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# PENSION TERMINATION DUE TO BUSINESS FAILURE, LIQUIDATION, OR MIGRATION

BY

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PENSION TERMINATION DUE TO BUSINESS FAILURE,
LIQUIDATION, OR MIGRATION

By

James Arnold Graaskamp
(Under the supervision of Professor Richard M. Heins)

The purpose of this study has been to examine the pension security of the older worker in light of the insecurities of employment in a dynamic economy which can force a business to migrate, to close, or to discard much of its labor force. The frequency with which pension plans unexpectedly terminate was first determined from various federal, state, and private data sources. While data sources were inadequate to pinpoint frequency of pension loss situations, a time-lag correlation was found to exist between initiations and terminations of approved plans; further correlations were found between scale of employer assets, number of employees, and number of plants and involuntary termination of plan or participant.

The greater part of this study was concerned with the collection and analysis of typical cases illustrating the consequences of full or partial termination of insured and noninsured pension plans. Thirty-five of these case histories were selected from interviews with, and private files of, various pension professionals east of the Mississippi or in the southwestern part of the United States. In addition to a review of pertinent legal and institutional environments, individual chapters have treated full termination of insured pension plans, full termination of noninsured plans, and the relationship between individual involuntary severance and partial termination of a formal pension plan. Each chapter concluded with

suggestions for technical improvement of existing plans or terminal procedures. The final chapter concludes that true equity in event of involuntary unemployment or planned termination would require complete reformation of present pension practices to achieve concurrency among legal theories of a pension as a conditional contract, actuarial policies for funding benefits payable, and social values as to vesting of benefits and understanding of risks of fulfillment implicit in the private pension movement.

The major value of this study might well be its proposal to reconcile legal, actuarial, and social premises so that pension expectations will be in accord with pension realizations where there is need for employment flexibility in our competitive economy. In essence the proposal called for segregating funds according to allocation of risk in the probable continued prosperity of the business as related to wage contract equity. It was suggested, with some qualifications, that:

1. Benefits for the retired worker be funded in full upon retirement of the participant.

2. Benefits earned following initiation of the program be funded in full with cash or surplus notes subordinate to the general debt of the employer.

3. Actuarial liability for service credits earned prior to initiation of the plan be recognized as a gratuity subject to future contingencies of the business.

Retirement benefits would be vested and the funding commitment executed; earned deferred benefits would be funded or validated with a claim on effective employer net worth at liquidation, but vesting could be contingent on involuntary severance or a minimum number of

service years. Past service liability would be a residual trust, allocated by actuarial proration to favor the older worker, funded only should conditions be favorable. On annual statements or upon individual severance or at final termination the resources and liabilities could be arrayed in these three classes so as to instantly reveal the substance of each individual's rights to a pension expectancy.

# PREFACE

In the Spring of 1960 the faculty of the School of Commerce at the University of Wisconsin initiated a study of retirement plans from the viewpoint of the older worker. The research program enjoyed the sponsorship of the Ford Foundation, and encompassed a number of scholastic disciplines and subjects, including:

A. Labor mobility of the older worker.
B. Pressure for earlier retirement of the older worker.
C. Retirement experience of the elderly worker.
D. Safeguarding of pension benefit commitments to the older worker.
E. Adequacy of benefit formulas and vesting for the older worker.

This monograph on Pension Termination Due to Business Failure, Liquidation, or Migration was initiated as part of the study of safeguarding pension benefits. Interviews and the search for primary data were generously financed from the Ford Foundation Grant, although preparation of the manuscript as a dissertation has been the responsibility of the author. The economic power of the Ford Grant was well matched with the teaching talent of my advisor, Professor Richard M. Heins, who was a major factor in my effort to mold a wealth of material fragments into academic form. His patience has been exceeded only by those who have typed this manuscript over the past two years of gestation.

The concatenation of events and persons which led to this study would interest few. But the author, an architect by predilection, wishes to point out that he is pursuing a teaching career as a result

of the subtle designs of Professor Francis J. Calkins of Marquette University. The foundations for teaching Insurance and Real Estate have since been set in place by Professors Charles C. Center and Richard U. Ratcliff over the past five years at the University of Wisconsin, and this study is a capstone on the various buttresses of the doctoral program. For the values received in these years I should rightfully extend a mortgage note of appreciation to Dean Erwin A. Gaumnitz, of the University of Wisconsin School of Commerce.

The blocks of information from which this study has been built were a contribution of a number of pension professionals who chose to remain anonymous lest they suggest that their files were public information. In addition there have been dozens of sidewalk superintendents who have made their contributions to one detail or another and then faded into the crowd.

However, the best of blueprints produces nothing other than what skill and material the general contractor can combine in the execution of the grand design. Thus this author must bear full responsibility for performance in what he has bid to do in this monograph.

Madison, Wisconsin
July 1, 1964

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CHAPTER I

THE INTRODUCTION

## A. The Public Interest in Safeguarding Pension Expectations

There is a growing public consciousness of the propriety in making available a pension to every earnest working man at the age of 65, perhaps as early as age 62, with funds drawn from public, private, and individual sources. Private pensions in the aggregate are so important a part of the national welfare that pension planning for the private concern has fallen in the public domain. The public interest in pensions has been estimated to include more than 90,000,000 people with some future or present expectation of a public or privately financed pension income. Of this number about 34.4 million have a possible interest in $93.1 billion of assets including $20.2 billion in private insured plans, $35.1 billion in non-insured plans, and $37.7 billion in public plans, not including the Social Security program. In 1961 private plans distributed $2 billion to nearly 2 million individuals and an additional 1.6 million persons received benefits from various government employee plans.[1]

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[1]For details since 1950 see Appendix I; estimates of assets and coverage taken from Pension and Profit Sharing Report, Vol. XX, no. 8, February, 1963, pp. 7 and 8.

The scale of the retirement problem and the breadth of public groups affected, however, does little to define the relationship between the public interest and the individual rights of the employer and the employee committed to a private pension contract.

In approaching the subject of how individual pension transactions reflect public interest, one is humbled by the constantly expanding legal and economic literature on the character of a pension expectation and the means of "safeguarding" pension interests. Some of these materials appear to confuse the assumed public interest with individual legal interest. There is an implicit assumption that a pension expectation is a "right" of the older worker; that is, a private pension program is becoming something more than a gratuity reflecting employer concern for a loyal but "depreciated" employee. One is reminded of John Kenneth Galbraith's comment on what is a vested interest:

> The notion of a vested interest has an engaging flexibility in our social usage. In ordinary intercourse it is an improper advantage enjoyed by a political minority to which the speaker does not himself belong. When the speaker himself enjoys it, it ceases to be a vested interest and becomes a hard-won reward. When a vested interest is enjoyed not by a minority but by a majority, it is a human right.[2]

By this definition thirty million participants in the private pension field evidently have a "hard-won reward" which, when considered with the pension expectations of many millions of others, pushes a pension expectation to the brink of recognition as a basic

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[2]John Kenneth Galbraith, The Affluent Society (Boston: Houghton Mifflin Company, 1958), p. 181.

"human right." However, legal rights have not infrequently been at a variance with human rights, and the development of the law may be several steps behind what may be called social value judgements.

Certainly the court systems in our country provide ample means of safeguarding and enforcing a property right where one can be shown to exist. By conventional standards, however, most pension values are owned by no one in particular. A pension expectation has its origin in contract and is concerned with a contingent future interest in property;[3] it only becomes a legal right when it can be established in the courts that an individual has fulfilled the conditions precedent to a specific ownership interest, however it may be qualified as to its use or possession. Satisfaction of this right depends on the availability of funds from an employer or from segregated assets or funds. A funded pension plan has a basic premise that over a period

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[3] A clear and interesting statement distinguishing "rights" from expectation was made by the court in a recent case involving who was entitled to share in the proceeds of a pension termination distribution. Said the judge:

> Appellants' so-called rights in the pension fund were actually not rights at all, but were in the nature of expectancies, and as such were subject to the terms of the instrument under which they arose. The Pension Plan, under which they arose, expressly gave the company the right to amend or terminate, in whole or in part, the Plan at any time for any reason whatsoever. In acting under this expressly reserved power, the Company and the Trustee breached no legal rights of the appellants. The position of the appellants appears analogous to the "interest" of named beneficiaries in a will prior to the death of the testator, who, at any time before death, can change the will and eliminate the expectant legatee without liability to himself or his estate.

Finnell v. Cramet, United States Court of Appeals, Sixth Circuit, No. 14145, April 19, 1961.

of time an employer can segregate and accumulate sufficient wealth to honor the employee's expectation that his long years of service will lead to the security of the pension. These segregated funds are in a legal limbo. Tax laws have established a drafting practice to the effect that pension assets are not to revert or divert to the employer's benefit; trust law does not give trustees or insurance companies acting as depositories an ultimate title. Yet the great majority of beneficiaries have no legal right that represents ownership until they have met various conditions precedent, such as age and service.[4] Moreover, the capacity to pay benefits may lie in contributions yet to be received from the pension sponsor, and a property right or title to property which has not been transferred has doubtful legal status. The legal quandary notwithstanding, the funding process eventually produces pension property for the individual who completes the required service process, all of which requires time. Yet, the passage of time exposes both parties to a wide number of loss-causing variables which cannot be anticipated or controlled, thus undermining the effective strength of pension rights.

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[4] For one of many good examples see Schneider v. McKesson & Robbins, Inc., 254 F. 2d 827; Circuit Judge Waterman was summarized in the head notes as follows:

> . . . where employer set up pension plan for benefit of employees financed entirely by employer contributions through instrument creating trust and reciting that employees who qualified as participants were entitled to retire at age 65, or age 60 by special vote of board of directors, with annual retirement allowance computed in accordance with terms of plan, but if participant ceases to be an employee for any reason, his participation therein terminated, discharged employees, under the age of 60 had no interest in funds held by trustee.

Much like existential concepts of being as a process of becoming until death places a final limit on development, pension expectations might be thought of as contract rights in the process of becoming court-recognized quantities in the nature of property. The final test of the substance into which these rights have been transmuted by the passage of events would be at the point in time where the pension plan was brought to a close. A finite measure of what a pension is to become is the reserve which represents the present value of future pension claims. In the words of one noted actuary:

> The essence of the reserve concept from the facet of employee security is frequently overlooked; it lies in an admission that the plan may have to wind up some day.[5]

While the pension plan is in operation, it is common practice to indicate the degree of funding, and by implication the strength of individual benefit expectations, by means of a funding ratio, i.e., a ratio of available assets to estimated actuarial liability. However, at termination the adequacy of funds is measured by the extent to which eligible individuals are satisfied according to their ranking on a priority list. For example, if priority were based on age, reserve adequacy would be indicated by a statement that benefits were paid in full at age 60, and the others received 20%, or 30%, as the case might be. Funding ratios are meaningless as a measure of pension strength when priority may give the annuitant with fifteen years service his full pension and deny the active employee of thirty years

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[5]Dorrance C. Bronson, F.S.A., Concepts of Actuarial Soundness in Pension Plans (Homewood, Illinois: Richard D. Irwin, Inc., 1957), p. 74.

any claim at all. In short, pension expectations are not so much determined by the extent of funding at termination as by termination provisions and priorities established at its inception and reflecting the values and objectives of the parties of interest.

This observation has led this research to examine an idea that terminal distributions should be consistent with the legal theory or values attached to the original pension agreement. If the plan is considered a gratuity, one set of responsibilities at termination should follow and be provided for in the plan. If the plan is to be regarded as a conditioned promise, there must be an implicit debt created to those who have met the prescribed conditions, and if a pension is thought of as deferred compensation, far more stringent obligations would seem to follow as appropriate to termination. The fact that the progenitors of a pension plan may not relate terminal distributions to their overall view of the plan as gratuity, bonus, or deferred wage may be a significant threat to original pension expectations.

## B. The Nature of Pension Expectations in Relation to Employment Expectations

The system of competitive capitalism under which industry operates in this country requires freedom to leave the business scene as well as to enter a profitable area so that the entrepreneur may adjust labor and capital commitments to changing business opportunities. Often his adjustments are not adequately responsive and the system quickly bankrupts the moribund. Consider how pension

expectations can be effectively frustrated by an involuntary loss of employment with either the best or the worst of the entrepreneurs:

1. The need for mobility of labor and capital exposes the individual worker to the possibility of a temporary layoff, a permanent reduction in work force, a transfer of department operations to other employment areas, obsolescence of work skills, migration of an entire company to another area, or a variety of other threats to continued employment.

2. Scale of the business enterprise may provide the best source of financial security for the pension plan as an entity at the same time it creates the greatest threat to individual pension expectations. The same large corporations which have done most for advancing the concept of private pension coverage for employees as a class are the ones which have been able to mitigate the risks of competitive degeneration in part because of efficient management of their work force, which is in a constant state of flux in terms of individuals, skills, location, and working hours.

3. Conversely, substantial businesses may wane and fail, may close for lack of management continuity, or may be absorbed by larger firms in the process of locational and market concentration. In short, there is a life cycle to a business enterprise which bears little relationship to the cycle of income needs of those dependent on it for employment.

4. Ironically, efficient management reacting to economic dynamics will mean the pension plan may be more vulnerable to change than employment or the enterprise itself. It is usual and proper for management to reserve to itself the power to avoid the expense of investing in future pension benefits in order to protect, if necessary, the viability of the firm in the immediate present.

One can only observe that the dynamics of competition, technology, and the mysterious cycles of managerial innovation and vitality all combine to create massive economic insecurity for the average business enterprise and its employees. Technical and legal considerations to the contrary, one must conclude that in the long run a pension plan is in essence a profit sharing agreement, for without profits the pension sponsor fades, his power to employ shrivels, and the pension plan is left without its source of financing. The efficient allocation of

resources in a free enterprise system creates mortal uncertainties for the individual.

Who can provide a prospective forecast for an individual worker as to the probabilities of business and employment continuity over a period of time which would allow accumulation of funds for his eventual retirement pension? Perhaps the odds-makers would rate such continuity over a forty-year work life span at less than even. In this light "safeguarding" of pension expectations is best directed to proper recognition and preparation for the contingencies and uncertainties of ever realizing any financial benefit from a pension plan. It has far greater implications than the regulations and enforcement of laws governing possession of property which would one day give substance to a pension expectation. Rather it is concerned with preserving the social values to be found in the competitive system while preventing the frictional costs of this system from falling on just those individuals who have a vested but economically obsolete interest in the old order. The competitive system should be ruthless in the evolution of new institutions but considerate of the individuals upon which these institutions are built. A pension expectation is just one small facet of the consideration due the individual who is relatively powerless in matters economic.

To reduce the impact of competitive dynamics upon the individual, various devices have been introduced in more progressive plans to permit "portability" of accumulated pension credits. Portable pension rights are a broad topic area bearing on both voluntary and involuntary employment changes and have been treated

extensively in other recent studies. Instead, this study will focus on involuntary termination of such scale that it might be construed as a reduction in work force, so substantial as to represent partial termination of the pension plan, although individual involuntary terminations cannot always be viewed separately where equity is to be done. Surprisingly, the frequency and scale of pension expectations involuntarily terminated has never been adequately studied or determined. The concern of Chapter II of this study will be to establish as accurately as possible the frequency and severity of involuntary termination in full or in part, in order to challenge a common and implicit assumption that a pension plan will survive its beneficiaries.

## C. The Degree of Permanence Ascribed to Pension Plans

A variety of educational and institutional limitations preserve the aura of permanence which surrounds a privately funded pension plan despite its carefully designed contingencies. In general, the public is just beginning to understand the economics of pensions. An appreciation of the capital amounts which must be accumulated to sustain a given amount of income for life is not common. There is limited knowledge of how the mechanisms of pension funding formulae and arrangements sacrifice severable individual interests to group objectives of pension security. Certainly the concept of what is "actuarially sound" cannot be understood by many in the general public, when there is little agreement on its definition among

pension professionals.[6]

The educational and financial information supplied to employees who are the nominal beneficiaries of a private pension plan is not designed to stress the contingencies but rather the potential benefits of continued employment with the sponsoring business enterprise. The presumptions of a private pension plan can be found in such company reports by those with analytical ability but their implications will be missed by the majority of would-be pensioners. In a recent court action involving misinformation supplied a pension beneficiary by his company, the court commented that the plaintiff could not have been expected to know the mechanics of the particular plan without being told:

> Neither the Plan nor the employees' booklet, so dutifully clear to the experienced draftsman, used the kind of language that is fully understandable by even an intelligent layman; perhaps it is just not possible to do so.[7]

One can wonder if the phrase "pension plan" may not connote to the employee a kind of contract similar in security to the annuity policies of an insurance company, particularly when his compatriots so often receive an annuity policy purchased with pension fund proceeds at the time of their retirement.[8]

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[6] Ibid., p. 11.

[7] Gediman v. Anheuser Busch, Docket No. 27075, 1-30-62, as taken from "Watch Your Employee Communications," Pension and Profit Sharing Forms, April 20, 1962, Report Bulletin 10, Volume IV, pp. 25, 113.

[8] There was a time that group annuity contracts were called group pension plans,but the name was changed to group annuity contract when the term "pension" fell into disrepute as a result of unfavorable experience with nonactuarial pensions. Robert I. Mehr and Robert W. Osler, Modern Life Insurance (New York: Macmillan Company, 1956), p. 296.

At the same time that an illusion of permanence is not dispelled by better public understanding of pension mechanics, a false sense of security is produced by the workings of industrial psychology. Once sufficient seniority is established to avoid the day-to-day threat of temporary layoff, a typical worker can be expected to find a certain sense of personal security in the daily work regimen and in the immovable brick and steel of a plant which he has known for many years, perhaps since childhood.[9] Management and union people can give countless illustrations of the trauma and permanent loss of morale precipitated by a plant closing. Permanent shutdown is often incomprehensible to long-term employees even after shutdown is an accomplished fact. It follows that these same employees would not foresee the contingency of shutdown and bargain for plan provisions which would salvage some part of their pension expectations. Only with the impact of automation, have the largest unions bargained to include special severance provisions in pension agreements for cases of shutdown or reduction in work force.[10] Automation is a good example of the necessity to bring about change which will benefit the entire social good but at the expense of a few adversely affected by the reallocation

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[9] There are many examples of research confirming this problem; for a good recent example, based on shutdown of the Packard Motor Company, see Too Old to Work, Too Young to Retire, Harold L. Sheppard, Louis A. Ferman, and Seymour Faber, prepared for Special Committee on Unemployment Problems of the U. S. Senate, 1960, U. S. Government Printing Office.

[10] 1960 wage and pension settlements in the auto-steel-can industries all contained provisions for lump sum pension settlements for non-vested employees discharged for reasons of plant shutdown or the closing of a department. These are treated in more detail in Chapter III.

of resources. Termination of pension expectations may be one small part of these issues, but are typical of the planning adjustments necessary by individual decision makers within the economic system of planning.

Qualification of the pension fund for Federal income tax exemption introduces an additional suggestion of permanence. The Commissioner of Internal Revenue reserves the right to review all pertinent circumstances at the time a pension is qualified (or terminated) to determine that the intent of the plan was to create a mechanism to provide permanent and continuous benefits rather than to secure a temporary tax shelter for funds earned in a period of high income tax rates. The tax law further requires that upon termination all values vest directly with eligible pension beneficiaries who must be satisfied in full before any funds can be returned to the employer as a dividend called "actuarial error." Dutiful recitation of this minimum requirement in a typical pension document may satisfy the casual reader that the problems of termination have been adequately anticipated. The fact is, while there must be a plan for terminal distribution, the I.R.S. has few requirements as to the nature of the plan.[11]

Since many pension plans are the product of collective bargaining, the strategy and psychology of negotiation may influence attitudes as to the probable permanence of the plan. The pension thinking of many employers is in terms of package settlement or pattern

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[11] I.R.S. 401 (a); Reg. 1.401-1(b) (2).

plans for an industry, with provisions weighed in terms of cents per hour, competitive cost, rather than in terms of equity as a social device.[12]

The possibility of termination is further pushed from sight as actuarial advisers provide 20 and 30 year projections of company growth, employment, and profits. Attorneys, too, may tend to ignore specific consideration of future contingencies as they are susceptible to the security of imitation of established pattern of legal expression and of broad amendment provisions so that the plan can be modified to meet future needs or to correct past mistakes. Local unions are not immune to the ease of accepting pattern contracts without penetrating consideration of that contract as applied to their particular situation. Union officers may bargain hard for benefits which make the most political impact within the union but may be reluctant to push for provisions which imply the imminent collapse or shutdown of a particular plant. After all, the general prosperity of the plant has been a key argument for the adaptation of other wage contract improvements.

Again precedents in union bargaining strategy may discourage the one real safeguard of pension expectancies, namely, money from a generous funding program. Management has reason to fear that if

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[12]For example, collective bargaining in the steel industry is the responsibility of a committee representing the ten largest companies, the leader of which is U. S. Steel. Liquidation or bankruptcy of the employer is ignored as beyond the realm of possibility for these ten companies. Unfortunately, many small companies refuse to modify the steel pattern agreement to recognize their own possible mortality.

reserve assets appear too adequate, the unions will demand additional benefits, rather than permit a reduction in contribution once past service liabilities have been met.[13] To increase benefits could conceivably deprive an employee with less termination priority of a pension that was adequately funded prior to the change in benefits. There is an understandable bias of the parties at interest toward economic optimism which leads to an economic myopia.

Provision for termination of the pension plan is generally considered a legal bridge to be crossed only if and when it is reached. It is the purpose of Chapter III to review the legal and economic factors basic to pension termination. The legal view reflects both the theory of the nature of pension rights and the typical contractual provisions for implementing these views. Taxes, tactics, and pension techniques, as found in Chapter IV, must be viewed from the position of employer, funding agency, the beneficiary, and general public in light of liquidation, failure, migration, or plant shutdown.

## D. The Scope and Importance of the Problem of Pension Terminations

Greater concern for termination problems has been indicated by both labor and management in recent years. Businessmen most knowledgeable in pension matters have been willing to introduce liberal vesting and severance benefits for the pension participant displaced through no fault of his own. The larger industrial unions push hard in negotiation for reforms to protect workers severed from jobs because of business failure, migration, or automation. Suggestions have come from

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[13]Bronson, op. cit., p. 76.

the labor side[14] that the consequences of pension termination should be mitigated by a federal system of reinsurance for private pension funds, by use of general government revenues for early retirement pensions prior to social security payments, and by more radical plans for centralized governmental pension plans.

However, pension literature gives scant treatment to the severity or solution of private pension termination. The continuity record of private pensions and their performance when terminated would seem to be of critical importance in evaluating the success of the private pension movement from the viewpoint of employer, employee, and the society alike. Nevertheless, the subject of termination is generally treated only as a corollary to more popular subjects such as vesting, severance, or funding. Indeed, it is difficult to say on the basis of published government data just how many plans have been forever or partially foreclosed and how many participants have been adversely affected in any single year. Even attempts of one government agency to compilate government data from other government sources on this subject have been frustrated in large part.[15]

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[14]See a report on a special collective bargaining convention by the UAW in Detroit in April of 1961, as reported by Profit Sharing and Pension Forms, Volume III, No. 11 (Englewood Cliffs, N. J.: 1961), p. 2. Information also reflects an interview by the author with John F. Tomayko, Chief of the Pension and Social Security Department of the USW, at his Pittsburg office August 16, 1961.

[15]Joseph Krislov of the Division of Research and Statistics in the Social Security Administration has done two such reports: Termination of Private Pension Plans (Analytical Note No. 109), Bureau of Old-Age and Survivors Insurance, Division of Program Analysis, May, 1960; and, more recently, "Notes and Brief Reports--Private Pension Plan Terminations," Social Security Bulletin, Volume 26, No. 12, December, 1963, pp. 18-21.

Private comment addressed directly to termination as the major subject has been limited to a few law review articles and to the work of two men in particular, Dorrance C. Bronson,[16] an actuary, and Merton Bernstein,[17] a law professor. With these notable exceptions termination provision and procedure have been submerged within literature stressing other themes.[18] A few analyses of the problems of termination are hidden away as parts of court opinions on issues derived from a terminal situation. Therefore, a study which attempts to bring together various aspects of pension termination as a specific topic area is in some ways unique. When it is estimated that more than one of every seven plans initiated will terminate within eight years of initiation, the subject is a significant part of pension administration, although it will be shown that this is a judgment difficult to quantify.

Evaluation by comparison of governmental pension programs with those of the private system is not the approach of this paper. Still, the continuity record of private pensions is a sensitive area of study

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[16] Basic background reading in this subject should include his "Pension Plans--Provisions for Termination of Plan," Transactions of the Society of Actuaries, Vol. VIII, June, 1955. In addition, Dorrance Bronson has stressed the termination problem in several other publications and speeches which will be noted in later chapters.

[17] "Employee Pension Rights When Plants Shut Down: Problems and Some Proposals," Harvard Law Review, Vol. 76, March, 1963, pp. 952-973. Professor Bernstein will shortly publish a book, The Future of Private Pension Plans, in which termination is the subject of one chapter.

[18] Just one of many examples is Pension Funds and Economic Power, Paul P. Harbrecht, S.J. (New York: The Twentieth Century Fund, 1959). In particular, his Chapter 6, "Beneficiaries in Court," was excellent background for this study.

where private plans are compared unfavorably and often unfairly with little qualification to tax supported public arrangements. Nothing could be further from the intent of this research than an attack on the concept of diversity and temporality of private plans. It is customary in the United States to provide both public and private solutions to each social problem. Each form of pension support has its advantages, and private pension planning not only provides greater freedom of choice as to the mode of wage compensation and retirement but provides an opportunity for innovation, experimentation, and competition for personnel, thus affecting allocation of resources for the economy as a whole. This competition takes the form of a wage contract to meet business purposes. The concern of this study is to strengthen the effectiveness of this contract by improving its mechanics in regard to terminal situations and by achieving greater concurrency in the relationship of funding, expectations, and understanding by the participant of the nature of the pension process. Implicit in this objective is a premise that a private pension program can use forfeiture provisions to serve the business need for loyalty and increased productivity while at the same time sharing the exogenous risks of eventual realization of the social need for retirement income with the employee.

To strengthen and improve the private pension effort, it can be assumed that review of individual case experience can reveal both instances of creative administration and wasteful termination from several points of view, namely management, participant, and public policy. Terminal statistics as found in Chapter II can do little to suggest the scope and importance of the problem of pension termination

unless the details of consequences are available to suggest what is needed to strengthen the effectiveness of private pensions. Thus specific case examples, although they may reduce the scope of study possible with more general observations, form a major part of this study, with Chapter V devoted to insured pension programs, Chapter VI to non-insured trusteed pension plans, and Chapter VII to the problems of partial termination due to mass reduction in work force.

Thus, the scope of the study is reduced to cover only questions related to the execution of termination of the pension contract, and the subject is given this singular importance because what the participant realizes of his expectations where the plan is prematurely terminated is the most revealing measure of the substance of his pension rights when and if the plan were functioning. Of course, the topic area to be manageable must be further qualified.

## E. Definitions and Limitations of Research Objectives

The research topic area of this paper is restricted to the nature and quality of expectations derived from private pension plans as qualified for special tax treatment by the Internal Revenue Code.[19] In essence, a qualified pension plan is an arrangement under which the employer undertakes to provide in a systematic and equitable fashion for the payment of definitely determinable benefits. These benefits are payable to disabled or retired employees or certain survivors over a period of years, usually for life, following retirement or determination of a permanent disability. Non-qualified plans have been ignored

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[19] IRC 1.401-1 (b) (1) (i) and 401 (a).

for lack of available public information, and multiple employer plans have not been treated, as these have been the subject of other research.[20]

The important area of profit-sharing agreements has been slighted not only to restrict the research topic within manageable bounds but also because a critical problem in the event of termination of a pension program is missing in the case of profit-sharing. The majority of profit-sharing plans make provision for the creation or measurement of individual interests in existing profit-sharing funds, thus avoiding the pension termination problem of distributing inadequate funds among actuarial claims of various classes of participants in event of premature termination. Various welfare or combination plans which integrate pension and other benefits for unemployment, hospitalization, or accident have been omitted from study as they are not similar in kind or purpose and therefore unsuitable for comparison or generalization with single purpose pension programs.

The specific research interest is the termination of individual pension expectations, which is defined to include both the termination of a formal pension plan before the last eligible employee is fully pensioned and the involuntary loss of an employment opportunity leading to accumulation of retirement benefits under circumstances implying or

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[20]Walter Kolodrubetz, Multi-Employer Pension Plans Under Collective Bargaining, Spring, 1960, B.L.S. Bulletin No. 1326, United States Department of Labor. Also see an unpublished dissertation by Joseph Mallone, Wharton School of Finance, University of Pennsylvania, 1961.

justifying partial termination. In this study, formal termination of a plan is of interest only when it can be attributed to business failure, liquidation, or migration. In some cases where business merger has meant consolidation of operations and termination of a plan due to consolidation of operations with termination of employment for many beneficiaries, the situation is considered a liquidation. However, where merger has meant integration of personnel and pension plans or where termination of a pension plan has been followed by creation of a profit sharing plan or some other benefit program, the situation has been omitted from study. These latter subject areas have received extensive research treatment in conjunction with work done by the Pension Research Council.[21]

Termination of a pension expectation is more often a process than a single event. Temporary layoffs may last until seniority status is lost and a permanent reduction of a work-force has been accomplished. As the business situation worsens, contributions to the plan may be suspended until the practical result is a reduction or cessation of annuity payments to existing annuitants. This process of termination leading to full or partial dissolution of the pension plan of the single employer is the area of interest for this study. To a degree this concern overlaps with the broad area of labor turnover due to voluntary job changes, attrition due to age and illness, and to other considerations, all of which will be slighted to focus on involuntary

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[21] J. B. Hammond, "Pension Programs As Affected By Mergers" (unpublished Ph.D. dissertation, Wharton School of Finance, University of Pennsylvania, 1960).

termination of pension expectations due to the dynamics of a competitive society.

It should be noted that at no point is there an intent to decry the loss of a job or firm in the face of the pressures of free competition. Only the consequences of this means of reallocating resources in relation to the private pension agreement are open for critical comment.

Within the remaining topic areas as thus delineated, this research proposes:

1. To determine the frequency and severity of loss of pension terminations as might be revealed from analysis of available data and thereby suggest the significance of the problem.

2. To collect, assimilate, and analyze typical termination experiences to highlight possible areas for technical or legal refinements, which would reconcile the present and future prospects of the employer with the uncertainties of employee pension expectations.

3. To put forward tentative observations and suggestions intended to stimulate rethinking of private pension theory where it may adversely affect pension expectations of the older worker with recognition of the proper allocation of personal risks and social resources consistent with the American economic system.

## F. The Research Methods

The general research objectives of this study have been greatly hampered by the difficulty in obtaining the most relevant information. Two kinds of data have been sought, (1) aggregate national data which could indicate the frequency and scale of the problem, and (2) case data which could delineate severity of the consequences or specific problems deserving greater professional consideration. Much of the

available information is held to be confidential by governmental or private custodians. Of the two distinct sources, government agencies and private pension professionals, the government would appear the best source of aggregate data.[22]

A prime source of information would be the Internal Revenue Service (IRS) files of correspondence assembled from firms seeking approval of full or partial pension plan terminations. As developed in more detail in Chapter II, these records could be an invaluable source of consistent and specific data on national trends, but of course such correspondence touches on matters of personal income tax and is considered by law to be most confidential and available only to the employees of IRS. Therefore it was necessary to find alternative sources for this same kind of information from private sources as it pertained to the pension program and not personal incomes.

A variety of mail and interview approaches was used to locate termination case records throughout the country.[23] Unfortunately each source was willing to divulge information of a different degree or kind, and most wished the confidential nature of the data disguised to

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[22]The range of government sources is indicated by the following list of mail and interview contacts: (1) Internal Revenue Service, (2) Federal Welfare and Pension Report Division of the Department of Labor Standards, (3) United States Department of Labor, (4) United States Department of Commerce, (5) Special Subcommittee of the Congressional House Committee on Health, Education and Welfare, (6) various state agencies involved with state Pension and Welfare Disclosure Reports, (7) State corporate registration agencies, and (8) State development and economic resource agencies.

[23]The private sector of pension professionals included the following in relative order of importance of material supplied: (1) Actuaries and Pension Consultants, (2) Labor Union Officials and Pension Technicians, (3) Corporate Trust Companies, (4) Dun & Bradstreet, Inc., and (5) Factory Location Services.

protect the source of the material, the parties involved, and the business relationships of the informant. The result is a considerable body of observations, case histories, opinions, and recollections which may be sorted by subject but certainly have none of the attributes of statistical collections often associated with this kind of research.

The reader is warned that he shall find no curvi-linear support for conclusions, no mass of data providing irrefutable evidence of the correctness or ignorant bias of a favorite hypothesis, indeed little that is quantifiable. Rather the substance of this topic reviews particular situations and modest assemblies of data to understand implicit legal assumptions, social welfare factors, and economic considerations of the employer, employee, and society as well. There is a possibility of a hidden bias in the preselection of case material by the many private individuals who control access to information. The study attempts to represent all the viewpoints of interest, but the reader is put on notice that qualitative review as opposed to quantitative analysis may interject the viewpoint of the author despite even the best intentions. And of course the reader may arrive at different inferences from the facts presented --small misunderstandings due to "the insensible bias of position," in the delicate phrase of Thorstein Veblen.

As factual information is introduced in the following chapters, the method by which it was obtained is explained in accompanying notes. Literature, interview, direct mail inquiry, and detailed review of available files each have their place and their distinct limitations in this study. Here again, procedure of this study clashes with

customary practice, for footnotes can not always be fully referenced, a condition imposed by the need to preserve the privacy of the parties at interest as well as the source of the case data.

G. Structure Outline of Following Chapters

Chapter II is concerned with the range of pension termination experience revealed by various national agglomerations of data. Federal and state sources at least give a clue to the cause and frequency of termination, the assets and participants affected, and the trend in the national rate of plan dissolution. The termination experience of banks, insurance companies, and other pension professionals is also explored prior to a speculative estimate of the national incidence of termination and affected participants. In addition, some modest implications of termination experience are drawn from reports of business failure, liquidation, and migration.

Chapter III explores the legal factors affecting the process of pension plan termination, thereby providing an opportunity to examine much of the literature which is pertinent to termination. The chapter attempts to condense a great variety of legal procedures, contract clauses, and legal theories if only to provide a background of information for the reader of case commentaries in later chapters and to trace origins of the legal confusion implicit in many pension contracts.

Chapter IV touches lightly on other background material which bears heavily on the termination process. Space permits only a sketchy review of the actuarial, tax, regulatory, and other interested party

viewpoints. Certainly the actuarial and tax factors are a matter of fact reviewed extensively in other publications, so that inclusion here is only for analytical reference and, in a manner of speaking, further review of the literature pertinent to the subject.

Chapter V is devoted to twelve case illustrations illustrating termination problems of insured pension plans. The cases were selected from more than two dozen examples collected but edited for reasons of incomplete data, inconsequential research import, or duplication of illustration. An attempt is made in the summary and conclusions to this chapter to suggest possible improvements for the contract, suggestions which must be limited by the fact that the critic has little formal law training.

Chapter VI represents more of the case approach, although in this chapter some sixteen cases illustrate the dilemmas of terminating trusteed, non-insured pension plans. The chapter stresses the imbalance between available funds and legitimate pension claims, a disequilibrium which may mean excessive funding as well as cash shortages. Again the chapter summary puts forward possible technical improvements to the typical plan provision format, although administrative procedure receives much stress as there is more room for discretionary action than is true of the insured program.

Chapter VII has attempted to explore a gray area involving rather fine distinctions between individual employment severance and partial termination of a pension program as a result of a reduction in work force. It is in this area that most pension terminations can be said to occur and in which equity for the various parties involved is

most obscure. While the chapter may dissect the major issues in this area with the aid of several lengthy case discussions, the summary can only initiate further discussion by attempting to extrapolate some basic equity guidelines.

Chapter VIII attempts to build its final conclusion around a major reform of pension theory which may hold a key to termination problems with equal application to insured, non-insured, partial, and individual pension termination problems alike. If the proposed legal treatment of pension benefits were to be acceptable, then the technical drafting suggestions in the previous chapters represent only legal patchwork. Such a conclusion is not debilitating as most pension plans today are legal patchwork, so this study may offer an alternative--either create greater concurrency of law, wage policy, and actuarial funding assumptions or anticipate the effects of non-concurrency in event of termination to prevent inequitable consequences. The final chapter is also concerned with possible institutional devices which would ease the adverse consequences of termination, devices external to the contract and therefore given short shrift elsewhere in the study. The entire chapter organization parallels and serves to summarize what has been realized in regard to the initial objectives of the study.

## CHAPTER II

## PUBLIC INFORMATION AND THE RANGE OF PENSION TERMINATION EXPERIENCE

### A. Objectives of Chapter

The intent of this chapter is to explore available data bearing on the aggregate national experience of pension termination frequency and severity. It has been necessary to collate[1] rather tenuously related or sketchy information from both Federal and state government agencies to suggest the scale of the pension termination problem area. The variety of both government and private sources reviewed for appropriate information was briefly noted in Chapter I, but the bulk of private data, with few exceptions, was in the nature of case study material. This latter information was found in such a variety of forms from sources of such divergent nature that aggregate compilation of these experiences would offer nothing of statistical merit. The study, in this chapter, has depended primarily on government sources, principally the following, upon which this chapter is structured:

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[1]An earlier collation was prepared by Joseph Krislov of the Economics Studies Branch of the Social Security Administration. A more extensive report was made impossible, Mr. Krislov reported to the author, for lack of accessability to additional data and a limit on research budget. His preliminary work was published in May, 1960, as Analytical Note No. 109, Division of Program Analysis, Bureau of Old-Age and Survivors Insurance, Social Security Administration.

1. Internal Revenue Service Reports
2. New York State Banking Department
3. Wisconsin State Insurance Department
4. Welfare and Pension Report Division of the Department of Labor
5. Selected Bank and Insurance Company Data

Indeed, dissatisfaction with the availability of some government data prompted inclusion of a critique of the present and potential values of some of these information sources.

On the subject of partial termination aggregate data will be shown to be even less satisfactory because of the difficulty in reducing reports of business failures, liquidations, or migrations to those few which meant the demise of pension expectations. Nevertheless, these various sources are apparently the only ones available and can be used to provide some finite measure of termination frequency and severity.

## B. Frequency and Scope of Pension Plan Termination

A primary source of pension termination data would seem to be material collected in the course of operation by the Internal Revenue Service (IRS). Aside from the tax code, rulings, and memoranda issued by the department, the IRS has made some kind of quarterly report of the number of newly qualified plans and terminations, together with other miscellaneous material since 1942.

Internal Revenue Service figures as displayed in Table 1 have not been consistent as to technique of recording the initiation or termination of stock bonus, profit-sharing, and annuity plans. Determination letters for initial qualification or termination of

TABLE I

*QUALIFICATION OF STOCK BONUS, PENSION, PROFIT-SHARING, AND ANNUITY PLANS*
As Reported By the Internal Revenue Service

| Period | Original Qualification | Termination | Net | Cumulative Balance | Cumulative Total Terminations Since 1942 | Cumulative Total Terminations Including Prior 1942 | Termination As A % of Total Plans Since 1942 | Terminations As % of Newly Qualified Plans | Annual Term. As % of Net Cum. Plans At Beginning of Period | Index of Annual Term. 's 1947-1950 Av. = 100 | Index of Annual Qualif. 's 1947-1950 Av. = 100 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Prior to 1930 | 110 | - | 110 | 110 | | | | | | | |
| 1930-1939 | 549 | - | 549 | 549 | | | | | | | |
| Jan. 1 '40-Sept. 1 '42 | 1288 | - | 1288 | 1947 | | | | | | | |
| Oct. 21 '42-Jun. 30 '47 | 10608 | 209 | 10399 | 10399 | 209 | 12346 | 3.92 | 1.97 | | | |
| Jul. 1 '47-Jun. 30 '48 | 1134 | 275 | 859 | 11258 | 404 | 13205 | 5.38 | 27.13 | 2.20 | 107 | 92 |
| Jul. 1 '48-Jun. 30 '49 | 1123 | 227 | 896 | 12154 | 711 | 14101 | 6.91 | 22.42 | 1.70 | 89 | 100 |
| Jul. 1 '49-Jun. 30 '50 | 1034 | 263 | 771 | 12925 | 974 | 14872 | 7.56 | 25.44 | 1.86 | 103 | 106 |
| Jul. 1 '50-Jun. 30 '51 | 1897 | 151 | 1746 | 14671 | 1125 | 16618 | 7.65 | 7.10 | 1.01 | 59 | 121 |
| Jul. 1 '51-Jun. 30 '52 | 2493 | 146 | 2347 | 17018 | 1271 | 18965 | 7.35 | 5.86 | .88 | 57 | 140 |
| Jul. 1 '52-Jun. 30 '53 | 2780 | 123 | 3657 | 20675 | 1394 | 22622 | 7.10 | 3.25 | .66 | 48 | 170 |
| Jul. 1 '53-Jun. 30 '54 | 4076 | 212 | 3364 | 24539 | 1606 | 26486 | 7.33 | .52 | .93 | 43 | 202 |
| Jul. 1 '54-Jun. 30 '55 | 3699 | 336 | 3363 | 27802 | 1942 | 29849 | 7.47 | 9.10 | 1.26 | 131 | 229 |
| Jul. 1 '55-Jun. 30 '56 | 4420 | 279 | 4141 | 31943 | 2221 | 33890 | 7.46 | 6.31 | .94 | 109 | 263 |
| Jul. 1 '56-Jun. 30 '57 | 6042 | 308 | 5734 | 37677 | 2529 | 39624 | 7.36 | 5.10 | .91 | 120 | 311 |
| Jul. 1 '57-Jun. 30 '58 | 6872 | 388 | 6484 | 44161 | 2917 | 46108 | 7.32 | 5.65 | .67 | 152 | 364 |
| Jul. 1 '58-Jun. 30 '59 | 6955 | 459 | 6496 | 50657 | 3376 | 52604 | 7.37 | 6.60 | .10 | 180 | 418 |
| Jul. 1 '59-Jun. 30 '60 | 8737 | 500 | 8237 | 58894 | 3376 | 60841 | 7.43 | 5.72 | .95 | 196 | 486 |
| Jul. 1 '60-Jun. 30 '61 | 10001 | 643 | 9358 | 68252 | 4519 | 70199 | | 6.43 | 1.05 | 252 | 563 |

To convert published figures for 1954 from a published calendar year basis to a fiscal year basis it was necessary to assume that its reported figures were distributed equally between the first half and second half periods. To determine rulings for the first half of 1955, an inquiry directed to the Reports Division of the U. S. Treasury produced the following bits of information: First, there were 203 terminations for the first half of 1955; second, approvals totaled 960 and 778 for the first and second quarters for a grand total of 1538, according to correspondence with Harry K. Dellinger, Director, Reports Divisions, Internal Revenue Service: May 29, 1962. No other information was available and so 1538 was used as the total number of approvals in the first half and this figure was subtracted from calendar year totals to determine second half approvals, thus leaving the net cumulative total at the end of 1954-55 period substantially correct.

employee benefit plans are not required, and therefore IRS figures may not represent or permit computation of a net total of welfare plans in existence. However, prior approval is generally so desirable that it is almost a universal practice, and thus IRS figures represent a workable universe for research purposes. As individual types of plans were not distinguished in reported figures prior to July, 1955, it was necessary to construct a time series with the aggregate pension and welfare plan totals. More recent data by quarters were rearranged to establish a common July 1-June 30 fiscal year for the entire series, as in Table 1. Examination of this time series produces some interesting insights into the rate and incidence of termination for all plans of this type, although not specifically and solely to pensions, the basic subject under study.

1. Over a span of almost 25 years one out of every fourteen plans has been terminated at a rate of approximately 1% of the plans in force at the beginning of each fiscal year (column 9).

Of 74,818 stock bonus, profit sharing, pension, and annuity plans reported to the IRS and qualified by June 30, 1961, 4,519 had terminated, or about 6% of all plans prior to or after October, 1942. Of the total cumulative balance qualified since 1942, cumulative terminations at the end of each year to the balance of plans in force at the beginning of each year have equaled a rather stable 7.3%.

2. While the number of terminations has been increasing steadily (column 2), their rate of growth is less than half of that experienced by the cumulative balance of welfare plans in force.

Reference to columns 10 and 11 provides a comparison of these

rates of increase by means of an index where the average period totals for July, 1947, to June, 1950, equals 100.

3. A ratio of terminations in any one year to new plans qualified in any one year is of help in recognizing the impact of business conditions on qualifications and terminations.

The ratio of terminations to original qualifications exaggerated the inverse relationship these can be expected to have in the business cycle. Presumably good business conditions would facilitate installations of this kind of employee benefit plan while poor business should precipitate termination of benefit programs by marginal firms. Such a ratio was calculated in column 8. The unusually high ratio of periods ending June 30, 1948-1950, could probably be explained by considering the large number of plans established during the years of World War II (October, 1942-June 30, 1947) followed by the difficulties of readjustment to peace-time production prior to the beginning of the Korean War. The generally good economic conditions from 1951 through 1953 produced the lowest number of terminations and the lowest ratio of terminations of .52 for the 1953-54 period. The dramatic jump in the ratio for the 1954-55 period presumably was related to the sharp down turn in production and profit levels experienced during this period. The ratio moved up a point during the 1958-59 recession and again in the 1960-61 slow down. Terminations in the latter period increased 29% over the previous year, but the ratio was much lower than it might have been because the number of plans qualified increased very significantly too, a factor not present in 1954-55 and related to union bargaining demands and

settlements in 1960.

4. Fluctuations in termination not only appear to vary inversely with business conditions but also to lag the index of cumulative plans in force (column 11) by roughly 6 to 7 years. This time lag has potential significance.

If it were assumed that 10% of all newly qualified plans would be terminated over a 7 year span in equal amounts each year following qualification, the hypothetical cumulative terminations charted on Table 2 can be derived. This assumed rate of termination received some statistical support, as suggested by the following paragraphs.

Noteworthy correlation was achieved between this projection and the actual IRS termination figures for the years 1955 through 1959; the projection always underestimated the number of actual terminations (except in 1959, one of the better business years in recent times), a failure which might be explained by termination of plans formed prior to 1947 and thus excluded from the tabulation or attributed to qualification of terminated plans which did not seek initial qualification. Only in 1954 and 1960 were the model projection figures significantly understated, however. In 1954 terminations were at an abnormally high level, as indicated by the ratio of terminations to newly qualified plans discussed earlier. Again in 1960-61 the ratio of terminations was unusually high, a ratio partly attributable to unusually high mortality among profit sharing plans.

5. Therefore it may be possible to infer from this hypothetical projection of terminations compared to actual IRS figures that there may be a normal attrition of all qualified welfare plans of about 10% within 7 years of qualification.

TABLE 2

HYPOTHETICAL PROJECTION OF IRS DETERMINATION LETTERS FOR QUALIFIED TERMINATIONS ASSUMING 10% OF ORIGINALLY QUALIFIED PLANS TERMINATED WITHIN 7 YEARS IN EQUAL ANNUAL INCREMENTS AND ASSUMING ACTUAL REPORTED IRS INITIAL PLAN QUALIFICATIONS FOR YEARS INDICATED

| | 1948 | 1949 | 1950 | 1951 | 1952 | 1953 | 1954 | 1955 | 1956 | 1957 | 1958 | 1959 | 1960 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1947 | 16.2 | 16.2 | 16.2 | 16.2 | 16.2 | 16.2 | 16.2 | | | | | | |
| 1948 | | 16 | 16 | 16 | 16 | 16 | 16 | 16 | | | | | |
| 1949 | | | 14.8 | 14.8 | 14.8 | 14.8 | 14.8 | 14.8 | 14.8 | | | | |
| 1950 | | | | 27.1 | 27.1 | 27.1 | 27.1 | 27.1 | 27.1 | 27.1 | | | |
| 1951 | | | | | 35.6 | 35.6 | 35.6 | 35.6 | 35.6 | 35.6 | 35.6 | | |
| 1952 | | | | | | 54 | 54 | 54 | 54 | 54 | 54 | 54 | |
| 1953 | | | | | | | 58.2 | 58.2 | 58.2 | 58.2 | 58.2 | 58.2 | 58.2 |
| 1954 | | | | | | | | 52.7 | 52.7 | 52.7 | 52.7 | 52.7 | 52.7 |
| 1955 | | | | | | | | | 63.1 | 63.1 | 63.1 | 63.1 | 63.1 |
| 1956 | | | | | | | | | | 86.3 | 86.3 | 86.3 | 86.3 |
| 1957 | | | | | | | | | | | 98.1 | 98.1 | 98.1 |
| 1958 | | | | | | | | | | | | 99.4 | 99.4 |
| 1959 | | | | | | | | | | | | | 124.8 |
| | | | | | | | 222 | 259 | 306 | 377 | 448 | 512 | 583 |
| Actual Internal Revenue Service Figures ---------- | | | | | | | -336 | -279 | -308 | -388 | -459 | -500 | -643 |
| Deviation of hypothetical termination from actual IRS experience ---------- | | | | | | | -114 | - 20 | - 2 | - 11 | - 11 | 12 | - 60 |

Moreover, it would seem logical that years of adverse business conditions would produce sudden, abnormal increases in termination experience. The timing and magnitude of this increase would be as unpredictable as the business cycle which gave rise to the fluctuations; the increase has ranged between 30-50% of the previous normal year termination figure, but this estimate is too crude to be of much value for projection. Nevertheless, it would seem that the basic model could be of use in projecting terminations one year in advance, and perhaps further if there were reliable estimates of the number of plans to be qualified in any one year. Such speculative projection has been deferred to a later section of this chapter; the assumption was brought forward here to facilitate analysis of the meager data released by the IRS.

Unfortunately, the above discussion dealt with a wide assortment of welfare plans and not exclusively with pensions, the specific concern here. Table 3 has provided a breakout of profit sharing and pension plans as they were originally qualified or terminated since the first quarter of 1955. Unfortunately, the IRS did not provide a cumulative total of each kind of plan in force to which the new plans were added, beginning in the third quarter of 1955. Hence, one cannot say what per cent of the cumulative total of profit sharing or pension plans in force were terminated over time or in any one year.

6. The annual average of plans terminated to those qualified (columns 7 and 8) indicated there were somewhat more pension plans than profit sharing plans terminated each year in relation to new plans started.

TABLE 3

FREQUENCY OF PROFIT SHARING AND PENSION TERMINATIONS
AS INDICATED BY DETERMINATION LETTERS ISSUED BY
THE INTERNAL REVENUE SERVICE IN QUARTERLY REPORTS
FROM ITS STATISTICS DIVISION

Source: Assembled from quarterly reports on file in the library of the IRS Statistics Division

| Year | Quarter | Profit Sharing Plans: Orig. Qualification | Profit Sharing Plans: Termination | Net | Pension & Annuity Plans: Orig. Qualification | Pension & Annuity Plans: Termination | Net | Profit Shar. Ter. As % of Those Qualified | Pen. Term As % of Qualified | Profit Sharing Grow. Index Quart. 1956 Ave. = 100 | Pen. & Annuity Growth Index 1956 Quarterly Average = 100 | Prof. Shar. Term. Index 1956 Quarterly Average = 100 | Pen. & Annuity Ter. Index 1956 Quart. Ave. = 100 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1955 | 1 | | | | | | | | | | | | |
| | 2 | | | | | | | | | | | | |
| | 3 | 295 | 27 | 268 | 608 | 29 | 579 | 9.15 | 4.77 | 57.4 | 76.6 | 94.4 | 60.4 |
| | 4 | 360 | 25 | 335 | 627 | 47 | 580 | 6.94 | 7.50 | 70.0 | 79.0 | 69.2 | 97.9 |
| | Total | 655 | 52 | 603 | 1235 | 76 | 1159 | 7.93 | 6.15 | | | | |
| 1956 | 1 | 498 | 22 | 476 | 819 | 51 | 768 | 4.41 | 6.23 | 96.9 | 103.1 | 78.6 | 106.3 |
| | 2 | 426 | 39 | 387 | 770 | 39 | 731 | 9.15 | 5.06 | 82.9 | 97 | 139.9 | 81.3 |
| | 3 | 496 | 16 | 480 | 725 | 50 | 675 | 3.23 | 6.90 | 96.5 | 91.5 | 57.1 | 104.2 |
| | 4 | 635 | 33 | 602 | 861 | 52 | 809 | 5.20 | 6.04 | 123.5 | 108.4 | 117.9 | 108.3 |
| | Total | 2055 | 110 | 1945 | 3175 | 192 | 2983 | 5.35 | 6.05 | | | | |
| 1957 | 1 | 746 | 35 | 711 | 979 | 44 | 935 | 4.70 | 4.50 | 145.1 | 123.3 | 125.0 | 91.7 |
| | 2 | 673 | 42 | 630 | 918 | 35 | 883 | 6.23 | 3.81 | 130.7 | 115.6 | 150.0 | 72.9 |
| | 3 | 733 | 41 | 692 | 765 | 54 | 711 | 5.60 | 7.06 | 142.6 | 96.5 | 144.4 | 112.5 |
| | 4 | 734 | 53 | 681 | 865 | 47 | 818 | 7.22 | 5.43 | 142.8 | 108.9 | 189.3 | 97.9 |
| | Total | 2885 | 171 | 2714 | 3527 | 180 | 3347 | 5.92 | 5.10 | | | | |
| 1958 | 1 | 836 | 31 | 805 | 1083 | 53 | 1030 | 3.70 | 4.90 | 162.6 | 136.4 | 110.7 | 110.4 |
| | 2 | 797 | 49 | 748 | 1044 | 60 | 984 | 6.14 | 5.74 | 155.1 | 131.5 | 175.0 | 125.0 |
| | 3 | 728 | 43 | 685 | 935 | 49 | 886 | 5.90 | 5.24 | 141.6 | 117.8 | 153.6 | 102.1 |
| | 4 | 701 | 56 | 645 | 821 | 62 | 759 | 8.00 | 7.35 | 136.4 | 103.4 | 200.0 | 129.2 |
| | Total | 3062 | 179 | 2883 | 3883 | 224 | 3659 | 5.84 | 5.77 | | | | |
| 1959 | 1 | 824 | 51 | 773 | 982 | 75 | 907 | 6.20 | 7.64 | 160.3 | 123.7 | 182.1 | 156.3 |
| | 2 | 844 | 54 | 790 | 1096 | 67 | 1029 | 6.40 | 6.11 | 164.2 | 138.0 | 192.9 | 139.6 |
| | 3 | 858 | 45 | 813 | 864 | 69 | 795 | 5.24 | 7.99 | 166.9 | 108.8 | 160.7 | 143.8 |
| | 4 | 870 | 50 | 820 | 882 | 59 | 823 | 5.74 | 6.67 | 169.3 | 111.1 | 178.6 | 122.9 |
| | Total | 3396 | 200 | 3196 | 3824 | 270 | 3554 | 6.00 | 7.06 | | | | |
| 1960 | 1 | 1328 | 60 | 1268 | 1184 | 70 | 1114 | 4.52 | 5.91 | 258.4 | 169.1 | 214.3 | 145.8 |
| | 2 | 1313 | 78 | 1235 | 1398 | 66 | 1332 | 5.94 | 4.72 | 255.4 | 176.1 | 278.6 | 137.5 |
| | 3 | 1179 | 48 | 1131 | 1322 | 78 | 1244 | 4.07 | 5.90 | 229.4 | 166.5 | 171.4 | 162.5 |
| | 4 | 1116 | 70 | 1046 | 1107 | 86 | 1021 | 6.27 | 7.77 | 217.1 | 139.4 | 250.0 | 179.2 |
| | Total | 4926 | 254 | 4680 | 5011 | 300 | 4711 | 5.19 | 5.99 | | | | |
| 1961 | 1 | 1252 | 74 | 1178 | 1387 | 96 | 1291 | 5.91 | 6.92 | 243.6 | 174.7 | 264.3 | 200.0 |
| | 2 | 1228 | 91 | 1137 | 1406 | 98 | 1308 | 7.41 | 6.98 | 238.9 | 177.1 | 325.0 | 204.2 |
| | 3 | 914 | 98 | 816 | 1112 | 93 | 1019 | 10.72 | 8.36 | 177.8 | 140.1 | 350.0 | 193.8 |
| | 4 | 1056 | 97 | 959 | 1014 | 87 | 927 | 9.19 | 8.58 | 205.4 | 127.7 | 346.4 | 181.3 |
| | Total | 4450 | 360 | 4090 | 4919 | 374 | 4545 | 8.09 | 7.60 | | | | |
| 1962 | 1 | 1357 | 85 | 1272 | 1342 | 97 | 1245 | 6.26 | 7.22 | 264.0 | 169.0 | 303.6 | 202.1 |

These conclusions were suggested by an index of growth and termination for each type of plan based on a 1956 quarterly average equal to 100. Since late 1956, profit sharing plans have been growing at a rate considerably in excess of the rate of increase in pension plans (columns 9 and 10). More significantly the index of terminations for both types of plans (columns 11 and 12) has been growing more rapidly than the index or rate of increase in the number of plans themselves. This phenomenon might be related to two factors. It has already been suggested that the number of terminations was a cumulative fraction of plans previously qualified so that a large number of qualifications up to seven years prior to the termination year under consideration would have an impact on the current termination figure. In short, it is a moving aggregate, and the components of this aggregate have been increasing in recent years. The cumulative aspect coupled with the probability that there was no direct cumulative relationship between plans qualified in one year and the number qualified in the next might explain why terminations have been growing at a more rapid rate.

7. An examination of the average number of employees participating in new pension plans qualified by the IRS as presented in Table 4 (columns 3 and 4) disclosed the average number of participants has fallen rather dramatically since 1955.

If such a drop meant that the larger firms, in terms of employment, were the first to have pension plans, the implication would be that the expansion of the private pension movement was now due to the smaller firm adopting this kind of fringe benefit program.

TABLE 4

AVERAGE NUMBER OF PARTICIPANTS IN NEW PLANS AS INDICATED BY INTERNAL REVENUE SERVICE QUARTERLY REPORT DATA

| | Emp. Participating in New Prof.-shar. Plans | Emp. Participating Under New Pension Plans* | | Ave. Participants in New Prof.-shar. Plans | Ave. Participating Under New Pension Plans |
|---|---|---|---|---|---|
| 1955 3 Qr. | 10,815 | 121,767 | | 37.0 | 2,002 |
| 4 Qr. | 19,006 | 186,218 | | 52.7 | 2,970 |
| | | | ½ yr. total | 44.9 | 2,486 |
| 1956 1 Qr. | 30,326 | 93,836 | | 68.8 | 1,146 |
| 2 Qr. | 27,323 | 129,589 | | 64.1 | 1,682 |
| 3 Qr. | 38,761 | 83,579 | | 78.1 | 1,180 |
| 4 Qr. | 44,569 | 245,027 | | 61.0 | 2,846 |
| | | | Yr. total | 67.5 | 1,713 |
| 1957 1 Qr. | 29,608 | 151,612 | | 39.7 | 1,549 |
| 2 Qr. | 32,700 | 102,178 | | 48.6 | 1,125 |
| 3 Qr. | 56,018 | 81,677 | | 76.4 | 1,086 |
| 4 Qr. | 38,031 | 188,400 | | 51.8 | 2,170 |
| | | | Yr. total | 54.3 | 1,478 |
| 1958 1 Qr. | 35,319 | 120,535 | | 42.2 | 1,113 |
| 2 Qr. | 24,919 | 205,220 | | 31.2 | 1,966 |
| 3 Qr. | 27,108 | 123,069 | | 37.2 | 1,316 |
| 4 Qr. | 267,878 | 109,216 | | 38.2 | 1,330 |
| | | | Yr. total | 37.3 | 1,431 |
| 1959 1 Qr. | 29,333 | 95,008 | | 35.5 | 967 |
| 2 Qr. | 37,378 | 121,032 | | 44.2 | 1,104 |
| 3 Qr. | 36,791 | 72,622 | | 42.8 | 840 |
| 4 Qr. | 38,125 | 112,231 | | 43.8 | 1,272 |
| | | | Yr. total | 41.5 | 1,045 |

TABLE 4 (Continued)

| | | Emp. Participating in New Prof.-shar. Plans | Emp. Participating Under New Pension Plans[a] | | Ave. Participants in New Prof.-shar. Plans | Ave. Participating Under New Pension Plans |
|---|---|---|---|---|---|---|
| 1960 | 1 Qr. | 62,749 | 199,529 | | 47.2 | 1,685 |
| | 2 Qr. | 52,795 | 206,859 | | 40.2 | 1,479 |
| | 3 Qr. | 52,255 | 252,818 | | 44.3 | 1,912 |
| | 4 Qr. | 66,681 | 134,836 | | 59.8 | 1,218 |
| | | | | Yr. total | 48.0 | 1,573 |
| 1961 | 1 Qr. | 140,005 | 140,520 | | 111.8 | 1,013 |
| | 2 Qr. | 35,545 | 120,675 | | 28.9 | 858 |
| | 3 Qr. | 38,920 | 98,971 | | 42.5 | 890 |
| | 4 Qr. | 36,245 | 146,739 | | 34.3 | 1,447 |
| | | | | Yr. total | 54.5 | 1,052 |
| 1962 | 1 Qr. | 29,104 | 97,702 | | 21.4 | 728 |

[a]Source: Internal Revenue Service quarterly release on determination letters.

Presumably the smaller firm should be more vulnerable to failure, merger, or other shifts in business fortune which could lead to pension termination; as less substantial companies join the pension movement, therefore, there might be a tendency for pension terminations to rise.

8. That termination increases as the size of the employer declines has also been implied by the termination experience of profit-sharing plans.

While there have been fewer profit sharing plans in existence than pension plans, the number of profit-sharing plans terminated has risen to a point almost equal to the mortality experience of pensions. Since the average number of participants in a profit-sharing plan has been so much smaller than is true of the pension plan, it might follow that the business sponsor was generally smaller than that of a pension, and hence, more subject to decline or failure. On the other hand, the small number of participants would also reflect the application of profit sharing to selected groups with managerial responsibility in the larger firm. The degree to which these opposite situations are combined in published figures has not been indicated so that more positive conclusions have not been made. Nevertheless, in general, profit-sharing plans have been thought to be more subject to termination because of disillusionment when profits first declined and prompted termination in response to adverse conditions. A pension plan would probably continue to operate for several unprofitable years until the business prognosis required that this financial burden be eliminated.

9. Analysis of the IRS data above has been rather limited by both the accuracy of the data and the depth of content.

As a measure of terminations IRS data are incomplete. The law has not required a firm to submit a plan for tax qualification approval either at its initiation or termination, so that it has been impossible to state exactly how many plans are in existence or the relationship of qualified terminations to the net figure of plans in existence. Further, it has not been necessary that qualified plans be reported as terminated in a qualified manner in the same time period that actual business operations were reduced or came to a halt, as the windup of business affairs might be prolonged. In rare instances, in the opinion of one IRS official interviewed, the termination might not be reported at all because the dissolution of the pension plan would be highly discriminatory in favor of those who control the business enterprise, thus sure to sacrifice past tax exemptions if brought to IRS attention.[2]

Finally, it should be recalled that IRS statistics have treated

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[2]For example, if a company reduced operations and staff to a minimum level, the attrition in employment would rapidly reduce the non-vested actuarial liability of the pension plan while leaving pension assets unaffected. The funding ratio of benefits to those remaining would soar conceivably to a point above 100 per cent. Should a distribution be undetected for three years, the pension plan tax status would be protected and the termination validated by the statute of limitations on tax recovery and litigation. Trust officers, actuaries, and attorneys interviewed maintained that their position would not permit them to render services supporting such an effort to subvert the tax law. Corporate trusts must report terminations to state and Federal tax agencies, so that it would appear logical that if there were an attempt to execute an unqualified termination, it would probably be the work of a personal trustee.

only actual pension terminations. They have not reported cases where plant closing or work force reduction has meant loss of pension expectations for those who were left unemployed. On the other hand, the IRS termination total included partial terminations in which a good portion of the work force remained covered under the surviving insurance program. Therefore, IRS figures represented an unknown portion of the universe of situations where pension expectations have been terminated. The second failure of IRS data has been the failure of arithmetic counts to provide any real depth of research content. This failing will be highlighted in the following section and the topic of a special sub-section of this chapter.

C. The Causes of Pension Termination

The significance of the frequency of termination for the purposes of studying pension termination due to business failure, liquidation, or migration depends on knowing what proportion of gross terminations could be attributed to the causes under study. To this point the statistics division of IRS once did a sample study of the reasons for termination put forward in 99 letters requesting qualification of termination in the fall months of 1957, and this short study appears in Table 5. While the pattern of business necessity for business termination could have changed in the intervening 5 years since publication of the IRS study, the figures were still of interest. Of 99 terminations, 51 were of pension plans. Of these, 26, or 51%, took place for reasons which infer loss of employment opportunity and a good part of the pension expectations of the

TABLE 5

NUMBER OF TERMINATIONS OF PENSION AND DEFERRED PROFIT SHARING PLANS IN SEPTEMBER, OCTOBER AND NOVEMBER, 1957 GROUPED BY REASON FOR TERMINATION

| Reason for Termination | Total | Pension Plans | Profit-sharing Plans |
|---|---|---|---|
| Merger | 25 | 14 | 11 |
| Sale of company | 14 | 8 | 6 |
| Financial difficulties | 19 | 13 | 6 |
| Corporation dissolved | 20 | 5 | 15 |
| Death of employer | 1 | 0 | 1 |
| Automatic termination | 1 | 0 | 1 |
| Lack of employee participation | 3 | 1 | 2 |
| Establishment of new plan | | | |
| collective bargaining | 1 | 1 | 0 |
| non-collective bargaining | 1 | 1 | 0 |
| Change to cash-bonus | 3 | 0 | 3 |
| Change to a profit-sharing plan | 8 | 5 | 3 |
| Substitution of a salary increase | 1 | 1 | 0 |
| Loss of bargaining rights by the union participating | 1 | 1 | 0 |
| By agreement with union | 1 | 1 | 0 |
| Total | 99 | 51 | 48 |

Source: Statistics Division, Internal Revenue Service.

work force. Reference was made specifically to financial difficulties (13), corporate dissolution (5), and sale of the company (8). In the latter case sale might still permit continuity of employment, but situations where this would be the case have been offset by excluding all termination due to merger, assuming integration of employee participants of one firm with the pension program of the second. Terminations of profit-sharing plans for these same reasons, together with the death of the employer, totaled 28 of the 48 plans surveyed, or about 58%, somewhat higher as might be expected for reasons previously noted.

The only other comprehensive study of the reason for termination was done several years prior to the IRS study by the Banking Department of New York State,[3] and a summary and explanation of this study appears in Table 6.

The State of Wisconsin has also required financial and actuarial disclosure of all funded welfare plans benefiting employees who work in Wisconsin. A review of the Wisconsin files by the author revealed a total of 85 registered welfare plans had been terminated in the period 1957-61, the years in which disclosure was required. However, 30 so-called terminations of all welfare plans were of

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[3]New York State Banking Department, Pension and Other Employee Welfare Plans, New York, 1955, Table 8. The significance of the New York report is highlighted by the fact that in September, 1955, New York banks held $7.5 billion pension trust fund assets, almost 60% of all such trusteed funds in the United States. Only 15.21% of the covered employees worked in New York State for the 1,024 plans in operation. Extensive reference will be made to this study in following sub-sections.

TABLE 6

NUMBER OF PENSION AND DEFERRED PROFIT-SHARING PLANS TERMINATED AMONG PLANS WHOSE FUNDS WERE HELD IN STATE AND NATIONAL BANKS IN NEW YORK STATE, 1936, TO DECEMBER 1, 1954 CLASSIFIED BY REASON FOR TERMINATION

| Reason for Termination | Total | Pension Plans | Profit-sharing Plans |
|---|---|---|---|
| Discontinuance of business | 25 | 19 | 6 |
| Adverse business conditions | 33 | 32 | 1 |
| Change in operations | 4 | 1 | 3 |
| Change in ownership | 5 | 4 | 1 |
| Merger | 4 | 2 | 2 |
| Purpose of plan accomplished | 3 | 1 | 2 |
| Failure to accomplish purpose | 2 | 2 | 0 |
| Employees absorbed by new plan | 7 | 4 | 3 |
| Failure to meet internal revenue requirements | 7 | 5 | 2 |
| Court order | 1 | 1 | 0 |
| Participants withdrew | 1 | 1 | 0 |
| No reason given | 5 | 5 | 0 |
| Total | 97 | 77 | 20 |

Source: New York State, Banking Department, Pension and Other Employee Welfare Plans, 1955, p. 8.

filings which were found on review not to fall under the recording requirements of the Wisconsin law. Of 45 pension plans terminated in Wisconsin, 15 were terminated when the Wisconsin insurance department found annual contributions, number of employees, or lack of any fund outside of insurance policies exempted the plan from compliance with Wisconsin disclosure statutes. Of the remaining 30 pension plans, 15 were found to have been terminated because of business failure, liquidation, or migration.

On the basis of such sample evidence, the IRS experience, the older New York report, and the Wisconsin file, it can be inferred for discussion purposes in this study that at least one-half of all pension terminations[4] have been occasioned by circumstances which brought an end to employee pension expectations, and quite possibly to employment of participants in the defunct plan.

Again it must be pointed out that this assumption applies only

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[4] Other causes of pension termination or curtailment would include:

1. Unsound features or structural faults.
2. Mergers, consolidations, reorganizations, change in ownership and control of companies.
3. Financial difficulties of companies.
4. Change to profit-sharing plan.
5. Union pressures.
6. Employees prefer wage increases rather than deferred payments.
7. Extension of Federal Social Security Act.
8. Inadequate communication of program, lack of educational effort to create understanding and appreciation by employees.
9. Improper climate for plan: (a) inadequate consideration of psychological factors, (b) failure as group incentive, (c) inadequate replacement for low wage structure, and (d) improper use of plan to solve other management problems.

to actual plan termination. All these sources have ignored the problem of plant shutdown or migration for the multi-plant firm whose company-wide plan is untouched by the closing of a single plant, department, or a substantial part thereof.

D. The Unavailability of Federal Research Material

1. The real impact of pension termination and its cause ought to be measured by the scale of each termination in terms of the number of employees affected and the proportion of expected benefits actually realized by each participant.

On these crucial points Federal government information has been unavailable, and a short diversion from the main line of discussion in this chapter to this intelligence gap is appropriate. Data from government sources perhaps could be made available from either the Welfare and Pension Report Division of the Department of Labor Standards or from the Statistics and Records Division of the Internal Revenue Service. The records of the former[5] are public information, and so to protect the private affairs of those who must file reports, as well as the interests of pension plan participants, Congress has defined very carefully what kinds of information might be sought. None of the disclosure form questions have been directed specifically to the termination situation. While a pension sponsor must file a final report for the year of termination, it need only report its assets distributed and the plan dissolved.

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[5]The Welfare and Pension Plans Disclosure Act, P.L. 85-836, 72 Stat. 997 as amended March 20, 1962, by P.L. 87-420.

2. Attorneys and actuaries or others who file disclosure reports have appeared to be at a loss as to how much information to furnish on the termination case.

To spotcheck what is actually done, the author drew fifteen known termination cases from the files of the Welfare-Pension Report Division of the Labor Department. Since the disclosure procedure required that only one case could be read at a time, the number was limited to fifteen when it became obvious that few of the files contained any information specifically related to the cause and terms of the plan termination. One case included a carbon of the letter sent the IRS seeking tax qualification of the termination. Three reports briefly described the distribution under questions B-2.[6] The majority reported only the balance sheet values of the plan as of the date of the report without detail as to the impending termination. It was concluded by all concerned[7] that these records were of little value for this terminations study.

3. The IRS could furnish far more information on pension termination than it does from existing files without violation of personal privilege.

The IRS was not at fault, however; the desired information was generally scattered in its field office files across the country and a limited research budget has prevented collection and study of this non-centralized information. Moreover, some of the information

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[6]See Appendix II.

[7]Frank W. Kuehl, Chief of Welfare and Pension Report Division of Department of Labor Standards; E. Keith Rowe, Assistant Division Chief; U. J. Colan, Chief Branch of Inquiry and Disclosure.

available was considered confidential and it would be illegal for the IRS to make this information available to private researchers.[8] However, this information need not be lost. Consider the nature of the data and the ease with which information regarding personal income could be removed and protected.

A request for a determination of the tax effects of a proposed termination or curtailment of a qualified plan must be accompanied by full explanation of the reasons for and the results of the termination plan. The IRS has required the employer to furnish full information on the following items:[9]

1. Date of actual or proposed action.
2. Statement of reasons and circumstances relative to action.
3. Tabulation in columnar form showing certain information about each of the 25 highest paid employees under the plan.
4. Schedule showing for each year of the plan's operation, the number of employees participating and changes in this number during the year.
5. Statement as to whether any funds under the plan will revert or become available to the employer; if so, details are to be furnished.
6. Full particulars as to any funds under the plan which at any time were contributed in the form of, or invested in, obligations, or property of the employer or related companies.

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[8]From an interview with John Hurley, Assistant Chief of IRS Pension Department, reaffirmed by letter from William H. Smith, Assistant Commissioner of Planning and Research.

[9]Specified in Exhibit "A" of Revenue Procedure 56-12, as reported on page 4533 of <u>Pension and Profit-Sharing Report</u>, <u>op. cit</u>.

The date of the termination from Item 1 when combined with the date of original qualification would provide information on the age of a pension plan at the time it was dissolved. A distribution of the reasons and circumstances relative to termination in Item 2 for each quarter would provide a direct insight into the impact of business conditions, labor negotiations, and employment levels on the strength of the pension movement. This information could be available quickly and in time to be useful. It would identify current threats to pension expectations and so simplify the selection of whatever courses of action might reduce the consequences to pension expectations. The information on personal income contained in Item 3 is the specific information which makes the entire contents of the letter restricted information is relevant only where the problems anticipated by Mimeo 5717 appear. Information furnished the IRS in the termination letter of particular value to pension termination study would be the data the IRS has collected for Items 4, 5, and 6 above.

The employer has been required to show in Item 4, for each year of the plan's operation not exceeding five prior to termination, the number of employees participating and changes in this number during the year. A typical tabulation might look like the actual case presented in Tables 7a and 7b. Table 7a demonstrates both labor turnover and attrition of employment prior to closing a foundry. Presumably a good number of the employees lost their interest,[10]

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[10]Placed on layoff for lack of work, their pension expectations would be lost when continuity of service rights during layoff expired or they accepted work with another employer, assuming benefits did not vest until retirement.

TABLE 7a

X, Y, Z COMPANY

SCHEDULE OF PARTICIPANTS IN THE PLAN IN ACCORDANCE WITH PARAGRAPH (4) OF EXHIBIT "A" OF REV. PROC. 56-12

| | 1951 | 1952 | 1953 | 1954 | 1955 |
|---|---|---|---|---|---|
| (a) Number of participants at the beginning of the plan year | 451 | 499 | 477 | 434 | 406 |
| (b) Number of participants added during the plan year | 114 | 348 | 380 | 139 | 2 |
| (c) Number of participants who dropped out during the plan year | 66 | 370 | 423 | 167 | 223 |
| (d) Number of participants remaining at the end of the plan year | 499 | 477 | 434 | 406 | 185 |

TABLE 7b

SCHEDULE INDICATING THE NUMBER OF EMPLOYEES COVERED BY THE PLAN AS OFTEN SUMMARIZED BY TYPICAL LETTER REQUESTING QUALIFIED TERMINATION APPROVAL FROM INTERNAL REVENUE SERVICE

| | Non-retired With Seniority | Retired | Vested |
|---|---|---|---|
| 10/1/55 | 352 | 5 | - |
| 10/1/56 | 329 | 9 | 4 |
| 10/1/57 | 286 | 15 | 5 |
| 10/1/58 | 280 | 21 | 7 |
| 10/1/59 | 272 | 23 | 10 |
| 10/1/60 | 265 | 22 | 14 |

Taken from 1959 Case Furnished for this Study by an Actuarial Consultant.

nebulous as it might have been, before it was decided to close operations and terminate the pension plan. The exact pension interest would depend on labor and pension contract provisions for seniority status during layoff and provisions for vesting, early retirement, and so on, considerations all to be discussed in more detail later. Table 7b illustrates how the kind of information in Table 7a was often summarized by those who contributed case examples for this study. Incidentally, the disparity between vested beneficiaries and non-retired beneficiaries could be indicative of the far greater significance of pension expectations as opposed to pension rights.

The possible reversion of funds to the employer following termination and distribution of termination fund assets to be recorded in Item 5 generally has received a negative answer. Where there was a surplus, what the profession calls the product of actuarial error, the circumstances of the error could be of great interest to the student of pension problems. Actuarial error could indicate cautious actuarial assumptions but it might also indicate that sharp attrition of employment had reduced actuarial liabilities in relation to assets even though the bulk of pension expectations have been destroyed. Such controlled attrition has always been possible where the employment contract has not made adequate provision for the effect of layoff on the privileges of service continuity. Such a surplus might also indicate superior investment results or acceleration of the funding process. In any event, it could act as a notice to the analyst that a particular plan was worthy of further study. Item 6 provides a view of the more unusual case where the pension fund has made

investments in the securities of the company sponsor. In relation to the pension situation it might reveal the frequency with which overdue contributions were recognized with a company note and the extent to which this note had a preferred credit position.

Undoubtedly there would be many research applications of data found in Items 1, 2, 4, 5, and 6 and perhaps an additional question or two might be suggested. But at this point it is only important to inquire why this kind of information, from files already in existence, could not be developed. These files could not be assembled by private research teams; nor could it be expected that the IRS staff analyze the available information on the present budget when the findings would not be likely to contribute to the collection of tax money. To increase the budget for basic research by IRS staff members would require Congressional interest. There are a number of sub-committees which have had an interest in the pension and welfare fund area. At the request of such a committee and with budget recognition of the cost of collecting information from decentralized files, the IRS could provide more adequate reporting of termination facts and figures. This suggestion was put forward in an interview with Counsel for the House Committee on Labor, Education, and Welfare,[11] which was responsible for achieving amendment of the Welfare-Pension Plans Disclosure Act.[12]

The opinion expressed in this quarter was that it had been

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[11]Mr. Howard Genzer, in an interview at his Washington office in April, 1962.

[12]Public Law 87-420 87th Congress, H.R. 8723, March 20, 1962.

extremely difficult to find significant cases of abuse of pension responsibilities or aggregate data which would support legislation affecting all plans, which in general were well and fairly administered and entitled to freedom from unnecessary administrative expense. It was pointed out that the Committee was of the opinion that the employees' rights in pensions were basically those which they had bargained for and that the committee was not interested in unnecessary legislation or laws which curbed the freedom to bargain. Since revision of the Disclosure Act has been accomplished and it would be several years before experience might justify further improvement, the Committee and its counsel were directing their efforts to other fields.

4. The inescapable conclusion was that there has been no Congressional interest in the kind of information on pensions which the IRS could assemble without breach of trust to the taxpayer. The IRS has had no incentive to perform basic research without inquiry from the Congress, and the result has been that the only reservoir of national information on pension termination must remain in limbo.

As an alternative to extensive review of past history, the IRS might revise procedures through which district offices report termination data to the division of Statistics and Reports so that future experience might be more precisely defined.

The inaccessibility of this vein of research carries several implications for this study. First, basic information must be assembled from incomplete and somewhat inconsistent data; second, attempts to measure the frequency and severity of the termination of pension expectations will be speculative at best and, therefore, need

be most conservative to be valid estimates; third, a secondary objective of this study might be to determine whether the incidence of termination experience and severity of the consequences have been of great enough significance to argue for greater research interest and to alert interested members of the Congress to the need.

## E. Incidence and Severity of Pension Plan Termination

The only major study of Welfare Fund statistics with some attention given to frequency and consequence of termination of pensions was an extensive and detailed survey of pension, deferred profit sharing, thrift, and other employee welfare funds held by state and national banks in New York State. The study was undertaken in the spring of 1954 by the New York State Banking Department under the direction of George A. Mooney. A preliminary report consisting of 136 tables compiled from a general questionnaire was published December 30, 1955. Of the 2,560 funds with almost $7.5 billion in assets at the end of September, 1955, 1,024 funds were pension trusts. The number and location of employees covered by these trusts has been summarized in Table 8. A distribution by size of fund has been presented in Table 9; more than 97.3% of these funds were concentrated in 13 banks, while the other 2.7% were spread out among 78 banks.[13]

1. The smallest and weakest companies and pension funds were subject to termination, and it is a fair presumption that the cause was generally business failure or liquidation

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[13]New York Department of Banking, Pension and Other Employee Welfare Plans, p. x, op. cit.

TABLE 8

NUMBER AND LOCATION OF EMPLOYEES COVERED BY PLANS INCLUDED
IN NEW YORK DEPARTMENT OF BANKING STUDY

| | No. of Funds | Covered Employees Working in: New York | Elsewhere | Total | Assets Book Value (-000-Omitted)[a] |
|---|---|---|---|---|---|
| "New York" plans | 649[b] | 553,080 | 2,014,335 | 2,620,143 | $3,163,310 |
| Non-"New York" plans | 375 | 12,311[c] | 1,024,200 | 1,036,511 | 1,731,232 |
| Total | 1,024 | 566,181[d] | 3,038,535 | 3,656,654[e] | $4,894,542 |

[a]Asset figures are for the last fiscal year of the reporting trustee. For the most part (83 per cent), this reflects the condition of the several trusts as of the end of 1953.

[b]Consists of 643 plans.

[c]Includes 6 plans with a total of 11,057 covered employees working in New York. Since each of the employers has more than twenty employees working in New York, these plans would normally be considered "New York" plans. However, in each of them only partial questionnaires were filed (Part III only) and for convenience of tabulation, the plans were classified with Non-"New York" plans.

[d]It will be noted that only 15.21 per cent of the covered employees work in New York State.

[e]The place of employment of 61,938 employees was not given.

Source: New York, Department of Banking, Pension and Other Employee Welfare Plans, p. x, *op. cit.*

TABLE 9

DISTRIBUTION OF FUNDS ACCORDING TO SIZE FOR PLANS INCLUDED IN NEW YORK DEPARTMENT OF BANKING STUDY

| | | Size of Funds | |
|---|---|---|---|
| Size of Fund (-000-Omitted) | No. of Funds | Assets Book Value (-000-Omitted) | % of Total |
| $0 - 99 | 279 | $ 12,022 | .25% |
| 100 - 499 | 252 | 61,843 | 1.26 |
| 500 - 999 | 124 | 90,754 | 1.85 |
| 1,000 - 4,999 | 221 | 504,219 | 10.30 |
| 5,000 - 9,999 | 58 | 392,272 | 8.02 |
| 10,000 - 24,999 | 50 | 843,511 | 17.23 |
| 25,000 and over | 40 | 2,989,921 | 61.09 |
| Total | 1,024 | $4,894,542 | 100.00% |

Source: New York, Department of Banking, Pension and Other Employee Welfare Plans, p. x, op. cit.

in some form.

The New York study provides the first glimpse of the number of employees affected by pension termination and the age of pension plans at their demise. Reference to Table 10 reveals a very significant fact: while 77 terminations represent 7.35% of all the pension plans that were at one time or another in force between 1936 and 1954, the number of active employees who were affected by termination represented less than two-thirds of 1% of the number of active employees in 1954; only 70 retired workers were involved but no indication is given whether any lost their pension thereby. These terminated plans apparently represented 52/100 of 1% of the total reported book value assets of all pension funds.

For example, the distribution in Table 10 indicates the number of plans terminated each year increased to 1950, the year which marked the end of the postwar economic decline, and then reached another low in 1954, the last year of the study; note the number of active members averaged between 10 and 60 per plan terminated each year and at no time exceeded 200 participants in any one plan. Unfortunately the figures did not indicate whether the retired members were receiving pensions from an insured plan or directly from the pension trust, and if so, whether it was necessary to curtail benefits for any of these retired members. The information in Table 12 on the distribution gave no indication of who received priority claim on assets distributed; generally, however, pension plan distribution clauses gave preference to retired members, who appeared adequately covered by book value assets in 1949, 1951, 1953, and 1954. What has not been learned is the

TABLE 10

PENSION PLANS TERMINATED[a]--1936 TO DECEMBER 1, 1954[b]
DISTRIBUTION ACCORDING TO DATE OF TERMINATION

Pension Trust Plans

| Year of Termination | No. of Plans | Number of Members Active | Retired | Assets Book Value[c] (-000-Omitted) |
|---|---|---|---|---|
| 1936-1943 | - | - | - | $ - |
| 1944 | 2 | 49 | - | - |
| 1945 | 8 | 87 | - | 6 |
| 1946 | 5 | 94 | - | 1 |
| 1947 | 7 | 450 | - | 159 |
| 1948 | 7 | 339 | - | 150 |
| 1949 | 9 | 268 | 4 | 483 |
| 1950 | 10 | 339 | - | 165 |
| 1951 | 9 | 284 | 42 | 691 |
| 1952 | 7 | 204 | - | 80 |
| 1953 | 7 | 134 | 13 | 294 |
| 1954 | 6 | 187 | 11 | 539 |
| Total | 77 | 2,435[d] | 70 | $2,568 |

[a]Mere substitution of a trustee or agent is not considered a termination for purposes of this table.

[b]Information regarding termination of plans was requested in the form of a "General Questionnaire" which each bank was asked to submit. Of the 97 banks which submitted such questionnaire (these were all the banks in the state which were handling employee welfare plans of any type), 26 reported that they had acted for a total of 111 plans which had been terminated during the period, from 1936 to date. Of the banks so reporting, 10, which reported an aggregate of 78 terminations, are among the group of 13 largest banks in which a major portion of the business is concentrated. The remaining 16 banks reported an aggregate of 33 terminations. For distribution according to length of time plans were in existence, see Table 11. For summary of reasons for termination and disposition of assets on termination, see Table 12.

[c]Exclusive of insurance company contracts.

[d]This figure includes the aggregate number of active employees at date of termination in only 95 of the 111 reported terminations. Of the 16 plans which failed to indicate the number of their active employees at termination, 8 were pension trusts, 5 were profit-sharing plans and 3 were other types of plans. Of these 16, 9 had assets at termination totaling $231M. No information was received as to the other 7 which would furnish a clue as to their size at termination.

number of active members whose age or continuity of service led to strong expectations of a pension income and the degree to which these expectations were not satisfied by the funds at hand.

2. The early New York experience indicated about 2/3 of all welfare plans terminated were brought to a close within 6 years of their initiation while more than 80% were dissolved within 8 years of initiation.

The New York study also distributed terminations according to the age of the terminated plan and this material is the backbone of Table 11 covering all 111 terminations and not just pensions. This experience was not far astray from the hypothetical termination rate of 10% of plans initiated within 7 years discussed previously. A small amount of additional statistical evidence favored this hypothesis. Of the 66 case studies selected for use in this report, it was possible to determine the number of years the plan had been in existence at the date of termination in 42 files. This distribution (Table 13) indicated 80% of these cases involved plans less than 8 years old when terminated. The ages of the 15 Wisconsin pension plans terminated for reasons relevant to this study (Table 14) might not be as indicative as the other two samples given because of the small sample and because Wisconsin firms are somewhat conservative in their adoption of private pension plans;[14] nevertheless the distribution in Table 14 indicated more than two-thirds of the Wisconsin plans

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[14] A prominent Milwaukee attorney who tends to specialize in pensions stated few Milwaukee plans offered vesting prior to retirement; most plans use a combination of retirement income policies and a trust with an investment side fund.

TABLE 11

N.Y. PLANS TERMINATED--1936 TO DECEMBER 1, 1954[a]
DISTRIBUTION ACCORDING TO NUMBER OF YEARS THAT PLANS WERE IN EXISTENCE

| Years in Existence at Date of Terminations | No. of Plans | Cul. No. of Plans[b] | Cul. % of Term. Over Time[b] | Status at Termination: Number of Members Active | Status at Termination: Number of Members Retired | Status at Termination: Assets Book Value[c] (-000-Omitted) | Status at Termination: $/Active[b] |
|---|---|---|---|---|---|---|---|
| Less than 1 yr. | 7 | 7 | 6.3% | 18 | - | $ 8 | 444 |
| 1 yr.-less 2 yr. | 10 | 17 | 15.3 | 415 | 1 | 661 | 1,592 |
| 2 yr.-less 3 yr. | 16 | 33 | 29.7 | 192 | 8 | 285 | 1,484 |
| 3 yr.-less 4 yr. | 13 | 46 | 41.4 | 900 | - | 552 | .613 |
| 4 yr.-less 5 yr. | 20 | 66 | 59.4 | 610 | - | 523 | .857 |
| 5 yr.-less 6 yr. | 9 | 75 | 67.5 | 219 | 7 | 327 | 1,493 |
| 6 yr.-less 7 yr. | 9 | 84 | 75.6 | 499 | 19 | 704 | 1,410 |
| 7 yr.-less 8 yr. | 7 | 91 | 82.0 | 308 | - | 90 | .292 |
| 8 yr.-less 9 yr. | 7 | 98 | 88.2 | 188 | 11 | 199 | 1,058 |
| 9 yr.-less 10 yr. | 4 | 102 | 91.8 | 82 | - | 7 | .085 |
| 10 yr.-less 11 yr. | 3 | 105 | 94.5 | 100 | 42 | 516 | 5,160 |
| 11 yr.-less 12 yr. | 5 | 110 | 99.0 | 103 | 5 | 114 | 1,106 |
| 12 yr.-less 13 yr. | 1 | 111 | 100.0 | - | - | - | - |
| Total | 111 | | | 3,634[d] | 93[e] | $3,986[f] | |

[a]See Table 10 for distribution in more detail according to date of termination and Table 12 for summary of reasons for termination and disposition of assets on termination.

[b]Columns added by author for ease of comparison of data with other statistics to follow.

(continued)

TABLE 11 (Continued)

[c]Exclusive of insurance company contracts.

[d]This figure includes the aggregate number of active employees at date of termination in only 95 of the 111 reported terminations. Of the 16 plans which failed to indicate the number of their active employees at termination, 8 were pension trusts, 5 were profit sharing plans and 3 were other types of plans. Of these 16.9 had assets at termination totaling $231M. No information was received as to the other 7 which would furnish a clue as to their size at termination.

[e]This figure includes the aggregate number of retired employees at date of termination in only 82 of the 11 reported terminations. Of the 29 plans which failed to indicate the number of their retired employees at termination, 22 were pension trusts, 4 were profit sharing plans and 3 were other types of plans. Of these 29, 22 had assets at terminations totaling $199M. No information was received as to the other 7 which would furnish a clue as to their size at termination.

[f]This figure includes the aggregate assets at date of termination in only 104 of the 111 reported terminations. Two of the remaining 7 were pension trusts, 2 were profit sharing plans and 3 were other types of plans. No information as to them was received which would furnish a clue as to their size at termination.

Source: Pension and Other Employee Welfare Plans (A Survey of Funds Held by State and National Banks in New York State), Preliminary Report by George A. Mooney, Superintendent of Banks, State of New York, op. cit.

TABLE 12

PLANS TERMINATED--1936 TO DECEMBER 1, 1954--REASONS FOR TERMINATION AND DISPOSITION OF ASSETS[a]
NEW YORK BANKING STUDY EXPERIENCE

| | Pension Trust Plans | | Totals | | Number of Plans Distributing Assets Assets on Term, to: | | |
|---|---|---|---|---|---|---|---|
| Reasons for Termination | No. of Plans | Assets at Term. (-000-Omitted) | No. of Plans | Assets at Term. (-000-Omitted) | Participants | Company or Liquidator | No Assets |
| 1. Discontinuance of business | 19 | $1,436 | 26 | $2,000 | 25 | - | 1 |
| 2. Adverse business conditions | 32 | 522 | 37 | 619 | 36 | 1 | - |
| 3. Change in operations | 11 | 406 | 4 | 517 | 3 | - | 1 |
| 4. Change in ownership | 4 | 93 | 5 | 123 | 5 | - | - |
| 5. Merger or absorption of employer | 2 | 5 | 7 | 119 | 7 | - | - |
| 6. Purpose of plan accomplished | 1 | 2 | 4 | 14 | 4 | - | - |
| 7. Failure to accomplish purposes of plan | 2 | - | 2 | - | 2 | - | - |
| 8. Employees absorbed by new plan | 4 | 7 | 7 | 329 | 6 | 1 | - |
| 9. Failure to meet Internal Revenue Requirements | 5 | 6 | 10 | 204 | 4 | 3 | 3 |
| 10. Court order | 1 | 33 | 1 | 33 | - | 1 | - |

TABLE 12 (Continued)

| Reasons for Termination | Pension Trust Plans | | Totals | | Number of Plans Distributing Assets Assets on Term, to: | | |
|---|---|---|---|---|---|---|---|
| | No. of Plans | Assets at Term. (-000-Omitted) | No. of Plans | Assets at Term. (-000-Omitted) | Participants | Company or Liquidator | No Assets |
| 11. Union opposition | - | - | 1 | - | 1 | - | - |
| 12. Participants withdrew from plan | 1 | - | 1 | - | 1 | - | - |
| 13. No reason given | 5 | 28 | 6 | 28 | 3 | 1 | 2 |
| Total | 77 | $2,568 | 111 | $3,986 | 97 | 7 | 7 |

[a]See Table 10 for distribution in more detail according to date of termination, and Table 11 for distribution according to number of years plans were in existence.

Source: Pension and Other Employee Welfare Plans (A Survey of Funds Held by State and National Banks in New York State), Preliminary Report by George A. Mooney, Superintendent of Banks, State of New York, op. cit.

TABLE 13

AGE AND TIME SEQUENCE OF PENSION PLAN TERMINATIONS IN CASE FILES COLLECTED SPECIFICALLY FOR THIS DISSERTATION

| Years in Existence at Date of Termination | No. of Plans | Cumulative No. of Plans | Cumulative % of Terminations Over Time |
|---|---|---|---|
| 1 yr. - less - 1 yr. | 1 | 1 | 2.4% |
| 1 yr. - less - 2 yrs. | 1 | 2 | 4.8 |
| 2 yrs. - less - 3 yrs. | 5 | 7 | 12.5 |
| 3 yrs. - less - 4 yrs. | 9 | 16 | 38.0 |
| 4 yrs. - less - 5 yrs. | 4 | 20 | 47.6 |
| 5 yrs. - less - 6 yrs. | 5 | 25 | 59.5 |
| 6 yrs. - less - 7 yrs. | 2 | 27 | 64.3 |
| 7 yrs. - less - 8 yrs. | 6 | 33 | 78.6 |
| 8 yrs. - less - 9 yrs. | 2 | 35 | 83.3 |
| 9 yrs. - less - 10 yrs. | 0 | 35 | 83.3 |
| 10 yrs. - less - 11 yrs. | 0 | 35 | 83.3 |
| 11 yrs. - less - 12 yrs. | 1 | 36 | 85.6 |
| 12 yrs. - less - 13 yrs. | 0 | 36 | 85.6 |
| 13 yrs. - less - 14 yrs. | 1 | 37 | 88.1 |
| 14 yrs. - less - 15 yrs. | 2 | 39 | 92.9 |
| 15 yrs. - less - 16 yrs. | 1 | 40 | 95.2 |
| 16 yrs. - less - 17 yrs. | 2 | 42 | 100.0 |

Source: Case records collected by author. Age of plan was determinable in 42 of 66 cases.

TABLE 14

WISCONSIN PLANS TERMINATED--1957 TO DECEMBER 31, 1961--DISTRIBUTION ACCORDING TO NUMBER OF YEARS THAT PLANS WERE IN EXISTENCE

| Years in Existence at date of Terminations | No. of Plans | Cum. No. of Plans | Cum. % of Termin. Over Time | Number of Members Active | Number of Members Retired | Assets Book Value[a] (-000-omitted) | $/Active Employee |
|---|---|---|---|---|---|---|---|
| Less than 1 yr. | | | | | | | |
| 1 yr.--less 2 yr. | | | | | | | |
| 2 yr.--less 3 yr. | | | | | | | |
| 3 yr.--less 4 yr. | 1 | 1 | 8.33 | 13 | | 19,848 | 1,527 |
| 4 yr.--less 5 yr. | | | | | | | |
| 5 yr.--less 6 yr. | 1 | 2 | 16.67 | NA | | 38,490 | |
| 6 yr.--less 7 yr. | 3 | 5 | 41.67 | NA | | 59,289 | |
| | | | | 18 | | 73,231 | 4,068 |
| | | | | 167 | | 144,165[a] | 8,633 |
| 7 yr.--less 8 yr. | 2 | 7 | 58.33 | NA | | NA | |
| | | | | NA | | NA | |
| 8 yr.--less 9 yr. | 1 | 8 | 66.67 | NA | | NA | |
| 9 yr.--less 10 yr. | | | | | | | |
| 10 yr.--less 11 yr. | | | | | | | |
| 11 yr.--less 12 yr. | | | | | | | |
| 12 yr.--less 13 yr. | | | | | | | |
| 13 yrs. or more | 4 | 12 | | 36 | | 40,111 | 1,114 |
| | | | | 70 | | 107,374 | 1,533 |
| | | | | 63 | | 234,555 | 3,723 |
| | | | | 34 | | 22,115 | 650 |
| Total | 12[b] | 12 | | | | | |

[a]Asset value of all 12 plans unknown as some distributed insurance policies without stating accumulated cash values. With so small a sample, combination of data was felt inappropriate and average dollars per participant was calculated for each plan and then averaged. One partial termination case involving more than 1200 employees was omitted as non-typical.

[b]Only 12 of 15 pertinent Wisconsin cases indicated the date of origination of the plan.

terminated were less than 9 years old.

3. Terminations for reasons of failure, liquidation, or retrenchment befell the smallest companies with far greater frequency than the big companies which first initiated the private pension movement.

The number of active members in Wisconsin termination cases was generally less than 60, experience roughly comparable to that of New York State for an earlier decade. Compare this low figure to the fact that the average employment covered by plans registered with the IRS ranges between 1,000 and 2,000 each year, and the conclusion could only be that as private pensions have become more numerous, the certainty of accomplishing these plans has declined, at least for those covered under the small firm program. Scale of the pension sponsor still has jeopardized only a small segment of the work force presently covered under private pension plans since the largest national firms employ a majority of those workers which have a privately financed pension expectation.

4. The New York Study was not primarily interested in termination experience and so its general application is limited.

There was no information on actuarial liability, adequacy of funding for retired or long-term service employees, or attrition prior to termination. The Study was further limited to plans in the hands of bank trustees. Pension plans directly related to an insurance company did not appear, and since the smaller firm might prefer some sort of insured plan, the omission was a serious one for this analysis. Therefore, termination experience of a sample of private pension

institutions was reviewed before reaching any conclusions on the characteristics of the typical pension termination due to business failure, liquidation, or migration.

### F. Termination Experience of Banks, Insurance Companies, and Consulting Firms

1. Bank trust departments were found to be well insulated from the problems of termination.

Pension Trust Department officers of major banks in New York City, Chicago, Milwaukee, and Madison were contacted and interviewed in regard to trust department experience with pension termination for reasons of business failure, etc. The two large New York banks were able to recall only one or two terminations for reasons of financial necessity, although the New York Banking Study reported 10 of the 13 largest trust departments accounted for 78 of the 111 terminations reported. Three of the 4 largest Chicago banks interviewed reported they had not lost an account for reasons of business failure or liquidation.[15] All of the trust officers emphasized that their department was highly selective in terms of the pension plans which they would accept as trust appointments. By restricting pension trust services to national concerns of superior financial quality, they found that it was possible to limit their functions to investment management and payment distributions. All administrative decisions and record keeping were effectively shifted to the pension sponsor. All distributions were made according to the

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[15]New York interviews, April, 1961; Chicago interviews, September, 1961.

instructions of the pension administrators without participation of the trust officers in whatever decisions were necessary to determine the distribution.

Each of these trust departments entered the pension field very early in its development, often because major national firms were already banking clients and it was felt desirable to service these accounts as completely as possible. On the other hand, the remaining Chicago bank and several in the Milwaukee area had entered the pension field more recently and served a more numerous but far less wealthy business clientele. To compete for trust business these banks offered a wide variety of administrative services beyond those related to the investment function. These banks had experienced a variety of termination situations, and each estimated that at least one per cent of their trust appointments were terminated each year for the reasons under consideration in this study.

As an additional source of information on the frequency with which termination was experienced by trust departments throughout the country, it was possible to insert a single question in a questionnaire sent a national sample of trust departments as part of another pension study undertaken in conjunction with a University of Wisconsin Ford Foundation pension study project.[16] By combining a question on terminations with other information in the questionnaire it was possible to compile Table 15 from 20 questionnaires returned from a

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[16]Emerson Beier, "Preliminary Study of Administrative Costs for Pension Plans" (a dissertation in process of completion, University of Wisconsin, Madison, Wisconsin).

TABLE 15

A NATIONAL SAMPLE OF TRUST DEPARTMENT PENSION AND PROFIT SHARING APPOINTMENT TERMINATION EXPERIENCE AS TAKEN FROM UNPUBLISHED RESEARCH INCLUDED IN A THESIS IN PROCESS BY EMERSON BEIER OF THE UNIVERSITY OF WISCONSIN

| Pension Trust *(6a) Appoint. *(6b) | Profit-sh. Trust Appoint. *(16b) | Professional Liability Insurance *(17a) | Total Term in Last 10 Yrs. *(17b) | Term Due to F.L.M.[a] *(17c) | Suggestions For Term. Clauses |
|---|---|---|---|---|---|
| 400 | 250 | N | 61 | 49 | Simplicity to avoid confusion and delay in liquidation |
| 175 | 125 | Y | 10 | 5 | Companies uniformly reserve right to term. plan and discontinue contribut. |
| 86 | 120 | Y | 0 | 0 | |
| 214 | 171 | Y | 30 | 27 | Same as #2 |
| 267 | 137 | N | 3 | 1 | None |
| 89 | 37 | Y | 4 | 3 | |
| 43 | 91 | Y | 10 | 3 | Trust agreement sets term, fee and pay-out proc. |
| 99 | 197 | | | | |
| 100 | 100 | Y | 4 | 4 | |
| 20 | 50 | Y | 3 | 2 | |
| 50 | 50 | | 2 | 0 | |
| 60 | 15 | Y | 10 | 10 | Final accounting inst. & complete release of liab. |
| 31 | 59 | | 3 | 0 | 30/60 days notice |

TABLE 15 (Continued)

| * Pension Trust * (6a)Appoint.(6b) | Profit-sh. Trust * Appoint.(16b) | Professional Liability* Insurance (17a) | Total Term in Last* 10 Yrs.(17b) | Term Due to F.L.M.[a] * (17c) | Suggestions For Term. Clauses |
|---|---|---|---|---|---|
| 50 | 100 | | 0 | 0 | |
| 50 | 118 | N | 0 | 0 | |
| 4 | 14 | N | 0 | 0 | |
| 25 | 180 | | 20 | 15 | Demand equitable terminable term. laws in original agreement. |
| 180 | 120 | Y | NA | NA | |
| 49 | 23 | Y | 0 | 0 | |
| 1,992 | 1,857 | | 160 | 119 | |

[a]Business failure, liquidation, or migration.

*These numbers refer to specific item in direct mail questionnaire used in Beier thesis.

mailing list of 66. Of 3,849 trust appointments for pension and profit-sharing plans reported by trust departments participating, 160 had been terminated in the last 10 years, or more than 4 per cent. Of these terminations almost three quarters were alleged to be due to business failure, liquidation, or migration. There was a faint suggestion that the terminations experienced by each bank varied by geographic region, although the sample was not suitable to confirm such a relationship. The two largest number of terminations were indicated by New England banks which were adversely affected by the textile migration southward and the general recession in some branches of manufacturing in their area. By the same token southwestern banks generally had few terminations, and again it appeared that the largest regional banks had the fewest terminations, presumably because these banks might be more selective of the size and stability of the pension trustor. The general frequency of termination is less than that indicated by IRS cumulative statistics, but it is possible that those banks which have only a modest number of appointments have entered the pension area in the last five years, limiting termination experience, and preventing the usual accumulation of terminations within 8 to 10 years.

In addition the sample contained a number of the larger banks referred to previously which reported no terminations among their prime clientele, thus reducing the termination ratio significantly. With allowance for these factors, it might be quite possible that trust department termination experience in the aggregate would parallel IRS statistical measures of frequency. However, termination

experience for individual banks varied widely depending on trust department policy on the selection of appointments, and on regional preferences for pensions or profit-sharing agreements.

A resume of commentary on the role of the bank in termination situations was of more value than statistical summaries. Table 15 indicated that only 4 of 14 trust departments reporting stated they carried no professional liability or errors and omissions insurance. Trust officers were agreed that investment and proceed distribution functions carried a relatively small exposure for opportunity to act negligently when individual accounts were kept by a separate administrator who issued the necessary payment instructions to the trustee. When the bank offered a greater variety of services to the pension account, it entered an area where accounting or clerical errors could be multiplied into a significant liability exposure. Most of these same banks had no suggestions for phrasing of termination clauses except on the point of termination fees and pay-out procedure, provisions established very specifically by the trust agreement.

None of the trust officers interviewed felt that measures of book value assets, funding ratios, or ratios of assets to participants were very meaningful. The pattern for smaller trusteed pension plans, particularly in Wisconsin and the Midwest, was described as a combination of paid-up deferred retirement income insurance with an investment side fund, both administered by the trustee. Upon retirement any vested interest in the investment side fund was used to purchase additional annuity values for the pensioner; it was hoped such a fund would reduce the impact of inflation on expected pension benefits. The

book value of assets reported by such a combination fund is almost invariably distorted and generally understated. Pension trust accounting apparently does not always recognize the cash value of insurance policies purchased by a trust fund for future retirement benefits. Failure to recognize these values is justified by trustees on the grounds that there is a great reluctance by insurance companies to render an annual accounting on a large number of individual, and sometimes fractional, policies.

The cash values in each contract will vary from those projected in the contract when mutual dividends are invested in paid-up additional features of these contracts. The cash value is further confused should an employer find it necessary to suspend contributions, as the trustee will then often borrow on the cash value with the hope that the employer can restore contributions with an upturn in business profit. Since the original cash value of the insurance contracts has been given a nominal $1 valuation on the balance sheet, loans on the cash value do not affect the net value of the pension trust while the loan proceeds appear as additions to value in the receipts of the trust. Similarly, most trust companies report these cash values on Federal and State disclosure forms at nominal values to avoid extra accounting expense. Several trust officers made reference to a special termination problem which owed its origin to such expense items. When a trusteed plan was terminated and policies distributed, 95% of the beneficiaries cashed in their insurance policies within 6 months. One trust officer recounted a situation in which both the personnel manager of the liquidated firm and the trust officer took

special care to explain the insurance features carefully to policy recipients. Nevertheless, some applied for a cash-out of their policies from the local insurance home office before the trust officer returned to the bank the same afternoon of distribution. Trust officers thought several factors contributed to the nearly universal preference for cash instead of annuity. In many cases cash would be needed for those who face unemployment. However, even when cash is not needed, the life insurance companies have discouraged retention of smaller annuity policies where they could expect no future premium income despite continued servicing expense. Such business volume has been thought to affect their net cost factor, the principal sales point of some mutual life insurance carriers. What is worse, some agents might be tempted to advise cash-out of a policy to provide funds for new contracts or mutual funds on which the agent would receive a commission. This kind of abuse has proven most difficult to investigate and substantiate.

To summarize trust department experience with pension termination, there was little indication from available statistics of the frequency or scale of the termination problem. The termination experience of individual banks varied according to trust department policy, date of entry into the pension trust field, the type of clientele of the allied bank, the relative regional preference for pensions versus profit-sharing plans, and a host of other considerations. Their experience in the aggregate paralleled IRS statistics but did not contribute to the continuity or universality of Federal figures. Moreover, a pension trust is essentially an impersonal

conduit of funds, removed from the business and administrative decisions which determine the course of the pension life cycle and insulated from the individual expectations of participants generally known to it only as computer code numbers.

2. Insurance companies were unwilling to provide both a figure for plans in force and for terminations experienced.

For the insurance company viewpoint on pension plan terminations, a letter of inquiry was directed to six major insurance companies which stress group annuities and deposit administration plans. Several companies provided an inventory of cases for one year and one provided a resume of single premium group annuity business written to close-out terminated deposit administration and trusteed funds. The list of close-out cases was used to make some comment on the severity of injury to retired employees and those with vested rights at termination. Of 29 cases reported,[17] only 5 produced less than the full annuity for retired or vested participants; 4 plans provided both a full annuity and some death benefits.

The fact that those who were entitled to receive pensions received the full amount which they had earned seemed significant. However, the record was less impressive when one considered that these pensions ranged from $20 to $70 a month. Then, too, annuitants probably represented only a small percentage of the total work force

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[17]Correspondence received April 25, 1962. The respondent explained that the insurance company, when bidding on a single premium, group annuity contract, generally deals with a consultant and, therefore, rarely knows the details of a termination.

affected by the termination and qualified for a pension because they were in one of the first categories of priority. Group annuities were purchased for as many as 386 participants or for as few as 3. One company, which stated that the majority of its pension cases were group annuity plans for the smaller firm, estimated its termination rate at 3-4% of active cases each year.

In matters that were not statistical and revealing of business success or failure, the insurance companies queried provided considerable information on problems in procedure for termination, material which appears in Chapter IV. Only one company related termination experience in a twenty-two month period to a cause of loss as specific as financial difficulty or failure. In this report 18 pension trusts were dissolved, 8 because of merger, 5 because of a change in funding method,[18] and 5 because of financial difficulty or failure of the sponsor. Since it was stated specifically in regard to the mergers that the participants were absorbed into the existing plans of other companies, the frequency of loss for reasons pertinent to this study would be 5/18 or 28%, somewhat lower than previous estimates of 50% or more. Unfortunately, the number of terminations was not related to the number of appointments so an incidence rate was unavailable.

The Institute of Life Insurance has published[19] a few

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[18] Correspondence received October 31, 1961.

[19] Pension and Profit Sharing Reports, op. cit., Vol. XIX, no. 56, p. 2.

statistics on insured plans which are applicable to the research problem. Its annual survey of insured pension plans reported that during 1960 a total of 3,970 insured plans were created in the United States covering 1,700,000 workers. There was an average of 40 persons under each new plan, a drop from the 1955 average of 100, a decline attributed to the increasing use of insured pension plans by small businesses. Sixty plans out of a total of 28,430 were terminated for all causes, a termination rate of .21 of 1%. This rate of termination was considerably lower than the estimate in this study but probably did not pick up termination of various individual policy plans which comprised about two-thirds of all insured plans but covered only 12% of the total persons enrolled.

An attempt was made to determine the termination rates for individual company packages of group annuities and deposit administration plans covering a period of ten years from data published by the Institute.[20] Presumably, the number of plans reported at the end of one year, plus the new plans reported for the following year, minus the total plans in force at the end of that year, would produce a figure which represented all plans terminated for any reason whatsoever. Unfortunately, there was seldom any relation between annual reported figures, since the formula would produce a minus number of terminations in some years. Consequently, this approach was abandoned.

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[20] Employee Benefit Plan Review, op. cit.

3. Pension consultants lack the total view of terminations as a percentage of plans in operation.

A number of large actuarial firms in the midwest were contacted to catalog their opinions of the frequency and scale of pension terminations due to business failure, liquidation, or migration. Each firm provided a resume of their file of termination experiences, but felt that a ratio of termination cases to plans in which they had participated at their initiation would not be a meaningful figure. As consultants they were not in a position of annual retainer for most plans, only for the larger more complex programs for which they often provided complete administrative service under a service contract. As a result they might only participate in initiation of the plan, or be consulted only at termination of others to the extent of determining actuarial liability as of a proposed termination date.

In some cases the actuary would be responsible for negotiating the entire settlement made at the time of termination, but in any event the number of termination situations bore little relationship to the number of plans initiated by the consultant. The regional consulting firms had rather limited experience in responsibility for a full termination case; the national firms with branch offices around the country were able to assemble from one to two dozen cases for which their records were reasonably complete. When requested for an evaluation of the estimates of termination frequency projected in this study from federal and state records, the consensus of the actuaries was that 1-1.5% of all pension plans in force was a reasonable estimate of terminations for the reasons under study.

Review of the correspondence and interviews with banks, insurance companies, and consulting actuaries leads to the conclusion that each was unwilling to provide information in a form that might provide intelligence for its competition and that administration of pensions in this country is so well subdivided among competing regions and institutions that homogeneous data of sufficient sample size is unattainable. On the other hand, each source in its own manner provided considerable information on theory, procedure, and case situations related to pension termination. If the null hypothesis could be applied on the strength of such meager evidence, nothing in the experiences of these sources would refute the proposed frequency rate of 10% of all new plans within 7 years, with a range of .8% to 1.5% per annum depending on business conditions. There was no information available on the degree to which non-vested, long-term employees have been injured when unfunded pension expectations were upset prior to retirement. There was some evidence[21] that retired personnel receiving pensions directly from trust funds have generally been satisfied in full with an annuity were the trust terminated.

G. A Speculative Estimate of Employees Affected by Termination

Efforts to obtain an accurate measure of the number of employees affected by pension termination have been demonstrated to be unavailing. However, assuming the possibility of a rather wide range

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[21]While there are a few notorious cases of failure to pay retirement benefits, the evidence presented in Chapters V, VI and VII will suggest these unfortunate situations to be the exceptions to the rule.

of possible error, one can estimate the number of employees who each year find their pension expectations drastically diminished by the failure, liquidation, or migration of their employer. Some reasonable assumptions which may permit such an estimate can be made from the data presented thus far.

It will be recalled that a conservative estimate of the proportion of terminations actually caused by failure, liquidation or migration was determinated at 50%. There were indications that the increase in terminations lagged initial IRS qualifications by 7 to 8 years, and that a hypothetical termination rate of 10% of plans initiated within 7 years fit the facts reasonably well. There was further evidence that the average number of participants in newly qualified pension plans was falling significantly each year as more smaller firms introduced pension plans. Finally there was some evidence to show that the great majority of terminations for reasons germain to this research occurred to plans sponsored by the smallest firms.

With these characteristics of the pension termination problem in mind, a simple model to accumulate the number of affected employees was built, using the basic IRS data on terminated pension plans available since the third quarter of 1955. As a first approximation a termination rate of 10% in 7 years or 1.43% of plans originated in base year, first tested against all welfare plans in Table 2, was tested as it applied to pensions since 1955. This projection (Table 16) was built to the year 1961, the first year for which 7 years cumulative data is possible. The accuracy of the hypothetical projection compared

TABLE 16

A MODEL PROJECTING ACCUMULATED TERMINATIONS OF ANNUAL PENSION PLAN INITIATIONS ASSUMING A TERMINATION RATE OF 10% IN 7 YEARS OR AN ANNUAL RATE OF 1.43%

| New Pension Plans | Year | 1955 | 1956 | 1957 | 1958 | 1959 | 1960 | 1961 |
|---|---|---|---|---|---|---|---|---|
| 1235 | 1955 | 17.6 | 17.6 | 17.6 | 17.6 | 17.6 | 17.6 | 17.6 |
| 3175 | 1956 | | 45.4 | 45.4 | 45.4 | 45.4 | 45.4 | 45.4 |
| 3527 | 1957 | | | 50.4 | 50.4 | 50.4 | 50.4 | 50.4 |
| 3883 | 1958 | | | | 55.5 | 55.5 | 55.5 | 55.5 |
| 3824 | 1959 | | | | | 54.6 | 54.6 | 54.6 |
| 5011 | 1960 | | | | | | 71.6 | 71.6 |
| 4919 | 1961 | | | | | | | 70.3 |
| | | 17.6 | 63.0 | 113.4 | 168.9 | 243.5 | 305.1 | 365.4 |
| Actual terminations from quarterly reports, Internal Revenue Service | | 76 | 192 | 180 | 224 | 270 | 300 | 374 |
| Ratio of hypothetical terminations to actual IRS experience | | .223 | .328 | .627 | .750 | .900 | 1.01 | .975 |

with the actual terminations experienced is a bit misleading. The 1955 termination factor of 17.6 cases (.0143 x 1235) represented only 6 months and might better be stated in the neighborhood of 35 cases. While the projection properly represented only a progressively increasing portion of actual totals for the years 1955-1960, the proportion seemed a bit high in view of the absence of any knowledge of terminations of plans initiated prior to 1955. Moreover, the 1960 estimate was 101% of actual experience despite the fact that only six years terminations contribute to the total and that one of those years was represented by a six-month figure.

Recalling that the 10% in 7 years termination assumption produced consistently understated results in Table 2, it appeared that the termination factor might be better adjusted to 10% in 7.5 years. Such a deviation from the previous projection would be consistent with the observation made earlier that profit-sharing plans had a slightly higher termination rate than pension plans and that the projection did not include terminations of plans formed prior to 1955, or never formally qualified, so one should logically expect the projection to be less than 100% of actual IRS figures.

Support for this expectation can also be found in those statistics brought forward earlier that indicated no more than 80% of all terminations occurred within 8 years of plan origination. Consequently a hypothetical projection of the number of terminations each year, grouped by year of original qualifications since 1955, has been adjusted in Table 17 to reflect a 7.5 year span in which terminations accumulate to 10% of each base year qualified total. Note that the

TABLE 17

A MODEL PROJECTING ACCUMULATED TERMINATIONS OF ANNUAL PENSION PLAN INITIATIONS ASSUMING A TERMINATION RATE OF 10% IN 7.5 YEARS OR AN ANNUAL RATE OF 1.33%

| Actual Pension Qualifications | Year | 1955 | 1956 | 1957 | 1958 | 1959 | 1960 | 1961 |
|---|---|---|---|---|---|---|---|---|
| 1235 | 1955 | 16.5 | 16.5 | 16.5 | 16.5 | 16.5 | 16.5 | 16.5 |
| 3175 | 1956 | | 42.3 | 42.3 | 42.3 | 42.3 | 42.3 | 42.3 |
| 3527 | 1957 | | | 47.0 | 47.0 | 47.0 | 47.0 | 47.0 |
| 3883 | 1958 | | | | 51.8 | 51.8 | 51.8 | 51.8 |
| 3824 | 1959 | | | | | 51.0 | 51.0 | 51.0 |
| 5011 | 1960 | | | | | | 66.8 | 66.8 |
| 4919 | 1961 | | | | | | | 65.5 |
| A. Projected termination from post 1955 qualifications | | 16.5 | 58.8 | 105.8 | 157.8 | 208.6 | 275.4 | 340.9 |
| B. Actual pension terminations from IRS figures | | 76 | 192 | 180 | 224 | 270 | 300 | 374 |
| C. Ratio of projected to actual terminations | | .217 | .306 | .587 | .703 | .772 | .918 | .911 |

projection never exceeded 91% of the terminations actually experienced and deals with pension terminations exclusively.

In the absence of data on the number of participants affected by terminations reported in IRS data and of any indication of dollar values involved, an exact measure of severity of termination consequences has been impossible. However, a rather speculative extrapolation might be acceptable were the measure of severity the number of pension participants involved in plan termination. The projection here began with a known base, the average number of pension participants of plans qualified in each year. A portion of each year's plans was terminated each year and so presumably a proportionate share of participants lost pension coverage. However, on the evidence of New York State experience and the Wisconsin Disclosure File three important assumptions must be made:

1. Pension plans that terminate have generally been those in the lower half of the lowest quartile of firms ranked by the number of employees participating.

2. The smallest firm would have the smallest number of employees on the average participating in a pension plan, if plans qualified for salaried employees or supplementary plans for special groups are ignored.

3. To make possible an extrapolation, it was assumed that the average number of participants as reported by IRS at the initiation of a pension plan was also the dividing point between the second and third quartile distribution of plans ranked by average number of participants. It was further assumed that the distribution was evenly distributed in the lowest quartile.

On this basis in 1955 IRS reported an average of 2,486 initial participants (Table 4), suggesting the lowest quartile of firms would have 622 participants as a median. Thus firms in the lower half of this quartile would have a

median average number of participants of 311. This lower segment has been assumed as the class in which most liquidations and failures occurred. The medians of the lower half of the lowest quartile have been recorded in column 2 of Table 18.

The increase in the numbers of terminations and the gradual decline in the number of employees covered by the typical new plan are realistically, if not accurately, reflected in columns 2 and 3. The product of these two columns (columns 4 and 5) was intended to suggest the number of employees who were threatened with loss of pension coverage due to the termination of pension plans categorized by year of origination. The footing of these two columns represented the number of employees each year who saw their pension expectations affected by termination of a pension plan. One could not say if all expectations were lost for most plans have some assets with which to meet their promises. However, it would be safe to say that most plans are not fully funded, indeed sufficiently funded for even vested benefits, at the time they terminate when the great majority are liquidated within eight years of their initiation.

The footings in columns 4 and 5 required further adjustment because the sketchy data available has suggested that a minimum of 50% of all plan terminations are due to failure, liquidation, or retrenchment imposed by adverse circumstance. Therefore, 1961 subtotals were adjusted by a factor of .5 in column 6 to arrive at an estimate of 30,300 would-be pensioners who faced potential upset or a reduction of pension expectations when their sponsor was forced to terminate. Thirty thousand people is little more than a "guestimate,"

TABLE 18

A HYPOTHETICAL MODEL OF THE NUMBER OF PENSION PLAN PARTICIPANTS ADVERSELY AFFECTED BY TERMINATION EACH YEAR

| Year | Average Annual Participants in Pensions Year of Initiation (1) | Estimated Participants as Median of Lowest Quartile (2) | Estimated Termination Per Year From Table 17 (3) | Pension Participants Injured by Termination by Year of Original Plan Qualification (4) | Pension Participants Injured by Termination by Year of Original Plan Qualification (5) | Pension Participants Injured by FLM Termination (6) |
|---|---|---|---|---|---|---|
| 1955 | 2,486 | 311 | 16.5 | 5,132 | 5,132 | 2,566 |
| 1956 | 1,713 | 214 | 42.3 | 9,052 | 9,052 | 4,526 |
| 1957 | 1,478 | 185 | 47.0 | 8,695 | 8,695 | 4,347.5 |
| 1958 | 1,431 | 179 | 51.8 | 9,272 | 9,272 | 4,636 |
| 1959 | 1,045 | 131 | 51.0 | 6,681 | 6,681 | 3,340.5 |
| 1960 | 1,573 | 198 | 66.8 | 13,226 | 13,226 | 6,613 |
| 1961 | 1,052 | 131 | 65.5 | | 8,580 | 4,290 |
| Total | | | | 52,058 | 60,638 | 30,319 |

Source: Composite of IRS data, hypothetical termination model, and assumptions explained in body of report.

but it would seem to be conservative:

1. The hypothetical rate of 10% in 7.5 years produced estimated terminations only 91% of those actually experienced in 1961.

2. The estimate did not include any employees whose employer was forced to sharply reduce employment due to business reversals although the pension plan continued in force.

3. The estimate did not reflect those who have lost their pension expectations when their employer moved operations to a new labor area.

4. Not all terminations would involve the very smallest firms, although extremes might or might not be reflected in the choice of class median.

5. The model overlooked possible increases in the number of participants following report of original qualifications. Of course this factor was offset to an unknown degree since the assumed average number of participants at termination also ignored attrition among participants prior to actual termination of the plan.

6. It was impossible to estimate how many of the original participants had retired or were still alive at the time the plan was terminated, and so it has been necessary to assume that those who dropped out of the plan were replaced in the production line.

Admittedly an estimate of 30,300 is crude at best but there would be no need for reliance on speculative projections based on a series of broad assumptions. Instead the IRS could simply report the number of participants at the time of qualified termination as well as at initiation. Were these facts combined with an indication of the number of participants participating in the terminal distribution or with report of terminal assets and terminal liability aggregates, the severity of disappointment of pension expectations of termination would come into far better focus. In the meantime the involuntary loss of most pension expectations by 30,300 participants each year would seem

to indicate a flaw in the private pension system deserving closer examination.

## H. Pension Termination and Business Failure or Liquidation

To this point analysis has attempted to interpret pension terminations of record as they would relate back to business failure, liquidation, or migration. Incomplete or unavailable data lead only to a rough estimate of the frequency or severity of termination consequences. Another approach might be to establish the frequency and employment scale of failures, liquidations, and migrations, and then to establish what proportion of these might involve pension programs.[22] The question of partial termination might be clarified with proper use of labor turnover statistics.

1. The best available source of information on business failure has generally been agreed to be Dun & Bradstreet, Inc., but its data bank was inappropriate for the study.

A second source would be the Administrative Offices of the U. S. Courts. Since the U. S. Department of Commerce has estimated some 337,000 firms discontinue annually, it was desirable to control the scope of the research area to business failures involving court proceedings. A Dun & Bradstreet definition, as used in its statistical services supplied the U. S. Congress, described a failure as a firm declared bankrupt or otherwise closed or reorganized under

[22]Data on business failures not only led to aggregate data but provided leads for specific pension termination cases as well.

circumstances involving substantial loss to the creditors.[23] Of course, a great number of unsuccessful enterprises have disappeared merely as discontinuances, sales, or voluntary liquidations, and these have been said to outnumber failures "by a wide margin, estimated at 25:1 in recent years."[24] Failures have exceeded 14,000 annually, but considering that the average liability outstanding at the time of failure for these firms has been less than $50,000 it was probable that most failures occurred to the smallest firms, firms probably too small to have a formal pension plan. Still there were 1,284 firms representing more than 9% of the failures with liabilities between $100,000 and $1,000,000.[25]

There were 62 firms in 1959 which had liabilities in excess of $1 million; presumably most firms with large liabilities once had sufficient assets to justify their credit position and it is reasonable to infer that firms which were in manufacturing or retailing employed people on a scale roughly proportionate to business liabilities at the time of failure. These larger employers would also be more likely to operate employee and welfare pension benefit plans had they been in operation at least a minimum number of years. The age of business failures by major business classes was noted but there

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[23]U. S. Congress, House Committee on Small Business, Final Report, 86th Congress, 2nd Sess., 1960, p. 6.

[24]Comment on Dun & Bradstreet mailing piece providing general statistics on long term business failure statistics.

[25]U. S. Congress, House Committee on Small Business, Final Report, op. cit., p. 7.

were no comparable pension termination experiences which would justify review of all 44 business classes distinguished by Dun & Bradstreet statistics.

The U. S. Bureau of Labor reported that of 127,000 welfare and pension benefit plans recorded as of August 31, 1959, only 24,561 are pension plans, 19% of the total, and most of these were concentrated in the manufacturing and wholesale categories of business enterprise.[26] Therefore it was decided to sample 1960 and 1961 manufacturing and wholesale failures with liabilities in excess of $100,000 to see if firms in business more than three years old had offered a pension plan, and if so, what had become of it as a result of financial difficulties.

Through the generous cooperation of Dun & Bradstreet, Inc., it was possible to cull their records for business receiverships in the first quarter of 1960 of manufacturing and wholesaling firms with liabilities in excess of $100,000, more than three years old at the time of their failure. Dun & Bradstreet was then able to furnish an address, generally one belonging to the attorney or creditors committee of the defunct firm.[27] The results of a mailing have been outlined in Table 19. Of 47 companies on the mailing list, only 9 replied, less than 20%, and 11 letters were returned unopened. The latter problem occurred when the address was of the company itself and

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[26]U. S. Bureau of Labor Standards, Division of Welfare and Pension Reports, <u>Characteristics of 127,657 Welfare and Pension Benefit Plans</u>, May 1, 1960.

[27]A mailing was prepared, consisting of a questionnaire and explanatory cover letter, which was mailed in March of 1961.

TABLE 19

MAILING TO 1960 FIRST QUARTER RECEIVERSHIPS OF COMPANIES WITH LIABILITIES IN EXCESS OF $100,000

Companies or receivers to whom letters were mailed .............. 47

Companies that replied .............................................. 9

Letter Returned ... Unopened ...................................... 11

Receiverships involving a formal pension plan .................... 1/9

SUMMARY OF SCALE OF FAILURE AND NUMBER EMPLOYED

RQ-1 .... Forced liquidation, 100% loss to creditor ... 20 employees ... 3 management personnel. No pension plan ... In business 9 yrs ... Mfg. TV antennas.

RQ-2 .... Chapter XI reorganization ... Merger with larger operating company ... 85-150 employees ... 3 management personnel ... Insured individual pension policy plan for salary employees only, non-insured trust fund plan on industry basis for 60 employees, and a group life plan ... None were terminated ... In business since 1927 ... Mfg. lighting equipment.

RQ-3 .... Chapter X ... Successfully reorganized ... Number of employees not available ... No pension plan of any kind ... In business since 1948 ... Plastics.

RQ-4 .... No information available except business organized in 1946 ... Mfg. knitwear ... Bankrupt with liabilities of $700,000.

RQ-5 .... Forced liquidation ... No regular employees ... Research engineering, no pension plan of any kind ... Organized in 1955 ... Mfg. packing machinery.

RQ-6 .... Rehabilitated ... 60-15 employee reduction ... 6-3 management personnel reduction ... No pension plan ... Group medical plan ... Organized in 1950 ... Mfg. metal doors ... Liabilities of $390,000.

RQ-7 .... Voluntary bankruptcy ... Employment unknown ... No pension plan of any type ... Organized in 1937 ... Office equipment ... Liabilities of $592,000.

RQ-8 .... Forced liquidation ... 40-0 employee reduction ... 6-0 reduction in management personnel ... No pension plan despite group life insurance contract ... Organized in 1930 ... Plastic mfg. ... $400,000 loss to creditors due to corporate officers' misappropriation of funds.

TABLE 19 (Continued)

RQ-9 .... Liquidated ... 30 employees ... Management personnel unknown ... No pension plan ... Organized in 1941 ... Mfg. printed posters ... Liabilities of $248,000.

time had erased it from the scene or when the attorney representing the creditors had disappeared or changed address. Of 9 replies which are summarized in Table 19, only 1 possessed any kind of pension plan and that was limited to salaried employees. This single exception (RQ-2) was interesting only from the standpoint that a Chapter XI reorganization merger had not found it necessary to terminate any employee welfare plan in the process. However, serious attrition of employment from a high of 150 to a basic 60 in number suggested reorganization came at a price for an old well-established firm and the pension expectations of its employees.

The sample study proved of little value because the mailing list was relatively obsolete. To test this approach further it was decided to send a second mailing to companies entering receivership in the first half of 1961 with liabilities in excess of $250,000 and with a date of origination prior to 1957. Hopefully a current list of troubled companies would reduce the number of dead letters. The level of minimum liabilities outstanding was increased because it was felt more probable that larger firms were more likely to have a pension program and that liabilities were an indication of size. Financial upsets were limited to those occurring in a six-month period to reduce the cost of an unproven research tool.

The approach of the questionnaire was changed from questions stressing detail of a pension termination, where one existed, to simply determining if there were a pension plan involved, and if so, the name and address of the attorney, actuary, or other official who could provide detail on the pension program as it was affected by

bankruptcy or reorganization. Of 63 letters mailed, 15 brought replies containing usable information, almost 25% of the sample, while more than 30% were accounted for; a summary of the information available appears in Table 20. Of 15 adequate replies, 3 reported some kind of pension benefit available to employees, one a multiple-employer plan and two of the trusteed variety. One of the latter was unaffected by a Chapter XI reorganization while the other settled a termination settlement litigation for fifteen cents on the dollar.

A second letter to these two sources for more detail produced nothing, and a search of legal case reporting services did not reveal a suit with the company name in it. The multiple-employer plan was, of course, not terminated; unfortunately, the bankruptcy of a single coal mine merely reflected an industry-wide trend so adverse to pension funding that pensions promised by the miner's pension plan were reduced to spread existing funds further.

Again the results were inconclusive except that the replies did contribute to the inventory of case data information. Without pretense of statistical accuracy, the two samples hint that perhaps 10% to 20% of companies in this class have pension plans. Many of these plans were probably saved when firms were reorganized or merged, but more precise knowledge of specific situations was unavailable for two reasons: first, the addresses furnished by Dun & Bradstreet were not often of those people most concerned with the pension of the embarrassed firm and so the inquiry was ignored or felt to be beyond their area of knowledge and interest; second, once the firm has been dissolved there was no one with responsibility or records for

TABLE 20

MAILING TO 1961 FIRST HALF RECEIVERSHIPS OF COMPANIES
WITH LIABILITIES IN EXCESS OF $250,000
(Firms originated before 1957)

| | |
|---|---|
| Companies or receivers to whom letters were mailed ........... | 63 |
| Letters returned unopened ..................................... | 3 |
| Letters returned with no information ......................... | 2 |
| Letters returned with usable information ..................... | 15 |
| Total questionnaires accounted for ........................... | 20 |
| Percentage of response ......................................... | 33% |
| Receiverships involving a formal pension plan ................ | 3/15 |

SUMMARY OF INFORMATION AVAILABLE FROM DUN & BRADSTREET RECORDS AND RETURNED QUESTIONNAIRES

RR-1 .... Bankruptcy ... coal mine closed. Unknown number of employees were covered by the United Coal Miners Pension Fund. The co-receiver attached the following note:

"The Miners Pension is a fraud. No Coal Co. will hire a man over 25. Any new mine opened will not continue operation more than twenty years. The man will be 45 years old. Where does he get a job then--where is his pension--a union mine has to have at least 20 tons production per man daily to pay the union scale and welfare of 40¢ per ton or $8.00 per day of $160.00 per month Pension and Hospital Care ... pretty high, isn't it. Should the miner get killed or die his widow gets $1,000.00 and the Hospital Care for one year, then she is on her own. All money paid in for a pension should be paid into one fund so anywhere he worked he would benefit from it some day. Why should there be two pensions for anybody?"

RR-2 .... Bankruptcy proceedings resulted in sale and dissolution. Number of employees not known ... there was no union and no pension plan. In business since 1946 as a general machine shop ... liabilities of $309,710.

RR-3 .... Voluntary bankruptcy ... number of employees unknown ... no pension plan ... organized in 1880 as a brewing company ... liabilities of $443,000.

RR-4 .... In receivership this manufacturer of Resins and Industrial Chemical products did not reveal the number of employees but reported there was no pension plan of any kind ... organized in 1946 ... liabilities of $250,000.

TABLE 20 (Continued)

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RR-5 .... Forced liquidation ... unwilling to supply information on employment or pension plan ... manufactured glass fishing rods and archery equipment ... organized in 1946 ... liabilities of $1,160,516.

RR-6 .... Chapter X, operation under a trustee ... unknown number of employees had no pension plan ... organized in 1955 ... manufactured aluminum castings ... liabilities of $449,717.

RR-7 .... Reorganized by the creditors ... unknown number of employees had no pension plan of any kind ... organized in 1953 ... manufactured electrical equipment ... liabilities of $500,000.

RR-8 .... Operation halted for unknown number of employees ... no pension plan of any kind ... organized in 1955 ... manufactured sliding shower doors ... liabilities of $323,657.

RR-9 .... In receivership ... unknown number of employees ... no pension plan of any kind ... organized in 1955 ... manufactured germicides ... liabilities of $650,000.

RR-10 ... Forced liquidation ... unknown number of employees ... no pension plan of any kind ... organized in 1949 ... manufactured doors ... liabilities of $1,185,100.

RR-11 ... Forced bankruptcy ... unknown number of employees ... no pension plan of any kind ... organized in 1924 ... manufactured lamps, cigarette boxes, and novelties ... liabilities of $406,908.

RR-12 ... Receivership ... unknown number of employees ... no pension plan of any kind ... organized in 1932 ... manufactured jewelry settings ... liabilities of $443,750.

RR-13 ... Liquidation ... unknown number of employees ... no pension plan of any kind ... organized in 1952 ... sales agent for heavy equipment and trucks ... liabilities of $346,846.

RR-14 ... Reorganized under Chapter XI ... 42 participants in a Corporate Trustee Pension Plan ... none were retired ... plan has been terminated and a court settlement of "15% on the dollar" is being processed for payment ... no union ... the plan was voluntary ... organized in 1953 ... manufactured boats ... liabilities of $3,000,000.

TABLE 20 (Continued)

RR-15 ... Forced liquidation ... unknown number of employees ... no pension plan of any kind ... organized in 1956 ... manufactured windows ... liabilities of $456,000.

RR-16 ... Reorganized under Chapter XI ... unknown number of employees ... pension plan was not disturbed, company has returned to profitable business ... organized in 1936 ... manufactures electrical components ... liabilities of $300,000.

RR-17 ... Voluntary liquidation ... unknown number of employees ... no pension plan of any kind ... organized in 1956 ... manufactured toys ... liabilities of $300,000.

providing this kind of information.

It was first thought that better use of the Dun & Bradstreet material would be possible if the samples selected were culled for registration of a pension or welfare plan by the staff of the Disclosure Records Division. However, the chief of the Disclosure Records Division felt such a use of the disclosure files would establish a precedent for other private business men doing a market analysis of pension programs within their potential clientele or that of a competitor. Disclosure record files are available to the public, but only one file can be drawn at a time. Consequently the mailings reported were used as an alternative but with only limited success.

The bankruptcy petitions filed in the United States in 1960, as recorded by the Administrative Office of the U. S. Courts, totaled more than 110,000 of all kinds including business firms, farmers, and individuals.[28] This heterogeneity made such statistics of little use to this study. An alternative source might have been a mailing to those law firms which tend to specialize in commercial receiverships to seek opinions as to the proportion of such situations which involve pension plans. This thought was discarded as too expensive in production and in loss of good will among attorneys troubled for so small a bit of information. Review of all these materials or sources of data on business failures led to the conclusion that there is little

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[28]U. S. Congress, House Committee on Small Business, op. cit.

usefully classified material in this area and that the phenomenon of business failure could well bear some scholarly research.

2. Investigation of material on corporate liquidations produced an amazing lack of results.

The proper corporate registration agency in each of 50 states was surveyed by mail to obtain data on the number, asset size, and age of corporate liquidations for the past 10 years. Despite the general lack of real knowledge of business mortality, none of the states keep adequate records on as basic a statistic as corporate registration and liquidation. Such figures may presently be broken down according to legal form, such as stock, cooperative, and non-stock; for each of these there may be divisions according to newly formed companies, dissolved companies, reinstated companies, and those dropped from grace for failure to register each year as required. None of the states record the asset size, employment, business purpose, or age of the corporate structures liquidated, facts which could be of value in discussing the problems of small business. Moreover, a large number of corporations simply fail to register each year with the result that it is not known if they have become inactive, dissolved, or disenfranchised from ignorance of state reporting requirements.[29] It

[29]In Wisconsin failure to file an annual report causes a domestic corporation to lose good standing. In this event a secretary of state can no longer accept any documents respecting such a corporation except documents incident to its dissolution. A corporation can be restored to good standing by payment of penalties not exceeding $100. Failure to file remains a cause for involuntary dissolution under Wis. Stats. 180.769 and 180.793.

would be an interesting project to compare a sample of corporations which have failed to re-register with the active corporate business files of a credit reporting firm like Dun & Bradstreet. Where a firm was still active, it would be possible to contact the management and discover why it had failed to preserve the legal entity of their corporate status by failing to return the annual reporting form to the proper state agency. For purposes of this research the state records were of no value in estimating frequency of pension termination or discovering possible sources of pension termination cases. In Wisconsin, where it would have been economically feasible to select a sample directly from the corporate registration files of the State Secretary, it was not necessary as full information on pension plan mortality was available from the Disclosure Records kept within the State Insurance Department.

## I. Pension Termination and Plant Migration

Early in the process of interview and the search of public records for information it became clear that pension termination due to plant migration was occurring with increasing frequency and with adverse impact on larger groups of participants than in the case of failure. Not only might migration have brought about termination of a pension plan, but more often than not, migration of a single division of a multi-location firm would be accomplished without any partial or full termination of the company pension. Therefore, there was need of establishing the frequency of migration, the number of participants involved, and the frequency with which migration would foreclose

pension expectation.

The scale of the industrial migration phenomenon in the past 25 years has been the subject of study by the Social Science Research Council and the first of its efforts has recently been published.[30] While the figures in this study could not be used to pinpoint pension terminations, a brief reference to some of the data served to support our contention that migration of business enterprise should continue to be a major disruptive force in pension development and expectation both now and in the future.

For example, assuming pension expectations could be associated more with manufacturing employment than with service work, reductions in work force by region and by wage level were put forward in Tables 21 and 22. As generally known, the traditional manufacturing areas of New England and the North Central area have endured the most severe shifts in manufacturing employment. While study data spans 1929-54, the real growth of private pensions has come since World War II and so only changes within manufacturing employment since 1947 were shown. Information by major industry group was based on measures of

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[30]See Changes in the Location of Manufacturing in the United States Since 1929, as prepared by Victor R. Fushs (New Haven: Yale University Press, 1962). On page 29 of this volume the author observes that the industrial landscape is a "mosaic of infinite variety" and then goes on:

> "When the pattern of change in this mosaic over a period of 25 years is examined and analyzed, the final impression that emerges is a sense of the mobility and adaptability of the American economy, and of the power of competitive economic forces. As with a roaring river, there may be times when these forces should be controlled and directed in order to protect human and social values. A wise public policy, however, will never ignore these forces, or underestimate their strength."

TABLE 21

COMPARATIVE GAIN OR LOSS, ALL MANUFACTURING, BY STATE, 1947-54

| State | Value Added (Millions of Dollars) | Total Employment (Hundreds of Employees) | Value Added (Per Cent) | Total Employment (Per Cent) |
|---|---|---|---|---|
| Maine | -130 | -106 | -19.7 | -9.9 |
| New Hampshire | -71 | -44 | -15.0 | -5.5 |
| Vermont | -29 | -43 | -12.7 | -11.5 |
| Massachusetts | -880 | -966 | -17.2 | -12.7 |
| Rhode Island | -328 | -346 | -32.8 | -22.2 |
| Connecticut | -87 | -197 | -3.0 | -4.7 |
| New York | -1,211 | -540 | -8.3 | -2.8 |
| New Jersey | -126 | -39 | -2.0 | -.5 |
| Pennsylvania | -839 | -1,331 | -8.0 | -8.8 |
| Ohio | 246 | -273 | 2.4 | -2.1 |
| Indiana | 22 | -158 | .4 | -2.7 |
| Illinois | -645 | -946 | -6.4 | -7.6 |
| Michigan | 557 | -538 | 6.5 | -5.2 |
| Wisconsin | -198 | -274 | -6.0 | -6.3 |
| Minnesota | -84 | -70 | -5.5 | -3.7 |
| Iowa | 139 | 70 | 11.9 | 4.4 |
| Missouri | 123 | 19 | 4.9 | .5 |
| North Dakota | -11 | -2 | -25.0 | -3.0 |
| South Dakota | -5 | 0 | -5.7 | -.1 |
| Nebraska | -43 | 4 | -11.1 | .8 |
| Kansas | 298 | 437 | 29.7 | 35.5 |
| Delaware | 54 | 0 | 16.4 | 0 |
| Maryland | 135 | 34 | 7.5 | 1.4 |
| D. C. | -9 | -4 | -5.9 | -2.1 |
| Virginia | -17 | 23 | -1.0 | 1.0 |
| West Virginia | -48 | -201 | -4.7 | -14.8 |
| North Carolina | -310 | 238 | -12.6 | 5.7 |
| South Carolina | -188 | 155 | -15.5 | 7.1 |
| Georgia | 10 | 291 | .6 | 9.8 |
| Florida | 221 | 326 | 29.5 | 28.2 |
| Kentucky | 244 | 84 | 23.6 | 6.4 |
| Tennessee | 152 | 141 | 9.4 | 5.6 |
| Alabama | -53 | -83 | -3.9 | -3.8 |
| Mississippi | -5 | 65 | -1.0 | 7.3 |

TABLE 21 (Continued)

| State | Value Added (Millions of Dollars) | Total Employment (Hundreds of Employees) | Value Added (Per Cent) | Total Employment (Per Cent) |
|---|---|---|---|---|
| Arkansas | 18 | 25 | 4.2 | 3.5 |
| Louisiana | 62 | -49 | 5.6 | -3.5 |
| Oklahoma | 44 | 186 | 7.7 | 24.0 |
| Texas | 740 | 780 | 22.0 | 19.9 |
| Montana | -11 | -4 | -8.2 | -2.0 |
| Idaho | -8 | 26 | -4.7 | 12.8 |
| Wyoming | -3 | 0 | -5.3 | .3 |
| Colorado | 10 | 27 | 2.0 | 4.5 |
| New Mexico | 31 | 55 | 26.8 | 40.4 |
| Arizona | 23 | 96 | 12.8 | 39.5 |
| Utah | 77 | 27 | 28.5 | 9.6 |
| Nevada | 17 | 25 | 28.5 | 47.1 |
| Washington | 98 | 234 | 6.9 | 13.3 |
| Oregon | -127 | 51 | -12.3 | 4.3 |
| California | 2,145 | 2,794 | 26.6 | 28.7 |

Source: _Changes in the Location of Manufacturing in the United States Since 1929_, _op. cit._, p. 59.

TABLE 22

COMPARATIVE GAINS AND LOSSES, DIVISIONS BY MAJOR INDUSTRY GROUPS, 1947-54

| Major Industry Group | New England: Value added ($ thousands) | New England: Value added (per cent) | New England: Total employment (employees) | New England: Total employment (per cent) | Middle Atlantic: Value added ($ thousands) | Middle Atlantic: Value added (per cent) | Middle Atlantic: Total employment (employees) | Middle Atlantic: Total employment (per cent) | East North Central: Value added ($ thousands) | East North Central: Value added (per cent) | East North Central: Total employment (employees) | East North Central: Total employment (per cent) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 20 | - 48,000 | -10 | - 2,000 | - 4 | - 51,000 | - 2 | - 2,000 | - 1 | - 7,000 | - c | - 5,000 | - 2 |
| 21 | - 2,000 | -39 | - 300 | -30 | - 50,000 | -31 | - 2,000 | -11 | - 19,000 | -40 | - 2,000 | -30 |
| 22 | -252,000 | -23 | -49,000 | -30 | - 34,000 | - 3 | -32,000 | -13 | 34,000 | 16 | - 3,000 | - 7 |
| 23 | 14,000 | 4 | 1,000 | 2 | -233,000 | - 7 | -37,000 | - 6 | - 86,000 | -15 | -27,000 | -20 |
| 24 | - 13,000 | -10 | - 1,000 | - 5 | 15,000 | 8 | 2,000 | 7 | 33,000 | 10 | 4,000 | 7 |
| 25 | 500 | 1 | 500 | 2 | 5,000 | 1 | 1,000 | 3 | - 70,000 | -10 | -16,000 | -14 |
| 26 | -114,000 | -18 | -11,000 | -14 | -183,000 | -16 | -15,000 | -11 | - 89,000 | - 7 | - 7,000 | - 5 |
| 27 | - 16,000 | - 4 | - 900 | - 2 | - 83,000 | - 4 | -17,000 | - 6 | - 4,000 | - c | - 1,000 | - 1 |
| 28 | - 49,000 | -10 | - 6,000 | -12 | -399,000 | -13 | -29,000 | -11 | -237,000 | - 9 | - 4,000 | - 2 |
| 29 | - 12,000 | -28 | - 600 | -16 | -168,000 | -25 | - 5,000 | - 9 | 69,000 | 11 | - 418 | - 1 |
| 30 | - 1,000 | - c | 2,000 | 4 | - 21,000 | - 7 | - 2,000 | - 5 | - 94,000 | -11 | -10,000 | - 9 |
| 31 | - 7,000 | - 2 | 9,000 | 8 | - 49,000 | -10 | 100 | c | - 33,000 | -10 | -11,000 | -16 |
| 32 | - 20,000 | -11 | 800 | 4 | -113,000 | -10 | -14,000 | -10 | 7,000 | 1 | 3,000 | 2 |
| 33 | - 35,000 | - 9 | - 5,000 | - 9 | -254,000 | -10 | -17,000 | - 5 | 58,000 | 2 | 4,000 | 1 |
| 34 | -143,000 | -19 | -20,000 | -18 | 6,000 | c | - 3,000 | - 1 | -164,000 | - 5 | -17,000 | - 4 |
| 35 | - 79,000 | - 4 | - 8,000 | - 3 | 89,000 | 3 | 9,000 | 2 | -376,000 | - 5 | -48,000 | - 5 |
| 36 | 28,000 | 3 | - 6,000 | 5 | 77,000 | 3 | -13,000 | - 4 | -388,000 | -13 | -38,000 | -10 |
| 37 | 93,000 | 26 | 3,000 | 5 | -127,000 | - 7 | -33,000 | -13 | -1,609,000 | -23 | -191,000 | -23 |
| 38 | - 71,000 | -22 | - 6,000 | -15 | - 82,000 | - 7 | -12,000 | - 8 | - 15,000 | - 3 | - 700 | - 1 |
| 39 | - 46,000 | -10 | - 2,000 | - 3 | - 67,000 | - 7 | - 1,000 | - 1 | 35,000 | 6 | - 4,000 | - 4 |

Note: The figures for value added have been rounded to the nearest one million except where below one million, where they have been rounded to the nearest one hundred thousand. Total employment figures have been rounded to the nearest one thousand or, where below one thousand, to the nearest one hundred. All percentages are rounded to the nearest one per cent.

[c]Less .5%

406, Changes in the Location of Manufacturing in the United States Since 1929, op. cit.

changes of manufacturing value added and total employment for the New England, Middle Atlantic, and East North Central states, as defined and reported by the U. S. Bureau of Census. These statistics cannot be modified to reveal the actual number of pension expectations which were frustrated because the number of plans, percentage of participation, or the distribution of terminated employment among jobs covered by pensions were all unknown or uncorrelated. Still, the thousands of employees who have had to find other employment, jobs which may or may not offer pension benefits, inferred that these gradual changes in manufacturing employment levels have had great impact on pension plan expectations. Plant shutdown has been the topic of a vast body of legal, social, and pension research, to which more extensive reference has been made later in this study.

To determine specific migration experience in the various states, attention was directed to contacting agencies in each state. The Wisconsin State Development and Planning Board was able to furnish a mailing address for similar agencies in all 50 of these United States. This statistical dragnet produced assorted fragments of information from 24 replies, but the data were as heterogeneous as the statistics from state registration agencies. Many states had no statistics at all, for their state planning and economic development agencies were so new that research in this area had barely begun. The states which had been most aggressive in soliciting investment in new and expanding industry were able to provide the most information,[31] but no two

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[31]For examples of heterogeneous data obtained by states, see Appendix III.

states used the same form of compilation. It would seem that the relatively uncharted economics of industrial migration within this country would be deserving of an effort among state agencies to establish a standardized reporting form for industrial investment activity within each state. Since many states have yet to begin research to accumulate such information, it would seem highly desirable to organize such a system at once. Unfortunately for the purposes of this study, information provided by the states was intriguing, stimulating, but unavailing of any national measure of frequency estimate.

2. Another approach involved contact with three national factory location consultants.

Two of these firms, representing experience with more than 2,500 commissions involving facility location in the last ten years, were able to estimate the frequency of migration as defined by this study. These firms were asked to estimate "the number of proportion of your commissions for the selection of a site which resulted in the closing of facilities at one location with actual termination of employment and the opening of a replacement facility in another employment area." The estimates of these two firms were expressed as a proportion, ranging between 15% and 20% of total commissions. (The remaining 80% of site selection centered on plant expansion, duplications, and warehouse location.) It was estimated that employment figures for each of these relocated facilities ranged between 200 and 300 persons, although there were numbers of exceptions with greater numbers of employees involved. Their estimate tends to support our guess derived

by seeking the median of the lower quartile of average number of employees covered at the initiation of a qualified plan.

3. Primary data on pension termination implicit in relocation efforts is hard to obtain.

To relate frequency of migration to incidence of pension termination required a mailing list of actual industries which had moved. The plan location services were unwilling to provide such a list. A proposal to the services, calling for a questionnaire to be provided for mailing and collection by the service in a manner designed to preserve the anonymity of its clientèle, was rejected. The services felt that former clients might be irritated by the nature of the inquiry as they tended to be defensive in explaining their moves as possibly motivated by a reduction in fringe benefits. A second source of an address list was the survey of state development agencies previously discussed and a few states were able to provide a list of firms by name and location. North Carolina provided such a list, and in the judgment of the author, this state provided the best example of aggressive and businesslike solicitation of new industries from New York and the Eastern Central industrial area.[32]

A questionnaire was mailed to 60 plants which had moved to North Carolina in the past three years to discover the scale of each and the extent of facilities reduced in size or closed, if any, at their previous location. Three additional letters of inquiry were

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[32]This program was partially responsible for elevating its Governor, Luther Hodges, to Secretary of Commerce in the Cabinet of President John F. Kennedy.

sent the home office of companies which had closed branches in North Carolina. Twenty-two of the 63 addresses gave some reply. Only three reported any pension plan at all, and only one of these plans had been terminated by the move to North Carolina, although six reported the move represented the relocation of an entire facility, a number consistent with the rough estimate of 20% provided by the location services. Only nine firms reported the North Carolina facility as their only production plant. The remaining firms were multi-plant national concerns which were expanding their operations with additional facilities in North Carolina; in these cases there was transfer of key personnel to the new location, but these transfers did not affect their pension expectations under the terms of the company-wide pension plan.[33]

## J. Pension Expectations and Labor Turnover

Although definition of the research problem excluded extensive treatment of the portability of pension rights between two viable pension programs, the problem of labor turnover has still been shown to bear on pension termination. Termination could follow a period of progressive labor force reduction from causes which eventually lead to termination of a pension plan. Unless such a plan provided certain vested rights to those who left the firm through no fault of their own, those who were dismissed before termination would receive nothing

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[33]Questionnaire and summary of information are included in Appendix IV.

while those who remained because of seniority or function in the business would enjoy a steadily improving pension expectation. Expectations would be improved because available pension funds would be shared with ever fewer participants. There have been few measures of involuntary loss of employment, but some good use could be made of a recent manpower report by the Department of Labor.

In the year 1961 about 11% of all males employed changed their jobs one or more times. The rate of turnover was highest for those in the 14 to 24 year of age classifications and dropped precipitously as the workers grew older to where less than 4% of those over age 55 changed jobs.* At the same time, those in the older years who did change jobs generally attributed it to an involuntary loss of job specifically in 56.2% of the cases reported. Significantly those involuntary job losses did not include losses due to illness, firing, retiring, or other reasons not reported. In other words, more than 2% of the 6.8 million people in the years 55 to 64 years, when pension expectations should be greatest, lost their jobs in just one year.

Of course this figure represents all types of jobs while pension expectations have been primarily concentrated in a few major industrial groups. It is therefore useful to refer to Table 23 where employment turnover by industry is broken out of the aggregate groups of figures. About one-half of employees in non-farm establishments but including federal, state, and local governments have been covered by retirement plans, both pension and deferred profit sharing. More than nine-tenths of retirement coverage was attributable to private

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*See Table E-2 in Manpower Report of the President, as published by the United States Department of Labor, March, 1963.

TABLE 23

REASON FOR CHANGING JOBS, BY MAJOR INDUSTRY GROUP, CLASS OF WORKER OF JOB LEFT, AND SEX, 1961

| Major Industry Group, Class of Worker of Job Left, and Sex | Total Number of Jobs Left (in thousands) | Reason For Leaving | | | | |
|---|---|---|---|---|---|---|
| | | Total | Job Loss | Improvement in Status | Termination of Temporary Job | Other[a] |
| **Male** | | | | | | |
| All industry groups............... | 8.986 | 100.0 | 37.5 | 33.7 | 10.9 | 18.0 |
| Agriculture ........................ | 849 | 100.0 | 16.9 | 23.7 | 43.7 | 15.6 |
| Nonagriculture industries........... | 8,137 | 100.0 | 39.6 | 34.7 | 7.5 | 18.2 |
| Wage and salary workers........... | 7,846 | 100.0 | 39.3 | 34.8 | 7.5 | 18.4 |
| Forestry, fisheries & mining.... | 193 | 100.0 | 41.1 | 28.0 | 13.0 | 17.6 |
| Construction..................... | 1,909 | 100.0 | 66.0 | 17.4 | 4.6 | 12.0 |
| Manufacturing.................... | 1,897 | 100.0 | 41.9 | 36.8 | 3.7 | 17.6 |
| Transportation & public utilities..................... | 426 | 100.0 | 33.7 | 33.5 | 9.1 | 23.7 |
| Trade.......................... | 1,822 | 100.0 | 26.7 | 43.9 | 7.3 | 22.1 |
| Service........................ | 1,351 | 100.0 | 19.1 | 46.3 | 13.4 | 21.3 |
| Public administration........... | 248 | 100.0 | 25.0 | 31.5 | 20.6 | 23.0 |
| Self-employed and unpaid family workers........................ | 291 | 100.0 | 47.8 | 32.0 | 7.6 | 12.7 |

[a]Includes illness, household and school responsibilities, fired, retired, other reasons, and reasons not reported.

Source: Manpower Report of the President and a Report on Manpower Requirements, Resources, Utilization, and Training, by the United States Department of Labor, March, 1963.

pension plans.[34] If true, then changes in jobs for non-farm industries in one year affected pension expectations in more than four million cases.[35] For example, in manufacturing, 41.9% of job losses were involuntary, about 794,843 job situations. Four per cent of these jobs lost occurred to men in the age 55 to 64 class, that is, 31,794 men lost their jobs in the most critical years prior to achieving a pension. It is not known how many participated in retirement programs which offered vesting, early retirement, or portability features, but probably vesting benefits would be limited to those meeting certain requirements, generally in regard to age and length of service. The cumulative total of workers thus affected in manufacturing alone would become impressive in only five or ten years. While the dollar loss of pension expectancies has never been determined, the exposure to workers in large pension plans without vesting provisions might be indicated by the pensions payable to more than 4 million workers in plans without vesting provisions. (See Table 23) Moreover, vesting provisions which were most liberal in reducing the years of service required became less common as plans grew smaller, and it has been established that vulnerability of both the plan and employment increases as the scale of the business declines.

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[34] Manpower Report of the President and a Report on Manpower Requirements, Resources, Utilization, and Training, by the United States Department of Labor, March, 1963.

[35] Total number of jobs left by non-agricultural industries equals 8,137,000, and this figure would be multiplied by .5.

Workers moving between jobs might be protected if their pension plan were to remain in force and if their accrued benefits were vested despite involuntary termination. A recent review[36] by the U. S. Department of Labor of pension plans with more than 5,000 participants indicated 37.4% offered no vesting of any kind while another 10% permitted involuntary separation vesting. Of more than 9.8 million workers included in the study, 41.4% were without vested coverage. Since these figures involved only the very largest plans it might be assumed that the percentage would increase if smaller firms were studied. For those which did have vesting, almost half required ten years of service or more and more than three-quarters provide the same benefits for any separation case.

Of special interest to this study was that 40% of the workers, presumably covered by a pension program, would receive no benefits should they face involuntary unemployment, not of sufficient scale to terminate the plan and to affect vesting for the workers still employed at that time. Gradual attrition of employment, as a particular process loses profitability, would permit some employees to enjoy a fully funded vested interest while those discharged from lack of seniority received nothing. It would appear that losses of pension expectations would be sufficient to justify greater reform of standard pension provisions.

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[36] Manpower Report of the President, op. cit., p. 63. See Appendix V.

## X. A Summary of Available Pension Termination Data

Review of the many and diverse sources of information suggests a sea in which wallows the indeterminate bulk of the pension expectation termination problem. Perspective on the problem must remain impressionistic at best. Some basic details can be readily observed above the surface of employment statistics pertinent to the frequency and severity of pension termination:

1. There has been an annual termination rate of qualified pension plans well in excess of 1% of the plans in force at the beginning each year, and over the long run it would appear that 10% of plans initiated were terminated within 7.5 years of their inception.

2. The annual number of terminations fluctuates with business conditions and with changes in business and labor preferences for profit sharing vis-a-vis strict pension plans. The annual total number of terminations has been increasing because it represents a moving cumulative fractional portion of plan initiations for a period of up to eight years prior to the current termination record.

3. The rate of termination has been about one-half the rate of increase in qualified plans at present but could be expected to increase. The rate is linked to increasing registrations but lags over a 7-8 year cumulative pattern. The rate also reflects the size of plans registered in terms of participants and financial strength of sponsor.

4. The rate of termination can not only be expected to increase in number but to accelerate in proportion to registrations because the recent increase of registrations of new plans has occurred primarily among smaller employer organizations. Plans from this sector have suffered a higher mortality rate than those of the large, multi-plant employers.

5. If incomplete information can be relied on, the average termination involves less than 300 employees and many affect groups of less than 75 employees. Speculative extrapolation would suggest that each year 30,000 would-be pensioners are adversely affected by pension plan terminations. Anticipating case experience to be developed in following

chapters, it can be said that terminal distributions seldom reach workers below the age of 55 at the time of termination. Since the majority of workers fall in the 25-54 age group, the largest part of all expectancies of these 30,000 involved have never been realized.

6. With more confidence, one may conclude that slightly more than 50% of all recorded terminations can be attributed to business failure, liquidation, or migration. Generally, any of these causes is preceded by a time of economic strain, violence, or drains on company resources which would preclude adequate prior funding or severance contributions sufficient to fund a pension program, so that in most cases termination for these causes immediately implies disappointment of a legitimate pension expectation.

However, it would appear that the bulk of the pension termination problem is hidden and immersed within the problem of involuntary unemployment. There is an implication in national statistics on business discontinuance or employment turnover of the tragedy to the expectations of all concerned, but it would be difficult to interpolate the severity of disappointments just within the pension field.

7. National statistics on migration, discontinuance, and labor turnover implied that perhaps 2% of the labor force suffered adverse influences on pension expectations each year. If there were about 23,000,000 covered by private pension programs, perhaps 460,000 suffered some infringement of their expectancy.

8. Severity of loss was not easily measured in terms of employees affected, benefits lost, or assets liquidated. The little evidence available indicated that while 10% of the plans were terminated, only about 1% of total covered employees were affected. As a rule, in the New York Study it appeared termination came early before pension assets could accumulate more than six or seven years and the incidence of termination fell on the smallest and weakest firms which could not afford an adequately funded plan. Funding ratios were irrelevant as a measure of severity of loss as termination priorities redistributed the funds to particular participants. On the national scene one was unable to determine directly how often pensioners, older

> workers, or vested participants suffered a reduction or loss of benefits.

Some survey measurements of the pension termination "iceberg" have been collected by the IRS as it has cruised the corporate seas. However, the best available data for charting the future course of private pensions has been put out of reach by blanket, non-selective legal restrictions on the Internal Revenue Service. The same data remains beyond the reach of the pension reporting files of the Bureau of Labor Statistics due to overly selective ennabling legislation. The best hope for improved information without breach of privileged information prerogatives is amendment of reporting form D-2 presently required by the Office of Welfare and Pension plans of the U. S. Department of Labor. This annual report form should contain alternate questions to be answered only in the event of a full or partial terminal settlement. To avoid unnecessary bookkeeping these questions could require the same information as need be filed with the IRS upon application for a qualified termination, with the exception of wage and income data of the pension participants or top twenty-five salary or wage earners in the plan.

# CHAPTER III

## LEGAL FACTORS AFFECTING THE PROCESS OF PENSION PLAN TERMINATION

### A. Objective of Chapter

The pension contract could be viewed as a legal effort to allocate a share of productive wealth among parties with a vested interest in its production, labor, capital investor, and government. Each has been willing to sacrifice something to provide for the social problem for the elderly, but not at the total expense of wages, profits, or tax receipts. These interests have been compromised with a certain degree of harmony because of the elasticity of time and money variables in the actuarial formula--if the plan were to operate over the long term. Remove the time element in the process of money accumulation, as would happen when it is necessary to curtail or terminate the plan, short the accumulation process, and the rough equities struck among economic interests would be lost.

Each interest group would then break down into various conflicting sub-classes striving for a share of pension funds inadequate to meet all expectations. Conflicting interests have been generally resolved by establishing priority of claim,and this priority should reflect the lawyers' interpretation of the economic and social philosophy inherent in the original plan. This chapter will be concerned with the legal and economic character of the employer and employee interest, certainly the principal interests at termination.

However, there would be corollary interests in terminal shares, including those of the Internal Revenue Service, funding media, actuarial consultants, and others related to the administrative process--and these parties on the periphery of the termination process were treated in Chapter IV. It has been left to this chapter to explore the factors which lie behind the distinct shift in the relative equities of the individual and the group, of the group and the employer, when time and money have run out at the termination of a pension plan.

B. A Definition of Pension Termination

Termination of a pension plan may be the result of explicit action or may be implicit in surrounding circumstances. There are four basic patterns of explicit termination:

a. The employer terminated the plan at a time of his own choosing.

b. Either the employer or the labor representative has terminated the plan on 60 to 120-day written notice of such intent, in which case all funds vested with participants as of the date of termination.

c. The plan has terminated automatically upon dissolution of the business or at the end of a labor contract period.

d. Insured plans have terminated if the number of active participants fell below a given minimum group size.

In general an employer has reserved the right to terminate a pension program by action of its board of directors for any reason at any time. Such action by the employer would probably be dictated by economic necessity, such as excessive cost, unlimited liability due to unexpected actuarial results or changes in labor economics. Over time the individual has introduced certain provisions insulating him

to a degree from the shocks of pension or employment termination, such as those for vesting, early retirement, or plant shutdown.

An implicit or defacto termination must be given explicit recognition before any of these individual safeguards can be operative. There is a variety of such termination situations including partial termination of the plan, tax law definition of retirement, and court definition of what has occurred in point of fact.

1. Terminations as defined by court precedents provides some criteria with which to convert implicit terminations to recognized explicit termination in full or in part.

For example, in one case[1] it was determined that sale by the corporate employer of one of its two operating divisions was discontinuance of its profit sharing and retirement program with respect to 55 persons, including seven salaried employees discharged following sale. Sale with discharge of the employees of one division representing about 50% company activities was considered "an extraordinary incident in the structure, function, and life of the company" and therefore a significant reduction in corporate activity. Sale was accomplished by action of the board of directors and the court implied an action on the part of the corporate board to terminate a portion of the pension program coincident with sale. This case varies from the general pattern of court decisions which have tended to follow slavishly the termination provision wording of

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[1] Fernecke v. CMP Industries, 222 N.Y.S., 2d 582 Appl. Div. 3rd Dept.

the contract. The court distinguished this particular case from another well cited opinion[2] in which the plaintiffs had not succeeded in establishing partial termination and hence a vested interest, when discharged following sale of one of 17 company divisions. The liquidated division employed 108 men of a total work force of 1,740 persons, or 6.2% of the work force. A similar decision[3] held there was no partial termination when a single division of a firm was discontinued, where the division represented 1.6% of a total employee force of 9,000 persons.

Apparently termination of somewhere between 6% to 50% of the work force is considered an implicit termination of a part of a pension plan, but not where discontinuance of employment is 6% or less. If a termination is not implied in these cases, the employer could benefit excessively from returns applied.[4] If the court were to construe termination in terms of the number discharged, the court would establish the doubtful precedent that members of a closed division of some size have a more enforceable interest in a pension plan than a single individual also supplanted because his work was

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[2] Bailey v. Rockwell Spring & Axle Co., 13 Misc. 2d 29, 175 N.Y.S., 2d 104.

[3] Schneider v. McKesson & Robbins, Inc., 2 Cir., 254F. 2d 827.

[4] Funds which the employer contributed on behalf of employees who were terminated without vested benefits, are first applied to current employer contributions required up to the amount annually excluded from income taxation. This amount plus interest compounded thereon is applied to remaining liability before additional contributions are made.

automated, sub-contracted, or otherwise eliminated. Courts have generally been unsure of themselves, or at least unrealistic in actions seeking implicit termination.[5]

2. Termination has been defined and dissected most finely by the Internal Revenue Service, whose definitions have identified different states in the terminal process.

Tax qualifications placed no time limit on pension plans. A tax qualified plan can be brought to a close without penalty for any reason which reveals a "business necessity."[6] The Internal Revenue Service has liberalized its definition of a business necessity to recognize any valid business reason or condition which is beyond the control of the employer or beyond foreseeability and therefore made it improvident to continue the plan.[7] What is improvident not only may include that which seriously endangers the financial condition of the firm but also contemplates that which indicates the plan would not accomplish the objectives of business in reducing turnover or motivating employees. If the reason for termination is not acceptable to IRS, the Commissioner may determine retroactively whether or not the plan was ever intended to be permanent and, hence, entitled to tax exemption.[8] The tax code further requires that a pension plan

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[5]For additional discussion, published since these paragraphs were first written, see Bernstein, Merton, "Employee Pension Rights When Plants Shut Down; Problems and Some Proposals," Harvard Law Review, Vol. 76:950-973.

[6]IRS Reg. 1.401-1(b)(2), 1.401-4(c), PS No. 7, PS No. 52.

[7]IRS Mim. 6136 as modified by Rev. Rul. 55-60, 57-163.

[8]Longhine v. D. Bilson, 159 Mac. 111, 287 N.Y.S. 281 (1936).

include a provision vesting fully the rights of all participants upon termination, hence the interest of the courts in establishing partial termination. In addition, a provision is needed for distribution of funds upon termination, but with the exception of certain restrictions against discrimination, almost any provision would be acceptable.

The tax code has also defined curtailment, discontinuance, and suspension. A curtailment which lowered benefits, reduced contributions, narrows coverage, or makes vesting less liberal may be treated as an unjustified termination unless the employer's action does not affect any current benefits or cause the unfunded past service cost to rise higher than it was at the beginning of the plan.[9] Employees can be eliminated who are picked up under another retirement plan to which the employer contributes and adjustments can be made to reduce discrimination in favor of company officers and high salaried employees. However, curtailment can lead to discontinuance, an informal termination of the plan occasioned by discontinuance of contribution.[10] Where contributions are delayed or stopped only temporarily, the Treasury will view the situation as a suspension.[11] Suspension will not require full vesting if the benefits to be paid are not affected at any time by the suspension and the unfunded past service cost does not exceed the unfunded past service cost when the

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[9]Mim. 6136, CB 1947-1, 58.

[10]Aaron, op. cit., p. 67.

[11]Pension and Profit Sharing Report, op. cit., 4216-A.

plan was established or amended. Suspension can prove to be discontinuance if the situation does not improve. The significance of the IRS definitions to this study is that termination of a pension may not be expressed and dated until long after the fact for ease in determining and safeguarding the interest of various participants. The fact that termination took place and the date on which this could be said to have occurred may be set retroactively by the tax commissioner or by the court introduces a certain speculative element to the definition of explicit plan termination and distribution.

> 3. A definition of termination and the date on which it can be said to occur is related to the employment status of participants and their status as of the day of termination.

Those pension fund assets not already committed to vested benefits vest with that class of employees recognized as participants on the date of termination. This class would be defined by provisions unique to each pension plan as to eligible employees, continuity of service, rights in event of layoff, and forfeiture under various circumstances. Where termination can be anticipated, it is possible for the employer to amend the definition unilaterally and exclude certain classes of employees actively employed or laid off at the time of termination. Moreover, the courts[12] have said that the negotiating committee of the union can negotiate such an exclusion without incurring liability to its own members who fail to qualify under the amended plan of allocation.

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[12] Finnel v. Cramet, Inc., op. cit.

For the purposes of this study, then, termination of a pension plan occurs whenever the employer's unilateral offer is explicitly revoked, a bilateral contract is amended or rescinded by mutual consent, benefit payments or funding schedules are curtailed beyond tax law tolerance, or an incident in the business situation has such an extraordinary impact on its structure or employment level the courts would consider it to be tantamount to partial termination. Termination of employment excludes voluntary withdrawal, temporary layoff (so long as all rights based on continuity of service are unaffected), and discharge for cause.

C. Source of the Employee Pension Right[13]

1. The Gratuity Theory

There was a time when a pension was universally considered a gratuity, a gift by the employer, subject to withdrawal before or after a pension income had begun, thus not vesting until each increment was

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[13]Pension literature contains many discussions of the nature of the pension interest; this section is a synthesis of comment from the following sources:

Benjamin Aaron, Legal Status of Employee Benefit Right Under Private Pension Plans, Pension Research Council, University of Pennsylvania, 1961, pp. 5-14.

Ackerman, "The Legal Aspects of Amendments to a Pension Plan," Labor Law Journal, Vol. 1 (1950), p. 929.

Comment, "Consideration for the Employer's Promise of a Voluntary Pension Plan," University of Chicago Law Review, Vol. 23 (1955), pp. 990111.

Somers and Schwartz, "Pension and Welfare Plans: Gratuities or Compensation," Industrial and Labor Relations Review, Vol. 4 (1950), pp. 77-85.

"Legal Problems of Private Pension Plans," Harvard Law Review, Vol. 70 (1957), pp. 491-502.

paid,[14] a delivery of the gift, as it were. These earlier plans generally contained an express statement identifying benefits as gratuities, disclaiming any enforceable right for an employee, and disavowing any liability on the part of the company. Most modern plans still contain strong vestigal remnants of these traditional disclaimers.

2. Conditional Contract Theory

More recently legal analysis has been able to discern elements of a unilateral contract in either voluntary or negotiated pension plans. It is now possible to identify in an employment situation involving a pension program an offer, acceptance, and consideration essential to the existence of the pension contract.

A number of court decisions[15] have found the publication of a pension plan to be an offer by the employer to provide a stipulated pension to any employee who indicates his acceptance[16] by working faithfully and continuously to satisfy the conditions of eligibility

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[14] There are a great number of cases on this point. Those leading cases briefed for this study are:

McNevin v. Solvay Process Company (1898) 32 App. Div. 610, 53 N.Y.S. 98, affirmed 167 N.Y. 530, 60 NE 1115.

Dolge v. Dolge (1902) 70 App. Div. 517, 75 N.Y.S. 386.

Burgess v. First National Bank (1927) 219 App. Div. 361, 220 N.Y.S. 134.

Korb v. Brooklyn Edison Co. (1939) 258 App. Div. 799, 15 N.Y.S. 2d 557.

Menke v. Thompson (1944)(CA 8th Mo) 140 F 2d 786.

Hughes v. Encyclopedia Britannica, Inc. (1954) 1 Ill. App. 2d 514, 117 NE 2d 880, 42 ALR 2d 456.

Abbott v. International Harvester Co. (1953) 36 Erie Co. LJ 271.

[15] Hunter v. Sparling (1948) 87 Cal. App. 2d 711, 197 P2d 807.

Magee v. San Francisco Bar Pilots Benevolent and Pension Association (1948) 88 Cal. App. 2d 278, 198 P2d 933.

[16] Wallace v. Northern Ohio Traction and Light Co. (1937) 57 Ohio App. 203, NE 2d 139.

for a pension. The loyalty of the employee represents consideration,[17] a valuable commodity to the employer who would presumably profit by the reduction of turnover, higher morale, and the efficiency that came with experience. Where the gratuity serves as a reward for service, the unilateral contract calls for forfeiture of the pension element of compensation should the worker fail to satisfy certain conditions precedent, such as reaching a minimum age, employment for a minimum number of years, or remaining with the employer until retirement age.

3. Deferred Wage Theory

The theory of a unilateral contract was then quickly extended by some to a logical conclusion that pensions are deferred wages.[18] There have been innumerable instances where the courts have spoken of pensions as deferred compensation or deferred wages. The implication of a deferred wage analysis would be that the employee's rights vest as he earns the amount contributed for his benefit, whereas the

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[17] Cowles v. Morris (1928) 330 Ill. 1, 161 NE 150.

Bos v. United States Rubber Co. (1950) 100 Cal. App. 2d 565, 224 P2d 386.

Dolan v. Heller Brothers (1954) 30 N.J. Super 440, A2d 860. (Plaintiff lost but victim argued continued service was consideration for contract.)

[18] For more detailed discussion see Benjamin Aaron, Legal Status of Employee Benefit Rights Under Private Pension Plans, op. cit., pp. 10-14.

An important precedent for the deferred wage theory was established in Kern v. Longbeach (1947), 29 Cal. 2d 848, 179 P. 2d 799.

The court allowed recovery of a public pension repealed before retirement age on the ground that denial was unconstitutional.

unilateral contract interpretation withholds rights until the employee reaches retirement age. The most literal extension of deferred wages theory would imply individual employee accounts of accumulated contributions as earned. However, this latter implication has been studiously avoided by both management and labor, each for its own purposes.

4. Discussion and Comparison of Pension Legal Theory

The gratuity theory offers no vested interest to the pensioner as periodic payments could be denied or reduced after retirement. Such a curtailment would not be supported by the law of either the unilateral contract theory or the deferred wage approach. Comparing pension plans which are properly funded for retirement benefits in accordance with tax qualification provisions, there is little legal distinction in result between gratuity and contract theories. Because tax deductions for contributions to pensions are only possible when irrevocable, the net effect under any theory is an irrevocable pension to the employee who works until retirement.[19] However, the area of pre-retirement rights has been pointed out as the most vulnerable and

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[19] David v. Veitcher Magnesitwerke Actien Gesellschaft (1944) 348 Pa. 335, 35 A2d 346. In this case the court referred to the employee's right to a pension as an inchoate right like dower rights before he had complied with conditions entitling him to benefits. Thereafter the pension right was vested.

See also Gilbert v. Norfolk and Western Railroad Co. (1933) 114 W. Va. 344, 171 SE 814.

Texas and Northern Ohio Railway Co. v. Jones (1937) Tex. Civ. App. 103 SW 2d 1043.

insecure, and it is in this area that the choice of theories has real significance.

Before retirement the pension expectation can be lost if the employer attempts to suspend or amend the pension plan or if the employment relationship is severed. Given a voluntary plan, which denied the existence of any contract of employment for a definite term or pension, a provision permitting the employer to amend or terminate would permit the employer to do so under the gratuity theory or unilateral contract theory. An employer could revoke any pension offer which had not been accepted by serving until retirement age.[20] The deferred wage theory, however, in its simple version would entitle the employee to some share of the pension fund. The harshness of legal theory, which presently still endorses the gratuity or unilateral contract analysis, is only mitigated by the tax law which requires irrevocable contribution and full vesting upon termination. Terminal vesting has been of small comfort for the non-vested employee discharged shortly before termination or for participants of a plan which enjoyed little funding. The deferred wage theory reduces the possibility that termination of the plan could vest such pension funds as might be available in a special class of participants differentiated from all employees by means of stringent eligibility rules. Probably dissolution of a pension fund according to the tenets of deferred wage theory would require distribution of prorata shares

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[20] _Hughes v. Encyclopedia Britannica, Inc_. (1954), _op. cit._

based on hours worked since the outset of the plan.

Since most pension plans contain some expression which denies liability if employment is terminated before retirement or some specific set of conditions for vestment are satisfied, termination of employment has the same practical result under either the gratuity theory or unilateral contract analysis. The commentator in the University of Chicago Law Review[21] illustrates how the deferred wage analysis might produce a different result by means of the case of Roberts v. Mays Mills, unfortunately for current precedent, a legal sport of 1922 vintage. The case was briefed as follows:

> An employee, hired for an indefinite period and wrongfully discharged, was allowed to recover a prorata share of the bonus promised him at the end of a year's work. The court explained its holding on the theory that the employee accepted the unilateral offer of the bonus, not upon completion of the year's service, but upon beginning work. The limitation of the employee's recovery to a prorata share was justified on the basis that employment was for an indefinite period and could be terminated at will.[22]

The deferred wage theory could be adapted to such situations, the commentator goes on to suggest, by permitting the rights of an employee to vary according to the circumstances that prompted termination of employment. These circumstances could be arranged in order and ranked from one extreme of discharge in bad faith for the purpose of avoiding pension liability to the other extreme of voluntary resignation by the employee.

At either extreme justice according to the lights of deferred

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[21] Op. cit.

[22] Roberts v. Mays Mills (1922), 184 N.C. 406, 114 S.E. 530.

theory is quite direct and understandable. Bad faith on the part of the employer should entitle the employee to recover[23] the amount of the pension already accrued in service, a result which might be possible under the gratuity and unilateral contract approach as well.

Conversely discharge for cause[24] or a voluntary resignation would waive the employee's pension claim under the deferred wage theory. His rights would be forfeited due to inadequate service or due to a voluntary relinquishment upon resignation. In the middle ground of this array of possible situations, where neither party has had free choice due to circumstance, loss of employment should entitle the employee to recover a prorata share of pension contributions. Presumably he was dismissed for business reasons unrelated to the quality of the services and has therefore earned part of his promised pension; it could be assumed that the employee was prepared to work until retirement. Since the pension plan is often supported with provisions for death or disability payments, inability to complete the employment term for these reasons has been ignored but the deferred wage theory might produce some compensation for the estate of the employee in lieu of each provision.

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[23] For example, in Wisconsin the courts recognized substantial performance of the conditions for a share in a profit sharing plan as acceptance of an offer when an employee was discharged the day before becoming eligible for a claim under the profit sharing plan.
Zwolaneck v. Baker Mfg. Co. (1912), 150 Wis. 517, 137 N.W.769.

[24] Marquart v. Baltimore and Ohio Railroad Company (1934), 49 Ohio App. 141, 195 N.E. 396. In this case the plaintiff lost his pension right when discharged for insubordination even though he had satisfied the service condition of his pension, despite the fact that the court followed unilateral contract theory.

Were the deferred wage analysis to govern the courts, its pre-retirement decisions would conflict with those provisions in pension plans which disclaim liability to employees who do not work until retirement age. The Chicago Law Review has suggested that this difficulty might be resolved by construing the provision as ambiguous, since it did not refer specifically to wrongful discharge. Ambiguities would be decided in favor of the employee with the precedents of unilateral contracts in the insurance field. Where denial was quite specific the courts would be forced "either to abandon the deferred wage theory as being practically indistinguishable from the unilateral contract theory, or to strike the term down."[25] Support for the latter alternative might be generated "on the theory that it was an unconscionable imposition on the employee, in light of the inequality of bargaining power between employer and employee, to deprive the employee of his full earned wage when he is dismissed without fault on his part."[26]

To avoid creating a binding pension contract with its attendant liability, employers specify in their offer that the pension is a gratuity and that no enforceable rights are created. A few courts try to interpret these provisions strictly to favor a litigating employee, but generally courts have followed the general principle of contract law "that a provision in an agreement stating

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[25]"Consideration for the Employer's Promise of a Voluntary Pension Plan," op. cit., p. 110.

[26]Ibid.

that it will have no legal consequence will prevent the formation of a contract."[27] However, some legal scholars[28] have argued that the employer should not be permitted to avoid a pension obligation, particularly when it has been his practice to pay a pension according to the terms of his offer, and when reliance on the part of the employee could create a condition of promissory estoppel.

Since a pension plan could not achieve its desired effect on employee motivation without reliance on the part of the employee, and since it would be impossible to argue that the employee did not intend to remain with the employer until retirement, it would seem unjust to enforce a gratuity clause in light of the inequality of bargaining power. The introduction of equity because of inequality of bargaining position infers that a pension plan which is the result of collective bargaining would have more difficulty in circumventing a gratuity clause. Provisions to amend, revise, or terminate a pension plan can have the same impact on pension expectations as a gratuity clause. While court precedent has not yet established a pattern defining a limit upon the right of the employer to deprive the employee of his pension, the same spectrum of curbs on the application of the gratuity clause, under the unilateral contract or deferred wage theory, should also apply here.

For the moment discussion of legal alternatives with which to contest a termination distribution is best deferred to the section in

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[27]"Legal Problems of Private Pension Plans," op. cit., pp. 494-5.

[28]1 Corbin, Contracts 153 (1950).

this chapter on contesting termination of pension expectations. The important point here is that the property interest of pension plan participants is greatly strengthened in theory where the deferred wage concept determines the equitable interest of participants vis-a-vis the interest of the employer and investor. The viewpoint that pensions are earned by workers rather than donated by employers is consistent with the layman's viewpoint and is actually an old idea among pension professionals. As far back as 1916, years before the National Labor Relations Act, one research project observed:

> It is generally agreed by economists that a free pension provided by an employer, whether that employer be a government or an industrial organization, is in effect a part of wages . . . a pension system considered as part of the real wages of an employee is really paid by the employee not perhaps in money, but in the foregoing of an increase in wages which he might obtain except for the establishment of a pension system.[29]

Elaborations of this theme can be found in a wide number of fields such as economics, law, and industrial relations. The gratuity theory has lost its acceptability and vitality;[30] the unilateral contract theory is affecting a growing number of decisions. Obviously the deferred wage theory would be a still more desirable legal precedent from some employee viewpoints when faced with problems of failure, liquidation, or migration of the pension sponsor.

5. Problems in Application of Deferred Wage Pension Theory. However, the deferred wage theory overlooks many of the social and

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[29]Sommers and Schwartz, "Pension and Welfare Plans: Gratuities or Compensation," op. cit., p. 83.

[30]Ibid., p. 85.

actuarial considerations of a pension plan, which would modify termination distribution outcomes predicated on deferred wage equity. First, private pensions are a device for socializing earnings by transferring a portion of current wages to those who retire soon after the plan was established and long before it could expect to be well endowed financially. The mechanism of collection and distribution for pensions certainly obscures the idea that funds received can be specifically allocated to any one individual. The pooling of funds bears some similarity to the sharing of risk in a mutual insurance arrangement when it is a clearly delineated objective of a pension plan to take care of the older workers as they reach an age when their usefulness is impaired. The younger workers are willing to direct funds generated from their productive efforts to support pensions for those entering retirement in expectation that one day another generation of workers will lend their retirement the same kind of security. Moreover, if it is the avowed intention to provide the older workers with a significant pension income, whether or not sufficient working years for accumulating earned benefits remain following the inception of a pension program, a portion of the first pensions paid represents a gratuity although whether it is at the expense of the employer or fellow employees is not clear. Often the older worker receives more than a prorata share in the pension plan because younger workers gain more than proportionate benefit from other components of the welfare benefit packet, such as family medical insurance or supplementary unemployment insurance. Presumably the younger men have a larger group of dependents who can benefit from medical insurance or

lack the seniority which may insulate them from temporary layoff. Once the idea of equity for employees as a balance of interest between welfare programs as well as within a single plan is introduced, the simple equity system which lies behind the deferred wage theory falters. Finally the deferred wage theory is not even compatible with the actuarial theory which determines the cost feasibility of any pension program. The average employer can simply not afford to pay each employee annually the capital value of an increment in pension benefit earned. Instead the establishment of a minimum number of service years, attainment of a given age, and other conditions precedent to a pension preselects and reduces the number of those reaching retirement. This much smaller group can be given a proper pension within the financial capability of the employer when the power of compound interest operates. The younger workers forego a vested interest to make it possible for the employer to offer the older worker a reasonable pension expectation. These compromises of individual interests to secure a collective security make it impossible to establish an equivalence of pension expectation and an alternative increment in cash wage necessary to support an argument based on the deferred wage theory of law. The deferred wage theory may be used to define the class interest of employees in relation to the unilateral powers of the company, while labor law must define the relationship between the individual participant and his representatives in pension negotiations. Therefore, the simplicity of preretirement termination equities in light of deferred wage theory is illusory. As a practical matter the deferred wage concept has received far more abstract legal

theorizing than actual application in the courts. Its role in determining the basic nature of a pension and hence the relationship between the interest of the employer and employee has been summarized as follows:

> . . . the deferred wage theory has thus far failed by a wide margin to gain sufficient judicial support to warrant reliance upon it as a means of securing the rights of covered employees. Indeed, it is no exaggeration to say that the one legal principle upon which employees may reasonably rely for protection of their pension benefits is that the typical modern pension plan is an enforceable contract. It follows that employee rights in specific situations will almost invariably be determined by the terms of the plan itself, and not in accordance with the theory that pensions are deferred wages.[31]

6. Conditional Contract Theory as a Basis for Termination Process.

By accepting the pension plan as a contract and looking to the contract for definition of the rights of the parties, there is a question of how among competing interests equity is to be established for all participants. The equity between the employer and the employee is established when the contract is drafted. Eligibility and value of individual pension rights are shaped by various contract terms, and the resources available to meet these claims may or may not rest on contract definition of the rate of funding. However, management does not necessarily anticipate termination nor a return of its contributions should termination be necessary, and so the problem of allocating limited resources to a large number of claims is placed on

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[31]Benjamin Aaron, Legal Status of Employee Benefit Rights Under Private Pension Plans, op. cit., p. 13.

union representatives. If the union organization is to be spared the damaging consequences of intramural dispute in the event of terminal distribution, priority of claim on inadequate assets should also be established in the original contract.

Those who find the contract or the termination process ambiguous, inequitable, or injurious may find the source of rights in the common law and the opportunity to contest a terminal distribution.

D. Opportunity to Contest Termination Distribution

1. Source of Legal Standing.

Depending on the definition of a pension as a gratuity, unilateral contract, or deferred wage, a participant who feels an injury due to his termination or the termination of the pension plan may have recourse in the courts under the law of equity, contract, or wages. As pointed out previously, the deferred wage theory is not generally accepted and the gratuity theory provides little ground for suit. Consequently the basic remedies of the injured, expectant pensioner lie in contract law, where the pensioner has fulfilled the conditions of the plan, or has status as an ordinary beneficiary of a trust. A contract right clearly exists where the pension plan is part of a bilateral contract which obliges the employee to perform certain things and the employer to pay a pension when these conditions are met. And as pointed out before, a binding obligation is also created when the employer's unilateral offer of a pension is accepted by completing its requirements of continued employment, etc. Where such rights

exist the employee may bring suit for pension payments as they fall due.[32] His rights may be barred by the Statute of Limitations or marred by a defense pleading the Statute of Frauds. The continuing nature of an annuity income generally entitles the recipient to sue for any individual installment within the Statute of Limitations.

On the other hand most pension plans effectively obstruct the use of contract remedies when contesting pension plan administration through use of gratuity clauses which specify that any pension is a gift and that no enforceable rights were to be created or implied from the existence of a formal pension plan. A few courts will twist these clauses to comfort the litigant,[33] but generally formation of a contract is forestalled by a provision which maintains the agreement has no legal standing.[34]

2. Possible Court Action Against Gratuity Clause.

One legal writer has argued that a gratuity clause could be defeated in certain cases by the theory of promissory estoppel.[35] It is argued that reliance only on chance of acquiring a pension is not sufficient reliance to support a charge of estoppel. On the other

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[32] 4 Corbin, Contracts, 958 (1951).

[33] California-Western States Life Insurance Company v. Gibbons, No. 53142, Cal. Super. Ct., San Joaquin County (1955), as summarized in Pension Plan Guide, published by Commerce Clearing House, p. 10494.

[34] Menke v. Thompson, 140 F. 2d 786 (1944).

[35] 49 Harvard Law Review 148, 149 (1935).

hand if the employee could see that the employer had always paid a pension in the past and that conditions indicated he too might expect a pension, the employer should not be permitted to deny liability under a gratuity clause when the employee could have placed reasonable reliance on the pension expectation. This theory presumes a voluntary pension plan, and an implication of unequal bargaining power. A pension plan as a result of collective bargaining provides less excuse for twisting the terms of the plan.

3. Legal Remedy Under Doctrine of Substantial Performance. A recent analyst writing in a law review[36] theorized on the legal remedies available to employees when termination of employment meant forfeiture of accumulated pension credits. On the precedents of several old cases[37] which did not specifically apply to pensions, it was argued that an employee may leave employment before fulfilling the terms of the pension offer and still enforce payment under the doctrine of substantial performance, if the deficiency in performance is minor, perhaps technical, and the employer has received full satisfaction. In at least one case substantial performance was denied because the circumstances leading to termination were "intentional, deliberate, and willful."[38] Further support for this view can be garnered from Restatement of Contracts. Here it is stated that a condition not an essential part of a contract may be excused where its enforcement

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[36]--"Legal Problems of Private Pension Plans," Harvard Law Review, op. cit., pp. 494-495.

[37]Zwolanek v. Baker Mfg. Co., op. cit.

[38]Cramer v. Essweim, 220 App. Div. 10, 220 N.Y.Supp. 634(1927).

would result in an extreme forfeiture.[39] The analyst believes this would mitigate the effects of a provision calling for forfeiture where employment is terminated prior to satisfaction of all pension qualifications.

4. Legal Remedy Under Doctrine of Quantum Meruit.

Where the court might be susceptible to implications of the deferred wage theory of a pension, the same analyst as above suggests that the employee might seek to recover in quantum meruit in at least certain jurisdictions.[40] With such an action the employee would be required to prove that he had benefitted his employer to an extent where the value was significantly greater than the wages he received. A monetary measure of loyalty and the values of continuous service in comparison to the employee's reliance to his detriment in the expectation of the pension would be nearly impossible. By the same token, basic defense of the employer would be to refute the employee's

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[39] In Re Schenectady Railway Company (1950), DC NY, 93 F Supp. 67, the trustee appointed to manage an insolvent corporation during reorganization paid, as operating expenses, pension benefits to retired employees under the terms of the collective bargaining agreement. The court approved these payments even though the trustee had not decided whether to assume or reject the labor contract. The court held that payment of monthly pensions to employees under the negotiated wage agreement was actually a part of the consideration for services presently performed by active employees. The trustee was required by the court to discontinue pension payments to employees not represented under the labor contract because their pensions were in the nature of gratuities and had been created solely by the terms of the resolution adopted by the board of directors.

[40] Apparently this remedy is appropriate only where courts follow the rule of Britton v. Turner, 6 N.H. 481 (1834) from Note 43, "Legal Problems of Private Pension Plans," Harvard Law Review, op. cit., p. 496.

assertion that it was the pension expectation which induced him to remain with the firm. These restrictions on courtroom evidence and procedure restricts the use of this remedy to a rare and inconceivable situation.

5. Legal Remedy Under Doctrine of Impossibility of Performance. Where termination of employment makes it impossible for the employee to fulfill the conditions precedent to a vested pension expectation, there are circumstances which would give him an enforceable claim. Where the pension is part of a bilateral or negotiated employment contract, a discharge not recognized as for good cause under the terms of the contract will permit a successful claim. In a unilateral contract termination which prevents qualification is really tantamount to revocation of the contingent offer to provide pension benefits. The analyst mentioned previously found a preferable precedent in his view in the basic principle that a promisor cannot rely on a condition which he has prevented the promise from fulfilling.[41] To this point he finds two cases[42] involving bonus contracts as analogous to the pension situation. In these the courts allowed an employee to recover on a unilateral contract after discharge even when the employer had acted in good faith, unless the employee was discharged for a cause that would have justified his dismissal in any event. A

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[41] Williston Contracts, par. 677 (rev. ed. 1936).

[42] American Security Life Ins. Co. v. Moore (1954), 37 Ala. App. 552,72 So. 2d 132 (bonus); Roberts v. Mays Mills (1922), op. cit. (profit sharing bonus). Contra, Sabl v. Laenderbank Wien Atkiengesellschaft (Sup. Ct. 1941), 30 N.Y.S. 2d 608, 616 (dictum).

bonus plan does not seem analogous to a pension plan, in this regard, since it does not contain the actuarial contingencies of a pension program. He could generally collect a bonus prorata if he died before completion of the work for which he contracted. Similarly he would not collect the pension if he died prior to retirement age. Discharge before time could prove the assertion of the employee that he would have provided continuous service and leaves the employer in the defenseless position of having to deny the intentions and motivations in the mind's eye of the employee. This technical legal impasse seems to differentiate the long term pension prospect from the shorter term bonus plan.

Failure only to satisfy a condition which requires the passage of time does not entitle an employee to benefits when he contests his discharge under the doctrine of anticipatory breach.[43] If an employee is wrongfully discharged before he has met service requirements, he may sue at once although he has not reached the minimum age required of pensioners. On the other hand, if discharge follows completion of service but is prior to his pensionable age, legal action is premature until the company indicates that it is not going to pay benefits at the commencement of retirement. In those cases where immediate suit would be possible the measure of damages would require discounting the value of a deferred pension.

The need to discount for life expectancy does not appear to

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[43]See Restatement, Contracts, Par. 318 (1932); 4 Corbin, Contracts, Par. 962 (1951) takes issue with the majority view.

enter court decisions affecting a bonus. In theory the court would have an alternative of declaring the employee eligible for a pension, deferred until he reached the required age.[44] The same legal authorities define the measure of damages as the total value of wages and pension rights the employee would have received if he had been permitted to fulfill the conditions of the contract minus the total compensation he could receive in alternative employment.[45]

6. Legal Remedy Impairing Rights of Others.

Where pension assets are in the control of the trust, it has been held that a wrongfully discharged employee may not recover where his recovery would impair the rights of other beneficiaries.[46] One commentator feels that if recovery cannot be sought from the trust, the employee should be able to proceed directly against the employer for breach of promise or for interference with an advantageous relationship.[47] However, this possibility seems to be forestalled by the general practice of inserting a pension clause denying that the existence of a pension plan implies any promise of continued employment or immunity from discharge. Very recently one author has suggested that termination can provide unjust enrichment for the employer who has funded benefits that would have been payable to

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[44] 4 Corbin, Contracts, 969 (1951).

[45] See Restatement, Contracts, Par. 329, 336 (1932); 5 Williston, Contracts, Par. 1358, 1359 (Rev. ed. 1937).

[46] Twiss v. Lincoln Tel. & Tel. Co., 136 Neb. 788, 287 N.W. 620 (1939).

[47] See Prosser, Torts, Par. 107 (2d ed. 1955).

separated employees. A major difficulty for the plaintiff employee, in this case, would be establishing the degree of such enrichment by means of actuarial assumptions upon which the plan was built as compared to the actual figures experienced.[48]

7. Legal Remedy After Liquidation or Bankruptcy of Employer. The legal remedies discussed to this point are basically individual actions which presume the continued existence of the pension plan and the employer. However, a somewhat different legal situation prevails where the plan and perhaps the employer go out of existence because of bankruptcy, liquidation, or migration. An important area is that of employee pension rights when the employer enters bankruptcy. Where a trust has been interposed between employer and employee the remedies for injury, fancied or incurred, may be as discussed above. But the problem arises of what recourse can be had against an employer who not only failed in his business but failed to meet his funding obligations under the terms of the pension plan. Generally, the problem is whether contributions due to a pension plan can be considered wages and, hence, enjoy a preferred status of claim against the bankrupt's assets.[49] The

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[48]Section 64 of the Bankruptcy Act reads in part: "The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be . . . (2) wages not to exceed $600 to each claimant, which have been earned within three months before the date of commencement of the proceeding, due to workmen . . ."52 Stat. 874 (1938), 11 U.S.C. sec. 3104 (1958).

[49]See Chapter VII for a discussion of this problem by Professor Merton Bernstein, op. cit., pp. 974-978; a quantum meruit recovery presents many technical problems of proof, many of which bear on the

lower courts presented diametrically opposed precedents in the cases Matter of Sleep Products, Inc.[50] and Matter of Otto.[51] In the first case the employer was obligated by his union contract to contribute a percentage of gross monthly payroll to a welfare fund to which no employee had a vested right. When the employer went bankrupt he was sued for payments due but not paid the welfare fund. The court held that these payments were not wages but were paid directly to the trustees of the fund. The payments were not taxed as wages, and the intent of the Bankruptcy Act in respect to the meaning of wages was to provide immediate income for subsistence to employees discharged by the bankruptcy. Deferred insurance benefits were not considered to satisfy this intent. The court concluded that the individuals could not sue the employer directly because the defaulted contributions were due directly to the trust.

In the second case, Matter of Otto, the defunct business was obligated by its union contract to pay pennies per hour worked by each employee into a welfare fund on a monthly basis. The fund was to pay a cost of living bonus or wage increase, and no one was given a vested interest beyond benefits payable. The court concluded that such contributions were compensation or wages for services rendered and disputed the reasoning of the previous case. Intent was attacked on

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legal nature of the actuarial estimate of employee liability and the variations of assumptions that can be made plausible for any given plan. Proof of loss would require a jury able to weigh conflicting actuarial opinions.

[50]141 F. Supp. 463 (S.P.D.N.Y. 1956).

[51]146 F. Supp. 786 (S.D. Calif. 1956).

the grounds that a number of other federal statutes and rulings recognized welfare payments as wages. The income tax criteria was held to be irrelevant. The law and the court was not empowered to distinguish various forms of compensation in determining priority of claims. Instead, it viewed the contribution as an assignment, a portion of which went to the welfare trust, and it pointed out the well known principle that an assignment retains the same legal powers as the original plan. Consequently, overdue contributions to the pension for up to three months would enjoy priority of claim on the assets of the bankrupt employer.

8. Pensions Differentiated from Wages.

This conflict in the common law was resolved by the United States Supreme Court in United States v. Embassy Restaurant, Inc.[52] Labor contracts with two local unions obliged the restaurant company to contribute $8.00 per month per full-time employee to individual welfare trusts for each local which provided life and hospital insurance benefits to union members. The trustees of these funds were given power to take legal action under the provisions of the formal trust, and these trustees filed claims for unpaid contributions on the basis of wage priority. Priority was denied by the referee in bankruptcy but granted by the trial court and the court of appeals. The Supreme Court in a divided decision (4-3) reversed the decision and denied the priority of pension contributions as wages.

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[52] 359 U.S. 29 (1959).

The argument, in brief, demonstrated that the history of bankruptcy legislation clearly showed that Congress did not regard all types of employer obligations to compensate employees to be within the concept of wages. The concept of welfare fund contributions as wages was further denied because the amounts in this case had no relation to hours or productivity or wages and the collective bargaining agreement did not even speak of the welfare payments as wages. Then too, the payments were owed to the trustees and not individual employees. Possible definition of wages and other federal acts were considered to be irrelevant for the issue was to construe only the Bankruptcy Act and not to interpret business practice of including welfare fund commitments within negotiated wage settlement contracts. In a strong dissent[53] the minority saw wages as an evolutionary concept which has undergone continual revision in the Bankruptcy Acts. The reasoning of the dissent was more concerned with policy than statutory interpretations, and would give great comfort to advocates of the deferred wage theory. The case left unresolved the question of just what rights an employee may have in proceeding against an employer who is delinquent in the contributions required of him by a pension contract. Moreover, the majority opinion declared that the restaurant workers had "no legal interest . . . whatsoever" and had no legal powers to force payment of delinquent contributions from the employer. The implication is that legal action to collect is left to the discretion of the

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[53]The majority opinion was written by Justice Clark; the minority opinion was the work of Justice Black, with whom Chief Justice Warren and Justice Douglas concurred.

trust, the trustees of which may or may not favor the employer.

E. Other Legal Actions Surrounding Pension Termination

1. Rights of Individuals Subject to Collective Bargaining Agreement.

As Benjamin Aaron outlined in his report,[54] the common law has long given the individual status to sue to enforce terms of a collective agreement under a variety of theories, as third party beneficiaries, as principals in an agency relationship, or as parties to a contract of hire.[55] This right of individual action can be restricted by a specific qualification within the pension contract. Such a provision has been overruled when the courts found that a conspiracy existed involving the trustee to divert funds from the benefit of eligible employees to the interest of a trustee, union officer, and insurance agent.[56] In this case the court ruled that contingent as the interest of the beneficiaries might be in the pension fund, nevertheless, they had a direct interest. When through "continuous neglect" the trustees failed to protect the trust, the plaintiffs were justified in bringing an independent suit. In such event the individual or class representatives name both the trustees and the delinquent employer or other party as co-defendants in a suit at equity.[57]

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[54]Benjamin Aaron, Legal Status of Employee Benefit Rights Under Private Pension Plans, op. cit., p. 84.

[55]See Notes 83, 84, and 85 for case reference and law review discussion; ibid.

[56]Booth v. Security Mutual Life Insurance Co., 155 F. Supp 755 (N.J. 1957).

[57]---"Rights Under a Labor Agreement," Harvard Law Review, Vol. 69 (1956), p. 652.

2. Limits on Individuals as Members of a Labor Union.
Liquidation of the business entity will lead to vesting of pension fund values with those participants who remain active employees until the pension plan is terminated. As demonstrated by the recent case Finney v. Cramet,[58] the employee's rights of action are limited to problems of construction and redress of injury due to wrongful discharge or missadministration. The employer has complete freedom to enter or leave business as he chooses, and within the restrictions of a particular plan to amend, suspend, or terminate a plan as he will. To the extent that the employer reserves these powers to himself by means of the pension agreement and does not wrongfully administer the agreement, the employee has no pension expectation which he can enforce through legal action.

3. Creditor Rights to Pension Trust Funds.
Such funds as are available in the pension trust of a bankrupt employer cannot be claimed by the creditors even though the employer is acting as trustee. However, there is no constructive or implied trust created for funds which the employer deducts from pay checks but fails to pay over to the trust; in this case the trust stands as a general creditor.[59] Bankruptcy gives participants in the plan the same rights to pension trust funds as if they had been wrongfully

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[58]Op. cit.

[59]New York has a statute which requires that contributions from wages to a retirement plan be considered as held in trust by the employer. N.Y. Debt. & Cred. Law Section 21-a.

discharged before retirement since bankruptcy is treated as an anticipatory breach of contract.[60]

## F. Conclusions on Individual Remedies to Pension Termination

It has been shown that the participant of a pension plan may have certain legal remedies either in contract or as a beneficiary of a trust, but that the courts are prone to enforce the pension contract as it has been written. Perhaps it is fair to say that the majority of cases instigated by employees with non-vested pension expectations have been decided against the plaintiff in a court of equity, providing there was no evidence of bad faith. It follows that remedial law in the courts is no substitute for preventive law when drafting the contract. Therefore, it is appropriate to review the provisions within the pension agreement which govern termination of the plan or individual employment.

## G. Pension Agreement Provisions For Termination

### 1. The Pension Agreement.

If the usual pension plan has assumed the nature of a unilateral contract, and if the rights of the beneficiaries affected by the termination of pension expectations have depended almost entirely upon the provisions in the contract, analysis should stress those provisions which affect terminal pension rights. To some extent every pension agreement clause would help to determine "who" was

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[60] Restatement, Contracts, Par. 324 (932).

eligible to collect "what" amount of benefit from "which" administrative body. It has been a legal truism that a contract had to be read and analyzed in its entirety if each provision was to be understood. Nevertheless the need to limit this discussion to manageable proportions has prompted an analysis which begins with those provisions which would directly define rights in event of (1) termination of plan or (2) withdrawal from employment. That part of the pension contract bearing on benefit formula, funding, and eligibility have been slighted and deferred pending comment on the actuarial viewpoint and the administrative viewpoint.

The first comprehensive survey of provisions for termination of the pension plan reported in professional published material was a paper by Dorrance C. Bronson,[61] June, 1955, under the title of "Pension Plans--Provisions for Termination of Plan." This paper formed one corner of the structure of this section. However, this study was intended to be more general, touching on both termination of a plan and retrenchment or involuntary termination of employment. In the latter situation vesting, severance pay, plant closing, early retirement amendment, and other provisions would all enter into defining termination rights.

2. Termination of Plan Clauses.

Private pension programs have been classified for the purposes of this

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[61] Dorrance C. Bronson, "Pension Plans--Provisions for Termination of Plan," <u>Transactions of the Society of Actuaries</u>, Vol. VIII, June, 1955.

discussion into five broad types of plans as follows:

a. Insured individual policy plan
b. Insured group permanent plan
c. Insured group annuity plan
d. Insured deposit administration plan
e. Non-insured trust fund plans

The first three types have generally provided rather specific termination clauses[62] and so enjoyed a greater ease of administration at the time of termination than generally experienced for the last two types. However, the last two have been more flexible and hence more subject to modification as conditions warrant, an adaptability which might or might not bring a more timely equity at termination. Except for the built in, automatic termination procedures of types 1 and 2, Bronson recognized three distinct varieties of pension termination provisions, defining three degrees of generality and indefiniteness. Most indefinite have been those clauses where the interests and allocations at termination were left "to be determined," presumably by the employer, in conjunction with a trustee, an actuary, a pension committee, or a union representative, without specifying the mechanics of how the values were to be derived. The intermediate variety called for allocation done "in an equitable manner" or "on an accepted actuarial basis" but provided no critical definitions of these phrases.[63]

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[62] In discussing the rights of employees who sever their connection with the company and its pension plan, it should be pointed out that while death and disability are a severance of a kind, these benefits were not within the scope of this paper. The interest here has been withdrawal or discharge of the employee to suit business plays of the employer pension-sponsor.

[63] Bronson, op.cit., pp. 227-8.

The variety which most approximates the specific termination proposal merely established employee class priorities of claim on limited assets, or less frequently, set allocation ratios for various categories of participants.

3. Termination of Individual Policy Pension Plans.

A substantial portion of pension plans have been funded with the aid of individual annuity, retirement income, or life insurance policies for eligible employees. Often there has been a trustee to hold the policies until the worker retires or leaves the sponsor, at which time most plans have provided for vesting.[64] In some cases the trusts managed investment side funds to generate cash for the conversion of life insurance contracts to annuities when retirement began. This transfer of ownership in the policy and a prorata share in incidental fund through vesting could be simply extended to all interested parties at the time of termination. Some portion of the side fund might be applied to expenses or be returned to the employer as the individual plans might provide.

This simplicity of assignment to individuals has served well in a partial termination situation, where a number of employees were released at the same time because of a reduction in operations or spin-off of a subsidiary. An example of this kind of termination provision was included in Appendix VI. It should be noted that there has been little for the actuary or the attorney to do in these cases,

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[64] ...Employee Benefit Plan Review, op. cit., pp. 101.6-.7.

except where the restrictions of IRS 5717 would require reallocation of certain individual policy cash values to participants not in the restricted group. Consequently, the employer has made such decisions as are necessary, and the trustee has enjoyed relative ease of administrative responsibility. Since the individual policy trust has generally been suitable only for the smaller firm, the firms which seem to be most vulnerable to premature termination, this kind of plan reduced significantly the area of indefinable employee rights which has existed in other types below. One factor in termination which should have been weighed when the individual policy plan was established was the different tax treatment for terminal distribution of an annuity policy as compared to other forms containing an insurance element, such as ordinary life insurance. Where the life insurance was not imperative or where the participant would not continue payment of premiums to maintain the full contract after terminal distribution, it might be desirable to convert retirement income policies with an insurance element to reduced, paid-up annuity contracts to preserve the capital gain tax treatment for beneficiary.[65]

The principal flaw in termination of the individual policy plan has been that its ease of execution could produce results which were not suited to the preference of the distributee and hence created unnecessary cost. For example, a side fund might have been used to convert a retirement income policy to an annuity contract, which the

[65]See Section G., "Internal Revenue Service Viewpoint."

distributee then converted to cash so that he might buy some mutual fund shares or household items until his next job. The employee's loss was the difference between cost and reserve value.

4. Termination of Group Permanent Pension Plans.

The second type of plan, the group permanent form, evolved from the individual contract plan and was designed to introduce economical features of group underwriting and administration. Consequently termination features have been similar to those of the individual policy type with certain modifications, the details of which can be read in Appendix VII. The group permanent type, utilizing a master contract and individual certificates for participants, could feature either a high premium retirement income contract or a low premium, permanent insurance form, to be supplemented at retirement by an auxiliary investment fund. The plan might use a separate trust or a deposit administration account with the insurer. At retirement the eligible worker would receive a certificate representing a paid-up annuity income. Therefore only pension expectations of the non-retired worker would be affected by termination of the plan. He would receive a special certificate as evidence that he had a vested interest in reduced paid-up coverage of the form offered by the plan. Generally he would not have an opportunity to continue the coverage in full by paying future premiums himself although he might have the option of purchasing sufficient paid-up insurance to bring his minimum coverage up to the level required by the statutes governing group insurance. Where there was a side fund, the fund net of expenses

would be distributed according to a formula or used to increase paid-up annuity value. The termination technique was designed to be relatively simple, but as in the case of individual policies, could distribute an employee's interest in a form which does not meet his immediate need.

5. Termination of Group Annuity Pension Plan.

The traditional insured group annuity pension plan probably has incorporated the most definitive termination provisions in a single document of any pension funding medium employed today. The applicable provisions would be spelled out in the master contract between the employer-sponsor and the insurance company. Should the plan terminate, the employee-participant would receive all the accrued unit benefits purchased for him since the inception of the pension plan as a deferred annuity pending retirement. While each employee received current service benefits, past service benefits would be amortized over a period of years and credited to employees by means of one of several alternative methods of priority. Past service contributions by the employer have been applied according to a specific provision in the master contract, and in event of termination employees have received past service credits only to the extent that they have been purchased according to the formula of amortization. This formula would pay up past service annuity benefits in full beginning with the employees as funds were made available. Other plans have used a weighted formula to sprinkle annual contributions among all past service employee participants on a graduated scale. Should the plan have terminated

before all past service credits have been funded, it is obvious that some pension expectations would go unrealized in whole or in part. The non-contributory, vesting group annuity termination provision, which appears in Appendix VIII, has been one of the few pension termination provisions which anticipated explicitly dissolution, merger, bankruptcy, or receivership of a corporate entity.

Special problems of partnership reorganization or the death of a single proprietor were also anticipated. The plan would be considered to be terminated the day before any business terminating event specified for the above forms of business organization, unless special agreement were made with the insurance company before or within six months after the event to recognize a substitute employer for the purposes of the group annuity master contract. If an agreement for continuity of a master contract has been established, the plan would still be considered to terminate in respect to those employees who were employed the day before specified terminating events but on the day following were not in the employ of the employer named in the contract continuity provision.

Other causes which could bring a discontinuance of the group annuity contract, aside from an expressed intent of the employer to terminate, have been default on premium payments beyond grace period limits or the reduction of coverage in force below contract minimums. Suspension of contributions therefore terminates the program, and automatic anticipation of IRS definitions of termination. The second part of the provision not only indicates the deferred paid-up retirement annuity interest of each employee but establishes that partial

termination rights shall be the same as though the entire contract had discontinued. No further purchases under the contract are allowed and no cash or other investment assets are anticipated because of the very nature of the plan so that no formula for proration is necessary. The particular schedule for funding past service liabilities is another provision of the group annuity master contract provision to which no reference is made here because the phrase "all retirement annuities purchased" includes both current and past service benefits. Were the plan contributory there would be an additional provision for an employee option to withdraw his contributions with a subsequent reduction in his paid-up deferred annuity. Beneficiaries already on retirement would continue to receive their payment unabated as it is standard insurance company operating procedure to require that retirement benefits be fully funded before annuity payments may begin.

While termination of the group annuity plan can be relatively simple, there are occasions where there can be extensive complications. Where a group annuity plan has been supplanted by a deposit administration contract, amendment of the two plans might permit consolidation of reserves at termination so that all deferred annuities might be issued on a full-paid basis. As an alternative, consolidated reserves could remain invested under trust management in hopes that below average mortality experience and improved investment yields could increase the maximum benefits payable individuals during the lifespan of eligible employees. A few group annuity plans make provision for a different priority of paid-up deferred annuity

distributions in event of termination than in the case of continued operation of the plan prior to full amortization of past service liability. In effect purchases of past service benefit unit are converted back to cash for reassignment to a broader class of participants.

6. Termination of Deposit Administration Pension Plans. There are two kinds of insured deposit administration type pension systems. The first variation combines both the plan and the administrative contracts in one document. The second variation works with a master contract which implements, and incorporates by reference, a separate pension contract document. Once the plan is distinct from the master contract, it is possible to terminate one without affecting the other. Termination of the combined master contract-plan, say to introduce a new funding vehicle, would require filing of termination forms with the IRS and submission of a new form of pension as if none had existed before. In the second case, however, the master contract could be terminated while the plan continued unchanged, supported by a new method of financing benefits. The first variety inherits the basic simplicity of termination of the group insurance pension form while the second variety resembles the trust in its flexibility and complexity.

A non-contributory deposit administration plan with vesting contains a definite termination provision similar to that which appears in Appendix IX. It recognizes four primary causes of termination similar to those of the group annuity, but including exhaustion of

purchase fund. In event of termination it applies funds of the account to the purchase of deferred annuities for participants who have met the appropriate vesting conditions on or before the day of termination, with any remaining balance credited pro rata to members of the non-vested class of participants. The ratio used for distribution represents the remaining balance as a proportion of the total present value of deferred accrued annuities for all the participants in the class. Excess funds would be used to purchase additional retirement annuities for all participants. Annuities to retired workers remain unaffected unless the termination distribution is subject to IRS Mimeo 5717,[66] discussed below. Certainly the mechanics of termination are well established by the contract provisions, and there is little room for decisions which can shift the relative equities of participants merely because the plan is terminated. An intermediate form of termination provision which is sometimes used with deposit administration plans would maintain a deposit fund in order to purchase annuities as participants reached eligible retirement age. This alternative method shifts the insurance guarantee element to the participants, who hope to increase the funding ratio because of adverse mortality experience or investment yields in excess of annuity interest

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[66] These instructions apply to qualified pension plans terminated within ten years of inception. It restricts maximum benefits payable to highest paid officers and employees and submits termination to close scrutiny as to intent within requirement of permanency.

assumptions.[67]

If this alternative is used, it is impossible to determine exactly how much each employee shall receive until the retirement date is reached; the individual share will be based on the ratio of the aggregate value of accrued annuity benefits at the time of termination, and so it is apparent that the alternative would be appropriate only where accrued benefits were only partially funded at termination. The insurance company at no time guarantees the adequacy of the deposit fund in relation to accrued liabilities nor the propriety of any distribution decided upon. In recent years the ostensible ease of termination of deposit administration cases has been clouded through disagreement and misunderstanding regarding the proper annuity mortality table which should apply to terminal purchase of deferred annuities and an equitable transfer charge where the deposit administration fund is moved intact or in installments from one company to another or to other funding media. Chapter V is directed to these problems so they are overlooked at this point.

Where the deposit administration contract is distinct from the plan, it is necessary to examine both in order to compile the applicable termination provisions. In many such agreements there would appear to be inconsistent or conflicting provisions in the plan drafted by the employer and his counselors and the master contract drafted by

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[67]This arrangement implies risks to future annuitants similar to those experienced with a wasting trust.

the insurance company. Generally the insurance company can give precedence to the pension plan because the master contract makes no specific guarantees to any employees other than to retired annuitants. Since it will not expose itself to a class action by disgruntled participants, it can accommodate its distributions to the company plan to give further demonstration to its claims of flexibility for the deposit administration type of plan. In effect the deposit administration plan is a form of trust designed to carry out the funding and investment function of the pension plan, which could be amended to provide a wide number of alternative terminal distribution solutions when the insurance company is amenable.

7. Termination of Trusteed Pension Plans.

It is the fifth variety of pension plan, the trust fund type, which offers the more indefinite forms of termination clauses. Where the insured plans which combine coverage and funding procedures under one contract are specific as to the contingency of termination, the trust funds are written with indicative but relatively indefinite preparation for termination allocations. The pension plans may be an integral part of the trust indenture, or form a separate document, which itself may be a unilateral expression of pension benefits agreed to as a part of a negotiated labor settlement. While the most simple trust plan and agreements may not carry instructions, priorities, or other provisions for allocation or distribution, actual termination would be controlled. The Internal Revenue Service would not permit a

discriminatory distribution formula to pass without severe tax repercussions on the pension fund or the employer.[68] The pension agreement is generally worded to recognize that employees similarly situated will receive equal treatment under the plan or its amendments so that to do otherwise would expose the employer to breach of contract suit. Where there was a union representing the employees in a negotiated wage agreement which gave rise to the pension plan, any modification or termination of the plan while the wage agreement was in force would precipitate action against the employer from this quarter. The implication of fair and equitable treatment is heightened where these phrases are introduced explicitly into the general statement of termination procedure. Specific examples of the variety of possibilities for termination of trust fund which are silent as to a precise method of terminal distribution are best postponed to the case study analysis of Chapter VI and beyond, lest the discussion become inordinately long and repetitive.

For those trusteed pension plans which do provide "definite or precise" provisions for termination, Dorrance Bronson recognizes three main possibilities for the allocation of trust resources at termination. He calls these three provisions (a) the immediate priority allocation method, (b) the delayed priority allocation method,

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[68] Isidore Goodman, "Establishing a Tax Qualified Pension, Annuity, Profit Sharing or Stock Bonus Plan," a speech on October 26, 1961, to Central Arkansas Estate Council. Reported in Pension and Profit Sharing Report, op. cit., No. 60-13, pp. 1332-34.

and (c) the immediate ratio allocation method. Not only may these methods of measuring and establishing a claim be applied to terminations but also these can be used to evaluate relative equities in a situation involving partial termination of the work force. The termination provisions need not apply to transfer of pension funds between trust or to other new funding media when the controlling plan is modified so that an added element of flexibility is available which would not be possible under the insured pension forms. Retired workers might or might not be affected by termination depending on whether the trusteed plan was self-insured or whether it purchased retirement annuities for workers as they became eligible. At this point it is desirable to review the various methods of allocation and associated concepts so that there is a basic familiarity with them when discussion of cases in future chapters is introduced.

H. Equity in the Allocation of Terminal Pension Benefits

The immediate priority allocation method utilizes a ranking of employee categories to determine priorities of claim on the fund. Any balance insufficient to satisfy in full the claims of the category with priority is distributed prorata or by some similar method. This technique establishes definite benefits, either deferred or immediate, for participants of each class compensated in full while determining a ratio for participants in the last class to receive some settlement, though the dollar amount remains unknown for these "residual legatees." Because the person as well as the individual proportion of resources is fixed in this plan as of the termination date, mortality

of the specific group in the years following termination of the plan but prior to termination of the trust does not enter into consideration.

To permit the forfeitures of premature deaths among annuitants to augment benefits payable to others in the group, the delayed priority allocation method may be used. Built upon various classes of employee priority, as used in the previous method, this method allocates funds ultimately when employees in each category reach the age of 65. The delay in resolving equities may require retroactive adjustments for those individuals in any group who reach age 65 first and begin to receive the normal benefit, and the trust could go on indefinitely. However, the pension plan benefits for those who would survive until eligible would be improved thereby if investment results were as expected.

A third method used is the immediate ratio allocation method which prorates the fund over the entire group of covered employees without attention to age or service categories. On occasion even the retired workers are affected and their pensions reduced. To introduce greater equity in this system proration may be based on certain actuarial reserve assumptions or on credited service. This method retreats somewhat from the general practice of meeting pensions in full for the retired or oldest active employees first in favor of recognizing each individual share in the fund according to the actuarial reserve values of accumulated pension rights. Presumably the benefits due the oldest workers would be represented by the higher actuarial reserve values so the method still gives weight to those nearest

retirement. A reduction in pension for those already retired would be its greatest drawback. Another form of this kind of termination provision would give priority to pensioners and then distribute the balance prorata on the number of years of credited service so that a man age 50 and one age 30 could each receive the same benefit. This approach removes the socialization or insurance element from the terminal distribution and comes closer to equating benefits with earnings. It is important that this shift in equities in event of termination, in short, the distinction between proration on the basis of service or on the basis of benefit value, be recognized. The more weight that service time carries in termination proceedings the closer the pension plan moves to the deferred wage theory on the nature of pensions.

Originally the trusteed form of pension plan may have been chosen to provide more flexible use of employer contribution for alternative benefit programs or to permit more discretionary and presumably more profitable investment. Special, death, disability, or dependents' benefits will also be considered where the actuarial benefit system of proration is used, while these incidental benefits would be curtailed under a service credit system. In some cases the service credit system is used to establish an individual unit interest in a trust fund which proves inadequate to actuarial liabilities at the time of termination but which is then treated as a common investment pool in hopes that investment appreciation will erase the deficiency in time.

The use of employee categories to determine priority in the event of termination can take many forms. A simple dichotomy between pensioner and active employees has already been illustrated. However, refinements of the priority system can lead to a surprising number of employee classifications. Table 24 illustrates possible categories based on the imminence of pension payments, a system which could be further subdivided by distinguishing between vested and non-vested participants in each class. Assignment of priority to each of these subclasses cannot be done in an arbitrary fashion. The pension sponsor or the union representative must decide the relative importance of employee contributions to pension security for the oldsters, the deferred vested annuity of former employees compared to the claims of non-vested but active employees, and, in event of a partial termination, the rights of those remaining relative to those separated from employment with the sponsor. When a pension plan is only partially funded and the termination provision is governed by a priority clause, this single clause will determine for many employees whether they have a substantial pension interest or none, regardless of vesting or contributions. To make such decisions when the plan is established may create the risk of arbitrary or untimely inequity, but to defer a decision as to priority until termination actually occurs prolongs settlement and breeds legal contest.

I. Pension Plan Provision for Partial Termination

1. Types of Termination Benefits Available to Displaced Employees.

Where it is employment rather than the pension plan which is

TABLE 24

POSSIBLE CLASSES OF EMPLOYEES OR OTHER PERSONS
UNDER A PLAN AT TIME OF TERMINATION
(Listed generally by order of imminence of pension payment and not necessarily on the basis of "rights" in the fund)

1. Retired employees:
   ( i) as to their remaining pensions,
   (ii) as to any potential death benefit or contingent annuitant.

2. Existing contingent annuitants or installment beneficiaries of deceased retired employees.

3. Existing annuitants or installment beneficiaries of deceased active employees.

4. All non-retired employees in respect to their own accumulated contributions, if any, to the plan.

5. Employees now over normal retirement age, or approved for early or disability retirement, whose actual pensions have not yet commenced.

6. Active employees between certain ages (e.g., 55-64) or in the age interval of eligibility for early retirement.

7. Active employees who otherwise are of such age and length of service as to meet any vesting conditions of the plan.

8. Ex-employees below the normal retirement age who have previously terminated their service after meeting the conditions of vesting.

9. All other employees in the plan (or further classification of them by age, service or otherwise).

Source: Dorrance C. Bronson, Pension Plans--Provisions for Termination of Plan, op. cit., p. 235.

terminated, a variety of pension clauses may become operative. An entire group of employees may be seperated from company service when a subsidiary is sold, a division eliminated, or an individual plan closed or a single employee may be discharged due to a reduction in the work force or technological unemployment. First a worker might be eligible for early retirement benefits, generally a reduced pension income for which he would have been eligible in a few years time. Secondly, a younger worker may have satisfied the conditions of age and service for a vested, deferred retirement annuity. More recently non-vested employees have shared in the pension pot because of special severance pay plans. Early retirement, deferred annuities, and severance benefits are all forms of vesting, but since full vesting is an anathema to most employers, these various mutations have appeared.

2. Vesting and Termination Benefits.

The concept of vesting refers to the property interest[69] of "non-forfeitable rights"[70] which an employee acquires in the contributions made by the employer for eventual distribution as benefits for the employee. Generally all benefits are "severance benefits" as they are payable for total disability, death, or retirement. Only recently

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[69]Dan M. McGill, Fundamentals of Private Pensions (Pension Research Council, University of Pennsylvania, 1955), p. 58.

[70]The term is generally used by the Internal Revenue Code. See Isidore Goodman, "Problems of Vesting in Pension and Profit Sharing Plans," a speech on December 2, 1961, to a forum of the Federal Tax Institute of New England. Reproduced in Pension and Profit Sharing Report, op. cit., No. 62-17, pp. 1339-47.

have benefits been available for those facing involuntary unemployment.

Every participant in a qualified pension plan gains a 100% vested interest in his attained normal retirement benefit providing he satisfies the requirements of the plan.[71] A vested interest upon disassociation of the employee from the company is also contingent on certain conditions, partly to avoid full vesting and partly to preserve certain tax preferences. The tax status of pension credits payable to a participant changes if benefits are made immediately available to him, whether or not he actually receives benefits. To prevent adverse tax consequences vesting is made contingent on initial eligibility age, and service participation. It is also contingent on separation from service of the employer.

Finally the amount of benefit which vests may be 100% of accrued pension credits or a graded proportion of these credits. One survey of 317 pension plans for groups of less than 100 employees found over 115 different methods used for vesting the employer's contribution.[72] The degree of vesting ranged from 5% of the total which had no vesting provision to another group of 6% which vested 100% of the contribution at the end of the first period.[73] This

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[71]For further detail on vesting provisions for large pension plans, refer to Appendix V. For additional discussion there are innumerable articles bearing on the point, and so the many issues of vesting have been treated only briefly.

[72]"Pension Plans with Less Than 100 Employees Participating," Employee Benefit Plan Review, op. cit., pp. 102.1-102.18.

[73]Ibid., p. 102.6.

survey indicated three basic patterns of vesting dominant among the wide number of fine variations:

1. Partially-graded vesting starting the first year plus the same percentage each year until 100% vested with several variations where the initial percentage is increased or decreased. There are 46 plans on that basis or about 14½% of the total.

2. Partially-graded vesting after an initial waiting period ranging from one year to 15 years. This is similar to the first method except for the waiting period. There are 169 plans on this basis or about 52% of the total.

3. One hundred per cent vesting after a period of time with an age qualification in some cases is provided under 28 plans or nearly 19% of the total.

Since there is no way of knowing in most cases whether the firm in event of economic adversity is more likely to terminate the pension plan or just the work force, vesting is as significant as provision for termination of the plan. However, vesting provisions must adapt to the economics of each particular situation, while termination provisions can be far more standardized because upon termination the situation is neatly circumscribed and does not need to adjust to the continued successful operation of the business. Vesting introduces additional expense which is more appropriate to increasing maturity and established stability of the older plan, and thus suitable for gradual introduction by amendment. Liberalization of vesting provisions is of value to all parties and therefore not subject to conflict of interest. On the other hand, problems of termination by amendment can be trouble-some when some must lose so that others may salvage a useful pension benefit.

3. Early Retirement Benefits.

To encourage older workers to leave the job and to maintain income for those older workers many plans permit early retirement at income levels which are actuarially adjusted to be equivalent of pensions at estimated retirement age. One significant study[74] by the Bureau of Labor Statistics covered 300 negotiated pension plans represented all major industries except railroads and airlines, including in the study coverage available to 4.9 million persons. More than five-sixths of the plans were non-contributory. Of these 300 plans, 218 permitted early retirement as against 174 which provided some form of vesting. While service requirements were parallel to those of vesting, with 15 years the most common, age requirements were much higher and were stipulated at age 55 and generally age 60. Consequently, early retirement aids primarily the older worker, who may elect to retire[75] when faced with involuntary termination of employment. In three out of four plans there was a minimum age requirement for early retirement benefits, with age 40 the most common prerequisite. The study also reported that in a few plans the nature of the employee's separation precipitating early retirement could affect his vested rights, although under most plans the reason for termination was immaterial.

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[74]Walter W. Kolodrubetz, "Vesting Provisions in Pension Plans," Monthly Labor Review, July, 1959.

[75]Early retirement at the election of the employee is a growing trend. The pattern is demonstrated in another survey called the 1960 Study of Industrial Plans, prepared by Banker's Trust Company, New York, Revenue Ruling 57-163, Part V (f) limits the value of early retirement benefits to the employee's vested benefits where the employee needs the consent of the employer to retire.

4. Vested Deferred Pension Benefits.

Basic to the development of vesting has been the right of the worker with a vested benefit to leave his employer in pursuit of other alternatives without loss of his right to apply for his accrued pension benefit upon reaching eligible retirement age. The more liberal the age and service conditions of a vesting provision, the more adequately the plan is equipped to handle involuntary termination of its participants. However, in event the pension plan is terminated too, deferred annuities for workers no longer on company seniority lists are generally given little priority and therefore left unsatisfied. Termination agreements may create cut-off dates, requiring application for a terminal share by a given date or forfeiture of deferred benefits by the former employee.

5. Severance Payments to Non-Vested Participants.

The pace of automation and plant relocation in some industries has accelerated so much in recent years that many workers find it difficult to meet even liberal vesting conditions requiring 10 or 15 years service. In lieu of full vesting to meet the needs of these employees, labor and management have agreed on a terminal cash payment[76] from pension funds to displaced employees not otherwise entitled to any present or deferred retirement benefit. The nature of these provisions is developed in more detail in Chapter VII. Payment of such benefits

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[76]"Lump-Sum Severance Payments," Profit Sharing and Pension Forms, Vol. 9, No. 9, March 25, 1960, p. 25127-8.

introduces the ironic possibility that these non-recurring, erratic, and additional charges to pension funds may adversely affect the pension expectations of those who remain with the firm. Equity among these classes of interest as well as between employer and employees relates to the question of how risk of unemployment should be distributed among society in a competitive economy. This question also receives more adequate treatment in Chapter VII.

6. Other Provisions Affecting Termination of Employment Pension Benefits.

Partial termination rights in terms of severance allowance or vested benefit also depend on the power and inclination of pension administrators and sponsors to adapt to an unexpected but necessary reduction of work force. Of great importance are provisions controlling amendment, liability, and rate of funding. Generally the amendment section does not specify when or why an amendment can be made and an amendment may be given retroactive effect where necessary to preserve pension tax status. Amendments may be retroactive unless they would deprive a participant of a possible benefit earned in a period prior to that of the amendment. Implicit in many amendment provisions is the fact that they may be instituted without the consent of the participants. Generally an amendment requires approval by the employer board of directors but it is not necessary, if the plan recognizes the power of the company officers to authorize a change. The powers to amend must be circumscribed by a restriction preventing the diversion of any pension assets from the exclusive benefit of the participants, including taxes and administrative expense, unless a surplus of funds

results from "erroneous actuarial computations." Some plans which establish a schedule for the priority of claims in event of termination will not permit amendment of this schedule so that the controversy of relative equities at termination can have no effect on the plan distribution. Additional restrictions on the power of amendment are intended to protect other parties at interest in the plan; the trustee will not permit amendment which would increase or modify his responsibilities in any way without his consent; often an amendment calling for an increase in contributions requires approval of stockholders or the board of directors. In succeeding chapters there will be examples of how the power of amendment can be used to shift pension plans to supplementary unemployment benefit plans, to finance the purchase of unexpired seniority privileges, or to complete funding of other welfare programs felt to have greater priority.

7. Limits of Responsibility for Terminal Benefit Realization. The value of vesting or amendment to recognize involuntary termination of unusual scale is greatly diminished by the array of limits of liability protecting the sponsor for inadequate funding or administrative error. The administrator is immune by contract from any liability because of loss, damage or depreciation, except in the case of willful misconduct or gross negligence. A recent revision of the Federal Disclosure Act requires certain employees to be bonded.[77] Members of the administrative committee ideally are indemnified by the

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[77]Public Law 87-420, 87th Congress, H.R. 8723, March 20, 1962.

employer for claims and expenses which arise from performing their duties as their judgment dictates unless they are proved to be guilty of gross negligence or misconduct. Where a trust agreement is used, the trustee requires provisions so that he may be protected against liability in making investments or in relying on written instruments, etc. No individual trustee is liable for the acts or omissions of other co-trustees or the negligence of prior trustees. The trustee is further protected against error or negligence of counsel or agents, and the clause authorizing the trustee to make payment contains a further provision to absolve the trustee of liability. Some plans detail the trustee's duties and responsibilities to remove any question of liability for error in other fields. Of interest to annuitant and terminal distributee alike are provisions which establish that the trustee has no duty to investigate mailing addresses. Either mail is deemed to be sent when deposited with the post office or payments by mail or instructions for mailing may be withheld until addresses are certified by the administrative committee. In many states it is the practice to relieve the trustee of the need for reporting to a court supervisor. A participant under a trusteed pension plan is relieved of exposure to suits as only the trustee and the employer are recognized as parties to suits involving the trust. The most significant liability of all, that of the employer for supporting contributions, is always effectively limited through reservation of power to amend, terminate, or suspend contributions.

J. Summary and Conclusions

Recitation of the legal theory and of commonly used pension plan provisions relevant to termination has served to illustrate the inconsistency of present legal and contract standards. Because projected pension benefits of most plans are so costly, funds to assure payment of benefits cannot be immediately segregated and the uncertainties of expectations prevent any irrevocable commitment to supply funds in the future. At the same time a negotiated pension agreement borders so closely on the nature of deferred wage compensation that a variety of contract devices and legal fictions must be employed to protect business enterprise against unconditional exposure to a colossal liability. Confusion at termination is further compounded by tax, tactical, and actuarial considerations which are developed in the following chapters. When these latter factors are related to the law in Chapter IV, further conclusions as to legal standards and procedures for pension termination can be drawn.

# CHAPTER IV

## NON-LEGAL FACTORS AFFECTING THE PROCESS OF PENSION PLAN TERMINATION

### A. Objectives of Chapter

The legal structure of pensions does not operate in a vacuum at termination (or any other time), but rather in response to outside circumstance and in reflection of the attitudes of various people at interest. Two major bodies of fact affecting pension design or termination and common to all pension programs are the mechanics of actuarial science and the regulations of the Internal Revenue Service. Perhaps most important of all, an existing selection of contract provisions, laws, actuarial formulae, and tax considerations must be applied to an ever changing employment scene by administrators of ordinary ability. The manner in which these men fit the pension structure to individual situations will reflect the attitudes of management, labor, funding media,and professional consultants. It is possible that the process of pension termination can also be indirectly influenced by the manner in which administrators of state and federal welfare disclosure acts use their limited powers.

It is not the intent of this chapter to review all of these factors in detail, but rather to outline selected features or items which serve to place check points or controls on the termination process. Review of critical tax detail, in particular, will permit

future chapters to incorporate this material by reference in explaining various considerations of cases under discussion. Finally, the interrelationship of law and the attitudes of those applying it lead to certain conclusions which follow appropriate to a summary of both Chapters III and IV.

B. Aspects of the Actuarial Viewpoint

1. Termination and Actuarial Soundness.

The law and the Revenue Service, the employer and the employee, the investor and the creditor are all concerned with the money necessary to make the pension agreement an operating reality. For the pension agreement which enjoys segregated assets equal to the value of the benefits promised, termination poses no threat. Ideally the goal of the pension sponsors should be to achieve solvent funding of eventual pension fund obligations. Since no business has a guaranty of immortality, the employer who offers no funding in support of an announced formal pension program is perpetrating a cruel but legal hoax on those participants who look to the plan for financial security in those years when they are unable because of age to provide adequately from earnings. On the other hand, assuming that a pension plan should seek to be fully funded, the goal is quickly obscured by problems of what constitutes "full funding" or "an actuarially sound basis." Unfortunately, a plan which is deemed fully funded or actuarially sound may nevertheless produce severe loss of pension expectations in event of full or partial termination of the plan.

The subject of what constitutes actuarial soundness is too broad for this study; books have been written on the subject and the terms are still undefined for the pension area generally. One excellent text offered this explanation of what a strict, actuarial standard for achieving a fully funded plan might be:

> My idea of an actuarially sound plan is one where the employer is well informed as to the future cost potential and arranges for meeting those costs through a trust or insured fund on a scientific orderly program funding under which, should the plan terminate at any time, the then pensioners would be secure in their pensions and the then active employees would find an equity in the fund assets reasonably commensurate with their accrued pensions for service from the plan's inception up to the date of termination of plan. Note that this definition admits of a long time before all the original past service credits reach a funded condition. Note further, that I have tied this definition in with a presumption of the plan's termination. . . .[1]

Another prominent actuary at the same seminar found two philosophies of adequate funding in his experience:

> . . . One philosophy aims to compute proposed outlays so that there is <u>reasonable certainty</u> of the adequacy of the contributions to provide the promised benefits. There is no <u>planned reliance</u> upon future supplemental contributions to make up deficits which are recognized in the future. This I have called the Grade A Philosophy of funding. The other philosophy uses actuarial assumptions which produce cost estimates that are <u>probably adequate</u> but which may not be. If not adequate, it is <u>planned</u> to rely upon supplementary contributions in the future as deficits arise and are recognized. This I have called the Grade B funding philosophy. The important consideration is that where Grade B funding is used, the successful funding of pension benefits may well <u>depend upon the continued existence of the employer</u>. Wherever this proves to be true it must be recognized that there has been an impairment of the ideal of actuarial

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[1]Dorrance C. Bronson, "What Is Actuarial Soundness in a Pension Plan?" a panel discussion sponsored by the American Statistical Association, Chicago, December 29, 1952, and published as <u>Proceedings of Panel Meetings</u> by the American Statistical Association. Passage was quoted in the Bronson book, <u>Concepts of Actuarial Soundness in Pension Plans</u>, <u>op. cit.</u>, p. 14.

> soundness. Of course, some persons active in the pension field today have called my Grade A funding "plush" funding, and Grade B, the "realistic" one.[2]

While many plans may provide for those who already are receiving pension income, the inadequacy of funding as measured in dollar benefits lost falls on the active employees in event of plan termination. It is these latter employees with deferred pension expectations who are most likely to suffer disappointment. Consider the following text explanation:

> A plan may be actuarially sound for pensioners while entirely lacking in security for active employees. The so-called "terminal-funding" procedure exemplifies this. On this basis the employer undertakes to supply, through a trust or insured fund, sufficient assets or guarantees to pay out the lifetime pension for employees at the time they retire. Inasmuch as in the usual new plan persons will reach retirement age each year in increasing numbers, a terminal funding undertaking will snowball in costs, and yet only those actually on the retired roll at any time will have any security. On a criterion of employee security, the existence of these actuarial reserve assets does not bring actuarial soundness to the plan as a whole.[3]

Thus it would appear there are two facets to the problem of pension plan termination. The importance of the contract in establishing an orderly and equitable procedure for dissolution of the interest of various parties has already been developed. But distribution of property rights presumes a prior accumulation, and it is here that the actuary must provide a formula for funding which prepares a plan financially as well as legally for unforeseen dissolution.

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[2]Ray M. Peterson, F.S.A. Vice-President and Associate Actuary, Equitable Life Assurance Society, as quoted by Bronson, Concepts of Actuarial Soundness in Pension Plans, op. cit., p. 17.

[3]Ibid., p. 76.

2. Termination and the Funding Ratio.

Since it is seldom economically possible to fully fund a pension plan immediately, it is necessary to establish criteria for assuring the adequacy of a progressive funding of total accrued liabilities. A common measure of financial adequacy of a pension plan is the funding ratio, and a progressive increase in this ratio each period is considered a sign of actuarial soundness.

A funding ratio represents the proportion of assets to liabilities, liabilities measuring the present value of all expected future claims. Liabilities represent a mathematically precise combination of individual subjective projections on a variety of variables such as mortality rate, withdrawal, salary scale and retirement age, to name a few. Asset values also represent an arbitrary accounting valuation based on market value on any given day or on purchase cost adjusted for various amortization schedules, and are oblivious to contingent income and expense items of the near future. At best it is a rough measure. Even constant improvement in the ratio of available funds to estimated liability need not indicate an actuarially sound plan. A plan which started without funds would enjoy an increase in its funded ratio by contribution of even a dollar. Were the contributions less than annual cost of earned benefit credits for the same year, it is possible for the funding ratio to increase for some years while the unfunded benefit liabilities expressed in dollars continued to grow. Eventually, of course, the curve of these ratios would turn downward long before a 100% funding ratio was achieved. Moreover, the liabilities of a pension plan which can look forward to continued operation

are significantly different than the liabilities it will face on the day of termination. When used in connection with funding ratios the term liability is a rather imprecise combination of factors. Even the connotation that liability may have in terms of a debt owed is inaccurate. As used here liability is simply a measure of future costs discounted for various actuarial assumptions which could be expected should everyone choose to continue the pension plan. It can be subdivided into estimates for unfunded prior service, for benefit credits accruing in the current period, or for future service benefits which present employees may be expected to earn.

The best quantitative measure of the ratio of reserve assets to liabilities is to analyze available funds at termination in relation to the priority class of liabilities at termination. The rank of the last priority group to be satisfied in full and the ratio or proportion of accrued pension expectations provided the next group will best reveal the funding adequacy of a pension plan for both its retired and actively employed participants. With this knowledge the balance of unfunded liability and the number of participants who received nothing can provide additional depth to the measure of severity of loss due to premature termination.

When accrued service liability, past and present, is estimated for purposes of determining employer contribution parameters, adjustments are made for expected future withdrawals, shifts in pay scale, long term trends in the investment area, and perhaps other prospective changes in factors contained in the actuarial formula. Liability at termination is concerned only in accrued liability as of the date of

termination, perhaps only in the liability that will vest with employees surviving on the payroll until the date of termination. Prospective adjustments are irrelevant as there is no future in sight for the plan. Valuation of actuarial liability in the case of termination is simply a matter of determining the single annuity premium value for each employee category defined by a termination priority claim schedule, included in the original contract or added by a negotiated settlement amendment. The author of the illustrative table on Table 25 has pointed out that the actual proportion in Item 10 distributed to the younger employees might vary considerably depending on the mode of distribution to each class. While it would be possible to purchase single premium annuities for all, actual distribution could be split between annuity purchases for the older workers and continued trust investment for the younger; or all the assets might be left in trusts from which pensions would be paid when due until the funds were exhausted. Another alternative would be to pay cash to the group with the least priority as a kind of severance pay or as a means of liquidating very small claims. Dorrance Bronson maintains that it is well to think of the last category of workers when appraising the actuarial soundness of the program so that they will receive some value from the residual after satisfying prior claims in full. If too large a group of employees go without any share in the pension pot after being led to believe they were participating in a funded pension program, the result would be disillusion with the private pension system. Such discontent would be contagious and it is conceivable that eventually niggardly funding would lead to legislative

TABLE 25

ALLOCATIONS BY A PRIORITY CLAUSE AND BY TWO PRO-RATA CLAUSES

| Category and Description | Number | Aggregate Years of Accrued Pension | Allocation of Assets: By Priority Clause of Exhibit 7a | By Exhibit 9a Clause 50% Across the Board | By Length of Service Clause[a] |
|---|---|---|---|---|---|
| First: Retired | 120 | 3,000 | $1,267,200 | $ 633,600 | $ 302,200 |
| Second: Eligible to retire | 20 | 540 | 280,800 | 140,400 | 54,200 |
| Third: Range of early retirement | 420 | 8,400 | 1,799,900 | 1,134,000 | 845,800 |
| Fourth: All others | 2,500 | 21,300 | (nil) | 1,439,900 | 2,144,700 |
| Total covered group | 3,060 | 33,240 | $3,347,900 | $3,347,900 | $3,347,900 |

[a]Allocated on the basis of the applicable aggregate years of accrued pension.

Source: Table derived from hypothetical examples used by Bronson, "Pension Plans--Provisions for Termination of Plan," Transactions of the Society of Actuaries, op. cit., pp. 237, 243.

reform which stressed a government administered pension program supported by a tax on employers' payroll.

3. Priority of Claim and the Funding Ratio.

Having marshalled the liabilities, it is a simple matter to demonstrate how far the assets will stretch when different methods of allocation are used. Assume that assets represented 50% of the total liabilities indicated in Table 25, or $3,347,900. Note that an allocation by length of service or by 50% across the board greatly favors the younger groups of employees while inflicting a severe reduction on the pensions previously received by those already retired. If priority of settlement is left for negotiation between union and management in event of termination, it is conceivable that union representatives would be forced to choose that method of allocation which represents the will of the majority of the people they represent rather than the social objective of the plan as originally conceived. By the same token, a partial termination necessitated by closing of a department or a subsidiary would provide an opportunity for the employer to profer an allocation method which would favor his future pension costs for those workers remaining on the payroll.

For example, if the division had more than its share of younger employees and each employee were given the same share as he would (Table enjoy in event of complete termination of the plan, then a length of service clause would drain the fund of more dollars than the liability was reduced by discharging workers. The employer's future pension

TABLE 26

PRIORITIES FOR TYPICAL TERMINAL CLAUSE

| Category and Description | Number | Liability |
|---|---|---|
| First: Retired | 120 | $1,267,200 |
| Second: Eligible to retire | 20 | 280,800 |
| Third: In age range of early retirement | 420 | 2,268,000 |
| Fourth: All others | 2,500 | 2,879,800 |
| Total covered group | 3,060 | $6,695,800 |

Source: Table taken in entirety from Bronson, "Pension Plans--Provisions For Termination of Plan," Transactions of the Society of Actuaries, op. cit., p. 240.

costs would be accelerated. Conversely, distribution according to a priority clause based on proximity to retirement would cost him nothing if all the discharged employees were members of the fourth class. Accrued liability service would be reduced by an amount greater than the amount of assets distributed, causing his funded ratio to rise and perhaps reducing his aggregate pension outlays over the long term.

Management and union representatives, or a pension board exclusively representing management, may therefore have a conflicting interest in determining settlement distributions when termination becomes imminent. It would seem far better to determine the actuarial lines of procedure from the start and incorporate such a procedure in contract termination provisions.

A number of procedures may be acceptable in terms of both the employer cost consideration and the union conflict of interest between age groups. For example, full or partial termination allocation might be determined on the basis of priority or pro-rata distribution clauses. Partial termination distribution might be based on the ratio of an up-to-date actuarial valuation of benefits for those left unemployed compared to the total actuarial liability of the entire work force including those terminated. Another method, where a divison or subsidiary is closed or spun-off, would be to determine what part of the pooled investment fund was generated by the particular operation about to be dropped from the pension plan. This gross contribution, adjusted for an investment earnings factor and the present value of pensions for workers already retired from the division in question,

could then be distributed among the non-retired division employees on a prorata basis of seniority or proximity to retirement. In each case, however, the object is to divide the fund as it exists at termination. There is seldom a presumption of further contributions by the employer beyond amounts which are already due the plan. Moreover, partial termination does not lead the employer to raise future level of contribution to protect remaining employees.

No matter which method is chosen, one group which has little opportunity to protect its interest is the number of employees who left the service of their employer involved in pension termination after having met age and service conditions for vested benefit. Often this group is given a low priority or is not recognized in the termination allocation at all. In short, they have a right to expect a pension should the plan continue past their retirement age but not necessarily any right to receive a terminal distribution. At best they must take their chance with active employees with the same age or service record that funds shall be adequate to purchase their supposedly vested benefits.

The employer may have opportunity to receive a refund of past contributions to the pension plan in event that assets at termination of the plan exceed liabilities. This surplus is called "actuarial error" although it results from over funding due to actuarial conservatism or an artificial reduction of liabilities because the employer reduced the level of employments under a non-vested plan prior to effecting actual termination of the plan with attendant automatic vesting.

4. Actuarial Balance vs. Legal Equity.

A general comment on the actuarial viewpoint would have to stress that actuarial balance does not mean that legal claim and obligation has been equated. Consider the general form of the actuarial pension equation:

PV Future Contributions = PV Future Benefits +
PV Future Expenses - Fund on Hand

Now it has been shown that future contributions are seldom a certain obligation enjoying the status of a bond or wages. It is a claim subordinate not only to all accounts payable but also to a reasonable profit return for the business owners, a profit without which business and pension would be terminated. On the other hand, it is looked on as an asset to complement funds on hand in the pension fund account, funds which the employer cannot expect to repossess until all future benefits and expenses are met. Future expenses do not figure in the termination situation but in the long run have a priority on future benefits. Future benefits have the most indefinable legal status of all. It is an aggregate which represents cumulative averages over time rather than the sum or individual accrued benefits as of a particular point in time. If termination prevents a discount for withdrawal rates from having its diminishing effect on liability, liability is understated. On the other hand, if present value liability anticipates future salary increases, it is overstated. The item of future benefits further does not distinguish between vested retirement income, vested rights to a deferred retirement income and anticipation of deferred pensions which have yet to be vested. In

termination the actuarial balance sheet would be better stated as follows:

Accrued benefit credits - Fund on Hand = Sum of Present Value of Future Contributions lost to Each Class of Participants

The last item represents the true loss to the reasonable pension expectations of the older worker. The allocation of assets can then be understood as a system to shift the disappointment of expectation to those best able to adjust to this loss. In this light the IRS restrictions on distributions to the more highly paid employees is easily understood; with this view a priority termination distribution clause favoring the elderly at the expense of even the vested, younger participant seems more equitable, while the prorata systems are revealed to depart from collective pension security objectives of the original plan.

## C. Internal Revenue Service Viewpoint

Just as tax considerations play a major role in the design and initiation of a pension program, tax questions may have a pervasive influence on the manner of pension termination. The interest of the IRS is to maximize government revenues within the requirements of the tax laws. Since contributions to a qualified pension plan reduce taxable income, the IRS code contains certain limitations on the amount of reduction allowable in any one year for contributions to pension cost by the employer. In event of retroactive disqualification of a plan because of an unqualified termination, the Commissioner has

the power to disallow tax deductions for all tax years upon which the Statute of Limitations has not run so as to prevent him from making an assessment.[4]

The avoidance of taxes might be accomplished by using a qualified pension plan as a channel to defer and convert to capital gain compensation of officers, supervisors, or other highly paid employees.

1. Financial Discrimination.

A pension plan would be viewed as discriminatory and ineligible for qualification as a tax exempt plan were special classes of employees to benefit exclusively or excessively. There are situations where a pension plan could be non-discriminatory in operation if it continues to operate indefinitely, but could prove extremely unfair if terminated. The discrimination may not be intentional and may result despite the absence of any formal termination, when contributions prove insufficient to support the contemplated pension. To anticipate leakage of otherwise taxable business income, the regulations contain the following provision:[5]

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[4]Except where there is fraud, the Statute of Limitations applies three years from the time of filing a return or six years in cases where more than 25% of gross income has been omitted from the return.

[5]A qualified pension plan is one that meets the requirements of 401(a) of the Internal Revenue Code (IRS) of 1954 and the regulations and rulings which interpret this section of the law. Regulations, rulings and instructions in effect immediately before the August 16, 1954, inactment of the code have continued in effect to the degree they are consistent and remain unsupplanted by more recent interpretations.

The general requirements for a qualified plan include the

> Although a plan may provide for termination at will by the employer, this will not of itself prevent a trust from being a qualified trust. However, in certain cases that fact may necessitate some provision which will preclude such termination from effecting the prohibited discrimination. This may occur where, for example, certain officers or highly compensated employees are at the inception of the plan within a few years of retirement age and an operation of the plan will fund and vest their benefits in a short period, thus resulting in such discrimination in favor of such officers or highly compensated employees.

To further control the potential for tax favor discrimination under the guise of pension termination, the IRS published Mimeograph 5717.[6] Outlined in the following subsection, this ruling provides some control of benefits paid the 25 highest paid employees in event of termination of the plan or failure to meet the full current cost of the plan during the first ten years following initiation or substantial amendment. Further IRS rulings bearing on termination can be more briefly noted. No. 56[7] was issued to advise trustees of a terminated pension plan to seek the approval of the IRS before terminal distribution of the assets of the fund. The intent is to avoid dispersion of

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following minimum features:

1. Plan must be established by employer for exclusive benefit of employee.
2. Purpose of plan is to offer an income after retirement.
3. Plan is permanent, in writing, communicated to the employees and in effect.
4. Where a trust is involved, it must be impossible for trust funds to revert to the employer, the trust must be valid and created within the United States or District of Columbia.
5. The contributions to the trust must be solely for the purpose of accumulating funds for distribution to employees or beneficiaries according to an actuarial plan.

   IRS Reg. 1.401-4(c)

[6] CB-1944, 321, as reported in Pension and Profit Sharing Report, op. cit., p. 4221.

[7] Ibid., p. 4216.

the assets prior to a finding that the termination disqualified the previous tax exemption, exposing trust funds to additional tax liability, properly payable before liquidation. PS No. 57[8] requested a similar notice when the current costs of a pension sponsor are not met. In such an event a reappraisal is made by the IRS to see if such failure will produce discrimination due to inadequate funding. The definition of adequate funding is similar to that of Mimeo 5717 and is discussed below. PS No. 60[9] prescribed the information required of the pension sponsor who desires a ruling by IRS as to the effect on qualification of a proposed termination of suspension in contributions.[10] Approval or disapproval by IRS in any of the situations above cannot be considered a judgment by IRS that the plan of the proposal to terminate or suspend contributions to a plan has been judged actuarially sound but rather that the fund is being operated in a manner consistent with the statutory criteria for exemption from income tax. Finally, Revenue Ruling 55-186[11] stated that a pension plan must provide for granting fully vested rights to participants upon discontinuance (and perhaps upon suspension) of the plan or contributions to the plan, to prevent a few surviving employees benefiting to excess from forfeiture of interests of those dropped from employment.

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[8] Ibid.

[9] Ibid., p. 4180.

[10] The specific items of required information are reviewed in detail in Chapter II, pages 49 and 50.

[11] I.R.B. 1955-14-8.

2. Outline and Comment for Mimeograph 5717.

To prevent discrimination in favor of officers, shareholders, or highly paid employees in the event of early termination, Mimeograph 5717 establishes a limit on funds which may be used as benefits of the 25 top paid employees[12] at the time of plan initiation. Significant conditions and restrictions or the application of this body of rules include:

a. The rule applies only to those whose anticipated annual retirement income generated from employer contributions is in excess of $1,500.

b. The maximum employer contributions which may be used for any restricted employee cannot exceed the greater of: (1) $20,000 or (2) an amount equal to 20% of his annual compensation, times the age of the plan in years, or $10,000, whichever is less.

c. Benefits purchased within these limits are known as unrestricted benefits.

d. Benefits in excess of these limits can also be paid, with limitations conditional only in cases of early retirement or failure to maintain full current costs of contributions.

3. Pension plans must be made to conform with Mimeo 5717 by the addition of a suitable clause in the pension agreement or by a rider upon annuity contracts. Provisions must be specific as to the amount of unrestricted contribution or benefit so that incorporation by reference to Mimeo 5717 is not enough.

For an active, adequately funded plan, the rights of individuals who retire, terminate employment, or die are only moderately affected. Death benefits are not reduced as long as current

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[12]These 25 most highly paid employees are a closed group, fixed by the date of plan initiation and are to be distinguished from the list of the 25 top paid employees required each year under IRS 1.404(a)-2 to support a deduction under 404.

costs are met. For the 25 top aid employees whose retirement entitles the pensioner to benefit in excess of $1,500 a year, full current benefits are paid as long as the plan and full current cost contributions are continued. However, the pension administrator cannot surrender full title to an annuity contract providing such income in excess of the $1,500 maximum. A lump sum settlement upon retirement is only possible if capital amounts in excess of the $20,000 maximum are placed in escrow and invested in such a way as to assure the availability of the principal sum should the plan terminate within the ten-year period. Under normal conditions severance pay for the top paid employee who leaves employment before retirement would be limited to the capital value of unrestricted benefits payable each year plus the annual excess withheld the previous year, if current costs have been met in the succeeding year.

Termination or failure to meet full current costs[13] can bring the restrictions of 5717 to bear heavily on the top paid employee group. For those receiving retirement income when termination or funding problems arose, pension income would be reduced to the unrestricted maximum. For those who terminated their association with the company prior to retirement, the possibility of recouping benefits

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[13] In the case of insured plans full current costs are met with the payment of annual premiums. Where there are group annuity plans, current costs are met if service costs are paid and past service costs are offset sufficiently to keep unfunded past service liability from increasing. In a self-insured plan the employer may make contributions to the fund on the basis of actuarial assumptions approved by the IRS where unfunded past liability does not increase.

in excess of unrestricted amounts in subsequent years would be foreclosed. Death benefits payable,whether death occurred before or after retirement but prior to the limitations of 5717 becoming operative, are not affected. Should annuity payments be due the widow, they are not reduced. On the other hand, if death occurs after the provisions of 5717 apply, the widow's benefits are subject to the same reductions, although it is possible that reinstatement of the pension program can lead to retroactive readjustment of benefits paid the deceased's beneficiary. After limitations of 5717 become operative, funds available for benefits in excess of the maximum allowable must be reapplied in favor of active employees who are not in the restricted group. Redistribution need not follow a particular formula to satisfy the IRS, but neither can it discriminate in favor of top paid personnel.

3. Taxation of Terminal Pension Distributions.

Termination and liquidation of a qualified pension plan will create certain tax questions for the participant as well as the sponsor of the expiring plan. A benefit from a qualified pension program, in excess of that portion contributed by the employee, is included in the employee's income in the year in which the benefit is "distributed or made available" to him. These benefits are taxed under the annuity provisions of the 1954 code, with four exceptions all of which bear on the problem of pension termination.[14] These exceptions can be

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[14] IRC 402 (a) (1).

identified as:

(a) Full distribution because of employee retirement, resignation, discharge or death.

(b) Distribution of an annuity contract.

(c) Distribution of a life insurance contract.

(d) Distribution from trust of stock or other securities of employer corporation or parent or subsidiary corporation.

In general situations of the first instance, where the employee's entire interest is paid out to him or a beneficiary in a single tax year due to separation from employment for any reason or due to his death, the balance of the distribution in excess of his own contributions is treated as long term capital gain.[15] What is so apparently clear-cut, however, is clouded by what constitutes "distributed or made available" and "separation from employment." The phrase "made available" has made it possible for the IRS to invoke the doctrine of constructive receipt to impose a current tax on an employee in the year in which amounts become payable to him without penalty at his selection.[16] Constructive receipt can be defeated by the existence of a penalty of substance should the employee make a withdrawal or by the prior, irrevocable declaration of the employee to defer receipt of the amount otherwise payable at his election.[17] This problem arises in termination where there is a transfer of funds from one funding medium to another.

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[15]IRC 402(a) (2) 403 (a) (2).

[16]IRS Reg. 1.402 (a) - 1 (a) (1) (i).

[17]Pension and Profit Sharing Report, op. cit., p. 5301-B.

4. Actual Separation from Service and Liability for Income Tax. A terminal distribution of pension assets may enjoy taxation as a capital gain, to the benefit to the employee, if the individual has experienced an actual separation from service. The IRS applies this rule most strictly,[18] and it is most significant that long term capital gain treatment is not available for distributions received just because the plan was terminated. In the Glinske case[19] the company went out of business, disposing of its assets to another firm, while the trusteed pension plan was left in force and assumed by the surviving company to be terminated three weeks later. Since Glinske had been employed by the surviving company, the Tax Court denied long term capital gain treatment of a lump sum distribution from the liquidated trusteed pension plan because distribution was due to termination of the plan, not separation from employment. Prior planning could have avoided the tax loss in a number of ways. The pension plan could have been terminated and dissolved just prior to the sale of the defunct firm's assets. The surviving company could have maintained the trusteed plan until each participant terminated his employment with thesurviving company and received a lump sum settlement. An alternative method could have presented Glinske with a deferred annuity contract, the tax treatment of which will be

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[18]For example, in one case an employee stayed on without pay to liquidate a business which had been abandoned and which had terminated its qualified pension plan. A lump sum distribution from the plan was ruled to be ordinary income to the hapless employee because there was not "a complete severance of all relationships between the employer and the employee." Rev. Ru 57-115 as reported in Pension and Profit Sharing Report, op. cit., p. 5305.

[19]E. J. Glinske, 17 TC 562 (1951).

considered below.

The position of the Commissioner in regard to future cases bearing on the nature of complete seperation from service of the pension terminating sponsor is not entirely clear. Two tax Court Cases upset the IRS position that "separation from the service" meant "separation from the business or enterprise in which the employees were engaged when they became participants of a pension plan."

a. In the case of Lester B. Martin,[20] corporation A sold all of its outstanding stock to Corporation B, which then operated the acquisition as a subsidiary for several months until absorbing all the assets, liabilities and employees of A and terminating the qualified pension trust.

b. In re Mary Miller[21] can be summarized as a case in which Corporation A transferred its business operation to Corporation B, which in turn transferred the operation to a wholly owned subsidiary, C, the employer of A's former employees. At that point the qualified pension trust initiated by A was terminated. The tax commissioner could find no real break in service when a company transferred its assets as a going operation prior to termination of the pension trust and merger while employees continued to work for the successor business enterprises. Moreover, technical separation from service notwithstanding, the distributions were seen as caused by discontinuance of the plan and not by separation from service. The courts held the opposite, recognizing a literal separation from service, that precipitated the pension distributions.

While the commissioner has published an acquiescence, he does not entirely accept the court rationale. His future rulings may hold there must be a formal change in ownership as well as a real one to permit terminal distributions tax treatment as long term capital gains.

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[20] Commissioner of Insurance vs. Martin, 26 TC 9 (1956).

[21] Commissioner of Internal Revenue vs. Miller, 22 TC 293, affd. 226 f. 2d 618 (1955).

5. Form of Distribution and Income Tax.

If distribution to an employee, in full or in part, takes the form of an annuity contract, the cash surrender value under the contract is not taxable to him except in the amounts of his interest which he converts to cash. The trust from whence the annuity is distributed must be qualified in the year of distribution. Otherwise, the balance of the cash value in excess of the employee investment will be ordinary income. For these purposes an annuity contract is defined as one which provides periodic installment payments to a named annuitant and which does not provide death benefits in excess of the total premiums paid for the annuity benefit. There can be no pure insurance protection in an annuity contract. Since October of 1956 the entire cash value of a retirement income, endowment, or other life insurance contract has been taxed as current income, unless these values are irrevocably turned into an annuity contract within 60 days after distribution.[22]

When an employee receives terminal distribution of securities, where the pension trust is liquidated by distributing non-cash items, the value of the distribution for tax purposes is the then current market value security of the property distributed.[23] Redemption value of the security at the time of distribution becomes the basis for the employee beneficiary where he is subject to capital gain. The

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[22]Reg. 1.402(a)-1(e)(2).

[23]Reg. 1.402(a)-1(1)(iii).

employee is taxed only where redemption values exceed his contribution and tax treatment is restricted to bond purchased in the name of the pension trust, for apparently the regulations do not explicitly treat the case where the trust buys securities such as government bonds in the name of particular employee beneficiaries.[24] When distributions are not made entirely in one taxable year, only the first distribution will be taxed as long term capital gain; a supplemental distribution will generally be considered as ordinary income.[25] Where terminal distribution is made in several installments it is important that these fall within one taxable year, or the values distributed will be taxed with ordinary income. Such a tax consequence can be avoided by deferring distribution a year to accumulate otherwise individual payments and by leaving the mode of distribution to the discretion of an administrative pension committee, which could distribute interest to the best advantage of the individual employee-beneficiary. Of importance too, with a trend to international business operations, is the fact that long term capital gain privileges do not extend to terminal distributions to non-resident aliens outside the United States.[26] While there may be circumstances in which special treaty provisions between our government and the country in which an alien

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[24]Reg. 1.402(a)-1(a)(6)(i).

[25]Reg. Rul. 56-558. A supplemental distribution may occur when it is impossible to liquidate a pension fund within a single year because the sponsor is remiss on contributions or certain investments prove difficult to sell.

[26]Reg. 1.871-7.

resides determine tax rates, distributions to aliens in excess of unrecovered contributions are generally taxed at the rate of 30%, which must be withheld at the source.

6. Limitations of Tax Review.

The preceding summary of tax regulations affecting pension termination is intended only to indicate principal tax considerations of the pension administrator, sponsor, and employee beneficiary in one situation, that is, final termination and distribution of such pension aspects as there may be. It does not venture into the treatment of annuity income, life insurance value, and available exemptions and deductions for the individual as tax detail is not the principal concern of this paper. The tax difficulties of liquidating a non-qualified pension plan, or a plan whose termination is ajudged after the fact to be non-qualified, have been omitted as an accounting paradise of reallocations and accruals beyond the realm of this study as defined in Chapter I.

## D. Responsibility For Termination and Distribution Decisions

### 1. Pension Administration.

There is generally a distinction between administration of pension funds and administration of the pension plan. Those responsible for the fund are involved with the purchase, sale, and maintenance of investment securities; in addition, as the repository for funds, the fund administrators are responsible for the mechanics of disbursement. Where the plan and trust agreement are separate documents, the powers

and duties of the fund administrators are covered in the trust agreement. The administration of the plan is responsible for determining when employees have fulfilled eligibility, what amount of benefits is payable, how various provisions shall be interpreted as they relate to specific situations, and of course, providing adequate records. These functions will be performed by someone other than the funding medium no matter what kind of plan is used. The powers and duties of this group are either administrative or discretionary, perhaps even quasi-judicial in those cases where the findings of the pension board are stated to be conclusive in the pension agreement.

Generally, the administrative chores are performed by company personnel on company time. The judgment required when applying the plan to particular situations as they arise requires direct attention by the employer, by an administrative committee or by an administrative trustee. Presumably, an employer could administer and interpret the company plan without discrimination, and often such is the case; but there are times when the employer, as an administrator, might face a conflict of interest with the employer, as the entrepreneur. Consequently, the preferred method for most negotiated plans is to delegate responsibility for funds to a corporate trustee and administrative matters to a committee or other trustee. The latter refers to individual trustees, rather than corporate ones, and is essentially a committee system. The powers of each group are defined in each particular case by the documents giving rise to the pension system, and it is not necessary to review the infinite variety of forms which these can take.

What is important are the attitudes and motivations which will influence the individual employer as he administers the plan or will determine the position which each member of the committee will try to protect or advance as the committee decision process shapes its rulings. Some of the variables of motivation and attitudes which might be encountered are explored below.

2. Attitudes of Management.

Business events and decisions as drastic as those related to failure, liquidation, or migration are the direct concern of a business owner or board of directors. A decision to terminate a pension plan is a policy matter decided by the top business manager. Except where company officers have a substantial pension interest involved, however, the termination of a pension is a relatively unimportant consideration when the business faces the disaster of failure, the dilemma of liquidation, or the confusion of a major change of location. When a pension plan explicitly states that all contributions are to be for the benefit of the employees, the profit motivation for extensive management concern is lacking. If there is a union to represent the interest of the employee, management generally is content to delegate allocation and termination of pension funds to union officials. Often management will permit amendments of the basic plan in regard to settlement features, feeling that the pension fund is a windfall which the union representatives may distribute as they consider appropriate. The degree of management concern will vary to the extent that they expect the future will require them to maintain good relations with community

or labor organizations.

More recently, many companies terminating a pension plan have shown much greater concern, motivated by their own interest, as pension termination can indirectly affect business profits. For example, many firms which border on failure or face reorganization may have the opportunity to sell out or merge with a larger, more successful, organization. The manner in which a pension plan is terminated may influence the sale price realized. If the weaker firm encourages a certain amount of attrition among non-vested employees the funding ratio will rise. Should it rise to a point significantly above the financial strength of the plan in existence with the firm into which the first shall merge, the second firm can reduce its future funding obligations by integrating pension plans following merger, and then reducing employment levels among the non-vested employees as necessary. A well funded pension may mean past earnings are understated and merger values based on capitalized earning must be adjusted or will be distorted.

On the other hand, where an older family concern was liquidated because of economic obsolescence or failure to provide continuity of competent management, more personal ties between long term employees and retiring management may motivate supplementary contributions, or at least careful execution of a mode of termination most favorable to each employee. In the past few years the phenomenon of plant migration from one industrial area to another has alerted management to the value of a pension termination settlement in easing the way for transfer of company operations. A negotiated pension settlement may

include special additional contributions by the firm to assure pension benefits to certain classes of employees or to provide supplementary unemployment payments to others. Such largesse can be used to extinguish seniority privileges of terminated employees or to encourage employee cooperation until the final plant closing. Since a decision to liquidate or migrate is willful and decided on a dollar and cent basis, despite full knowledge of the hardships resulting from unemployment and attendant economic dislocation, management in these situations may be sensitive to a need to assuage the injury with some kind of monetary settlement. Where a pension plan does not contain sufficient funds to purchase deferred annuities of significant amount, there is an inclination to subvert the pension objectives of the plan by permitting a terminal cash distribution. In the minds of the recipients, a cash pension benefit will probably not be distinguished from severance pay. Private pension expectations, however, are thereby foreclosed.

Perhaps the worst situation is that of the individual trusteed plan covering all employees of the small firm. Here it is conceivable that a gradual reduction in the work force, a reduction which paralleled the general business situation, would permit the employer to convert a partially funded plan to the benefit of a few insiders remaining on the date of its actual termination. Even where management was not covered by the pension plan, if attrition among non-vested participants were sufficient, survivors could be paid their deferred benefits in full while a substantial actuarial error could be refunded to the firm. Were the termination accomplished merely by

suspending contributions for three years, it is possible that the terminal distribution could violate the limitations of IRS Mimeo 5717 and be protected from tax suit by the Statute of Limitations. While there has been no court test of such a situation, there are tax people who feel such situations will occur, but infrequently, since individually trusteed plans represent such a small proportion of all pension plans in force.

3. Attitudes of Labor.

The basic attitude of labor representatives must, by the very nature of the circumstances which surround pension termination, be defensive. Liquidation or migration of a plant may mean dispersion of the very labor group which created a position for the labor representative. The dislocation and economic hardship of large scale unemployment cracks the unity of the union organization and may shift the thinking of the union representative to the immediate money problems of his constituents, rather than long term retirement needs. This of course creates an additional bias for the conversion of pension assets to immediate cash resources for the unemployed. On the local level, each experience with a termination situation shapes future bargaining demands on matters such as early retirement, vesting, severance settlement, and distribution priority clauses.

On the national level, several unions have full time pension staffs whose experience is available to local AFL-CIO Unions involved in a pension termination situation. Not only can the expertise of the specialist improve a termination settlement, but the objectivity of a

union representative who is one step removed from the heartache and economic disaster of a local plant closing can be a valuable stabilizing influence on labor relations during shutdown. As will be shown in later chapters, these staffs can aggressively negotiate a pension settlement which maximizes benefits for the affected pension participants because of a superior bargaining position with both the employers and the insurance or trust companies. In cases of business failure some national union experts feel that a form of guaranty institution may be feasible to insure certain minimum benefits and this idea will be explored a little further in Chapter VIII.

In the case of business migration, it is national union policy to press for all kinds of reforms in areas like seniority, unemployment insurance, organization of unorganized labor areas to convert the social costs of such moves to actual cost for the employer. By increasing the capital cost of relocation, the advantages of moving from one employment area to another are reduced, the economic friction of such moves increased, and the flow of jobs to other employment areas is checked. As to the individual worker, his attitude will vary with his age and life service. The oldest worker will look toward early retirement and a temporary supplement pending eligibility for social security as a shield against the rebuffs and discriminations which meet his efforts to find reemployment in his late fifties. The younger worker may have as many years of service as his older, discharged compatriot and may wonder why his deferred interest is reduced to favor the older worker. Those without vested interest may not feel the loss of pension income quite so strongly and may prefer cash

settlement to provide a cushion for the family during a period of relocation.

4. Attitudes of Insurance and Trust Companies.

The insurance company tends to find much of its business with the smaller firm, and consequently, expects a higher rate of appointment termination than does the corporate trustee. Removed from administrative problems, the insurance company is influenced more by the aggregate dollar volumes involved in termination and by the number of small, individual policy insured plans. Liquidation of investments or issuance of a large number of individual contracts of small value create operating expenses which can affect the company capacity to pay dividends to policy holders or stockholders. Moreover, the continuing skirmish between the insurance media and the corporate trustee creates a certain inflexibility of mind and contract when dealing with termination situations, particularly in regard to lump sum distribution penalties as developed in Chapter V. One also gains the impression that the actuarial formula of annuity rate making are not so complex that they cannot allow for a profit margin reflecting what the traffic will bear. The corporate trustee of pension funds can be untouched by the administrative quandries of a negotiated termination. It need only protect itself against clerical errors and unwitting violations of tax law. Its basic attitudes could be characterized as detachment and preselection of clients to reduce the frequency of termination.

E. The Role of State and Federal Disclosure Act in Termination

The Federal Disclosure Act is predicated on a belief that the individual party at interest can protect those interests in the courts if he has sufficient financial and actuarial detail for the plan in which he has an interest. At best, federal officials hear of the termination and its accounting when the distribution is past history, and it has been shown in Chapter II that little specific termination information is sought or supplied. State pension fund reporting and auditing requirements maintain investment and accounting standards but seldom affect termination settlement allocations. On occasion, a state official may use the "arrogance of position" to influence a pension termination settlement where he has little legal recourse to affect its outcome. Such power as state pension supervisors may have is the power to enjoin or prosecute acts which are unlawful under their enabling legislation. They have no power to force termination, monitor distribution, or interfere with provisions of the pension plan. Therefore, the basic position of the state pension fund supervisor is that of a corner policeman who cannot interfere in a family argument until there is danger that someone will be physically injured.

F. Summary and Conclusions

The inconsistent relationship between the popular concept of wages and the rights inherent therein and court interpretations of pension interest concepts are magnified by typical attitudes of the parties of interest. Certainly the tax law affects the amount and

manner of distribution, but perhaps nothing is so important to control a termination as aggressive interest in the termination by the beneficiaries. The conditions described in Chapters III and IV might be summarized and lead to the following conclusions:

1. Nobody but the pension beneficiary and his representatives are greatly motivated to effect equitable termination of the pension plan should it be necessary to do so. Management generally sees termination as a peripheral consequence of greater economic difficulties or conversely, in the case of smaller business situations, as a source of cash recovery to provide salvage from a business reversal.

2. In event of the latter, provisions necessary to meet Internal Revenue Service requirements are intended to control the abuse of termination as a means of converting company income to capital gain via an eventual refund to the company or lump-sum distribution to the owner-participant. IRS rules may favor pension beneficiaries indirectly, but basically are intended to limit the diversion of taxable income to pension purposes in order to maintain tax receipts. Restrictions which retard funding obviously affect participants adversely.

3. Corporate trustees have generally avoided termination issues by restricting their functions to investment and the mechanics of distribution. Those banks which assume other administrative functions are more interested primarily in termination provisions to avoid liability for administrative error.

4. Insurance company termination methods are most thorough but are most inflexible. Both individual and group plans contain termination provisions with valuable procedures applicable to all pension termination provisions. Recently changes in accounting practices for administrative expense and for the new money method of funding have advanced insured plan termination techniques and will be discussed in Chapter V. With these exceptions, typical pension termination clauses are indefinite as to procedure and incomplete in establishing the powers of terminal administrators.

5. Regulatory agencies are virtually powerless to arrange a pension termination or police its administration unless injury to one of the parties involved has already occurred or is imminent.

6. The bias of actuarial work is basically toward guidelines for financing contributions of a continuing plan, rather than toward liquidating values and liabilities. The weight placed on past service funding to be amortized over long periods of time creates a conflict between those most interested in past service credits and those who are expected to forego earned benefits to fund the long service benefits.

7. These conflicting allocations of funds can create political problems within groups such as unions, or salaried participants. Points at issue are the result of insufficient preparation of pension rights when the defunct plan was negotiated. Standard priority clauses at the outset would eliminate dissension within ranks and some unions have introduced technical improvements for determining equitable shares for those within a given class.

8. Adequate funding is a prerequisite of adequate settlement, but pension termination problems arise where funds are scarce relative to claims. Return of cash to individuals for comparable efforts is distorted by the insurance function of a pension plan which pools resources to meet first needs first, such as giving preference to the elderly as a social objective valued above individual property rights.

9. Therefore it follows that equitable dissolution of the pension agreement depends on the power of the participants. Ultimately their rights depend on success in reducing the range of contingencies which they face by means of bargaining power and more enforceable contracts.

10. In view of the courts' reliance upon the terms of the contract, the first requisite for safeguarding the pension expectations of each worker is explicit preparation of the pension contract for the contingencies of the complete or the partial termination of the plan in circumstances beyond the control of the employee.

11. A number of devices for easing secondary termination problems may be desirable and will receive further discussion later in the study. Standard pension termination clauses can be made available. To alleviate the problem of locating pension participants, a registry agency has been suggested to record individual accumulated pension rights. To offset total pension expectancy losses, a guarantor has been proposed to insure against loss of minimum coverage due to failure of pension funds or sponsor.

In presenting a survey of law, tax, and administrative detail at some length and detail, a variety of critical comments were presented which need not be repeated here. Instead, the next three chapters will review various case situations in which a majority of the factors surveyed here will play a part. Further comment is deferred to the final chapter on recommendations and conclusions.

# CHAPTER V

## CASE ILLUSTRATION OF FACTORS PERTINENT TO TERMINATION OF INSURED PENSION PLANS

### A. Objectives of Chapter

The next three chapters recount the adventures and misadventures of various pension plan terminations, using the narrative as a vehicle for comment and criticism of common termination practices for insured plans, trusteed plans, and partially terminated plans of each type. Chapter V is restricted to the insured plan, including individual policy, group permanent, single premium deferred, and deposit administration forms. The true identity of each situation has been disguised in accord with the wishes of the sources. The detail furnished has been edited to bear on the principal problems under discussion and to avoid repetition. Where appropriate, each case is concluded with an appraisal of the problem and possible solutions now in vogue. The final section of the chapter attempts to summarize common, unresolved problem areas encountered in terminating an insured pension plan, suggesting ways and means to their solution or alleviation. The topics discussed are not necessarily the only problems to be found, but rather represent the issues raised by the collection of case materials which were available.

### B. A Typical Distribution of Individual Policies

This first case is of value primarily because the ease and

simplicity of its termination will serve as a constant reminder that pension termination need not be a protracted, complex procedure, that all terminations are not grist for those who wish to discuss problems and issues of great moment, and that termination can be a matter of bookkeeping and not social policy making.

## CASE #1

Facts: A long established candy company sold its assets and customer lists to a larger firm, which then closed and liquidated the older manufacturing facilities. Two hundred and ninety people had been employed, of whom 89 were eligible for the employee's retirement fund. The plan, as begun in 1945 and modified over the next 12 years, was supported entirely by company contributions. It consisted of a pension trust managed by a joint management-labor administrative board, which used company contributions to the fund to pay premiums on individual retirement income contracts for each employee. The benefits were vested fully either at time of retirement or termination of employment with the company, so that despite a gradual reduction in the work force during the year prior to actual termination, each eligible employee received his contract as a terminating liquidation from the trust. When the plan was finally closed, 70 participants shared a pension trust worth $107,374, which was distributed according to the schedules in Tables 1 and 2. In this particular case the annual statements of the trust recognized cash values in the individual retirement income policies at full value.[1] The difference

[1]As pointed out in Chapter III, it is often the practice of

between book value of assets at the end of the year in Item 14 and in the summary of operation equals the value of terminal distributions to 19 employees who left the firm before the plan was terminated. The average amount of these distributions was quite small, as the lay-off preceding final shutdown affected first the younger employees with the smallest financial interest in the plan.

Adequate notification of impending termination for employees and trust officials was no problem. Since company officers, as well as salaried employees, were eligible for coverage and participated on the trustee and advisory committees of the fund, preparations for termination paralleled organization to dissolve the business.[2] Only two board meetings were necessary to terminate the trust. The first passed the resolution to initiate termination proceedings. The second and final meeting (7 weeks later) of the trustee board approved final accounting procedures and resolved to terminate the fund and discharge the Board. The final resolution was also careful to assign the closed account books of the trust to the secretary of the company by name so that its financial history would not be lost in event of suit. While such an assignment seems elementary, yet many terminating plans make no provision for preserving such records for at least a few years to

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insured plans not to require the insurance company to record annual increments to cash values of annuity policies to avoid accounting expense of the insurer. In event of termination, a special accounting is necessary to determine individual annuity values accumulated cash values.

[2]In many negotiated plans terminal administration and distribution is complicated because management has no financial interest in hourly wage pension plans, but may feel it expedient to keep company plan as secret as possible.

minimize the dilemma of a possible need for records when the trustees are dispersed, trust funds are liquidated and the original employer is dissolved and past history. To further reduce the possibility of an undiscovered error in the distribution, which might be discovered after trustees and trust fund were no longer in existence, the secretary had carefully cross checked the amounts credited to each participant, a process which appeared in the minutes of the final meeting as follows:

> The Secretary reported that he had reviewed the Trustee's final report, and that the amounts appearing to the credit to each participant's account appeared proper. He also reported that he had inspected signed receipts from each of the participants, acknowledging receipt of his (her) insurance policy as well as the receipt of the amount of cash shown as payable in the Trustee's final report, and that he had also inspected and compared with the receipts the related cancelled checks returned by the bank.

Conclusions: Full vesting and the explicit provision of the trust for termination left little room for difficulty. The care of the individual trustee in the final accounting is to be noted because if there is an inadvertent error which comes to light after the plan and the employer no longer exist as legal entities, there are few avenues of redress. Trustees' bonds do not insure against clerical error and the liability of the pension sponsor is limited to his contributions to the plan. Not all terminations, of even the smaller company, proceed so expeditiously.

C. The Application of I. R. S. Mimeo 5717

Since there is some evidence that the majority of pension terminations occur in the first seven years of the plan, the restrictions on distribution of pension assets imposed by Mimeo 5717 can be

expected to modify termination results frequently.

CASE #2

Facts: For example, consider a small van and warehouse company with 27 employees, which found that it could not afford a luxurious pension plan utilizing a trust to purchase and to hold retirement income policies for seven eligible salaried employees. The plan was terminated after the automatic premium loan feature of the retirement income contract had been used to maintain policies in force for two of the plan's seven years; in effect these years illustrate a suspension which leads to full termination as envisioned by the tax code. From correspondence it would appear the reason for termination lay in over-selling by an insurance company of a retirement income program. The employer soon discovered it could not support both a substantial salary scale for its owner officers and a retirement income plan as well. The plan was originally intended to serve the two brothers who owned the business and five salaried personnel, two of whom were no longer in the employ of the company at termination of the plan and so were not eligible to share in the terminal distribution.

Similar in most respects to the previous case, termination required no formal announcement when this course of action was decided on by the management. The governing termination provision provided by the pension agreement and trust document appears in Table 27; it is significant that no reference is made to the restrictions of the Tax Code as is generally required in this section of the plan document. Table 28 provides a summary of values credited to each eligible

TABLE 27

TERMINATION PROVISION FOR VAN AND WAREHOUSE COMPANY

XV:1. The Company reserves to itself the right, through action by its Board of Directors, to terminate this Plan and Trust, which termination shall become effective upon filing with the Committee and the Trustee of written notice of its election to terminate.

XVI:2. The Company reserves the right, through action of its Board of Directors, to amend this Plan and Trust without the Consent of any participant or death beneficiary; provided, however, that no amendment to this Plan and Trust shall deprive any Participant or death beneficiary of any vested equitable interest herein nor shall such amendment increase the duties and obligations of the Trustee hereunder except with its consent.

XVI:3. This Plan and Trust is created with the intent and purpose that it shall qualify as a Pension Trust within the terms and conditions of Section 165 of the Internal Revenue Code and contributions thereunder shall come within the terms of Section 23 (p) of the Internal Revenue Code. The Company, therefore, reserves to itself through action of its Board of Directors the right to amend this Plan and Trust in such manner as may be necessary or advisable so that said Plan and Trust may qualify and continue to qualify under the provisions of said Internal Revenue Code as are now in force and as may hereafter be changed or amended, or under any other related provision or provisions of said Code.

XVI:4. In the event of termination of the Plan and Trust, the Trustee shall pay, assign, transfer and set over to each then living Participant any contribution for such Participant not paid over to an Insurer any contracts then held on his life if permitted by the insurer and shall dispose of any funds then held as provided in Article XIII. In the event the rules of the Insurer prohibit the transfer of any contract, the Trustee shall surrender such contract to the Insurer for its cash value and pay such cash value to the Participant.

TABLE 28

WAREHOUSE COMPANY (3-1-60) PENSION TRUST DATA
(Effective Date: 12-21-54)

| Participant | Officer | Stock | Born | Reference[a] | 1954[b] | 1955 | 1956 | 1957 | 1958 | Totals |
|---|---|---|---|---|---|---|---|---|---|---|
| A | Yes | 50% | 1897 | (a) | $15,000.00 | $20,000.00 | $20,000.00 | $20,000.00 | $ 9,000.00 | $84,000.00 |
| | | | | (b) | 5,387.75 | 7,060.49 | 6,910.17 | 6,876.59 | 6,917.11 | 33,152.00 |
| | | | | (c) | None | ---- | | | | |
| B | Yes | 50% | 1901 | (a) | 15,000.00 | 20,000.00 | 20,000.00 | 20,000.00 | 20,000.00 | 95,000.00 |
| | | | | (b) | 3,509.50 | 4,879.37 | 4,758.20 | 4,729.69 | 4,749.94 | 22,626.00 |
| | | | | (c) | None | ---- | | | | |
| C | No | None | 1925 | (a) | 5,100.00 | 5,964.60 | Discharged for Cause: | | | |
| | | | | (b) | 286.43 | 253.58 | no vesting; see footnote c below | | | |
| | | | | (c) | None | ---- | | | | |
| D | No | None | 1922 | (a) | 2,990.80 | 3,443.80 | 3,071.46 | 3,411.46 | 3,524.50 | 16,442.00 |
| | | | | (b) | 243.45 | 259.35 | 256.15 | 245.00 | 258.95 | 1,271.00 |
| | | | | (c) | None | ---- | | | | |
| E | No | None | 1902 | (a) | 3,900.00 | 4,365.00 | 4,400.00 | 4,400.00 | 4,004.00 | 20,269.00 |
| | | | | (b) | 512.52 | 507.90 | 504.90 | 504.90 | 506.70 | 2,587.00 |
| | | | | (c) | ---- | | | | | |
| F | No | None | 1913 | (a) | 6,500.00 | 7,150.00 | 7,300.00 | 7,573.50 | 6,860.00 | 35,383.00 |
| | | | | (b) | 689.47 | 620.24 | 613.65 | 609.55 | 617.12 | 3,150.00 |
| | | | | (c) | None | ---- | | | | |
| G | No | None | 1920 | (a) | Not eligible | | 7,150.00 | 6,825.00 | Quit; no | |
| | | | | (b) | | | 570.24 | 506.74 | vesting; | |
| | | | | (c) | | | None | | see footnote d | |

[a](a) Non-deferred compensation, (b) Annual premium or retirement income contract, (c) Employee contribution
[b]Plan instituted 12/21/54

participant during the life of the plan. As might be expected, the cash value of the retirement income policy purchased for A, the oldest brother, was highest, amounting to $26,625.60 as of termination, anticipating a more imminent retirement. The terminal distribution plan put forward to request approval of the termination from the Internal Revenue district office expected to distribute full individual account values to each of the five participants. Approval was not forthcoming, for the distribution plan was not in accord with Mimeo 5717, which was pertinent for a plan only seven years old. As described in Chapter IV, this ruling established the total value of terminal benefits could not exceed the greater amount of $20,000.00, or 20% of the employee's average compensation multiplied by the number of years for which current costs of the plan were met. The average annual, non-deferred compensation for brother A for six years, from 1954 to 1959, was $14,250, and 20% of this amount for five years, the five years in which full current costs were met from 1954 to 1958, was also $14,250. The applicable limit was therefore $20,000 and so it was necessary that A forfeit $6,625.60 for distribution among the other four remaining participants. Since the second brother was entitled to policy cash value approaching the $20,000.00 limit, the balance of the forfeiture was distributed in proportion to the total amount of non-deferred compensation received by the remaining three employees over the period of the plan's existence. The final distribution plan is summarized in Table 29; the two brothers retained their contracts while the other three employees chose a cash distribution.

As mentioned before, the original plan, when it was submitted

TABLE 29

FINAL TERMINATION DISTRIBUTION OF WAREHOUSE COMPANY PENSION TRUST
AFTER ADJUSTMENT FOR IRS 5717

| Name | Total Non-deferred Compensation 1954 thru 1959 | Policy Value at Plan's Termination | Adjustment | Adjusted Amount Distributable | Ratio of Adjusted Amount to Compensation |
|---|---|---|---|---|---|
| A | $ 85,500.00 | $ 26,625.60 | ($6,625.60) | $20,000.00 | 23.4% |
| B | 113,000.00 | 18,389.04 | 1,610.96 | 20,000.00 | 17.7 |
| F | 43,083.50 | 2,639.30 | 2,470.21 | 5,109.51 | 11.9 |
| E | 24,450.00 | 2,248.98 | 1,402.09 | 3,651.07 | 14.9 |
| D | 19,926.62 | 1,560.15 | 1,142.34 | 2,702.49 | 13.6 |
| Totals | $ 285,960.12 | $ 51,463.07 | $6,625.60 | $51,463.07 | 18.0% |

for tax approval in early 1954, made no provision for the restrictions of Mimeo 5717, and it was necessary to amend the plan to achieve initial qualification. The amendment, attached to the end of the pension contract, was never integrated with the other termination provision. Upon termination, the same attorney then disregarded these provisions when forwarding the original termination plan to the I.R.S. for qualification and preservation of tax exemption. The reply from the I.R.S., seven weeks later, was extremely well detailed, clearly stated the requirements of the Code, and also proposed a solution that would qualify the termination. The I.R.S. letter referred to the correspondence with the attorney which had taken place when the plan was first originated and which concerned the omission of a plan provision making termination benefits compatible with Mimeo 5717. This correspondence is significant because it means that the attorney should have been aware of the problem in regard to this specific plan before requesting approval of the termination, a condition which implies an unqualified form of terminal distribution was proposed because it was hoped that the I.R.S. would overlook the deviation.

The attitude that I.R.S. technicians might not discover small deviations from the law was far from uncommon among professionals and employers interviewed for this study. Several other cases will be noted in this section where an attitude of hostility to the requirements of pension tax law achieved nothing but additional paper work for all concerned and prolonged the termination process. Whether this attitude reflects an entrepreneurial or legal state of mind is unknown, but it seems a most expensive indulgence. Approval of a termination

involving five people required an elapsed time of four months, although the intent of the law was clear and explicitly stated in the pension plan itself. It would seem a basic assumption for those involved in a pension termination should be that a Federal tax technician can do and will do a thoroughly competent job of judging the termination proposal in light of the law. It follows that the pension professional, to give service to his client equal to value received, should apply the law and the provisions of the plan with equal attention to detail.

D. Discrimination Where 5717 Does Not Apply

The definition of a discriminatory pension plan is far more difficult to apply when the plan is terminated 120 months after its last amending requiring I.R.S. approval and Mimeo 5717 no longer has application.

CASE #3

**Facts:** One illustration of a qualified pension termination which seemed to have discriminatory overtones to any but a tax technician concerns a family-operated, wholesale specialty house. The business was sold, precipitating liquidation of the employee trusteed pension fund. A split fund plan requiring one year employment for eligibility and two years of participation before vesting, the plan made termination distributions to 18 of 45 employees. The exact amount of distribution was not determined by formula, but through a discretionary pension committee which represented management. The investment functions were delegated to a corporate trustee, which was

not a bank trustee, but rather the firm of an industrial investment specialist. The plan was a package designed and administered by a general life insurance agent for a large national life insurance carrier. The entire program was subject to modification and revocation at the action of the company board of directors. The distribution of the investment side fund and the cash value of insurance policies distributed to their owners is presented in Table 30. More than 50% of the $153,259 went to the president of the firm, and more than 70% of the assets went to members of the family. The three largest distributions were made to the three men on the pension committee who were also the three principal officers of the firm.

Conclusions: The disclosure records available on this case contained no answers to the specific question of the date on which the original plan was established and qualified. Since 20% of the reported salary for the president of the firm the year of distribution was $2,800, one must presume the plan was in effect for more than ten years and hence, not subject to Mimeo 5717, which would have limited a qualified distribution to $28,000 at best. The impact of Mimeo 5717 on the adequacy of funding will be further demonstrated when discussing several trustee plans in Chapter V where the application of this rule to some of the participants meant recovery in excess of 100% for others, who might otherwise have received only a pro-rata share of their pension expectations.

## E. The Mode of Termination Distribution

Since 1957, the changing purchasing policies of major auto

TABLE 30

TERMINAL DISTRIBUTION OF DEPOSIT ADMINISTRATION FUND

Wholesale Specialty House

| Participants | Cash Payments Conversion Contribution | Cash Value of Policies Distributed | Total |
|---|---|---|---|
| Distributions (1-25-60) | | | |
| A | $ 79,026.97 | 0 | |
| B | 24,716.64 | 0 | |
| Dividend accumulations | 5,436.31 | | |
| | $ 30,152.95 | | |
| Distributions (2-25-60) | | | |
| C | 2,939.73 | 2,241.25 | 5,180.98 |
| D | 660.11 | 365.38 | 1,025.49 |
| E | 781.19 | 249.75 | 1,030.94 |
| F | 656.59 | 190.34 | 846.93 |
| G | 476.13 | 258.19 | 734.32 |
| H | 2,435.88 | 1,579.02 | 4,014.90 |
| I | 185.77 | | 185.77 |
| J | 1,822.62 | 1,402.85 | 3,225.47 |
| K | 5,541.75 | 1,402.54 | 6,944.29 |
| L | 119.58 | | 119.58 |
| M | 4,117.80 | 3,142.13 | 7,259.93 |
| N | 1,602.10 | 960.43 | 2,562.53 |
| O | 219.74 | 10.61 | 230.35 |
| P | 283.42 | 27.76 | 311.18 |
| Q | 2,337.63 | 1,457.20 | 3,794.83 |
| R | 2,713.79 | 2,057.59 | 4,771.38 |
| S | 224.88 | | 224.88 |
| T | 615.44 | | 615.44 |
| Total 2-25-60 | $27,734.15 | $15,345.04 | $43,079.19 |

manufacturers have adversely affected the volume of auto parts manufacturers: a reduced demand for items produced by independent contractors was accelerated by a fall in the demand for new autos.

## CASE #4

**Facts:** In 1958 one auto parts manufacturer, employing 850 persons, found that the annual pension contribution for the salaries personnel plan pushed the company into a deficit. The salaried pension plan was ended but the trust continued. As part of the company reorganization and adjustment to new market conditions, it was able to merge its technical personnel into another firm, but by 1962 its major production facility had been closed, and both the salaried and negotiated employee pension programs had been terminated.

The 15-year old plan for salaried employees involved a trusteed insurance purchasing program with a small side fund. When the plan was terminated, the trust was continued to protect the employees from an income tax on their pension interest since there was no severance of employment. The employees were given four options for terminal distribution, but these options were only available should they leave the company or the locale of their present employment, in accordance with rules for distribution upon termination in Article XX (2) (b) as in Table 31. The four options, as explained to each participant in a letter from the general insurance agent, appear in Table 32. Notice that the causes of termination are defined more explicitly than in the previous case. However, the definition of dissolution refers to "legal" dissolution of the company, to be distinguished from

TABLE 31

ARTICLE XX--TERMINATION OF TRUST
(For Salaried Employees)

1. Causes of Termination. This trust shall cease and terminate upon the happening of any one or more of the following events:

(a) Bankruptcy. In the event the Company shall at any time be adjudicated bankrupt or insolvent.

(b) Dissolution. In the event the Company shall at any time be legally dissolved.

(c) Merger or Consolidation. In the event the Company shall lose its corporate existence by merger or consolidation in and with another company, and such other company shall not agree to continue this Trust with proper agreement with the Trustees.

(d) Notice From the Company. Thirty days after the receipt by the Trustee of written notice of termination from the Company.

2. Distribution Upon Termination. In the event this Trust shall terminate for any of the reasons set forth in Section 1 of this Article XX hereof, the Trustees shall, without regard to the provisions for vesting as set forth in Article XV:

(a) Pay over and distribute to each participant, his entire separate share of the General Trust Fund, provided that no payment shall be made prior to January 1, 1955, except in the event of the death, sickness, disability, or retirement of the participant, and further provided that after January 1, 1955, payments to participants shall be made in approximately equal installments, over a period of ten (10) years.

(b) Assign to each participant, all contracts issued on his life, and then held by the Trustees, such assignments to be made under options or restrictions which will prevent the participant, in the absence of his death, retirement, sickness, or disability, from receiving payments pursuant to the contracts or the cash surrender value thereof prior to January 1, 1955, and preventing payments after that date, in the absence of one of the contingencies just specified, over a period of less than ten years in installments which shall be approximately equal each year.

TABLE 31 (continued)

(c) Upon the death, retirement, sickness or disability of any participant, the participant or his beneficiaries may have the same benefits as though this trust had not terminated, and the assignments of any contracts may make provision therefor.

(d) Deliver to the beneficiary of any contract issued on the life of a deceased participant, any and all contracts under which such beneficiary shall then be entitled to receive the benefits thereof under the provisions of such contracts.

When it was decided to liquidate the side fund in less than ten years to provide each participant with contracts on his life according to options offered by the company, it was necessary to amend Part II of Article XX and create a new article governing the termination of the trust. The amendment which follows created full vesting for surviving participants and still preserved the essential features of the provisions it supplanted:

In the event this Pension Plan shall terminate for any of the reasons set forth in this Article XX this Trust Agreement shall be invalidated with the exception of Articles I, II, VIII, IX, XI, XIII, XIV, XVIII, XIX, XX, XXI, and XXII hereof as amended, which Articles alone shall henceforth govern the operation of this trust. The account of each participant shall vest in its entirety and each participant shall be entitled to exercise either immediately or at any time in the future any of the options offered by the issuing company with respect to the insurance contracts comprising his account in the trust, provided, however, that should he elect cash settlement, payment shall be made at a rate not to exceed 20% of his account for each year that elapses commencing August 1, 1959, such percentage to be cumulative. The Trustees shall retain all incidents of ownership in the contracts until request is made by the participant for transfer to himself of such ownership. If the Trustees are satisfied that such transfer will be in the best interest of the participant, transfer shall be immediately effected by the Trustees upon such request, and the contract shall be restrictively endorsed to give effect to the provision herein before outlined with respect to cash settlement.

TABLE 31 (continued)

ARTICLE XXI

TERMINATION OF TRUST

This Trust shall terminate upon satisfaction of all liabilities with respect to the participants hereof. Distribution to each participant of his separate share in the General Trust Fund and his insurance contract or contracts shall constitute satisfaction of all liability hereunder.

(3) Re-numbering Article XXI to read Article XXII.

TABLE 32

DISTRIBUTION OPTIONS FOR SALARIED EMPLOYEES

Option I. Your contract will be continued on the present basis, which provides the following:

1. Insurance in event of death (or cash value, if greater) $______
2. Guaranteed cash value at age 65 $______
3. Present cash value $______
4. Increase in cash value to age 65 $______
5. Estimated net premiums to age 65 $______
6. Estimated gain $______
7. Guaranteed monthly retirement income $______

Annual premium deposit $______ less estimated dividend

of $______ payable ______________________________.

If this Option is elected, you may subsequently change to any of the other options.

Option II. Your contract will be paid up for the following benefits:

1. Insurance in event of death (This amount will be increased by any dividends accumulated to date of death $______
2. Guaranteed cash value at age 65 $______
3. Estimated accumulated dividends to age 65 $______
4. Estimated total account value at age 65 $______
5. Guaranteed monthly retirement income at age 65 $______
6. Monthly retirement income from estimated accumulated dividends $______
7. Total monthly retirement income $______

If this Option is elected, Option IV will be available at

TABLE 32 (Continued)

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| | |
|---|---|
| | any future date and your account value will be higher than that shown above. |
| Option III. | Under this option you will have $______ of insurance protection for the next ______ years. At the end of this period your account will have a value of $______ which would be payable to you in one sum or under any of the settlement options offered by the Insurance Company. |
| | If this Option is elected, you may subsequently elect to change to Option IV, in which case the account value will be somewhat higher than that currently shown. |
| Option IV. | Present value of your account (including current dividend) $______ |
| | If you elect to receive a cash payment commencing September 1, 1959, you will receive $______ each year for ten years, plus any interest earned, and the tenth payment will terminate your interest in the Trust. |
| | If this Option is elected, the amount received each year will constitute ordinary income for tax purposes. |

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NOTE: Dividends are estimates based on present scales and are not guaranteed.

May 29, 1959.

contraction and liquidation not affecting the corporate shell. This case is the first which suggests that pension plans should, but do not, anticipate radical contraction of employment or operations with a more precise definition of termination.

The pension trust in this situation was paying premiums on 75 "income endowment at 65" contracts at the time of termination, of which 8 were surrendered for cash at termination. Of the remaining policies, all of which vested at termination, 64 were endorsed to become reduced paid-up endowment at 65, and 3 were converted to an extended term basis as accumulated values were only sufficient to preserve the protection feature. In the past three years, 29 of the paid-up policies have been surrendered for cash, the predominant reason being transfer of the policyholder to other operating divisions of the reorganized firm. This rather low lapse rate for these termination policies is the most significant aspect of this termination.

The preference of participants in a terminating distribution of a pension plan for cash has long been the subject of comment. Many people feel that a cash distribution in lieu of a deferred annuity defeats the pension objectives of management and society in favoring such an allocation of resources. A particular effort was made by the insurance company to encourage retention; in addition to a personal letter of explanation of the termination and options available to each participant as a result, a representative of the insurance company and the personnel officer of the firm held a special seminar for the entire group of employees covered to explain the pension program and its

values. Desirable as such efforts are, and rare as they have been in the past, the intended result was forced by other circumstances.

While the plan was terminated, the trust which held the policies which vested with demise of the plan was continued until the last of the participants was to enter retirement or was permitted to surrender his contract because of a change in employment. These conditions protected the participants who had received a vested terminal interest from immediate taxation under the theory of constructive receipt. In addition the plan called for payment of lump-sum cash benefits in 10 annual installments, but this provision was amended to permit the trustees to distribute more than $23,000 in five annual installments, a schedule which avoided a progressive tax levy, yet expedited trust administration. The fact that the plan had been in operation for nearly 15 years had permitted accumulation of almost one-quarter of a million dollars, a sum sufficient to provide a significant deferred annuity for all but a few recent employees, so that a deferred annuity had meaning. The termination tax status of the individual participants was further compromised by the fact that most continued to work for the company so that there was no separation of service which would have qualified a terminal cash distribution from the trust for capital gains treatment.

Conclusions: Thus all of these factors contributed to a high retention rate for retirement income insurance contracts. Nevertheless, the company was concerned with protecting the tax position of its employees and preserving the pension objectives with the plan. For this reason it took care to amend the plan and maintain the

trust. There will be other examples where the firm carelessly penalized its employees by creating unnecessary tax burdens simply due to the manner in which a pension plan was terminated.

CASE #5

Facts: This same firm also terminated its negotiated pension plan a little more than two years later, following sharp reductions in the number of active hourly employees. Financing of this program had required full funding of current pension service credits and thirty-year amortization of past pension credits. Designed on the autoworker pension pattern, employees with ten years of service credits were eligible for a pension at age 65 or early retirement at age 55, with benefits vesting after 10 years at age 40. Termination provisions of the plan called for paying retirement benefits (as opposed to some additional group insurance benefits) from retirement funds remaining after expenses with the following order of priority:

1. Retirement benefits to those over age 65.
2. Retirement benefits to those age 60-65.
3. Normal retirement benefits to employees 55-60.
4. Normal retirement benefits for those below age 55.

A pension fund of somewhat less than $1 million was sufficient to provide full benefits for the first class and 90% of accrued pension credits for the second class, but the balance of the employment force received nothing. In this plan priority on the basis of age or prior vesting with a class was specifically excluded, a somewhat less refined priority clause than appears in other auto plans. Eligibility

for a pension required achievement of seniority under the existing union contract, which provided that seniority would survive up to five years of lay-off.

Conclusions: As a consequence, all employees in the lay-off crew participated in the termination distribution as they would had they been continuously, actively employed. The value of this provision will be highlighted in later cases where employees in a lay-off status were arbitrarily "amended-out-of" pension expectations. Both pension plans were terminated because of the change in the economic role of the firm that was beyond the control of company management to predict or prevent. Still, both plans managed to meet pension liabilities in part because there had been time to make a serious effort at funding.

### F. Cash-out of a Small Pension Plan

Not all insurance company efforts to administer the termination of a trusteed pension plan are handled as expeditiously as the salaried employees' plan in the prior case. It is to the advantage of the insurance company to encourage retention of individual policies which might be distributed from a trust as well as to hold the administrative work to a low-cost minimum. Reflect on the implications of a case involving a general contracting firm which operated throughout the country with a small permanent crew of technical and supervisory personnel.

#### CASE #6

Facts: When a major contract began to produce substantial

losses, the firm decided to conserve cash by terminating a pension trust agreement used to purchase retirement income policies for 27 persons. Aggregate cash value of the policies at termination was $38,490. The insurance company general agent, who had originally assisted in the establishment of the program, assumed the administrative duties of termination. Under the contractor letterhead a letter was sent each participant explaining the options and account value open to the participant under the terms of the pension agreement. The letter emphasized the sizable benefits available to the participant if he should undertake to pay the premiums until his retirement. The option to take cash immediately was placed last and given little play. Twenty-four participants elected to cash-out.

As most employees remained on the job following termination until the contract was completed, election of a policy form of distribution left in trust pending separation from employment would have reduced the tax paid on the distribution. The letter made no mention of the tax angle, and there was no opportunity for personal discussion with the participants as they were scattered at various sites around the country. Three policies were retained but amended to 65 full-paid life insurance contracts of a reduced amount. A year later a $5,000 65 full-paid was cancelled when the participant left the employ of the firm. Presently, two policies remain in force, one for $5,000 and another for $2,000. In the meantime the insurance company has found the administrative service rendered to accomplish termination most trying and expensive.

Insurance company officials stated in several interviews that annual premium values must exceed $25,000 per to offset the cost of enrollment and withdrawal administration. This agency, however, serviced the small plan without charge to accommodate the client while the plan operated normally for there was little to do. With this precedent the agency fell heir to the administration of termination at the same rate of compensation. The contracting firm was neither particularly concerned with matters of detail nor overly cooperative in the termination. The contractor neglected to follow the tax counsel of the insurer in regard to termination reporting and as a result it has yet to receive complete tax qualification; litigation is imminent. The insurance agency evidently used the letter of notice of termination to encourage continued premium payments on an individual basis, thereby preserving its commission basis. Certainly, it had little success, and instead, has only found itself responsible for the bulk of correspondence related to the tax question of business necessity and permanency which concerns the Revenue Service.

Conclusions: The situation raises the question of the wisdom of leaving administrative responsibility with an insurance agent who profits should the plan grow but who has little incentive for diligent administration should the plan terminate, the one point where beneficiaries of the plan could benefit from astute administration. Again the arrogance of management to tax considerations will redound to its discomfort and cost the insurance company further sums to provide information as grist for the lawyers' mill. The indifference

of the contractor to pension arrangements may have also created additional tax losses for the participants. While the courts have established a clear responsibility for the employer to inform pension plan participants of their rights under a plan accurately, it is not clear that the pension administrator has any responsibility to inform participants on their individual tax problems. Neither is there any obligation on the part of the company to discourage the universal preference for cash at termination to further the social desirability of privately financed annuities.

G. Division of Pension Termination Responsibility

The effect of the attitude of management toward termination is further demonstrated in a case where the management of a firm which was sold remained in control of the pension trust while the management of the new controlling interest attempted to divert pension assets to the indirect benefit of the surviving firm.

CASE #7

Facts: A wholesale hardware company employing 120 persons created a pension trust in 1950 to purchase retirement income insurance contracts for all salaried employees with three years of service. Participation was voluntary and elected by 92 employees who were required to contribute 2% of their salary.[3] The employer made additional contributions as required to purchase a retirement income

[3]Excluding overtime and bonus.

contract for each employee. Employer contributions became vested 10% a year after 10 years of participation. With structural changes in the marketing channels of the principal lines which the company represented, the company encountered serious operating losses for several years. A family firm for more than three generations, the company decided to liquidate only with great reluctance. In May of 1958 the employees were given six weeks notice of business discontinuance. A few employees were asked to remain with the company somewhat longer to aid in final liquidation and an announcement to salaried employees included the following statement:

> "Salaried employees will be assigned full equity in the pension plan subject to Treasury ruling."

At this point an out-of-state buyer offered to buy all the common and preferred stock of the company ostensibly to continue the business but evidently for a tax-loss offset. Sale of the company was consummated at the end of May, at which time all former officers of the company resigned as required by the buyer. During the pendency of this offer the company took no formal steps to modify the pension trust because the management-owners were led to believe that the buyer planned to continue the business in a modified form. However, the buyer immediately began a rapid liquidation of the entire business, and he notified the remaining employees of their termination by the end of June. By the end of July only six employees, who were also participants in the pension trust, remained on the payroll. By the end of November all inventories were liquidated and all participating employees had been terminated.

The company had made no contribution to the pension trust after payment of the annual policy premium in December of 1957. These premiums exhausted the cash fund, which was replenished, however, when a number of employees were terminated in the period prior to sale and their contributions refunded the forfeited balance remaining in the fund. These forfeitures of about $23,000, plus additional employee contributions of 2% and policy dividends in December of 1958, increased the cash value of various retirement policies in force and represented additional values of more than $224,000.

The trustee of the pension plan was advised by counsel that the intent of their statement to salaried employees regarding investment required amendment of the plan as of May, 1958, so that each participant would be entitled to receive the amount credited to his account and would not forfeit the company contribution under the ten-year vesting provisions of the original plan. Formal consent of the company was necessary to accomplish this modification to be followed by termination of the plan. The new management did not respond to repeated requests for such consent until February of 1959; then company consent was obtained in exchange for a release by the trustees of both the company and the buyer for all liability which might arise under the plan.

In the interim an additional premium on all policies had become due in December of 1958. Cash funds were insufficient to pay the premiums, and in the absence of actual modification of the vesting provisions of the original plan there was doubt the trustees

had authority to continue premium payments for a workforce no longer employed. As a result some of the retirement policies lapsed, some were automatically converted to paid up insurance, and others became subject to a premium loan against cash value. These contracts fell into three classes: retirement annuity policies with cash value in excess of premium due, those with insufficient cash value, and a few optional annuity contracts which were not eligible for premium loans or conversion. In addition to the insurance policy, there was a cash fund for which no distribution formula was available. This situation raises a general question not only of trustee powers to invade loan values of insured contracts but also of employer liability for service time following payment of a period premium due date. Presumably a contribution to the trust for payment of retirement income policy premiums represents recognition of a year's service up to the date of the contribution while the insurance policy remains in force over the following period of employee service. It could be argued that the employer's obligation to pay future premiums exists until specific announcement is made that contributions are to be suspended or terminated. Before such announcement, anticipation of the continuance of the retirement income policy program represented part of the consideration of the employment and hence a pro-rata share of the annual premium represents an accrued liability of the employer. Such a provision would encourage the company to announce suspension of contribution sufficiently early to permit considered thought on the advantages of terminating the plan or utilizing the expensive automatic loan privilege.

The delay in termination far beyond the time necessary to accomplish the pension amendment and distribution led the pension trustees to believe that the buyer was considering how the pension assets in excess of employee contributions might be added to those of a pension plan operated by the buyer for employees of his own corporation. Alarmed that the promise of the deposed management would not be honored, the trustees petitioned the State Insurance Commissioner for assistance. The Commissioner was obliged to point out that his powers were injunctive and intended to prevent unlawful acts. Since no unlawful moves were evidenced by the new buyer, the state was powerless to act. Nevertheless, the state did indicate its interest in the fate of the pension plan by directing several letters of inquiry on the progress of termination to the new buyer.

The authority of the state to interfere in the matter was summarized as follows by a staff member in an intra-office memo to the Commissioner:

> A has done nothing illegal thus far. All he has done is to sit on the proposed plan of termination. If A refused to terminate the trust and made no move to complete dissolution of B, it would become incumbent on the trustees. If A undertook to do this with new trustees, we still could not object since this would be in accordance with trust provisions and not unlawful under our act.
>
> The only thing we might complain about is the delay in paying off employees but I hesitate to push this too hard since this would force the trustees to take the position of paying out only the vested amounts under the severance provision and that would be inconsistent with their efforts to have A consent to a complete payout.
>
> We have no authority to go to court to force a termination of the trust and a complete payout. Our power is injunctive--to prevent threatened unlawful acts. Here no unlawful act is threatened, but a court might rule that in effect the company has been

dissolved within the meaning of the trust and that therefore the participants should be paid their full equity. We do not have the authority to take such action. The trustees do not appear inclined to take such action, perhaps they don't want to prejudice any attempts to settle the purchase and sale of the company. Perhaps the best course would be to advise the employees to contact a lawyer to determine whether or not to bring suit. The trustees could show their action to terminate the trust and the consent of the employees of B. A's refusal to consent would then appear as an attempt to get the money paid into the trust by B for the sole benefit of employees of C.[4]

Before it was possible to obtain the buyer's consent to amendment and termination, it was necessary to institute legal action on behalf of the trustees and against the company. The first problem was to establish the rights and interests of the employees under the termination clause, an excellent example of how a typical provision or its terms are not sufficiently explicit to avoid controversy on basic definitions. The entire termination provision read as follows:

> The trust herein created may be terminated by the employer at any time upon thirty (30) days' notice in writing of such termination given to the trustees. In the event of the dissolution of the employer or its merger or consolidation, without provision for continuing the trust in the same or modified form, or upon the judicial finding of bankruptcy, or insolvency of the employer, the trustees shall declare the trust terminated. In the event of such termination the amount credited to the account of each employee hereunder, as represented by investment in a policy contract or otherwise, shall become the property of each such employee.

The specific issue that would have been before the court was a definition of dissolution and consolidation of the firm as it would apply to this provision, and what provisions for continuing the trust in such event were made or should have been made to an extent sufficient to satisfy the provision above. It seemed from the facts that there was

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[4] Memo was written by John M. Grogan, Chief, Employee Welfare Funds Division, Insurance Department, State of Wisconsin.

a dissolution of the affairs of the employer but not of the corporate entity. There was no consolidation of the books of accounts of operations of the two firms, and there was no definition of whether a merger contemplated sale of stock, exchange of stock, or transfer of a majority of stock control to a common ownership. It would seem essential that these terms be specifically defined in the agreement in accordance with accepted standard legal terminology of accounting criteria. In this particular case the issue did not reach the courts. The buyer was apparently swayed by a letter from the counsel for the trustees, who in addition to announcing the intent to take legal action, reminded the new management of the firm:

> The expense of such proceedings, including our services, will be chargeable to and enforced against the company as a cost of administration which the company is obligated to pay under the terms of Paragraph F of Article XII and all other applicable provisions of the Pension Trust.

Two months later consent of management for amendment and distribution was obtained, at the cost of a release from liability of the company and buyer. As a result, the cost of substantial legal services and distribution expenses were contributed by former stockholders and officers of the company in the interest of their former employees; the trust was not charged any distribution expense. Subsequently, the pension plan was amended and terminated in February of 1959 but dated as of July, 1958, to vest the full employer account with each employee of May, 1958, as of the day of the first announcement concerning liquidation. The reason given for the business necessity which occasioned the termination was that business had been "in process of contraction," thus neatly side-stepping the issue of

dissolution or merger. It was necessary to obtain from those few employees who had remained on the job to assist in liquidation, a signed consent which waived accrued pension rights after the May termination date, and any claim for benefit by virtue of forfeiture of account values by employees terminated in May without fully vested benefits.

With the consent of the company and the employees, two of three trustees approved the final distribution, the third trustee disqualifying himself from voting, as he was a participant in the plan. The assets of the pension trust were then distributed according to the following plan and the trust dissolved:

1. Each participating employee as of May, 1958, was assigned the policies held for his account.

2. Each participating employee as of May, 1958, was paid in cash, the dividends realized by the Trustees as of December, 1958, on the policies held for his account.[5]

3. Contributions made after December, 1957, by each participating employee as of May, 1958, were returned in cash.

4. Each participating employee as of May, 1958, was paid his proportion of unallocated cash (forfeitures resulting from terminations prior to May, 1958) based on the ratio which the premiums due December, 1958, on the policies held for his account bear to the total premiums due that date on all policies held for participants.

Conclusions: The delay and friction generated by the lack of definition of terms in the pension trust provision governing termination could have been avoided through better drafting of the pension

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[5]It was not possible to check the lapse rate of these policies in relation to our interest in beneficiary preference for cash because the contracts were placed in a number of insurance companies and the records did not reveal which policies were with which companies.

agreement and better recognition of the pension agreement and the intent of old and new management in the contract of sale of the business. The mechanics of termination should be self-contained in the pension agreement and should not depend on the details of a purchase and sale agreement for the business. In the latter case the interest of the employer in the pension plan becomes subject to the bargaining pressures of sale, and often the interests of the employer at this time can naturally be expected to conflict with those of the employee. It is conceivable that the buyer of the firm could have converted the dividends and forfeitures generated from non-vested interests of discharged employees to his advantage, perhaps as a refund of actuarial error upon termination or as partial funding of pension benefits for other employees of the buyer not originally connected with the liquidated firm. If this had been his strategy, the buyer's failure to replace the trustees of the pension plan at the same time he replaced the company officers was the mistake which created the impasse. It divided control of the pension plan between two groups of different loyalties; the courts would tend to favor the pension trustees, while the costs of extended litigation would have fallen on the company in any event. The vulnerability of his legal position, and the prospect of double legal cost, more than a desire for good will, probably influenced the buyer's decision to consent to termination without an open fight.

## H. Cost Problems of Insured Pension Plan Terminations

Two features of the deposit administration group annuity contract

form in common use may create misunderstanding and frictional cost in event of a terminal distribution. The first provision concerns the necessity for payment of dividends where a mutual insurance company is requested to issue a single premium, deferred group annuity which represents some portion of accrued retirement benefits due under a terminated pension plan. The second problem concerns a termination provision, sometimes erroneously considered a termination penalty provision, which permits a charge against the deposit administration fund of up to 5% of the fund should it be withdrawn from the insurance company in cash. This charge is intended to compensate for the loss of unamortized aquisition expense, final distribution expense, and the investment losses of security liquidation at inopportune market prices. While these expenses should be borne by the pension fund, there is a suspicion among pension administrators that the charge also serves to discourage transfer of deposit funds to a trusteed form of funding or transfer to another insured deposit administration carrier who may offer a somewhat more favorable guaranteed return or single premium annuity rate. In the past year steps to the solution of both problems have been taken by the insurance industry, which have required special legislation and major revisions of the usual deposit administration contract procedure. These changes indicate there has been a significant degree of resistance to former practices to force changes, but since these changes are far from universal industry practice, they warrant illustration and discussion. Research provided a number of situations of this kind, but only one is reported here, carefully

disguised, to conceal the sources of competitive bids for a single premium deferred group annuity which represented termination and distribution of a deposit administration plan.

CASE #8

Facts: As a manufacturing company of more than 500 employees suffered sales reverses, it was necessary to lay off the younger employees of low seniority. The average age of the work force still employed rose higher and the average actuarial cost of their annual service credit annuity rose sharply. The company fell behind in its contributions to the pension fund. Fearing the company would fail or close, the union strove to achieve a preferred creditor status in regard to the contribution arrears. It was first able to negotiate a second mortgage on the plant, and then later to substitute an installment note series, which it was hoped would amortize the payments past due.

These notes were made payable to a temporary trust rather than to the insurer responsible for the deposit administration plan. The union insisted upon this temporary diversion of funds because it contended that the insurance company would charge too high a rate on its guaranteed basis if and when termination forced conversion of deposit funds to single premium deferred annuities. Despite evidence that the guaranteed rate was quite out of line with its own current annuity rates and with similar guarantees from other companies, the insurance company refused to adjust its rate. When the company closed the plant because the union did not appear overly willing to help

reduce a non-competitive labor cost factor, the union decided to investigate the possibility of terminating the deposit administration fund in order to use the net proceeds to purchase a single premium deferred group annuity from a competing carrier.

The amount of premium money available exceeded several hundred thousand dollars, and there were more than 100 lives to be insured. Funds were sufficient to pay all accrued benefits for workers age 60 and over, and so it was the objective of the union to increase the pro-rata share of accrued service benefits payable to disabled workers and those age 50 or above. The decision to bid was based on an actuarial evaluation which indicated that, if the company made good on its installment notes, employees in the 50-59 age group would receive 12.4% of their pension expectations. Since eligibility for a pension required 10 years service, the minimum available to an eligible employee would have been $291.70 should the union have decided to remain with the deposit administration fund carrier despite the insurance company's unwillingness to change its rates. For the alternative, the actuarial review indicated that if the funds were withdrawn from the deposit administration carrier and annuities were purchased from a competitor at GA-1951 3% rates, the 50-59 age group could double the value of its benefits. The members of this class could receive 23.4% of their rightful pension expectation or a minimum cash value of $435.30. The pension trust was amended to permit the trustees to seek competitive bids from at least six companies with the following conditions:

1. The rate basis for quotation was to be specified.

2. The amount of premium applicable to the purchase of annuities in each priority class was to be specified.

3. The percentage pro-ration applicable to the 50-59 benefit class was to be specified.

4. No commission was to be paid, except a most nominal one where it was necessary that an agent of record be designated.

5. The contract was to be a non-participating, single premium life annuity without cash value payable to beneficiaries living as of midnight, just prior to the effective date of purchase and certified by the joint board of administration.

Seven companies were invited to bid in a letter which explained the reason for the bid, quoted the pension trust document as to the authority of trustees to request such bids, and furnished the necessary certified list of beneficiaries and accompanying actuarial data. The companies had 15 days to submit their proposal so that transfer of trust and deposit funds could take place within the calender year. While waiting for their return of the bid notices, the board of trustees mailed a notice to former employees eligible for benefits to discover errors in address and to bring up to date mortality records on vested but terminated employees.

The direct result of the bidding by six companies which met the conditions above (reproduced as a reasonable facsimile of the actual figures in Table 33) was to improve the position of those in the 50-59 group by more than 400% based on the benefits these persons might have expected under the existing deposit administration plan. It should be remembered that this increase was achieved despite the fact that the net single premium available represented only 95% of the deposit administration fund assets due to a flat 5% charge for terminating and

TABLE 33

COMPETITIVE BIDS ON SINGLE PREMIUM DEFERRED
LIFE ANNUITY WITHOUT CASH VALUE

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1. 1951 Group Annuity
   3½% interest
   Loading of 1% of gross, no commission
   Resulting pro-ration for 50-59-55, 76%

2. 1951 GA, 3/4% interest, 3¼% loading,
   commission of 1% of 1st $50,000 and
   50-59 pro-ration 54.46%

3. 1951 GA, 3% interest, no loading, "finders' fee"
   commission of 3/4% on 1st $50,000 and ¼% on
   next $450,000 50-59 pro-ration 53.37%

4. 1951 GA Projection C, 3 3/4% interest, 3½%
   loading "normal" commission
   50-59 pro-ration 52.4%

5. 1951 GA rated one year, 3% interest,
   4½% loading, commission of $602.32
   50-59 pro-ration 48.05%

6. 1951 GA Projection C, 3¼% interest,
   5% loading, no commission
   50-59 pro-ration 46.72%

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liquidating the fund in a single transfer.

More interesting to the student is the wide disparity of actuarial assumptions and the significant variables in each case. Many of the unsuccessful bidders offered the best interest guarantee. By matter of elimination the critical factor was apperently the loading element as both the best bid and the worse purported to pay no commission. The uninformed laymen, seeking a carrier for a normal pension plan, would have little basis for reaching a decision on which plan would cost him least without some indication of how the various assumptions would affect contributions or the scale of past service liability was evaluated according to insurance company actuarial assumptions. There have been many cases where pension termination of a trust or deposit administration plan would have provided sufficient premium volume to justify competitive bidding. Several insurance companies interviewed stated they were not interested in these cases unless a single premium could be expected to exceed $30,000-$35,000; one company does not participate in such bidding situations unless the single premium will exceed $75,000.

Conclusions: Since the guaranteed rate of the plan to be terminated is often set several years before termination, and since sale of the plan by a particular insurance company may have been motivated through reciprocity, family ties, or other non-competitive factors, it is possible that it is vulnerable to competitive bidding. The implication for trustees or administrators of insured plans or trusteed plans liquidating with the aid of deferred annuities is that it is their responsibility to seek a number of competitive bids based

on a careful set of specifications. Insurance executives interviewed were almost unanimous in their appraisal of their present annuity business, which they saw entering a new phase of intense competition that was generally not present only a few years before. If the residual beneficiaries would receive a larger share of their approved service benefits when the total available funds sans termination charges are used to purchase deferred annuities, the pension administrator or trustee would seem derilect in his responsibilities not to do so. As in other purchases through competitive bidding, the art lies in designing the right set of specifications and then strictly enforcing these specifications to assure comparability. These specifications should be drawn to take advantage of (1) new techniques for reducing the need for a 5% termination fee, and (2) a recent change of New York law as it affects mutual life insurance companies in regard to single premium group annuity contracts, which are generally the objective of competitive annuity rate bids.

I. A New Approach to the 5% Termination Fee

The 5% termination rate generally applies only to cash transfers from deposit administration plans. Insurance companies will liquidate group annuity plans without special charges if individual beneficiaries receive certificates representing a deferred annuity income or cash payments representing the present value of insignificant deferred annuity incomes.

CASE #9

Facts: One attorney has drafted an assignment form which can transfer the individual beneficiary interests from an insured plan to a trust without exposing the participant to the termination fee or to income tax on transferred pension values under the tax theory of constructive receipt. Approved by the Internal Revenue Service, rather reluctantly according to its author, as research began on this paper, the assignment form has become common knowledge through the various pension reporting services. Its basic technique is easily described. Just prior to the desired termination each employee with a vested pension interest is given the choice of taking a deferred annuity from the present carrier at the guaranteed rate or of assigning his cash value to a trust which will purchase a deferred annuity at a rate which will presumably produce a larger annuity income on the basis of competitively determined rates. The assignment can be designed as a power of attorney so that the original carrier can make its final termination distribution with checks to individual participants, which checks are cashed by the new trustee. With proper explanation to the participants each is happy enough to sign the form to receive higher pension benefits so that the first plan is 100% terminated. The participant never has the option of receiving the funds as his assignment of the funds is sought before the plan was terminated and the funds have vested. Consequently, the Internal Revenue Bureau could not find grounds for constructive receipt, for the universal consent of all beneficiaries establishes "an agency

resembling a conduit through which the funds pass from one trust to the other."[6]

Conclusions: This device can be used wherever the plan provides that distribution without penalty upon withdrawal of termination will only be made to individual participants. First used in the withdrawal of an employer from a multi-employer trusteed plan, it can also be used where an insurance company insists on issuing individual contracts or checks to each participant rather than transfer all cash directly to a temporary trust or permanent pension trust. Such an assignment by each individual may require an amendment of the pension agreement spendthrift clause to be valid. The trust may suffer a small loss in the transfer due to the difference between the actual annuity premium and the offsetting cash value reserves. This opportunity cost must be offset by the expectation of a lower deferred life annuity rate or a higher investment return from more flexible trust investment management.[7]

Since the 5% termination fee has been criticized by pension administrators as unjustified, often exceeding the expense incurred in terminating the larger plan or the actual investment losses of

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[6]Revenue ruling 55-368 and 55-425 as reported in <u>Pension and Profit Sharing Report</u>, <u>op. cit.</u>, 5301-B.

[7]In Revenue Ruling 55-427 the participants in a supplanted non-trusteed plan had to be included in the new trusteed plan, and the insurance company which issued the individual annuity contracts under the old plan required, as a condition of transfer to the new trust, cancellation of those contracts and the transfer of all accumulation under them. In this event there was no constructive receipt of taxable income.

liquidation, several insurance companies are substantially revising their contract on this point. For a long time many insurance companies have worded their contract so that the fee was not a flat 5% charge, but rather permitted a charge which could vary up to 5% of the total value of the contract. Presumably the charge would be scaled down as the principal of the fund increased, reflecting the relationship of relatively fixed administrative expense to the principal amount. Such a reduction would be adjusted for any liquidation losses due to a portfolio market valuation less than cost, although there is no record that unrealized market appreciation was ever used to reduce the penalty fee.[8]

CASE #10

Facts: More recently the approach to deposit administration funds in regard to a termination penalty fee can be expected to change because pension fund accounting has been changed. Investment experiences may now be determined on the basis of the "new money" interest allocation method. This "investment-generation" method of allocating interest earnings can be defined as an individual class of investors being given a pro-rata share of the interest earned on the total portfolio as determined by calender year of investment.[9] For example,

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[8]This omission may not be as inequitable as it appears; the principal is guaranteed for the insured so that investment profits rightly belong to the party which must absorb investment losses.

[9]Edward A. Green, John Hancock Mutual Life Insurance Company, speaking to a 1961 meeting of the Society of Actuaries, as reported by the Employee Benefit Plan Review, op. cit., 150.2-13.

if class A had provided 10% of the investments for the year of 1950 investments and their succeeding reinvestments, similarly class A would receive investment return credits on its proportion of each year's investable cash flow. Put another way the total return can be analyzed as a series of investments categorized by the time at which funds were received and the rate of return earned by the common pool on investments made at that time. In short it produces a dollar averaging return on the turnover and flow of funds so that the policyholder gains immediate participation in portfolio interest gain. To simplify accounting, administration and aquisition expenses are charged directly to the policyholder so that the investment reserve would be charged only for annuities purchased. This approach stopped short of a fully segregated fund now permitted for deposit administration contracts in some states.[10] Unlike this newer form, it preserves

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[10]Life insurance companies have been allowed to establish and maintain segregated investments accounts for pension plans of the deposit administration type so that part or all of the fund may be invested in equities to a greater extent than commingled assets. More volatile investment experience requires that investment guarantees be removed and that deposit administration funds operate on an immediate participation basis with cost plus accounting and billing. Public Act 317 of the Connecticut laws of 1959 and Senate bill #230 of the 1960 Massachusetts Legislature introduced permissible segregation. More recently, in March 20, 1962, New York State Legislature passed Assembly Bill 4817, Print 5111 to permit separate accounts for qualified pension, profit sharing, and annuity plans. Objections of corporate trustees to an insurance company as a trustee required that assets in these separate accounts be owned by the insurer, that a special contingency reserve equal to the minimum capital and surplus be required of a domestic life insurance company and that existing deposit administration funds cannot be transferred to separate accounts. Initial separate accounts will be limited to future employer contributions only and to funds now held by corporate trustees under split funding. Employee Benefit Plan Review, op. cit., 150.2-11.

the broad insurance principal of risk sharing, for the interest credit formula would give each class the advantage of a rise in a company's overall interest rate to the extent to which its contributions permitted new, higher yielding investments. It would protect each class against a decline in overall yield to the extent the flow of funds from other classes contributed in the decline. In the meantime the capital investment remains guaranteed, with the inherent stability and diversity of a pooled investment account and without the difficult judgments of assigning segregated security items to individual portfolios.

With this innovation the reasons for a fee upon termination in excess of direct costs are largely eliminated. It is then possible to modify the termination provision so that, in effect, the insurance company will disburse funds at termination at a ratio of current market value to the cost of securities purchased by the insurance company over the years since the plan began. The ratio must fall within a range that will be not less than 95% nor greater than 105% of the adjusted cost of the investment portfolio. A full statement of the new form is given in Appendix IX. It should be noted that aquisition cost of securities refers to the entire insurance company portfolio purchased following each increment to the deposit fund, and not just a segregated fund, with the result that security cost approaches that of the "dollar-averaging" method.

The rights of the contractholder vary slightly depending on whether discontinuance results from written notice to the company for any reason whatsoever or is caused automatically for failure to pay

the premium or to maintain conditions which preclude selection against the insurance company. Provisions permit full withdrawal of accumulated values but reserve to the insurance company the right to make payment in ten equal annual installments, providing the minimum annual installment is $100,000. This latter restriction is included for depression situations in which the liquidity of the company is affected and is similar in purpose to banking restrictions on saving account withdrawal; in addition there is a provision which provides for vesting and priority of distribution of deposit funds should the contractholder fail to notify the insurance company that the pension plan, as opposed to the deposit administration funding vehicle, continues in existence as a qualified retirement plan. The priority list establishes four classes of beneficiaries, and should there be insufficient funds to meet the full value of the deferred annuities due, each member would share in the proportion of the present value of his earned annuity to the aggregate present value of all annuities due members of the class. This priority system recognizes variations in age and length of service within a class as inequities could otherwise double when the definition of class is far broader than the 60-65 or 50-55 classes encountered in previous problems.

Conclusions: It would seem that new approach strikes a more appropriate compromise between the possibility of loss to the insurance company because of an unforeseen or untimely termination and the arbitrary 5% charge which heretofore compensated the insurance company for cost which the insured was in no position to audit properly. When combined with date of entry investment accounting procedures, it

permits the termination of an insured pension plan for the special costs of final liquidation and termination. As a result stated current asset values are more closely in line with traditional accounting evaluation by liquidation value. It should be noted that while the advantages are possible, correspondence with the major group pension underwriters indicates that many have not put such a plan into effect as yet, and that operational procedures have not yet been established as the termination problem obviously must follow installation of the new contract forms.

J. Administrative Flexibility and Responsibility

Not all termination problems related to insured plans derive principally from a lack of funds or indefinite legal preparation for termination contingencies. Some problems are created by accident or by unnecessary rigidity in standard operational procedures.

CASE #11

Facts: A classic demonstration of chaos in the administration of a pension termination occurred when a multi-plant, national firm producing manufactured components closed one of its older and less efficient plants employing about 400 hourly workers. The plan was well funded by means of a deposit administration plan with a major insurance company. Sufficient cash was available so that full benefits could be paid down to the age of 50, and those in the below 50 age group would receive a proportion of their vested benefits. While older workers received deferred annuities, the men below the age of 50

stated in a union meeting that they wanted a cash payment as a lump sum settlement of long deferred annuities. The insurance company refused to release cash unless the total earned annuity was less than $10 per quarter, as specified in the negotiated pension agreement and the deposit administration contract. The employer was willing to amend this provision to $10 a month, and the union pressed for $20 a month. As a union official expressed it in correspondence with the insurance company:

> While we generally share the view expressed by company representatives that it is socially undesirable to pay cash in lieu of larger annuities, we cannot overlook the fact that in this case the employees under 60 are mostly people in their late 30's or early 40's. To tell a man that 25 years from now he will get a monthly annuity of $11.38 while he can see the possibility of getting a few hundred dollars right away must make him mad, and we must admit that giving him the cash now is socially more useful than letting him wait for an annuity which many years from now is bound to be insignificant. We are not even sure that $20 per month will mean too much 25 years or more hence, and we feel, therefore, that the present ceiling of $40 per year should be raised to at least $240 under the particular circumstances should be subject to rate considerations comparable to those which are applicable to annuity purchases.

Eventually, this point was resolved by an amendment which compromised at a $180 figure annually.

The indirect allusion of the above letter in regard to the expected impact of inflation contains some potent implications. If the reference to inflation was genuine and not merely used to argue this particular issue, then all pension benefits now scheduled will be "insignificant," which foretells a spiral of pension increases and an indefinite postponing of full funding of past service liability. In that event, termination problems related to the relative weight which

past service should play in allocating terminal distributions will be a permanent issue and not a temporary one, eliminated by amortization in twenty or thirty years. More immediate issues were to arise, however.

First the insurance company insisted that annuities of all types, including paid-up annuities which are deferred for many years, must be purchased at the participating contract rates. The insurance company, a mutual, was laboring under the advice of counsel that state law would not permit issuance of any non-participating contracts, even in termination cases. Still the deposit administration contract specifically called for issuance of a nonpar contract in termination situations.

According to the insurer, dividends which resulted from the contract rates were to be paid to the employer, which was only closing one plant and did not dissolve. This prospect was totally unacceptable to the union and an unwanted turn of events for the company, which realized that it would receive, via dividends, some of the trust contributions of the predecessor company. Not only would the Internal Revenue Bureau attack such a result, but the pension contract itself would be violated, as it contained a customary provision that all the money paid into the plan belongs to the workers and was to be used for their benefit. The union felt that, if necessary, it might be possible to use rates which were participating only in name, with a saving clause providing that any dividends should be used for the purchase of pro-rata increases of annuities for those which were trimmed from contract amounts for lack of funds. On this point the

insurance company finally yielded, agreeing to apply dividends to deferred annuities which represented less than the full value of earned benefits. Amendments were introduced into the pension plan and the insurance contract to permit lump-sum settlements for employees under the age of 60 would be entitled to a deferred pension of less than $180. By this time it was necessary to extend the termination date another 60 days.

The insurance company then received certified listings of those workers entitled to pensions or lump sum benefits, and having calculated what was considered the frozen amount of fund assets available for distribution, sent notices to eligible employees reporting the amount of their cash settlement. Three days later the company received two notices to purchase annuities for workers already retired, and the purchase price of these should have been removed from the fund available for allocation. Apparently the clerk assumed that these two retirement notices would also appear on the certified listings. The actuarial department, unaware of these credits to the administration fund, allocated benefits to the listing based on the old balance. After amendment of the contract, notices were sent to employees as to the amount of the cash settlement they might elect in lieu of annuity based on a total fund about $7,500 greater than was the actual case. The error was discovered in a routine audit prior to mailing the checks. Consequently, the insurance company reduced the residual allocation to each employee by 2.7% and enclosed a short letter of explanation when the checks were mailed, thus creating considerable antagonism against

both local union officials and local representatives of the insurance company.

The local agent of the insurer reported a number of people cancelled their individual policies when the company paid less than each individual had been told to expect. Dissatisfaction with the distribution was magnified when it was discovered that the employer had erred in preparing the certified listing. The company paid the insurance company an amount sufficient to fund the additional benefits to which the employees were entitled but denied when their birth dates were reported in error. While the union felt the insurance company should have borne the cost of its own mistakes, as the employer had done, the insurance company only conceded an official explanation and apology in order to relieve pressure on local union officials. These errors, together with the administrative problems created by an out-of-date mailing address sheet, required the insurer to assign a special service representative to handle the accumulation of complaints. Many were resolved by the expensive expedient of long distance telephone calls to individual plan participants. The completed distribution is summarized in Table 34.

Conclusions: The case raises three issues germaine to pension termination. The first concerns the appropriate place of participating deferred annuity contracts in a terminal distribution situation. The second concerns responsibility for making a distribution in accounts which are in error, a mistake which is not discovered until all funds are exhausted from distribution and the employer no longer exists as a legal entity. Finally in our opinion the sensitivity of insurance

TABLE 34

SUMMARY OF DISTRIBUTION

1. Total funds assumed available February, 1960, when notices were first sent to eligible employees, $416,740.24.

2. Less adjustment for annuities for two employees purchased October, 1959, but not previously posted, $7,477.28.

3. Corrected balance of funds available for allocation, $409,262.97.

4. Allocation in form of immediate or deferred annuities to 40 employees over 60 as authorized by Board, $315,482.45.

5. Allocation to 51 employees under age 60 entitled to deferred annuities of $15 monthly or more, $66,806.71.

6. Total amount allocated for purchase of annuities, $202,289.16.

7. Allocation to 246 employees under age 60 entitled to cash settlement, $206,973.81.

8. Total of Items 6 and 7 above, $409,262.97.

companies to competition from trusteed forms of pension planning sometimes takes unreasonable forms, and on this point a number of cases will follow in later sections.

K. The Problem of Dividends Resolved

Diverting discussion from individual case analysis to a more general viewpoint, the single premium group annuity once offered mutuals a technical problem. Some mutuals discovered that the law of the state in which they were domiciled required policyholder participation in the surplus of mutual life insurance companies. The New York insurance law was amended in 1961 by the addition of the following language to Section 216(7), bearing on participation in life insurance company surplus:

> This section shall not be deemed to require the apportionment or distribution of dividends . . . on any single premium group deferred annuity contract covering a class or classes of participants in a pension plan duly qualified under subsection (a) of section four hundred one of the United States internal revenue code with respect to which class or classes further contributions have been discontinued under the plan and notice of such discontinuance has been given to the commissioner of internal revenue.

While the state statutes of all states have not been checked for this point, other major domiciles of life insurance companies do not find legislative amendment necessary. In Connecticut and New Jersey a mutual company can issue non-participating annuity contracts, and in Wisconsin the law[11] gives mutuals full discretion as to the participating feature. The resistance of company policy to issuing non-participating

[11] Wis. Stats. 201.135.

contracts has also been largely erased for the major companies informed their agency workers in 1962 that agents would be permitted to bid for certain single premium group pensions where the company actuarial department was furnished the necessary data. Undoubtedly, however, state laws remain to be amended, particularly in those states which have previously used New York statutes as a model for their own.

L. The Problem of Errors and Omission

Provisions of the pension plan and of the documents controlling the investment of funds take great pain to relieve the employer, the insurance company, and the trustee from liability for operational errors or negligence. Still there remains the question of what to do about a mistaken distribution which may overlook some eligible participants or overpay others at a time when discovery may not occur until funds are exhausted. The fair rule would seem to require each party to the administration of the pension to pay for his own mistakes. This rule breaks down in application. Accounting errors of amount are the easiest to prevent as there are various checks and balances which should signal the more common errors. More frequently errors of omission concern proper certification of individual eligibility, location of individuals shifted about the country by the various forces which reflect the mobility of our population, and by improper calculation of actuarial liabilities due to erroneous data such as age, length of service, or benefit classification. Some trust companies so carefully restrict themselves to accounting functions which can be checked and investment functions for which they have broad discretion, that they

find it unnecessary to carry professional errors and omission insurance.[12]

Companies may be willing, but generally are not obliged by the pension contract, to pay the cost of such claims as can be attributed to personnel records. The pensioners, however, may not return over-payments which they received at the expense of some other individual or class, and collection costs relative to amount of excess award may not justify recovery action. Some pension awards may go unclaimed for many years due to lack of adequate notice; recently arrangements have contained a clause which limits the time during which the distribution agent must hold funds and conduct a search for an eligible participant. The trustee is deemed by the pension contract to have satisfied his responsibilities at the end of a year, and some plans hold that the vested but no longer employed worker forfeits his interest at the end of that time.

A number of insurance company and trust company officials pointed out that a major problem of a terminal distribution was locating the eligible participants. While those who were recently employed could be located through company or union offices, the vested participant who had moved from the area was often difficult to trace. It has sometimes been possible to locate workers reemployed elsewhere via the Social Security Department, which will pinpoint the last reported quarterly OAS withholding deposit made in the name of the

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[12] Beir, Emerson (unfinished thesis), op. cit.

missing individual. Newspaper advertising is generally ineffective, and the gradual dissemination of information regarding the termination through the social linkages of employees themselves may or may not produce inquiries within a reasonable period of time. Consequently, some trustees contend that the problem of unclaimed pension benefits, either terminal benefits or normal retirement benefits, will equal and surpass the inexplicable phenomenon of unclaimed bank accounts.

Various plans have been put forward including creation of a national registration agency[13] for vested pension rights or amendment of the O.A.S.I. Act to give the Social Security Administration power to enter a record of earned and vested pension rights upon the social security file of an individual worker should he leave the employment of the vested pension sponsor. The latter solution would be most expeditious, but it creates the spectre in the minds of many of gradual governmental encroachment on the private pension institution.

It is not the object of this study to advocate any particular registration system for vested benefits, but rather to determine or suggest how the pension contract should anticipate the problem of the vanishing participant. Forfeiture after a year has passed with benefits unclaimed seems severe, and obviously favors the administrative viewpoint of the insurer or the trustee. It would seem that the major insurance company or bank trustee could be empowered to

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[13]We understand that such a registry is the subject of one chapter of a book which will appear as The Future of Private Pension Plans, Merton Bernstein, to be published by the Free Press of Glencoe, as previously noted.

establish a single trust fund for all such unclaimed interests, which might be required to hold the funds until the missing claimant would have reached age 70. No interest would be paid on this account, as this income could be considered to compensate the trustee for search efforts made according to certain criteria. Unclaimed principal amounts might revert to state retirement funds or the like.

Two other administrative problems may be even less solvable. For one reason or another employees may understate their age on company employment records, only to discover at retirement that this understatement may affect benefits, priority of claim on limited funds, or the amount of terminal benefits. When the error is discovered, it is difficult to establish if the employee or personnel office were responsible, and if it was the employee, what was the intent of his misstatement. It would seem equitable that payment of pension benefits be subject to a clause similar to that of life insurance contracts which generally provide for payments in event of misstatement of age in proportion to the actuarial ratio of actual and stated age. Then too, pension administrators are also beginning to suspect[14] there may be a growing problem of fraudulent claims brought against pension fund by relatives of deceased pension participants whose benefits were vested before he moved to other employment, or were paid monthly prior to his death which was unreported.

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[14]Several trust officers could recount cases of fraudulent claims; two trusts were initiating the use of a fingerprint on the pension registration form as a means to validate identity in future years. However, their suspicion had no corroborative, pooled statistical background.

## M. Priority of Claim on Insufficient Assets

The typical termination of a deposit administration plan may develop over a period of years from business moves which complicate or obscure questions of equity among beneficiaries.

### CASE #12

Facts: In one case a firm was purchased by an out-of-state manufacturer of a similar line which hoped to maintain operations in two widely dispersed plants. However, as residential construction fluctuated, so did its overall employment level, and so it was felt more efficient to consolidate operations in a single plant. A settlement of the pension plan was negotiated which merely recognized the termination of the plan controlled by the labor contract which outlined the procedures for issuing notices and checks, and which did not require the company to contribute any additional amounts to the fund. The steps in the termination procedure went as follows:

Step 1. A memorandum of agreement confirming the effective termination of employment of workers employed in the bargaining unit at the closed plant was executed and attached to the Labor Contract. A second agreement was executed as an amendment to the pension plan to stipulate the date, procedure, and the issuance of instructions to the insurance carrier to prepare for discontinuance of the deposit administration fund. The date of termination was set forward to give sufficient time to collect and review all applications for immediate or deferred annuity.

Step 2. The pension board of administration would then make approval of the processed applications official. In this case there was no formal meeting of the board as there were few issues; instead the appropriate documents were circulated to obtain the necessary signatures of board members.

Step 3. With authorization a company representative did then formally notify the insurance company of impending termination and provide a certified list of names, ages, and benefits to be paid. The company would then begin to send notices of the distribution and of any cash or deferred annuity options.

Step 4. With the beneficiaries accounted for, the deposit administration fund would be distributed.

Step 5. The employer, alone, would be responsible for filing termination information with the Internal Revenue and with disclosure bureaus in any states in which they operated.

Note that it was not necessary to negotiate the distribution or termination since the pension agreement established a priority distribution clause in event of termination similar to that used by the Auto Workers Union. The case of termination therefore depended on the accuracy of employer personnel records and the adequacy of funds. In this case the actuarial analysis and allocation of resources went as follows:

| | Amounts already purchased for annuities due | Additional amounts needed to fully purchase annuities due |
|---|---|---|
| Category A--Retired on pension | $115,789.22 | None |
| Category B--Over age 68 and retired or to be retired | None | $ 28,181.00 |
| Category C--Other age 65 or over | None | 44,987.87 |
| Category D--One employee who attained 65 after C was determined but before termination | None | 4,644.16 |
| Total (age 60 and over) | $161,957.18 | $243,652.02 |

To offset these liabilities there were $91,057.73 in pension assets,

and these funds were sufficient to take care of all service credit annuities due to employees age 65 and over, but left a balance of $13,245.82 for the age 60-64 group. The unfortunate situation of this group was then summarized as follows:

| Needed | | Available | |
|---|---|---|---|
| Already purchased | $ 26,167.96 | Already purchased | $ 26,167.96 |
| Additional amounts needed | 165,840.06 | Fund balance available | 13,245.82 |
| | $192,008.02 | | $ 39,413.78 |

The amounts already purchased represented values from a group annuity plan which the deposit administration had supplanted. The customary way of expressing the adequacy of funds would be to state it as a funding ratio of 22.9%.

However, a better measure of the loss to pension expectancies is obtained by multiplying this ratio times the annual increment expected for credited service. In this plan the employee expected to receive a monthly annuity income of $1.50 for each year of credited service, but in fact, after termination, would realize only $0.34 for each year of credited service. Those under the age of 60 would receive no benefit. In this particular case the older workers were discharged into an employment area already burdened with large scale unemployment. It is not possible to discover how many workers found other work. The national corporation which closed this local plant might have purchased far more good will with its national union, with which it could expect to deal at other plants for many years to come, by voluntarily adding to the pension fund an amount sufficient to pay

the 60-64 group an early retirement income that represented at least half of their pension expectancy. Such a donation would have cost in the neighborhood of $47,000.

Conclusions: The disparity between expectancy and realization for the older worker probably arose because past service benefits were paid for the oldest workers first, in full, even though past service benefits had not been fully funded. If past service benefits were granted because they should have been a proper charge to past period production costs, then theoretically company profits have been over-stated, and long term amortization represents a gradual adjustment of surplus to reflect the overstatement in company earnings. Should the plan terminate before this adjustment is complete, might not accounting theory provide an argument for making good a shortage of pension funds when social conscience does not provide the motivation? On the other hand, if the objective of a pension plan is to provide an adequate pension to the older workers as they reach retirement age, with funds accumulated for each worker in turn, might it be possible to argue that retirement at 65 or termination at 60 are equally valid points for recognizing workers whose turn has come for retirement support? If it is to be the practice of management-labor relations to observe the letter and not the spirit of the contract then this study is to the point, for it seeks to encourage more realistic draftsmanship of the letter of the contract.

## 4. Summary and Conclusions

The foregoing evidence suggests either that most terminations

are most troublesome or that the research file has been biased by preference for bad examples. While it is true that the cases selected here were chosen because their difficulties would best illustrate problems common to many pension termination situations, it is also true that almost all the material collected from which these cases were culled contain elements of conflict and error. The conflict stemmed from the attitudes of the parties to the contract, from incomplete contract forms, from problems of agreement on equitable distribution, and from inept administration.

1. The most difficult variable to control in the termination situation is the attitude of employee, employer, or insurer. Where attitudes lack mutual empathy for the respective positions of the parties concerned, then the draftsmanship of the contract proves to be clumsy or inadequate; then there is room for arguments on equity; and then there is an atmosphere conducive to inept administration. Employees generally do not understand the mechanics of pension operation or termination, and there would seem to be great need of educating the would-be pensioner as to the nature of his pension expectations as well as to an accounting of pension assets.

2. The employer is prone to disinterest in termination arrangements. First the need is generally prompted by major business decisions with which he naturally would be preoccupied. Secondly, his concern for matters of social or actuarial objectives may be colored by the bias of his traditional relationship with organized labor and the internal revenue service. The failure of an employer to devote his best attentions to the problems of termination when it occurs militates for this kind of thought when the contract is drafted so that amendment and interpretation of the pension agreement need not play such a predominant part of termination proceedings.

3. The principal agent of the problems compounded by attitude is the pension plan and supporting documents controlling funding. Words used by insurers to bring about automatic termination of the plan, such as "sale," "dissolution," or "consolidation" create problems of interpretation. A definition of partial termination is generally omitted in these automatic termination provisions, perhaps causing unnecessary or

inequitable forfeiture of non-vested benefits. As the problem of defining such words reoccurs in later chapters, recommendation for an improved treatment is deferred.

4. The terms of the insured plans in regard to priority of distribution in event of termination might serve as a model to more complex union agreements and trusteed plans. The latter often have many classes of priority established with a single criterion, often age, with distribution of insufficient funds for any single class based on equal shares of each member of the class. However, the insured plans generally reduce priority to no more than four classes of individuals, with distribution within a single class made pro-rata according to the actuarial value of the accrued pension expectations of each individual. In this way a somewhat larger group may receive some recognition of their expectancy, though not in full, which is an approach somewhat more refined than distribution by a multitude of age classifications.

5. While all pension documents contain various forms of hold-harmless agreements and, in the case of trust, bonding provisions, none seem to allocate responsibility or liability for administrative or clerical errors, particularly errors which may not be discovered until funds are distributed and exhausted, with administrative responsibility dissipated upon final dissolution of the trust, the board of administration, and the employer.

6. Insured agreements generally make little provision for the problem of locating beneficiaries whose address is unknown. Insured plans should define the extent of search efforts required of the pension administration board or the insurance company, perhaps placing a time limit before benefits are forfeited and available funds applied to other pension needs.

7. None of the trusteed insured plans reviewed as cases in this chapter made specific provision for the extension of trustee powers during the hiatus between suspension of contribution and decision to terminate a plan. Such a lapse can be troublesome, for example, when annual premiums on policies held by the trust may fall due after the decision to terminate and prior to actual termination. There is also the problem of employer liability for fractional premiums on an annual premium plan when the termination date does not correspond with individual employee service credit dates.

8. Some provisions for the protection or convenience of the insurance company may sometimes seem harsh. One example is the application to termination purchase of the contract guaranteed

rate governing premiums for purchase of individual retirement annuities or annual increments to deferred annuities. A guaranteed rate is loaded to project investment and mortality experience for at least five years into the future. It does not seem appropriate that these projections should govern when all annuities are to be purchased at once as a single premium, deferred group annuity and when such a guaranteed rate will produce benefits only 85% of what the principal sum might buy from another company.

If the competitive rate structure can shift so dramatically, it is to the advantage of both parties to be able to negotiate a special single premium rate in the event of whole or partial termination. The insurance company can maintain its level of assets and number of lives insured, with perhaps a special advantage of some past experience with the particular risk carried. The pension sponsor is relieved of the necessity of losing up to 50% of his accumulated reserves to take advantage of more equitable annuity rates with a competing company or of feeling constrained to accept the guaranteed rate for lack of bargaining position.

9. The typical charge of up to 5% of funded assets is also a crude way of recognizing legitimate insurance company interests in unamortized expense and possible declines in investment portfolio values. The advent of "new money" plans for the allocation of administrative expense and investment experience permit the most equitable termination charges. However, there is an institutional lag factor which will delay widespread adaptation of these plans, and in the meantime there are grounds for suspecting that one occasion flat termination charges are also liquidation penalties designed to restrict the outflow of pension funds.

10. Another difficulty of the same type is a restriction on lump sum cash distribution to participants in lieu of a small deferred annuity. A requirement that all of a certain group purchases a deferred annuity at termination is a necessary adjunct to group underwriting practice, and individual exceptions are made when an individual annuity would produce a periodic check too small in amount to warrant its administrative cost.

    However, a check large enough to enjoy administrative acceptance by the insurance company may bear no relationship to what is large enough to be of economic significance to the annuitant. While an annuity may be preferred and encouraged as a general thing, there are occasions where judicious use of lump sum payments in lieu of special termination pay or for hardship cases may be advised. Often such a cash distribution is

prevented by the insurance company definition of what constitutes an allowable cash distribution. It would seem that the group insurance contract could carry a provision recognizing the right of the pension trustees of administration board to allow cash distribution where it seemed justified by circumstances. Such a provision would not violate the control of adverse selections which is sought by present restrictions on cash or annuity options.

11. Administrative judgment can only be questioned when the administrator can find advantage to himself in the manner of distribution chosen or can avoid significant expense. The preceding material provides at least two examples: one is the case where new management has power of administration of a well-established plan. The second is the case where the insurance agency became the administrator partly by the fault of management responsibilities and partly to gain a sales advantage. Both situations weaken the role of disinterested administration and represented a design or drafting error.

12. What can be said about attitude, a product of sensibilities and the insensible bias of position? It would seem that all parties to a termination should draft and then temper the letter of the contract in recognition of the fact that a pension termination in event of business failure, liquidation, or migration is affecting a working man in the throes of economic catastrophe with unknown traumas and terrors. This participant is entitled to considered administrative judgment which is more than efficient, or legal, or actuarially precise. At the same time such considered judgment presupposes a pension contract which recognizes termination, provides the mechanics to deal with it and possesses sufficient funds to meet the minimum responsibility of the pension sponsor. Discussion of the cases on the above summary point out where such mechanical improvement can be made. Specific recommendations as to how they can be made are deferred to the final chapters of this study.

CHAPTER VI

# CASE ILLUSTRATION OF TRUSTEED PENSION FUND TERMINATION PROBLEMS

## A. Objectives of Chapter

The typical trusteed pension plan differs from an insured pension plan, which may use a trust to channel funds to an insurance company, in its assumption of responsibility for the investment of reserve pension assets and for periodic distribution of benefits due. Except for the largest trusts, investments are generally easily liquidated so that in event of premature upset or termination the trustees have a relatively free choice as to the mode of distribution of the assets to the eligible beneficiaries. In large part the effectiveness of the distribution depends upon the amount of cash available to do what has to be done to fulfill legitimate expectations. But in some measure the skill with which trustees allocate resources to alternative modes of distribution, when these resources are insufficient to realize the benefits of the original plan, will determine the effectiveness of the defunct pension program.

The approach of this chapter is similar to that of Chapter V in its use of illustrative termination cases to further discussion of termination of the trusteed, non-insured pension plan. The cases are restricted to those collected for this study to avoid repetitious review of a number of well known legal cases which bear on termination of a pension trust. Many of the same problems which appeared in

contract terminology in Chapter V reappear in the non-insured plan, such as determination when termination should take place or responsibility for administration of a terminal distribution. But perhaps the key characteristic is the freedom of choice as to the manner of termination which the plan administrators enjoy in the uninsured trust when given cash, discretionary powers, and the right of amendment. Discussion will attempt to underscore problems that arise or can be avoided by the design or administrative decision in the operation or termination of a particular plan.

## B. Some Typical Terminal Distributions of Trusteed Pension Plans

Termination of a trusteed pension plan can be done expeditiously where the plan makes adequate provision for dissolution procedure and where the administrators are knowledgeable in terminal problems. It is customary for pension plans of the United Auto Workers Union to establish well-detailed termination guidelines and for a pension expert from the national union office to oversee the negotiation and administration which must bring a plan to a close.

### CASE #13

*Facts:* Consider a typical U.A.W.[1] plan which was three years old when terminated, and so labored under a past service actuarial

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[1]Benefit formula granted an annuity of $2.25 monthly for each year of service or twice that amount where early retirement was required due to disability. Workers were eligible at age 65 and 10 years service or for early retirement at age 60 after 10 years of service. Disability benefits reduced retirement age to 50 years after 15 years of service. Benefits vested after 10 years, although deferred to age 65 and the plan was under a joint union management board of administration.

liability of $939,000 at the time of origination to be amortized in thirty years, plus accrued earned benefits for an actuarial value of $1,265,000. At the time of termination pension trust assets totaled $403,000, about 32% of total actuarial liability. Twenty-seven hourly workers were already on retirement, and 31 were eligible to receive retirement benefits should they so elect under postponed or early retirement rules. Final closing of the plan was presaged by layoff and normal attrition, although employment at the time of termination still did not fall below early levels of participation. Termination of the plan utilized the purchase of a single premium deferred annuity with assets from the trust transferred to a life insurance company selected on the basis of competitive bidding. The latter procedure was urged by the union, which then sought to specify its preference for termination procedures in an agreement of termination negotiated with the company in regard to the hourly-rate employees pension plan. An abridged version of this agreement to provide details on mode and administration of the distribution appears in Appendix X. Employees under the age of 60 received small, lump sum cash settlements. While priority of claim for a retirement annuity was based on the age group of the individual, the cash distributions to workers in this class were made pro-rata on years of service related to the total service credit.

Conclusions: This difference in priority treatment reflects a basic dilemma in labor union thought as to the proper priority allocation. From the social point of view it is probably better that

the older workers are fully pensioned so that with the aid of social security they may be self-sustaining as well as effectively removed from the job market. At the same time such a priority means that the older workers with a minimum number of service years benefit while the relatively younger men who have more years of continuous service will realize nothing from the pension fund because the years of their retirement are still fifteen or twenty years in the future. An equitable solution is not readily apparent in this situation, for the younger worker is only willing to postpone funding his benefits to retire the older worker, not to forego all interests should the plan dissolve before his turn has come. There is a question as to whether the cooperative, pooling aspects of pension funding should be maintained when the plan is aborted.

CASE #14

Facts: A second case will further illustrate the relative simplicity of pension trust termination and dissolution where adequate provision has been made for such an event. Similar in its benefits, eligibility, and vesting provisions as the previous case, this particular plan did not experience the significant advance in actuarial liability over the three years of the pension plan's operation. Its total actuarial liability advanced less than $40,000 from an original past service liability of about $475,000. This fact is explained by the relatively large number of retirements just prior to termination and the steep reduction in work force experienced during the life of the plan, two factors summarized as follows:

| | Non-Retired | Retired | Vested |
|---|---|---|---|
| 7/1/55 | 435 | -- | -- |
| 7/1/56 | 545 | 4 | -- |
| 7/1/57 | 298 | 10 | 8 |
| 7/1/58 | 232 | 12 | 14 |
| 7/1/59 | 273 | 21 | 9 |

Assets in the neighborhood of $110,000 suggested a funding ratio of 21% which tells the reader nothing unless it is also reported that those on retirement received annuities purchased from the life insurance company while eligible employees aged 50-59 participated in a cash distribution representing a 20% share of their accrued pension credits.

The facts in this case underscored another problem of establishing priority of claim. Just prior to termination 14 participants were receiving retirement benefits and only three participants were working who were eligible for postponed retirement benefits. Nevertheless, 21 people were on retirement before terminal distribution was made, including 5 who were eligible to receive early retirement benefits. The rush of these latter individuals into early retirement was motivated not only by the prospect of unemployment after closing of the plant, but also by a quirk in the order of priority provisions which are standard usage in United Auto Worker contracts. These priority provisions are reproduced in Appendix XI. It is possible for an employee in some situations to select against the priority system to his advantage. For example, an employee age 60 or over but less than 65 could elect an early retirement privilege, assuming he has sufficient years of service, and move from priority class D to A. The only requisite would be some advance information regarding imminent

termination and plant shutdown. While this possibility is not a major flaw in the priority provision, which is one of the most thorough in widespread use, it does serve to illustrate one of the pitfalls of anticipating priority needs before the fact. Another clause in this particular agreement which is noteworthy and desirable is the differentiation made between years of service required for eligibility and years of service for determining the amount of benefit in event of discontinuance of the pension plan. Each employee receives service credit for eligibility "as though his period of service included the period between the date of discontinuance of the plan and his sixty-fifth birthday." However, he receives benefit units only for the years actually worked. Such an arrangement reduces the inequities of an arbitrary service requirement while making benefits still dependent on length of service as well as age. This special provision has a further advantage to those in the older age groups who were first employed at a comparatively advanced age, if a supplementary, negotiated pension termination agreement is used to refine priorities. Such refinement generally takes the form of sub-division within age groups by vested and unvested employee classifications. Such a provision may mitigate the harshness of otherwise favoring age over duration of service.

On the other hand in the particular plan of Appendix XI, the interests of terminated employees with vested rights are greatly reduced as retired employees and active employees are given precedence in the distribution of benefits. Moreover, these former employees will forfeit their interests when they cannot be located within one year of

discontinuance after a reasonable effort by the trustee. Paragraph 5 gives the administrators considerable flexibility in the liquidation while establishing the priority rankings as beyond amendment. Moreover, this paragraph contains one of two undefined terms in the entire article. The first appeared in paragraph 2 where the method of proration was not established, and the second provides for allocation of some trust assets in cash without defining limits as to amount or circumstance. Both these ambiguities had to be covered in the supplementary termination agreement. Finally, paragraph 6 covers a point which has been the subject of no little litigation, namely, the employment status of an individual laid off prior to termination insofar as this status affects possible interests in the pension plan. By linking the definition of employee to circumstances relating to the business necessity for termination, legal quibbles involving status after merger or liquidation or a host of other forms of reorganization are eliminated for the purpose of defining eligibility for terminal pension distribution.

Conclusions: With this legal foundation a termination agreement between union and management contained only a minimum amount of real subject material aside from agreement of the union to permit termination prior to the 5-year expiration date of the labor contract which originally gave rise to the pension agreement and its documents. First the final agreement specified the date after which the plan was to be considered discontinued. Agreement on such a date can be a critical issue where a large number of employees have been laid off

for an extended period of time and can expect to retain or lose their interest in a pension fund depending on whether the termination date fell within the life span of continuity service rights following lay-off. Such a problem was not present here but appears consistently in such "boom 'n bust" industries as aircraft. A second administrative detail, left unspecified in the original contract, concerns the minimum monthly check of annuity income ($10.00 per month) which the insurance company would be willing to mail. As an alternative to annuity income, there is a lump sum of equivalent actuarial value of annuity income which the trustee can pay in lieu of a pension.

The final subject of the termination agreement is setting a date for the termination of the trust agreement with the corporate trustee, empowering the trustee to convert the entire trust fund to cash for distribution of the balance after expenses to eligible beneficiaries and to the insurance company underwriting the deferred group annuity. The closing statement is agreement that all affairs related to the pension agreement must be considered ended and the joint board dissolved. The entire agreement, including the usual legal incantations of identity in dates and authorized signatures, barely covers two pages of typewritten material. While one may disagree with value of one specific provision or another, the efficiency of procedure and the effort to achieve equity must be respected. As further cases in this section will demonstrate, it is our opinion that the majority of pension terminations lack such neat execution.

## C. Some Implications of More-Than-Adequate Funding

The principal inadequacy of pension plans at the time of termination is basically a dearth of funds with which to satisfy vested pension liabilities. However, an excess of funds can also prove an embarrassment.

### CASE #15

Facts: For example, consider the termination problem of a regional steel warehousing firm. Upon sale of the company the trusteed pension plan was dissolved scarcely more than three years after its initial qualification. Despite past service actuarial liability at the time of origination of $118,000, the total actuarial liability at the time of termination was $103,000. While one individual had retired, so that his insured pension no longer appeared as a liability, the total number of eligible and covered employees had increased slightly. To offset this liability the segregated pension trust had assets of $154,000, a wealth which indicated funding as approximately 150% of liabilities. In part, the surplus can be explained by the contribution level which used the attained age normal method of funding. Funding with such a "level premium" technique accumulates funds at a faster rate than the single-sum values of the accrued benefits are increasing. Some labor turnover in the last two years of company operations also resulted in forfeiture of some outstanding past service actuarial liability. Investment profits could also explain part of the increase in assets, although no case information was available on annual contributions and

portfolio appreciation. Investments were made in stocks to reflect a benefit schedule which would pay a monthly retirement income equal to years of credited service multiplied by the sum of (a) $1.50 and (b) 1¼% of a final monthly take home pay in excess of $350.00. The plan vested at age 55 and after 15 years service. As an additional benefit the actuarial value of an annuity was earned and vested if an employee died before retirement and his beneficiary was eligible for an annuity. Annuitants who died before the single sum value of their initial pension was exhausted could name a beneficiary to receive the balance of 120 monthly payments. Administration of the plan provisions was in the hands of a retirement committee which had power to authorize and direct the trustee to disburse funds to pensioners, insurance companies, and other agencies with which expenses might be incurred. The significant miscellaneous provision in this case was the typical clause which defined company contributions as irrevocable, reverting to the company after all liabilities had been satisfied. The termination clause (Table 35) gave the company the right to terminate at any time in addition to an automatic provision which read as follows:

> . . . . The plan shall automatically terminate upon adjudication by a court of competent jurisdiction that the company is bankrupt or insolvent--whether such proceedings be voluntary or involuntary--upon dissolution of the company or upon its liquidation, merger, or consolidation without provision being made by its successor, if any, for the continuation of the plan.

It should be noted that there was no definition of terms and no provision for sale to an individual buyer of this closed corporation, although such a sale proved to be the case. A number of similar

TABLE 35

ARTICLE VIII

AMENDMENT AND TERMINATION

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1. This agreement may be amended by the company from time to time in any respect whatever by delivery to the trustee of a copy of the resolution or resolutions of the board of directors specifying such amendment or amendments duly certified by an officer of the company, and upon acceptance by the trustee, subject to the following limitations:

   (a) Under no condition shall such amendment or amendments result in or permit the return or repayment to the company of any property held or acquired by the trustee here under or the proceeds thereof, or result in, or permit, the distribution of any such property for the benefit of anyone other than employees of the company who are beneficiaries under the plan, except to the extent provided for by Paragraph 3 of Article IX.

   (b) Such amendment or amendments shall not increase the duties of responsibilities of the trustee hereunder without its written consent.

2. This agreement and trust may be terminated at any time by the company by delivery to the trustee of a copy of the resolution of the board of directors of the company specifying such termination certified by an officer of the company. This agreement and trust shall automatically terminate when no cash or other property remains in the trust.

3. In the event of termination of the plan, the trustee shall distribute all cash, securities and other property then constituting the trust fund, less any amounts constituting charges against the trust fund, in such manner and at such times as may be directed by the retirement committee.

4. Nothing in this agreement and trust shall be construed to prevent the company from suspending contributions to the trust for any period whatsoever or permanently, but such a suspension, whether temporary or permanent, shall not of itself terminate the trust.

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examples will appear throughout the chapter without extended comment. These instances should be noted as support for a conclusion that automatic termination provisions need greater precision and definition of terms.

On preparing for termination it became evident that one eligible employee would be limited as to the benefit he could receive by the provisions of 5717. As a result, the surplus was further accentuated and the owner of the company decided to amend and to increase the benefits payable to eligible employees rather than receive a reversion in the form of actuarial error, subject to capital gain taxation.

Originally a split fund plan, the group annuity portion had been cancelled and the cash value returned to the custody of the trustee. To distribute the entire assets including the surplus the plan was further amended to create two steps in the apportionment. First each eligible employee received a credit toward purchase of an annuity equal to the present value of the retirement income which had accrued to his benefit as of the date of termination. In addition each employee shared in the remaining surplus in proportion to the ratio of his basic actuarial claim and the total original actuarial liability for all eligible employees. These amounts were then used to purchase deferred annuities for participants.

Conclusions: Since the company remained in operation under new ownership there was no permanent severance of the employment relationship for anyone but perhaps employee-stockholders, whom we presume left management control to the new owners. Without severance

of employment a cash distribution would have been subject to taxation of ordinary income. The case file does not provide any figures as to the ultimate size of individual shares in the fund or to the number of personnel who shared in the distribution.

CASE #16

Facts: In another situation involving a manufacturing company, a small pension plan was terminated in order that its assets might be combined with a profit sharing plan. Its actuarial liability at termination for past service and earned benefits after four years of operation was $63,700, which represented a net increase of only $13,000 over original past service liability. This relatively small net increase can be attributed to the great attrition in the number of participants covered by the plan. For some reason, which could not be established, the original number of participants fell from 47 to 26 in the first plan year, and while a half dozen individuals joined and dropped out each of the following years, only 26 remained to be reflected in the actuarial liability aggregate and to participate in the final distribution. These 26 were to participate in pension trust assets of $53,350, which would suggest a funding ratio of 83.75% at termination. Once again Mimeo 5717 limited the amount of credit one participant could receive in the transfer to a profit sharing trust fund. The forfeited amount was of sufficient size to permit allocation to all other participants of amounts equal to 100% of the present value of their deferred pension benefits, an amount transferred to the profit sharing plan, while leaving an additional amount for return to the

company as an "actuarial error."

Conclusions: The case is noteworthy here only to indicate the irrelevance of the funding ratio to the pension expectancy realized and to underscore the impact of Mimeo 5717 in closely held corporate situations.

CASE #17

Facts: In another similar case involving the transfer of assets from a pension fund to a profit sharing fund, a three-year old plan was able to meet 100% of benefits payable to retired and vested employees and still pro-rate sizable amounts to the balance of 311 employees, an increase of 50% in the number of original participants. At termination the single sum value of accrued benefits was $428,745, a liability offset by $308,742 of segregated pension trust assets. This favorable fund position was due solely to the employer's desire to fund its past service liability in just 15 years. Twelve people on retirement or eligible for retirement received 100% of their retirement income interest while the remaining group of participants received more than 50% of their past service accrued service single sum benefit values, pro-rated on the basis of actuarial liability. These later amounts were transferred to the profit-sharing plan of the surviving company in a sale and merger situation. The case is mentioned here as a notable example of strong investment resources at termination, not because a good percentage of actuarial liability had been erased through discharge and turnover of employees, but because the management had been determined in its effort to properly fund the pension

program. Our case information did not reveal how their funding decision had affected the terms of merger, which would be related to reported earnings after taxes for the firm over a span of years, earnings reduced by heavy pension charges.

Conclusions: It is conceivable that the management of this company was growing older and found it to their advantage to fund a pension plan before relieving themselves of managerial responsibility by means of a merger with a larger national organization. This suggestion is put forward to illustrate the possible uses of accelerated funding prior to anticipated termination of the pension plan as part of the intermediate period business plan of a firm aiming toward the change in ownership and management while maximizing return to original owners. Indeed the terse report furnished the study indicated that the fully retired individuals received a lump sum payment in cash. Generally such a distribution would be preferred by the more well-to-do pensioner, particularly where the capital gains provision was of substantial importance. However, since 5717 played no part in the distribution, one can assume distributions to any one individual were less than $20,000 in any event. The number of participants eligible for postponed retirement benefit (nine) suggests merger was prompted by the imminent retirement of many key men, and the solicitude of management for an adequately funded retirement program suggests these key men were managers and owners.

CASE #18

Facts: More impressive than 15-year amortization of past

service liability was one case where an original past service liability of $351,300 was funded in just one year! Apparently time was of the essence, for just two years and one month after its inception, the plan was terminated when the warehouse company was sold to new parties. During the two years of the plan's operation employment dropped from 104 to 86, including nine individuals who retired. At termination actuarial liability was estimated at $326,600 and pension assets were valued at $394,300 or about 120% of liabilities. Despite rapid funding the plan contained no vesting provisions and no provision for early retirement. The theoretical objection to vesting of all or part of accrued pension liabilities is the additional amortization expense this creates for the pension sponsor. Such pressure did not exist in this case as the plan was fully funded almost from the start. The managers, at least, would be interested in protecting their interest in this fund from forfeiture over the long run if they had sincerely expected a long run. This observer has the impression that the Internal Revenue Service might have challenged the tax qualification of this plan at termination on the grounds that there had been no intent to establish a permanent plan. However, the tax privilege was not challenged, and pension assets were used to purchase individual insurance company deferred annuity contracts unless the amount allocated to each participant would have purchased less than the minimum annuity issued by an insurer, in which case the employee received his share of the assets in cash. All employees, except one restricted by the provisions of Mimeo 5717, received annuities having cash values greater than their accrued pension interests.

This particular case was terminated early in the 1950's and it was not possible to locate sources supplementary to our original find to determine the exact circumstances under which the plan was created and then terminated. However, the terms of the plan strongly suggest that it typifies a situation in which a closely held corporation can use a qualified pension fund as a tax sheltered transfer of corporate profits to individual owner-managers. First, only salaried, full-time employees were eligible after reaching the age of 68 and after 15 years of continuous service. Eligibility was retroactive to salaried employees 68 years old or more with 15 years of service where they had retired prior to the creation of a pension plan. The benefit formula called for paying annuity equal to 50% of average monthly compensation for the 36 months period immediately prior to retirement, reduced by an amount, determined monthly, of the primary insurance benefit payable under federal social security laws. Full benefits required 20 years of service; the employee with less than 20 years of service received 50% of average monthly compensation less 1% for each full year of continuous service less than 20. Such a benefit formula, which allows for reduction of the annuity upon any increase of social security, obviously favors the high salaried individual. The text of the pension plan document gave the following illustration of the benefit formula, and it will serve to emphasize the bias of the plan to favor the owner-managers even though the bulk of the employees ostensibly benefited. The example given was as follows:

> Richard Roe, a salaried employee, retires at the age of 68 after completing 18 years and 6 months of continuous employment

> with the Company. His average monthly compensation during the 36-month period immediately preceding retirement is $300. Richard Roe will receive, commencing at age 68, a monthly pension under the plan in an amount equal to $60.50.[2]

What the pension plan text did not illustrate was the relative impact of a change of social security benefits on the higher salaried employee and the Richard Roes who were earning $300 a month. An increase of $6.05 per month as a result of amendment of the social security laws would reduce Richard Roe's company annuity by 10%, but for the individual averaging $800 a month, his total pension of $400 minus $85 per month of Social Security benefits would mean a company annuity of $315. $6.05 reduction here barely equals 2% of the company annuity. Moreover, any increase in social security benefit level would automatically change the assumption on which the actuarial liability of the plan was calculated, reducing the liability significantly and thereby reducing the need for additional company contributions. Moreover, the employee must forfeit three years of social secutiry even at the time this particular plan was in operation to reach the qualifying age of 68 or do without his benefits for the first three years of retirement, assuming he has the minimum years of required service. Even this option is limited to cases of total and permanent disability or indefinite layoff, for the pension document specifically states, subject to the above acceptance, that:

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[2]$60.50 was computed as follows: 50% minus 1-1/2% (a 1% cutback for each full year of continuous service less than 20) equals 48-½% multiplied by $300 per month average compensation equals $145.50 per month total pension minus $85 per primary Social Security benefit equals a $60.50 per month pension payable from the pension plan.

> ... no benefits whatsoever shall be payable to any salaried employee who ceases to work for the company for any reason prior to Normal Retirement Date, irrespective of the years of continuous service to the company of such employee. Nor shall any benefits be payable under the plan to any employee who dies while in the employ of the company.

When the plan was first submitted for approval as a tax exempt plan, it was necessary to add an amendment restricting distribution in event of termination within ten years of its initiation. Lump sum distributions were not to exceed the greater of $20,000 or an amount equal to 20% of the first $50,000 of the employees' basic annual salary multiplied by the number of years between establishment of the plan and the event causing distribution or termination. When the plan was terminated, it was necessary to amend the benefit formula so that the benefit level, once determined by Federal Social Security laws existing at retirement, would remain constant. Obviously, once the trust had been terminated and outstanding retirement income funded with insured annuities, no mechanism would remain for adjusting pensions to parallel changing developments in the Social Security field.

Conclusions: While IRS did not challenge the qualification of this pension plan for tax exemption, it would seem that the manner of funding, design, and sudden termination of this plan was an abuse of pension tax law privileges. This kind of abuse has prompted a number of attacks on the capital gains privilege as it applies to lump sum and terminal distributions. In the recent legislation enabling self-employed people to initiate pension plan funding enjoying certain tax

privileges,[3] an amendment initiated by Senator Eugene J. McCarthy would have removed the capital gains privilege for officers of closed corporations. The amendment expanded the definition of "owner-employee" to include the owner-managers of corporations who own more than 10% of the value of outstanding stock of the corporation or who own more than 10% of the total combined voting power of all classes of stock entitled to vote, in effect granting this group the same privileges and restrictions as applied to the owner-employees of unincorporated businesses.[4] The intent was equity. The amendment was not initiated without reference to recommendations of the IRS, and it can be presumed that the Revenue Service has evidence of frequent abuse of the spirit of pension tax laws as demonstrated by the case first under discussion. Nevertheless, the frequency or severity of this abuse has never been defined as aggregate statistics have never been released. It would seem that assimilation of the facts of tax experience to date should precede tax reform. Moreover, in a case such as the one just described, tax reform would not be necessary to discourage such an abuse when the tax commissioner already had it in his power to challenge the original presumption of permanency required of a tax qualified pension plan. This latter prerogative of the

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[3]Self-Employed Individuals' Tax Retirement Act of 1962, H.R. 10.

[4]For full detail see pp. 63-64 of H.R.-10 (C), (D), (E). The intent of the amendment was given in correspondence from Senator Eugene McCarthy to the author September 24, 1962.

commissioner can be more selective and equitable than simple removal of, or restrictions upon, income and capital gains tax applications. Perhaps the tax service has felt that challenging the intent of the party at origination as to their good faith in anticipating the continuity of the pension plan would be a difficult legal chore. In the case at hand, sale of the business would appear a legitimate business purpose which could only be challenged if it could be shown that the Board of Directors was contemplating sale of the business to parties unknown or to a specific party as an objective of their business strategy prior to adoption of a pension plan. For such a situation the law might well be amended to permit inference or strong presumption from criteria of permanency which could be applied to known figures and facts.

The problem of pension assets in excess of pension liabilities has many explanations. Pension liabilities may be small because of the age of the work force, few past service credits, or extensive attrition of employment. Perhaps most important is the difference between the prospective actuarial liability and terminal liability of the pension. The latter may be severely restricted to a few eligible individuals with vested rights of termination, while prospective liability includes all accumulated, non-vested service credits. Compared to the smaller figure segregated assets may appear most adequate, though reflection leads to the conclusion that vested benefits were inadequate. The other explanations are those in which investments have increased in value at a rate in excess of increasing liabilities. A number of the pension professionals interviewed agreed with the

author that over-funding the pension plan for the smaller, more closely held corporation can be a genuine area of concern for the tax service. The frequency with which these situations occur is probably higher than most people realize or is indicated by replies to direct inquiry. It is the other situation, the lack of funds to pay even retirement committments, which captures more research attention and sympathetic reform legislation.

D. Funds Insufficient for Current Retirement Costs

The non-insured, trusteed pension plan which undertakes to pay retirement benefits directly from trust funds faces the ever present danger that it will be terminated or fail to receive contributions at a time when it lacks the resources to complete outstanding obligations. The inadequacy of funds is not always apparent until it becomes obvious that claims are consistently exceeding actuarial estimates. Perhaps the most severe disappointment of pension expectations is that which occurs when payments to retired workers must be reduced, for the retired worker has generally found it necessary to scale his standard of living with sacrifice to the monthly pension checks, both public and private, which he expects to receive. A further reduction of income, once the older person has made the first adjustment, is a most severe hardship.

Case situations where retired workers suffered a reduction of previously established pension benefits were not found in the study

sample as frequently as one might expect.[5] Such situations were not even related primarily to business failures. Corporations have few compunctions against moving away or closing a plant location, leaving the pension plan to stand or fall as it will without additional subsidies.

CASE #19

Facts: An auto parts manufacturer consolidated his operations and closed one of its older plants which had retired eighteen persons previous to termination, half of which had been retired two years or more when the plant closed. The pension plan was a negotiated one on the auto worker pattern. Its benefit formula provided for $2.00 per month per year of service up to a maximum of $60.00. Normal retirement, early retirement, or disability required 15 years service, and responsibility for administration lay with a joint company-union board of administration. While the actuarial liability at origination is not known, there was $68,330 of segregated pension trust assets at termination, representing a current cost plus 30-year amortization of past service liability. The liability which this offset had been sharply reduced by a reduction of employment in the plant from 130 to 118, and then 29 on three successive anniversaries. The retired

[5]Only three situations were found in the sixty odd cases selected for review, a percentage of 5%, a factor which has no statistical credibility but is nevertheless significant since such instances would generate the most hard feelings; it would follow that these cases would be the first offered to researchers by those professionals which found commuted retirement benefits a most serious and inexcusable breach of the pension promise.

participants suffered a reduction in benefit of 35% of what had been received theretofore, and this reduced benefit level was stabilized with the purchase of annuities from an insurance company. Termination was marked by several contractual features of interest here. A year and a half prior to termination the union brought about amendment and restatement of the pension agreement calling for automatic termination of the pension plan "in the event the company discontinues its manufacturing operations at its plant at ... and moves said operations to another plant established by it at a location beyond a radius of thirty miles" from its then existing plant location. This provision was intended to protect pension participants from a shift in plant location beyond its former employment area, a move which would not necessarily require a corporation to terminate its plan.

Conclusions: Theoretically workers who lacked a year or two of vesting who would not move to the new employment site would lose accumulated pension expectations. At the same time the company would gain pension assets which would fund a greatly reduced pension liability for newly hired employees at the new location. In this case this advantage to the company was not clear, but it would have been to the advantage of retired workers for the plan to remain in effect despite company relocation. Instead, a sound improvement on the typical pension plan brought about consequences that were not contemplated, a result to be considered more closely when the migration problem is treated in Chapter VII. One can wonder what satisfaction management derived from allowing a plan to terminate without additional funds, so that those who served the company 15 to 30 years

took a reduction in pension income, which could have been prevented by an additional contribution of less than $40,000. The company did not go out of business and was able to build a new plant while upsetting the pension expectations of those left unemployed or in retirement. The exposure of the retired individual to the possibility of a reduction or loss of pension income due to unilateral or automatic termination of a pension trust which has not fully funded commitments to workers already on retirement could be readily reduced. The standard denial of liability should be qualified to preserve company liability for benefits payable to retired workers or at least those over age 65 where early retirement liability might be excessive. Common law would grant a retired worker a vested interest in a pension income which had been promised as an additional incentive during his working years, and it would seem against social policy to permit a formal pension agreement to deny all liability whatsoever.

In addition to a locational clause, the termination settlement called for the employer to contribute an additional $4,100 to the pension fund in excess of his required funding to purchase additional annuities for employees electing early retirement in lieu of severance benefits payable at the time of termination. Five employees elected this option, raising the total number of participants in the plan to receive benefit to 23. None of the other 130 employees covered by the plan prior to the reduction of the work force leading to termination received any benefits. Finally, provision was made for the joint administration committee to continue to function beyond the termination date of the pension agreement to instruct the trustees in the

transfer of funds to an insurer and to "take such appropriate action as may be requested" by the trustee. This extension of limited powers was dated to expire six months following the termination of the plan and trust. In this way an agency to instruct the trustee continued to function, providing more flexibility to meet unexpected contingencies than would have been the case were extensive instructions drafted as an amendment to the original trust document. Such a simple device to anticipate the last minute detail tangle of termination is quite often overlooked in termination of trusteed pension plan.

CASE #20

The problem of pension termination and adequacy of funds is affected by the average age of the employees covered as well as the time during which pension assets may have accumulated. The older the work force at the time when a pension plan is initiated, the more important is the past service credit liability. Where the work force is being severely reduced as a business fails or is relocated, the average age can be expected to advance rapidly for the remaining force as the younger worker, with less seniority, departs for other employment. As average age rises, funding of past liability per employee rises, and this rise is reflected by a high ratio of accrued liability to normal cost.

Facts: In one case employment fell from 460 to 90 in just five years, with a brief spurt of activity for one year. When the plan in question terminated, 30 were receiving pension benefits while 106 enjoyed a "vested" interest. Termination followed sale and spin-off

of a fully owned subsidiary. By agreement the subsidiary elected to withdraw its appropriate portion of the pension fund assets according to a pro-ration based on actuarial liability of individual accounts within company divisions. The actuarial liability of the division sold was slightly in excess of $60,250, which produced a share of $31,550 for the participants. This fund was quite insufficient to meet benefits for those already retired. The priority clause of distribution upon liquidation followed the auto workers' pattern, but did not decide whether the retired worker would be charged to the fund of the original company or the fund of the spun-off division which had employed the individual in question.

Conclusions: It would seem that the 30 already on retirement would have had greater security if they had been permitted to remain with the pension account of the parent firm. Moreover, it seems inconsistent with the intent of the priority clause to transfer these charges away from the principal body of assets before application of the priority rule. The plan of the subsidiary was later terminated before it had opportunity to accumulate sufficient assets. The only real beneficiary was the parent firm which escaped any further liability to those retired workers for which responsibility was transferred to the firm created by the spin-off and ruined, in part, by the burden of pension costs.

## E. Contributory Pension Plan Termination

The distribution of a contributory pension plan must of necessity follow a different formula than one appropriate to termination of

a non-contributory plan. Since the preponderance of pension plans are non-contributory, some difficulty was found in locating contributory pension case illustrations. Several contributory plans have played a part in previous discussion, but an additional one is included here to emphasize variation in priority between return of contributed funds with interest and allocation of company contributions toward the jointly supported plan.

CASE #21

Facts: In this example a subsidiary plant was closed and the employees were not absorbed by the parent company, 110 employees thus being left jobless. The employee pension plan, an integrated program requiring benefits of .514 of earnings up to $4,800 and .128 of earnings above that amount, was terminated precisely according to the termination clause as originally written for the contract. A critical element in distribution is the return of contributions plus simple interest thereon to each contributor. Lest assets be reduced by payment of retirement allowances to a level insufficient to meet contributor claims, termination signals the end of monthly retirement allowances from the trust until evaluation of assets can be made. From the total fund thus appraised, sufficient assets are set aside by the trustee to pay the outstanding expenses of the plan and its terminal distribution and then to pay all retired and non-retired participants the value of their contributions. This amount is adjusted for income credits and charged for benefit payments already paid annuitants or their beneficiaries.

Out of the balance remaining, the retirement allowance paid retired participants at the time of termination is restored to the degree the remaining assets may be sufficient. Termination pensions called for reduction of retirement allowances "proportionately" but did not state the formula for proration. Presumably the ratio selected would be that of the single sum actuarial value of an individual claim to the aggregate single sum values of all claims. However, this might be modified to favor the larger group with the lower average level of earnings by computing benefits only on the basis of the first $4800 of earnings.

Conclusions: Placing a ceiling on maximum benefit would be a shift of priority at the expense of the older, higher paid worker and those who were eligible for retirement but had not applied prior to the day of termination. It seems unwise to distinguish between benefits or priority of claim for those who have retired and those who could have retired at the normal retirement date. Such discrimination exposes those who are willing to continue to work to possible penalties at the time of termination. Where the difference is maintained, the insider can select against the plan and his co-workers upon ascertaining the termination is imminent simply by requesting his retirement and the benefits to which he is thereby entitled and assured where an annuity is purchased.

Before moving on to another case area, the reader should note in Table 35 the same difficulty in defining just what circumstances shall automatically terminate the plan. In addition, the retirement committee is protected against a court challenge of the asset

evaluation and actuarial assumptions which they must make by providing that their judgments for purposes for termination "shall be final and conclusively binding upon all parties." More than one pension plan was found which not only left important decisions to be made in conjunction with termination to an uncompensated administrative board but also left this board vulnerable to a challenge as to the wisdom of their particular judgment. Such errors of omission in drafting seldom receive critical attention or cause their author much embarrassment because only one out of every seven plans fail. Typically the failures are among the smallest plans, and often the legal position of the parties is sufficiently unequal that arbitrary amendment is possible.

F. All-Cash Terminal Distributions

There are many occasions for distributing the assets of a defunct pension plan entirely in cash. Aside from cases where individual claims are too small to warrant annuities, benefit formulas contribution formulas may also militate for simple cash distributions.

CASE #22

Facts: Consider the pension plan of a small local public utility, which was about 15 years old when the local firm was dissolved following sale of its assets to a larger regional utility. The original plan called for a retirement income based on the participants' average monthly rate of compensation for the ten calendar years preceding termination of employment or retirement. The actuarial liability of the firm under this plan was based on projected estimates

of salary levels, rates of advancement, and other long term factors which had no opportunity to take much effect when the plan was terminated. The original plan had not been funded and only four years prior to termination the plan had been amended to provide for 30-year amortization of past service liability by the company and some portion of employee contribution to current service.

Conclusions: Since there was no one on retirement or within striking distance of retirement, the pension plan administrators avoided reexamination of actuarial functions by simply returning employee contributions and pro-rating the remaining balance of cash on the basis of years of service.

Wherever the pension benefit formula has been related to average earnings over several years prior to retirement, a termination settlement was necessary which greatly modified and simplified both eligibility and benefit formulas. Although a specific case illustration with extensive documentation was not found, a number of cases in point might be mentioned briefly.

CASE #23

Facts: In one plant relocation a pension was terminated in which the benefit formula was based on earnings in the last 128 months of service prior to retirement with an allowance for a total service factor. In a negotiated settlement the benefit formula was ignored, along with an elaborate termination clause which attempted to apply the original benefit formula, and a cash distribution was made instead, pro-rata on the basis of years of service.

Conclusions: It is difficult to imagine a workable termination clause of a plan in which benefit formulas were based on the average wage component. In the short term there would never be a suitable balance between complex actuarial projections of future wage levels at retirement and investment results of available funds committed to securities with long term appreciation potential. Abrupt termination of such plans in their early years would make the actuarial basis of the plan irrelevant, and it might be that in the short term the appreciation of invested pension aspects lagged the appreciation in wage levels which determined benefit levels. As a result, termination by amendment has reduced the terminal distribution to some more immediate and simplified basis. Where there was no one already on retirement, and the grand plan of pension income formulae has been abandoned, it has been natural for the administrator to think in terms of cash liquidation.

Cash liquidations which supercede original benefit formulae always require a provision in the termination settlement protecting the members of the pension committee from challenge for:

> . . . any and all divisions, appraisals, apportionments, and allotments made by the committee shall be final and not subject to question by any employee, retired employee, or other persons.

This denial of liability is in addition to the standard clauses of exoneration which appear elsewhere in the plan, as termination is considered to be something beyond normal operational responsibility. An argument can be made that terminal distribution requires the exercise of far more discretion than is true of the normal pension operations, so that perhaps the administrative committee or parties

negotiating a terminal distribution require very specific protection from challenge and liability.

CASE #24

Any pension plan where there are funds may be subject to cash liquidation because of the economic position of the participants at termination. In situations of the kind that mean lost jobs and employment workers need cash to live and the employer needs to find cash for special severance pay. The natural move is to appropriate pension funds for these purposes where other funds are not likely to be available. It is impossible to say to what degree a general suspicion of insurance devices causes the workman to prefer cash, but there is some vague resistance to long term "policies." Many pension administrators and trustees spoke to the author of the unseemly haste with which deferred pensioners surrendered their certificates for cash even where there was no pressing need.

Facts: One bank trustee told of a situation where a plant was closed during a period when jobs were plentiful for those skilled machinists who were displaced. Special efforts were made to have the trustee officer speak to each of some 200 participants on the value of their deferred pension certificates. These certificates were issued one noon and a sizable number of the participants reached the downtown home office of the insurance company to cash-out before the trustee returned to his office at the bank.

Conclusions: Cash may not only be preferred by the pension participant but may be urged by his life insurance salesman or car

salesman. As pointed out previously, a cash-out of a small pension annuity is generally not discouraged by the insurance company which may find its servicing expense ratio a little high and which can be expected to refund a cash value something less than the purchase price of the annuity.

The cash distribution is certainly in order where individual account values are too small to buy a significant pension, and it has been pointed out that a minimum significant pension may be three or four times as large as the minimum check which the insurer is willing to distribute periodically. The need for cash during transitional unemployment may be immediate but the need for retirement income will be imperative. Generally the resources of employees are not sufficient to bear the costs of unemployment and a savings plan for retirement. The pension board has what cash is available to be allocated to competing socially desirable ends.

Preservation of pensions is an important social aim and perhaps accomplishes a measure of foresight for the group, which would be unlikely for the individual. The employer or the union officials may feel very strongly that pension values should be left out of reach of individuals until time for the annuity income to begin. However, freedom of economic choice would argue that vested pension values of a terminated plan, which can no longer meet its original goals, should be offered to each participant in any form he chooses. Each pension participant may convert his windfall into new kitchen cabinets, or a college education for a child, or into a variable annuity as he chooses, since (in theory) he alone must bear the ultimate risks of

old age. Without carrying this discussion further, it becomes evident that a terminal distribution by cash or by pension is not necessarily decided on grounds of efficiency, equity, or adequacy, but rather as a political preference. Some pension administrators have strong preferences, and a few cases will be examined where an annuity was the only form of distribution open to participants.

G. Distribution of Annuity Contracts Exclusively

Termination provisions are often very specific in granting pension administrators powers to make terminal distributions far broader than those to distribute pension values in the ordinary course of operation of the pension plan. For an example, a common clause regarding the choice of terminal distribution might begin as follows:

> The distributions in liquidation upon such termination of the trust made to the extent no discrimination in value results,
> (a) in cash; or
> (b) in insurance or annuity contracts; or
> (c) by monthly payments of annuities as they become payable under Article III hereof, until the actuarial equity is exhausted; or
> (d) any combination of the foregoing in accordance with the determination of the trustees at the time of the termination of the trust.

In a number of cases discussed by bank trust officers, who would not release more detailed information, pension administrators were so firmly convinced that accumulated pension values should be preserved until due that a special trust was created to assure this result. Termination of a pure pension trust was accomplished through purchase of individual annuity policies for qualified participants. These policies were in the name of the participants but placed under the

control of a trust, the trustees of which were empowered to release the contract upon retirement of the participants or in event of special hardships. In the latter case the participant was required to initiate a special request for the single sum value of his annuity or for an early retirement income, and the trustees would act as the sole board of control as to whether the situation warranted such a premature release of funds. According to the source, such boards tended to be rather stringent in honoring hardship requests.

II. Distribution of Annuities or Cash by Class

The use of annuities and cash is best determined by the need of participants, and a common means of discriminating by groups is to give the older workers an annuity and the younger workers cash. Such a method is generally consistent with need and with the small values that the younger worker has generally accumulated, an amount further reduced when priority of distribution leaves only a partial settlement.

CASE #25

Facts: For example, a large automobile supplier shut down one of its plants, a plant which enjoyed an independent pension plan of the UAW pattern. In general the administrators[6] rather than the pension joint-board channeled instructions to the trustee as required by the plan. The plan began with an original past service liability of about

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[6]There was a joint-management board with limited responsibility (lest authority lead its members seek costly prerogatives like office space and secretarial help) and a full-time administrator.

$150,000 and ten years later, at termination, faced an actuarial liability of $834,000, despite the attrition of employment indicated in the table below:

SCHEDULE INDICATING THE NUMBER OF EMPLOYEES COVERED BY THE PLAN

| | Non-Retired With Seniority | Retired | Vested |
|---|---|---|---|
| 10/1/55 | 352 | 5 | - |
| 10/1/56 | 329 | 9 | 4 |
| 10/1/57 | 286 | 15 | 5 |
| 10/1/58 | 280 | 21 | 7 |
| 10/1/59 | 272 | 23 | 10 |
| 10/1/60 | 265 | 22 | 14 |

To meet these liabilities, $339,000 was available in the segregated pension trust count. Subject to a negotiated pension agreement to be reviewed presently, 24 previously retired workers, 2 participants who had postponed benefits, 19 who elected early retirement, and 2 disability cases received their full annuities in the form of insurance contracts. Lump-sum cash payments were made in partial fulfillment of the expectations of eligible employees in the age 50-59 group, while no one, not even long service participants, under the age of 50 received any benefits.

The negotiated settlement agreement should be noted for several rather unusual provisions. First the company paid to the trustee an additional $13,000 so that the last class benefit, the age 50-59 group, would receive a significant 40% of their accrued benefit. For this consideration the company was relieved from any further liability of any kind under the agreement. While the agreement presumed that everyone in the 50-59 group would receive cash, individuals could make

application for pensions, either immediate or deferred, within six weeks of termination. Cash payments were pro-rated on the basis of total service credits of the individual to the total aggregate service credits for all such persons. Thus priority was based on age and amount was based on service of workers. The board of administration processed all applications for pensions and forwarded instructions to the bank trustee. The time-table for termination is of some interest. It was agreed to terminate as of March 1, and no employee was to be eligible for pension benefits unless he made application by May 10. It was not necessary to locate and notify employees with a vested interest who had long since left the employ of the company since eligibility required seniority status as of March 1 and since the majority of the 14 vested, non-retired workers were still in the employ of the company. In effect, seniority status or a cutoff period for application works as both an exclusion or a form of priority favoring those closest to the company.

When a termination settlement agreement introduces the requirement of seniority status on the date of termination and a one-year time limit for application, it may divest workers no longer in the employ of the company of what was a vested pension interest. General legal opinion holds to the view that a vested pension interest cannot be destroyed by future amendment, and in this case two vested, former employees were contacted and there was no occasion for legal test. Still, had these men not been located the termination agreement would have divested them of their interest.

Conclusion: The law is vague as to the precedence given the

termination settlement over the pension agreement so that these controls to ease the administration of termination should be anticipated in the original plan. A seniority condition and a time limitation for application for a terminal benefit should be included in the original pension termination clause, regardless of whether or not the plan calls for negotiation at termination.

Supposing for a moment that several vested participants were divested by the settlement plan, and assuming the courts felt such divesting was unlawful, to whom would the dispossessed address themselves for recovery? Annuities not in force by March 1 were to commence payment on July 1, by which time the bank trustee was to have transferred sufficient funds to an insurance company selected in the basis of a single premium competitive bid for group immediate or deferred annuities. As soon as possible thereafter, the bank trustee was to distribute the remaining cash assets to the qualified participants, and the plan called for automatic dissolution of the board December 31. This board, consisting of four members divided equally between union and management, was designed to supplant or continue the joint board which lost its powers as of the termination date March. It was relieved of liability for "any mistake of judgement or action taken in good faith." The company was forever relieved of any liability connected with the plan as of March 1. The trustee had always been protected against liability for clerical or investment error. The question is, therefore, to whom would an employee seek redress where he was inadvertently denied payment (or made an erroneous payment, for that matter)? If the original schedules are correct, the

trust officers reassure us that a simple trial balance will detect any error. But what if the original schedules are in error? The experts would not advance an opinion as to where liability would fall were a former vested employee to arrive on the scene a year later to claim his pension. It is the opinion of this writer that such an injured party could sue his representative in termination negotiations, _i.e._, his union, for consenting to the distribution of an irrevocable right. Presumably the union representative acted on advice of counsel, and so there is an off-chance the attorney too might be liable. Of course, the local union may have disbanded with the closing of the plant, the employer may have been misplaced. Counsel for the union representing the interest of vested participants may be the only survivor and the only entity with cash resources. Why not make him a target of a malpractice suit? He would seem to be the only party not covered by a hold-harmless clause, and since court precedent exists establishing union agents as the representatives of former employees on these matters,[7] could not the link of representation expose union counsel to liability for misrepresentation?

The desire to provide a pension may lead to a distribution of annuity policies at termination in amounts which are too small to be of real value to the participants, together with cash amounts which are meaningless.

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[7] See the brief for _Fimnell et. al. vs. Cramet, Inc._, _op. cit._

CASE #26

Facts: For example, a small electronics firm established a trusteed pension plan for its salaried employees. Reduced business volume led to lay-offs of over half the original participants and within seven years of the beginning of the plan the company decided it could not afford one. At termination, 16 participants shared in assets of $30,764.46 as follows:

| Participants | Cash Value of Policy Contracts | Cash | Estimated Monthly Annuity |
|---|---|---|---|
| A | $ 871.54 | $ 30.43 | $ 5.23 |
| B | 718.79 | 23.83 | 4.32 |
| C | 763.81 | 21.15 | 4.56 |
| D | 12,647.31 | 344.08 | 75.00 |
| E | 513.43 | 18.39 | 3.60 |
| F | 472.09 | 16.31 | 2.82 |
| G | 880.91 | 32.80 | 5.28 |
| H | 1,000.70 | 36.77 | 6.00 |
| I | 960.70 | 32.41 | 5.96 |
| J | 1,139.49 | 39.89 | 6.84 |
| K | 1,600.43 | 55.48 | 9.60 |
| L | 1,322.25 | 48.01 | 7.92 |
| M | 571.81 | 20.53 | 3.42 |
| N | 1,073.91 | 38.23 | 6.42 |
| O | 4,874.05 | 185.17 | 29.28 |
| P | 396.56 | 13.20 | 2.40 |

Assuming everyone to receive an annuity were age 65 and immediately retired, they would receive a monthly annuity of the minimum in the third column above, based on a guaranteed rate of $6.00 per month per thousand. More likely most annuities would be deferred for many years so that on the average cash values might double before retirement. Even in that event 6 of 16 beneficiaries could not expect to receive $10.00 per month, and eleven of 16 could not expect to receive $15.00 per month. As quarterly checks the payments still would not be

impressive. Only D, K, and O could expect significant retirement income aid.

Conclusions: It would seem, therefore, that either a cash payment would be more in order or that the participants could receive more immediate benefit if some other form of life insurance were chosen. This latter alternative would preserve the tax protection of the pension funds, and in this case where there was no separation of employment, avoid the penalty of income tax instead of capital gains treatment. Life insurance policies might be purchased on a single premium or prepaid premium basis so that younger men would continue to receive immediate benefit of life insurance protection as well as the long term accumulation of cash values which could be converted to retirement income. Prepayment of premium for say five or six years on an ordinary life insurance contract would not only achieve immediate purchase economics but also make it possible for participants to continue life insurance premium payments at a later time when presumably they would be in a stronger financial position, all the time enjoying life insurance rates of a younger age. Other alternative uses of distribution shares might be variable annuities or purchase of mutual fund certificates from companies offering conversion to annuity options upon retirement. The point which these alternatives serve to demonstrate is that premature and early termination of a pension plan should not automatically suggest to the administrators the use of annuity contracts to the exclusion of other financial alternatives which may lead indirectly to retirement income with less immediate opportunity cost or greater immediate benefit to

the younger participants not due to retire for 16 years or more.

I. The Use of the Wasting Trust

The use of the wasting trust is an excellent example of the discretion in the hands of an administrative committee responsible for terminating a non-insured trust plan. Such a trust would permit continuance of a trust after termination of the pension plan in hopes of reducing unfunded and unsatisfied liabilities by means of investment and actuarial speculation. Since benefits are paid only as long as funds last, the pensioner always faces the prospect of an abrupt curtailment of his pension; on the other hand, those who might not receive a penny should pension assets be liquidated at termination of the plan, may realize some benefits as time changes the relationship between appreciating assets and declining liabilities. In some cases assets are maintained in a wasting trust only until a beneficiary is eligible to receive payments, at which time an annuity is purchased with his appropriate share of the fund. Each participant may share pro-rata on the basis of credited service at the time of termination, and these service credits measure the number of units he holds in the wasting trust which might be thought of as a mutual fund with overtones of the old tontine contract. Should an annuity be purchased, the fund loses the speculative value of favorable actuarial errors on the conservative side. A wasting trust is most valuable when there would be a group with well-deferred pension expectations, continuity of management, or other common bonds which hold the group together geographically and thus simplify the location problem.

CASE #29

Facts: In one sizable case the sale of a real estate service organization led to termination of a pension plan for about 100 employees. Segregated pension assets of $296,000 were available to meet an actuarial liability at the time of termination of $854,000. The original company sponsor was liquidated, selling its assets to a national concern which immediately hired all the salaried personnel of the firm. Of the 101 eligible participants, 6 were on retirement, 9 had postponed retirement, and 44 were eligible for early retirement. Assets were allocated to each participant on a pro-rata service credit basis, to establish his unit share as of the termination date. Each retired participant receives 1% of his pro-rata allocation of the monthly value of the invested assets of the firm, the entire fund being invested in mutual fund shares. The net effect of this arrangement was to provide each participant with a variable annuity. It was hoped that for the early years annuitants would be paid out of dividend income.

Conclusions: It is too early to tell how successful this arrangement will be in terms of the number or amount of pension benefits eventually supplied, but certainly 1962 developments in common stock prices must have given administrators some doubts as to its eventual success. In several other instances union pension experts reported the use of a wasting trust with considerable success, having been able to expend the list of eligible beneficiaries by several dozen people. In fact, it was suggested that a wasting trust with open end shares might be created as a depository for funds from many

terminated plans of insufficient size or inadequate administrative potential. Partial fixed benefits due to incomplete funding might, under some formula, be converted to a variable annuity in anticipation of appreciation to full payment levels. The wasting trust may be found more commonly in cases of merger or sale in order to freeze pension liability under an existing plan which does not integrate well with the pension plan of the surviving firm and whose participants will benefit under the plan of the surviving firm. These arrangements are beyond the scope of this paper.

In pursuit of appreciation of investment values or of actuarial speculation, the trustee has jeopardized the pension expectancy of those with age or service priority in the interest of making benefits available to those with less priority and less immediate need of a pension. It is a difficult policy decision, and it would be desirable to provide the retirement committee with some criteria for judging which situations are suitable for a wasting trust. This form of terminal distribution was common for many pension efforts which came to grief in the depression era, and has only received more attention as inflation and stock market profits became ingrained in financial thinking.

J. Discussion of Model Trusteed Pension Plan

To provide a more universal base for discussion of provision for termination and a trusteed pension plan, several model plans were secured from a nationally prominent attorney as examples of what he considered current drafting. At risk of violating the legal practice

of evaluating a contract on the basis of its entire text, only the termination provisions have been reproduced together with sufficient background to place them in relationship to the entire contract.

CASE #28

Facts: The first plan to be considered is a plan negotiated by a Midwestern firm with a local of the United Steel Workers Union. The company was required to fund only at a rate necessary to satisfy IRS requirements, so that there is no indication that anything more than the interest is being met on past service liability. Termination was visualized as occurring either at the expiration of the basic labor contract at a specific date two years in the future or upon "a permanent shutdown of the Company's plants covered by this agreement. . . ." In a separate section a deferred, vested retirement was granted to any employee who was "laid-off" and not recalled within two years, of whose employment terminated as a result of a "permanent shut-down of a plant, department, or subdivision thereof" where the employee had reached his fortieth year and had fourteen years or more of continuous service. Pensions were to be paid in monthly installments except if less than $10 per month it might be liquidated in a single lump sum actuarial equivalent. The principal feature of the termination provision is a priority of claim upon such funds as remain in the trust after expenses have been met. First the agreement differentiates between those who are receiving benefits and those who are eligible to receive benefits but have not so elected. As noted previously, such a distinction not only penalizes those who would

rather work than take pension benefits but creates an opportunity for an eligible employee to improve his priority should he foresee a plant shutdown or a failure to renegotiate a labor contract at the pre-determined expiration date. The next priority class properly recognizes the pension problem of the employees age 60 or older, and correctly eliminates possible discrimination due to the order in which members in the class reached age 65. However, it is not clear in the priority clause whether pro-ration within a class is on an actuarial or years-of-continuous service basis; only the latter method would technically pro-rate without reference to the order in which members of the class reached age 65. The third order of priority is for those in the broad class of age 40 to 60 who have met deferred vesting requirements or who have met the continuous service requirements. In regard to the latter, an employee at the time of termination may count those years he would have worked had termination not interrupted his career prior to age 65. The same recognition of the impossibility of meeting continuous service requirements is extended to the final class of priority, specifically employees below the age of 40. Since there is a good possibility that the pension plan may expire with the labor agreement, provision is then made to implement the original plan through continuance of the trust fund or use of some other funding agency to provide continuity at the discretion of the administrative board. Then follows a disclaimer of any liability on the part of the company for additional contributions following terminations, which repeats a disclaimer in an earlier provision regarding funding as follows:

> Contributions by the Company to the Pension Fund in accordance with this section shall be in complete discharge of the Company's financial obligation under this Pension Agreement. The benefits under this Pension Agreement shall be only such benefits as can be provided by the assets of the Pension Fund, and there shall be no further liability or obligation on the Company for any such benefits or to make any further contributions to the Pension Fund for any reason.

Now this was a two-year agreement and the company was obligated only for current annual cost contributions. Of what legal or financial value are the pension expectations of a pensioner who has been retired 15 years when changing conditions entirely irrelevant to his own environment dictate close of the plant? Without adding to current labor cost the company could at least be made responsible to fulfill commitments in event of shutdown to the first two categories of priority, a contingent liability which would not disrupt a balance sheet or destroy a complete current cost, unless pension provisions had been unrealistic from the start.

A pension sponsor would deny any desire to curtail pension and do so with the best intentions. Ironically, advice of counsel takes precedence over good intentions, for immediately following the disclaimer clause, the general provisions of the plan provide:

> No pension properly payable pursuant to this Pension Agreement shall be discontinued or reduced during the life of any pensioner except as expressly provided in Paragraphs 10.4 and 11.1. (This reference is to the funding and termination clauses outlined above.)

Termination benefits therefore depend on funding, and the company makes no promises as to funding except to the IRS.

Conclusions: Such careful reservation of power to the company, together with various restatements of limits of liability, is

ostensibly to protect the company from the indeterminate liabilities inherent in the actuarial estimate of future claims. Limits on annual contributions are intended to control demands on operational cash flow and on indirect costs. But with termination liabilities become fixed, and without operations, cash flow and indirect cost is irrelevant. To refuse to maintain existing pension commitments by refusing further contribution upon termination is to say, in effect, that the plan was a gift, a gratuity, from a donor with tongue in cheek. The courts will not recognize the pensioner as a general creditor of the enterprise, and though his income may stand or fall on the profit and loss of the firm, he does not have the standing of the lowest form of stockholder at the dissolution of the business. The gratuity theory of pensions would appear Neanderthal in regard to those who have met the conditions of the pension through legitimate service credits and have retired. These pensioners have made an irrevocable commitment of working for years to the company in partial consideration of a pension; if there is to be consideration on the part of the company in such a conditional contract there should be an irrevocable commitment to execute the contract, i.e., fulfill the pension expectation, once it is in effect.

The plan in point did make provision for involuntary termination, but the great majority of plans make no provision for attrition, change of location, or a lay-off which lengthens into shutdown. Similar provisions for limiting liability as to funding, or for the power to amend or terminate in the absence of a negotiated wage agreement to the contrary, appear in all current plans. Indeed, one plan ". . . may be amended by the company, retroactively or otherwise, at any time." The

termination clause provided an automatic liquidation ". . . in the event the company for any reason shall cease to exist, . . . unless continued by another. . . ." To suggest in the face of such standard practice that the company be liable for outstanding pensions for those 60 or over in event of termination, giving the pension trust the status of a general creditor should company operations be terminated, is heresy. Still such a reform does not seem to presage political revolution, a march to socialism, or the end of private property. It only seems consistent with our basic principle of honoring a contract for which the consideration by one party was a substantial part of his working and creative lifetime. Of course, this is an opinion based on social values, for as pointed out earlier, the status of a pension agreement as gratuity or contract has not been clearly established, at least to the lawyers who tend to favor vestigal phrases from the paternal pensions of the 1920's.

K. Summary and Conclusions

Pension contract drafting generally fails to anticipate all the occasions which would call for full or partial termination of a non-insured pension trust and to take advantage of the flexibility of terminal settlement inherent in the pension trust form. Since it is impossible to anticipate all terminal problems at the initiation of the plan, the original planner must identify and allocate proper legal responsibilities between the basic pension document and a separate termination agreement when and if required. Specific details on the

mode of distribution of inadequate funds and on the time schedule for termination procedure are best tailored to the facts as they exist at the time of termination, and so are properly material for a supplementary amendment or negotiated agreement to the basic pension document. However, definition of what constitutes a circumstance properly calling for termination as well as the priority and proration of individual shares are best understood from the beginning of the original pension program. In addition, the original pension document should consider some policy problems relating to the specific and discretionary powers of those responsible for administering the termination process. Finally, the question of unqualified waiver of liability by all parties to the contract should be restudied to better reflect the current legal character of a pension expectancy.

Therefore, a non-insured trusteed plan should be drafted, giving weight to the following needs, to update the more or less standard clauses which have been appearing for many years:

1. Termination should be automatically precipitated in the event of bankruptcy, sale, merger, or a change in management control where a unilateral pension agreement would be adversely affected. Not only should there be definitions of these business situations, but the last innovation would require definition so as not to threaten the concept of permanence cherished by the IRS. As will be discussed in Chapter VII, this clause should also anticipate locational changes or partial reductions of employment, although inadvertent and adverse effects to the participant of automatic termination should be tempered by redefinition of the employer liability for existing pension commitments.

2. The draftsman must be careful that automatic termination does not destroy the powers of those responsible for administration and that these individuals receive the additional discretionary powers which the condition of a termination process requires. A suitable extension of administrative authority in time or in

scope must be included in a termination article or powers article and brought into full force and effect by an appropriate reference to termination as condition precedent.

3. A statement of powers in event of termination prior to adequate funding should carry a list of alternative modes of distribution available to the board. Basic issues in the choice of alternatives are criteria for judging when funds are adequate to fulfill the original objectives of the trust and for deciding when long term objectives are best abandoned to favor immediate needs such as severance pay, life insurance, or speculative investment. Enumeration of alternatives should be as broad as possible to satisfy a legal preference for flexibility while meeting any management bias for a particular plan such as irrevocable deferred annuities in the hands of a corporate trustee.

4. While flexibility as to mode of distribution is desirable, a clear and irrevocable statement of priority of claim and the formula for pro-ration among classes for which there are inadequate funds is necessary. The social implications of pensions call for priority by age class but in a less elaborate manner than is typical of the well known U.A.W. plan. Pro-ration within a class should not be on an actuarial basis, however, for it gives additional weight in favor of age at the expense of service. It would seem more equitable to pro-rate within a class on the basis of service credits, excluding the class of retired or postponed retired claimants. If and when pensions gain greater recognition as deferred compensation, then it would seem pro-ration and priority would have to reflect service credits alone.

5. A priority clause will depend on proper definitions of eligibility. Obviously, the vested employee should have some preference over his fellows. Less obvious in eligibility and priority but also important are employment or layoff status at the time of termination, seniority status, and the status of vested rights of former employees with or without seniority status in the face of a time limitation clause controlling application for terminal benefits.

6. Since it would not be equitable to treat the individual worker any differently than a group under circumstances of involuntary termination, the individual must be given a vested right upon his involuntary termination comparable to those of his cohorts who remain employed until the pension plan itself is terminated.

7. Liability of the parties should be modified in two respects, one technical, and one a major policy reform. On the technical

side hold harmless clauses should be more discriminating. Responsibility to locate or to pay claims after a cutoff date of one or two years should be eliminated. A discovery period followed by incontestibility should permit bringing the termination process to an early legal conclusion and encourage the administrative board to use its judgment on apportionment and distribution media, free from exposure of future legal attack.

8. Errors of the administrative committee in their actuarial mathematics or of the agent serving as custodian of their funds should not arbitrarily be ignored. The insurance industry should be able to create an errors and omissions contract or bond withh all the parties of interest as named insured, providing settlement and defense in event of error.

9. More dangerous to present pension policy thinking is the thought that in event of termination the pension sponsor should be subject to a demand note for the funded actuarial balance of pension commitments in existence or postponed after a normal retirement date. Such a note would reduce demands of the pension on working capital without the danger of defaulting on earned pension commitments. To do otherwise is to make "hold harmless clauses" grotesque and unconscionable. Admittedly such a suggestion is sweeping in its implications and will be treated at length in the conclusions of Chapter VIII. It is introduced here to underscore the distinction between proper use of a hold harmless clause and definition of the extent of the financial commitment of a sponsor.

A supplementary amendment or a negotiated agreement should not only recognize the desirability of determination but establish a time schedule for the various steps in procedure. It may provide for a temporary extension of necessary administrative powers. It could serve as a device to recognize officially that pension objectives of the plan are unattainable due to the premature termination of the program so that such assets that may exist could be diverted to distribution in some other form than a deferred annuity. Finally, of course, a negotiated agreement may contain a release of the employer by employee representatives of rights which might exist beyond the life of a single contract or arise in areas beyond that of a pension expectation, to

extinguish seniority rights, for example. Such a release would serve as consideration for supplementary contributions to a pension plan or other severance arrangement.

As in Chapter V, the attitude of management toward the pension plan and the sophistication of employee representatives play a critical role. Attitude and ability could correct the flaws in the initial contract. At risk of generalizing from too small a sample, the author ventures the following opinions. Where management had a pension interest in a salaried employee plan, pension assets were more adequate and distributions better selected, selected at least to favor the income tax position of the manager. Where a pension termination was negotiated by a large union, not only was the union often able to obtain supplementary cash contributions in consideration of employee cooperation but also was able to secure more efficient purchase of annuities or distribution of cash for its membership.

However, most pension administrators were imbued with the belief that what began with the objective of furnishing a pension should end as close to this objective as possible, i.e., with a deferred annuity. While this writer would agree with the desirability of providing private pension sources for as many as possible, he cannot agree that deferred pensions in amounts as small as insurance companies are willing to administer are justified. A pension program which must be terminated in its early years, long before its actuarial liability can be amortized, should not be foreclosed with only its frustrated long-term objectives in mind. A pension of $15 a month 15 years hence has far less utility to the average worker than $1500 in cash at the time

of his unemployment and of his family rearing responsibilities. In the absence of separate severance pay programs, there is nothing wrong in considering the pension accumulation due a single employee as a savings account for a rainy day, a day which is now upon him when his employer has closed its doors for whatever reason. Perhaps the pension administrator could provide this employee with a more valuable service by giving him some simple guides to estate management, suggesting preservation of his small capital sum in the form of prepaid life insurance, a savings deposit, or a mutual fund commitment. Indeed, this capital sum might implement a counseling program intended to mitigate the trauma of a plant closing with assistance in job retraining, financial planning for some family dream apparently put out of reach by the change in employment security, or in some other morale and security-building measure. Too often it appears the various aspects of administering a plant failure, closing, or migration proceed without relating to each other or to the total problem of the employee. What is legal may not necessarily be social, and it seems that the potential flexibility of terminating a simple trustee pension plan has not been exploited by pension draftsmen or administrators. It is ironic that the attorney should argue for flexibility of a terminal distribution article to a pension plan when the eventual resolution of all but the largest plans generally follows such a stereotyped pattern.

## CHAPTER VII

## CASE ILLUSTRATIONS OF THE PROBLEM OF PARTIAL TERMINATION

### A. Objectives of Chapter

Unemployment brought on by automation or business adversity leads to a most ambiguous area of pension termination, a range of possibilities which might be classed as partial termination of pension expectations. For reasons to be developed, partial termination defies precise definition. Significant court opinions in this area were treated in Chapter III, and so this chapter will stress examples of non-litigated, partial termination settlements, forged by circumstance and illustrative of the conflicts and techniques of such a settlement. Once typical experience with the problem has been developed, the value of special plant shutdown provisions and severance pay benefits recently introduced into some major programs will be discussed. Finally the chapter will attempt to appraise various pension modifications which might alleviate the injustices of involuntary termination. Undoubtedly the chapter will raise more questions of equity than it can resolve. Nevertheless, discussion can help to focus attention on certain value decisions which the pension sponsor will have to make if the provisions of his pension program are to be consistent with one another and with current philosophies of employee compensation.

### B. Partial Termination Defined

As discussed previously, pension service credits vest upon

satisfaction of certain conditions or upon termination of the plan. A great variety of vesting prerequisites generally puts qualification beyond reach of many employees. Explicit termination is limited to certain prescribed circumstances by the pension agreement. Participants are therefore vulnerable to a decline of employment levels leading to permanent discharge, prolonged layoff to the point where seniority rights expire, or a change in job classification excludes the participant from the plan. Some plans do not even provide for cumulative pension credits for different periods of employment with the same employer.

If one subscribes to the theory that funding of an eventual pension is part of wage compensation, then involuntary termination produces forfeiture of a portion of wages while precluding the employee from an opportunity to fulfill the conditions necessary to receive these wages. The employee with a non-vested benefit must either look to special provisions covering involuntary discharge for lack of work on precipitate termination of the plan as of the last day of his employment. Efforts in the latter direction have led to the confusing court situation described in Chapter III. As the reader may recall, the courts inferred a partial termination of a pension plan in only one set of circumstances, _i.e._, where sale of a company division led to discharge of 50% of the total employee force. The court viewed this reduction of employment as a part of "an extraordinary incident in the structure, function, and life of the company." Apparently the courts require that partial termination of the pension plan parallel partial termination of the business, and that is difficult to

establish where the reduction is one of scale of operations rather than diminution of specific activities of the business. Partial termination to achieve vesting by means of court action requires a major corporate reorganization as well as discharge of a substantial portion of the work force before any individual may gain a vested interest not granted in the normal course of the plan's operation. However, even this faint hope appears to be inequitable for there is no good reason why the rights of a single individual should be less than that of a group in the event of his involuntary termination. Not only is it impossible to find an equitable distinction between an individual and a group, but it is also impossible to distinguish between two groups of the same size discharged from different sized employee groups or pension groups. For the multi-plant company with a single plan, a particular group may represent a very small proportion although the same group could be a significant part of a pension program covering one location of a similar multi-plant firm. Therefore, one must look to common sense rather than court law for a workable definition of the partial termination problem.

> 1. Partial termination in the broad sense must include the involuntary forfeiture by any individual worker of accumulated pension service credits for lack of suitable work resulting in permanent dismissal, protracted lay-off with expiration of seniority rights, or sporadic employment with non-cumulative pension service credits.

The courts also seem to follow a different path from the IRS as to the parties at interest in the question of equity upon involuntary unemployment. For example, in Gorr v. Consolidated Foods Corporation, the court reasoned, "in no event . . . would the employer receive back

any contributions made by it under the plan." Instead these funds are to ". . . be applied toward the purchase of annuities" for those who remained employed. The court concluded, "the real parties in interest are the continuing employees on the one hand and the terminated employees on the other."[1] The employer, however, not only enjoys a reduction in the pension service liability which he must fund but also receives benefit funds previously accumulated for the discharged employees' expectation which must be applied toward the allowable tax deductible contributions in succeeding periods. In one case, the credit was of such size for an air-frame manufacturer which concluded a government contract, that it was excused by the terms of its contract limiting contributions to tax deductible sums from any further funding contributions for more than three years for its remaining employees. Certainly the company benefited indirectly from this relief of claims on its cash flow, while the employees who remained enjoyed only a temporary improvement in the degree to which their benefits were funded. As an interesting sidelight, the employees discharged were on layoff for more than two years, their seniority expired together with their interest in their pension eligibility, and then a change in government purchasing policy brought about their rehiring sans all past service pension credits by the manufacturer.

Since the employer may indirectly benefit and since the courts distinguish between a reduction in business activities and the severance of a few employees, there would appear to be need of a consistent

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[1] 253 Minn. 385, 91 N.W. 2d 778.

contractual provision for termination of pension eligibility and accumulated service credits. However, the employee may not be entitled under the wage theory of pensions to his entire service credit accumulation. To the degree that he receives a pension for service credits earned before the plan was created, pension represents a gratuity. That proportion which represents earned pension credits represents a true deferred wage and an equity interest of the employee.

2. Partial termination as used in this chapter will refer to a qualified reduction of the plan. Severance termination will refer to involuntary unemployment of the employee due to the labor economics of the employer, as opposed to disability or discharge for cause, when the pension plan remains unaffected. The cases which follow will begin with the more narrow interpretation and then expand to meet the broad spectrum of unemployment possibilities.

C. Partial Termination of a Single Plant Work Force and Pension Plan

CASE #29

Facts: A midwestern firm discontinued one of its principal operations related to metal casting to redirect its resources to the electronics field. About one-half of its employees were unsuitable to its electronic operations and were released, but the company continued operations at the same location with its remaining employees who were generally already employed in a second division of the company. The initial plan, originally negotiated five years previously, provided that when an employee's services were terminated, he ceased to have any rights to participate in any of the benefits of the pension fund. The company voluntarily sought to amend the existing termination provisions to avoid what it called "a grave inequity . . . to those

employees who have been released." Unfunded past service liability totaled $320,000 although trust fund assets were about $500,000. Normal cost exceeded $29,300. To terminate the plan the company negotiated a settlement agreement with the union (Table 36) and amended the termination article of the pension plan as in Appendix XII. While the plan was executed in October following a significant reduction in work force prior to actual closing of the foundry division, all employees on the seniority list as of the first of August were included in the allocation. As can be seen from the negotiated agreement in Table 36, workers age 60 and above received insurance annuity contracts. It should be noted that only ten years service was required for eligibility in the 60-64 age bracket. Insurance contracts were purchased on a competitive bid basis and the bids and their rate basis are included in Table 37. The company first requested a comparison of rate structures between companies at age 65 but later sought comparison on a list of eligible employees of given age and benefit. It found that annuity rates at each age vary between companies and that the average age of its pensioners above age 68 produced a different competitive picture in the aggregate than was true of rates at age 65. Moreover, the fact that remaining assets were dispersed to other employees below age 60 in cash made it necessary to weight annuity quotations for the possibility of future mortality improvement among younger deferred annuitants.

Conclusions: There is a clear lesson for the pension administrator in this case; a closed group of older personnel can be furnished annuities at a lower cost because there need be less cushion for

TABLE 36

NEGOTIATED TERMINATION AGREEMENT
(Abridged)

Foundry - Electronics Corp.

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Paragraphs Describing Parties to Agreement, Basic Definitions, and Date of Agreement.

The Company and the Union agree as follows:

1. (Date of termination)

2. The assets of the Trust Fund shall be allocated in the manner set forth below and all employees on the seniority list as of ... (date three weeks prior to termination) shall be included in the allocation of the Trust Fund.

3. Sufficient Funds shall be allocated to purchase insurance annuity contracts for all employees age sixty-five (65) or over with ten (10) or more years of service. Such annuities shall provide monthly benefits equal to the benefits the employees would receive under the provisions of the Retirement Income Plan.

5. Sufficient funds shall be allocated to purchase insurance annuity contracts for all employees age sixty (60) through sixty-four (64) with fifteen (15) or more years of service. Employees eligible for retirement benefits under this paragraph shall have the option of receiving benefits commencing at age sixty-five (65) or may receive benefits commencing immediately upon application for early retirement. Employees in this group may elect to receive a cash settlement. Such request shall be submitted to the joint Board of Administration and the maximum benefit payable under this option shall be no greater than the sum required had the employee participated in the Group Annuity Plan.

6. The remaining assets of the Trust Fund shall be allocated to all other employees eligible to participate under this agreement on the basis of hours worked from ... to ... (dates of a six-year period) with a maximum of 9600 allowed hours for this period. Allowed hours shall be handled in multiples of 400 hours and employees with less than 9600 hours of credit will revert to the next lowest multiple.

   Example - 9300 hours worked - 9200 hours credit
   9000 hours worked - 8800 hours credit

   Information as to hours worked shall be furnished by the Company and the list of eligible employees including hours worked, as

TABLE 36 (Continued)

approved by the Company and the Union shall be submitted to the Board of Administration and shall be the basis of distribution of funds allocated under this paragraph. Only those persons on the list approved by the Company and the Union shall be eligible to participate in the benefits covered in this agreement and neither the Union nor the Company shall be subject to the grievance procedure or legal action instituted by any former employee.

7. The allocation of funds as set forth in this agreement in Paragraphs 3, 4, 5 and 6 shall be determined by the actuary and shall be subject to review by the Actuarial Representative of the Union. Upon approval of the allocation of funds for the purchase of insurance annuity contracts as set forth in this agreement, the actuary and the Trustee shall be authorized by the joint Board of Administration to purchase insurance annuities for those employees eligible for retirement benefits under this agreement.

8. Termination of the Retirement Plan and allocation of the assets of the Trust Fund shall be subject to approval of the Bureau of Internal Revenue and no such allocation shall be made until approved.

9. The expenses of carrying out the administrative duties necessary to terminate the Plan shall be paid from the Trust Fund.

10. The termination of the Retirement Income Plan and the allocation of the assets of the Trust Fund to the employees eligible to participate under this agreement shall relieve the Company of any responsibility for funding past service credits prior to ... (same as the termination date) for any employee under any pension agreement that may be negotiated in the future.

TABLE 37

SUMMARY OF INSURANCE COMPANY QUOTATIONS

| | Total Consideration | Rate Basis | | | | |
|---|---|---|---|---|---|---|
| | | Mortality | Interest | Loading | Method or Applying | $1/mo. at Age 65 |
| A . . . . . . | $ 132,665.32 | '37 S.A. | 3% | 4% | age nearest | |
| B . . . . . . | 138,116.28 | '37 S.A. | 2½% | - | age last | $137.66 |
| C . . . . . . | 138,118.14 | GA'51-1 | 3% | 4% | age nearest | 142.32 |
| D . . . . . . | Decline to quote on less than $300,000 premium | | | | | |
| E . . . . . . | 134,817.86 | GA'51-55 proj. | 3% | 4% | age nearest | 139.25 |
| F . . . . . . | 136,688.75 | s - '49 | 2 3/4% | - | age nearest | 140.50 |
| G . . . . . . | 136,442.47 | GA '51 | 2 3/4% | 5% | age nearest | 169.88 |

future increases in longevity and because companies are not necessarily comparable at selected ages. A bid must be obtained for a particular group with its own age distribution. A guaranteed rate for annuity purchase may be efficient for a continuing plan and too expensive for a terminating plan.

The remaining assets were distributed to all other eligible employees on the basis of hours worked from the beginning of the negotiated labor contract which gave rise to the original pension plan, a period covering about five years and eleven months. A maximum of 9600 hours was allowed any one worker for this period and these hours were handled in multiples of 400. For example, 9300 hours worked meant 9200 hours of credit while 9000 hours worked meant 8800 hours credit, as adjustment was made to the next lowest multiple of 400. Assets were then pro-rated on the basis of individual credit hours to aggregate credit hours of the entire eligible work force. In this case workers benefited from the entry age normal funding formula which tends to overstate assets in the early years of the plan. As a general rule union pension negotiators frown on distributions pro-rated by total hours worked, for when combined with general references to pension costs per hour worked, it tends to create an image of pensions as additional compensations per hour. This leads to misunderstanding of the pooling concepts of funding and dissatisfaction with the usual priorities of claim in event of termination, a confusion related to our earlier comments on past service credits as a gratuity and current service benefits as additional wage compensation.

In this light, distribution of a terminated pension fund by a formula pro-rating according to aggregate hours of work since the initiation of the pension fund, after provision for retirement benefits for those eligible to retire, seems eminently fair. The worker participant can see the justice of sharing in the fund strictly on the basis of service rather than a reallocation of funds to the past service liability iceberg according to age, group priority, or class averages. Distribution on a basis of pennies-per-hour may be inconsistent with the legal fiction of the gratuity theory, but then the gratuity theory seems inconsistent with the economics of negotiated pension plan contribution.

However, use of a pennies-per-hour approach requires certain pre-existing conditions. First, there cannot be a preponderance of older workers for whom retirement is socially desirable to remove them from the work force without the cruelty of job discrimination according to age. Then there must be records of individual labor hours worked and aggregate labor hours worked spanning the full period of time in question and easily assembled or modified for purposes of establishing pro-rata shares. The need to round off totals by units of 400 or some other basis is strictly a problem of mathematical convenience and would not have to be an essential part of determining aggregate hours worked. It would then be possible to use such a system for termination of employment of a single employee with a vested interest or involuntary job separation. This latter application of the formula would require some plan provision for vesting other than that required by termination of the plan and a refined turnover

actuarial assumption which considered only voluntary separation of nonvested employees. Otherwise it is appropriate only to termination or partial termination of a pension plan, and then we have turned full circle to the question of why a group of discharged employees should fare better than a single employee discharged for reasons of technological unemployment.

The termination settlement in the case under discussion is also noteworthy for its provision to relieve the company of any future responsibility to fund past service credits for any employee who remained with the firm and who might enjoy pension expectations under some future pension agreement. In such event a new pension plan would begin with a minimum past service liability and a minimum number of workers age 60 or above, producing a substantial reduction in pension cost.

Thus, termination of employment of a portion of a company work force could provide an excuse for termination of a pension plan with a distribution of assets to all employees. The result would be that past service pension credits for remaining employees would be liquidated for only a fraction of their total value when the terminal distribution was accepted. Equitable treatment of the pension expectations of those who were discharged could produce significant distortion of the pension expectations of those who remain while producing important fringe benefit cost savings for the company. Such a gambit would be most useful for the company with a unilateral pension plan which might be terminated at an appropriate plausible juncture without need for negotiation.

D. Partial Termination of a Pension Plan for a Multi-Plant Firm

Vertical integration of the major auto companies in recent years has been responsible for a large number of company liquidations and plant closings as the auto parts industry retrenched and readjusted. Major auto parts producers found there was more manufacturing capacity than business to match it; surviving firms looked beyond past alliances with one or another of the big auto firms to bid for additional business elsewhere with substantially reduced prices.

CASE #30

Facts: For example, there had been three principal manufacturers of dashboard instruments, Stewart Warner, Inc., King-Seely Corporation, and the Electric Auto Lite Company through its LaCrosse, Wisconsin, plant. King-Seely made a bid for Chrysler Corporation business of the LaCrosse plant at prices below those of Auto Lite. Retention of the business meant a cost and wage reduction program and an increase in productivity that was unacceptable to the U.A.W. union at the LaCrosse plant, and so it became impossible to obtain future business on a competitive basis and the plant was closed.[2] Closing led to a negotiated, partial termination of the pension plan to

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[2]The relationship of a pension termination to the larger problem of reemployment with new pension fringe benefits for workers who are the victims of a plant closing can be sketched in the Auto Lite case with far more precision because of a study by the Wisconsin State Employment Service. A short review of this study is included in Appendix XIII to give added significance to the potential cash or income resources available to pension plan participants. LaCrosse Reemployment Study, The Wisconsin State Employment Service, A Division of the Industrial Commission in cooperation with the Unemployment Compensation Department, September, 1960.

eliminate liability and necessity for completing the funding of all accumulated past service. This liability was particularly significant because of the long service records of the majority of Auto Lite employees. Only employees in the 25 years old or under group averaged less than ten years with the firm and those who were over 45 years old averaged more than 20 years of employment with the firm. Skilled employees had generally worked for the company for 25 years or more. Age and service level were considerably above those of other Auto Lite plants, as is indicated by Table 38.

If the discussion might digress for a moment from just pension termination, data on the unemployment situation in LaCrosse developed in Appendix XIII provokes the following comment. Certainly the economies of consolidation achieved by closing the plant take no account of the social frictional costs of the employment maladjustment created. Nevertheless, American industry must be free to move from one location to another if the mobility of capital necessary to efficient production is to be preserved. At the same time, there would seem to be a conflict of interest between national advisors to Management and Labor and local employee and community interests. Arrangements for pension termination, supplementary unemployment, and severance pay are the principal means of private efforts to bridge this gap. Inequities placed upon state and community resources such as the drain on unemployed compensation assets due to total unemployment instead of temporary partial unemployment as contemplated by charges to the firm must be corrected in the political arena. A fundamental economic question which arises, however, is to what degree the need for mobility

TABLE 38

DATA INDICATING ABOVE AVERAGE AGE AND SERVICE LEVEL
OF AUTO-LITE LA CROSSE PLANT EMPLOYEES

Auto-Lite Employees by Occupation

| Occupation | Total | Employees | |
|---|---|---|---|
| | | Male | Female |
| All occupations | 1,795 | 844 | 951 |
| Professional, semi-professional, and managerial | 58 | 51 | 7 |
| Clerical and sales | 223 | 180 | 43 |
| Service | 13 | 11 | 2 |
| Skilled | 97 | 97 | 0 |
| Semi-skilled and unskilled | 1,397 | 501 | 896 |
| Unclassified | 7 | 4 | 3 |

Average Years of Employment by Occupation

| Occupation | Male | | Female | |
|---|---|---|---|---|
| | Mean | Median | Mean | Median |
| Professional, semi-professional, and managerial | 20.3 | 21 | 13.0 | 13 |
| Clerical and sales | 11.9 | 12 | 11.8 | 11 |
| Service | 21.5 | 17 | 11.0 | 11 |
| Skilled | 23.4 | 25 | -- | -- |
| Semi-skilled and unskilled | 21.1 | 22 | 15.5 | 13 |

Employees by Age

| Age Group | Total | Male | Female |
|---|---|---|---|
| All ages | 1,795 | 844 | 951 |
| Under 25 | 15 | 6 | 6 |
| 25 - 34 | 235 | 47 | 188 |
| 35 - 44 | 445 | 203 | 242 |
| 45 - 54 | 577 | 308 | 269 |
| 55 and over | 321 | 178 | 143 |
| Unclassified | 202 | 102 | 100 |

of capital can absolve the individual firm from both its tentative private commitments such as pensions and implicit social commitments to community and state. Should a firm be permitted to deny liability for uninsured pension in force, for unemployment compensation benefits far in excess of reserves or rate assumptions, and for impairment of social capital such as schools and community development which was created as a secondary support to employment and which lacks mobility--just because its private income statement can be improved by a change in location? There may be some readjustment necessary among those costs of mobility which are properly the responsibility of the firm and those which society must accept as a cost of mobility of capital.[3]

Employment in the LaCrosse Auto Lite plant was subject to national group insurance, pension, and supplementary unemployment benefit programs negotiated with United Auto Workers by the central management group. Group insurance is beyond the province of this paper and the existence of a S.U.B. plan suggests that pension termination could be concerned with preservation of pension expectations rather than distribution of cash in lieu of adequate severance pay. The pension plan represented a typical U.A.W. plan calling for the creation of an uninsured pension fund, under the direction of a

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[3]This subject area is beyond the scope of this study. However, a number of states are studying what changes in unemployment insurance rate structure are necessary to reflect the unexpected costs of voluntary shutdown and its consequent full and permanent unemployment compensation loss. Plant shutdown for purposes of migration to another locality would appear to be a form of adverse selection against the state funds and the remaining employers which was not anticipated in the early years of unemployment programs.

board of administration or local subsidiary board. Normal retirement benefits at 65 or early retirement benefits at 60 required 10 years of service, as did a deferred termination benefit to those who leave the company service after attaining the age of 40 and before age 60. Finally, employees with 15 years service would be entitled to a disability pension in event of permanent or total disability. The amount of benefit was based on a formula of $2.50 a month benefit for each service credit year with twice this amount for a disability benefit. National participation in the Auto Lite Company and participation of the LaCrosse plant plan are summarized in Table 39.

The age and service credits of the work force discharged at LaCrosse qualified the large majority of workers for a vested pension interest. Therefore, the termination of employment would not reduce the past service liability attributable to these workers, and the cost would have been shifted to the remaining manufacturing operations throughout the country, a cost estimated to increase pension costs from an average of 12 cents an hour to as high as 40 cents an hour. To escape this past service liability the company chose to terminate the plan in part by segregating funds from the pension trust for distribution to the LaCrosse employees contingent. Ironically the privilege of vesting to safeguard pension expectations led to termination of the plan altogether.

The basic issue to be negotiated was then the formula by which funds were to be allocated; the company thought the total assets of the fund in the amount of $13.5 million might be allocated pro-rata according to the number of workers at LaCrosse compared to the total

TABLE 39

SUMMARY OF LACROSSE EMPLOYEE PENSION RIGHTS WITHIN NATIONAL AUTO LITE COMPANY PENSION PLAN

| | | |
|---|---|---|
| 1. | Number of participants 1/1/54 | 14,641 |
| 2. | Number added during period | 1,740 |
| 3. | Number pensioned | 882 |
| 4. | Number terminated or died | 4,170 |
| 5. | Number remaining as of 1/1/59 | 11,329 |
| 6. | Number of participants eligible for postponed retirement benefits | 4,744 |
| 7. | Number eligible for early retirement benefits | 613 |
| 8. | Number receiving disability benefits | 110 |
| 9. | Number employed in Wisconsin as of 8/1/59 | 1,795 |
| 10. | Total assets 8/1/59 | $13,540,532.81 |

Total Liabilities (in classes entitled to share in benefits on termination)

| | | | |
|---|---|---|---|
| Retired employees with annuities purchased | (858) | $ 4,758,410.00 | |
| LaCrosse retired employees | ( 95) | 740,865.00 | |
| Disabled (not yet 65) | (118) | 778,293.00 | including 2 pending |
| Active at age 60 and over | (525) | 3,893,639.00 | |
| Vested terminations 60 and over | ( 5) | 26,156.00 | |
| Total with full benefits | | $10,197,363.00 | |
| Liability for full benefits, active employees ages 50-59 | (2,069) | $11,352,003.00 | |
| Amount available to provide benefits | | 3,343,169.81 | |
| Ratio | | 29,450% | |

LaCrosse Liabilities for Unpurchased Benefits

| | | | |
|---|---|---|---|
| Retired employees | ( 95) | $ 740,865.00 | |
| Disabled employees | ( 20) | 129,993.00 | including 1 pending |
| Active at age 60 and over | ( 0) | -- | |
| Vested terminations 60 and over | ( 1) | 3,607.00 | |
| Active employees ages 50-59 | (394) | 691,114.00 | reduced benefits |
| Total LaCrosse allocations | | $1,565,579.00 | |

number of employees. However, such a distribution formula would not recognize that the labor force in LaCrosse was older, had accumulated more service credits, and had generated pension funds for a longer time than some other Auto Lite divisions. Distribution according to vested interest would have exhausted the company-wide fund for LaCrosse beneficiaries alone. Therefore, it was decided to establish the interest of each age group for all company employees according to the priority classes defined in the original pension agreement as eligible to share in termination benefits. The workers at the LaCrosse plant were similarly categorized according to these priority classifications and then shared in pension benefits pro-rata with their class for the entire company.

Reference to the valuation and distribution of assets indicates that approximately one-third were with a trust company, one-third were committed to a deposit administration fund with an insurer, and that another third represented cash values of annuities already purchased for retired employees. Except for the annuities already purchased the guaranteed rate offered by the original insurer made it desirable to seek by means of competitive bidding a new insurer for the balance of the benefits due the LaCrosse employees. Anticipation of the level of benefits payable was complicated by the fact that benefits payable to disabled employees would vary depending on whether they were, or would become at age 50, entitled to federal Social Security benefits. For the purposes of actuarial valuation the highest cost possibilities were assumed, so that it became necessary to make arrangements for the distribution of any actuarial savings experienced in this area.

Division of funds under the most conservative actuarial assumptions meant that employees aged 50 and over but less than age 60 would be entitled to 29.49% of their accrued pension benefits upon reaching normal age. However, actuarial savings that might be realized from the disability income group could improve this ratio by another 10%. After reviewing proposals as to how the segregated LaCrosse fund might be allocated among insured or trusteed devices, a pension consultant recommended the course of action summarized below to the pension board and the company with the approval of union representatives:

1. That the board formally agree that it is practicable and desirable to place the entire fund in the hands of the insurance company subject to certain conditions as set forth below.

2. That the company select a life insurance company by competitive bid and execute a contract with certain special features.

3. That the group annuity contract so negotiated provide for the immediate purchase of retirement annuities for all normal and early retirements not already purchased from the original insurer of the companywide plan, and for the creation of a deposit administration fund from which payments would be made to disabled employees. The deposit administration plan was to receive interest at not less than 4% per annum and was to include funds for those previously receiving their disability income from their original insurer. Should the disabled employee reach age 65, a life annuity would be purchased from the fund at the rate guaranteed by the insurer at the outset of the plan. Until all benefits were purchased experience credits were to be added to the fund, and then the balance of these funds would be applied to the purchase and benefits for employees in the age 50-59 group.

4. That the employees, age 50-59, at termination also participate in the deposit administration fund. The insurance company would be supplied initially a certification of full pension benefits to which they would have been entitled had assets been sufficient for the purpose. Beginning in 1964, and at least once during the next ten years, the insurance company would reevaluate the potential liability for all employees in the 50-59 group to ascertain whether each remains alive. It will estimate on the basis of such valuation the percentage of

the full accrued benefits which can thereafter be provided to all members of the group whether then receiving benefits or not, and will adjust the benefits of those then receiving them accordingly. If either of the two incapacitated pensioners under age 50 lived until August 31, 1974, the insurance company would purchase life annuities for them from the deposit administration fund, and apply the entire remaining fund for the benefit of the 50-59 age group. Subsequent experience credits would be used for the benefit of this group until total benefits equaled full accrued pensions. Any excess might be applied equitably for the benefit of the entire group.

5. The insurance carrier would immediately assume its duties as dispersing agent, and with certification by the Board of eligible members for an eventual pension, would assume the burden of administration so that for almost all purposes the company Board would be relieved of any further duties in regard to the defunct LaCrosse production unit.

The proposals of the actuary were accepted by the Board and acted upon. The insurer selected by competitive bidding purchased rates for immediate retirement on the basis of 4% interest, no expense allowance, and mortality rates based on the 1951 GA table for males without projection, with ages set back one year for males and six years for females. Alternative bases were offered for a deferred annuity. If the client were to retain any right of withdrawal, interest was guaranteed at 4% for the first five contract years and at 3½% thereafter. On a non-withdrawal basis a 4% interest rate for both the deposit administration fund and the guaranteed purchased rates would apply, and it was this latter alternative that was selected by the Board. The insurance company made the offer good through November 30, 1959, and retained the right to withdraw the offer on five days notice. The insurer was reluctant to accept a transfer of pension assets in the form of bonds rather than in cash. However, agreement was reached for the transfer of government issues on the closing bid price at the date of transfer, but the insurer felt that valuation of industrial issues according to

market quotations was not feasible because available quotations were "frequently of artificial nature." Despite a termination charge by the existing insurer, transfer of disability pensions to the new insurer produced a significant saving while the remainder of assets transferred came from the trust account. No cash was distributed as the long service records of the limited classes of eligible employees meant cash had accumulated pension credits of significant value. Moreover, this was consistent with the existence of S.U.B. and special severance pay programs.

Conclusions: Review of this partial termination case underscores some basic points of termination. First, prior establishment of priority of claim to insufficient assets creates a sound position for determining a formula of distribution. Second, the existence of generous vesting provisions does not in itself assure the employee of receiving his pension expectations although it may force the employer to terminate the plan rather than avoid all pension liability by discharging a large group of employees. The value of the right is contingent on sufficient funding and continuance of the plan. Vesting may give an individual a place closer to the head of the line when the pension pot of gold is distributed, but it makes no promises as to how many pieces of eight will be in the pot. Third, the termination plan demonstrates the efficient and flexible use of funds to improve pension expectations of those receiving only a part of their original pension rights when pension administrators know their job. Finally, the mode of distribution as well as the consequences of not terminating the plan indicate the distortions which may appear where one adheres

too slavishly to the past service liability deemed to exist prior to formation of the pension.

## E. Plant Closing in a Multi-Plant Firm

The economic scale, geographic dispersion, and product diversification of a multi-plant national company represent security and stability to an investor but compound the insecurity of the expectant pension participant. A multi-plant company is in a better position to observe variations in regional costs and to transfer division operations from one location to another to take advantage of various efficiencies that might be realized. In short, the mobility of the capital is increased and therefore the possibility of unemployment should capital be transferred is also increased. Generally, these firms have a companywide plan and a single trust or deposit administration funding vehicle. Plant shutdown at one location almost never is an occasion for partial termination of the plan even though there is partial termination of the work force. Workers eligible for immediate or deferred pension benefits generally continue to participate in the company plan but discharge of the remainder merely reduces the past service liability of the employer. Since the older, less efficient[4] plants with a longer established work force are those most likely to be closed, a firm can reduce its past service liability substantially where benefits are not vested until the workers are advanced in years

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[4]While functional physical obsolescence of the plant may be one source, the high cost of fringe benefits to an aging work force may be a major cost inefficiency.

and credited with 15 years of service or more.

CASE #31

Facts: One indication of the frequency with which plant closings take place without affecting the pension program can be gained from a survey of 40 United Steelworker local union groups which expired when the local plant was shut down. In four cases the plan was terminated because it existed solely for that division as a vestigal remnant of an earlier merger. In 16 cases the plan was unaffected and there was no negotiation of any sort involved at termination of employment; four replies of the 24 received were not applicable. While a number of plans provided vesting at age 64 or after 15 years of service, at least one-half the plans contained no vesting at all. This adverse experience led to the design of a variety of provisions which were first widely introduced in 1958 and 1960 negotiated wage agreements.

To protect each and every worker from the loss of pension expectations due to involuntary unemployment, the unions broadened vesting provisions, extended early retirement alternatives, introduced severance pay provisions, and refined termination provisions. One study[5] by the Bureau of Labor Statistics indicated early retirement was more prevalent than vesting, as 218 of 300 plans permitted early retirement although only 174 provided some form of vesting. While

[5] Walter W. Kolodrubetz, "Vesting Provisions in Pension Plans," Monthly Labor Review, July, 1959, p. 743.

service requirements were parallel to those of vesting, with 15 years the most common, age requirements were much higher and were stipulated at age 55 and generally age 60. Consequently, early retirement aids primarily the older worker,[6] who may elect to retire when faced with involuntary termination of employment. In a few plans, the study reported the nature of the employee's separation could affect his vested rights, although under most plans the reason for termination was immaterial. Since the study was prepared, union negotiators have pressed for universal introduction of vesting and early retirement provisions, particularly unions affiliated with the auto and steel industries.

Introduced in 1958 and 1960 were specific severance payment and plant shutdown clauses.[7] Severance payments would be made in a lump sum to employees not otherwise entitled to early retirement or deferred vested pension. The employee with a vested pension interest may elect to receive the severance payment in lieu of the deferred pension. The payment amount is determined from years of service and a percentage of earnings during years of continuing service credit. The severance pay

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[6]Early retirement at the election of the employees is a growing trend. The pattern is demonstrated in another survey called the 1960 Study of Industrial Plans, prepared by Banker's Trust Company, New York. Revenue Ruling 57-163, Part V(f), limits the value of early retirement benefits to the employee's vested benefits where the employee needs the consent of the employer to retire.

[7]Technically there are four types of severance benefits under pension plans; in addition to the most recent recognition of technological unemployment, there are death benefits, total disability benefits, and early retirement benefits.

provision which appears in Appendix XIV restricts eligibility to those employees with at least five years service credit who are physically or mentally unable to transfer to another job or have reached retirement age without establishing sufficient service time for pension. In the steel-aluminum-can industry the Steel Workers Union won two special severance benefits. (See Appendix XV.) One was a lump sum settlement at retirement in the amount of three months pay or 13 weeks vacation pay less accrued vacation pay. Regular pensions are not to start until the fourth month. More significant are the unreduced, immediate plant shutdown benefits for workers with 15 to 20 years of service who are 55 years old or more. Several examples of these clauses which appear in Appendix XV provide full retirement pensions for eligible employees terminated "by reason of a permanent shutdown or by reason of a layoff or sickness resulting in a break of service." A layoff beginning two years prior to eligibility may qualify the employee and the company has the discretionary option to retire a worker in layoff status when there is little likelihood that he will be recalled to work.

Merely to recognize the problem of plant shutdown as it stunts the pension expectation of the discharged employee is not the entire answer. Such severance pay[8] creates an additional contingent liability on the assets of the pension plan or trust which is not generally offset by a plan for adequate funding. Since severance pay for reasons of

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[8]"Lump Sum Severance Payments," Profit Sharing and Pension Forms, Vol. 9, No. 9 (March 25, 1960), pp. 25127-8.

plant shutdown is not susceptible to accurate long-term anticipation in the funding formula, funding may not anticipate these costs at all. Should severance cost appear as current costs, there is a question as to whether only the pension trust is liable, or whether the employer is liable as well. A second problem is the priority given severance benefits on available assets. As these benefits are payable only to workers not otherwise eligible, it would indicate vested pension interests have priority. If so, does priority of claim restrict severance payments to a level that will not adversely affect the funding of at least earned pension service credits of those with a vested interest, if not, past service pension credits? It would appear that severance pay provisions would only be free from conflict with vested benefit interest where there was almost certain continuity of the plan for many years in the future. United States Steel Company or American Can Company cannot be expected to go out of business altogether, although they may relocate some individual facilities. Vested beneficiaries have more or less certainty that the company will continue operation and fund its pension obligations. However, the smaller company which must discharge its employees as its business declines would strip its pension fund of assets to meet severance pay benefits with the result that employees remaining at the final close of operations would face pro-ration of very limited funds among their vested claims.

The cost of a severance pay program can only be mitigated over a long period of time and in relation to a large work force, so that the

frequency and severity of aggregate claim can be distributed over a large number of wage hours and tax periods. For the smaller company with uncertainty as to employment levels over a five or ten year span, the qualifications of severance pay will have to be as strict as those for a vested pension interest itself. Moreover, if the employees fear unemployment more than loss of pension as the more immediate possibility, the company welfare program might better stress a supplementary unemployment program. Indeed, if company operations fluctuate or decline it will have trouble enough funding the pension program and be uncertain as to when and how it might be terminated to best advantage of participating employees, as the next case suggests.

Severance pay benefits for a pension program, at least in excess of earned service credits, are a luxury of the viable and prosperous corporation which is improving operational efficiency by supplanting labor with capital to meet a profitable and increasing demand for its product.

F. Partial Termination or Spin-Off

CASE #32

Facts: A technically proper spin-off of pension funds to parallel sale of a company division may make no sense financially, economically, or equitably. A high cost division of a furniture company was spun off as an independent firm as an alternative to closing the plant and adversely affecting the community in which it was located. Unfortunately, this young company had an old work force with an average age of 50.6 and a long average service of 23.5 years, so that

accrued liability approached a ratio of 33:1 of normal cost. Annual normal cost per employee was $110, but with 40-year amortization of past service liability total annual payment per employee was $279 and rising as reduced operations dropped employment of the younger staff members. Employment fell from a seasonal peak of 375 to 100 in just two years. At the same time many employees elected early retirement so that in two years the ratio of retired to active employees changed from little more than 1% to 30% (4/375 to 30/100). The pension trust of the new firm had begun with assets of $41,550 transferred from the parent company, but it had recognized past service credits with the parent company so that it began with past service liabilities of $335,679. After only two years of operations, the company could not afford to carry this plan any further, and it was terminated with those on pension receiving less than a third of their due while the others received nothing. The surviving parent company reduced its past service liability by nearly two-thirds so that its annual payment per employee dropped drastically. It was clear of the onus of pension failure because its spun-off subsidiary did not give up on its pension program until almost two years later, although it had been apparent from the start it could not afford the program. One can question the equity of diverting retirement income responsibilities of long term employees to a newly formed independent firm of questionable economic strength solely on the rationale that these employees, on the verge of retirement or of eligibility for early retirement, were still active

at the time of the spin-off.[9]

Conclusions: It would appear most logical and equitable that an employee of 25 years or more with one firm might look to that firm for his pension security. It would seem that vesting would have been more appropriate than spin-off for these employees, for then the renewed vitality of the parent might have given greater hope of realizing their pension expectations while at the same time improving the competitive strength of the newly formed independent.

The little, new company could not afford consideration of severance benefits as it retrenched and reduced employment drastically. This same retrenchment caused the average age of the work force to rise even further and scuttle the pension plan even faster; retrenchment led to a retreat or push into early retirement for many and this accelerated the drain on available funds. In effect each procedure for meeting sale, reduction in work force, and funding was illusory, virtually a fraud upon the workers, for the parent company had not or could not provide the funds necessary to make the program work in view of the actuarial characteristics of the work force and the economics of the spun-off division.

Contract provisions, the paraphernalia of negotiation and spin-off, and funding efforts must all be tempered by common sense and good faith for there is no panacea for the consequences of dislocation of

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[9]Assets of the original pension fund were pro-rated according to actuarial liability accruing to active employees' service records, but the parent company offset high service credits of subsidiary with the numbers of employees in its national organization.

long-time employees.

G. Involuntary Termination vs. Vested Pension Rights

Various authorities have tried to establish a criterion for indicating a proper juncture for partial termination of a pension plan. The courts have used a significant change in business activity or a substantial mass discharge of employees to signal an implicit termination. Some plans have introduced shutdown or automation clauses to advance vesting for those discharged as a result. However, in the majority of cases structural changes in the firm are anything but dramatic and involve only a few at any one time. Returning to a recurrent theme, few pension plans have comprehensive definitions of conditions which cause termination, and almost none have made recognition of partial termination. Then there is the gap between eligibility for the accumulation of service credits and the time of actual vesting. Employees discharged while they are still in this awkward age despite many years of service have no recourse but to sue. The object of the suit must be to establish that partial termination has taken place or that the employee has substantially performed his part of the pension contract. To establish a theory of recovery based on quasi-contract law, one legal authority has raised some interesting points, questions which in the opinion of this author he may not have satisfactorily answered.

1. Partial Termination and Quantum Meruit Theory

Professor Merton Bernstein[10] finds a parallel between the contract conditions of the typical retirement plan and those favorite cases of trust and estate law professors, life-care suits in which the promisor induces life-long service in exchange for an inheritance. At risk of dulling his argument by abridgement, a summary would begin with the assumption that pension benefits are part of the wage contract and he begins with Section 357 of the Restatement of Contracts, which holds:

> Where the defendant fails or refuses to perform his contract and is justified therein by the plaintiff's own breach of duty or non-performance of a condition, but the plaintiff has rendered a part performance under the contract that is a net benefit to the defendant, the plaintiff can get judgement . . . for the amount of such benefit in excess of the harm that he has caused to the defendant by his own breach, in no case exceeding a ratable proportion of the agreed compensation, if (a) the plaintiff's breach or non-performance is not willful and deliberate. . . .[11]

Relating to the pension situation, the breach of duty by the plaintiff would be the unfulfilled age and service condition for vesting which involuntary discharge would make impossible to complete. It must then

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[10] Professor Bernstein is a Lecturer-in-Law at Yale University. An Article in the Harvard Law Review, March, 1963, is the source for his ideas which are developed more extensively in his forthcoming book, The Future of Private Pension Plans.

[11] Restatement Contracts Section 357 (1932). Comment(c)of Section 375 (i) makes it clear that the rule covers unfulfilled conditions as well as unperformed duties: The plaintiff may have made no promise to do what he has not performed; or he may have been excused from performing his promise by reason of impossibility or by the defendant's own consent. In such cases the defendant is not permitted to retain the benefit of a part performance without paying for it. (Taken from Bernstein, op. cit., p. 963.)

be shown that the defendant did not make long service the essence of the contract. Our reference here well summarizes the complex motivations of the employer which leads to an offer of a pension. References are made to meeting competition for capable employees, to increased efficiency due to reducing the attrition of experienced help, or to the desirability of removing superannuated employees by means of a retirement program. He concludes that long service is not the basic objective of the pension plan and that therefore partial performance by the pensioner would appear to have stronger basis for quantum meruit[12] recovery than in life-care cases where the defendant did seek life-long service as his objective. The case for the plaintiff is even stronger because he is blameless for his non-performance.

Again, referring to the Restatement, our reference authority finds Section 468 (1) bearing on a quantum meruit recovery:

> Except where a contract clearly provides otherwise, a party thereto who has rendered part performance for which there is no defined return performance fixed by the contract, and who is discharged from the duty of further performance by impossibility of rendering it, can get judgment for the value of the past performance rendered. . . .[13]

He then moves to Williston to attempt to define when part performance represents fulfillment of conditions, quoting Williston's inquiries:

> Did the plaintiff take the risk of the impossibility which has occurred? Is the contract to be construed as providing not only

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[12]This same theory of recovery was discussed in part in "Legal Problems of Private Pension Plans," Harvard Law Review, Vol. 70 (1957), pp. 496-7. The argument in this latter commentary was reviewed in Chapter III, p. 136.

[13]Restatement, Contracts 468 (1) (1932).

> that the plaintiff should receive pay for his performance on certain contingencies, but that except on those contingencies he should receive no pay?[14]

To these questions our source finds the following answers in Williston:

> In the United States the right of recovery is general, whether the contract is for the sale of goods or land, or the rendering of services, unless a contrary intention clearly appears . . . yet the mere fact that there is stated in the contract a condition on which payment shall be made, and that the condition (is unfulfilled) . . . is usually not enough to preclude recovery.[15]

However, these answers do not seem to bear on some critical points raised in the previous paragraphs, and Bernstein himself seems more concerned with the problem of establishing the equivalence, or more accurately, the lack of fair consideration, of service values conferred on the employer for cash wages received by the employee. First, the exception first noted in the Restatement could be found in those pension contracts, a majority, I believe, which contain a caveat that enrolling in the pension plan makes no guarantee of future employment for any reason, presumably including a desire to qualify for the pension. Certainly this exception is reinforced by frequent use of the word "gratuity" and generally excessive reminders that the liability of the employer is limited to the assets of the pension fund.

The plaintiff is also vulnerable on the question of who took the assumption of risk for unemployment and hence non-satisfaction of the pension conditions. In the absence of special individual contracts

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[14] 6 Williston, Contracts 1972A (1938).

[15] Ibid., pp. 5539-40.

to the contrary, it has always been the prerogative of the employer to hire or discharge employees in a non-discriminatory fashion. The employee whose rights have been negotiated would seem to take the risk of impossibility of performance when his representatives fail to negotiate provisions adequate to meet his needs or when his agents agree to benefit schedules which have no immediate prospect of adequate funding. The traditional burden of unemployment upon the employee has only been mitigated in recent years by society, which has seen fit to create public unemployment insurance programs, private supplementary unemployment or guaranteed wage plans, or special relief measures in particular cases. Since the cost of these plans falls on the employer, they are shifted to the consumer. Forfeiture of the pension expectation offers no advantage to the employee, perhaps some temporary advantage to the employer, and seldom produces any saving for the consumer. It would seem more equitable for the employee to lose that part of his pension for which he received service credits preceding the plan. These benefits are a gratuity as opposed to earned pension service credits which were made with knowledge and presumably with interest in the pension plan. Should the discharged employee receive a deferred interest in his earned pension credits, the employer would not profit by reduction of employment. Until the gratuity is separated from credits earned in anticipation of the plan following its start, this writer does not believe a quasi-contract exists, or at least exists without clearly stated exceptions to the substantial performance of a quasi-contract urged as a remedy.

In attempting to measure the damages or, conversely, the unjust

enrichment of the employer due to returns of funds committed toward forfeited pension expectations, Professor Bernstein does suggest two possible measures of termination. Assumption of the risk of unemployment theory implies foreseeability, the absence of which might place the risk upon the employer. However, the turnover rate used in establishing liability and funding needs certainly foresees loss of employment for a number of reasons including some cyclical fluctuation of labor needs. Therefore our source suggests that only unemployment in excess of that anticipated by the turnover rate[16] used for a particular pension plan would be fully acceptable as unforeseeable to the employee and as a measure of the source of unjust enrichment for the employer. However, this tack in the Professor's argument would discriminate between those who were discharged within the limits of the turnover ratio and those who were discharged en masse, a distinction which is unacceptable. Not only does such a comparison favor the individual in a large group over a single individual with a common reason for loss of employment, but it also compares non-comparable figures, since the turnover rate is for attrition from all causes except retirement or disability. It should be noted, however, that this flaw in his theory of recovery is due to his effort to correct an inequitable situation (so far as possible) within the rules of evidence bearing on suit rather than to amend the pension form to avoid creating the original inequity. This latter approach is the basic but

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[16]Gross premium costs or annuity plans do not have a prospective anticipation of turnover, but here the employer pension planner has a good expectation of credits against future premiums for returns and forfeitures.

less pragmatic approach in efforts to secure more concrete pension rights for everyone at once, regardless of actual reform of pension contracts. A better measure of damages might be found in his previous arguments that pension funding could be measured as a cents per hour alternative to additional wages. The ratio of dollars funded to hours worked in a comparable period would automatically adjust for any turn-over assumption of the employer. However, adjustment would have to be made for the proportion of contributions directed at the reduction of past service liability, lest those discharged with less seniority receive a higher proportion of benefits than those retained because of more seniority and hence higher past service credits. Any attempt to direct these returns to the discharged employee where no vesting had taken place would seem to place some restriction on the employer in choosing to limit his work force, at least sufficient limit in the hands of an able attorney to violate this typical pension clause:

> Nothing contained in this Plan shall be construed as a contract of employment between the Company and any employee, or as conferring a right on any employee to be continued in the employment of the Company, or as limiting the right of the Company to discharge any employee.

This same clause would seem to create something of a hurdle for the quasi-contract theory as well in the case of unilateral pension programs.

In effect, the quantum meruit remedy might be a possible approach where the evidence is most dramatic as to long-term service and the financial returns to the employer due to pension forfeiture of significant amount. The court might seize upon such an argument more out of sympathy with the plaintiff than out of sympathy with the

legal argument. As to measuring or marking a partial termination by relating actual turnover to anticipated turnover, it is not only not definitive in its comparison of one kind of termination in comparison with expected terminations from all sources, but also vulnerable to distortion. The employer could deliberately select a higher rate of turnover to leave himself more flexibility of employee termination, while reducing the apparent need for funding the plan. Any step which reduces the number of dollars added to the pension fund undermines pension expectations.

2. A Deferred Benefit vs. Liquidated Share

Another problem affecting the "when" of partial termination is the relative advantage of vesting of a deferred benefit versus liquidation of a present claim at a discount. If partial termination precipitates liquidation or spin-off, the beneficiary of a partially funded plan will have to accept a part of his total claim as payment in full. It is possible that the continued operation of the pension plan might allow further accumulation to permit payment of all or at least a better percentage of the deferred pension claim. Certainly it is to the advantage of the older worker to keep all the funds possible in the original account to be dispersed as benefits become due. Were it to become a wasting trust for lack of sufficient future contributions, the older worker would fare better than the discharged employee with a deferred pension not due for payment for some years to come. If service prior to the agreement is to play so prominent a role to favor the oldsters, then partial termination should be avoided in

favor of deferred benefits to give the older worker a priority of claims on pension assets. If the majority of claims are too small to justify a deferred settlement, perhaps the pension plan might also avoid cash distributions to favor the old timers.

Vesting of deferred benefits not only reduces cash needs of the plan but also protects the plan against union raiding to provide additional unemployment compensation.

## 3. Further Discussion of Deferred Vesting

In the well-known Kaiser Motors pension termination struggle,[17] a large portion of available funds in the Kaiser plan had been generated by merger of a pension plan acquired with the purchase of an engine plant. Liquidation would have distributed these funds to many more workers in addition to those who joined Kaiser with the engine plant subsidiary, diluting the interest these employees enjoyed before joining Kaiser. Finally, vesting preserves the age distribution of participants for actuarial purposes, and could be qualified to eliminate short-term employees with future minute, deferred pensions, thereby placing more of the risk of short-term employment with the employee.

There are two principal arguments against deferred vesting. The first is that it does not reduce past service liability for the firm and therefore increases the relative burden of the cost per remaining employee. This objection is eliminated if only benefits

[17] George v. Haber, 343 Mich.218, 72 N.W. 2d 121 (1955).

earned during the span of the pension program are vested. In effect, the employee would assume the risk of receiving a gratuity for past service. The second objection is an administrative one. The expense of distributing deferred pensions to valid beneficiaries at unknown locations far in the future could well be an unfair burden. Liquidation would avoid the problem of unclaimed benefits, interim pleas for funds to meet a family crisis, or misunderstanding due to erosion of dollar purchasing power over time. In the case of trust plans, it avoids the ill will of losses due to investment experience, to unexpected actuarial results, or to forfeiture in the face of prior claims upon full termination of the plan. For the insured plan, liquidation avoids proliferation of many small, token annuities with their attendant cost to the insurer.

The administrative problem of identification and location could be shifted to a national registry, and it has been suggested that it be a part of the Social Security Administration, utilizing records kept for the Bureau of Old Age and Survivors Insurance. Vested benefits of non-active employees or those moving to other employment could be recorded on Social Security records, to be recalled at the time the applicant made claim for retirement. Given notice as to where to inquire, the would-be pensioner could conduct his own correspondence with the private pension administrator. By the same token, a plan at termination could locate vested but non-active employees via the Social Security machinery. For the family crisis, the pension trustees or administrators could be empowered to release actuarial equivalents of vested pensions under severely extenuating circumstances after

review of an application by the participant.

Barring write-off of past service liability or improved administrative techniques, a few general guidelines might be drawn. Deferred vesting of accrued benefits upon involuntary termination would be suitable for a multi-plant, well-established company which could not be expected to vanish from the business scene in the intervening years before realizing the deferred annuity. A vested, deferred severance benefit is more easily provided for by contract and recognized in the absence of an infallible condition precedent to partial termination. In this way it is possible to circumvent the necessity of defining when it is proper for partial termination in the large majority of cases. For the balance of severance situations, where involuntary termination was due to a decline in business for the smaller firm, the employee may be well advised to urge partial termination and liquidation of his claim, thus avoiding the uncertainties facing his one-time employer and the priorities favoring other fellow employees in event of full termination. In these cases the employees may find some legal comfort and strength in the court precedent for definition of a major structural change in business activities[18] or even more uncertain assistance from the law of quasi-contracts. However, a more dependable alternative would be widespread use of a contract provision providing service awards in the event of involuntary discharge or defining partial termination by some percentage drop in

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[18] Fernekes v. CMP Industries, 222 wys, 2d 582 App. Div. 3rd Dept.

employment.[19] There is always the danger that service awards or partial termination distribution will reduce supplementary unemployment benefits otherwise available due to the social consciousness of management.

The need for decision to grant severance or partial termination benefits may be greatly reduced as management and labor devise better means of adjusting job assignments to the pressures of automation and changing production requirements. It is suggested that in the long run the technical aspects of partial pension termination are peripheral to the great problem facing our economy of reconciling full employment with full efficiency of invested capital. It is not in the scope of this study to review the diverse methods which are being tried by various companies to hold men within the firm as job needs change or employment levels fluctuate, but one can be hopeful that the most severe dislocations of manufacturing employment have already been experienced.

## H. Summary and Conclusions

Involuntary severance or partial termination may often create more difficult problems of equity than those of complete termination. The two distinct poles of interest in full termination which we have seen to be various sub-classes of pensioners and company labor cost

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[19] For example, should employment fall 35% or more of the peak figure for a 20-month period, or a period somewhat less than the extension or seniority privileges, an employee could have the option of calling for his pro-rata share of available funds as though partial termination took place.

objectives are further sub-classified where the plan remains while participants are forced out. The needs of employees who stay and those discharged for reasons beyond their control are very different, and management can find opportunity to profit indirectly from a reduction of pension expectation burdens, or directly where managers are participants in the plan. The potential for conflict of interest might be reduced by reappraisal of present pension philosophy, contracts, administrative procedure, and applicable federal tax codes.

The degree to which one finds involuntary termination adversely affecting an equitable realization of pension expectations depends on one's view of pensions as gratuities or deferred compensation. Both views have good points and, as discussed previously, the arguments for each are more cogent if benefits granted in a program are delineated more carefully. One possible delineation leads to the compromise discussed below, a possible accord of gratuity and wage theory that would bear useful results in weighing the equities of all where some face involuntary termination of employment and pension. Service credits granted for service prior to first initiation of a pension plan are very much like a gift; however, service credits earned after inception of the pension program would seem to be akin to wages, albeit deferred. Current earned benefits are best funded currently, while past service benefits must be amortized in the future as the cash flow of the firm will allow. Thus a note of future contingency is introduced due to the nature of business risk. Risks of future employment, both prospective funding of past service benefits and

opportunity to earn additional benefits, must be borne by the employee for the employer cannot be responsible for both job and wage guaranty; the employer must protect his freedom of exit as well as entrance to a given endeavor. However, funding of accrued earned benefits is properly a current cost to the employer's operation, a payment for which he should bear the risk. On this basis it is suggested that in event of individual severance or partial termination, the employee would forfeit past service credits but receive a vested interest in earned service credits.

This vested interest might be modified by requiring a minimum number of service years so that a monthly pension of significance would result. For example, if the benefit formula called for $2.50 per month at retirement for each year of service, a six-year qualification period (of service from date of plan inauguration) would produce a pension check of $15 per month at retirement. Such a proposal has the following rationale:

1. Vesting of a deferred retirement benefit is to be preferred to a cash-out as a form of severance pay. A deferred benefit retains cash in the plan to secure benefits in the order in which they arise, thus preserving more of the mutual or cooperative pooling of funds implicit in a viable pension plan.

2. Vesting of only earned benefits relieves the employer of past liability expense while preventing a tax credit for contributions toward currently earned benefits. As a result, where his funding obligation is limited to tax deductible contributions, he receives only a small credit for funded past service forfeitures which may have been in a process of amortization over thirty years or more or subject only to interest payments thereon.

3. Vesting upon involuntary termination for reasons other than cause, and permit more stringent vesting provisions to reduce

the liability to voluntary terminations or remaining employees, holding down pension cost and labor turnover.

4. Vesting upon involuntary termination would eliminate those situations in which the discharged sought to establish partial termination of the plan by court action, with its attendant legal and actuarial costs and risk of untimely liquidation.

5. Vesting of a deferred benefit leaves open the possibility of an employee returning to the job at some future date to accumulate additional earned benefits and perhaps secure reinstatement of his forfeited, or at least suspended, interest in past service credits.

6. Severance cash payment plans are best suited to very large-scale national pension programs of only the biggest companies, because in these cases the cost can be spread over large-scale outputs and because individual termination circumstances involve only a small proportion of the total labor force at any one time, thus avoiding cash demands for a large portion of pension assets at any one time.

7. Vested deferred benefits create problems of location, identification, and realization by the employee at the time of his retirement. This flaw could be greatly alleviated by the creation of a national registry of pension benefits due former employees, a registry which might be allied with the Social Security Administration.

While a deferred severance benefit can eliminate much of the necessity for seeking a partial termination, the latter may still be in order where the business makes drastic reforms affecting a large segment of covered employees. Such termination may represent a spin-off of pension assets for distribution or transfer to a new plan. Less commonly, partial termination may take the form of a reduction in benefit levels. None of these alternatives should create windfall gains for the employer, or remaining employees, at the expense of the pension security of those with the group discharged. Experience reflected in the cases of this chapter would indicate:

1. Any spin-off should not include retired pensioners whose benefits are not fully funded and insured. Their security should lie with the entity of their one-time employer and his financial position, not the unproven resources of the newly created or transferred business entity. In the latter case, those eligible for early retirement but active after transfer, might also look to the original plan to the degree that benefits represented earned benefits for which cost would be properly allocated to the first employer.

2. By retaining pensioners and eligible pensioners with the parent pension entity, the parent is not excused from a benefit it already has invested by a liquidation settlement for only a portion of the claim.

3. Partial termination does produce a liquidated settlement; it is important that the original pension agreement call for partial distribution according to the same priorities, and pro-rations of a full termination, so that parties can go their separate ways with their respective equities as of the moment of termination. In effect, this calls for an actuarial analysis similar to that employed in the Auto Lite case discussed in this chapter.

4. By separating those eligible for pensions from the remainder of the work force, it would be possible to establish priority according to accrued earned service credits. Generally such a formula would still give preference to age, which seems to be a desired objective of most plans, as the older worker would probably have more years of service. At the same time, this would eliminate the glaring inequity of the thirty-year man who would receive nothing because he was not yet 55 years old or other cut-off age for eligibility.

5. Provision should be made for partial termination when non-seasonal employment falls to an extent of some significant percentage of total employment, say 35%, in just 18-20 months term. This would prevent younger employees from suing to be considered as severance cases rather than partial termination cases, in which case they might not receive full earned benefits because of higher priority claims on assets.

Provision for deferred severance benefits or automatic partial termination requires parallel anticipation in procedural measures contained in the original pension agreement. Authority of the administrative board would need to be extended to authorize vesting of deferred benefits under circumstances indicating involuntary

termination. Indeed, the board might be called on to decide when eligibility under this provision existed. The board would need additional power to execute the partial termination procedure if necessary. The board might be given power to hold in abeyance final decision on applicability of severance or partial termination procedures pending expiration of seniority rights within a designated period. The possibility of delaying would anticipate severance cases which later, in total, gave occasion for partial termination within an 18-20 month period, as an arbitrary example. However, this hiatus could be avoided by stipulating that recognition of a deferred severance interest meant waiver of a partial termination interest, thus reducing the need to liquidate the plan should partial termination occur. If severance benefits and priority schedules at termination both were based on accrued earned service credits, those discharged first who elected severance deferred benefits would not enjoy some advantage over those discharged later but subject to priority claims applicable. It is true that those participating in partial termination would receive only a liquidated portion of their total benefit, but the beneficiary of a deferred benefit will only receive his full claim if the business prospers and the plan receives further funding. By risking these contingencies, he becomes entitled to the possibility of receiving a better share of his earned claim.

The provisions of negotiated partial termination suggest additional powers which might be created for the pension board. For example, if deferred vested benefits were created, it might be desirable to draft machinery by which the beneficiary could receive an actuarial

cash settlement in severely extenuating circumstances. To prevent unnecessary attempts by claimants to raid the cash box, the administrative board would have to establish very strict definition of "extenuating circumstances." It might be feasible to place some duty upon the administrators to seek competitive bids for single-premium, deferred group annuities, assembled over time in lots of sufficient number to create premium volume in volumes to attract bids. Legal authorities are of different opinions as to the need of preventing amendment of certain provisions such as priority clauses. Preventing amendment would effectively forestall inter-necine conflict among different classes of age and service priorities, of employment status, or of administrators. Therefore, proscription in the pension agreement of any amendment of termination priorities would be an optional method of avoiding negotiation on this point should it become necessary to terminate the plan in part.

# CHAPTER VIII

## SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This final chapter will attempt to summarize the apparent conclusions to be drawn from the prior chapters as related to the objectives of the study as set forth in Chapter I. To review, consider the objectives as previously outlined:

1. To determine the frequency and severity of loss of pension terminations as might be revealed from analysis of available data and thereby suggest the significance of the problem.

2. To collect, assimilate, and analyze typical termination experiences to highlight possible areas for technical or legal refinements, which would reconcile the present and future prospects of the employer with the uncertain pension expectations of the employee.

3. To put forward tentative observations and suggestions intended to stimulate rethinking of private pension theory where it may adversely affect pension expectations of the older worker with recognition of the proper allocation of personal risks and social resources consistent with the American economic system.

The ultimate objective, of course, is to abstract from the details developed in the first two steps some rational foundation on which to base some useful conclusions and improvements on pension theory. While the focus of this paper has been the individual pension plan and its terminal problems, some concluding comment will be directed toward the institutional framework within which pensions may operate.

### A. Research Methodology

This monograph began with an intent to add a record of new

terminal experiences to the occasional items on termination found within existing pension literature or well-known legal cases originating from termination situations. Therefore, the research method has stressed interview and case file reviews and avoided cataloging of those cases which reached the courts. It follows that conclusions must stress policy considerations and administrative matters rather than legal nuances of recent court decisions.

Over a period of 18 months from late 1960 to 1962 prominent, accessible pension professionals were interviewed in their capacities as trust officers, union officers, insurance executives, pension consultants, lawyers, or government administrators. Many of those interviewed were able to contribute a valuable assortment of opinion and comment from personal recollection of limited experience with pension termination situations, but a few were in position to have had frequent exposure to these problems throughout the country. These latter individuals provided the core of case material, with additional cases gleaned from the "dead files" of state pension disclosure agencies, primarily Wisconsin files after letters of inquiry elsewhere revealed state programs were too new to have much material. The federal disclosure files were found inappropriate because terminal cases had to be known by name, read one at a time in the Washington office, and were of spotty value since the disclosure form requires little that is revealing about a full or partial termination.

Depending as it does on cases supplied by those interviewed, the study material would appear to have a certain bias for the experience of the midwest or northeast where the interviews were conducted.

However, one national actuarial firm provided cases from its entire national branch office chain, and correspondence was established with several western insurance companies. Then, too, industrial migration, a major cause of pension plan termination, has been occurring most frequently in the midwest and northeast to favor the south and the west. Generally, the cases available were selected by those interviewed and may represent the worst of their experience. Any overstatement of the conclusions which would follow is mitigated by the fact that our principal conclusions take issue with the conventional mode of pension terminal distributions, the inequities of which are common to both the typical and "worst" terminations. The latter simply better dramatize the maladjustments of funding policy and distribution policy.

The cases for which sufficient material was available were overly detailed and hence edited and extracted to form the basis for Chapters IV - VII, and the experience of those relying on recollection rather than case files has been mentioned in passing in case comment in these chapters. The array of cases selected were grouped around common factors to provide a focal point for other professional comment from interviews and analytical comment by the researcher.

To place these isolated cases somewhere within the national pension scene some secondary data on the frequency and severity of such situations was developed from tax and disclosure records. Such data had a limited role in the research approach, in part because of an intent to plow a new furrow and in part because of the barrenness of available statistics.

In the process of fact collections various methods were tried

to pinpoint pension termination situations throughout the country as they developed with little success.

Identification of business failures through Dun & Bradstreet records proved unrewarding because identification lagged actual liquidation. An effort to trace relocated businesses back from a new southern location to a former northern location had better results, but those employers which had left a pension plan in the lurch were the very ones who would not respond to mail inquiry so this approach was not pursued further than for the state of North Carolina.

Federal and state disclosure records were always retrospective in regard to termination, and newspaper identification of these situations for national circulation was limited to items of the scale of the Studebaker closing in South Bend or the move of the Norge division of Borg-Warner from Muskegon, Michigan, to Fort Smith, Arkansas. Negotiations in these situations were not available while they were in progress. The one central national source of terminal data was the Internal Revenue Service, and of course these records must remain privileged information. Thus the conclusions put forward based on the cases underlying this study cannot be considered universal judgments, but simply a tentative effort to identify a few common threads of experience woven through the existing private pension fabric.

## B. Some Ethical Guidelines to Conclusions on Policy

Private pension plans are a product of the law and the law is a composite of social objectives and social ethics. Ethics and their philosophical roots are a highly subjective factor in constructing what

otherwise may be a logical and rational explanation and solution in law to a problem of social concern, as pensions are. Therefore, precision requires that first approximation of policy proposals directed to pension termination problems be put forward only after underscoring the value judgments implicit in the proposals.

Behind the great debate of private pension plan issues--gratuity vs. deferred wage, vesting vs. economic feasibility, actuarial soundness vs. corporate financial viability, and all the many corollary issues--we have found one central theme:

> To what degree shall each party at interest in a pension plan bear the financial risks of dynamic economic change in business, employment, and pension plan expectancies?

In part, the American economic system is predicated on mobility of capital and labor, on a speedy exit from the economic scene for those unable to respond, as well as on freedom of entry into any field for those seizing opportunities. A predilection for material and human conservation demands a system by which enterprises can be newly cast or abruptly scrapped while conserving each element of the business alloy of human life commitments, social capital investment, and natural resource allocations. The personnel of business must be prepared, financially and mentally, for a constant progression of regroupings within and among various businesses as the pace of technological and market changes accelerates. The conclusions which follow reflect the view that the individual employee should be insulated to a degree from some of the financial consequences of regrouping as required by a viable economy. However, such a view does not mean that the individual need not share responsibility for his own economic

security or that full responsibility should rest with the government, a philosophy which has found expression in various aspects of current welfare economics. Instead, it should be remembered that pension plans evolve as part of the incentive system, and the bias of this study is that the pension should continue to be tied to loyalty, services rendered, at least with equitable limits, and a vested interest of the employee in the continued prosperity and productivity of his employer.

If one can accept such an underlying pension ethic, and it is certainly a value standard shared by a good many thoughtful men,[1] many difficult decisions of pension equity can be made. The key to equity, we believe, turns on a distinction between pension credits given for service prior to the existence of the pension plan and pension credits earned following initiation of the pension plan. Undoubtedly the reader will recall from discussion in Chapters VI and VII that the former service credits would then be so clearly a gratuity that the amortization of this liability over twenty years or more would not seem an unjust exposure of the employee interest to the vicissitudes of business earnings. Prior to the plan he had no reason to anticipate these benefits in making his financial plans nor did the employer have any responsibility for providing these benefits from his financial resources. Equitably, the employee should bear the risk of non-fulfillment of the funding objective if the employer is willing to bear

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[1]For example, these values are reflected in the various viewpoints expressed in Chapter II of Concepts of Actuarial Soundness in Pension Plans, previously cited.

the cost of funding these benefits should future earnings permit. An established pension plan with a given work force, on the other hand, does provide a foreseeable business cost for currently earned pension credits, to be charged to current production. Where the plan is negotiated, non-contributory, and a tool of personnel policy, an earned pension benefit is logically an element of wage compensation and thus, in its most elementary form, a benefit to be funded and vested.

There are several social considerations which can modify the currently earned, currently vested approach to pension benefits. First, society has always seen fit to provide various devices to limit the liability of the entrepreneur in order to encourage him to explore economic opportunity more aggressively and to make more economic enterprises feasible. At the same time society recognizes the private pension as a tool of personnel management, a form of motivation designed to stabilize the work force and standardize company policy in regard to its long term and older employees. By making pension benefits contingent on some years of service and continued loyalty,[2] the business objectives of the plan can be advanced while delimiting and reducing cost. Then too, society would favor recognition of the immediate needs of the retired or about-to-be retired worker. Can there be any reason why these employees after retirement must continue to bear any exposure to the loss of pension income because of change

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[2]Qualification might be five years' service and age 30 before earned benefits would begin to accrue, while loyalty might be served by requiring forfeiture of up to five years qualified earned credits, in event of voluntary termination.

in the economic fortunes of their past employers? This risk might properly be that of both the employer and the active employee, who could share it by funding the past service liability upon retirement from additional payments by the employer and from the absence of earned benefits for the youngest and least seniority workers in the employee force.

Resolution of the policy question of risk might then be possible by distributing the risks in the implicit contingencies of a pension expectation introduced by the mortality of economic enterprise as follows:

Past service pension liability: <u>a risk of the employee</u>

Earned service pension liability: <u>an immediate cost of the employer</u>

Immediate retirement benefits: <u>fully funded by combined sacrifice of employer and active employee</u>

Now these basic allocations of the risk of enterprise and employment must be implemented with a variety of technical solutions selected with the objective of concurrency for each plan of legal theory, pension provisions, actuarial assumptions, and full funding of feasible vested interests. Scant knowledge of the law restricts legal draftsmanship displays of illustrative pension plans, but the objectives of key provisions of plans as proposed above can be outlined, suggesting how concurrency of risk in funding, benefit and service obligation, definition and economic reality can convert implicit contingencies to explicit anticipations.

C. Concluding Thoughts On Pension Theory and Pension Termination

Orientation of the pension contract around a single theory of equitable allocation of the financial risks of economic dynamics permits conciliation of each legal viewpoint as to the nature of a pension benefit within a single plan. The policy guidelines below would relieve the courts and legal scholars from awkward interpretations of gratuity, conditional contract, or deferred compensation theories required to achieve a semblance of equity, as sketched in Chapter III. Probably no one of these guidelines represents a radical departure from practice somewhere in the private pension field today, but it is felt that this is a unique attempt to draft the pension agreement around an explicit, integrated allocation of risk as to the contingencies which may upset the pension plan. Further, it is argued that, had these guidelines been a part of the various cases discussed in Chapters III - VII, much of the conflict would have been avoided.

Therefore, a statement of nine basic modifications of existing pension objectives is followed with very brief supporting references to selected case examples to which a particular principle is best related. To avoid repetition of previous analysis, only the case number is given, together with an opinion of the improved results that would have obtained had the proposed guideline been in effect in that situation.

It is proposed that pension agreements should be negotiated and drafted to achieve the following results:

1. Pensions granted to retired employees would be fully funded or guaranteed by the employer. Purchase of annuities

immediately or comingling of these assets with those for earned service credits would be possible with an employer guaranty limited to unfunded obligation in an amount specified on a surplus note.

2. Earned service credits would vest and be funded immediately in a funding device subject to certain conditions of eligibility such as age and several qualifying years of employment.

3. If vested and guaranteed pension rights were not funded as accumulated, the segregated pension trust should require interest bearing surplus notes of the employer, which were subordinated to all trade and financial indebtedness of the employer.

4. Past service credits would be gratuities, separately funded over time, and progressively vested on a basis of age priorities until retirement produced full funding.

5. Forfeiture of pension expectations in event of voluntary termination or termination for cause should be reasonably strict, but involuntary termination should leave earned deferred pension expectations intact.

6. In the event of involuntary termination, the individual should fare as well as a group, receiving cash where his accrued pension lacks future economic significance or a deferred pension insurance contract where possible. A defense against cash-out for temporary unemployment needs might be included here.

7. Pension agreement may establish a definition of circumstances calling for full or partial termination or individual severance due to involuntary unemployment.

8. The nature of a terminal pension distribution should be related in part to the existing framework of labor contract, supplementary unemployment benefits, unemployment compensation, and in part to administrative discretion for individual circumstances.

9. Past service benefits, earned service benefits, and the severity of qualification for eligibility or of forfeiture of voluntary termination should be matched to the present capacity of the firm to fund actuarial estimates of cost. In this way the gap between valid pension expectations and resources can be reduced to almost nothing, and a pension expectation will have the vested and tangible value of a true property right.

With these guidelines there would be no need for court distinctions as to what percentage of the work force must be discharged before it represented partial termination of the plan as discussed in Point #1 of Chapter III. With these guidelines, there would be no cause for such doubtful equity as was found in Case #3 among many where the 60-65 age group received 90% of their benefits while those long service personnel just below age 60 received nothing. Nor would there be reason for conflict in the case of partial termination between the discharged employees and the continuing employees as the court found in Gorr v. Consolidated Foods.[3]

Perhaps these conclusions reiterate comments and conclusions of Chapter VII, but that is because solution of the problem of equity and administration for partial termination leads to resolution of full termination situations as well. Vesting of funded benefits for involuntary termination for any cause removes the sticky problem of defining all the circumstances which would call for full or partial termination of the plan, a difficulty which pervades these chapters and common law cases related to pension termination. In a related view it would be unnecessary to construct the legal rationales or court room demonstrations required of breach of contract or quantum meruit cases. It will be recalled that the administrative efficiency of vesting in event of involuntary termination of one or all employees was the key to the exemplary close-out of Case #1 in Chapter V. Should the pension contract be premised on equitable sharing of the uncertainties of

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[3]253 Minn. 375, 91 N.W.2d 772 (1958).

business unemployment, the approach suggested here would substitute a direct and simple theory of individual pension interests with suitable service qualifications for experiments to obtain greater technical and sophisticated contract drafting.

It should be noted before discussing certain aspects in more detail that this approach need not contribute to the annual cash cost of the program nor undermine its value as a productivity incentive. Eligibility rules can defer the beginning of earned benefits, and past service credits are only funded when funds exceed the need for deferred earned credits or present retirement costs. The surplus note permits deferral of transfers from working capital to aid in business expansion without complete waiver of claim should the company meet more difficult times. By use of surplus notes with a definite term, the option of the company is reduced from a question of _if_ it should fund the program to _when_ it should fund the program. Such a program does not disturb the option of management in regard to the mode of distribution or its freedom to fund pension costs in a manner to maximize tax credits. Most important, it creates a plan which conforms to both the concept of actuarial soundness and of solvency espoused by Dorrance C. Bronson in his book, _Concepts of Actuarial Soundness in Pension Plans_:[4]

> An actuarially sound plan is one where the employer is well informed as to the future cost potential and arranges for meeting those costs through a trust fund or insured contract on a scientific, orderly program of funding under which, should the plan terminate at any time, the then pensioners would be secure in

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[4]See Chapter X of Bronson's text, particularly pages 171-174 from which these quotations are taken.

their pensions and the then active employees would find an equity in the fund assets commensurate with their accrued pensions for service from the plan's inception up to the date of termination of plan. Note that this criterion would admit of a long time before all the original past service credits reach a funded condition, but the asymptote for the funded ratio is 100 per cent and not something less. Note further, that this definition is tied in with a presumption of the plan's termination...[5]

Solvency might be said to obtain when the fund or contract has the ability to pay off, or firmly arrange for, all these "just debts" (vested benefits for the retired, eligible retirees, and long service participants) forthwith, if called upon to do so. Under this idea of solvency it becomes tantamount to a funded ratio which has reached a magnitude such the termination of plan could result in a pay-off of at least the minimum intended promises held forth in the language of the plan.....[6] Solvency could be reached and maintained at a funded ratio below 100 per cent; a fully conservative view of actuarial soundness would require a funding program at least asymptotic to 100 per cent.[7]

After two years of study on the problem of pension termination and its crushing, twisting effects on expectancies, this author must admit that his strongest impression is one of the need for solvency of at least earned benefits or concurrency of vested promises and funding efforts.

D. Concluding Thoughts On Pension Drafting Detail

The guidelines above require administrative detailing to be useful, and the elements of the following subsections reflect the conclusions drawn at the end of earlier chapters.

1. Pension Documents.

Guidelines for a pension agreement must affect the inter-

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[5] *Ibid.*, p. 171.

[6] *Ibid.*, p. 172.

[7] *Ibid.*, p. 173.

relationship of labor contract, pension plan, administrative powers of discretion, and any negotiated terminal settlement.[8] It is natural that the interested attorneys would wish to rely on broad powers of amendment in order to meet the unforeseen or to correct difficult non-concurrencies in these agreements. Still, this dependency may lead to almost no provision for termination of the plan, as termination implies such drastic turnabout that only an amendment would be appropriate. Eventually settlement by amendment becomes contingent on a mosaic of bargaining issues related to a difficult terminal labor situation. As negotiators take the offensive, pension administrators take the defensive ignoring basic pension values to pursue that which falls within basic contract language or easy bargaining accord. Unless adequate powers for pension termination are provided within the plan from the start, the result is unnecessary rigidity, despite apparent amendment powers, in the documentary structure surrounding the pension agreement.

The wage settlement should recognize earned pension benefits as wages and past service benefits as gratuities, to provide a legal basis for enforcing minimum funding requirements. In addition, the use of surplus notes or a guaranty by the company in lieu of immediate cash should be subject to certain restrictions established in the general labor agreement. Where the labor agreement calls for creation

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[8]For example, seniority may be defined within the labor agreement, then used to measure the life-span of accumulated pension credits for the unemployed individual subject to the pension plan, used as a unit for proration and distribution in a negotiated settlement, and appear often as the issue submitted for administrative adjudication in the collective bargaining machinery.

of a joint administrative board, it should grant the board special discretionary powers and time to act after termination is in process to bring about an orderly termination should it be required after expiration of the labor agreement, disbanding of the employment force, or another event in the business life of the employer. A negotiated terminal settlement would be unnecessary and thus removed as an issue in a terminal situation involving other matters in the labor agreement.

2. Vested and Contingent Pension Benefits.

Within the pension plan, the guidelines 1, 2, and 3 previously outlined would affect almost every type of provision. The dichotomy of past service credit and earned service credit would first lead to revision of benefit provisions. In the interest of keeping cost within economic feasibility, the pension planner would begin by determining the cost of desired earned service credits and any immediate commitments. Should any part of the allowable pension cost per year be left unallocated, this could be used for the past service liability which would then be tailored to fit the available cash. For example, the earned service credit might be $2.50 per month for each year of service while the past service credit might be no more than $1.00 per month for a maximum of 15 service year credits. Presumably, at the end of 15 years past service liability would be fully amortized and fully vested. By placing a 10 or 15 year cut-off date on credits given for past service, it is possible to place a limit on past service funding for immediate, qualified pensioners. The present practice of

prolonging the funding of past service liability for 30 or 40 years, and perhaps mushrooming the liability by renegotiating a single benefit formula, maintains indefinitely the potential inequity of reallocation of so-called "vested benefits" when a terminal distribution finds funds short of commitments and reverts to age rather than service as the key element of priority. In most cases the lack of financial balance or solvency of vested benefits in private pension programs is due to past service liability, and if this can be brought under control, a large portion of the termination problem in regard to competing claims on inadequate assets is simply removed as an area of issue. Moreover, recognition of which benefits were being funded in full as they accrued and which benefits would be amortized should all future contingencies permit, would go far to clarify the distinction in Chapter I between a vested pension right and a future pension expectancy.

3. Eligibility.

Directly related to vesting above and the cost of funding below, is the question of eligibility. Cost should be more a function of those who are not covered for the early years or voluntarily terminate, while involuntary termination itself as presently constituted is often involved in arbitrary selection of which participants are eligible for a terminal distribution. Where a pension interest vests upon involuntary termination of employment, regardless of other vesting service provisions, the entire question of eligibility for liquidating interests is removed. Such a provision prevents employee attrition to the benefit of remaining management participants as in Case #5,

over-funding of benefits as found in Cases #14 and #15, or arbitrary exclusion of those with seniority but with lay-off status as found in Finney vs. Cramet. However, vesting of benefits upon involuntary termination, for which there is a growing preference as indicated in the model plan in Case #28, is valueless unless these benefits are already funded. A company operating on a reduced scale is in no position to fund deferred vested benefits after these were vested with termination of part of the employment force. Vesting of earned benefits must be linked to immediate funding of deferred benefits at the expense of more contingent realization of separately funded past service benefits, which leads to a discussion of funding.

4. Funding and the Use of Surplus Notes.

The funding media need be little changed from current practices if the plan establishes a priority of benefits to be paid from existing assets giving preference to retirement, earned, and past service benefits in that order. Where retirement benefits are not insured, insurance should be required where funds at termination may not be adequate to survive an actuarial error as to the longevity of the annuitants. However, it might also be possible to establish two trusts, one for earned or immediate retirement benefits and one for past service liabilities, the latter a spill-over trust which might benefit from its own attrition assumption and its own speculative investment portfolio. Since these benefits would be understood to be contingent, the trustees could have more latitude in selecting equity investments for capital gain potential. The use of unit purchase

group annuity plans or other insured plans are just as suitable for the proposals as trusts. Of more concern here is the source of funds for any basic program, and the need for compromising cash needs of the pension fund and the pension sponsor.

Funding could lag current earned benefit costs where cash might be better retained in the business to finance growth under one condition:

> Where company net worth or working capital is increased at the expense of contributions to the pension plan, the pension funding media should acquire a claim in the amount of the deficit in funding of vested benefits against the net worth position of the company.

Such a claim has always been an anathema to corporate treasurers because of the damage it would do to credit ratings and debt capacity. Therefore it is proposed that the pension trust receive subordinated surplus notes, which would not interfere with trade credit and financing, but would give the pension trust some status in event of liquidation or merger. The interest on these surplus notes, set equal to the interest assumption of the actuarial formula, would best be made payable annually, lest the power of compound interest over the years put redemption of notes and accumulated interest out of reach. It would be desirable for those representing the pension trust to give these notes a serial redemption feature and a maximum aggregate limit of, say, 25% of employer net worth. These latter points are matters of individual preference; what is important is placing the pension administrators in a position to make a claim upon assets of the bankrupt, dissolving, or reorganizing employer. Suit for specific performance on a written note is far more feasible than any other theory of

recovery as demonstrated by the pension administrators in Case #8 who used a second mortgage on the plant to secure delinquent contributions.

Should it be necessary to accept a surplus note, it could be counted as an asset of the fund and included in tests of funding adequacy. Admittedly such a note would be worthless in event of total bankruptcy, but it is more likely that the larger firms will fall as a result of technical insolvency than complete bankruptcy. Including the notes which appear collectible in fund assets will then permit a measure of solvency as defined by Dorrance Bronson. A conservative approach, consistent with de-emphasis of past service, would be to allocate as many of the surplus notes to the past service account as possible as it is the intent of this account to accept the risks of future business success.

The solvency of the plan would be readily demonstrable in its accounting reports to participants. While the actuarial assumptions implicit in a statement of retirement, earned, and past service pension liabilities might prove to be in error over the years, a statement for any one day would indicate the degree of solvency for each of the vested benefit groups, and the degree to which any surplus could spill over to the benefit of past service liability. Funding ratios in gross would then be equal to the funding ratio for any individual claim and would not obscure the effect of redistribution in favor of age that is hidden in most present terminal agreements. Present systems of reporting funding ratios are meaningless to the individual, but such an improvement in reporting forms still leaves the problem of explaining actuarial soundness of the measure of

liability. More understandable annual reports will go far to make participants aware of the contingencies implicit in their pension plan and of their interest in continuity of business operations. Awareness of the transitory nature of employment will mitigate the trauma of involuntary termination as well as encourage greater labor-management cooperation to prevent such situations.

5. Limits of Liability.

The network of vesting in funding arrangements above are inherently a method to circumvent the shield of disclaimers that now exist in the typical pension agreement, for it is not reasonable to expect that the employer would expose himself to any indeterminate liability. The arrangements proposed distribute economic risks of business continuity among the parties while retention of the various limits of liability within the pension agreement leaves the present or future participants the risk of adverse investment experience, actuarial error, or misappropriation of funds. Pension administrators are in a position to control these risks or shift them with the aid of dishonesty bond coverage and the use of insured policy or deposit administration plans. In this manner an element of security through combination and diversification remains with the pension plan to distinguish it from a profit sharing plan, though admittedly the difference between these two media is narrowed to the degree that pension benefits are funded as earned and vested with individuals at that time or at termination of employment.

6. The Nature of Terminal Distribution.

In all cases of pension termination decisions have to be made as to the amount, form, and timing of distribution of individual terminal shares. As illustrated by Cases #5 and #6, among others, the preference of participants is for cash although social policy might prefer deferred benefits. The choice is first dependent on the amounts of the present interest of each participant, and although efforts have been made to fund vested benefits adequately, the amount of each terminal share can vary greatly.

Assuming there have been no losses to segregated pension assets, the retired individual could recover the value of a fully funded annuity. The active employee could recover presently or on a deferred basis the value of his earned pension service benefits, and a share of funds available for any accrued past service benefits. Any shortage of funds for the last account can be easily anticipated by a provision for pro-ration of such funds as are available according to a base which represents actuarial shares (to be concurrent with funding formula) or a weighted distribution by years of service, depending on preference of the plan's draftsmen. Should financial losses to the segregated fund occur net of all valid and collectible guaranties of retirement benefits or surplus notes for future benefits, additional provision for proration is necessary. First priority of the three segregated interests would be maintained. After satisfaction of retirement commitments, remaining funds for earned service credits would be allocated on an actuarial[9] basis and divided among all

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[9]Actuarial proration means that existing funds will be

eligible participants. Past service credits, if any funds remained, would be pro-rated in the same manner. This priority system illustrates that although service benefits are segregated for purposes of funding and distribution, the assets themselves remain available to support each type benefit class in order of their social and legal value.

The form of a terminal distribution as cash or an agreement for deferred income can be related in part to administrative discretion as to individual needs at the time of unemployment and in part to the overall labor contract framework. Some situations offer the terminated employee more alternative cash severance compensation than others, depending on available severance pay, unemployment compensation, or supplementary unemployment benefits. While the company may wish to place a ceiling on a maximum cash payment and a minimum on a monthly deferred annuity, the pension administrator or company personnel officer should be given enough discretionary power to tailor a settlement to the financial needs of the former employee whose services were terminated in response to business economies. This kind of counseling can be feasible, valuable, and consistent with previous conclusions in this study that the average participant is poorly informed as to his financial alternatives in the face of economic dislocation.

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apportioned according to the ratio of the present actuarial value of deferred benefits of the individual to the sum of all present actuarial value interests of the group. This approach favors the older worker without excluding any vested worker entirely.

Timing of a terminal distribution is closely related to the form of the distribution in one sense, i.e., cash vis-a-vis deferred annuity, and is a matter of administrative power in another sense. The latter is our concern here. Provision must be made to provide for continuity of administration following automatic termination as seen in Chapter V during the process of liquidation and for continuity of the investment and distribution function after designation of individual interests. The administrators should be given power to seek professional consulting help, competitive bids, or expert legal assistance at the expense of the employer so that the delicate balance between vested benefits and available funds is not disturbed. The cost of this outside counsel should be charged to the employer, within some limit, to protect pension plan participants against the frictional cost of involuntary termination and to place the burden on those having the power to hire and fire. The employer should further be charged with the cost of collecting surplus notes, past due contributions, or delinquent benefit payments where the administrators or the participants must seek legal or court support for their claim.

7. Control of Administrative Decision-Making.

Review of available case experience creates no strong impression as to a preference to control termination by means of amendment as necessary or by extension of discretionary powers to the pension administrator. The principal objective of most amendments to existing termination provisions was to make possible a previously agreed on settlement contract which attempted to resolve questions of detail left unanswered by the original pension agreement. Employers often

used this opportunity to trade some small concessions or additional contributions to the pension plan for a release from further possible liability due to seniority rights growing out of existing labor contracts. In several cases in the early years of industrial exodus from Michigan, before courts had indicated the value of seniority rights, union leaders traded away these rights to salvage a portion of "vested" pension interests. With vested benefits funded, the unions could push more strongly for a significant contribution to past service liability or pressure the relocating employer by calling all surplus notes. Union management bargaining power would also be stronger because their position with rank and file members would not be undermined by discovery that vested benefits might not be collectible and that service time might not warrant any share of the pension fund. The need for prolonging administrative powers, proration formulae, or claim priorities would be obviated by the general pension proposals above. The employer who still needs opportunity to extinguish latent seniority claims on his future operation in event of full termination of the plan might offer to contribute something towards unfunded past service liability or to redefine what constituted an early retirement as distinct from a severance so that his older workers might receive full value for past service liability and hence leave the work force. Moreover, the basic equity of the proposal to fund benefits separately would seem to forestall much clamor for amendment at the time of distribution at full termination; amendment would lack constituent support in cases of individual involuntary termination. Therefore nothing would be jeopardized by preserving full powers of amendment in the off

chance that the future might uncover some hitch in the plan that might best be rewritten. Indeed, to suggest otherwise would forever discourage the legal profession from leaving their boilerplate and adopting the gist of these proposals.

E. Feasibility Of Split Funding Vesting

The suggestion to segregate past service credit benefits is really no more than an effort to relate pension promises to immediate intentions in regard to funding these promises. It assigns to the annual contribution the same priorities as the actuary of the Internal Revenue Service when computing liabilities, i.e., current pensions, earned benefits, interest on past service liability, and lastly, amortization of this liability.

A firm tie between the pension promise and the funding promise, however, may be too revealing for both labor and management where appearances may be as important as facts. Management of both sides might lose the prospective goodwill of prospective benefit schedules which anticipate high attrition among non-vested participants in order to claim actuarial soundness. Were the pension plan to promise only the small annual increment of vested deferred pension benefits which could be immediately funded for all rather than the minority expected to qualify, participants would lose interest and both business and social motivation purposes might be thwarted. Older firms first initiating a pension might find past service liability too dominant a feature to slight as the split plan fund does.

The newer firm with little past service liability to recognize

and much time to amortize such liability as there may be might adapt the system, but otherwise the proposals here would meet with little voluntary adaptation. However, it could be argued that the Internal Revenue Service should require vesting of earned benefits in event of involuntary termination to prevent funds from accruing directly or indirectly to the tax payer paying the pension cost. As the law stands now, pension resources need not vest until the plan is closed-out, giving management participants an opportunity to consciously redistribute resources to insiders by dropping non-vested participants from employment prior to termination. Even where management is not a participant employment attrition could be used to create a plan without beneficiaries, which could be dissolved and its assets returned to the company as "actuarial error," a capital gain return. Therefore, vesting in event of involuntary termination of employment for the individual seems consistent with IRS standards for tax qualifications, standards intended to prevent subversion of taxes and social objectives. At this date, such a requirement would be the only method with which to introduce the system extensively, and it is not certain that the clarification of real benefits relative to resources would do the private pension movement much good.

F. <u>The Alternative--A Legal Patchwork</u>

As an alternative to redressing present pension contracts to bring funded benefits and vested benefits into balance and solvency, one might just tinker with the clauses which define, administer, and precipitate termination of plan or employment. A patchwork approach

to technical flaws of pension contracts is implicit in the conclusions of Chapters III-VII. Some shading of typical priority of distribution formula and more precision in the definition of automatic full or partial termination would go far to create greater equity for the group although the individual might still suffer some neglect.

The following suggestions and caveats are brief because the legal background of the researcher is limited, and are offered even though it is recognized that it is difficult to consider a single provision independently from the full legal contract. However, to align customary drafting practice more closely with the theory of allocation of risk of pension contingencies, one or more of the following might be consistent with contemporary funding practices:

1. Provision for automatic termination could not only include the usual recognition of legal endings of a business entity but also anticipate geographic, managerial, or functional close-outs.

2. Provisions could be made for a partial termination where distribution is made to individual members just as though there were a full termination and proration according to some priority of claim on liquidation assets.

3. In lieu of early individual vesting, provision could be made for some terminal severance award in event of involuntary termination without partial termination or without receipt of some deferred benefit. Wherever possible the deferred benefit might be preferred, where it is economically significant, to a cash payout.

4. For all purposes of terminal distribution the deferred benefit should be favored so that all participants face the risks of time more or less equally, but the administrators might be given some discretionary power for cash awards where the total welfare plan makes little other provisions for involuntary unemployment and final discharge.

5. Given agreement on priorities of claim, provisions should be made from the start for proration of inadequate funds within various classes of priority. Early decision on this point

will force management and labor to make explicit their view of the pension plan as primarily a social support for the older worker or a business incentive for the future employee. This is the choice hidden in a proration which favors age or service.

6. The issue of age and service is also obscured in provisions outlining eligibility for vested benefits and conditions precedent to receiving some benefit from the pension program. The philosophy behind the method of proration should be concurrent with that of basic provisions for eligibility and vesting as the word is presently used.

7. Provision should be made for continuity of administrative power, following a condition precedent to automatic full or partial termination. Moreover, these powers should be broadened for period of termination so that administrators would be encouraged to make imaginative use of such things as competitive bidding, counseling, investment side funds, and so on.

8. Each party to administrative duties should be expressly liable for their own clerical oversights and location efforts, but with a contractual statute of limitations of, perhaps, two years. Certainly the surety industry could provide a bond naming a trustee as representative for whom it may concern for the two-year period following extinction of the pension trust, the employer, and the administrative machinery upon final termination.

9. As part of provision for increased discretionary power for pension administrators during the terminal process, these individuals should be freed of personal liability for errors in judgement or errors in apportionment, the latter picked up in the bond proposed above.

10. Some relief might be instituted for the air-tight network of hold-harmless clauses that pervade pension documents. The employer should at least be liable for pension due those on retirement or eligible for retirement, although it can be left open for individual parties to decide if this guarantee should be extended to early retirement recipients until they reach 60, 62, or 65.

Any one of these guidelines would have changed the course of one or more cases reviewed in Chapters V, VI and VII. For example, provision for automatic termination, as suggested in the first item, would have eliminated the conflict in Case #7 where corporate stock was

sold to transfer management to a buyer interested in a tax deficit shelter rather than sustained business operation. It would reduce the need to depend on management good faith as in Case #29, where a change in business function from foundry to electronics work meant a turnover of employees without a break in operations, change in management, or relocation. The second guideline would be appropriate for multi-plant situations where a single plant shutdown might involve employees of such number that deferred vested termination benefits were not and could not be funded. Instead, the plan could anticipate a distribution as illustrated by the Auto Lite situation in Case #31, where each priority group interest was determined for the national group before a local member's share in a partial terminal liquidation was determined.

As an alternative to termination procedures or liberal vesting, guideline #3 would create severance awards, as discussed for the big steel companies in Chapter VII. Such severance awards could be treated as liquidated damages for loss of pension covered employment. Such awards would make it more difficult for small plans to arrive at a position of over-funding due to attrition from lay-off prior to full closing, as illustrated in Cases #15-#18. The preference for deferred benefits of #4 assumes that controls on cash payments will not be so restrictive that minimal pensions become payable regardless of whether or not the amount will be of significance in later pension years. Guidelines #5 and #6 reflect an impression received from the cases that age oriented priority coupled with actuarial prorations of present value of pension interest unintentionally gave too great a preference to age as compared to service.

Since it is likely that if termination occurs, assets will not meet existing liabilities, it would seem that all pension programs should contain a provision for a formula for proration as well as reference to the term "proration" alone. Guideline #7 is the result of those many cases which indicated termination problem was complicated by inflexibility of administrative power or by disillusion of decision making power before the termination process was complete. As a corollary of greater administrative power for discretionary and imaginative termination decisions, the pension document must remove the threat of liability which might inhibit these actions, the object of guideline #9. However, to avoid the ill-feeling of the classic comedy of errors in the termination field, detailed in Case #11, each party should be responsible for his administrative mistakes which cost eligible participants some part of their benefit. Where the employer shall be extinguished as a legal entity, the accounting records might be surrendered to a bonding company which might handle claims like a title insurance company for a stated period before all settlements were final. The name of the bonding company should be made a matter of record in federal disclosure accounts so that would-be beneficiaries would have an immediate contact without expensive locational inquiries.

At the same time, recognition of the difference between earned and past service benefits should also distinguish between limits of liability for discretionary acts and any limits on liability of the pension sponsor for existing pension commitments. A pension sponsor should never be allowed to move away from his pension commitments to those over 60. Not only does it seem unethical not to fund a pension

for an old employee who has been led to expect a pension, but also it tends to undermine public confidence in all private pensions to the detriment of business management generally. If a business cannot afford to fund or guarantee a pension, it should not infer it has capacity to grant a pension, possibly dulling employee initiative to provide for themselves. To protect late claimants from complete foreclosure of their pention interests, there might be devised an insurance for no more than two years' coverage which would indemnify participants for losses arising out of clerical error before or during terminal administration.

Pension technicians would be better able to adapt these general provisions to particular plans. Perhaps their most important purpose as part of these conclusions is to underscore that the typical pension agreement is not generally written to the risks implicit in a long term contract. Life insurance has its nonforfeiture rights aligned with actuarial reserves; mortgages attempt to equate amortization with capacity to pay, and rate of depreciation for collateral values over the years. Long term commercial leases are geared to all manner of future contingencies which might disrupt the ordinary course of events. But pension contracts may have been slanted to minimize current costs of the employer, to maximize the appearance of negotiating prowess for labor representatives, and to meet the minimum of IRS concepts of permanence and social value so that the implicit contingencies have

been submerged and anticipated most informally.

G. Conclusions on Frequency and Severity of Pension Terminations

While pension termination appears to be an isolated phenomenon for a particular community or a pension professional, the situation in the aggregate for the nation as a whole has impressive proportions. Even from the meagre data available from the IRS in regard to qualified terminations cases handled each quarter, it is possible to conclude that termination lag originations but compound on a cumulative basis, with 10% of all plans initiated terminating within seven and one-half years. Although the actual number varies with business conditions, annual labor-management preferences for profit sharing or other fringe benefits plans, about 1% of all private pension plans in force at the beginning of each year will terminate in full or in part by the close of the year.

There are some indications that terminations occur more frequently among smaller pension programs, and in recent years most pension activity has centered in programs designed for the small employer or group. The present trend heralds an increased rate of termination in the near future. It follows that the inadequacies of the typical pension program in regard to termination will be in the spotlight ever more frequently.

Such evidence as there is in state and federal sources suggests that slightly more than 50% of all recorded terminations can be attributed to business failure, liquidation, or migration. And if a speculative extrapolation, such as found in Chapter II, is permitted,

30,000 would-be pensioners experience termination of their pension plan each year for these reasons. Since the majority of these participants are in the 25-54 age group and since terminal distributions are seldom made to those below the age of 55, most never realize anything from their expectancy, small as it might have been.

Unfortunately, federal and state data do even less to provide statistical measures of severity in terms of vested benefits, participants dropped from the program, or pensioners suffering a reduced benefit. Asset values and actuarial liabilities are never reported by the federal data sources. A more accurate measure of severity would need to include the losses of that much greater group who lose their employment unwillingly and unwittingly due to the adjustments of the system.

The statistical view of termination of pension programs or individual pension hopes is impressionistic at best, for there is no data available. The criticism of available sources in Chapter II merits constructive suggestions which follow in comment on avenues for continued study of pension problems.

## H. Some Additional Conclusions on Pertinent Institutional Factors

Despite the interest of this monograph in the problems of the individual pension plan confronted with termination of plan or participant, brief comment on the customs, agencies, and allied welfare problems is warranted. Directly and indirectly pension termination is affected by the attitudes of those at interest, the law of the land, the federal tax structure, small-employer pension programs, and unemployment

compensation. In addition, mention should be made of several devices proposed for termination problems, specifically, a national registry of vested interests and a pension fund guaranty agency.

1. Attitudes.

The attitude common to all parties at interest is that pension termination is the exception to the rule and can be dealt with on a case basis as it becomes necessary. But if one looks at the problem as one of termination of pension expectations for the participant, either because a job is supplemented or the pension plan itself is cut short, then termination is an ever present phenomenon. As such it should be treated with the same administrative efficiency as entry into the plan, retirement, or employee turnover for reasons other than involuntary unemployment. Organized labor has most at stake in making this view more common, although recognition of this view by the sponsor of the non-contributory, non-negotiated pension would seem to be an appropriate measure of the "moral obligation" under which he labors behind a wall of hold-harmless clauses.

Technical proficiency in handling the pension expectations of those facing involuntary unemployment will come quickly when the parties of interest have come to an agreement on how each shall share the uncertainties of enterprise and employment insofar as pension plans are concerned. Greater technical proficiency in providing for continuity or portability of pension expectations is well within reach when organized labor chooses to press these issues at the bargaining table. This power has been amply proven by the gains in provisions

for involuntary termination achieved by the steel workers and the auto workers since the late 1950's, when their unions were first hurt deeply by automation and plant relocation. The bigger national unions have had the technical talent to respond to the backlash of illusory plans for which benefits and funding were out of balance, in which individual interests were submerged to less refined class objectives, and with which an employer could escape only implied obligations. Smaller locals without benefit of national advisory staffs are still making the old mistakes, and salaried personnel covered under non-negotiated plans are not sufficiently aware of the problem to press for reform. One senses that the pace for the non-negotiated plan lags improvements won at the bargaining table for the negotiated plan. Technical improvements must therefore depend on better informed, more aggressive participants, not the technicians who can draft what participants desire, and this leads to the additional conclusions in the earlier part of this chapter on finding better ways to make pension participants informed on their retirement expectations.

Little comment can be made on the role of pension professionals in terminal situations, for insurance companies, pension consultants, and especially the banks, have often succeeded in remaining aloof from policy questions of vesting, severance, and termination. The trust companies have been most successful in isolating themselves from termination problems, barring those trustees which serve the smaller pension appointments and compete by offering a variety of administrative services. Where the insurance company is the funding media there may also be exposure to the greater termination frequency of smaller

clients, but insurance companies have achieved the most uniform techniques for administering terminal situations. Their legal departments are more practiced in the art of anticipating every future contingency and of standardization. Insurance companies are beginning to respond more favorably to past frictions in the termination process connected with fixed termination fees and with variances between guaranteed group entry rates and specific, competitively bid terminal group rates. The ability of pension consultants, actuaries, and lawyers to make their more constructive thoughts on termination change attitudes of the decision makers has probably been spotty. There has been a tendency for each new plan to read like the last one. More recently the best in each profession have gone beyond catering to their managerial clients, to introduce various plan improvements. Of particular interest has been the emphasis placed on more informative, educational annual reports to plan members as drafted by the pension consultants. As noted earlier, the recommendation to report funding ratios for retirement, earned, and past service benefits separately would advance the trend to clarify annual reports of assets and liabilities. Moreover, discussion of the contingencies and distribution of risk implicit in various land provisions would improve the incentive values of the pension by demarcating employee interests in employer success.

2. The Law of the Land.

A basic premise of this study has been that the courts can enforce any legal right in property or contract which can be shown to

exist and which has been injured by one party or another. The need is not for further regulation but rather more careful definition of such rights in the documents which give rise to their creation. The only exception to this premise in retrospect would seem to be the desirability of updating federal bankruptcy laws to recognize that the contributions to the pension fund are a form of wage expense to the employer and entitled to the same priorities and limits of liability as are cash wages. Of course, the same result could obtain where labor agreement recognized some part of the funding obligation as wages or surplus notes were used to cover delinquent contributions. But then, not all plans will be instantly modified in response to this study.

3. Tax Law Comment.

Similarly, it is difficult to criticize the federal tax structure as it affects pensions, and more narrowly, as it affects the consequences of pension termination. It is designed to discourage the use of pension funding devices as a means of securing a tax shelter for a minority of "insiders." However, one may question the wisdom of reducing allowable tax-free contributions by the amount of any reduction in past service liability because or involuntary termination of one or more of the work force. It would seem that the social desirability of encouraging as much funding of a pension plan as rapidly as possible might offset the desire to spread past service funding over at least ten years, particularly for those firms going into decline, and thereby suggesting that the pension expectations of

all, either those actively employed or those with deferred interests, may be in jeopardy. With separation of funds for the earned and past service pension liabilities, and with earned benefits vested, a reduction in past service liability due to the termination of employment of anyone with past service benefits should only result in a reduction of tax deductible contributions to the past service liability account. Voluntary termination before earned service credits became fully vested would similarly affect only allowable contributions to the earned service fund. Under the present typical vesting and funding arrangement the Internal Revenue Bureau can be suspicious, with reason, that termination of employees with nonvested pension interests will convert the pension plan into a "tontine" arrangement to the benefit of management. The proposal to create separate funds within the pension program avoids this possibility by full vesting of earned service credits at termination or after a certain service time and by provision for progressive vesting and prorata liquidation of funds available for past service liability so that those who remain with the plan are no better off than before their associates were dropped.

The tax law might also consider giving a cash liquidation of a pension interest of less than $1,000 exemption from income or capital gains taxation. The rationale of this exemption would be that the cash represented liquidated damages for loss of the long term pension expectation, made impossible by involuntary termination, and that cash was an involuntary conversion of the pension interest caused by the fact that it would produce an annuity too small to justify purchase of an annuity with expense of insurance company administration.

4. Small Employer Pension Programs.

There is evidence[10] that the increase in the number of qualified pension entries is occurring among smaller firms. There is further evidence[11] that these smaller firms experience a higher frequency of pension termination, that termination frequency may be directly inverse to the number covered under these pension agreements. It is suggested that these smaller firms have more opportunity to participate in regional multiple-employer plans which offer each participant several scales of benefit levels so that each firm may purchase only what it can afford or justify in relation to other wage costs. These plans would offer the scale in terms of assets and participants to justify competent professional management, investment diversification, centralized accounting and registration, continuity, and at least portability of earned, vested, but deferred benefits for employees of participating firms. This study does not pretend to advance the cause of multiple-employer plans because they have not been the province of this research. Instead we can only suggest this alternative to the situation which now exists among small employers whose pension plans can do little more than create an illusion of permanence and security while holding out the promise of past service benefits funded over a most unlikely firm life span. How can one secure the retirement of an employee who may live too long when the

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[10] For example, in Chapter II it was shown that the average number of participants for each new plan initiated is falling sharply.

[11] For example, the New York Banking Study of pension trusts in that state indicated that pension terminations involved only a fractional percentage of total assets although a good percentage in terms of pension plan numbers.

firm may die too soon? Of course, illusion can be dispelled where management is willing to fund as benefits are earned or retirement is granted--and past service liability is ignored or recognized as a speculative, long term bonus.

5. Forms of Unemployment Compensation.

Termination of pension expectations is only one aspect of the problem of labor mobility and unemployment dislocation, and perhaps a peripheral problem at that. However, if private pension support is to be a major factor in providing for the retired worker in future years, then benefits earned today, funded and deferred must not be sapped periodically by temporary problems of unemployment. The temptation to use pension funds for cash distributions to those temporarily unemployed can only lead in future years to terrible deficits in retirement income needs that will last for many more years than the temporary crisis of job relocation. If the funds of a pension program are not to be misappropriated by those who would obscure the true costs of unemployment, there must be other programs focused directly on the needs of the worker in transition from one job to another as a result of economic upset. At one point in this study it was suggested that equity between the younger and older worker would have to be judged on the basis of benefits available to each from the total welfare program including medical, group life insurance, supplementary unemployment payments and so on. In much the same way dedication of pension funds to deferred pensions only must be judged in reference to all sources of income assistance for those inadvertently facing unemployment. Unemployment

compensation in the face of automation or business relocation is a topical issue of national concern, an issue fraught with its own problems of inequity between employer and employee, among firms, and among the several states, a condition which indirectly and adversely affects terminal pension expectations. The greater social purpose of creating funded but deferred pension benefits for all must sometimes be bent to provide cash for the immediate needs of the unemployed. However, where the plan is to continue it would seem best to provide a deferred pension in every case unless the employee to be terminated made application for cash and showed cause why a cash payment was imperative. Even a pension value too small to be accepted by an insurance company for a deferred annuity might do for a useful single premium life insurance or endowment policy.

There is also a question as to whether a deferred annuity should be insured or included among the obligations of a pension investment trust. Where funds are adequate for benefits, the insured plan would do most to protect the beneficiary from investment and actuarial risks of the small pension trust. Where benefits are inadequately funded, cash flow analysis and the economic prognosis might favor equity investment for appreciation in excess of compound interest returns. Certainly, administrators should be given some indication of preference as to cash or pension distributions, insured or trusteed deferred pensions, competitive single premium group bidding or individual contract purchase, preference, that is, of parties to the pension agreement. Too often administrators serve more as liquidators rather than as representatives of parties who set

out to provide pension support for retired employees. Form of distribution is therefore a reflection of philosophy in part, and pragmatic adjustment to cash needs of the moment.

6. A Registry for Vested Benefits.

Suggestions have been made by many interested groups that there be a national registry of vested pension interests accumulated over the years by individual workers wherever they may have been employed. As retirement nears, the individual could use the services of the registry to locate and secure such pension expectations as might be realized. Of various proposals there is one which suggests that the Social Security Administration be empowered to enter basic minimum information on vested pension interests on individual permanent OAS records. Such information could be tied to existing computer records to be discovered by the uninformed pension participant when he applied for social security benefits. Presumably if the pensioner knew where his interest lay with the help of OAS records, he would address himself to the problem of application and collection of benefits. Such a system would take advantage of an existing institution which has almost universal public recognition and association with retirement income problems, aggressive information dissemination programs, and an extensive office network of claims counselors. A channel of communication and information already exists in the periodic filing of OAS withholding and contribution forms by employers. However, a government step in this direction is stayed by suspicion of many among management and pension professionals that such a registry would be the first move

in a calculated plan by the federal government to encroach on and eventually to absorb the private pension institution. At the same time, no one has rushed to create a privately operated central depository for this kind of information. Either there is no need for this kind of service or seeming disinterest is prompted by some other ulterior thought. Insurance, trust,and company officials often state that the problem of locating and identifying the pension participants in future years will be a major administrative problem, involving far more money than is left unclaimed in banks every year. United States urban population is commonly regarded as the most geographically mobile of any in the world, and for this reason as well as to facilitate mobility of capital and labor, greater stress is being placed on creating vested-deferred or portable pension benefits. Who can estimate the impact of these policies on population location over a thirty-year span and the implication of the problems in bringing together a pension trustee and former pension plan participants with vested interests? What possible objection can there be to anticipating these future needs with an adequate record and identification system compiled as the facts become known rather than assembled retrospectively? It would seem the principal objection may be the danger in assembly of evidence on a national scale of the great discrepancy between pension expectations and actual vested retirement contracts, the latter still contingent on proper funding. Anything which could contribute to public awareness of the great difference between conditional anticipations and funded, deferred income might damage the public image of the private pension institution. Either

expensive amendments to existing plans would be advanced in response to this disillusionment or political pressure would force expansion of the social security solution to retirement income. A registry for vested benefits must apparently wait on more widespread distribution of vested, funded benefits. These in turn must be made economically feasible and meaningful by dissociating earned and funded benefits from gratuitous past service benefits, which are not always financially feasible. After all, the latter need be only a temporary problem that will resolve itself in a generation if available funds can first be directed toward financing the accumulation of earned benefits, leaving amortization of the balance or expiration of the right to the contingencies of economic dynamics.

7. A Guaranty Agency to Secure Pension Funds From Terminal Losses.

Heavy losses of both vested and non-vested pension expectations suffered by locals of the bigger industrial unions with the advent of frequent industrial relocations and consolidations has prompted sporadic discussions of creating "a guaranty agency" to "insure" against total losses. The roll of the guarantor would be to insure some portion of the difference between pension promises and actual funding efforts in event that termination in some form exposed and fixed the amount of this flaw in expectations. The hidden assumption of advocates of a guaranty plan is that the shortage would have been funded in a matter of time, but that economic circumstances cut short the passage of time and contributions for a few plans. Parallels are drawn by these advocates between a pension guaranty and a mortgage guaranty

which insures the lender against default by the borrower who is also amortizing a fixed obligation over time. This borrower will fail to pay when he loses his job or the value of the property pledged as collateral falls below the outstanding loan balance. Since both these contingencies originate in the business cycle, their argument goes, why not guaranty a pension trust for failure of the employer to amortize his obligation because of economic perils?

However, upon closer examination the comparison breaks down because in the case of pension liability there is no collateral pledge of property which can be forfeited as in the case of a residential mortgage and employer liability is strictly limited. The mortgage guarantor is insuring the difference between foreclosure claim and property salvage values. Moreover, the guarantor is exposed to only a few small losses as a result of employee discharge from any one plant in any one community, while a pension guarantor would be liable to all employees of the firm so affected, thus facing low dispersion of risk and high severity of loss at the same time. And while little is known about mortgage foreclosure losses for actuarial determination of a charge for the guaranty, this study has indicated almost nothing is known of the frequency and severity of pension losses due to the economic threats to employment or plan combined.

Assuming a guarantor device were possible, however, what would constitute a frequency and severity of loss expectation with which an adequate and equitable premium charge might be calculated? First, the actuary would be confronted with the problem of defining which losses he was trying to insure. Would the loss be just a shortage or would

it be necessary to distinguish between investment losses, operational inefficiency, or actual misappropriation of funds--all of which may have contributed to the shortage which appears at termination, the fortuitous event which triggers the process of indemnity. The prospective guarantor would quickly come to the view that there must be some related decisions on which parties bear which economic risks and which of these risks could be insured or controlled. Presumably, the guarantor would have to isolate that portion of any shortage which was not due to malfeasance, actuarial optimism, or operational inefficiency.

If the guarantor could isolate a measure of the loss which he expected to insure, it would then be necessary to relate the measure to some frequency and severity distribution, a most improbable incidence prediction even for crude rate making purposes in light of our present storehouse of available information. The problem is compounded by the necessity to relate frequency and severity to a common unit of exposure, regional economic cycles, and selected underwriting criteria. These latter might include size of pension plan assets and a variety of actuarial elements in its funding plan. Moreover, underwriting would have to make allowances for the impact of priority, proration, and co-insurance in measuring possible severity of loss or indeed, even the maximum exposure to loss. To control adverse selection, such coverage might be made mandatory, with the result that, like FDIC insurance, strong members of the group would be forced to contribute to building reserves for certain losses among the weaker members of the group, and unlike banking, there is only so much good

management could do to forestall termination of a plan or a job.

A guaranty agency without workable actuarial expectations would have little appeal to private capital financiers. Therefore, a guaranty device most certainly would be a government agency, and its uncertain income-loss expectation would need be supplemented by subsidies. What better entre could government have for encroachment and takeover of private pension terms and financing than to offer this kind of help? Even the pension novice can appreciate the political resistance such a proposal would engender. Although the guaranty agency, either public or private, cannot be completely dismissed in light of experiments with investment guaranty funds and with some state insurance company failure guaranty funds, immediate prospects are dim, and the alternative of real funding of earned benefits and realistic discounting of past service benefits seems to hold greater promise as a solution to termination losses of pension expectancies.

## I. Areas for Further Research

There is little about the problem of the termination process that can be quantified, but those subjects related to frequency or severity or dollars and cents which might benefit from numerical analysis fail for lack of data. There is little precise information on the frequency, severity, causes, and social significance of the occurrence of business mortality. Nor is much known of the relative importance of the various causes of employment termination. One is stunned by the inability of government agencies to marshal vast reservoirs of facts into informative arrays, a situation which is the

essence of much of the comment of Chapter II.

Research of pension termination would therefore best be served indirectly by efforts to the following ends by or for governmental agencies:

1. Design of a disclosure form for the Welfare and Pension Report Division of the Department of Labor Standards that would incorporate IRS data not related to income, terminal financial data necessary to purposes of the Disclosure Act, and a system of retrieval which would permit more useful research. Indeed, research from this information is likely to safeguard more pension rights in the long run than the existence of a depository of information solely for individual recourse in the event of possible financial jeopardy of a pension interest.

2. Design of an interim study of a sample of recent terminal pension situations to be executed by IRS with a special congressional grant in conjunction with Senate-House study of the need for revising federal Welfare and Pension Disclosure Report Forms.

3. Design of a uniform system of corporate or trade name registration at the state level to provide both the legal necessities of various state agencies and the grist for economic research on the life cycle and locational patterns of business enterprise.

Further study of the threat to pension expectations from the implicit contingencies of a long term program might begin with better information on the preferences of informed participants. Specifically the next step would be:

4. Field research of the understanding and misunderstanding of basic pension concepts by both employer and employee in order to discover their preferences as to the form of a pension program were they to understand its premises and conditions.

5. Field research of the most effective and efficient methods of better informing the pension plan participant as to the nature of a pension and the financial support which currently exists for his particular accrued benefits.

In the meantime some technical work could be advanced for the

development of the following devices:

6. Design of a performance bond which would transfer the risk of omitting a pension beneficiary in a terminal distribution by accident from the soon-to-be-dissolved administrative group to a surety or participating life insurance company.

7. Design of a registration agency within or without the Social Security System which would both trace lost participants with vested benefits and authenticate long-lost claimants by means of a positive identification, registration system using finger prints or some other medium.

The pension field of course remains a fertile ground for academic and legal research; the suggestions above are only those which would stem directly from the conclusions of this study.

J. A Closing Statement

In our view, the evidence to be found in law, in collected case situations, and in interview favors the validity of the original hypothesis. Pension plans and individual pension expectancies are terminated more often than their progenitors anticipate; scarce funds are often wasted, distributed inequitably, and sometimes diverted directly and unintentionally to the benefit of the employer. The cases included in this study would tend to suggest that inequity is often the result of technical mistakes which leave administrators without the necessary authority, instructions, or incentive to bring about the best results possible, in what must always be adverse circumstances for some--i.e., business failure, liquidation, or migration. Moreover, the pension participant is left without the technical necessities for protecting his own interests in event of the unforeseen. These technical flaws in the private pension movement at the point of its

weakest characteristic--the double-edged problem of continuity and portability. Nevertheless, there is no reason to give critics of the private pension movement the advantage of the discontent created by the inexplicable consequences of inept pension termination. The pension agreement can be more carefully tailored to delineate the economic risks accepted by each party, to fund those interests which are vested, and to inform participants more accurately on the nature of their various interests. Thus, it is hoped that the suggestions in this study may provoke thought on those technical improvements which could place pension expectancies in better relation to pension realizations, and which could strengthen the role of the private pension as a wage incentive. To demonstrate the social equity of the private system in this way would be no small contribution to efforts to blunt the arguments of those who favor welfarism and the extension of social service programs.

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# APPENDIXES

# APPENDIX I

## NUMBER OF PERSONS COVERED BY MAJOR PENSION AND RETIREMENTS PROGRAMS IN THE UNITED STATES
(000 Omitted)

| | Private Retirement Plans | | | Government Retirement Plans | | | | |
|---|---|---|---|---|---|---|---|---|
| | Insured | Non-insured | Total | Railroad Retirement | Federal Civilian Employees[a] | State and Local Employees | Total | Grand Total |
| 1950 Active | 2,605 | 7,200 | 9,805 | 1,494 | 1,699 | 2,600 | 5,793 | 15,598 |
| Pensioners | 150 | 300 | 450 | 251 | 157 | 254 | 662 | 1,112 |
| 1955 Active | 3,815 | 11,600 | 15,415 | 1,264 | 2,033 | 3,500 | 6,797 | 22,212 |
| Pensioners | 290 | 690 | 980 | 416 | 229 | 377 | 1,022 | 2,002 |
| 1956 Active | 4,065 | 12,800 | 16,865 | 1,201 | 2,033 | 3,800 | 7,034 | 23,899 |
| Pensioners | 320 | 770 | 1,090 | 437 | 249 | 418 | 1,104 | 2,194 |
| 1957 Active | 4,375 | 13,800 | 18,175 | 1,085 | 2,167 | 4,000 | 7,252 | 25,427 |
| Pensioners | 370 | 870 | 1,240 | 455 | 279 | 468 | 1,202 | 2,442 |
| 1958 Active | 4,500 | 14,500 | 19,000 | 971 | 2,140 | 4,200 | 7,311 | 26,311 |
| Pensioners | 430 | 970 | 1,400 | 476 | 315 | 512 | 1,303 | 2,703 |
| 1959 Active | 4,770 | 15,400 | 20,170 | 937 | 2,172 | 4,400 | 7,509 | 27,679 |
| Pensioners | 500 | 1,090 | 1,590 | 501 | 343 | 555 | 1,399 | 2,989 |
| 1960 Active | 4,935 | 16,700 | 21,635 | 862 | 2,188 | 4,500 | 7,550 | 29,185 |
| Pensioners | 540 | 1,240 | 1,780 | 541 | 369 | 585 | 1,495 | 3,275 |
| 1961 Active | 5,075 | 18,000 | 23,075 | 840 | 2,291[b] | 4,600 | 7,731 | 30,806 |
| Pensioners | 560 | 1,390 | 1,950 | 563 | 401[b] | 637 | 1,601 | 3,551 |

APPENDIX I (Continued)

NUMBER OF PERSONS COVERED BY MAJOR PENSION AND RETIREMENTS PROGRAMS IN THE UNITED STATES

[a]Includes members of the U. S. Civil Service Retirement System, the Foreign Service Retirement System, the Tennessee Valley Retirement System, and the Board of Governors' Plan of the Federal Reserve Board. In this analysis, members of the Retirement System of the Federal Reserve Banks are also included with Federal Civilian Employees.

[b]Estimated.

Sources: Railroad Retirement Board, Social Security Administration, other administrative agencies, and the Institute of Life Insurance. Pension and Profit Sharing Report, Volume XX, No. 8 (February, 1963), pp. 7 and 8.

# APPENDIX II

NOTE: The following schedules are the only portions of D-2 Annual Welfare and Pension Plan Reports which might suggest that there had been a partial termination, or that a full termination was imminent in the next period.

## EXHIBIT B-1

### SUMMARY STATEMENT OF ASSETS AND LIABILITIES[1]

As of ______________________________

______________________________
(Name of plan)

______________________________
(Address of plan's principal office)

### ASSETS[2]

| | Column (1) | Column (2) | Column[3] (3) |
|---|---|---|---|
| 1. Cash . . . . . . . . . . . . . . . . | | ------ | |
| 2. Bonds and debentures | | | |
| (a) Government obligations . . . . | ------ | | |
| (b) Nongovernment bonds . . . . . | ______ | | |
| (c) Total bonds and debentures . . | ------ | | ------ |
| 3. Stocks . . . . . . . . . . . . . . . . | | | |
| (a) Preferred . . . . . . . . . . . | ------ | | ------ |
| (b) Common . . . . . . . . . . . . . | ------ | | ------ |
| 4. Common trusts . . . . . . . . . . . | ------ | | |
| 5. Real estate loans and mortgages . | ------ | | |
| 6. Operated real estate . . . . . . . . | ------ | | |
| 7. Other investment assets . . . . . . | ______ | ______ | |
| 8. Accrued income receivable on investments . . . . . . . . . . . | | ------ | |
| 9. Prepaid expenses . . . . . . . . . . | | ------ | |

## APPENDIX II (continued)

| | Column (1) | Column (2) | Column (3) |
|---|---|---|---|
| 10. Other assets | | | |
| (a) -------------------- . . . . . . | ------ | | |
| (b) -------------------- . . . . . . | ------ | | |
| (c) -------------------- . . . . . . | ______ | ______ | |
| 11. Total assets . . . . . . . . . . . . | | ══════ | |

### LIABILITIES AND FUNDS

| | Column (1) | Column (2) | Column (3) |
|---|---|---|---|
| 12. Insurance and annuity premiums payable . . . . . . . . . . . . . . | ------ | | |
| 13. Reserve for unpaid claims (not covered by insurance) . . . . . . . | ------ | | |
| 14. Accounts payable . . . . . . . . . . . | ------ | | |
| 15. Accrued payrolls, taxes and other expenses . . . . . . . . . . . . . . | ______ | | |
| 16. Total liabilities . . . . . . . . . . | | ------ | |
| 17. Funds and reserves | | | |
| (a) Reserve for future benefits and expenses . . . . . . . . . . . . . | ------ | | |
| (b) ---------------------- . . . | ------ | | |
| (c) ---------------------- . . . | ______ | | |
| (d) Total funds and reserves . . . | | ______ | |
| 18. Total liabilities and funds . . . . | | ══════ | |

---

[1]Indicate accounting basis by check: Cash ( ) Accrual ( ). Plans on a cash basis should attach a statement of significant unrecorded assets and liabilities.

[2]The assets listed in this statement must be valued in column (1) on the basis regularly used in valuing investments held in the fund and reported to the U.S. Treasury Dept., or shall be valued at their aggregate cost or present value, whichever is lower, if such a statement is not so required to be filed with the U.S. Treasury Dept. (Act.sec. 7 (e) and (f) (1) (B)). State basis of determining the amount at which securities are carried and shown in column (1):---------------------------.

[3]If A(2) in item 13, PART III is checked "Yes," show in this column the cost or present value, whichever is lower, of investments summarized in lines 2c, 3a, and 3b, if such value differs from that reported in column (1).

APPENDIX II (continued)

EXHIBIT B-2

SUMMARY STATEMENT OF RECEIPTS AND DISBURSEMENTS

For year ending ------------------------------

-----------------------------------------------

(Name of plan)

-----------------------------------------------

(Address of plan's principal office)

RECEIPTS

| | | |
|---|---|---|
| 1. Contributions | | |
| (a) Employer . . . . . . . . . . . . . . . . . . . . | | ------ |
| (b) Employees . . . . . . . . . . . . . . . . . . . | | ------ |
| (c) Other (Specify) ---------------------- . . . | | ______ |
| 2. Interest, dividends, and other investment net income . . . . . . . . . . . . . . . . . . | | ------ |
| 3. Gain (or loss) from disposal of assets, net . . | | ------ |
| 4. Dividends and experience rating refunds from insurance companies . . . . . . . . . . . . . . | | ------ |
| 5. Other receipts | | |
| (a) ------------------------------ . . . . . . . . | ------ | |
| (b) ------------------------------ . . . . . . . . | ------ | |
| (c) ------------------------------ . . . . . . . . | ______ | ______ |
| 6. Total lines 1 to 5, inclusive . . . . . . . . . . | | ______ |

DISBURSEMENTS

| | | |
|---|---|---|
| 7. Insurance and annuity premiums paid to insurance companies for participants benefits . . . . . | | ------ |
| 8. Benefits provided other than through insurance carriers or other service organizations . . . | | ------ |
| 9. Administrative expenses | | |
| (a) Salaries (Schedule 1) . . . . . . . . . . . . . | ------ | |
| (b) Fees and commissions . . . . . . . . . . . . . . | ------ | |
| (c) Interest . . . . . . . . . . . . . . . . . . . . | ------ | |
| (d) Taxes . . . . . . . . . . . . . . . . . . . . . | ------ | |
| (e) Rent . . . . . . . . . . . . . . . . . . . . . . | ------ | |
| (f) Other administrative expenses . . . . . . . . | ------ | ------ |

## APPENDIX II (continued)

| Item | | |
|---|---|---|
| 10. Other disbursements | | |
| (a) ------------------------ . . . . . . . . . . | ------ | |
| (b) ------------------------ . . . . . . . . . . | ______ | ______ |
| 11. Total lines 7 to 10, inclusive . . . . . . . . . | | ______ |
| 12. Excess (deficiency) of receipts over disbursements (line 6, less line 11) . . . . . . . . . | | ______ |

### RECONCILIATION OF FUND BALANCES

| Item | | |
|---|---|---|
| 13. Fund balance at beginning of year . . . . . . . . | | ------ |
| 14. Excess (deficiency) of receipts over disbursements (line 12) . . . . . . . . . . . . . . . . . . | | ------ |
| 15. Other increases or decreases in funds | | |
| (a) Net increase or decrease by adjustment in asset values of investments . . . . . . . . . | ------ | |
| (b) ------------------------ . . . . . . . . . . | ------ | |
| (c) ------------------------ . . . . . . . . . . | ______ | ______ |
| 16. Fund balance end of year . . . . . . . . . . . . | | ______ |

APPENDIX II (continued)

SCHEDULE 1

SALARIES PAID AND CHARGED TO PLAN FOR THE YEAR ENDING ------------------
(Month,Day,Year)

---------------------------------- (Name of plan)

---------------------------------- (Address of plan's principal office)

| To Whom Paid (1) | Purpose For Which Paid (2) | Amount of Salary (3) |
| --- | --- | --- |
| | | $ |

SCHEDULE 2

FEES AND COMMISSIONS PAID AND CHARGED TO THE PLAN FOR THE YEAR ENDING ---------------------------
(Month Day Year)

All fees and commissions paid and charged to the plan must be reported here. Include payments to an individual, firm, or corporation which administers the affairs of the plan on a contract or fee basis, and any fees and commissions paid to salaried administrators or others whose salaries are reported in Schedule 1, above. (Exclude those fees and commissions paid by the insurer and set forth in Exhibit A-1, part B or A-3. Also, exclude fees for medical, dental, optical, and other services to participants; such fees should be included as benefits paid or otherwise furnished in Item 7, PART I.)

| To Whom Paid (Give Name and Address) (1) | Purpose For Which Paid (2) | Amount of Commissions (3) | Amount of Fees (4) |
| --- | --- | --- | --- |
| | | $ | $ |

# APPENDIX III

## DATA RESPONSE TO QUESTIONNAIRE ON NEW PLANTS AND EXPANSION-1961 DIRECTED TOWARD STATE DEVELOPMENT AGENCIES

I. WISCONSIN

1. Reply
2. New and expanded operations - 331
   a. Investment - 65.5 million
   b. Square feet - 5,273,000
   c. Employees

II. FLORIDA

1. Reply
2. New plants - 724
3. Major expensions - 115

III. OHIO

1. Reply
2. New plants

| | | Investments | Square Ft. | Employees |
|---|---|---|---|---|
| a. Existing bldg. | - | $ 2,545,500 | 470,970 | 789 |
| b. New bldg. | - | 27,370,000 | 1,051,940 | 1,244 |
| c. Expansions | - | 190,709,371 | 11,828,937 | 6,350 |
| d. Relocations | - | 3,965,000 | 417,370 | 515 |

IV. ILLINOIS

1. Negative reply

V. ALASKA

1. Negative reply

VI. OREGON

1. Negative reply
2. New Plants - 122

VII. NORTH DAKOTA

1. Negative reply

VIII. ALABAMA

1. Negative reply

IX. INDIANA

APPENDIX III (Continued)

1. Reply
2. New Plants - 48
   a. Employees - 1,079

X. NEW YORK

1. Reply
2. New plants - 80
   a. Investments $925,448,000
   b. Square feet 2,727,720
   c. Employees 8,901

XI. CONNECTICUT

1. Negative reply
2. New plants - 2,954

XII. HAWAII

1. Reply
2. New plants - 839

XIII. PENNSYLVANIA

1. Negative reply

XIV. KANSAS

1. Reply
2. New industries - 106
   a. Employees - 1,970
   b. Relocations - 7
      a. Employees - 325

XV. MISSISSIPPI

1. Reply
2. New industries - 81
   a. Employees - 7,715
   b. Investment - $54,522,000
3. Expansions - 45
   a. Employees - 2,293
   b. Investment - $ 8,876,000

XVI. NORTH CAROLINA

1. Reply
2. New industries - 12) an average from a
   a. Employees 2,812) 5-year period

APPENDIX III (Continued)

XVII. COLORADO

1. Negative reply

XVIII. MASSACHUSETTS

1. Partial reply
2. New plants - 48

XIX. PENNSYLVANIA

1. Reply
2. New plants

| | | Investments | Square Feet | Employees |
|---|---|---|---|---|
| a. Existing bldg. | - 217 | $ 3,589,400 | 1,658,475 | 7,471 |
| b. New buildings | - 118 | 43,981,400 | 4,269,513 | 8,398 |
| c. Expansions | - 246 | 54,031,277 | 9,556,293 | 7,746 |

XX. KENTUCKY

| 1. Reply | | Investments | Employment |
|---|---|---|---|
| 2. New plants | - 57 | $67,440,126 | 4,753 |
| 3. Expansions | - 44 | 96,973,100 | 2,082 |

XXI. LOUISIANA

| 1. Reply | | Investments | Employment |
|---|---|---|---|
| 2. New and expanded operations | - 79 | $197,861,253 | 3,841 |

XXII. MAINE

| 1. Reply | | Investments (Est.Value) | Square Feet | Employ-ment |
|---|---|---|---|---|
| 2. New plants | - 19 | $ 3,556,000 | 495,800 | 1,022 |
| 3. Expansions | - 25 | | 271,000 | 625 |

XXIII. NEW HAMPSHIRE

1. Reply
2. No data on new plants and expansions
   Gain of employment during 1959 was 725

XXIV. NEW JERSEY

1. Reply
2. New plants and expansions - 105
   a. Square feet - 284,000 (only estimate--probably more)

Source: Correspondence booklets from individual state development agencies collated in Spring, 1962.

# APPENDIX IV

## RESPONDENTS AND SUMMARY OF DATA FROM SURVEY OF NORTH CAROLINA INDUSTRIAL EXPANSION AND MIGRATION CASES FROM SAMPLE LISTS SUPPLIED BY NORTH CAROLINA STATE DEVELOPMENT AGENCY

NORTH CAROLINA--63 plants written to

Plants that replied - 22
Plants that replied providing pension plan - 3
Replied--termination plan - 1 (no information)

Names of plants that replied:

1. Florida Steel Corporation, Charlotte, N. C.
2. Ball Brothers, Inc., Asheville, N. C.
3. Swift & Company, Wilson, N. C.
4. Gerber Products, Asheville, N. C.
5. Kent-Coffey Mfg. Co., Lenoir, N. C.
6. Fiber Industries, Inc., Shelby, N. C.
7. Laurens Glass Works, Inc., Henderson, N. C.
8. Crown Aluminum Co., Roxboro, N. C.
9. Shellcross Mfg. Co., Selma, N. C.
10. C. Howard Hunt Pen Co., Statesville, N. C.
11. E. I. DuPont De Nemours & Co., Inc., Brevard, N. C.
12. Cone Mills Corp., Greensboro, N. C. (closed in Randleman, N. C.)
13. Sylvania Electric Products Co., closed cabinet plant in High Point, N. C.

Plants that replied providing pension plan:

3. Swift and Company
10. C. Howard Hunt Pen Co.
11. E. I. DuPont De Nemours & Co., Inc.

Replied--termination plan:

14. No information.

APPENDIX IV (Continued)

I. Please circle those numbers indicating the appropriate answer (a) to each question.

A. Does your new plant in North Carolina represent relocation from another employment center:
1. Of entire plant or other physical facility?
2. Of an important segment of an operation or plant?
3. Of all supervisory and key personnel?
4. Of a significant number of supervisors or other key personnel?
5. Other? (Comment)

N-1...No.
N-2...Of an entire plant or other physical facility. Expansion of company.
N-3...New slaughter house and processing facility.
N-4...Of a significant number of supervisors or other key personnel.
N-5...No.
N-6...NA.
N-7
N-8...Of a significant number of supervisors or the key personnel from other companies, however.
N-9...
N-10...Of an entire plant or other physical facility. Of a significant number of supervisors or other key personnel.
N-11...New installation unrelated to other facilities.
N-12...Closed a rented facility after a short temporary program.
N-13...Pilot plant opened in 1954 was closed in 1957 after woodworking operation proved unsatisfactory.
N-14...Of an important segment of an operation or plant? Of a significant number of supervisors or other key personnel.
N-15...Of an entire plant or other physical facility.
N-16...Of an entire plant or other physical facility--Research Labs.
N-17...Of a significant number of supervisors or other key personnel. A significant number of these people were hired from other companies, transferred from the Celanese Corp. and Imperial Chemical Ind. of England.
N-18...Of a significant number of supervisors or other key personnel.
N-19...Of an entire plant or other physical facility.
N-20...Of an entire plant or other physical facility.
N-21...Other.
N-22...Not a relocation.

APPENDIX IV (Continued)

Question Number 2 from North Carolina Questionnaire:

B. Does your present plant represent:
1. Your only plant location?
2. One of a number of plants in a multiple plant company?
3. A division of a national concern?
4. An expansion of your operations beyond previous levels at other locations?
5. A move prompted by a desire to be closer to your market?
6. A desire to escape the higher costs of strongly organized labor?
7. A desire to move closer to sources of supply?
8. Other? (Comment)

N-1...One of a number of plants in a multiple plant company.
N-1...An expansion of your operations beyond previous levels at other locations.
N-2...One of a number of plants in a multiple plant company.
A division of a national concern.
An expansion of your operations beyond previous levels at other locations.
A move prompted by a desire to be closer to your market.
N-4...A division of a national concern.
A desire to move closer to sources of supply.
N-5...Your only plant location.
N-7...One of two plants in a multiple plant company.
N-8...Your only plant location.
N-10..Your only plant location--Our main office remained in N.J.
N-14..Your only plant location.
An expansion of your operations beyond previous levels at other locations.
A desire to escape the higher costs of strongly organized labor.
N-15..Your only plant location.
A desire to move closer to sources of supply.
N-16..A division of a national concern--Corporate Research Center and also an expansion of your operations beyond previous levels at other locations.
N-17..Your only plant location.
A division of a national concern.
N-18..Your only plant location.
N-19..Your only plant location.
N-20..Only plant location.
N-21..A division of national concern.
An expansion of your operations beyond previous levels at other locations.
N-22..One of a number of plants in a multiple plant company.

APPENDIX IV (Continued)

Question Number 3 from North Carolina Questionnaire:

C. If you did relocate to North Carolina, did you find it necessary in conjunction with the move:

1. To close your prior plant?
2. To reduce or terminate employment of previous employees?
3. To terminate one or more pension plans?
4. To terminate one or more profit sharing plans?
5. To liquidate pension funds to provide supplementary unemployment cash?
6. To spin off pension fund assets from a company-wide plan?
7. To negotiate such termination with an organized union?
8. To terminate employment with pension distributions limited to vested benefits?
9. Other?

N-1...Non operation.
N-2...Extended existing plan.
N-3...
N-4...Built another plant.
N-5...
N-6...
N-7...No changes.
N-8...
N-9...
N-10..To close your prior plant.
To reduce or terminate employment of previous employees.
We pensioned from profits. Have recently started a funded plan since coming to North Carolina.
N-11..
N-12..
N-13..
N-14..To close your prior plant.
To reduce or terminate employment of previous employees.
To terminate one or more pension plans.
To terminate employment with pension distributions limited to vested benefits.
N-15..To close prior plant.
To reduce or terminate employment of previous employees.
N-16..To reduce or terminate employment of previous employees--a few at their choice.
N-17..
N-18..
N-19..To close prior plant.
N-20..To close prior plant.
To reduce or terminate employment of previous employees.
N-21..None of the above.
N-22..

APPENDIX IV (Continued)

Question Number 4 from North Carolina Questionnaire:

D. Which one of the following statements best typifies the pension termination characteristics of your relocation experience?
   1. No pension plan existed for the relocated plant.
   2. Relocation of plant precipitated termination of pension plan at that location.
   3. Relocation of plant brought about a partial termination and liquidation of pension fund providing pension to the entire company in the name of equity for workers at old location.
   4. Relocation did not terminate existing pension plan nor produce any distribution of funds other than vested allocations.

N-4...Relocation did not terminate existing pension plan nor produce any distributions of funds other than vested allocations.

N-5...No pension plan.

N-7...Relocation did not terminate existing pension plan nor produce any distribution of funds other than vested allocations.

N-8...

N-10..No pension plan existed for the relocated plant.
Relocation did not terminate existing pension plan nor produce any distribution of funds other than vested allocations. We continued our practice of retiring people from profits.

N-14..Relocation of plant precipitated termination of pension plan at that location.

N-15..No pension plan existed for the relocated plant.

N-18..No relocation.

N-19..No pension plan existed for the relocated plant.

N-20..No pension plan existed for the relocated plant.

N-21..Relocation did not terminate existing pension plan nor produce any distribution of funds other than vested allocations.

APPENDIX IV (Continued)

N-16--from North Carolina Questionnaire:

How many pension or profit sharing plans were terminated at the time your operations were moved to North Carolina? None.

How many were employed at the old location? 200

How many were transferred to North Carolina? 192

How many were discharged from your employment? None.

If your company-wide plan was not terminated, could you tell us any of the following facts:

1. What percentage of discharged employees had vested rights when terminated? None.
2. What change in past service actuarial liability was brought about by plant relocation? None.
3. Were there other insurance plans such as convertible group insurance or SUB to ease the impact of termination on employees who were unable to move to North Carolina? No.
4. What percentage of your present North Carolina labor force came from <u>your previous location</u> and <u>enjoys vested pension benefits?</u>
   50% Approximately one-fourth of these

## APPENDIX V

### TABLE 17

### MONTHLY PENSION PAYABLE AT NORMAL RETIREMENT AGE BY LARGE PENSION PLANS WITHOUT VESTING PROVISIONS TO WORKERS WITH ANNUAL AVERAGE EARNINGS OF $4,800 AND 20 YEARS OF SERVICE, 1962[a]

| Monthly Pension | Plans | Workers (in thousands) |
|---|---|---|
| Total .............. | 202[b] | 4,035.4 |
| No benefit .................. | 20 | 356.2 |
| $10 - $19 .................... | 1 | 41.5 |
| $20 - $29 .................... | 6 | 60.8 |
| $30 - $39 .................... | 16 | 488.1 |
| $40 - $49 .................... | 26[c] | 426.7 |
| $50 - $59 .................... | 65[d] | 1,481.6 |
| $60 - $69 .................... | 14 | 208.7 |
| $70 - $79 .................... | 9 | 240.9 |
| $80 - $89 .................... | 17[e] | 241.9 |
| $90 - $99 .................... | 6 | 85.6 |
| $100 - $109 .................. | 9 | 121.7 |
| $110 - $119 .................. | 1 | 14.2 |
| $120 and over ................ | 5 | 219.0 |
| Not computable ............... | 7 | 48.4 |

[a]Based on plans with over 5,000 participants on file with the U.S. Department of Labor in late 1962; coverage data, however, relate to active workers covered in 1961.

[b]Includes 7 programs with 59,300 workers which reflect benefits provided by a basic plan and a supplementary plan.

[c]Includes 1 program with 4,000 workers without vesting of basic benefits and full vesting of supplementary benefits.

[d]Includes 1 program with 9,900 workers without vesting of basic benefits and full vesting of supplementary benefits.

[e]Includes 2 programs with 18,700 workers without vesting of basic benefits and either full or graded vesting of supplementary benefits.

Source: Manpower Report of the President, op. cit., p. 63.

# APPENDIX VI

## GROUP PERMANENT ORDINARY LIFE

## ARTICLE 307--RIGHT OF COMPANY TO CHANGE THE CONTRACT

307.1 Company, by giving at least ninety days advance written notice to Trustee, reserves the absolute right, on the fifth and any subsequent Contract Anniversary, to change any or all of the terms of this Contract, including but not limited to any interest rates, and any rates or other figures set forth in the tables contained herein, except that any such change shall not affect in any way the amount or terms of any benefits already in force prior to the Contract Anniversary immediately following the date such notice is mailed to the Trustee.

## ARTICLE 308--DISCONTINUANCE OF CONTRACT--EFFECT OF DISCONTINUANCE OF CONTRACT--TERMINATION OF CONTRACT

308.1 In the event the number of persons covered hereunder be less than twenty-five, or one hundred per cent of those persons eligible for coverage hereunder, this Contract shall be discontinued not later than the end of the then current Contract Year, but may be discontinued prior thereto by Company upon written notice mailed to the principal address of the Trustee stating the effective date of such discontinuance, which date shall not be less than thirty-one days from the date such notice is mailed.

308.2 The Trustee, upon written notice to Company, prior to the end of any Contract Year may discontinue this Contract.

308.3 This Contract shall be discontinued as provided in Article 303 (i.e., upon non-payment of premium within grace period).

308.4 If the Trust or Trust Agreement is changed at any time and Company shall then determine that it is not practicable to continue to provide benefits hereunder according to such changed Trust or Trust Agreement, Company shall have the right to discontinue this Contract upon written notice to the Trustee as of a date to be stated in such notice, which date shall not be prior to the date such notice is mailed to the Trustee by Company.

308.5 If this Contract is discontinued in accordance with the provisions of this Article 308, each Participant shall receive, in lieu of any further coverage hereunder, the amount of paid-up insurance coverage that may be provided for him by applying the full termination value of his coverage hereunder, at the time of such termination, to purchase such paid-up benefits in accordance with Article 311.

308.6 If, within thirty-one days of the date of discontinuance of this Contract, the Trustee furnishes written notice to Company that the Trust is being continued as a qualified retirement plan under the applicable regulations of the U. S. Internal Revenue Service, the Trustee may request Company to cancel, but only with respect to Participants other than terminated or retired Participants, all of the coverages provided under Article 308.5 for such Participants which have not previously been cancelled and to make a payment equal to the total amount of the termination values of such coverages as of the date of such discontinuance. On receipt of such request, Company shall cancel such coverages and pay the said amount to the insurer, Trustee or other custodian of retirement funds. However, Company reserves the right:

(a) to deduct from such amount a charge which shall not exceed five per cent of such amount; and

(b) to make payment of such amount in equal annual instalments over a period of years not exceeding ten, with interest allowed on the unpaid balance of such amount at the rate of 2 1/2 per cent per annum, compounded annually; provided, however, that the minimum annual instalment shall be $100,000.00 or, if less, the remaining unpaid balance of such amount; and

(c) before any payment is made in accordance with (b) of this Article 308.6, to require written notice by the Contract-holder to Company at its Home Office that said retirement plan has received the approval of the U. S. Internal Revenue Service.

308.7 If the Trustee requests Company to cancel the coverages provided under Article 308.5 and to pay the termination values thereof under Article 308.6, then the Participants whose coverages are so cancelled shall no longer have any right to surrender such coverages as provided under Article 311.3.

308.8 In lieu of the paid-up insurance provided under Article 308.5 and provided Company has not been requested to make a payment under Article 308.6, the Trustee, within 31 days of the date of discontinuance of this Contract, may elect to have the termination values of Participants' coverages hereunder applied as of the date of discontinuance to provide for such Participants any other form of benefit mutually agreed upon by the Trustee and Company, to which such Participants may be entitled according to the terms of the Trust.

308.9 Where any payment is made pursuant to Article 308.6 in compliance with appropriate instructions in writing from the Trustee, Company shall be under no obligation to inquire as to

the rights of any person receiving payment to act under any retirement plan, program, trust or contract, or as to that person's authority to receive such payment for such purposes or for any other purposes, or to inquire as to the existence of a valid retirement plan, program, trust or contract; nor shall Company be obliged, in any way or for any purpose, to see to the application of the payments by such person, and payment to such person shall fully discharge any and all obligation of Company with respect thereto. Further, in consideration of Company's compliance with the Trustee's aforedescribed request, the Trustee does agree to save Company harmless for so acting and to indemnify Company for any loss whatever that it may sustain by reason of such an action and to further indemnify Company for the cost of any action which may be brought against it because of any such payment.

308.10 This Contract shall terminate when all payments by Company of benefits previously provided and payable under the Contract shall have been completed.

ARTICLE 309--REINSTATEMENT OF CONTRACT

309.1 If this Contract is discontinued at the request of the Trustee or by reason of non-payment of premiums, the Trustee may, by written request to Company, reinstate this Contract and the benefits under this Contract for the Participants living at the date of such request and covered under the Contract on the date of such discontinuance, subject to the following conditions:

(a) The date of discontinuance of this Contract must have been not more than five years prior to the date of receipt of such request by Company.

(b) The Trustee, at the time of such request, must make payment to Company of all premiums that would have been payable, for the benefits to be reinstated, on this Contract had it not been discontinued, with interest thereon at 5 per cent per annum, compounded annually.

(c) The Trustee must furnish Company with the necessary authority to cancel any paid-up benefits on such Participants to be covered under the reinstated Contract.

(d) The Trustee must furnish evidence satisfactory to Company that the number and percentage of Participants to be covered at the time of reinstatement is as large as that number and percentage required to continue the Contract under Article 308 of this Contract.

(e) Evidence of insurability satisfactory to Company must be furnished for any amount of insurance to be reinstated for a Participant that is in excess of the group underwriting limit set by Company at the time of reinstatement.

ARTICLE 310--RESUMPTION OF CONTRACT

310.1 If this Contract is discontinued by the Trustee or by reason of non-payment of premiums, the Trustee may, by written request to Company, resume this Contract as of the beginning of what would have been the next Contract Year from the date of such request for the benefit of all Participants who would then be eligible under the terms of this Contract, subject to the following conditions:

(a) The date of discontinuance of this Contract must have been not more than five years prior to the date of receipt of such request by Company.

(b) The Trustee must pay the required premium for the Contract Year in which the Contract is resumed.

(c) The Trustee must furnish evidence satisfactory to Company that the number and percentage of Participants to be covered at the time of resumption is as large as that number and percentage required to continue the Contract under Article 308 of this Contract.

(d) Evidence of insurability satisfactory to Company must be furnished for any amount of insurance to be provided for a Participant which is in excess of the group underwriting limit set by Company at the time of resumption.

310.2 If this Contract is resumed, the effective date of the benefits shall be the Contract Anniversary on which this Contract is resumed, and the premium rates applicable shall be those then in effect for the then attained ages of the Participants.

ARTICLE 311--TERMINATION VALUES AND PAID-UP VALUES

311.1 The termination value of the insurance hereunder on any Contract Anniversary shall be the net level premium reserve taken to the nearest dollar.

311.2 The amount of paid-up insurance coverage on any Contract Anniversary is calculated by applying the termination value as a net single premium for paid-up life insurance at the then attained age nearest birthday of the Participant.

311.3 Except as otherwise provided in Article 308.7, if, after termination of his employment of discontinuance of this Contract, a Participant is entitled to have vested in him paid-up insurance, such Participant may elect to surrender such paid-up insurance as is vested in him for its value, which shall be equal to the net single premium for such paid-up insurance, taken to the nearest dollar, at the then attained age nearest birthday of such Participant.

311.4 If, after the termination of a Participant's employment or the discontinuance of the Contract, the total amount of paid-up insurance remaining in force for the Participant is less than $334.00, Company reserves the right to cancel the paid-up insurance at such time as it may determine and to pay the termination value thereof to the Participant in a single sum.

311.5 If, at any time after the termination of a Participant's employment or discontinuance of this Contract, the total amount of any paid-up annuity remaining in force for the Participant is not sufficient to provide an income of $3.34 per month on the normal income form at the Participant's normal retirement date, Company reserves the right to cancel such coverage at such time as it may determine and to pay its value to the Participant in a single sum.

# APPENDIX VII

## TERMINATION PROVISIONS OF A TYPICAL GROUP PERMANENT ORDINARY LIFE WITH SUPPLEMENTAL FUND PENSION PLAN

## ARTICLE 308--DISCONTINUANCE OF CONTRACT--EFFECT OF DISCONTINUANCE OF CONTRACT--TERMINATION OF CONTRACT

308.1 In the event the number of persons covered hereunder be less than twenty-five or seventy-five per cent of those persons eligible for coverage hereunder, this Contract shall be discontinued not later than the end of the then current Contract Year, but may be discontinued prior thereto by Company upon written notice mailed to the principal address of the Trustee stating the effective date of such discontinuance, which date shall not be less than thirty-one days from the date such notice is mailed.

308.2 The Trustee may elect, upon written notice to Company, to discontinue this Contract as of a date, to be stated in such notice, which is on or after the date of receipt of such notice by Company.

308.3 Failure by the Trustee (a) to pay any premium due in accordance with the provisions of Article 303, within the grace period provided therein, or (b) to make any payment due in accordance with the provisions of the Supplemental Agreement, within the grace period provided therein, shall discontinue this Contract as of the due date of such premium or such payment, as provided under Article 303.3 or Article 501.5.

308.4 If the Plan or Trust Agreement is changed at any time and Company shall then determine that it is not practicable to continue to provide benefits hereunder according to such changed Plan or Trust Agreement, or if at any time Company shall determine that the Trustee has failed to request Company to provide benefits hereunder for a Participant who in accordance with the terms of the Plan or Trust Agreement is entitled to receive benefits under this Contract, Company shall have the right to discontinue this Contract upon written notice to the Trustee as of a date to be stated in such notice, which date shall not be prior to the date such notice is mailed to the Trustee by Company.

308.5 If this Contract is discontinued in accordance with the provisions of this Article 308 and, within sixty days of the date of such discontinuance, the Trustee furnishes written notice to Company that the Plan is being continued as a qualified plan under the applicable regulations of the U. S. Internal Revenue Service, the Trustee may request Company to make a payment equal to the total amount of termination value as of the date of such discontinuance, reduced if applicable in accordance with Article 202A.2, of all insurance coverage hereunder. However, Company reserves the right to (a) deduct from such amount a charge which shall not exceed five per cent of such amount, and

(b) make payment of such amount in equal annual instalments over a period of years not exceeding ten, with interest allowed on the unpaid balance of such amount at the rate of 2 3/4 per cent per annum, compounded annually; provided, however, that the minimum annual instalment shall be $100,000.00 or, if less, the remaining unpaid balance of such amount of termination value.

308.6 Where any payment is made pursuant to Article 308.5 in compliance with appropriate instructions in writing from the Trustee, Company shall be under no obligation to inquire as to the rights of any person receiving payment to act under any retirement plan, program, trust or contract, or as to that person's authority to receive such payment for such purposes or for any other purposes, or to inquire as to the existence of a valid retirement plan, program, trust or contract; nor shall Company be obliged, in any way or for any purpose, to see to the application of the payments by such person, and payment to such person shall fully discharge any and all obligation of Company with respect thereto. Further, in consideration of Company's compliance with the Trustee's aforedescribed request, the Trustee does agree to save Company harmless for so acting and to indemnify Company for any loss whatever that it may sustain by reason of such an action and to further indemnify Company for the cost of any action which may be brought against it because of any such payment.

308.7 If (a) the Trustee does not request Company to make the payment as provided under Article 308.5; or (b) the Plan is terminated; or (c) this Contract is discontinued in accordance with the provisions of Articles 308.1, 308.2, 308.3 or 308.4 and the Trustee does not furnish written notice to Company at its Home Office within sixty days that the Plan is being continued as a plan which is qualified under the applicable regulations of the U. S. Internal Revenue Service, the insurance provided hereunder for each Participant shall be continued as paid-up Group Permanent Ordinary Life Insurance for an amount determined in accordance with Article 311.

308.8 This Contract, though discontinued in accordance with this Article 308, shall nevertheless not terminate until the Supplemental Fund shall have been exhausted and all payments by Company of benefits previously provided and payable under the Contract shall have been completed.

## ARTICLE 309--REINSTATEMENT OF CONTRACT

309.1 If this Contract is discontinued at the request of the Trustee or by reason of nonpayment of premiums, the Trustee may, by written request to Company, reinstate this Contract and the benefits under this Contract for the Participants living at the

date of such request and covered under the Contract on the date of such discontinuance, subject to the following conditions:

(a) The date of discontinuance of the Contract must have been not more than five years prior to the date of receipt of such request by Company.

(b) The Trustee, at the time of such request, must make payment to Company of all premiums that would have been payable, for the benefits to be reinstated, on this Contract had it not been discontinued, with interest thereon at 5 per cent per annum, compounded annually.

(c) The Trustee must furnish Company with the necessary authority to cancel any paid-up insurance on such Participants to be covered under the reinstated Contract.

(d) The Trustee must furnish evidence satisfactory to Company that the number and percentage of Participants to be covered at the time of reinstatement is as large as that number and percentage required to continue the Contract under Article 308 of this Contract.

(e) Evidence of insurability satisfactory to Company must be furnished for any amount of insurance to be reinstated for a Participant that is in excess of the group underwriting limit set by Company at the time of reinstatement.

## ARTICLE 310--RESUMPTION OF CONTRACT

310.1 If this Contract is discontinued by the Trustee or by reason of non-payment of premiums, the Trustee may, by written request to Company, resume this Contract as of the beginning of what would have been the next Contract Year from the date of such request for the benefit of all Participants who would then be eligible under the terms of this Contract, subject to the following conditions:

(a) The date of discontinuance of this Contract must have been not more than five years prior to the date of receipt of such request by Company.

(b) The Trustee must pay the required premium for the Contract Year in which the Contract is resumed.

(c) The Trustee must furnish evidence satisfactory to Company that the number and percentage of Participants to be covered at the time of resumption is as large as that number and percentage required to continue the Contract under Article 308 of this Contract.

(d) Evidence of insurability satisfactory to Company must be furnished for any amount of insurance to be provided for a Participant which is in excess of the group underwriting limit set by Company at the time of resumption.

310.2 If this Contract is resumed, the amount of the benefits under this Contract for each Participant will then be determined according to the Schedule of Benefits less any amount of paid-up insurance to which such Participant may have been entitled under this Contract. The effective date of the benefits shall be the Contract Anniversary on which this Contract is resumed and the premium rates applicable shall be those then in effect for the then attained ages of the Participants.

(3) If a Participant remains actively employed by his employer beyond his normal retirement date, as defined in the Plan, then any retirement income which the Participant is entitled to receive at his normal retirement date under the terms of the Plan and which is to be provided under this Contract shall be provided under the provisions of Article 503.1 or Article 203A.1, and not by means of instalments from the Supplemental Fund.

(4) The maximum amount to be so deducted during any one Contract Year shall not exceed the amount that would have been payable under Article 505.2 during such Contract Year had the Contract been discontinued during such Contract Year.

ARTICLE 503A--NORMAL AND OPTIONAL ANNUITY FORMS

503A.1 The normal annuity form for Retirement Annuity benefits payable under the Supplemental Agreement shall be a payment commencing at the Participant's Retirement Date and payable during his lifetime, with a guarantee that payments shall in any event be made for a period of 60 months certain. The first payment shall become due upon the Participant's Retirement Date, provided he is then living. Payments will terminate with the last payment preceding the Participant's death or at the end of the 60 months certain period, whichever is later. Upon the death of a Participant after he has received the first payment on the normal annuity form, such payments shall be continued to the Participant's beneficiary for the remainder, if any, of the certain period. Instead of such payments the beneficiary shall have the right to elect to receive in a lump sum the commuted value, commuted at an interest rate of 2 3/4 per cent per annum, compounded annually, of the payments for the remainder, if any, of the certain period.

503A.2 Instead of the normal annuity form, the Trustee may elect any one of the Options contained in Article 204 and such election shall be subject to the same conditions and restrictions as the Options under Article 204, except that such optional annuity form shall be determined using the same mortality table and interest assumption as provided in Article 504.

ARTICLE 504--BASIS OF RESERVE

504.1 The reserve to be maintained by Company for Retirement Annuities purchased hereunder shall be at least equal to the reserve computed upon the basis of the Group Annuity Table for 1951 (Male Lives) age set back one year for males and five years for females, with interest at the rate of 2 3/4 per cent per

annum, compounded annually.

ARTICLE 505--EFFECT OF DISCONTINUANCE OF CONTRACT UPON SUPPLEMENTAL AGREEMENT

505.1 If this Contract is discontinued under Article 308 no further Deposits shall be made on or after the date of such discontinuance, and except as otherwise provided in Article 505.2 and Article 505.4, no amounts shall thereafter be applied from the Supplemental Fund to purchase Retirement Annuities.

505.2 If this Contract is discontinued in accordance with the provisions of Article 308, and the Trustee furnishes, within 60 days of the date of discontinuance, written notice to Company at its Home Office that the Plan is being continued as a qualified Plan under the applicable regulations of the U. S. Internal Revenue Service, the Trustee may request Company to make a payment in an amount equal to the amount, on the date such request is received by Company, of the Supplemental Fund. On receipt of such request Company shall pay to the insurer, trustee, or other custodian of retirement funds for said retirement plan the amount of the Supplemental Fund. However, Company reserves the right (a) to deduct from such amount a charge which shall not exceed 5 per cent of such amount and (b) to make payment of such amount in equal annual instalments over a period of years not exceeding ten, with interest at the rate of 2 3/4 per cent per annum, compounded annually, allowed on the remaining balance of the Supplemental Fund, provided, however, that the minimum annual instalment shall be $100,000.00 or if less the balance of the Supplemental Fund. If the Trustee does not elect to withdraw the amount held in the Supplemental Fund, the Fund, if any, shall be applied, in accordance with the directions of the Trustee, to purchase Retirement Annuities under this Contract for Participants and their joint annuitants, if any.

505.3 Where any payment is made pursuant to Article 505.2 in compliance with appropriate instructions in writing from the Trustee, Company shall be under no obligation to inquire as to the rights of any person receiving payment to act under any retirement plan, program, trust or contract, or that person's authority to receive such payment for such purposes or for any other purpose or to inquire as to the existence of a valid retirement plan, program, trust or contract; nor shall Company be obliged, in any way or for any purpose, to see to the application of the payments by such person, and payment to such person shall fully discharge any and all obligation of Company with respect thereto. Further, in consideration of Company complying with the Trustee's aforedescribed request, the Trustee does agree to

save Company harmless for so acting and to indemnify Company for any loss whatever that it may sustain by reason of such an action and to further indemnify Company for the cost of any action which may be brought against it because of any such payment.

505.4 In the event that this Contract is discontinued under Article 308 and the Trustee does not furnish written notice to Company at its Home Office within sixty days that the retirement plan is being continued as a qualified retirement plan under the applicable regulations of the U. S. Internal Revenue Service, or in the event that the Plan is terminated, each Participant (and his joint annuitant, if any) for whom a Retirement Annuity has not previously been purchased under this Contract shall be entitled to receive immediately a paid-up deferred annuity on the form specified by the Participant, which form shall be one allowed under the provisions of Article 503A. The amount of such paid-up deferred annuity for any such Participant and his joint annuitant, if any, shall be equal to the amount which may be purchased by the amount of the Supplemental Fund that is allocable to such Participant as certified by the Trustee to Company.

ARTICLE 506--RIGHT OF COMPANY TO CHANGE THE SUPPLEMENTAL AGREEMENT

506.1 Occidental, by giving at least ninety days advance written notice to the Trustee, reserves the absolute right, on the fifth or any subsequent Contract Anniversary, to change any interest rates, any annuity rates, and bases for calculating such rates, including all tables or schedules, pertaining to or appearing in the Supplemental Agreement. No such change shall affect the amount or the terms of any Retirement Annuities purchased under the Supplemental Agreement prior to the effective date of such change, and any such change shall be applicable only with respect to the portion of the Supplemental Fund which represents the accumulation of Deposits made after the effective date of the change. In determining said portion of the Supplemental Fund the first in, first out, rule shall be applied, amounts paid or withdrawn being charged against amounts first becoming part of the Fund.

# APPENDIX VIII

## TERMINATION PROVISIONS OF A TYPICAL GROUP PERMANENT RETIREMENT INCOME INSURED PLAN

ARTICLE 306--ALTERATION OF CONTRACT

306.1 Subject to the laws of the State in which this Contract is delivered, this Contract may at any time be amended and changed by written agreement between Company and the Employer; provided, however, that no such change shall affect in any way the amount or terms of any benefits already in force prior to the effective date of such change.

ARTICLE 307--RIGHT OF COMPANY TO CHANGE THE CONTRACT

307.1 Company, by giving at least 90 days advance written notice to the Employer, may, effective on the fifth or any subsequent Contract Anniversary, change any or all of the terms of this Contract including the rates or other figures set forth in the tables contained herein, except that any such changes shall not affect in any way the amount or terms of any benefits already in force prior to the Contract Anniversary immediately following the date such notice is mailed to the Employer.

ARTICLE 308--TERMINATION OF CONTRACT

308.1 In the event the number of persons covered hereunder be less than 10, or 75 per cent of those persons eligible for coverage hereunder, this Contract shall be terminated not later than the end of the then current Contract Year, but may be terminated prior thereto by Company upon written notice mailed to the principal address of the Employer stating the effective date of such termination, which date shall not be less than thirty-one days from the date such notice is mailed.

308.2 The Employer, upon written notice to Company prior to the end of any Contract Year, may terminate this Contract.

308.3 This Contract shall be terminated as provided in Article 303 (upon non-payment of premium within grace period).

308.4 Subject to Article 209, if this Contract is terminated, each Participant shall receive, in lieu of any further coverage hereunder, the amount of paid-up retirement income insurance coverage or, if applicable, paid-up retirement annuity coverage that may be provided for him by applying the full termination value of his coverage hereunder, at the time of such termination, to purchase such paid-up benefits in accordance with Article 311.

## ARTICLE 309--REINSTATEMENT OF CONTRACT

309.1 If this Contract is terminated at the request of the Employer or by reason of non-payment of premiums, the Employer may, by written request to Company, reinstate this Contract and the benefits under this Contract for the Participants, living at the date of such request and covered under the Contract on the date of such reinstatement, subject to the following conditions:

(a) The date of termination of this Contract must have been not more than five years prior to the date of receipt of such request by Company;

(b) The Employer, at the time of such request, must make payment to Company of all premiums that would have been payable on this Contract had it not been terminated, with interest thereon at 5 per cent per annum, compounded annually;

(c) The Employer must furnish Company with the necessary authority to cancel any paid-up insurance and any paid-up annuity provided for a Participant to be covered under the reinstated Contract;

(d) The Employer must furnish evidence satisfactory to Company that the number and percentage of employees to be covered at the time of reinstatement is as large as that number and percentage required to continue the Contract under Article 308 of this Contract;

(e) Evidence of insurability satisfactory to Company must be furnished for any amount of insurance to be reinstated for a Participant which is in excess of the group underwriting limit set by Company at the time of reinstatement.

(f) The aforegoing provisions of this Article 309.1 shall not apply to any benefits provided under the Contract on the date of termination of this Contract for any person whose employment was terminated at any time on or after the date of termination of this Contract and prior to the date this Contract is reinstated, and any benefits previously vested in such person under Article 308 shall remain vested in him.

## ARTICLE 310--RESUMPTION OF CONTRACT

310.1 If this Contract is terminated by the Employer or by reason of non-payment of premiums, the Employer may, by written request to Company, resume this Contract as of the beginning of what would have been the next Contract Year following the date of such request, for the benefit of all Employees who would then be eligible under the terms of this Contract, subject to the following conditions:

(a) The date of termination of this Contract must have been not more than five years prior to the date of receipt of such request by Company;

(b) The Employer must pay the required premium due at the beginning of such next Contract Year;

(c) The Employer must furnish evidence satisfactory to Company that the number and percentage of Employees to be covered at the time of resumption is as large as that number and percentage required to continue the Contract under Article 308 of this Contract.

(d) The aforegoing provisions of this Article 310.1 shall not apply to any benefits provided under the Contract on the date of termination of this Contract for any person whose employment was terminated at any time on or after the date of termination of this Contract and prior to the date this Contract is resumed, and any benefits previously vested in such person under Article 308 shall remain vested in him.

310.2 If this Contract is resumed, the amount of benefits under this Contract will then be determined according to the Schedule of Benefits less any amount of paid-up insurance and paid-up annuity to which a Participant may have been entitled under this Contract. The effective date of the benefits shall be the Contract Anniversary on which this Contract is resumed and the premium rates applicable shall be those then in effect for the then attained ages of the Employees.

ARTICLE 311--TERMINATION VALUES AND PAID-UP VALUES

311.1 The termination value of the insurance hereunder on any Contract Anniversary shall be the net level premium reserve taken to the nearest dollar.

311.2 The amount of paid-up insurance coverage, on any Contract Anniversary, is determined by applying the termination value as a net single premium for paid-up retirement income insurance at the then attained age nearest birthday of the Participant.

311.3 If, after termination of his employment or discontinuance of this Contract, a Participant is entitled to have vested in him paid-up insurance, such Participant may elect to surrender such paid-up insurance as is vested in him for its value, which shall be equal, on any Contract Anniversary, to the net single premium at the then attained age nearest birthday of such Participant for such paid-up insurance taken to the nearest dollar.

311.4 If, after the termination of a Participant's employment or discontinuance of the Contract, the total amount of paid-up insurance remaining in force for the Participant is less than $334, Company reserves the right to cancel the paid-up insurance at such time as it may determine and to pay the termination value thereof to the Participant in a single sum.

311.5 The termination value of the retirement annuity hereunder on any Contract Anniversary shall be the net level premium reserve taken to the nearest dollar.

311.6 The amount of paid-up retirement annuity coverage is determined by accumulating the termination value of such coverage at the rate of 2 1/2 per cent interest per annum, compounded annually, to retirement date, at which time such accumulated value shall be applied as a net single premium to provide annuity payments.

311.7 If, after termination of his employment or discontinuance of this Contract, a Participant is entitled to have vested in him paid-up retirement annuity, such Participant may elect to surrender such coverage as is vested in him for its value, which shall be equal, on any Contract Anniversary, to the termination value at the date of such termination or discontinuance of such coverage accumulated at an interest rate of 2 1/2 per cent per annum, compounded annually, to the date of surrender.

311.8 If, after the termination of a Participant's employment or discontinuance of this Contract, the total amount of paid-up retirement annuity remaining in force for the Participant is not sufficient to provide an income of $3.34 per month on the normal annuity form at the Participant's Normal Retirement Date, Company reserves the right to cancel such coverage at such time as it may determine and to pay its value to the Participant in a single sum.

ARTICLE 312--RESERVE BASIS

312.1 The reserve on the retirement income insurance issued on the premium basis first effective under this Contract shall be computed upon the Commissioner's 1941 Standard Ordinary Table of Mortality to retirement date with interest at the rate of 2 1/2 per cent per annum, computed annually, and thereafter on the 1937 Standard Annuity Table of Mortality, set back five years for females, with interest at the rate of 2 1/2 per cent per annum, compounded annually, using the age nearest birthday.

312.2 The reserve on the retirement annuity issued on the premium basis first effective under this Contract shall be computed

upon the 1937 Standard Annuity Table of Mortality, set back five years for females, with interest at the rate of 2 1/2 per cent per annum using the age nearest birthday.

## ARTICLE 313--INDIVIDUAL CERTIFICATES

313.1 Company shall issue to the Employer for delivery to each Participant an individual certificate describing the insurance protection and other benefits to which the Participant is entitled and to whom such insurance and other benefits are payable, the conversion privileges granted by this Contract, and the insurance granted during the period in which application for a converted policy may be made.

## ARTICLE 314--PERSONNEL DATA

314.1 The Employer shall furnish Company with the personnel data required to carry out the provisions of this Contract.

## ARTICLE 315--MISSTATEMENT

315.1 In event of the misstatement of the age or sex of any person any amount payable under this Contract with respect to such person shall be the correct amount in accordance with the Contract, and adjustments shall be made so that Company shall receive the actual premium or amount required to provide such correct amounts at the true age or sex of such person.

## ARTICLE 316--INCONTESTABILITY

316.1 Except for the non-payment of premiums, this Contract shall be incontestable after it has been in force for two years from its date of issue. No statement made by any Participant relating to his insurability shall be used in contesting the Participant's insurance after such insurance has been in force prior to the contest for a period of two years during such Participant's lifetime nor unless it is contained in a written application signed by him.

## APPENDIX IX

### ARTICLE 406--DISCONTINUANCE OF DEPOSITS AND DISCONTINUANCE OF CONTRACT

406.1 Upon the occurrence of any one of the events hereinafter described in this Article 406, this Contract shall be discontinued as of the respective dates of discontinuance hereinafter set forth, to the extent provided for in Article 407.

(a) Failure by the Contractholder to make a Deposit after notification by Company under Article 301.2, within the 31 days grace period provided therein, shall discontinue this Contract as of the date of such notification.

(b) If the Contractholder fails to request Company to purchase a Retirement Annuity for a Participant who, in accordance with the terms of this Contract, is entitled to receive a Retirement Annuity under this Contract, Company shall have the right to discontinue this Contract upon written notice to the Contractholder as of a date to be stated in such notice.

(c) The Contractholder may elect, upon written notice to Company, to discontinue this Contract as of a date, to be stated in such notice, which is on or after the date of receipt of such notice by Company.

(d) If on any Contract Anniversary the number of Participants actually covered hereunder is less than 100 per cent of the total number of persons eligible for coverage hereunder, or if on such date the number of Participants hereunder is less than 10, Company shall have the right, upon written notice to the Contractholder, to refuse to accept further Deposits hereunder. In such event, this Contract shall be discontinued as of a date, to be stated in such notice, which is on or after the date of mailing of such notice by Company.

(e) If the Contractholder fails to furnish Company with the necessary information, as provided herein, to carry out out the provisions of this Contract, Company shall have the right to discontinue this Contract upon written notice to the Contractholder as of a date to be stated in such notice, which is on or after the date of mailing of such notice by Company.

406.2 In the event this Contract is discontinued, no payments shall

thereafter be made to the Contractholder by Company, unless such payment shall be the result of some prior erroneous actuarial computation.

ARTICLE 407--EFFECT OF DISCONTINUANCE OF CONTRACT AND TERMINATION OF CONTRACT

407.1 In the event that this Contract is discontinued, in accordance with the provisions of Article 406, no further Deposits shall be made on or after the date of discontinuance, and except as otherwise provided in Article 407.2 and Article 407.4, no amounts shall thereafter be applied from the Deposit Accumulation Fund to purchase Retirement Annuities.

407.2 If this Contract is discontinued under Article 406, and if within 31 days of such discontinuance, the Contractholder furnishes written notice to Company at its Home Office that the retirement plan is being continued or amended or that any other retirement plan is being established under applicable regulations of the U. S. Internal Revenue Service, the Contractholder may request that Company pay an amount equal to the Withdrawal Value of the Deposit Accumulation Fund on the date of receipt of such request, less any taxes resulting from such discontinuance as determined by Company in accordance with generally acceptable accounting practices. On receipt of such request, Company shall pay the Withdrawal Value as determined by the formula described in the following paragraph, less such taxes, to the insurer, trustee, or other custodian of retirement funds for said retirement plan. However, Company reserves the right to make payment of such amount in not more than 10 equal annual installments, with interest at the Guaranteed Average Interest Rate on the remaining balance of such Withdrawal Value. The minimum annual installment shall be one hundred thousand dollars ($100,000.00) or, if less, the balance of such Withdrawal Value.

The Withdrawal Value of the Deposit Accumulation Fund shall be determined by multiplying the amount of the Deposit Accumulation Fund on the date of the request for withdrawal by the ratio A/B where A and B have the values determined in (1) and (2) below and provided that the ratio A/B shall not exceed $1.05 nor be less than .95.

(1) The numerator, A, in the above ratio shall be the combined market value on the date of the request for withdrawal of all bonds owned on that date by Company which were purchased on or after the Contract Date.

(2) The denominator, B, in the above ratio shall be the combined cost to Company of the bonds described in (1) above.

APPENDIX IX (Continued)

If the Contractholder does not elect to withdraw the amounts held in the Deposit Accumulation Fund, the Fund, less any taxes resulting from the purchases from the Fund as determined by Company in accordance with generally acceptable accounting practices, shall be applied in accordance with the directions of the Contractholder to purchase Retirement Annuities under this Contract for the Participants.

407.3 Where any payment is made pursuant to Article 407.2 in compliance with appropriate instructions in writing from the Contractholder, Company shall be under no obligation to inquire as to the rights of any person receiving payment to act under any retirement plan, program, trust or contract, or that person's authority to receive such payment for such purposes or for any other purpose or to inquire as to the existence of a valid retirement plan, program, trust or contract; nor shall Company be obliged in any way or for any purpose, to see to the application of the payments by such person, and payment to such person shall fully discharge any and all obligation of Company with respect thereto. Further, in consideration of Company's compliance with the Contractholder's aforedescribed request, the Contractholder does agree to save Company harmless for so acting and to indemnify Company for any loss whatever that it may sustain by reason of such action and to further indemnify Company for the cost of any action which may be brought against it because of any such payment.

407.4 If this Contract is discontinued under Article 406, and the Contractholder does not furnish written notice to Company at its Home Office within 31 days that the retirement plan is being continued as a qualified retirement plan under the applicable regulations of the U. S. Internal Revenue Service, or if the retirement plan is terminated, each Participant who has retired and is receiving Retirement Annuity benefits on a Temporary Annuity basis and each Participant for whom a Retirement Annuity has not previously been purchased under this Contract from the time he last became an Employee hereunder up to the effective date of discontinuance of this Contract, shall be entitled to receive immediately on the normal annuity form but subject to the following provisions of this Article 407.4, the following: (1) in the case of such a Participant who has retired and is receiving a Temporary Annuity, a paid-up immediate or deferred annuity commencing at the time such Temporary Annuity actually expires; and (2) in the case of such a Participant, who, immediately prior to the effective date of discontinuance of the Contract, was receiving disability payments, an immediate annuity; and (3) for all other such Participants a paid-up deferred annuity or, if the Participant has reached his Normal

APPENDIX IX (Continued)

Retirement Date, an immediate annuity. Any such Participant may select an optional annuity form under Article 204. The amount of such immediate or paid-up deferred annuity for such Participant and his joint annuitant, if any, shall be equal to the amount which may be purchased by the portion of the Deposit Accumulation Fund that is allocable to such Participant as hereinafter determined. Subject to Article 208, the Deposit Accumulation Fund, less any taxes resulting from the purchases from the Fund, as determined by Company in accordance with generally acceptable accounting practices, shall be allocated as follows:

(a) The Deposit Accumulation Fund shall first be applied to purchase for each Participant who has retired and is receiving a Temporary Annuity the Retirement Annuity to which such Participant is entitled on the normal annuity form under Article 204. However, if the Deposit Accumulation Fund is not sufficient to purchase the said amounts of Retirement Annuity Company shall first determine the amount that would be required to provide the said amounts of Retirement Annuity for all such Participants and shall then determine a percentage for such Participant by dividing the amount to provide that Participant's Retirement Annuities, by the amount required to provide all such Retirement Annuities. Company shall then purchase a Retirement Annuity on the normal annuity form for each such Participant by applying from the Deposit Accumulation Fund an amount equal to the Deposit Accumulation Fund multiplied by the aforementioned percentage.

(b) The balance, if any, of the Deposit Accumulation Fund shall then be applied to purchase for each Participant who was receiving disability payments under Article 207 immediately prior to the effective date of discontinuance of the Contract an immediate Retirement Annuity payable for life equal to such Participant's monthly disability payment. However, if the Deposit Accumulation Fund is not sufficient to purchase the said amounts of Retirement Annuity, Company shall then determine a percentage for each Participant by dividing the amount required to provide that Participant's Retirement Annuity by the amount required to provide all such Retirement Annuities. Each such Participant shall then have applied by Company, to purchase a Retirement Annuity, an amount from the Deposit Accumulation Fund which shall be equal to such Fund multiplied by the aforementioned percentage.

(c) The balance, if any, of the Deposit Accumulation Fund shall then be applied to purchase for each other Participant a paid-up deferred annuity equal to the amount of Current

Service Retirement Annuity credited to each such Participant under Article 203 at the date of discontinuance of the Contract. However, if the Deposit Accumulation Fund is not sufficient to purchase the said amounts of Current Service Retirement Annuity, Company shall first determine the amount that would be required to provide the said amounts of Current Service Retirement Annuity for all such Participants and each such Participant shall receive that percentage of his Current Service Retirement Annuity as the Deposit Accumulation Fund bears to the amount necessary to provide all of the said amounts of Current Service Retirement Annuities.

(d) The balance, if any, of the Deposit Accumulation Fund shall then be applied to purchase for each such Participant a paid-up Deferred Annuity equal to the amount of Past Service Retirement Annuity credited to each such Participant who is then entitled to such Annuity under Article 203. To determine the amount of Past Service Retirement Annuity to be purchased for any such Participant, Company shall determine the amount that would then be necessary to provide all such Past Service Retirement Annuities and each such Participant shall receive that percentage of his Past Service Retirement Annuity as the remaining balance of the Deposit Accumulation Fund bears to the amount necessary to provide such Past Service Retirement Annuities, up to 100%.

(e) If, after the provisions of this Article 407.4 (a), 407.4 (b), 407.4 (c) and 407.4 (d) have been applied, there is still a balance remaining in the Deposit Accumulation Fund this balance shall be deemed to have resulted from some prior erroneous actuarial computation and shall be paid to the Contractholder under Article 406.2.

407.5 This Contract shall terminate when the Deposit Accumulation Fund shall have been exhausted and all payments by Company of Retirement Annuities previously purchased hereunder shall have been completed.

APPENDIX X

WHEREAS, the Company and the Unions have deemed it advisable to terminate the Plan and to disburse all assets of the Pension Fund;

NOW THEREFORE, IT IS AGREED:

That the Plan be discontinued as of October 18 which date shall be hereinafter referred to as the "termination date."

That the allocation of benefits upon termination of the Plan (after providing the necessary and proper expenses of administering and liquidating the Plan and the Pension Fund) shall be accomplished (a) by the issuance of insured annuity contracts by the Life Insurance Company to provide payment of benefits for all employees who retired under the Plan prior to October 18 and for all non-retired employees who had attained at least age 60 on October 18 with at least 10 years of credited service determined in accordance with the provisions of the Plan by such date and (b) by the payment of cash benefits by the Trustee to the extent that the remaining assets of the Pension Fund are sufficient to all other employees who were on the seniority rolls of the Unions as of October 18 and had at least one year of credited service determined in accordance with the provisions of the Plan by such date.

That the Trustee be instructed to transfer to such Insurance Company, the required consideration from the Pension Fund in a form to be hereinafter agreed upon for the purpose of issuing the above mentioned insured annuity contracts.

That such Insurance Company be instructed to employ the assets transferred to it by the Trustee:

(a) To issue annuities for payments commencing as of November 1 to all employees who are drawing benefits from the Pension Fund on or prior to the termination date as the result of normal, early or disability retirement and to all former employees who are receiving payment of a deferred pension from the Pension Fund on the termination date. Exhibit A, attached hereto, lists the names of such employees, the amount of the monthly benefit to which each is entitled, together with other personnel data.

(b) To issue annuities for payment commencing as of November 1 to all employees who are eligible for normal retirement on or prior to the termination date. The applications of such

persons will be processed by the Board of Administration established pursuant to this Agreement of Termination. Exhibit B, attached hereto, lists the names of such employees, the amount of monthly benefit to which each is entitled, and the date of first payment, together with other personnel data.

(c) To issue annuities for payment commencing as of the first of the month following the attainment of age 65 or, if earlier, November 1 to all employees who are eligible for early retirement on or prior to the termination date. The applications of such persons will be processed by the Board of Administration established pursuant to the Agreement of Termination. Exhibit C, attached hereto, lists the names of such employees, the amount of the monthly benefit together with other personnel data.

That the Trustee shall be further instructed to withdraw from the Pension Fund sufficient money, not to exceed $5,000.00, to satisfy the following:

(1) Trustee's fees, expenses, including expenses attributable to the liquidation of the Plan and Pension Fund, and charges against the Pension Fund.

(2) All Actuary's fees incurred in administering the Plan subsequent to July 1.

(3) All legal counsel fees incurred in regard to terminating the Plan and liquidating the Trust Fund.

(4) Any other Fees or charges that may be incurred as a result of terminating the Plan and liquidating the Pension Fund.

That the Trustee shall then be instructed to pay out as of November 1, or as soon as possible thereafter, the assets remaining in the Pension Fund in the form of a single cash payment to (a) each remaining eligible employee who was on the union seniority rolls as of October 18 and who at that time had at least one year of credited service determined in accordance with the provisions of the Plan, (b) each employee who transferred on or after January 1 from a classification formerly covered by this Plan, and (c) each former employee who terminated prior to October 18 and who at his date or termination of employment was eligible for a deferred vested pension commencing after October 18 in accordance with Article II, Section 2, of the Plan and who makes written inquiry regarding his interests within 45 days after the post date of a registered letter mailed to his last known address.

APPENDIX X (Continued)

Inasmuch as there are not sufficient assets in the Pension Fund to insure that each person in the aforementioned groups will receive the full present value of his accrued benefits in the Plan, each such person in these groups will receive a cash payment which bears the same ratio to the total cash available as his credited service as of October 18 bears to the total credited service for all such persons. (As used herein credited service for employees who transferred on or after January 1, 1956, from a classification formerly covered by this Plan means the amount of credited service accrued on the date of transfer provided it was in excess of one year and credited service for former employees means the amount of credited service that was vested at time of termination.) Exhibit D hereto attached list the names of such employees and former employees and the amount of the cash payment to which each is entitled, together with other personnel data.

That there shall be established as of the termination date a Board of Administration consisting of six members, three members to be appointed by the Company and three members to be appointed by the Unions. (Each of the three bargaining groups mentioned herein will appoint a member.) The power of the Board of Administration shall be limited to:

(a) Taking such appropriate action as may be requested by the Trustee; and

(b) Instructing the Trustee to take whatever action is required.

The members of the Board of Administration shall use ordinary care and reasonable diligence in the exercise of these powers but shall not be liable for any mistake of judgment or other action taken in good faith. The Board of Administration shall cease to function on September 1.

FURTHERMORE, IT IS AGREED:

That any employee on the seniority rolls of the Unions as of October 18 who has as of such date, at least 10 years of credited service under the Plan, may elect to retire either normally or early at any time during the period from October 18 to May 31 and commence to receive a retirement benefit based on the Plan as in effect immediately prior to the termination date. Furthermore, any employee eligible for early retirement as of October 18, and who has made no application for retirement by May 31, may during the period from July 1 thru July 15 apply for early retirement effective as of September 1. If no election is made during the aforementioned period then such employee will be eligible to receive only the benefits as set forth in Exhibits B and C, attached hereto. Furthermore, any employee listed in Exhibit C, attached hereto, may, at his own option, retire at any point in time between September 1 and his commencement date and elect to receive on

APPENDIX X (Continued)

such date of retirement a benefit which is approximately equal to the actuarial equivalent of the benefit due on his commencement date. The amount of such benefit will be determined in accordance with the terms of the insurance company contract providing for annuity payments for certain employees covered by this Agreement.

IT IS ALSO AGREED:

That, if there should be provisions in any agreements of understandings, whether written or oral, between the Company and the Unions which shall be contrary to the provisions of this Agreement, the provisions of the Agreement shall supersede such provisions on and after the termination date.

IN WITNESS WHEREOF, the parties hereto have signed this Agreement as of the 1st day of November.

APPENDIX XI

ARTICLE XII

TERMINATION

. . . . . .

(1) In the event of discontinuance of the Plan, the assets then remaining in the Trust Fund, after providing the expenses of the Plan, shall be allocated by the Trustee, to the extent that they shall be sufficient, for the purpose of paying retirement benefits (the amount of which shall be computed on the basis of credited service to the date of discontinuance of the Plan and compensation accumulated) in the following order of precedence:

(a) To provide their retirement benefits to Employees who shall have retired under the Plan prior to its discontinuance, without reference to the order in which they shall have reached age 65;

(b) To provide normal retirement benefits to Employees aged 65 or over on the date of discontinuance of the Plan, without reference to the order in which they shall have reached age 65;

(c) To provide disability retirement benefits to Employees who shall have applied for such benefits prior to the date of discontinuance of the Plan and who are determined to have been eligible for such benefits under the provisions of the Plan prior to such date of discontinuance, with reference to the order in which they filed application or met eligibility requirements;

(d) To provide normal retirement benefits at age 65 to Employees aged sixty (60) or over but less than sixty-five (65) on the date of discontinuance of the Plan, without reference to the order in which they shall reach age 65;

(e) To provide normal retirement benefits at age 65 to Employees aged fifty (50) or over but less than sixty (60) on the date of discontinuance of the Plan without reference to the order in which they shall reach age 65;

(f) To provide normal retirement benefits at age 65 to Employees below the age of fifty (50) on the date of discontinuance of the Plan, without reference to the order in which they shall reach age 65.

(2) If, after having made provision in the above order or precedence for some but not all of the above categories, the assets then remaining in the Trust Fund are not sufficient to provide completely for the benefits for Employees in the next category, such benefits shall be provided for each such Employee on a prorated basis.

(3) For the purpose of determining whether or not an Employee has, on the date of discontinuance of the Plan, sufficient years of credited service to be eligible to receive a retirement benefit under the provisions of subsections (d), (e) and (f) above in this Article (but for no other purpose and in particular not for the purposes of determining the amount of the benefit) each Employee who is on such date less than sixty-five (65) shall receive credit as though his period of service included the period between the date of discontinuance of the Plan and his sixty-fifth birthday.

(4) Terminated employees with vested right under the Plan, and any death benefits provided under the Plan, shall be included in the allocation specified above in this Article in their appropriate categories, except that, within each category, Employees shall have precedence in the distribution of benefits. The company and the Trustee shall make reasonable effort to locate any terminated employees who have vested rights at the date of discontinuance of the Plan. However, if any such terminated employees have not been located within one year of said date of discontinuance, their rights shall stand forfeited.

(5) Such allocation shall be accomplished through either (i) continuance of the Trust Fund or a new Trust Fund, or (ii) purchase of annuity contracts, provided, however, that the Trustee upon finding that it is not practicable or desirable under the circumstances to do either of the foregoing with respect to some or all of the groups listed above may, with the consent of the Company, provide for allocation of a part or all of the assets of the Trust Fund as cash payments of equivalent actuarial value to any or all of such groups, provided, however, that no change shall be effected in the order of precedence and basis for allocation above established.

(6) Notwithstanding any other provisions of the Plan, for the purposes of this Article, no Employee shall cease to be an Employee merely as a direct result of circumstances leading up to the termination of the Plan.

DEPOSIT ADMINISTRATION

## ARTICLE XII--TERMINATION OF THE PLAN

1. In the event of the termination of the Plan, any funds held by the Funding agent, after provision for expenses of administration and liquidation of the Pension Fund as determined by the Board, which have not been theretofore allocated or applied to purchase annuities, as the case may be, for employees and retired employees, shall be applied to purchase of annuities pursuant to the contract (based on Credited Service to the date of termination of the Plan), to commence immediately for employees then age sixty-five (65) or over and for employees under age sixty-five (65), then receiving disability pensions, and to commence at age sixty-five (65), in the following order of precedence to the extent that they are sufficient to provide the excess, if any, of the benefits provided already purchased, as the case may be, without reference to the order of retirement, or the order in which they shall have reached or shall reach age sixty-five (65):

(a) All employees who shall have retired under the Plan prior to its termination (including employees under age sixty-five (65) at the date of termination who then are receiving or have been approved for disability benefits);

(b) All other employees age 65 or over on the date of termination;

(c) All other employees age 60 or over but less than age 65 on the date of termination;

(d) All other employees age fifty (50) or over but less than age 60 on the date of termination;

(e) All other employees below the age of 50 on the date of termination.

2. In the event of the termination of this Agreement, no part of the corpus or income of the Plan can be used for, or diverted to, purposes other than the exclusive use of the beneficiaries and employees covered by the Plan.

3. Notwithstanding any other provisions of the Plan, for the purposes of this Article, no employee shall cease to be an employee merely as a direct result of circumstances leading up to the termination of the Plan.

APPENDIX XII

PENSION AGREEMENT

Foundry - Electronics Corp.

ARTICLE XII

Amendment and Duration of the Plan

1. The Plan may be modified, altered or amended upon mutual agreement of the Company and the Union. Any modifications, alterations or amendments required by the Bureau of Internal Revenue, for the purpose of approval of the Plan under Section 165 of the Internal Revenue Code, may be made retroactively and shall be accomplished by action of the Board of Administration with the consent of the Company and the Union.

2. The Plan shall continue in full force and effect for a period of five (5) years from and after the effective date hereof, and thereafter until either the Company or the Union serves upon the other a written sixty day notice of desire to negotiate with respect to a modification of the Plan. Negotiations shall commence at the expiration of said sixty day period or earlier by mutual agreement of the parties at any time during such negotiations or at any time after the expiration of said sixty-day period either party may serve upon the other a second written sixty-day notice of desire to terminate, in which event this Plan shall terminate sixty days after such termination notice has been served. . . . . . .

ARTICLE XIII

Termination of the Plan

In the event of discontinuance of the Plan, the assets then remaining in the Trust Fund, after providing the expenses of the Plan, shall be allocated, to the extent that they shall be sufficient, for the purpose of paying retirement benefits (based on credited service to the date of discontinuance of the Plan) to retirees in the following order or precedence:

(a) To provide their retirement benefits to Employees who shall have retired under the Plan prior to its discontinuance, without reference to the order of retirement.

APPENDIX XII (Continued)

(b) To provide normal retirement benefits upon normal retirement to Employees aged sixty-five (65) or over on the date of discontinuance, without reference to the order in which they shall have reached normal retirement age.

(c) To provide normal retirement benefits upon normal retirement to Employees aged sixty (60) or over but less than sixty-five (65) on the date of discontinuance, without reference to the order in which they shall reach normal retirement age.

(d) To provide normal retirement benefits upon normal retirement to Employees aged fifty (50) or over but less than sixty (60) on the date of discontinuance, without reference to the order in which they shall reach normal retirement age.

(e) To provide normal retirement benefits upon normal retirement to Employees below the age of fifty (50) on the date of discontinuance, without reference to the order in which they shall reach normal retirement age.

Such allocation shall be accomplished through either (i) continuance of the Trust Fund or a new Trust Fund, or (ii) purchase of insurance annuity contracts; provided, however, that the Board, upon finding that it is not practicable or desirable under the circumstances to do either of the foregoing with respect to some or all of the groups listed above; may, with the unanimous consent of all its members, provide for some allocation of a part of all of the assets of the Trust Fund other than the continuance of a Trust Fund or the purchase of insurance annuity contracts with respect to any or all of such groups; provided, however, that no change shall be effected in the order of precedence and basis for allocation above established.

## SECTION 6--AMENDMENT OR TERMINATION

The Company may, at any time, amend this agreement, provided, however, that no such action shall cause any part of the corpus or income of this Trust to be used for, or diverted to, purposes other than for the exclusive benefit of the employees or retired employees of the Company, prior to the satisfaction of all liabilities with respect to such employees under the Trust; and provided, further, that the duties and responsibilities of the Trustee shall not be materially increased without its consent. The work "Plan," as used in this agreement shall be understood to mean the Plan as it may be amended from time to time.

In the event of the termination of the Plan in accordance with its terms, the Trustee shall distribute the net assets in its hands in such manner as may be directed by the Joint Board of Administration, provided that in no event shall any such assets be returned to the

APPENDIX XII (Continued)

Company, except such amounts as may remain after satisfaction of all liabilities under the Plan and arise out of variations in actual from expected actuarial requirements.

# APPENDIX XIII

## A SHORT REVIEW OF LACROSSE REEMPLOYMENT STUDY

Published by the Wisconsin State Employment Service
In Cooperation With the Unemployment Compensation
Department, September, 1960

Employment opportunity lost to the community by the plant closing represented about 10% of all community employment, and other industries in LaCrosse were also having economic difficulties. The company surveyed the unemployment problem about the time the plant was closed in July of 1959 and some of their findings are summarized in Table 3, A., B., C. These data can be contrasted to the situation prevailing nine months later as surveyed by a study of 1,141 former Auto Lite employees by the State Employment Service, and some indicative statistics of this study appear in Table 1D. Reemployment was not indicative of a return to economic normalcy, for over two-thirds of those who were reemployed were earning less pay, as much as one-half the former wage level of $2.81 per hour for the men and $2.60 for the women at Auto Lite. Forty per cent of those who reported they had been reemployed were working outside of LaCrosse, and a fourth of these were outside of Wisconsin. Perhaps of most significance to policy decisions in the termination of pension plan was a host of data which indicated job discrimination against the worker over age 45 and the fact that full-time, permanent, re-employment correlated inversely with age and a lack of willingness to leave the LaCrosse area, as reflected in Table 1E. Wisconsin's unemployment compensation law permits a maximum of 34 weeks of benefits if the subject has worked 45 weeks of the preceding 52. However, cyclical employment in the year prior to termination indicated that Auto Lite employment had averaged only 32 weeks. Nevertheless, at least 868 workers, 512 of them women, applied for and received some unemployment benefits averaging more than $38.50 a week. One-half the men and 85% of the women exhausted their unemployment benefits without finding employment, and there were numerous relief situations or families which reported children leaving high school to take needed part-time jobs. A million dollars was paid to these workers in unemployment compensation, far in excess of the Auto Lite account. Real estate values were depressed which hindered or forced sale of properties by at least 10% of the work force, and naturally business in the area suffered a reduced business volume.

## APPENDIX XIII (Continued)

### A. Employment Status by Occupation, July, 1959

| Occupation | Unemployed | Employed | Retired | Unknown |
|---|---|---|---|---|
| All occupations | 1,421 | 251 | 28 | 95 |
| Prof., Semi-prof., and Managerial | 5 | 41 | 3 | 3 |
| Clerical and Sales | 139 | 70 | 1 | 13 |
| Service | 8 | 2 | 3 | 0 |
| Skilled | 49 | 45 | 3 | 0 |
| Semi-skilled and Unskilled | 2,220 | 91 | 7 | 79 |
| Unknown | 0 | 2 | 11 | 0 |

### B. Employment Status by Age and Sex,* July, 1959

| | Male | | | Female | | |
|---|---|---|---|---|---|---|
| Age Group | Unemployed | Employed | Retired | Unemployed | Employed | Retired |
| All Ages | 586 | 140 | 9 | 771 | 26 | 1 |
| Under 25 | 1 | 6 | 0 | 5 | 4 | 0 |
| 25-34 | 34 | 13 | 0 | 122 | 6 | 0 |
| 35-44 | 158 | 41 | 0 | 234 | 12 | 0 |
| 45-54 | 245 | 60 | 0 | 268 | 4 | 0 |
| 55 & over | 148 | 20 | 9 | 142 | 0 | 1 |

*262 unclassified by age or unemployment status omitted.

### C. Percent Willing To Move To Obtain Work* by Occupation, July, 1959

| | Male | | Female | |
|---|---|---|---|---|
| Occupational Group | Total Men Classified | Percent Willing to Move | Total Women Classified | Percent Willing to Move |
| All occupations | 761 | 33% | 854 | 10% |
| Prof., Semi-prof. & Managerial | 48 | 79 | 1 | 0 |
| Clerical & Sales | 137 | 31 | 43 | 2 |
| Service | 11 | 0 | 2 | 0 |
| Skilled | 97 | 55 | 0 | - |
| Semi-skilled & Unskilled | 468 | 33 | 808 | 11 |

*180 unclassified by occupation or willingness to move omitted.

APPENDIX XIV

GOODYEAR TIRE & RUBBER COMPANY

(Severance Pay Provision)

Section A--Eligibility

"1. The employer will pay a service award to any employee who has five or more years of continuous service and who is not eligible for a pension under any pension plan of the company or any Employer and

"(a) who retires after having attained the age of 65 years, or

"(b) who is retired by his employer because he is no longer able to meet the requirements of his job and is unable to qualify for transfer to another job.

"2. Any dispute regarding an employee's qualification for transfer to another or his ability to meet the requirements of his job shall be subject to the grievance procedure provided for in the basic agreement."

Section B--Amount of Service Award

"1. The amount of the service award will be computed on the basis of a percentage of the Employee's total earnings during his period of continuous service determined as follows:

"For an employee with at least 5 and less than 10 years of continuous service--2%.

"For an employee with at least 10 and less than 15 years of continuous service--2½%.

"For an employee with 15 or more years of continuous service--3%.

"For an employee with at least 5 years of continuous service who retires or is retired on or after attaining age 65--3%.

"2. Earnings, as used in this Part IV, shall mean the entire amount of compensation paid to an employee by the company or any subsidiary of the company, including piece-work earnings, bonuses, overtime pay, shift premiums, vacation pay, reporting for work pay and holiday pay. The earnings of an employee for all periods prior to January 1, 1955, shall be the amount determined at the time of his retirement by multiplying his average annual earnings during the ten-year period commencing January 1, 1945, by the number of full years and twelfths of a year between the first of the month in which his continuous service date falls and January 1, 1955. If an employee had no earnings during a portion or all of any year or years in the period for which his average annual earnings are to be determined, his average annual earnings shall be adjusted on the basis employed in determining average annual earnings of an employee under the applicable provisions

APPENDIX XIV (Continued)

and administrative regulations of the 1950 pension plan.

"3. For Purposes of this Part IV the continuous service of an employee who retires or is retired after February 1, 1957, shall not include any service after his attainment of age 65."

Section C--Miscellaneous

"1. An employee, by acceptance of a service award, thereby terminates his service with his employer.

"2. It is not the intention to grant service awards to temporarily disabled employees under the age of 65 who desire to leave the service of the employer of their own volition and are still considered employable by the employer."

# APPENDIX XV

## LUMP SUM PAYMENT AT RETIREMENT RULES

### Basic Steel

The basic steel contract provides

"Pay to each employee upon retirement under the pension plan or after January 1, 1960, except to those becoming entitled to disability or deferred vested pensions, an amount (to be called "special retirement payment") equal to 13 weeks of vacation pay (at the rate of pay for the vacation to which such employee is entitled for the year in which retirement occurs), reduced by any pay for vacation previously taken in the calendar year in which retirement occurs. If an employee has not taken his vacation in such calendar year prior to the date of his retirement, he shall not be required to take a vacation in that calendar year and he shall not be entitled to vacation for that calendar year. Regularly monthly pension payments will commence with the month following the three months for which such special retirement payment was paid."

### Aluminum Company of America

The Aluminum Company of America contract provides:

"Pay to each employee retiring under the pension plan on or after January 1, 1960, except to those becoming entitled to disability or deferred vested pensions, an amount (to be called "special retirement payment" and to be paid from the pension fund) equal to 13 weeks of vacation pay (at the pay for the vacation to which such employee is entitled for the year in which retirement occurs) minus any vacation pay received or receivable for that year. Regular monthly pension payments will commence with the month following the three months for which such special retirement payment was paid."

Employee Benefit Plan Review, op. cit., 111.22-1, 1-60.

APPENDIX XV (Continued)

AMERICAN CAN COMPANY

(Steelworkers)

This provision was negotiated in 1956 and remains unchanged in the 1959 contract:

"Section 1. Notwithstanding any other provision of the pension plan, any employee who shall be laid off and not recalled within two years, or whose employment shall be terminated as a result of a plant closing, after he shall have reached his 40th birthday and who at such time shall have 15 or more years of accredited service, shall be eligible, upon making application therefor, as specified****, to receive a deferred vested retirement pension in the amount provided (normal retirement benefit).

"Section 2. Application for a deferred vested retirement pension must be made to the company by an applicant otherwise eligible therefor, but not earlier than 90 days prior to his regular retirement age, and not later than his 70th birthday; otherwise, no deferred vested retirement pension shall be payable to him at any time.

"Section 3. If an employee eligible for a deferred vested retirement pension shall be recalled by the company prior to his regular retirement age and prior to his application for a deferred vested retirement pension, his eligibility and benefits under this pension plan shall be determined upon the basis of his accredited service prior to such layoff plus his accredited service after recall.

Section 4. If a person eligible for a deferred vested retirement pension shall be re-employed by the company after termination as a result of a plant closing prior to his regular retirement age and prior to his application for a deferred vested retirement pension, his eligibility and benefits under this pension plan shall be determined upon the basis of the accredited service which he had accumulated prior to such termination plus his accredited service after re-employment."

Employee Benefit Plan Review, op. cit., 111.22.-7, 9-60 Revised

APPENDIX XV (Continued)

## DISCONTINUANCE OF OPERATIONS

(Part V)

"If operations at any of the 10 locations covered by this agreement shall be completely and permanently discontinued while this agreement is in force, it is agreed, with respect to those employees whose employment is terminated as a result of such discontinuance of operations, that the employer formerly conducting operations at such location:

"(a) Will give its written consent to the early retirement, under the 1950 Pension Plan, of such of said employees as are then otherwise eligible for a pension on early retirement under said plan, and

"(b) In the case of employees ineligible for a pension under any pension plan of the company or any employer and also ineligible for a service award under Part IV hereof, will pay to each such employee any cash amount (but no other benefit) which he would have been entitled to receive as a service award if he had then been retired by his employer because he was no longer able to meet the requirements of his job and was unable to qualify for transfer to another job."

Employee Benefit Plan Review, op. cit., 111.22.-5, 7-59 Revised

 65-4800

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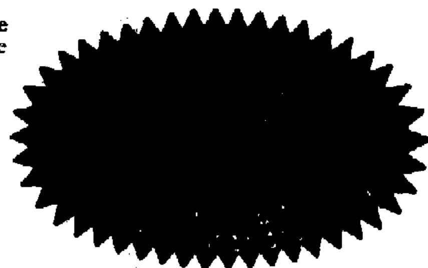

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