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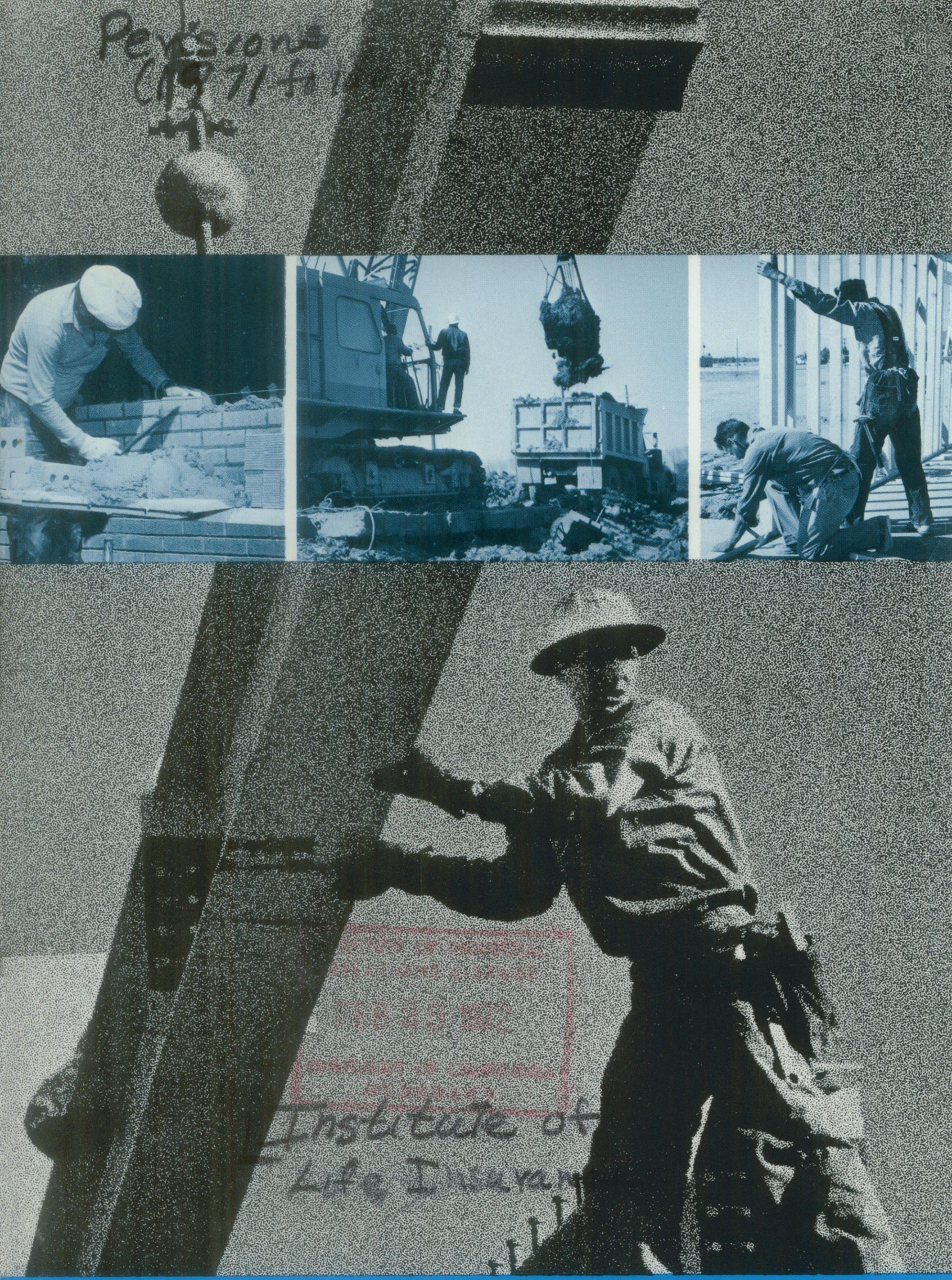

Institute of Life Insurance

Multi-Employer Pension Plans

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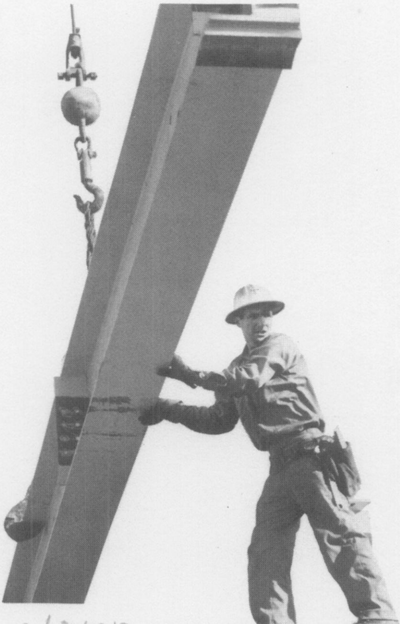

[Multi-employer pension plans]

Handbook,

Jointly Administered Labor-Management

(Multi-Employer) Pension Plans.

[2d edition]

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FOREWORD

This Handbook on jointly administered labor-management pension plans is now in its second edition and third printing; over 35,000 copies have been distributed. It has been revised to provide up-to-date basic information for the representatives of both unions and employers who will share the great trust of planning and administering retirement income plans for millions of American working men and women.

The publication is intended as a contribution of the life insurance business to the basic understanding of this highly complex subject. Labor-management trustees' involvement in the pension plan is but one of the many demands upon their time and talents. This Handbook has been prepared to include the general facts needed for a knowledge of the pension arrangement and to indicate the nature of the responsibilities assumed by trustees.

The Handbook is also intended as an informational source for plan administrators and consultants, for the press, and for life insurance people who have not previously had contact with this type of pension plan. It is intended to be of some assistance to small business employers considering joining a group pension plan that is not union negotiated but includes other employers in a similar industry or in the same geographical area.

Historically, the life insurance business has made major contributions to the development of pension plans. Actuaries of the life insurance companies constructed the mortality tables that are the basis for funding most of the benefits paid from pension plans.

For a long period, insured pension plans were at a disadvantage because of such factors as discriminatory Federal tax laws, methods of crediting interest, and inability to offer equity funding. Today, a more favorable climate prevails. Discriminatory Federal tax burdens have been for the most part removed. Interest rates credited to insured plans have increased markedly and, in almost every state, insurance companies can offer equity funding facilities based on common stock investments.

Coupled with these factors is the long experience and continuity of management enabling the life insurance business to provide a major contribution to sound pension planning.

In the preparation of this Handbook, the Institute of Life Insurance received advice and technical assistance from many sources having an interest in this project. They include:

1. Labor and management representatives who outlined what information was needed;

2. Government sources who provided an interpretation of the important Federal and state roles in this type of pension planning;

3. Trustees and typical employees who were interviewed as to their attitudes, understanding and communication needs relating to their particular pension plans;

4. Specialists in the life insurance business who have concentrated in the area of labor-management pension plans have contributed technical assistance. This Handbook represents the combined thoughts of actuaries, lawyers, researchers, and the men in the field who plan and service these plans.

The Institute of Life Insurance serves as the informational source for the life insurance business and its pension-writing companies. We shall be glad to try to answer any general question that readers might pose. For specific information, a list of the pension-writing life insurance companies in the United States and Canada is available from the Institute.

Joseph M. McCarthy
Assistant Vice President
Institute of Life Insurance

CONTENTS

CHAPTER

1

Jointly Administered Labor-Management Pension Plans

HISTORY

Pension plans have existed as part of our economic life for a long time. However, they did not begin to affect the general public until 1935, when generally depressed business conditions and reduced employment opportunities intensified the rising need for pensions in older age. Although private pension plans were beginning to be established by business, the widespread need for income for the aged unable to find employment led Congress in 1937 to pass the Federal Social Security Act, to provide retirement benefits when a worker retires at or after age 65 (now an option of age 62).

World War II gave impetus to the private pension movement in the United States. To fight inflation, the Federal government clamped a ceiling on wages. As this did not apply to employee benefits, liberal employee benefit plans, including pensions, became the order of the day. This development was also encouraged by the high corporate income and excess profits tax which allowed deductions for employer pension contributions. In 1949, further stimulus was given to pensions when the U. S. Seventh Circuit Court of Appeals affirmed a National Labor Relations Board ruling that pension and welfare benefits are properly subject to collective bargaining, and the U. S. Supreme Court declined to review the decision.

In some industries, it is readily apparent that private pension plans can be established only on a multi-employer basis, since the union is the primary cohesive factor in the economic life of employees. One example is the construction industry with its great number of small contractors, some of whom exist as a corporation only until a particular job is completed. A man can work for quite a few of them during the course of a year.

The objective in such cases is to set up a sound pension plan which would allow workers to accumulate pension credits as they change employers to follow the work. Many unions have negotiated with the employers in a given trade and geographic area to pay into a common pension fund a fixed number of cents for each hour of work performed for the employer by a member of the collective bargaining unit. Such a plan is called either a jointly administered labor-management pension plan or a negotiated multi-employer pension plan.

PLAN DEVELOPMENT

In general, the first step is that the employer contribution – the number of cents per hour worked – is agreed upon in collective bargaining negotiations between one or more local unions and an association of employers.

The next steps are to appoint a board of labor-management trustees, to adopt a trust instrument and establish a pension trust fund. The trustees then formulate the terms of the pension plan and arrange for the administration of the plan. Since contributions are fixed in advance, the benefit level is usually determined by estimating an amount which can be actuarially supported by the incoming contributions plus the investment income expected to be earned.

This amount is usually expressed in terms of a number of dollars a month for each year of service credited in accordance with the plan.

TRUST-TRUSTEES

Under law, a trust is defined as a fiduciary relationship whereby one person has legal title to property or money which he holds for the benefit of someone else. Therefore, a jointly administered pension trust is one under which the trustees hold title to the property and money contributed by the employers for the exclusive benefit of the employees covered under the pension plan.

The trustees are a small group of persons appointed or elected to represent the employees and employers in the operation of the pension plan. The total votes of the employee trustees and of the employer trustees must be the same.

The law requires very high standards of conduct on the part of anyone who acts in a fiduciary capacity. No one need accept the responsibilities of a trustee but, once he has accepted he must serve until he is relieved by the terms of the trust agreement, unless the trust agreement gives him the right to resign.

A trustee is obligated to act for the benefit of the beneficiaries under the trust. He cannot delegate his own duties as fiduciary, and he may not profit at the expense of the individuals who are to receive benefits under the plan.

Even if the terms of the trust agreement prove to be unwise, shortsighted or ill-advised, the trustee is obliged to carry out the terms of the agreement unless it becomes illegal or impossible to do so. This emphasizes the importance of a well drawn trust agreement, including provision for amendment of the trust by the trustees.

RESPONSIBILITIES OF TRUSTEES

Although the specific responsibilities of a trustee are governed by the terms of the trust agreement under which he is appointed, a trustee is generally responsible for seeing that:

1. His actions are legal, reasonable and prudent.
2. The pension plan is qualified in accordance with the Internal Revenue Code.

3. The union members and employers are receiving good value from the program.

4. The plan is being administered efficiently.

5. The plan is actuarially sound.

The trustee need not be a technical expert to meet these obligations. Actually, he can carry out his duties by appointing competent technicians and advisors to provide actuarial, legal and administrative help.

The *actuary* performs the mathematical computations to determine financial soundness of the plan. The *lawyer* provides the legal counsel and the documents needed to insure the smooth operation of the plan. The *administrator* is responsible for record keeping, accounting, collection and transmittal of contributions, and other similar functions. These advisors make periodic reports to the trustees concerning the operations of the plan.

One area where expert recommendation is important, for instance, is in funding the pensions provided under the plan. There are numerous ways by which this can be accomplished and it should be noted that there is no one best way to fund and administer all pension programs. Different circumstances will dictate different approaches; what works well for one group may be unsuitable for another. It is up to the trustees themselves, working with a team of technical experts, to determine which funding method best suits the needs of their particular group.

CHAPTER

2

Legal Considerations

Among the most serious considerations of jointly administered negotiated pension plans are their legal aspects. These should be examined carefully by the attorney retained by the trustees before the plan begins to operate. Attention must be given to the Labor-Management Relations Act and to Federal and state laws which have a bearing on the operation of a pension program:

LABOR-MANAGEMENT RELATIONS ACT

If a multi-employer pension plan provides for union participation in the administration of the pension fund – that is, joint management – it must conform to the Labor-Management Relations Act of 1947 (Taft-Hartley Act). A section of the Act makes it unlawful for an employer to pay or deliver any moneys to a representative of his employees and conversely prohibits the representative from accepting moneys from the employer.

However, pension and welfare trust funds established for the sole and exclusive benefit of employees and their families and dependents are exempt from this provision if the following conditions are met:

1. Payments are held in trust for the benefit of eligible employees.
2. The basis for making such payments is specified in a written agreement with the employer.

3. The employees and employer have equal representation in administering the trust fund and the agreement contains a provision which, in the event of a deadlock, permits the appointment of an impartial umpire at the request of either party.

4. The agreement provides for an annual audit of the trust fund.

5. Payments to provide pensions or annuities are made to a separate trust fund which cannot be used for any other purpose.

If a negotiated plan does not meet the requirements and a prohibited transaction takes place, each person who willfully violates any of the above provisions is liable for a fine of $10,000 or one year imprisonment or both.

FEDERAL INTERNAL REVENUE CODE

If a pension plan qualifies under the terms of the Internal Revenue Code, contributions by the employer:

✔ Are deductible as a business expense for income tax purposes.

✔ Are not considered as taxable income to the employees until benefits are made available or distributed to them.

✔ Are invested with the earnings not taxed until distributed or made available to the employees.

Briefly, the requirements for IRS qualification are:

✔ The plan must be established for the exclusive benefit of the employees and their beneficiaries. While the Code generally refers to a single employer, it is clear that a plan covering employees of several employers will also qualify if all other conditions are satisfied.

✔ It must be impossible under the trust agreement for any part of the corpus or income of the fund to be used for purposes other than for the exclusive benefit of employees and their beneficiaries.

✔ The plan benefits may not discriminate in favor of highly paid or supervisory employees.

- ✔ The plan must provide that the employees' interests will vest fully upon termination or discontinuance of the plan.
- ✔ The plan must be a definite written program and must be communicated to the employees.
- ✔ The plan must be permanent. A plan that is discontinued without a valid business reason does not meet the permanency requirement. The U. S. Treasury Department has indicated that a plan with no fixed termination date established under an agreement negotiated between an employer or group of employers may be considered as permanent, even though the agreement with the union may itself run for only a fixed number of years.
- ✔ The trust must file an annual return with the IRS on Form 990-P.
- ✔ The trust must be a valid trust under state law and must qualify under Section 501(a) of the Internal Revenue Code as exempt from Federal Income Tax.

Several Treasury rulings apply specifically to negotiated plans. As mentioned, one of the requirements for qualification is that the plan be a permanent one. Revenue Ruling 70-257 recognizes that negotiated plans usually call for a fixed rate of contributions in accordance with a collective bargaining agreement which may be terminated after a certain number of years.

Such a plan will nevertheless be considered permanent if an employer or the representatives of an association of employers, or the trustees (if the plan is jointly administered), certify that actuarial calculations indicate the contributions expected during the term of the collective bargaining agreement will at least equal the greater of:

1. The full costs of the prospective pensions for employees expected to retire under the plan during such term; and
2. The normal costs for currently accruing benefits, plus interest on the unfunded liability.

The trustees must also certify that the methods, assumptions and results of the actuarial calculations are considered reasonable by them.

FEDERAL WELFARE AND PENSION PLANS DISCLOSURE ACT

Under this Act, the administrator must file with the Secretary of Labor a description of the plan within 90 days after its establishment, and if the plan covers 100 or more participants, an annual report within 150 days after the end of the reporting year. For this purpose, two completed copies should be sent to: Office of Labor-Management and Welfare-Pension Reports, U. S. Department of Labor, Washington, D. C. 20210.

A copy of the plan description and the annual report must also be available to each participant, if requested. The administrator is the person or persons actually responsible for the ultimate control, disposition or management of the money received or contributed. The trustees would, therefore, be the administrator of a typical jointly administered plan.

Description of Plan: The description of the plan must be signed and sworn to and should include:

- Names and addresses of administrators.
- Their relationship to the employer or to the union, and any other offices, positions or employment held by them.
- Name, address and description of the plan and the type of administration.
- Names, titles and addresses of a trustee or trustees different from those defined as "administrator."
- A statement as to whether or not the plan is mentioned in a collective bargaining agreement.
- Copies of the plan or instruments under which the plan was established and is operating.
- The source of financing and identity of any organization through which benefits are provided.

- ✔ Specification of the fiscal year for accounting purposes.

- ✔ The procedure for presenting claims and the remedies available where claims are denied in whole or in part.

Amendments effecting a change are to be reported within 60 days after the changes have been put in force.

Annual Report: The following annual financial statement information must be published:

- ✔ Amount of employer and of any employee contributions.

- ✔ Benefits paid or otherwise funded.

- ✔ Number of employees covered.

- ✔ Statement of assets, liabilities, receipts and disbursements.

- ✔ Detailed statement of the salaries, fees and commissions charged against the plan, to whom paid, in what amount, and for what purpose.

Miscellaneous Information: Other information which must be indicated includes the type and basis of funding, assumptions used, amount of liabilities, various breakdowns of assets, and a detailed list showing all loans to the employer or to any interested employee organization. In addition, if the plan is insured, information concerning premium rates, claims and commissions must also be stated.

Annual report information is to be sworn to by the administrator or certified to by an independent certified or licensed public accountant, based on an audit conducted according to accepted standards.

Publication: Publication of the information required is to be made as follows:

Copies should be available for examination by an employee or beneficiary at the principal office of the plan. The administrator should deliver a copy of the plan description and an adequate summary of the annual report to each person or beneficiary who requests one in writing; and two copies of the description and report should be filed with the U. S. Secretary of Labor.

Bonding: Those who handle substantial funds or other property of a trust, as determined under Department of Labor regulations, must be bonded. However, for insured plans, no bonding is ordinarily required where premium payments are made directly to an insurance company by a union or an employer.

The bond must be at least 10 per cent of the amount of funds handled and must be in a form or of a type approved by the Labor Department. Such bond must be issued by a corporate surety approved by the Secretary of the Treasury. The bonds cannot be procured from any surety or through any agent or broker in whose business the plan, or any party in interest in the plan, has any direct or indirect significant control or financial interest.

It is a violation of the law for any person who is required to be bonded to exercise any control over funds or other property of the plan without being bonded.

The provisions of the Labor-Management Reporting and Disclosure Act of 1959 (Landrum-Griffin Act) also provide for bonding. However, any person required to be bonded under the Federal Welfare and Pension Plans Disclosure Act is relieved from the bonding provisions of any Federal or state law which overlap, insofar as handling funds of the plan is concerned.

STATE LAWS

In addition to the Federal laws mentioned, several states have legislation that should be considered in the creation and operation of a jointly administered pension trust. Among these are:

- State Welfare and Disclosure Laws: states with such laws include California, Massachusetts, New York, Washington and Wisconsin.

- State Tax Laws: govern taxation of trust income and disposition of benefits. A review of state income tax and inheritance taxes may be helpful in designing the plan benefits.

- State Trust Laws: may govern creation and operation of employee trusts, investment responsibilities of the trustees and law of agency as pertaining to the hiring of consultants and advisors.

- Rules Against Perpetuities and the Accumulation of Income: although many states have enacted legislation exempting pension trusts from these rules, the situation in a particular state should be investigated.

- Delinquency Laws: several states have enacted legislation which provides for fine and imprisonment if contributions due to the pension fund are not made within a stipulated period.

Some legal problems may arise beyond what is set down in the various laws regarding pension funds. For instance, it would be prudent to find out in advance whether the establishing organization has the power or authority to create a pension plan. Care should be taken to find out what rights and liabilities are created between the employee and the trust once a pension program is established. Also, consideration should be given to problems that may arise if the plan is amended or terminated.

SUMMARY

The problems listed here are not the only ones which may be encountered and the role of the attorney is very important. It is generally advisable to retain expert counsel who have specialized in this subject and are versed in both Federal and state laws governing multiemployer plans.

CHAPTER

3

Plan Design and Cost

Before going into some of the financial problems which have to be considered when planning a specific multi-employer pension plan, it might be helpful to review the pattern of benefits which has developed since such plans became popular. In most of these plans the entire cost is borne by employers, who contribute a fixed amount. The actual amount is usually fixed by collective bargaining, and is usually a set number of cents for each hour worked by a covered employee. It may also be related to units of production.

The difference between this type of plan and that of most plans established by single employers, is that all the benefits must be supported by fixed contribution (plus any investment income credited to it), without reliance upon other income such as extra contributions.

Thus, the trustees have the task of establishing a schedule of benefits which they believe can be supported by the fixed contributions. For this purpose they will need the guidance of an actuary.

FACTORS TO BE CONSIDERED

Between the fixing of contributions and the determination of benefits, however, lie such factors as:

1. The type of pension benefit formula.
2. Age at which retirement takes place.
3. Vesting rights.
4. Death, disability, and other types of benefits in the plan.
5. Hours of employment.
6. Employee contributions.

After analyzing the facts, the actuary makes his recommendations to the trustees as to the benefit level that can be supported by the incoming contributions. Before we examine the relative importance of each of these factors, one point should be made clear: a pension program is a long-range project. It must remain sound long after the original trustees have been replaced. The trustees need to remember this fact when they formulate the plan.

The proposed benefits should be designed so as not to place the plan in financial jeopardy at any time. In the early years, a certain element of conservatism is highly desirable in order to build a safety margin. It would be very undesirable to have the margins so thin that sometime in the future it might be necessary to reduce the pensions then being paid. Employees would be critical and no doubt feel resentful that their plan was letting them down.

On the other hand, a future increase in benefits would have the opposite effect. Because contributions may be used only for the benefit of the covered employees, the employees as a group are sure of benefiting in some way from each dollar contributed on their behalf, even though individual employees may not have such assurance. They may have to stay in covered employment to retirement in order to qualify for benefits.

Thus, the most prudent course to follow is to have a safety margin built into the plan to provide for its continuance should experience prove worse than expected or provide for increased benefits should the opposite be true. The immediate future should not, of course, be forgotten. However, the long-range nature of the plan itself is one of the most important facts to keep in mind. Here is a description of factors which affect cost:

1. Benefit Formula

The fixing of the benefit level is probably the last step taken by the actuary after he considers all of the details of the plan. However, for the purpose of this Handbook, it might be easier to start from this point, since the actual monetary effect of changing the benefit level is the easiest concept to illustrate.

While there is a mathematical relationship between the employers' contributions and the benefits which can be supported, the relationship is often highly complex. In some cases it may be so simple that doubling the contribution rate enables the benefit to be doubled. In such a case, if it were determined that a contribution of ten cents per hour made for each employee would provide a retirement income unit of $2.00 per month for each year of service credited, an increase in the contribution to twenty cents per hour would increase the unit payable to $4.00. However, in other cases the relationship may be less simple.

Under a fixed cents-per-hour type plan, the only sound basis for increasing the pensions payable without increasing the employer's per hour contribution would be if the experience has proven more favorable than that assumed in the cost factors of the plan.

Importance of Records: If, as is usually the case, the plan is to provide pensions based on the number of years an employee works in the industry or in the area, a major determinant of the benefit level will be the length of service each employee will have accrued when he retires. One difficulty arises from the fact that complete employment records are seldom available for service prior to the effective date of the plan.

In a few cases a solution has been reached for past service pension purposes by counting only the work years for the last employer or for the employer with whom the employee had seniority. If this is not practical, a questionnaire could be sent to each employee asking him to report all of the employers in the industry for whom he worked and the time worked. It may be possible to use Social Security records. These could be examined to determine how much credit for prior employment could be given.

Crediting of Prior Service: If a satisfactory record of prior employment has been accepted, the next step is to determine how much of the reported service can be used in determining the benefit. Suppose the aim of the trustees is to provide a monthly pension of $3.00 times the number of years of service credited.

In such an example, an employee who has 30 years of service when he retires at age 65, would have a monthly pension of $90.00. Suppose, however, that most of the employee's service, say 25 years, were completed before the plan became effective. If the majority of the employees of the group to which this employee belongs will have completed most of their service to retirement age before the plan became effective, a serious cost problem will exist.

Actually, it may be virtually impossible to recognize all the service credited before the plan begins to operate and still maintain financial soundness. The trustees might have to make a decision at this point, based on the advice of their actuary, to limit the prior pension credits in some way.

The decision might be to limit the number of years of prior service which are to be counted for credit purposes or to decrease the dollar unit of pensions based on prior service.

Keep in mind that the purpose of a pension plan is to provide pensions for employees who retire and are no longer drawing a paycheck. Thus, if prior service is in some way restricted, the dollar unit can be increased. If prior service credit were eliminated entirely, the benefit for service after the plan becomes effective could be increased substantially. However, this would weaken the initial effectiveness and acceptance of the plan. Employees close to retirement might only be able to accrue one or two years of service and find the income too small to be of much assistance in retirement.

Crediting of Future Service: The crediting of future service is not nearly as difficult as past service. But there are still a number of questions which must be resolved. For instance, it is a normal practice to record the number of hours worked by each employee during a year, and to establish a base or minimum number of hours that the employee must work in order to receive a full year of credit.

This base varies with the type of employment and from area to area. In Alaska, for instance, employees involved in outside work might only be able to complete 1000 hours of work per year. In a factory in the East, 2000 hours is representative of a normal work year.

Consider what this means. If the normal contribution is ten cents per hour in both places, the Northwest plan gets an average of $100 per member per year while in the East the contribution is twice as much. All other things being equal, it is reasonable to expect that the benefit in the second plan can be twice as much as that in the first.

What happens if a member works less than the number of hours required for a full year of credit? Usually he is credited with a fraction of a year of credit based on the actual number of hours he worked. If the base were 1000 hours, this means that an employee who worked 250 hours, but less than 500, might receive one-quarter of a year of service; 500 or more but less than 750, one-half year; 750 or more but less than 1000, three-quarters of a year.

Hours in excess of the quarterly base are usually excluded, as are hours in excess of 1000, the yearly base. Excess hours worked for which contributions are received, add to the financial strength of the plan during the year, and possibly may increase the benefit that can be paid out.

The number of years which must be completed before an employee becomes eligible for a pension is related to the overall problem of crediting service. If the eligibility rules are too stringent, few employees may become eligible for a pension and the purpose of the plan would be defeated.

On the other hand, eliminating all eligibility requirements may qualify so many employees that the dollar amount of benefit may have to be cut to a bare minimum. To achieve a happy medium, the rules regarding eligibility and crediting of service must recognize the characteristics of the covered group.

Some Practical Examples: Can prior service be credited in full? If not, by how much should it be cut back? Should it be cut back by limiting the number of years to be considered or by lowering the dollar unit? What about future service? Do the same questions arise? Should some minimum number of years be established before benefits become payable in full?

While the actuary can help answer these questions, consider the practical side of the problem. Suppose service is limited to a total of 30 years and at the same time no more than 20 years is to be credited for service before the plan begins operation. If a member is 56 years old when the plan is established and he has worked for 25 years before that, he will have a total of 29 years of service (20 prior years credit plus 9 working years) when he retires at 65.

For simplicity let us also assume that the dollar benefit is $3.00 per month per year of service credited. This will provide the member with a pension of $87.00 per month, plus benefits payable from Social Security. If the plan did not allow any credit for prior service, his pension would be only $27.00 per month.

Take a second example of an employee entering the plan at age 55 with 20 years of service. By the time he is 65 he will have accrued 30 years of service in all and would be eligible for a pension of $90.00 a month. But what happens to a man who enters the plan at age 45 with 20 years of service? By the time he is 55 he has accrued the maximum number of years that can be credited. From age 55 to 65 he accrues no additional benefit.

It is important to note that the contributions from age 55 to 65 are needed to support the $3.00 a month benefit for the group, even though the individual employee is receiving no credit for this service.

If there were no limit on the number of years of service that could be accumulated, the employee described in the last example above who entered at age 45 could accumulate 10 extra years of service. But chances are that if the plan operated in this way, the dollar unit of benefit would have to be reduced. This change would not affect the employee with a long work record, but could hurt the employee with a shorter period of service.

For the employee with less service, his total pension would be less than if service credits had been limited. In other words, the service limitation restricts service credits of the long service employees, but at the same time increases the dollar benefit that can be established for all employees.

Another practice which has an effect on the crediting of service, particularly in multi-employer plans, is the establishment of what is sometimes called a "cut-off date." This is the date after which no prior service is credited. Usually it is the date on which the plan becomes effective but it is sometimes delayed to benefit members of the bargaining unit in companies which enter after the plan is established.

There are two reasons for the "cut-off date":

1. To encourage local unions to negotiate for contributions to the plan or be penalized for delay.
2. To restrict the amount of the liability which can be incurred by the fund for late entrants.

The practical effect of a cut-off date is to restrict possible claims for prior service by automatically eliminating any period of time between this date and the later commencement of contributions under the plan.

There are two ways in which this is accomplished. The first is to establish a maximum period of prior service as of the "cut-off date," and to reduce this maximum by one year for each year which has elapsed at the time contributions into the fund begin.

The other method is somewhat less severe. It permits all service before the "cut-off date" to be considered regardless of when contributions to the plan begin. This has the effect of eliminating from consideration only the service completed between the "cut-off date" and the date contributions actually commence.

2. Retirement Age

Under most plans the normal retirement age is 65 – the first point in time at which an employee can retire and receive a full, unreduced benefit. It does not necessarily mean that retirement at age 65 is automatic or compulsory.

Although most multi-employer negotiated plans provide for completely voluntary action on the part of the employee, policy in a given plan should be decided on the basis of the applicable circumstances.

The fact that in most instances employees are not forced to retire at age 65 is very important to the actuary in his calculations. An increase in one year in the average retirement age increases the dollar benefit which can be supported by approximately 7%.

To illustrate: if an employee enters the plan at age 30 and the normal retirement age is 65, contributions are made on his behalf for 35 years. His pension, on the other hand, might be payable for about 15 years or until age 80, assuming this is his expected remaining lifetime. If the plan specifies a normal retirement age of 70, three factors would be at work. Contributions would be made for an additional 5 years or for a total of 40 years; contributions would be invested for a longer period and on the average, an employee would live to receive only 12 years or so of pension payments.

Naturally, a higher pension can be paid under plans where normal retirement occurs at age 70. If circumstances indicate the average age of retiring employees will be higher than 65, the actuary will use the appropriate assumptions in estimating the pensions which can be provided.

Early Retirement Option: Upon early retirement, an employee generally receives a reduced pension, or *actuarial equivalent.* The payment of benefits which are actuarially equivalent has no direct effect on the cost of the plan; one benefit is exchanged for a different benefit of the same value.

For example, assume that an employee would normally retire at age 65 with accumulated pension credits of $1,200 a year. Assume also that he will survive until age 80, or for 15 years. He will then live long enough to collect $18,000 from the plan. If, instead of waiting until age 65, this employee retired at age 55, his benefits would be reduced to recognize the early commencement of payments, which would be expected to be payable for almost 25 years, and also the shorter period of his covered service.

If we assume the employee had the maximum service credits at age 55, then to determine approximately the annual income at early retirement, divide the expected total return had he retired normally ($18,000) by 25. The result ($720 per year) is payable over the longer period. The cost to the plan is the same. That is, the amount of money required at age 55 to provide the monthly payment for life of $720 per year, is an *actuarial equivalent* of the amount of money required to pay the $1,200 a year for life commencing at age 65. This is a simplified illustration that does not take into account interest earned on the pension fund, mortality between age 55 and 65, and the loss of contributions to the fund after age 55.

The trend in recent years has been toward lowering the normal retirement age and toward the use of early retirement reduction factors that are more liberal than actuarially equivalent factors. These changes can increase the cost of the plan significantly.

Optional Forms of Settlement: Other actuarial equivalents which may be included in a plan are called "optional forms of settlement." One such option allows an employee who retires early to elect a higher pension before attaining age 65 (or 62) and a lower pension when Social Security payments begin; this provides him a level income for life.

Another option allows an employee to elect a reduced pension during his lifetime with the provision that upon his death the same reduced amount, or a portion of it, be paid to his wife as long as she lives. This option becomes more prevalent as the level of basic benefits increases.

Employment After Normal Retirement Age: What happens to an employee's credits if he continues to work beyond the normal retirement age? What happens to an employee's pension if he returns to work after retirement?

The answers to these questions depend on industry practices. If there is an abundance of labor in a particular industry, the view is sometimes expressed that older employees should make way for younger ones and should be encouraged to retire completely. In this case, pension credits may not be granted for service after normal retirement age. On the other hand, if labor is scarce, pension credits may continue to accrue since the retired employee is not "taking a job away" from a younger man.

Several methods have been used to encourage employees to retire at the normal retirement age. One method is to stop the accrual of benefits after a specific point in time. This allows the employee to work but his pension remains fixed after a predetermined age.

At the other end of the scale is a provision that for every year an employee remains at work after a specified age, he loses a year or a fraction of a year of his retirement credit. This has the effect of decreasing the employee's pension as long as he works. For an employee who goes back to work after having retired, the provisions range from the liberal – continuing his pension – to strict forfeiture of all pension rights. The more common provision is to stop pension payments while a man is in covered employment.

Naturally, between the extremes are probably as many provisions as there are plans. The need for a restrictive work clause depends on the situation in a particular industry, and calls for review from time to time.

3. Vesting and Turnover

Vesting is the right of an employee to a future pension if he leaves his employment covered by the plan before retirement age.

In a negotiated multi-employer type pension plan the problem of termination is different than under a single-employer plan. If termination with one employer should occur under a multi-employer plan, there is a chance the employee may continue to work in the area for a different employer also covered by the plan. Here the worker retains his accrued pension credits and for the purposes of the plan is not considered to have terminated his coverage.

Reciprocal agreements among multi-employer pension plans provide vesting for an employee who transfers from one pension fund to another, even if normal vesting requirements are not met. These agreements have become quite common – particularly between plans covering adjoining locals (or groups of locals) in the same international union.

In pension planning, the trend has been toward more liberal vesting, and various legislative proposals are being considered which would mandate minimum vesting provisions.

Reasons for Vesting: A young worker who leaves a given employer has ample opportunity to accrue pension credits elsewhere; but this is not as true for the older employee. In recognition, most plans now allow retention of credits if, for example, the employee works at least to age 45 or 50 and completes 10 or 15 years of service. The retained benefit usually begins at normal retirement age and is calculated on the basis of the credits earned up to termination.

Effect on Costs: Studies show that termination or turnover is much greater at younger ages – before an employee completes much service in a particular industry or job. Naturally, contributions previously made on behalf of non-vested employees are not needed for their benefit, since they lose their right to a benefit at termination. However, contributions which have previously been made on their behalf allow pensions for the remaining employees to be increased. The actuary can estimate the effect of such contributions in advance and adjust the benefit level accordingly.

4. Disability Benefits

While the primary purpose of a pension plan is to help provide adequate retirement income to employees and their families, total disability can create the same need at an earlier age.

In fact, the disability problem is probably more acute: not only does income stop, but more than likely, expenses increase at the same time. Recognizing this, about three-quarters of workers covered under single-employer pension plans, and more than half of all workers covered under negotiated multi-employer plans, provide for some form of disability benefits to be paid to an employee who becomes disabled before his normal retirement age.

Disability benefits are certainly desirable but their effect on cost cannot be overlooked. In some cents-per-hour plans, a liberal disability provision can reduce the average retirement benefit considerably. The cost of disability is, of course, dependent on many factors, including the amount of the benefit and the eligibility requirements.

Some of the factors to be considered in providing for disability in a pension plan are: eligibility – minimum age and length of service; what determines disability; who determines disability – a physician – or eligibility for Socal Security disability benefits; relationship of benefits, if any, to payments under Social Security and Workmen's Compensation Laws; length of payment; and provisions relating to recovery from disability and termination of disability payments.

While trustees should seek the opinion of their consultant or actuary, it must be realized that disability benefits under a pension plan can rarely provide an employee with all the income he may need if he becomes disabled. They can, however, give the employee a platform upon which he can build additional disability protection through personal savings or insurance.

5. Death Benefits

A payment made after an employee's death, either before or after retirement, can materially affect the cost of a pension plan. Such a benefit may be a lump sum flat payment, or a series of annuity payments to a beneficiary. The inclusion of a death benefit, of course, reduces the retirement benefits that can be supported by the fixed contributions.

Pension planners have recently shown a great deal of interest in benefits to widows upon the death of the breadwinner. In the few negotiated plans with this provision, it is usually an optional form of settlement. Here, the employee who lives to retirement elects a "Joint and Survivor Option" which provides that payments continue after his death to his wife as long as she lives. The amount of his pension is reduced actuarially to "pay" for his wife's benefits.

Some plans provide that should the employee die before retirement and after a specific age such as 55, it is assumed that he elected the option immediately prior to his death. His accrued benefit is reduced actuarially for early retirement and then reduced again to provide for the continuation of pension payments to his wife. Because of this double reduction the pension amounts payable are usually small.

A somewhat more liberal approach is followed by a growing number of plans which provide that the widow's pension will be 50 per cent of the employee's accrued pension with no other reduction.

In general, married women are younger than their husbands and live to an older age. Providing a benefit to them, therefore, is much more costly than providing the same benefit to their husbands. Reducing the employee's benefit actuarially is not the answer since it does not accurately reflect the needs of the wife upon her husband's death. Provision for a widow's benefit can be made directly from the trust fund, or by insurance premiums from the trust fund under a "risk premium" method offered by several life insurance companies, or through a group life insurance program.

If a program of widow's benefits is adopted, the trustees must set policy on payments after a widow remarries. It is often argued that the widow should not be receiving financial support from her late husband's pension plan if she is being supported by another husband, and therefore the plan should provide for the cessation of payments upon remarriage. This may cause administrative problems.

To avoid charges of sex discrimination under Title VII of the Civil Rights Act of 1964, many plans now provide for a *surviving spouse* death benefit rather than a *widow's benefit.*

6. Employee Contributions

Another major factor affecting benefits is whether or not employee contributions are required. Employee contributions could, of course, increase pension benefits. However, very few negotiated multi-employer plans call for employee contributions and there is no indication of change in sight.

CHAPTER

4

Financing the Plan

The previous section discussed how individual provisions affect the cost of a pension plan. This section covers the basic concepts of financing.

ACCUMULATED FUND

Contributions by employers go into an undivided fund; they are not set aside for any individual. When an employee retires his monthly pension is withdrawn from the fund. If the plan is insured, an amount may be withdrawn from the fund at his retirement to provide an annuity which is guaranteed for his lifetime.

Probably the greatest misunderstandings about pension financing arise from the fact that accumulated funds seem to grow to immense proportions. Many people look at these "huge" funds and, not understanding their purpose, ask why the pensions cannot be increased or why death and disability benefits cannot be added to the plan.

Actually, the purpose of the pension fund, however large it may seem, is to assure employees of payment of their pensions whether or not their employers are still doing business.

ACTUARIAL ASPECTS OF FUNDING

The aim of the actuary is to fix contributions – or in the case of a cents-per-hour type plan, the benefit level – so that there will always be sufficient funds on hand to pay the benefits which fall due. In making his calculations, he divides the total contributions into four parts: expenses, normal cost, interest on the accrued liability, and the accrued liability itself. Following is an explanation of these terms:

Expenses: Before anything can be paid out in pensions, certain expenses will be incurred, including the actuary's fee and that of the lawyer, administrator, investment counselor and investment custodian.

Another recurrent expense is the cost of checks and postage. (Under an insured plan, all of these separate expenses may be handled as a single collective item.) Still another expense in some pension plans is the trustees' expenses for attending meetings.

Expenses are small in relation to the total contributions made by the employers – usually less than 5 per cent. In a well-managed plan there is actually very little the trustee can do to reduce expenses appreciably below this figure.

Normal Cost: This is the cost of funding benefits expected to accrue in the future; that is, how much must be set aside now, which together with interest earned will pay these benefits to employees after they retire. When a plan is established without credit for prior employment service, expenses and normal cost are the only items that concern the actuary, and contributions can be based to cover only the two.

Interest on Accrued Liability (See page 55.): When benefits based on prior service are included, however, the situation changes. Here, even before one penny of contribution is received, the plan incurs an obligation which is often substantial; namely, the amount required to pay benefits which accrued before the plan became effective. This is the "unfunded accrued liability" – unfunded because no contributions have yet been received to pay off this obligation or debt.

As with any debt, the longer it takes to pay off, the more it costs in interest charges. If the obligation could be paid off in one sum, of course, there would be no interest charges, but the amounts involved are usually so large that it is impractical, if not impossible, to make a single payment into the plan. In a pension plan the interest payments are made into the plan. Tax considerations also favor the gradual amortization of the accrued liability. Therefore, as the debt is reduced, the interest on the unfunded accrued liability must also be paid. Whatever is left of contributions after expenses, normal cost, and interest on accrued liability can be used to reduce the accrued liability itself.

ACTUARY'S FUNCTIONS

The trustees of a pension plan should establish the amount of benefits with the advice of an actuary. Using age and service records, the actuary reviews turnover and average hours worked and arrives at a benefit level which can be supported by the anticipated contributions.

The actuary estimates expenses, normal costs, interest and repayment on the accrued liability for various benefit levels, and then suggests the particular level which will fit two requirements: anticipated contributions to a large extent based on future levels of employment, and payment of accrued liability in a reasonable time.

Fixing the benefit level is probably the most important problem that the trustees must resolve. Initial estimates upon which the early decisions are based are most critical. Actuarial assumptions involving the probabilities of death, termination, disability, the rate of pension fund earnings, and the age and rate of retirement, must be determined at the outset. Some conservatism in assumptions is desirable at the inception of the plan and before experience emerges. The resulting cost estimates should then be realistic and the benefit level supported by the fixed contributions provided in the bargaining contract.

In the final analysis, however, the true cost of the plan can only be determined in retrospect after the last plan member dies. Stated simply, the cost of any pension plan equals total benefits plus expenses, less investment income earned on the assets of the plan. Once the benefit level is fixed, the cost cannot be altered by juggling actuarial assumptions. It is the professional responsibility of the actuary to place before the trustees a benefit level which he believes will assure a sound and continuing pension program.

CHAPTER

5

Administration of the Plan

Administration of a pension plan can be arranged through a life insurance company, or carried out by a salaried administrator or a contract administrator. The salaried administrator manages the plan from an office provided for by the pension fund. The fund pays rent, equipment, and staff salaries. The administrator may also be responsible for administering other welfare plans for the same union-employer combination.

A contract administrator's services are usually provided by an outside specialist who administers a number of welfaré and pension plans. Such an administrator operates under a contract with the trustees, with the cost of his service normally negotiated in advance. He may, for instance, have an office solely for the administration of a particular plan with reimbursement for costs and perhaps a management fee. Or he may work out of his own office, using his own employees, charging a flat fee or percentage of the trust income.

Administrative arrangements can vary widely from these basic approaches. The determining factors are size, type of plan, availability of personnel, and the type of services to be rendered.

FUNCTIONS OF THE ADMINISTRATOR

The administrator has many additional responsibilities keyed to the operation of the pension fund. Among these are:

✔ *Employer Reports:* The administrator must maintain a flow of reports from employers on employees covered, number of hours worked, and contributions made by the employer. If employee contributions are required under the plan, separate records must be kept for each employee. If an employer is delinquent in his payments, the administrator must deal with him according to procedures set up by the trustees.

✔ *Employee Records:* If trustees decide to provide for annual statements to the employees in the plan, the administrator keeps the records and transmits them. Accurate record-keeping is absolutely necessary.

Should any change be contemplated in the plan, these records are invaluable in determining the extent and the nature of the change. The records are the property of the trust, and the administrator is responsible to the trustees for their safekeeping and availability.

✔ *Accounting:* Annual financial reports and forms are prepared from accounting records that are kept by the administrator.

✔ *Reports:* The administrator provides the actuary with the statistical data he needs in his calculations. The actuary needs other reports from time to time and the administrator assists in this respect.

✔ *Pension Records:* The administrator is responsible for payment of pensions to the individual. Application forms must be processed and pension payments authorized; individual records of pensions must be kept. If the plan is not insured, checks may be issued by the administrator or the bank handling the fund. Under an insured plan, an additional option is to have pension checks mailed by the life insurance company directly. Addresses of pensioners must be kept up to date; questions by individuals must be answered.

✔ *Trustees Meetings:* The administrator attends meetings of the trustees to report on his operations, to suggest ways to improve services, advises on problems, and assists the trustees in reaching decisions.

CHAPTER

6

Communicating the Pension Plan

This is an area to which prime attention should be given by trustees and administrators and possibly a professional communications adviser or consultant. Studies reveal that very few workers have any real conception or understanding of their pension plan.

The Welfare and Pension Plan Disclosure Act provides that workers have the right to know the provisions of their retirement plan: (1) what the benefits are; (2) how to become eligible to receive them; (3) who performs the various functions of the plan.

Answers to these basic questions are necessary so that workers can plan intelligently for retirement and protect their rights under the plan:

- How old must the worker be to qualify for the plan?
- What are the eligibility requirements for
  - a) normal retirement?
  - b) early retirement?
  - c) disability retirement?
- How much will the worker receive?
- How is service credit earned?
- How much service credit does the worker have?
- How can service credit be lost?
- When does the benefit vest?

Basically, the reception given the plan by employees will depend on the adequacy of the benefits, the degree to which they are understood and whether or not they seem equitable to employees as a group as well as to individuals.

The reactions of employees who retire in the early years of the plan are especially important. Their feelings quickly become known to the active employees and any dissatisfaction may create a hostile attitude toward the plan in its early stages.

Thus, it is practically mandatory for trustees to use careful judgment and skills in communicating the plan to the employees so that they understand their benefits. The union business agent or other officers can provide the personal communication necessary to have the endorsement and support of the pension plan by the membership.

Generally, communications about an employee benefit plan follow a pattern. The first or preliminary step is to announce that the plan is being discussed or developed, and to ask for data such as age and length of service of employees. At this time, the actuary or consultant and the administrator answer questions that may be asked by the workers.

The second step occurs when the pension plan becomes final. It involves the distribution of material describing the plan, usually a booklet, to each covered employee and to employees who will eventually become eligible for participation. In this second step, the lawyer plays a significant role on the professional team helping the trustees. This is an area where an effective personal touch is necessary.

For example, the literature that is distributed can be warm and friendly, and give the employee the facts he wants to know in a simple, understandable way. Too often pamphlets or booklets are written in a cold, formal, legalistic style and are so detailed and involved that employees never get far beyond the cover before discarding them. On the other hand, there are many examples of effective material which are available as a model or guide for a plan's own descriptive booklet.

Another effective approach is to prepare informative articles for regular publication in the union newspaper and in company publications. This can do much toward generating interest in the pension plan and making it more generally understood.

PRE-RETIREMENT COUNSELING PROGRAM

The inevitability of retirement from the job in today's society has caused a rapidly growing interest in communications programs of counseling and preparation for retirement. Studies have shown that workers are receptive to advice and guidance on what amounts to a new career, and unions and employers are recognizing that they have a responsibility to the retiring individual and the community to encourage positive attitudes toward retirement.

As with the pension plan which is specifically tailored to meet the needs of the individual fund, the pre-retirement planning program must also be geared to the particular membership of a jointly administered plan.

Individual and group counseling sessions are both important ingredients and both worker and spouse can be included in the sessions. Basic group discussion topics generally include orientation, financial planning, health, leisure time and family and living arrangements.

Vital to the success of the retirement counseling program is the selection and training of counselors and discussion leaders. Many community colleges and universities are now offering adult education courses, often in the evening, to prepare individuals for this assignment.

Further information on pre-retirement programs can be obtained by writing to the Institute of Life Insurance at 1701 K Street, N. W., Washington, D. C. 20006.

CHAPTER

7

Facilities of a Life Insurance Company For Multi-Employer Pension Plans

The successful operation of any pension plan involves many functions, as this Handbook has shown. Summarized they include:

- ✔ Actuarial and legal services.
- ✔ Investment management or arrangements for investment management.
- ✔ Accurate record keeping and maintenance of economical accounting systems.
- ✔ Effective communication to employees.
- ✔ Prompt payment of pensions and other benefits.
- ✔ Research facilities for keeping abreast of Federal and state laws and other developments affecting pension plans.
- ✔ Retirement counseling.

Actually these are functions in which the life insurance business has specialized for years. Combining the experience of an insurance company with that of the trustees' own advisors is an approach that is being used by many plans today. The trustees gain from an exchange of ideas and the possibility of a choice of different types of plans to meet the group's specific needs.

Only a life insurance company offers a guaranteed rate of interest, as well as guaranteed annuity purchase rates. The life company backs its guarantee with a successful and mature investment program, a wealth of actual annuity experience, and comprehensive service facilities.

WHAT IS AN "INSURED" PLAN?

It is a pension plan managed by a life insurance company. It differs from a "non-insured" or "trusteed" plan in several respects:

- ✔ The life insurance company typically provides important guarantees concerning the investment funds and benefit payments.
- ✔ The life insurance company handles virtually all the details. It receives the funds, invests them, provides actuarial calculations and accounting services.
- ✔ Funds behind the plan are invested by the insurance company, either as part of the company's general assets or in a separate account.
- ✔ The life insurance company makes all payments to retirees and their families.
- ✔ The life insurance company provides continuing service to employees, retirees and their families. For example, if a retiree moves a distance, he can obtain service at any regional office of the life insurance company.

Some pension plans combine a trust fund arrangement with an insured plan.

An insured plan is the surest way of providing adequate funding. It provides a high investment yield in conjunction with investment safety.

There is a similar relationship between the actuarial principles underlying life insurance and pension plans.

THE ANNUITY PRINCIPLE

An insured pension plan usually pays lifetime income to a retired worker under an *annuity* – which is, in effect, a life insurance policy in reverse. Instead of paying benefits when a person dies, an annuity pays benefits as long as he lives. So it is really a form of insurance. Like life insurance, it provides protection against mortality risk. But, instead of insuring against the risk of dying too soon, an annuity insures against living too long . . . against outliving one's financial resources.

FUNDING ARRANGEMENTS

Insured pension plans can be based on any of the following funding arrangements.

Deposit Administration: This contract form is first in popularity for the funding of pensions under a negotiated pension plan. Under the deposit administration contract employer contributions are accumulated in an undivided fund. When an employee retires, the money needed is set aside to provide an annuity equaling the employee's pension credits.

The life insurance company guarantees the interest rate at which these funds accumulate, and also the rates at which annuities are purchased. These guarantees are customarily made initially for the money paid during the first five years of the contract. (A further explanation of the contract guarantees will be found at the end of this section under the heading "Experience Participation.")

The deposit administration contract can be applied to almost any benefit formula, and to all methods of actuarial funding. Such contracts are particularly well suited to the multi-employer type of plan, under which contributions of many employers, fixed by collective bargaining in terms of cents per hour, are paid into a jointly managed pension fund. Under a deposit administration contract, once a life annuity has been purchased for a retiring employee, there is complete assurance in the form of an absolute guarantee that payments will be continued even if the employee lives to be 100, or beyond.

Immediate Participation Guarantee: This contract, sometimes called Direct-Rating Deposit Administration, is similar in operation to a deposit administration contract and is rapidly increasing in usage. The principal difference is in the nature of the guarantees provided by the life insurance company. It is appropriate primarily for larger groups.

Under a deposit administration contract, the life insurance company guarantees the interest rate applicable to the undivided fund and the annuity purchase rates. Favorable experience is reflected in dividends to the pension plan.

Under an immediate participation guarantee contract, the contract holder participates immediately in the experience of the plan as it develops. For instance, interest is credited at the rate actually earned by the insurance company. Also, mortality gains or losses are reflected immediately and expenses are charged as they are incurred.

It is particularly attractive to large groups who believe their funds can experience average or better mortality and investment results, but want to use the administrative and investment facilities of the life insurance companies.

Under some contracts of this type, annuities are purchased as employees retire – and experience rated. Under other forms of this contract, annuities are not purchased – retirement benefits are paid from an individual fund. However, in either case, pension payments to retired workers are guaranteed by the life insurance companies. For this purpose, in the contract which does not normally purchase annuities, if the IPG fund falls below a pre-established level, annuities are purchased for the retired employees at predetermined rates.

Equity Funding: Equity funding contracts (or equity supplements to more conventional contracts) are now available in almost all states. Under these arrangements, some of the pension plan's funds may be accumulated in a life insurance company "separate account" usually invested primarily in common stocks. Thus, a multi-employer pension plan may now obtain from a life insurance company both fixed-dollar and equity investment facilities. At retirement, the pension may be provided by withdrawal from the equity account or from a companion fixed-dollar account.

Variable Annuity: Under an insured variable annuity, the amount of each payment varies according to the investment results of the life insurance company equity separate account to which funds are set aside to provide it. Variable annuity contracts may now be issued in practically all states.

Although there are many negotiated plans which provide for a variable annuity pay-out, variable annuities to date are not widespread among negotiated multi-employer pension plans, except for supplementary annuity plans. The latter provide for individual accumulations for each employee, with some or all of the funds invested in common stocks. At retirement, the employee may usually choose between fixed-dollar annuity and variable annuity pay-outs, or a combination of both.

Pension Investment Contracts: As their name implies, these contracts provide for investment with no requirement to buy annuities. The pensions can be provided by purchase of annuities under another life insurance company contract (with the same or different life insurance company) or by direct payment from any of the pension plan's assets. These investment contracts may use the life insurance company's general account (as a fixed-dollar investment facility) or one or more of the company's "separate accounts." The latter may be invested in stocks, bonds, mortgages, short-term paper, or even real property. These contracts are frequently used when the pension plan has more than one funding agency.

Split-Funding: At one time this referred to the use of a trust company or bank (essentially for stock investments), and the use of a life insurance company for fixed-dollar investments and for the purchase of annuities for pensioners. With the advent of equity funding contracts and pension investment contracts, split-funding now refers to the use of two or more funding agencies for the same pension plan.

There are several other types of pension plans provided by life insurance companies which are not generally used for negotiated multi-employer plans. They include:

Group Deferred Annuity: This is one of the oldest forms of group contracts issued by life insurance companies for the funding of pensions, and offers comprehensive guarantees but it is seldom used for multi-employer plans. It calls for the purchase each year of a single premium deferred annuity which commences at retirement and is guaranteed payable for the lifetime of the person for whom it is purchased.

Most life insurance companies guarantee the *initial rate basis* for annuity purchases during the first five years of the contract and, since the cost of each year's pension accrual is met in full as it arises, there is complete assurance that the amount purchased will be paid, regardless of future contingencies.

Individual Policies: These policies are more or less standard and are basically a retirement income type that an individual can purchase for himself. Each employee is covered by a separate contract for the amount of his expected pension; as that amount changes, additional policies are obtained. The policies often include a substantial death benefit. The premium for each policy is guaranteed at issue for the life of the policy. Generally, a trustee is appointed to hold the contract and to receive any refunds which may become available. Such contracts are seldom used for multi-employer plans.

Group Permanent (or Group Retirement Income Policy): This type of contract resembles the individual policy except that it is issued on a group basis. One master contract is issued instead of a number of separate policies, eliminating the expense of having a corporate trustee administer the policies. The plan builds cash values that can be used in later years to fund pensions.

Blended Trust: This is primarily an individual policy plan with an auxiliary fund set up under a trust or deposit administration contract to provide some degree of advance funding.

SUMMARY

Life insurance companies can now offer negotiated multi-employer pension plans many investment alternatives. They can also offer valuable guarantees – especially as to the benefit payments to be made under purchased annuities. These guarantees are backed up by the entire assets of the life insurance company.

In specific situations they can prove extremely valuable to the contract holder and they always offer an added and very worthwhile measure of assurance to the employees covered. For the medium-sized or small pension fund, these guarantees are of particular importance. Such guarantees are made possible by the spreading of risk; and, along with the security inherent in them, can be offered on a contractual basis only by life insurance companies.

Another aspect which the various pension contracts of insurance companies have in common is the facility for continuing the operation of the plan and the payment of benefits previously purchased after contributions are discontinued. Whatever the problems in administering a pension plan and investing its assets while the plan is in active operation, they are compounded many times if it should terminate. In the event of termination of a group contract, the life insurance company stands ready to handle whatever the future may bring.

For example, the trustees of the fund are not forced to cope with the investment problems of a shrinking fund, since money in the plan is commingled with all of the funds of the life insurance company. Therefore, it does not become necessary to liquidate assets – especially in a depressed market.

For that matter, all that the trustees need to do is continue to use the facilities of the life insurance company. The expenses incurred by the life insurance company in making pension payments are paid for at the time annuities are purchased. No extra expenses are incurred as a result of the discontinuance of the pension plan. Any employee for whom a life annuity is purchased can be sure of getting his full pension as long as he lives.

INVESTMENT RESULT

Probably the single most important factor in the financial management of pension plans is the funding arrangement adopted by the administrator. Life insurance companies have achieved outstanding results in investing pension funds.

Fixed-Income: The excellent earnings realized by life insurance companies on their fixed-income investments result primarily from their capacity to make direct placement of new security investments.

Moreover, since a life insurance company can predict quite accurately its overall cash flow, the company can make long-term commitments which normally carry higher interest rates and result in more stability.

Security issues placed through direct negotiations have distinct advantages for the lender and borrower which tend to increase the yield obtainable on the investment. For instance, there is a considerable saving in the expense of floating a public issue. Also, the terms of the loan may be tailored to fit the specific needs of both the borrower and the lender. Since only two parties are involved, these terms may be modified during periods of general business decline in order to stave off defaults or to reduce losses.

In recent years, some life insurance companies have begun to employ direct placements to their mortgage investments. This is an important development, since over one-third of all life insurance company assets are invested in mortgages.

Instead of using an average portfolio rate of interest, most group contracts use the "investment year" method of interest credit. This method allows the crediting of interest earned on each year's investments to money received for investment in that year.

Equities: Life insurance companies have substantial experience in the equity investment area. The fund of a contract utilizing a life insurance company's separate account receives immediately and directly the result of the equity investments. In addition to the contributions of their own investment and analysis specialists, the companies receive investment information and analysis from major research sources. Separate account portfolio managers have achieved relatively attractive investment performances – possibly because they can concentrate on a few large portfolios rather than many smaller portfolios with different investment objectives.

EXPERIENCE PARTICIPATION

Most life insurance company group pension contracts provide for participation in the earnings of the company in the form of dividends or experience credits. Participation under a group contract is affected by both the experience of the contract itself and the overall experience of the life insurance company's business on all such contracts. The larger the contract the more weight is given to its individual experience. A very large contract almost always stands substantially on its own.

While the aim of all life insurance companies is to enable their contract holders to participate fully in their dividend or experience credit calculations, there are differences in the practices followed by individual companies. The following description of a typical procedure for a group annuity contract will help the trustee to understand the insured pension plan approach:

Most insurers maintain a calendar year record of financial experience for each contract. This record is called an *"experience accumulation."*

The amount of the *"experience accumulation"* for any contract at the end of a calendar year represents:

- All cash payments received under the contract, plus
- Interest earnings, minus
- All benefit payments made together with the expenses incurred under the contract.

As far as the experience accumulation is concerned, individual annuity payments are charged only as they are made. In this way, actual mortality is recognized. Carefully devised expense allocation methods are used to make sure that as far as practical, each contract is charged with expenses attributable to its operation.

The interest credited is normally the net rate after all investment expenses and other deductions and is therefore the true "working" return to the fund.

Through the operation of the experience rating plans of the insurance companies, each contract, over a period of time, receives the benefit of its actual experience as it relates to expenses and mortality and the actual investment results of the life insurance company.

SERVICE

A life insurance company with experience in the pension field can offer a complete range of all the specialized and administrative services needed for efficient pension planning and administration, including such specific facilities and services as:

- ✔ A trained staff of representatives to assist in designing and installing a pension program and available for service once the program is installed.

- ✔ A comprehensive means of keeping in touch with retired employees, and recording address changes in order to keep up regular pension payments. "Keeping in touch" is perhaps the most troublesome aspect of the administration of a pension plan. However, through the use of the same modern high speed computers which are used for calculating individual costs, personal records are kept accurately and up-to-date.

  Life insurance companies also have the use of regional and nationwide networks of local offices for locating employees with whom contact might be lost. Care is taken to mail each pension check timed to arrive on or before the date is due, regardless of where the employee happens to live.

  These functions have been fulfilled by the life insurance business for many years. As a result, life insurance companies are able to carry out these operations with maximum efficiency.

- ✔ A highly trained home office administrative staff skilled in record keeping, design of forms and experience in coordinating all facets of pension planning. These skills have been acquired through the administration of many pension programs.

- ✔ A qualified actuarial staff with facilities for specific case work and calculations, and for broad research into all areas of the actuarial aspects of pension plans. Some life insurance company actuaries devote their entire time to the specific area of pension research and planning.

- ✔ A legal staff to furnish regulatory references without delay. The services of this staff are available to the counsel for the pension plan in drafting the necessary documents. The company's legal staff can also assist him through discussions of the Federal and state laws which apply to pension plans.
- ✔ Communications specialists who can suggest ways of making the pension plan clearly understandable to the workers.

The ultimate success of a pension plan depends to a considerable degree upon the quality of advice received by the trustees, and upon which they can rely for the all important decisions they must make.

Objective measurements of funding methods are difficult but it is well to bear in mind that over the years, as all things change, two factors dominate in plans written by life insurance companies:

- ✔ The expectation of the worker to have a dependable and continuous monthly pension check available to him in his retirement years.
- ✔ Only from life insurance companies can guarantees on these expectations be provided.

APPENDIX

The Language of Pensions

Accrued Liability (or Past Service Liability) – The actuarial value (single sum) of the past service benefits as of the effective date of establishment of the plan. The maximum annual past service tax deduction allowable is 10 per cent of the original single sum liability. Minimum funding sufficient to prevent this liability from exceeding its initial size is required by the Internal Revenue Service.

Actuarial Cost Methods – Systems for determining either the contributions to be made under a retirement plan or level of benefits when the contributions are fixed. In addition to forecasts of mortality, interest, and expenses, some of the methods involve estimates as to future labor turnover, salary scales and retirement rates. The methods of prime importance are those, such as the Entry Age Normal Method, Attained Age Normal Method and Unit Credit Method, which have been recognized by the Internal Revenue Service.

Actuarial Equivalent – If the present value of two series of payments are equal, taking into account a given interest rate and mortality according to a given table, the two series are said to be actuarially equivalent on this basis. For example, a lifetime monthly benefit of $67.60 beginning at age 60 (on a given set of actuarial assumptions) can be said to be the actuarial equivalent of $100 a month beginning at age 65. The actual benefit amounts are different but the present value of the two benefits, considering mortality and interest, is the same.

Actuary – A person professionally trained in the technical and mathematical aspects of insurance, pensions and related fields.

Administrator – For purposes of the Federal Disclosure Act, the "Administrator" is the trustee of a jointly administered labor-management pension plan. In its usual meaning, "Administrator" designates the person or organization that performs the routine clerical operations of the plan.

Allocation – The setting aside of funds to purchase annuities or pay a benefit due.

Amortization – Paying off an interest bearing liability by gradual reduction through a series of installments, as opposed to paying it off by one lump-sum payment.

Annuity – A series of payments payable at fixed intervals of time, but usually for life. The person receiving the payment is called an annuitant. Annuity payments are usually made monthly but can be made quarterly, semiannually or annually.

Beneficiary – The person named by the employee to receive any death payment due under the plan.

Contingent Annuity Option (or Joint and Survivor Option) – An option under which an employee may elect to receive, under certain conditions, a reduced amount of annuity with all, or a specified fraction thereof, to be continued after his death to another person designated as his contingent annuitant, for that person's lifetime.

Contract-Holder – The group, entity or person to whom a Group Annuity Contract is issued – in jointly administered plans, the trustees.

Cut-Off Date – Date after which no prior service is credited. Discussed on pages 25-26 of this Handbook.

Death Benefit – A payment made to the designated beneficiary upon the death of the employee annuitant.

Deduction under Section 404 – Refers to the Section of the 1954 Internal Revenue Code under which the contributions by an employer to a qualified plan are claimed as a deduction for Federal income tax purposes.

Deferred Annuity – An annuity under which payment will begin at some definite future date, such as in a specified number of years or at a specified age. (See Immediate Annuity)

Disability Benefit – Under some retirement plans, if an employee becomes totally and permanently disabled before retirement, he becomes eligible to receive a monthly disability benefit.

Discounting for Mortality – The assumption that specified proportions of employees will receive specified retirement benefits. Contribution rates or benefit costs so calculated have been discounted for mortality.

Early Retirement Date – Under some retirement plans an employee may retire before his normal retirement date, usually with a reduced amount of annuity. Early retirement is generally allowed at any time during a period of 5 or 10 years preceding Normal Retirement Date.

Eligibility Requirements – (1) Sometimes these refer to the conditions which an employee must satisfy to participate in a retirement plan. One such condition may be the completion of from 1 to 3 years of service with the employer, another the attainment of a specified age such as 25. (2) Sometimes these refer to conditions which an employee must satisfy to obtain a retirement benefit. For example, the completion of 15 years of service and the attainment of age 65. Item (2) is more common to negotiated plans.

Equities – This refers to ownership of property, usually in the form of common stocks, as distinguished from fixed income bearing securities, such as bonds or mortgages.

Equity Funding – The funding of a portion of a retirement plan by investment in equities.

Fixed-Dollar Annuities – An annuity under which the amount of each annuity payment is a fixed number of dollars.

Funded Retirement Plan – A plan under which funds are set aside in advance to provide expected benefits. The plan is not necessarily insured.

Funding Agency – An organization or individual that provides facilities for the accumulation of assets to be used for the payment of benefits under a pension plan, or an organization that provides facilities for the purchase of such benefits.

Funding Instrument – Agreements or contracts governing the conditions under which a funding agency performs its functions.

Funding Medium – The character of the asset structure used by a funding agency in fulfilling its obligations as set forth in the funding instrument.

Future Service Benefits – Benefits accruing for service after the effective date of coverage under the plan.

Future Service Cost – The cost of future service benefits.

Group Annuity Contract – A contract issued by a life insurance company that may be used as the funding instrument for benefits to be made in accordance with a pension plan. A single master contract provides that the group of persons participating in the plan will receive annuities during retirement. Individual certificates stating coverage may be issued to members of the group. Forms of group annuity contracts include: Deposit Administration, Immediate Participation Guarantee, Pension Investment, Deferred Annuity, and Group Permanent. These forms are discussed on pages 45-48 of this Handbook.

Immediate Annuitant – An individual who, on the effective date of the contract, is eligible to receive an immediate annuity.

Immediate Annuity – An annuity providing for payment to begin immediately.

Insured Plan – A plan funded with a life insurance company. The life insurance company guarantees the payment of annuities purchased in the usual types of insured plans. Depending upon the form of contract used, other guarantees may be given with respect to purchase rates and interest rates.

Labor-Management Relations Act of 1947 (Taft-Hartley Act) – Controls conditions under which an employer may pay any moneys to a representative of his employees. Discussed on pages 11-12 of this Handbook.

Life Annuity – A series of payments under which payments, once begun, continue throughout the remaining lifetime of the annuitant but not beyond.

Life Expectancy At An Age – The average number of years (as estimated from a mortality table) that individuals will live, after attaining the specific age.

Maximum Benefits – In order to limit costs or to prevent discrimination prohibited by the Internal Revenue Service, some plans provide that an employee may not receive more than a prescribed benefit under the plan, regardless of the regular benefit formula.

Minimum Benefits – Some plans provide that a minimum amount of annuity will be paid if the regular benefit formula produces less. This minimum is usually payable only if certain service requirements are met at retirement.

Mortality Table – A table showing how many members of a group, starting at a certain age, will be alive at each succeeding age. It is used to calculate the probability of dying in, or surviving through, any period, and the value of an annuity benefit. To be appropriate for a specific group, it should be based on the experience of individuals having common characteristics such as sex, occupational group, etc.

Non-Qualified Plan – A plan which does not meet the requirements of Section 401(a) of the 1954 Internal Revenue Code and which, as a result, suffers distinct disadvantages from a tax viewpoint.

Normal Retirement Age – The age, as established by a plan, when retirement normally occurs. Since unreduced Social Security benefits are available at 65, that is the most common normal retirement age.

Participant – An employee, or former employee, who may become eligible to receive, or is receiving, benefits under the plan as a result of his credited service.

Past Service Benefits – Benefits for service before the effective date of coverage under the plan, or prior to a date on which a plan is amended to improve benefits.

Pension Plan – A plan established and maintained by an employer (or group of employers) primarily to provide for the payment of definitely determinable benefits to employees after retirement.

Pension Benefits – A series of payments to be provided in accordance with the plan of benefits.

Portability – Any provision for retaining pension rights when changing from one employer to another.

Postponed Retirement – Under some plans, it is possible for an employee to continue in employment beyond his normal retirement date, sometimes only with the consent of his employer. Most plans provide that pension payments will not begin until retirement actually occurs. Usually no benefits accrue for service after the normal retirement date.

Qualified Plan – A plan which the Internal Revenue Service approves as meeting the requirements of Section 401(a) of the 1954 Internal Revenue Code. Such a plan receives distinct tax advantages.

Reserve – The reserve, for an annuity, is the amount of money required to guarantee the payment of annuity benefits coming due.

Self-Administered (Trusteed or Directly Invested) Plan – A plan funded through a fiduciary which is generally a bank but may sometimes be a group of individuals which directly invests the fund accumulated. Retirement payments are made from the fund as they fall due. Actually, there is little distinction between this arrangement and a Pension Investment Contract issued by a life insurance company (see page 47 of this Handbook).

Separate Account – A separate account is a fund held by an insurance company which is separate and apart form its general assets and is generally used for investment of pension assets in equities.

Social Security Option – An option under which the employee may elect that monthly payments of annuity before a specified age (62 or 65), be increased, and that payments thereafter are decreased to produce as nearly as practicable, a level *total* annual annuity to the employee, including Social Security.

Split-Funding – The use of two or more funding agencies for the same pension plan. An arrangement whereby a portion of the contributions to the pension plan are paid to an insurance company and the remainder of the contributions invested through a corporate trustee, primarily in equities. Discussed on page 47 of this Handbook.

Spouse's Benefit – Payments to the surviving spouse of a deceased employee, usually in the form of a series of payments upon meeting certain requirements and usually terminating with the survivor's remarriage or death.

Temporary Life Annuity – An annuity payable while the annuitant lives but not beyond a specified period, such as five years. No payments are made after the end of the stipulated temporary period or the death of the annuitant.

Ten Per Cent Funding – The 1954 Internal Revenue Code will permit deduction of the entire past service cost at the annual rate of 10 per cent of the original past service liability, subject to experience adjustments because of turnover, dividends, etc. Such annual 10 per cent contributions will completely fund the Past Service Liability in about 13 years, using an assumed interest rate of 3¾ per cent and if actual experience follows the assumptions.

Ten Years Certain and Life Annuity – An annuity which pays an income to the annuitant for as long as he lives, but if he dies within 10 years after his retirement, continues payments to his beneficiary for the remainder of the 10 years.

Transferability – Any arrangement under which the accumulated benefit credits of a terminating participant, or their actuarial value, are transmitted from one plan to another, or to a central agency.

Turnover Rate – The rate at which employees terminate covered service other than by death or retirement. Expected future turnover can be taken into account, in translating contributions into benefits.

Variable Annuity (Insured) – An annuity under which the benefit varies according to the investment results of an insurance company's separate account (usually invested primarily in common stocks) in which funds have been set aside to provide the annuity.

Vesting – A plan may provide that an employee will, after meeting certain requirements, retain a right to the benefits he has accrued, or some portion of them, even though his service with the employer terminates before retirement. An employee who has met such requirements is said to have a vested right. Note that vesting is in the form of future annuity benefits, not the cash paid to purchase the benefits.

Widow's Benefit – Payments to a widow of a deceased employee, usually in the form of a series of payments, upon meeting certain requirements and usually terminating with the widow's remarriage or death.

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