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Pension Plans for Industry or Area Groups

A. In a Taft-Hartley pension plan which fixes both benefits and contributions, what criteria are used to determine the adequacy of contributions to support the benefits promised in regard to:
   (1) Period of adequacy?
   (2) Funding of accrued liability?
   (3) Provisions for cash or vesting benefits upon termination of employment?

B. What are the merits and demerits of the Internal Revenue Service tests of adequacy set forth in PS 64 (meeting maturing costs, normal costs, and interest on accrued liability)?

MR. CONRAD M. SIEGEL stated that a consulting actuary becomes involved in this type of plan with two different groups, (1) consulting with the joint employer-union board of trustees who are setting up the plan, or (2) consulting with an individual employer or group of employers. With this type of plan both contributions and benefits are fixed, a great many cross-subsidies are involved, and since funding is often of a minimal nature, there is an important subsidy in terms of the security of the pension guarantees as regards those at or near retirement contrasted with those employees with many years of active service remaining.

When an individual employer has the choice of retirement vehicles, there are several possibilities. The employer may want to include his union employees in the Taft-Hartley industry area plan, he may want to set up a plan of his own providing benefits substantially similar to the Taft-Hartley plan, or he may prefer to set up a pension plan with benefits and contributions entirely different from that of the Taft-Hartley plan. Quite often when the cost of a separate plan providing benefits substantially similar to those of an industry or area Taft-Hartley plan is determined, such cost might be more than twice as high as the contributions specified under the Taft-Hartley plan. This will lead one to examine the assumptions and funding methods of the Taft-Hartley plan. Sometimes one finds that the Taft-Hartley plan was established without the benefit of qualified actuarial advice; or where the plan has received qualified actuarial advice, it often turns out that the funding is minimal and often some benefit "gimmick" has been used to achieve actuarial equivalence.

There has been a recent tendency on the part of trustees to liberalize benefits for those already on the pension rolls on the basis of two or three years of actuarial gains, where it seems that such gains should more properly be used to improve the actuarial soundness of the plan. The note of caution in the actuary's report which never finds its way into the employee booklet is little comfort to the employee who later fails to receive the pension he was led to expect, or to the employer who must increase his contributions substantially.

MR. WILLIAM W. FELLERS outlined the Taft-Hartley conditions for this type of plan as (1) monies must be held in trust, (2) the detailed basis of the contributions must be contained in a written agreement, (3) employer and employees must be equally represented in administering the fund, with proviso for an umpire to resolve any deadlocks, (4) the fund must be audited annually, and (5) contributions for pensions or annuities must be segregated in a separate fund and used only for that purpose.

With respect to PS 64, an officer of a company that is a party to the union agreement should certify that actuarial computations have been made, and that actuarial contributions during the five-year period will be not less than the full costs for employees expected to retire during that period, nor less than the normal cost plus interest accruing on the unfunded past service costs during such five-year period for all employees under the plan.

One may wonder whether the five years is the PS 64 period of adequacy or whether the term of the union agreement is the PS 64 period of adequacy to be considered. From an actuarial standpoint, the period of adequacy would seem to be a much longer period of time than just a few years, this because the pension plan should be presumed to be permanent, one of the issues resolved by PS 64. It would seem that the period of adequacy considered should be either (*a*) for the lifetime of the group involved, or (*b*) ad infinitum.

With respect to the funding of accrued liability, an argument sometimes used against a fixed funding period for the past service benefits is that it would lead to redundant contributions when the past service of the plan becomes fully funded. Also, the relationship of the accrued liability of the going normal cost is important to consider, for the less the past service is in relation to the normal cost the less the need for establishing a fixed funding period for the accrued liability.

PS 64 refers to contributions as a fixed percentage of wages of all participating employees, but more of these plans seem to be established on the basis of cents-per-hour, this latter type of contribution being especially prone to difficulties if the number of hours per work year decreases or is spotty. Another factor related to the funding of the accrued liability is related to the whole gamut of actuarial assumptions made. To what extent are these assumptions conservative?

Going back to the fifth Taft-Hartley condition which stipulates that pensions and annuities be provided from contributions made to a separate fund, one may wonder when cash benefits got in. On occasion a separate plan has been set up with the emphasis on cash termination benefits, the plan as such being approved by Internal Revenue Service as a pension plan and apparently not questioned under Taft-Hartley.

The merits of the PS 64 tests of adequacy are (1) terminal funding at least is assured for those retiring while the plan is in operation, (2) the requirement of normal cost and interest on the unfunded past service costs usually means that certain funds are being accumulated in advance for the nonretired group, and (3) for an expanding group, the funded ratio should increase as time goes along.

Demerits are (1) the older the group, generally, the less the degree of funding that is required, (2) conservative as compared with not so conservative actuarial assumptions are not considered by the tests, (3) the employer, and not the actuary, is called on to certify to the reasonableness of the assumptions, (4) for a group decreasing in size, the older ones will usually be the ones who stay, and so the funded ratio will probably decrease, (5) the PS 64 test cannot be certified as actuarially sound by some definitions, and (6) any pension increases to the already retired would certainly reduce the funded ratio.

MR. JOHN K. DYER, JR. stated that in this particular situation there are probably more traps for the actuary than in any other kind of situation. Our guides to professional conduct, among other things, should be remembered. One of those that is particularly pertinent in this situation is Guide Number 9, which says, "The member will not make or sponsor any actuarial calculation, certificate, statement, report, or comparison, or give any testimony or interview on such matters, which he has reason to believe is false, materially incomplete, or misleading." It is the word "misleading" that is troublesome—misleading to whom? Frequently a serious effort is made to have the client-employer, or the trustees of the fund, understand the limitations in this kind of a situation; but how about the employees, the people who expect to get the benefits out of this plan—are they being misled? It was decided in one situation that the agreed-upon schedule of contributions would support the proposed schedule of benefits provided only the employees who were within a few years of actual retirement age would be funded and the rest of them would be ignored. That, he said, is a situation that we should not be willing to lend our name to unless we are sure that the people affected are going to be informed of the fact.

MR. SAMUEL N. AIN suggested that PS 64 has been beneficial in leading to the establishment of sounder multi-employer plans. Were it not for the requirements of PS 64 many plans which provide benefits supportable by the fixed contributions would provide excessive benefits, leading to the bankruptcy of the plans. However, it seemed to him that more good could be done if the Commissioner required the filing, in each such instance, of an actuarial report to support the adequacy of the contributions to provide the benefits proposed. As a result of the lack of understanding of the purpose of PS 64 it appeared that, under the present method of complying with its provisions, in many instances no actuarial study is made. While some District Offices presently require the filing of the actuarial report, it seemed that a requirement that this be done would greatly improve the effectiveness of PS 64, which, after all, would be in conformity with 1.401-1(b)(2) of the Regulations requiring that the plan be permanent.

CHAIRMAN JOHN B. ST. JOHN noted that two of the speakers had said that the certification as to the adequacy of the contributions to support the plan must be made by the employer. In two cases, at least, a specific request was made for certification by the joint board in the Taft-Hartley plan.