Pensions
(1956 folder)

[California state federation of labor.

the aBc of Pensions in Collective Bargaining

[San Francisco, 1956]

April 15, 1956

To all affiliates:

The importance of pension plans in present-day collective bargaining stems mainly from the inadequacy of Social Security benefits. Even with the 1954 improvements in the Social Security Law, the old-age benefits currently provided at age 65 fall far short of meeting labor's goal of security for retired workers.

A regularly employed worker earning, say, $2.50 an hour or $5,200 a year can, at best, retire on an old-age benefit of $108.50 a month or one-quarter of his earnings before retirement. If he has a wife who is also 65 years of age, he can raise this to $162.80 or less than 38% of his earnings. In the typical case, however, such an employee will have had some period of unemployment, sickness, or part-time work which will reduce his average wage and result in less than full Social Security benefits. Moreover, the fact that no benefits at all are payable before age 65, even if the worker is totally disabled, only emphasizes the need for greater protection than is afforded by Social Security benefits.

We have further proof of this in reports from the Social Security Administration that the overwhelming majority of applications for old-age benefits come from men who are out of work and cannot find a job, or whose physical condition does not permit them to continue working. The plain and the simple truth is that very few workers apply for Social Security benefits because they want to. Is that because the average worker is so attached to his

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job that he wants to keep working until his health gives out? Or is it because benefits are not large enough for him to maintain anything like the standard of living he enjoyed while working? The obvious answer is that Social Security benefits are too low. Indeed, they are based at a subsistence level and the employee must look to his own resources or to his employer for supplementary benefits.

The State Federation believes that the Social Security system should be made more adequate. However, considering the differences in wages and standards of living from one section of the country to another and from one industry to another, it is unlikely that the Social Security Law in the immediate foreseeable future will provide adequately for organized workers. For that reason unions will want to bargain for pensions, as part of collective agreements, with the employer assuming the entire cost.

The typical worker cannot accumulate enough, either through savings or through insurance, to provide himself with an adequate pension at age 65 to supplement his Social Security benefits. Much less can he accumulate enough if he must retire before age 65. A typical insurance company charge, at age 65, for a lifetime annuity of $50 a month without any death benefits is $7,954. At age 60, the cost is $9,367. For women, the premiums are substantially higher. His union, however, can meet the pension costs for him by negotiating with his employer to set up a retirement plan.

This pamphlet tells you about:

1. **Pensions and Collective Bargaining.**
2. **Individual Employer vs. Industry-wide Pension Funds**
3. **Factors Affecting Pension Costs.**
4. **Steps To Be Taken In Establishing a Pension Fund and Pension Plan.**

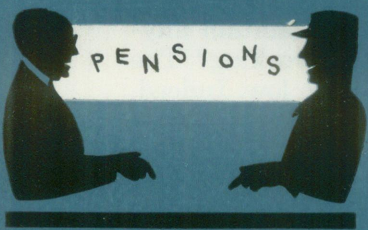
We believe this booklet will give you worthwhile information concerning pensions in collective bargaining.

Fraternally yours,

C. J. Haggerty

Secretary-Treasurer.

section 1



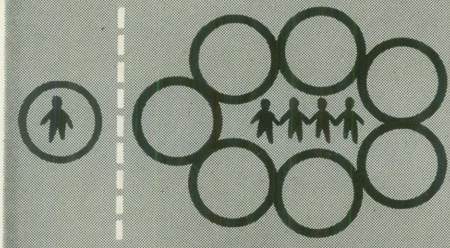
Pensions and Collective Bargaining

Negotiations for pension plans are now one of the most important aspects of collective bargaining, although they are still a fairly recent development. Before World War II, pensions were generally a matter for unilateral decision by the employer. During the war, however, because wage stabilization regulations restricted wage increases, unions sought improvements in fringe benefits, welfare plans, and pensions. The National Labor Relations Board, and later the Supreme Court, held that it was the duty of employers to bargain in good faith on group insurance plans and, by implication, on pensions as well. By now perhaps as many as 8,000,000 American workers are covered by pension plans which have grown out of union negotiations. Pension plans are still not as widespread as welfare plans providing for group insurance and health benefits. However, it can generally be anticipated that where a welfare plan has been established a pension plan will follow.

A pension plan established through collective bargaining is not a gift from the employer even though, as is usually the case, the cost is borne entirely by employer contributions. Rather, it has the same economic status as wages and conditions of employment, and is just as much a part of the employer's total labor costs. It also has the same legal status and an employer cannot refuse to bargain collectively on pensions. A pension is often negotiated as a substitute for a wage increase of equivalent value and can therefore be considered as a deferred wage payment. In one sense, it actually has an advantage over an immediate wage increase since the employee pays no income tax on the amounts contributed by his employer toward his pension. He will later be subject to a tax on his pension but at that time he will be in a lower tax bracket and will therefore have little or nothing to pay.

section 2

Individual Employer vs. Industry-Wide Pension Funds



A negotiated pension plan may be in one of two forms. It may be a plan negotiated with a single employer—or it may take the form of a pension fund covering an entire industry or craft in a particular area or region.

In negotiating an individual employer plan, the union may look for an agreement on the benefits to be provided, or it may ask for an agreement on a fixed rate of contributions, to be converted later into a pension benefit plan. In most cases, when an *individual employer plan* is to be set up, negotiations are in terms of an agreement on the *benefits*, that is, the pension rules and amounts. In some cases, however, unions have found it an advantage, even where no more than a single employer was involved, to negotiate a fixed contribution, leaving the types and amounts of benefits and the qualifying rules to be worked out by a joint committee.

In recent years there has been a very rapid growth in the number of multi-employer or industry-wide pension funds, operating on an area or regional basis. The collective bargaining agreement, in the typical case, is reached on a specified scale of contributions to be made by the employers into a pooled fund — so much per hour, day, or week, or a certain percentage of payroll. When negotiations are completed, representatives of the Union and the employers jointly work out a plan of benefits that the contributions can support.

In negotiating for an industry-wide fund, a prime consideration to both sides is that the cost should be the same to all of the competing employers. An equally important objective is that the benefits be substantially the same for all the employees represented by the union similarly situated. Now there is only one way by which these two objectives can be accomplished and that is the creation of an industry-wide pension fund.

The industry-wide fund is a pooling arrangement, which receives contributions from all the employers involved, mingles them in a single pension trust fund, and disburses benefits on a uniform plan to all of the employees covered by the union contract. If each employer were committed by the contract to a specified plan of pension benefits for its own employees, the cost would vary from employer to employer, depending on the age, sex, and employment patterns in each case. If, on the other hand, each employer were committed to a given level of contributions, the different groups of employees would come up with different scales of benefits. Consequently, where uniform competitive labor costs and uniform benefits are both important objectives, it is the rule that the union will negotiate an industry-wide pension fund.

Frequent changes in job from one employer to another make the case for the industry-wide fund extremely strong in certain industries. In most of the building trades, for example, it would not make too much sense to try to cover the men in a particular craft by a whole series of individual pension plans set up by each of the contractors separately. The typical craftsman is likely to have so many different employers in the course of his working life that either he would reach retirement age without any pension at all or else he would have to worry about collecting bits of pensions from a number of former employers. The only reasonable way to provide such a worker with a pension plan is to have a pooled fund which accumulates his service credits for all his work for contributing employers, regardless of how often he has changed jobs within the industry, and pays him a retirement benefit on the basis of his combined credits. An incidental, but important, consequence of the accumulation of service credits earned in different jobs is that it gives the worker greater mobility and freedom of action; it does not tie him down to a particular job for fear of losing the pension rights he has earned on that job.

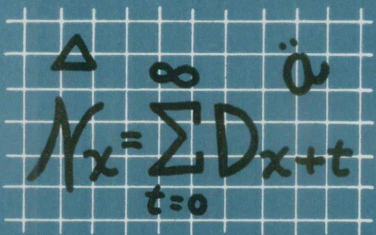
While the building trades are used as an illustration, the same is generally true of truck drivers, hotel and restaurant workers, and employees in many other trades and industries with irregular employment and job changes. In fact, the preservation of pension credits is a valuable right for *any* wage earner.

Another consideration which almost compels the creation of industry-wide funds in some cases is the fact that, in the absence of such pooling, it would be practically impossible for the small employer to establish his own pension plan. The union negotiator is often confronted with a situation in which, not only are many of the employers he is dealing with small, but the negotiations cover only one craft, department, or occupation, which makes the individual units smaller still. To cover these small units by individual pension plans might be unsound and wasteful.

What is more, even if pension coverage were established for small groups, company by company, it might mean insecurity for the men, since many of these small employers are likely to go out of business and leave their employees without any guaranteed retirement benefits.

As you can see, a joint labor-management multi-employer plan has many advantages to the worker.

section 3



Factors Affecting Pension Costs

Although the actual calculation of pension costs is done by a qualified actuary or consultant, the union negotiator or pension fund trustee should know in a general way what factors determine the amount of pension that can be provided by a given level of employer contributions. These factors can be outlined briefly.

First of all, there is the question of the types and amounts of benefits provided and the eligibility conditions for each type. Obviously, it costs more to provide a $100 monthly pension than a $50 pension. What should be just as obvious, but is sometimes overlooked, is that a plan which provides a pension at *age 65* to an employee who has had *30 years* of service is something entirely different from one which permits retirement at *age 60* after *15 years* of service. A plan which pays benefits on *all* years of employment in the industry is more costly than one which credits only the last *continuous* stretch of employment in the industry. The inclusion or exclusion of disability benefits, death benefits, and severance rights is also of prime importance in determining costs.

The present age of the group is important. A large proportion of employees close to, or past, retirement age tends to produce higher pension costs than a small proportion. A high average *length of service* before the plan went into operation and for which pension credit is to be allowed makes for higher costs.

A pension plan is more costly if it must provide for a sizable *proportion of women* pensioners than if only men are to be covered, since women live longer on the average. However, in many cases, the fact that many of the employees are women has the effect of *reducing* costs because a large proportion of the women may not stay in the industry until retirement age.

The expected retirement age – the age at which the average person can be expected to retire – has an important bearing on cost. For example, on the basis of the Group Annuity Table for 1951, an employee who retires on a $50 monthly pension at age 66* will, on the average, receive $8,200 in benefits, compared with $8,550 in the case of the 65-year-old pensioner. A pension plan set up for an industry in which employees are accustomed to working well past age 65 can therefore provide substantially larger benefits, all other things being equal, than one for a group of employees who are in heavy work and are likely to retire as soon as they can qualify for pensions. A difference of one year in the estimated average age at retirement can change pension costs by 9 to 10%.

Still another factor that must be taken into account is *turnover* – the rate at which employees drop out of the industry before reaching retirement age. To see how this factor operates, consider an employee who starts working at age 30 and retires at age 66. Allowing a 2½% interest accumulation, it is necessary to set aside $113 a year over the 36 remaining years in order to accumulate the $6,628 needed to pay a $50 monthly pension.

Now, some employees will die before retirement and the accumulation made on their behalf will be available to help finance the cost of pensions to those who survive. If allowance is made for these deaths, it is found that only $94, not $113, need be set aside each year for each employee who enters at age 30. But some employees will drop out of the group for reasons other than death and their accumulations, too, remain for the benefit of the other employees. In an industry with high turnover rates over the years, the $94 cost can be reduced as much as one-third or one-half.

A pension calculation will also take into account the number of *deaths prior to retirement* and the *life expectancy* of those who retire; the *interest rate* which the pension fund will earn on its reserves; and the extent to which *reserves* are to be built up in order to guarantee security to the employees who are covered by the plan.

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*While reference is made to age 65 or age 66, in various sections of this booklet, affiliates to the State Federation know that labor favors retirement at age 60, wherever this is feasible and possible. The references to age 65 or age 66, in this booklet are, therefore, simply for illustrative purposes in estimating costs. As you would expect, when there is an earlier retirement age, the Pension Plan will cost more.

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For predicting life expectancy among the employees involved the actuary may use one of a number of "mortality tables". For example, according to the Group Annuity Table for 1951, the average man of 65 can expect to live 14.2 years and the average woman can expect to live 17.1 years. At the rate of $50 a month this "average man" will draw $8,550 in pension payments and the "average woman" $10,300.

The interest which a pension fund can be expected to earn on its reserves depends on whether it is insured under a contract with an insurance company or whether it is self-insured. A self-insured plan involves a trust fund which is directly invested in securities without resort to an insurance company. If the fund makes its own investments, then its earnings depend also on the types of securities that it buys: whether government bonds, corporate bonds, preferred stock, common stock, mortgages, etc., and in what proportions. In making a pension calculation, the actuary makes some safe assumption as to what these interest earnings are liable to be. An actuary may for instance assume, for purposes of his cost calculations, that the reserves of the pension fund will earn 2½% interest even though in the particular case he knows that the fund will probably earn a higher rate.

For example, if it is assumed that reserves will earn 2½% interest, the *$8,200* figure quoted above as the amount needed at age *66* can be reduced to $6,628. If it can be assumed that the yield on the fund's assets will amount to 3%, the figure can then be reduced still further to $6,381. A difference of ¼ of 1% in investment yield can make a 5% difference, or more, in overall pension costs.

An important factor in determining pension costs is the question of funding. That has to do basically with the extent to which the fund will accumulate reserves in order to guarantee that the plan will be carried out.

A plan can be set up on the basis of higher or lower reserves in relation to the promised benefits. The higher the reserves and the faster they are accumulated, the lower the benefit amount the fund can afford to pay in the meantime.

Obviously, a sound policy has to be determined on reserves. On the one hand, responsible union trustees do not generally want a plan with benefits so high in relation to the fixed contribution that no reserves are built up in order to guarantee continuance of benefit payments to pensioners and others who may be close to retirement. On the other hand, it is possible to go to the other extreme and set aside so much of the contributions for building reserves that the pension benefit amount has to be fixed at a very low level. It is necessary to strike a proper and responsible balance: one which provides a realistic level of benefits, and, at the same time, builds up reserves so that if there should be difficulty with contributions in the future, pension payments will not have to be discontinued and men who counted on the continuation of pension payments will not be disappointed.

This question of funding or building reserves generally takes the technical form of deciding on payments for "past service costs". "Past service costs" arise from the fact that it is necessary, when a plan is first established, to take account of past years of employment during which no plan existed. These years of employment will be credited in determining the amount of pension that will be paid, but no contributions were made into the fund during those years. At the time a fund is first set up, the amount of money it would have had if it had always been in existence is known as the past service liability – it is a sort of debt with which the plan starts its life. This debt or liability is usually a huge sum and cannot be paid off out of employer contributions all at once. Instead, some schedule is decided on for the liquidation or amortization of the liability over some specified period. It may, for example, be agreed that the liability will be amortized over 25 years, in which case an appropriate portion of each year's contribution must be set aside to meet this schedule and the remainder is available to pay for pension credits currently accumulated. If a 40-year schedule is decided on, a much smaller portion of the contribution is taken up for this purpose and a correspondingly higher portion is available for current pension accruals. A higher pension can therefore be provided by a given level of contributions if the past service is amortized over 40 years than if it is amortized over 25 years. In some instances, a plan can be sound if the past service cost is not amortized but the interest payments on it are kept up.

The whole question of building pension reserves is a matter of policy which has to be decided by the trustees of the pension fund, after consideration of the problem with their pension consultant.

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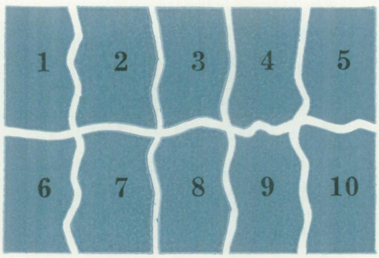
section **4**



Steps to be Taken in Establishing a Pension Fund and a Pension Plan

Let us suppose a union has completed its negotiations with a group of employers and has won a settlement in terms of a contribution to a pension trust fund. What are the next steps? In a sense, the job has just begun when the negotiations are over, since the establishment and maintenance of a pension plan is no simple standardized operation. Different employer groups and local unions in different geographical areas and in different industries have their own special problems.

These are steps to be taken by the pension fund's board of trustees, which is to be composed of union and employer representatives. In taking these steps, technical assistance is generally required from a pension consultant or actuary, a lawyer and an accountant. That being so, it is generally wise to secure that assistance from the beginning.

1. An Agreement and Declaration of Trust must be adopted. This legally establishes the pension fund and spells out the appointment, duties, powers, and limitations of the trustees.

2. Arrangements should be made for the collection and handling of employer contributions and for related administration such as the staffing of an administrative office, the opening of a bank account, and the selection of an accountant.

3. A census of the employees must be taken for purposes of an actuarial calculation. This census may

have to take account of the nature of the industry and of any special problems affecting the proposed pension plan.

4. An actuarial calculation must be made on a tentative plan or plans of benefits. In the light of what the fund can afford, the trustees can determine the types and amounts of benefits and the eligibility rules.

5. A specific pension plan must be adopted embodying all of the rules.

6. The pension plan, trust agreement, and other documents should be submitted for approval to the Bureau of Internal Revenue, in order to insure that employer contributions and investment income of the fund will not be subject to taxation.

7. A decision should be made on the question of insuring or self-insuring the pension program. If the plan is to be insured, competitive bids should be received from several insurance carriers before one is selected and the details of an insurance contract worked out. If it is to be self-insured, procedures for the investment of the pension fund should be considered and banks and other institutions should be asked to describe their custodial, investment advisory, or trustee services.

8. A descriptive booklet should be printed, spelling out, in layman's language, the main provisions of the pension plan. The full text of the plan is generally included.

9. Forms and procedures must be established for the orderly consideration of pension applications, the maintenance of records, and in general for the administration of the plan.

10. Periodic summary reports should be issued to the employees covered under the pension plan and to the contributing employers in order to advise them of the progress of the pension plan in providing security for the men and women whom it covers.

Conclusion

This booklet has been prepared by the California State Federation of Labor as a service to all its affiliates. It does not pretend to be a complete guide to all questions likely to arise in negotiating for, or in administering, a pension plan. It will serve its purpose, however, if it gives the union negotiator a general survey of the field and equips him to approach the pension problem with greater awareness of what it involves. Any affiliate interested in further information or assistance can write to the Federation office.