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Current Developments

A. What new developments are likely as a result of the series of studies on pension plans now being released by the Pension Research Council?

B. A number of pension plans have been established in recent years which provide for variable benefit payments. What has been the general experience of such plans? Are there particular types of employers to which these plans have more than normal appeal? To what extent are insurance companies making provision to supply such benefits?

MR. WILLIAM F. MARPLES: The Pension Research Council, working with the Wharton School of the University of Pennsylvania, has been carrying out an "inquiry into the factual basis of benefit expectations under private plans."[1] This is being done in four parts, each under the direction of a primary author backed up by a "Task Force" committee. The authors and subjects are Edwin W. Patterson, Cardozo Professor Emeritus of Jurisprudence, Columbia University, who examined the present legal protection of private pensions; Professor Benjamin Aaron, Director of the Institute of Industrial Relations and Professor of Law at the University of California at Los Angeles, who investigated the legal status of employee rights; Professor Carl H. Fischer of the University of Michigan and I who will report on the actuarial aspects of pension security; and Professor James E. McNulty of the University of Pennsylvania who discusses administrative problems of private pension plans.

Dan McGill, who is well known to all of us, has the responsibility of directing the entire operation. He will also write a report synthesizing all parts of the investigation. The first two reports have been printed. We expect the two unpublished reports and the summary to be released in the fall. The publisher is Richard D. Irwin, Inc., Homewood, Illinois.

We are fortunate to have Professor Benjamin Aaron here and will be happy to hear some of the interesting details on how his report was produced.

MR. BENJAMIN AARON: I feel as if I am a rank impostor in this distinguished gathering. My little monograph is primarily a legal work and I knew nothing of pension plans before attempting this task. As requested by the committee, I looked at the problem from the outside. To help me I had a very able group of men and we worked in complete harmony. One of the principal members of my Task Force was Robert H. Canan, Associate General Counsel of Lockheed Aircraft Corporation. The Industry representative was Gordon Mitchell of DuPont. The Labor

[1] Foreword by Dan McGill in *Legal Protection of Private Pension Expectations*, E. W. Patterson, Publication of the Pension Research Council, 1960.

representative was the late Carl Huhndorff, Research Director of the International Association of Machinists. Murray Latimer was also a member of the Task Force, as were John Hill, II, Associate General Counsel of the John Hancock Mutual Life Insurance Company, and J. Milton Neale, Vice President, Girard Trust Corn Exchange Bank. An unofficial member of the Task Force was Joseph Seligman of San Francisco, who gave us a tremendous amount of help.

The resulting book is only 130 pages long. In spite of its brevity, it overlaps some of the material covered in Professor Patterson's book, although it seems to me that our conclusions tend to differ rather substantially on some points. The findings and recommendations of our Task Force were, however, unanimous.

What we did was to investigate the legal theories underlying pension plans, tracing the development from the idea of the pension plan as a mere gratuity down to the new status of pension plans as contractual obligations. Our approach was to consider the rights of employees under private pension plans in a variety of circumstances. What happens to an employee at normal retirement? What happens if he quits or is discharged? What happens if the firm goes out of business, merges, goes bankrupt, etc.? We examined what has, in fact, happened when these situations gave rise to legal controversies which were adjudicated by the courts. The book is a lawyer's handy compendium of most of the significant reported cases on these various subjects. Our general conclusions were that the real problem in private pension plans is in the drafting of the plans.

The legal rights of participants depend upon the way plans are drawn, and, in our cases, we found some were drawn very peculiarly indeed. We also found that the danger to the security of pension plans was practically not at all in corruption or breaches of law, but rather in poor actuarial assumptions or poor investment policies. These seemed to us to be the greatest dangers to the security of the benefits, but as to them we did not have to express an opinion. We simply referred that problem to the other Task Forces.

We did not see the need for much in the way of additional legislation, which brings us sharply in conflict with some of Professor Patterson's conclusions. We did have observations on three areas in which we thought something probably should be done. One was in the case of bankruptcy.

You are probably familiar with the *Embassy* case which holds that payments due a health and welfare fund, past due and delinquent, are not entitled to the priority of wages due workmen under the Bankruptcy Act. We felt that they should be, whether or not you regard pensions as a

form of deferred wage. We felt that there is a contractual obligation which the employer has not met.

The second problem that concerned us was what happens in the case of merger of two firms where one firm has been contributing to a plan for a long period of time to the ultimate benefit of its employees, although no benefits are vested until those employees retire. Then, shortly before the bulk of them have retired this firm merges with another firm which takes over the pension fund. Then the employees of the first firm are all laid off prior to retirement, and the employees of the second employer inherit the fund and enjoy a windfall in terms of future benefits. Our recommendation was that there ought to be some provision to permit the benefits of the employees of the first firm to vest in them at the time that they retire or are laid off, in order to preserve equity.

Thirdly, there is a legal problem involved in the case of a delinquent employer. Now, by delinquent, we definitely do not mean an employer who does not contribute enough money to a plan to meet the cost of current retirements of his employees. What we are referring to here is where an employer has contracted to contribute amounts of money at given dates under an agreement, and he falls behind in his payments. The question arises as to whether the future employee beneficiaries, even though nothing is vested at the present time, should have a right to sue to compel payment of the contributions in the event that the trustees under such a plan are negligent or wilfully refuse to sue. Our feeling was that, after exhausting whatever internal remedies are available, the employees ought to be able to bring suit to compel payment by the delinquent employer in accordance with his contract.

The only other point that might be of interest is a recommendation we did not make, although we were strongly urged to do so, and that had to do with compulsory vesting of benefits. Our conclusion was that it would not be advisable to recommend compulsory vesting for two reasons. First, we felt that it would rather substantially inhibit the continued experimentation and development in the private pension field, which we think is highly desirable. Second, we think the question is rapidly becoming academic. If you study the results of the surveys you will see there is a tremendous increase in the voluntary acceptance of vesting in some form or another. We think this trend will undoubtedly continue; and, while all the members of the Task Force felt that vesting is desirable, we were quite content to allow things to take their normal course. This was the same conclusion reached by another committee on which I served, the Governor's Commission on Problems of Aging and Retired Workers.

MR. DENNIS N. WARTERS: Not as President of the Society but as an actuary who has served for quite a few years on the Pension Research Council, I would like to give you my impressions of the work the Council is doing.

In the first place, the Pension Research Council is an advisory group. It is not a group formally expressing opinions. It has little to do with the actual implementation of the work that is done under the direction of the Wharton School of the University of Pennsylvania. The Council offers advice to the Wharton School and to the University of Pennsylvania in the selection of projects to be studied in the pension field, in regard to how the studies may be made, and where talent may be found to help in the studies. The members of the Council have been selected by the staff of the Wharton School, who have made every effort to make the Council a body representative of the public, employers, beneficiaries of pension plans, and the pension industry. One-third of the Council are staff members of the University of Pennsylvania and include some famous names, such as Dr. George W. Taylor, Professor of Industry, who was one of the arbitrators in the recent steel strike.

The Council deliberations are largely guided by the academic staff of the Wharton School, who aim to be completely objective in whatever field they may study. As do all great universities, they want the truth no matter what it is, no matter where they find it. They display great independence of thought; they seek out the conflicts between us; they want to know wherein and why we differ and the reasons for the differences. I have been greatly impressed by their ability to express themselves.

As you know, the Wharton School has published several books as a result of the studies made in the pension field, including Dr. Dan McGill's book on the *Fundamentals of Private Pensions*. The current series of Task Force reports are the latest of their publications. In choosing authors for the books, the Wharton School tried to obtain people who are prominent in the academic or pension field, seekers of the truth who are known for the fearless way in which they will express their opinions. We have just listened to the leader of one of these Task Forces and you will agree with me that he has expressed his conclusions well. He has told you that he started without any particular knowledge in the pension field, but it is now obvious that he is expert in one area.

There is not necessarily community of opinion in a Task Force. The published report in great part reflects the Task Force Chairman's opinion, modified insofar as he is willing to accept the opinions of members of his Task Force who might disagree with him. Any major differences may be expressed in a dissenting opinion to be included in the book. All of this is

good. Publicity should be given to all sides of the problems involved in the security of pension plans.

Some of us will agree with the views expressed in these Task Force reports. Others will disagree. The Pension Research Council asks those who differ to come forward freely with their facts and their logic. Don't just disagree. Give the reasons and let these academic people consider your views. They search for all of the truth in every matter in which they are concerned.

MR. A. HAEWORTH ROBERTSON: Professor Aaron, did your study cover public or municipal retirement plans?

PROFESSOR AARON: We limited ourselves to private pension plans. However, there was reference to a couple of cases involving California public plans in order to determine what would be the proper public policy in the event a plan was changed so that the benefits were materially altered.

MR. FORREST S. OCKELS: My comments relate to section B. I assume that the first question is meant to cover more than just the financial experience under variable annuity plans. In Los Angeles we at Johnson & Higgins now act as actuaries for more than a dozen different variable annuity plans. Two of them became effective in 1956 and the others have been installed from time to time since then. The number of participants in each plan varies from about 125 to over 10,000 lives. With one exception the plans have both fixed and variable benefits, so they are what might be called combined retirement plans. In those plans where there are employee contributions, the employee money all goes into the fixed benefit part of the plan.

Our period of experience is far too short as yet to come up with any significant experience as to what these plans may do in terms of ultimate retirement benefits. However, the unit values of our variable retirement plans attest to the fact that the years since 1956 have been a reasonably good period for investing in common stocks. Of most interest are the unit values which we calculated during 1960, since they were determined towards the end of the year when the general market level was down significantly in terms of averages. In 1960 we had six plans that had been in effect long enough so that the value of the unit could be affected by investment experience. Four of these plans showed a higher unit value in 1960 than they had shown the year before and two showed lower values. Incidentally, these results were determined after charging against the investment experience the interest assumption which we used in each of the plans.

From an actuarial point of view there are other elements from our experience which are more interesting than mere investment results. For example, the first plans we developed contained rather specific and inflexible provisions for the handling of the funds and the determination of unit values. We soon found that this inflexibility created problems with certain clients who preferred to operate on a more informal basis, and who had sound arguments for their position. Accordingly, in later variable annuities we have used a more flexible approach in the plan provisions, thereby simplifying certain calculations, including the determination of the unit value at the end of each plan year. This later procedure puts more responsibility on the actuary in the area of being sure that all calculations result in maximum equity to participants. It is our opinion that this actuarial responsibility is desirable.

In our first variable annuity we handled mortality gains and losses in exactly the same way as interest gains and losses, *i.e.*, the mortality experience had an effect on the dollar value of the variable unit. In contrast, in our more recent plans we have credited mortality gains and losses against the employer's cost, a procedure which seems to have more validity from the point of view of the variable annuity concept.

Our experience with the qualification of variable annuity plans with the Internal Revenue Service has been normal except that the Service has insisted that benefits payable under a variable annuity plan must integrate at the date of payment rather than as accrued. To meet this requirement we have worked out special wording which has been approved by the Internal Revenue Service and which eliminates adjustments in benefits except under most unusual circumstances. As a matter of policy we now use a flat percentage benefit on total salary for the variable portion of the plan, thereby eliminating any integration problems as far as variable benefits are concerned.

There are a couple of classes of employers who have special interest in variable annuities. The first is the employer who has a large number of technical and scientific employees. This type of employee has an interest and understanding above the normal in the concept and investment philosophy behind a variable annuity. The second employer who shows special interest in a variable annuity is one whose employees are compensated at a rather low level and whose compensation does not react positively and quickly with inflationary trends. These employers tend to be interested in the variable annuity concept because they believe that, on a long-term basis, the variable annuity will produce larger retirement benefits.

MR. MYLES L. GROVER: I think we all know that right now most of the United States insurance companies are not in the position to insure variable annuity plans. Many, therefore, tend to resist any attempt among their group annuity policyholders to adopt a variable annuity. One exception might be the Prudential, which would obviously find it embarrassing to resist such a change. There are some others but we at Johnson & Higgins find the normal insurance company reaction to be an all-out attempt to preserve the insured plan intact. I think that, once an employer has decided on a variable annuity plan, the insurer should cooperate in the establishment of that plan.