larger groups.

2. ***The Role of Banks or Trust Companies in Connection with Pension Plans:*** If a plan is on a self-insured basis, the trustees will have the responsibility of arranging for the investment of the pension plan reserves. The trustees of most pension plans have found it advisable to use the services of qualified bank or trust companies in this connection. The general procedure followed is for the pension consultant to prepare a specification letter for transmittal to those banks from which the trustees may wish to obtain bids or proposals. Based on the proposals submitted by the banks, the ultimate selection is based on the fees quoted by the banks and their general qualifications and facilities for handling this aspect of the pension plan's oper-

ation. Sometimes such banks are used as "corporate trustees" whereby the trustees turn over to the bank the pension plan reserve accumulations for the bank to invest. The trustees set forth the general policy of investments (which, incidentally, is generally on a most conservative basis) and such policy is followed by the bank. In addition, the bank also acts as custodian of the invested assets of the pension fund in the sense that it physically holds the stock certificates or other evidences of the securities purchased on behalf of the pension fund. In addition, the bank "clips coupons", collects dividends and takes care of the other details in connection with the purchase and sale of securities and collection of income from such securities. Regular periodic accountings are submitted to the trustees. The trustees often designate a brokerage firm or firms through which the bank is requested to place orders for the purchase or sale of securities so that in return for the modest commissions received by the stock broker the trustees are able to obtain from such broker independent periodic appraisals of the investment portfolio of the pension fund.

Generally, the banks and trust companies are most anxious to receive this type of business and following the competitive bidding process will enable the trustees to obtain the most beneficial arrangement for the pension fund.

3. ***Employee Contributions to a Pension Plan:*** There are two schools of thought on whether it is advisable for employees to contribute to a pension fund. In our experience we have found that most multi-employer, collectively bargained pension funds do not provide for employee contributions. One of the major considerations is that from a tax point of view it is unwise for an employee to contribute to a pension fund. For example, in order for an employee to have $1 to contribute to a pension plan, he must earn approximately $1.20 because he has to pay income



tax on the $1.20, and the employee's contributions to a pension fund are not deductible for income tax purposes. If the employer contributes the same $1, it is not taxable to the employee as wages and the employer, of course, is able to deduct the dollar for income tax purposes. In addition, because employee contributions must be segregated and returned to the employee in the event he should leave the industry or die prior to his retirement, as a general rule, $1 of employee contribution can only buy two-thirds of the benefits that can be bought with the same $1 of employer contribution. (In the case of contributions made by the employer, no money is returned to the employee if he should die or leave the industry prior to his retirement. The only exception is in the case of certain vested pension plans.)

It is for the above reasons that it is sometimes surprising to learn of a collective bargaining agreement which is concluded providing, for example, a $2 a week contribution by the employer to the pension plan, $1 a week increase in wages and an agreement that the employees will contribute 50¢ per week to the pension plan. It would seem to make so much more sense to have the agreement read that the employer would pay $2.50 to the pension fund and that the wage increase would be 50¢ per week instead of $1 per week because the employees gain more from this type of settlement.

On the other hand, there is the argument that if an employee contributes to a pension plan it is a form of forced savings device whereby if he does leave the industry or die prior to becoming eligible for pension benefits, the money acts as a sort of savings account for him which is then paid to him or his beneficiary.

Some proponents of pension plans with employee contributions have also claimed that by this device employees become more interested in the pension plan and appreciate the benefits being provided. Frankly, we have not found this to be generally true and hardly feel it is a sufficient reason to institute employee contributions especially when you consider the unfavorable tax position the employee is in as a result of such contributions and the various complications involved in administration of the plan when there are employee contributions.

4. ***Automatic or Compulsory Retirement:*** The trustees of a multi-employer, collectively bargained pension plan may consider the question of automatic or compulsory retirement. In effect, this would be considered when the trustees decide whether any age limit should be set for retirement so that if the employee does not retire, he will be denied all future benefits from the pension plan. One difficulty with such provisions is that an employee's actual age does not necessarily govern his ability to continue to work effectively. An employee's decision to continue working beyond age 65 (or whatever retirement age is used) is generally based on his knowledge of his physical condition and ability to perform the job and of a comparison of his take-home pay with the combined benefits he would receive from Social Security and the pension plan. This latter point is most important in that as collectively bargained pension plans provide higher amounts of pension benefits and considering the recent improvements made in the Social Security benefits where the maximum primary benefit is now $108.50, the question of compulsory or automatic retirement is rapidly becoming academic. In some instances, the combined benefit from Social Security and the pension plan is so close to the take-home pay the employee receives while working that it is generally economically unwise for the employee to continue working. In most instances, the employee is better off retiring under Social Security and under the pension plan and, if his financial position so requires, obtaining some part-time less physically demanding job outside the industry to supplement the comparatively minor difference between the

combined benefits and his take-home pay if he continues working in the industry.

The argument for compulsory retirement is that by requiring retirement at a certain age there is a general improvement in efficiency of the employer's operation and also greater incentive provided for the younger employees to move up to the generally better jobs vacated by the older retiring employees. In this respect, it also provides for a more orderly system of retirement and planning, in advance, for the time the employee will retire.

While tradition in many industries has been for employer plans to provide compulsory retirement at age 65, there has been a growing tendency to increase the automatic retirement age to 68 and, in other instances, to age 70. (Some industries and unions favor compulsory retirement, where the work is particularly arduous.) There are also concerted efforts being made to lower the "normal" retirement age to 60.

In any event, most arguments pro and con on this subject are self-evident. The one phase of this question that becomes a cost factor is that if it is decided that compulsory retirement is to be at age 65, the assumption as to the average age at which employees will retire is resolved and this can be a cost factor in determining the ultimate pension benefits (as we discussed in the section dealing with cost factors in pension plans).

5. ***Vesting of Benefits:*** By "vesting", we generally mean that if an employee leaves the industry or ceases employment in the industry for any reason prior to his becoming eligible for pension benefits under the pension plan, some provision is made to return to him all or a portion of the amount of the employer contribution made to the pension plan on his behalf. While this is certainly an appealing type of provision, most groups quickly appreciate that including such a provision changes almost the entire structure of the pension plan and causes a substantial reduction in the ulti-

mate plan of benefits that can be provided for employees who do reach retirement age and have the required length of service in the industry.

As part of the actuarial studies, the pension consultant will review for the trustees the different types of vesting provisions that can be incorporated in a pension plan and also the impact such provisions will have on the level of benefits to be provided. The trustees then have a clear choice to make. However, it appears worthwhile to caution you that very few large multi-employer, collectively bargained pension plans have any meaningful vesting provisions as the general concept of such plans is that they are being established not as severance pay plans, but as plans to provide retirement benefits and security for employees who reach a reasonably acceptable retirement age after completing long years of service in the industry. One word of caution that is appropriate for negotiators is that until such time as the trustees have had an opportunity to consider this question and review the cost implications of vesting, no commitments should be made to the employees by either employer or union representatives as to whether or not the ultimate plan will contain vesting provisions.

This general subject should not be confused with the fact that when an employee does reach retirement age and has the required length of service to be approved for pension benefits, the pension benefits are "vested" in the employee to the extent that under an actuarially sound pension plan he will be guaranteed to receive pension benefits for the rest of his life following retirement.

6. ***Benefits Tied in or Related to Social Security:*** Most multi-employer, collectively bargained pension plans provide a pension benefit that is in addition to or independent of the benefits provided under the Social Security Law. However, this subject is being discussed because of patterns that have developed in

many industries, such as steel and oil, where, by tradition, the amount of Social Security benefit has been considered as part of the total retirement benefit to be provided by companies in those industries.

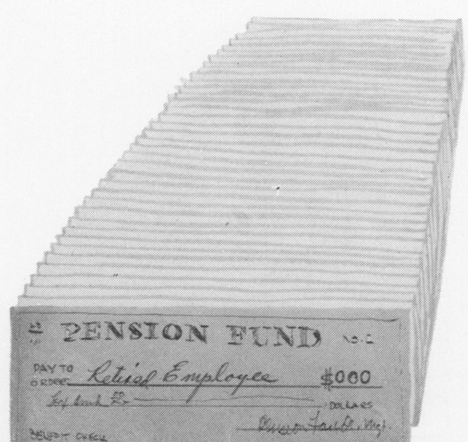
There have been many substantial and frequent changes made in the Social Security benefits throughout the last 15 years. As you know, the maximum primary benefit provided under the Social Security Law has increased from $41.60 in 1940 to the present benefit of $108.50. While it may appear that a pension plan is providing a higher benefit if it is announced that the total benefit includes the benefits the employee would be entitled to receive under Social Security, as a practical matter, most employees are sufficiently sophisticated about the Social Security benefits so that they would appreciate the plan just as well if a straight-forward statement were made as to the level of benefits provided in addition to those available under the Social Security Law. The possibility of future changes in the Social Security Law is the main reason for omitting a "tie-in" benefit.

7. ***Guaranteed Periods of Benefit Payments:*** A word of explanation is in order as to the subject heading. There is no question but that in an actuarially sound pension plan when an employee retires he is guaranteed to receive benefits for the remainder of his life following retirement. However, some trustees in multi-employer, collectively bargained plans find it wise to provide an additional guarantee to the effect that under certain circumstances the employee will be guaranteed to receive a *minimum* of "x" monthly benefit checks. Sometimes this figure is 36 monthly checks or 60 monthly checks, etc. The purpose is to avoid an inequity if an employee retires and then dies a few months following his retirement. In such circumstances, he would have received very little from the pension plan and yet, upon retirement, may have given up certain other benefits available under

Change in monthly Social Security Benefits

a group insurance program. In this respect, a guaranteed monthly benefit for the type of periods indicated eliminates the hardship of the employee's early death after retirement and yet is not too costly a factor for the pension plan. The cost implications of such guarantees should be reviewed with the trustees and the advisability of providing the guarantee is weighed against other benefits that the employee may be giving up upon his retirement.

8. ***Life Insurance, Hospitalization, Surgical and Medical Insurance for Retired Employees and/or Their Dependents:*** It is not uncommon for the trustees of a pension fund to ask about the cost and advisability of providing benefits for retired employees through the pension plan that are not strictly pension benefits. For example, it is commonly asked that life insurance, hospitalization, surgical and medical insurance should be provided for retired employees or their dependents. To put matters in their proper perspective, this should be a question for the trustees of a welfare fund and not the trustees of a pension fund. However, we would like to indicate that such benefits are generally expensive and careful consideration should be given to the cost implications before they are put into effect. Most groups find that providing a limited type of group insurance protection for retired employees can be done on a sound financial basis, but this is generally done through a *welfare fund* that may be in effect for the employees. On reflection, you will see that the guaranteed period of payments referred to in the preceding section has some bearing on this point in the sense that it is related to providing a life insurance benefit for retired employees.



VI.

Summary

Multi-employer, collectively bargained pension plans can be one of the most effective mediums for providing retirement security for employees who have put in long years of service in an industry. With the increase in Social Security benefits and with the current level of pension plans being established, retirement is becoming more and more of a reality for employees throughout the country. The combined benefits from Social Security and the pension plans are approaching a level where an employee can look forward to retirement without effecting a drastic change in his standard of living and without having to rely on savings accumulated during the course of his lifetime, or the support of his children.

The experience of these funds throughout the United States has been that they can be established and operated efficiently on a sound basis and produce substantial benefits.

This subject certainly warrants careful consideration by employer and union representatives in collective bargaining.

We hope that as a result of these several days of review you are now aware of the facts to be considered in negotiating, establishing, and administering a pension plan.

We look forward to helping you further on this matter in any way possible and will be more than pleased to answer any questions you may have.

THE MARTIN E. SEGAL COMPANY
CONSULTANTS

WELFARE FUNDS / HEALTH AND PENSION PROGRAMS

Martin E. Segal

Henry W. Wenning

Carroll J. Lynch, *Resident Partner*

Berton Jacobson, *Resident Manager*

57 Post Street / San Francisco 4, California

Telephone / EXbrook 2-0930