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THE PENSION PROMISE – REALITY OR ILLUSION

by Thomas R. Donahue

UNIVERSITY OF HAWAII • INDUSTRIAL RELATIONS CENTER

The Industrial Relations Center was established by the Board of Regents of the University of Hawaii in January, 1948. The objectives of the Center are set forth in the following excerpts from the minutes of the Board.

PRINCIPLES

To promote in the community a sound understanding of labor-management problems, labor-management techniques and policies; and to provide for labor, management, and the community sources of information in the field of industrial relations, through such mediums as:

1. A curriculum for the training of young men for industrial relations positions; credit courses for University students and non-credit courses for the general public to bring about a better understanding of the problems of management and labor consistent with the basic needs of the community.

2. A library devoted to maintaining current materials and information in the field of labor-management relations, as well as the basic and standard sources, to be available for use by labor, management, and the general public. It is proposed that this library will contain all the important services now available, such as the publications of the Bureau of National Affairs, Prentice-Hall, and Commerce Clearing House. It would also be desirable to maintain files of collective bargaining agreements, both state and mainland agreements, and arbitration awards, as well as standard texts in the major fields of industrial relations.

3. A library reference service for the purpose of making this information available to both labor and management.

4. Public lectures, conferences, and discussion groups.

5. Research studies in basic industrial relations problems.

Further information concerning the work of the Industrial Relations Center may be obtained by calling the Center, Phone 944-8332.

THE PENSION PROMISE – REALITY OR ILLUSION

by Thomas R. Donahue

INDUSTRIAL RELATIONS CENTER
UNIVERSITY OF HAWAII • HONOLULU, HAWAII

January 1969

INTRODUCTION

One of the objectives of the Industrial Relations Center is to make available to the community materials and information designed to promote sound understanding of labor-management techniques and policies, and to provide for labor, management and the community useful information in the field of industrial relations. The Industrial Relations Center has achieved this objective, in part, through sponsoring and developing various conferences; establishment of discussion groups; and occasional public lectures on subjects which are of current concern and interest to Hawaii, or have broader aspects applying to the nation as a whole with some implication and relevance to Hawaii. We have on occasion reprinted conference materials, discussions and public speeches because we believe that they should have a wider public dissemination and discussion in the community.

One of these speeches was given recently by Mr. Thomas R. Donahue, Assistant Secretary of Labor for Labor-Management Relations, U. S. Department of Labor, Washington, D. C. Prior to assuming his post with the Department of Labor, Mr. Donahue was executive assistant to the president of the Building Service Employees' Union, AFL-CIO. A graduate of Manhattan College and of Fordham Law School, he has served as instructor in Labor-Management Relations at Manhattan College, and was European Labor Program Coordinator in Paris for the Free Europe Committee, Inc., the parent organization of Radio Free Europe, between 1957 and 1960. Prior to that he was successively Editor, Director of Education and Director of the Contract Division of Local 32B of the Building Service Employees' International Union.

Mr. Donahue's speech was presented before the Industrial Relations Research Association, Hawaii Chapter, on December 6, 1968, at Honolulu, Hawaii.

Following the speech by Mr. Donahue are the comments of Mr. Everett A. Rea, Consulting Actuary, Peat, Marwick, Mitchell & Co. A graduate of the California Institute of Technology and the

University of California, Los Angeles, Mr. Rea has been associated with Peat, Marwick, Mitchell & Co. for the past 18 years. Previous to that he was with the Institute for Numerical Analysis, University of California, Los Angeles.

The Hawaii Chapter of the Industrial Relations Research Association was founded in 1966 with the purpose "to secure for members the advantage of free exchanges of ideas in the labor-management and industrial relations field." The present officers are: Bernhard W. Stern, President; Edward McMahon, First Vice President; Robert C. Knight, Second Vice President; Robert R. Grunsky, Secretary; and Ted T. Tsukiyama, Treasurer. A listing of the present membership may be found on the following pages.

Harold S. Roberts, Director
Industrial Relations Center
College of Business Administration
University of Hawaii
January 1969

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The Pension Promise – Reality or Illusion

by Thomas R. Donahue*

When a man steps down from his life's work and stands at the threshold of his "golden years" in this affluent nation of ours, he should be able to count on a certain irreducible minimum income. That income must come from social security, his private retirement plan and from any savings he has. More and more in this country we depend on social security and private pension plans rather than on personal savings. Obviously, what the private source does not supply the public source must--either in social security or in some form of state aid or welfare.

It is clear, then, that encouragement of the growth and effectiveness of private welfare and retirement plans is in the public interest.

I think it should be equally clear that the operation of such plans, with the tremendous impact they have on the public sector, properly is the concern of government. That concern has been expressed with the introduction of the Pension Benefit Security Act.

The 90th Congress packed up and went home without acting on the Pension Benefit Security Act, and much has taken place in the political arena since.

As a "lame duck" in the Democratic Administration, I am not prepared to speculate on what the new Administration will do about such legislation....but I like to believe that the Congress will not let it turn its back on it.

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*Assistant Secretary of Labor for Labor-Management Relations, U. S. Department of Labor, Washington, D. C. Remarks prepared for delivery before the Industrial Relations Research Association, Hawaii Chapter, on December 6, 1968, at Honolulu, Hawaii.

Senator Yarborough, who introduced S.3421--the bill I will discuss with you today--will be an influential member of the Senate Labor Committee (and may even be chairman of its Labor Subcommittee). Within the past few weeks, Senator Yarborough has said publicly that pension legislation is "an area in which the Committee started work last year and should finish next year..."

Senator Javits, whose proposed pension legislation is similar in most respects to the Yarborough-Labor Department bill, has been seeking action for some time. I doubt that he will diminish either his interest or his effort.

In other words, I believe that the need for pension legislation has been demonstrated so clearly in Congress that the drive to achieve it is still very much alive and that efforts to do so will be vigorously undertaken.

Opponents of the Pension Benefit Security Act claim that it is not needed and that it will harm the private retirement system, which, they maintain, is doing very well thank you, without government regulation. I suggest that this bill is urgently needed and that--far from harming the private retirement system--it will help it fulfill its potential as a vital supplement to the social security system. At present, the private system, despite its more than $125 billion in assets and its annual payment of $3 billion to 3 million beneficiaries, falls considerably short of this goal.

A chief stumbling block is the prevalence of unduly restrictive eligibility requirements. A lesser, but still significant, cause of pension loss is lack of sufficient funds to pay the promised benefits to those lucky enough to escape all the pitfalls that lie along the precarious road to pension eligibility.

A mandatory minimum standard for vesting provisions would offer at least a partial remedy for loss of pensions through inability to meet stringent age and service requirements. A minimum funding standard for pension plans, together with a system of plan termination insurance, would give participants greater assurance that they will receive the benefits they have qualified for.

I think most of the discussion on these issues unfortunately has not revolved around the desirability of the proposals. I think most professionals would concede the desirability of vesting and those who don't are holding to an archaic view that the absence of vesting is what insures that a man will stay with the company or industry forever and that such a man is the only one in whom the pension plan is interested.

I think the current level of funding of most responsible plans represents acknowledgement of the desirability of adequate funding.

And I don't think the view that plan termination protection which will guarantee employees the benefits they expect if a plan is forced to terminate, is likely to draw much dissent. I really wish we could keep all the discussion on the level of the desirability of these things because if that were our focus, and if we could record a shared conviction that these things are desirable--then we would move on together to determine how best to achieve these desirable objectives, without undesirable side effects.

Unhappily that is not true. The real focus of most of the negative debate on these proposals has been on whether these desirable objectives are really necessary. Can't we get along without them? And most of the discussion is about why we don't need a law to get to them. Essentially the argumentation against these proposals gets down to statements designed to prove three things:

1. We are moving very well toward the adoption by all of reasonable vesting provisions, so why legislate them?
2. There are not many terminations of improvident plans, few people are affected by them, so why spread the cost of preventing that to all of us?
3. The proposals will destroy flexibility of pension planning.

Just quickly, let me say (1) we are moving toward universal vesting at a snail's pace, (2) we can't allow even a small number of improvident plans to deprive their participants of expected security, and (3) pension plans can provide for all the flexibility they want above certain minimum standards.

Let's take a look at the proposals individually.

In its 1965 report, the President's Committee on Corporate Pension Funds and Other Retirement and Welfare Programs, concluded as follows:

> "As a matter of equity and fair treatment, an employee covered by a pension plan is entitled, after a reasonable period of service to protection of his future retirement benefit against any termination of his employment. Without vesting a worker displaced after long years of service is denied all of his accrued pension protection. A worker in a similar position who voluntarily changes his employment has to forfeit his right to a future pension. Both circumstances are charged with inequity."

I shall not try to impress you with the horror stories of persons who were denied their expected pension benefit because of the absence of a minimum vesting standard. Nor will I address myself at length to the desirability of vesting in terms of its impact on labor mobility, or in terms of its impact on the nation's overall approach to retirement protection.

The merits of vesting are almost universally recognized, yet it is completely absent in almost one-third of all pension plans covering nearly one-third of all participants. In many other plans, vesting is dependent upon the individual's meeting overly restrictive age, service or other requirements.

In the decade of the 1950's, substantial progress was made by many plans toward more liberal vesting provisions. This fact has been cited by many who believe that legislation is not necessary and that vesting will become virtually universal through private action. However, the situation today shows only a slight change over the prevalence of vesting in 1962-63.

Opponents of this provision say there is no necessity for it and allege that their case is proven by our own Department of Labor figures. The reference is always to a May 1968 article in the *Monthly Labor Review*. The universally cited statistic is that between 1962-63 and 1968 increases in the number of plans with vesting provisions raised the level of such plans to 70 percent of all plans, covering 63 percent of all workers covered by pension plans. It sounds like a very impressive figure, but it's not. Five years ago the comparable provisions covered 67 percent of all plans and 59 percent of all workers. At this rate of growth, it will take more than 30 years before we get any kind of vesting provisions in substantially all plans.

But take a look at some of the other things that are said in that same article. Sure 70 percent of all plans have vesting provisions. But 37 percent of plans with deferred full vesting don't vest until the participant is over 45 years of age--a point at which most Americans will have worked nearly 25 years, and will have only 20 years more ahead of them.

Twenty-eight percent of all the plans which have vesting, have deferred graded vesting--which is a stretched-out form of vesting. These plans cover 17 percent of all the participants in plans with any kind of vesting. In this group nine out of ten of the workers covered by graded vested plans have to have 15 years or more of service and often as much as 20 to 30 years before they become fully vested.

Let me illustrate the point by considering 100 workers aged 25 who join a wide range of pension plans. Under plan provisions prevailing in mid-1967, if these workers remain within their plan for ten years, only 24 of them will be vested; if they remain 15 years, only 46 of them would be vested. Only after 20 years would a bare majority of them have vested rights, and over 30 percent would never have a vested right.

The vesting standard called for in our 90th Congress bill would require full vesting of the earned portion of regular retirement benefits after an employee has acquired ten years of continuous service, allowing exclusion of service prior to age 25, with benefit payments beginning no later than age 65. Such a standard would become fully operative over a ten-year period after the effective date of the act.

If this standard were in effect today, rough estimates indicate that it would begin to benefit around 10 million participants. About half of these are participants with ten or more years of service under their plan who are not now vested. The other half are participants currently with less than ten years' service who are expected to remain on the job until they attain ten years' service but who, in the absence of the new standard, would not become vested at that time.

All of these employees would gain the assurance of knowing if they should leave the scope of their plan, their benefits would be vested. Even though these individuals are not actually terminated they would be protected in much the same way that any of us receive protection from our insurance policies even though our house does not burn down or our automobile is not involved in an accident.

However, an estimated 3 million of these 10 million participants will receive more tangible benefits. This is the estimated number of those who, without the proposed standard, would be terminated from their current employment without receiving any pension benefits.

The cost of complying with the standard naturally will vary among plans because of differences (a) in their current vesting provisions, (b) in their benefit provisions, and (c) in the characteristics of their members. Judging by the pension plans reporting under the Welfare and Pension Plans Disclosure Act, over 30 percent of the plans would either have no increases or increases of less than three percent in the plan's normal cost. About 25 percent of the plans would probably experience a three to six percent increase in cost. Higher cost increases would probably be incurred by the remaining plans, most of which have no vesting provision.

Differences in the cost of complying with the vesting requirements are recognized in two ways:

1. Several transition methods are included that can be used by any plan to make the cost increase as small and as gradual as possible.
2. A relief provision is included to aid plans that incur a substantial cost increase.

Is vesting necessary? Is a minimum vesting standard such as we have proposed necessary?

Yes--if the private pension system is to be believable.

Yes--if the private pension system wants to hold the faith and allegiance of its participants.

The Funding Standard

It is equally necessary that we insure that the money will be available to pay the benefits for which participants become eligible. The private pension system as a whole is to be commended for its funding practices. Practically all plans fund at least their current obligations to pay benefits in the future and most have set full funding--asset accumulation equal to accrued benefit rights--as their ultimate goal.

Our proposal in this area was designed to bring a minority of plans up to the funding standards already adopted by the majority. Is it necessary? Yes--unless we are prepared to see that minority weaken the overall success of the nation's private pension system.

The present Internal Revenue Service funding standard requires fund accumulations to be sufficient to meet the benefits earned each year since inception of the plan and to pay the interest on any unfunded past service liabilities. This is maintained as a basic standard under our bill.

However, this test cannot be relied upon any longer as the sole measure of funding adequacy because it does not provide for funding of past service costs and thus may not lead to sufficient funding in the event of plan termination. For this reason, S.3421 incorporates an additional funding standard to measure more accurately and uniformly a plan's ability to meet its vested commitments at any point in time, and specifically in the event of termination. Such a standard would have the additional advantage of setting a firm foundation upon which a system of plan termination protection can be based. The proposed new standard is built around a comparison at a point in time of a plan's assets with its vested liabilities based on benefits for retirees and for those with vested rights but not yet receiving benefits.

Although available data indicate that most plans are currently funding as rapidly as the proposed standard would require, some plans might encounter difficulty in complying with the new schedule. To avoid unreasonable hardships and to provide transition procedures as in the case of the vesting standard, existing plans may elect to enter the schedule at their current funding ratio if this is lower than the ratio specified by the new schedule based on the plan's age. In addition, beginning at that point, the plan's funding target would rise only three percentage points per year for the first five years, with the full four percentage points not required until the sixth year. New plans are not required to meet the new standard during their first five years.

Plan Termination Protection

Under present regulations an employer has no legal obligation to pay expected pension benefits upon termination of the plan beyond those which can be provided by his previous contributions. The proposed funding standards would prove extremely helpful in assuring that in the future adequate assets will be on hand to meet a plan's vested obligations. However, no funding standard can be expected to provide complete protection from the day of the adoption of this legislation, in the event of termination, since this would require full and immediate funding of all vested benefits.

To meet the problem of insufficient assets upon termination, a system of plan termination protection was proposed. The aim of such a program would be to provide protection during the early years in the life of a plan, before it has been able to build sufficient resources to meet the 100 percent goal. Plan termination protection would also serve the same purpose following amendments which liberalize plan benefits and which also typically require a period of time to become full funded.

Information on plan termination, while not complete, does indicate that significant numbers of plan participants are left without their full benefit rights. During the years 1955-65, about 4300 pension plans terminated involving 225,000 employees. Forty-four percent of these terminations occurred under circumstances--financial difficulties or dissolutions of the business--where losses were likely. Currently, about 500 pension plans involving 25,000 employees terminate each year. The well-known experience of the Studebaker employees when that firm closed down its South Bend, Indiana assembly plant in 1964 is only the most graphic example of what can happen when a terminating plan does not have sufficient assets to meet all vested benefits.

The system of plan termination protection proposed in S.3421 was developed with the aim of providing full protection for the vested rights of plan participants in the event of plan termination caused by shutdown of operations or adverse economic circumstances.

Is it necessary? No, or at least not if you are willing to write off to bad luck the perhaps 12,000 people whose pension plans terminate each year under circumstances--financial difficulties or dissolutions of the business--where losses are likely.

I don't think you are because that, too, is part of the overall health and well-being of the private pension system.

Finally, let's talk a bit about the respective roles of the Department of Labor and the Treasury Department.

It seems strange to me to say that wages, health and welfare plans, vacation allowances, sick disability pay, hours of work, job safety and every other aspect of the work relationship, the work place and the recompense for work, fall within the province of the Labor Department; but pension plans, and the administration of them should somehow not be the concern of the Labor Department, but solely the province of the Treasury.

This sounds doubly strange to me since, at a time when proposed vesting and funding standards were linked to changes in tax law, I generally heard from people most strongly against this, that the government's interest in private pensions positively should not be based on the tax provisions of the law.

Pensions are today a very important part of employee compensation. They are inextricably bound up with the "welfare of the wage earner," the promotion of which is the basic charter of the Department of Labor. Their continued vitality and their improvement will have a major effect on the work force of the nation, on the income, mobility and security of our working people.

I think that the development of the private pension system and the development of governmental interest in that system and concern for it, has passed far above the original level of interest which dictated a role for the Treasury Department related to a tax allowance.

In summary, let me say that in the present status of private pensions, in all too many cases, the pension promise shrinks to this:

> if you remain in good health and stay with the same company until you are 65 years old, and if the company is still in business, and if your department has not been abolished, and if you haven't been laid off for too long a period, and if there's enough money in the fund, and that money has been prudently managed, you will get a pension.

It is utterly indefensible in a society as affluent as ours that an individual's economic security in his later years should rest on such a flimsy foundation and be so endangered by such an incredible list of "ifs" and "maybes."

For my part, I am convinced and I can only hope that I have helped you to become convinced, that vesting, funding and plan termination protection, along the lines drawn in the legislation we proposed, are not only desirable but necessary, and are not only possible but practical. These standards, far from restricting the pension system or injuring its flexibility, will simply lift it to a new plateau--one on which it will not only grow and prosper, but one on which it will deserve and have the faith and allegiance of its participants.

COMMENTS

by Everett A. Rea, A.S.A*

Mr. Donahue, ladies and gentlemen, I, too, wish our discussion of the proposed pension legislation could be restricted solely to its unquestioned desirability from the employee's point of view. However, it seems to me that any consideration of possible federal legislation must be viewed in light of whether the pension proposals will improve pension plans and cause them to better serve their social purpose or will they stunt the growth of the private pension movement?

Most of the proposed legislation deals with three major pension facets: vesting (portability as a special case); funding; and reinsurance (or benefit guarantees, as Mr. Donahue prefers to call it).

Perhaps right here I had better add that I was asked to present to this group my view of management's reaction to the proposed legislation. My comments are not intended in any way to represent other than my own views and will not, I am sure, be in line with the feelings of most of the very distinguished union representatives here today. I will repeat our master of ceremonies' regret that your president, Mr. Bernie Stern, could not be here today, since he was to represent labor's reaction.

First, with respect to the vesting question. Management does not like faster vesting because it costs money, that is, it gives more to those who leave, thus there is less for those who stay unless management pays more. However, it is unquestionably socially desirable; the cost is not as great as many fear; and I personally favor the intent of the proposed vesting legislation supporting improved vesting and concur with the proposed means of accomplishing it.

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*Consulting Actuary, Peat, Marwick, Mitchell & Co.

Next, the part of the proposed legislation I most violently oppose--the so-called minimum funding standards. If legislation establishes minimum acceptable funding levels, then regulations specifying the means of measuring compliance must be adopted. Such regulations will inevitably lead to minimum acceptable actuarial assumptions and calculation methods and an ever-lessening degree of flexibility for employer pension cost. I fear such legislation as the first step toward federal legislation establishing mandatory "private" pensions, such as Canada now has.

Finally, the "reinsurance" or benefit guarantee part of the legislation. While I feel that there has been no showing of any substantial inadequacy of present funding, the concept of a "terminal" guarantee seems more workable than some overall year-by-year funding standard.

OCCASIONAL PUBLICATIONS

INDUSTRIAL RELATIONS CENTER • UNIVERSITY OF HAWAII

* 1. The First Six Months under the Taft-Hartley Act, by Harold S. Roberts (1948)
* 2. The Taft-Hartley Act in Review, by Harold S. Roberts (1948)
3. Seizure in Labor Disputes, by Harold S. Roberts (1949)
* 4. Compulsory Arbitration of Labor Disputes in Public Utilities, by Harold S. Roberts (1949)
* 5. Arbitration of Grievances under Existing Contracts, by Harold S. Roberts (1949)
6. Government Intervention in Industrial Relations, by Harold S. Roberts (ed.) (1950, 1955, 1962), $2.50 plus 18 cents postage
* 7. Plant Grievances, by Harold S. Roberts (1952)
* 8. Trade Unions and the Competitive Menace in Hawaii, by Mark Perlman and John B. Ferguson (1952)
* 9. Substitutes for the Strike, an Appraisal, by John B. Ferguson (1953)
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