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PENSION PLAN TERMINATION INSURANCE: DOES THE FOREIGN EXPERIENCE HAVE RELEVANCE FOR THE UNITED STATES?

An EBRI Policy Forum

EMPLOYEE BENEFIT RESEARCH INSTITUTE

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PENSION PLAN TERMINATION INSURANCE:

DOES THE FOREIGN EXPERIENCE HAVE RELEVANCE FOR THE UNITED STATES?

An EBRI Policy Forum
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CONTENTS

FOREWORD iv

EDITOR'S PREFACE v

EXECUTIVE SUMMARY vi

THE PENSION REINSURANCE PROGRAM
IN THE UNITED STATES 1

PENSION PLAN CREDIT AND INSOLVENCY
INSURANCE: THE FOREIGN EXPERIENCE 31

INSURANCE PROGRAM ISSUES: A DISCUSSION 41

CREDIT AND INSOLVENCY INSURANCE
PROGRAMS: SUPPLEMENTAL COMPARISONS 59

QUESTIONS AND ANSWERS 79

APPENDIX A: FEDERAL REPUBLIC OF GERMANY 109

APPENDIX B: FINLAND 121

APPENDIX C: SWEDEN 131

APPENDIX D: JAPAN 141

FORUM ATTENDANTS 154

ABOUT THE EDITOR 160

FOREWORD

Passage of the Employee Retirement Income Security Act of 1974 (ERISA) brought with it a new experiment in social programs: private defined benefit pension plan termination insurance. The experiment applied immediately to single employer plans, but deferred full coverage for multiemployer plans. The experiment created employer liability for unfunded vested benefits, but muted plan sponsor concern by requiring the Pension Benefit Guarantee Corporation (PBGC) to offer Contingent Employer Liability Insurance (CELI).

During 1977, the PBGC issued reports which concluded that the application of ERISA insurance provisions to multiemployer plans would not work, and that CELI was not feasible. Proposals have now been set out in these areas for Congressional considerations. The proposals lend themselves to analysis vis-a-vis the policy responses of foreign nations to similar problems.

The EBRI Policy Forum reported on in this book sought to elicit such analysis. Further, it provided the basis for a more thorough understanding of the selected foreign systems represented at the forum.

EBRI was established to contribute to the development of effective and responsible public policy in the field of employee benefits. The book should make such a contribution.

The forum would not have been possible without the cooperation and contribution of participants. To each of them, I express the appreciation and thanks of EBRI. A special thanks is extended to Mr. George B. Swick and Dr. Kenneth W. Tolo for their contributions, which made the forum and this book possible.

Dallas L. Salisbury
Executive Director

EDITOR'S PREFACE

On June 25, 1979, the Employee Benefit Research Institute (EBRI) sponsored an international conference in Washington, D.C. on pension plan insurance programs. Representatives from the Federal Republic of Germany, Finland, Japan, and Sweden were in attendance, as well as government, labor, management, and investment officials active in and knowledgeable about the United States private pension system.

This volume provides an overview of the pension plan termination insurance program in the United States and the pension plan credit or insolvency insurance programs in Germany, Finland, and Sweden. These foreign programs are described further in responses to common questions posed to program administrators prior to the June 25 conference and in Appendices A through D. We gratefully acknowledge the receipt of materials from the foreign participants which appear in these Appendices. Also included is an extended discussion among all conference participants on termination insurance issues in the United States and the applicability of foreign experiences to the resolution of these issues.

George B. Swick, Chairman of the EBRI Research Committee, presented the opening paper on the United States insurance program and moderated the subsequent discussion of insurance program issues. Burkhard Fürer, International Pension Consultants GmbH (Weisbaden, Germany) provided conference participants with an excellent overview of European programs. The program summaries of the participating countries, their responses to common questions, and the conference discussion were prepared for publication by the editor from materials submitted by the foreign representatives and from a transcript of the forum.

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EXECUTIVE SUMMARY

Five years have elapsed since the enactment of the pension plan termination insurance program in Title IV of the Employee Retirement Income Security Act (ERISA) of 1974. Unquestionably, this program has had a substantial, long-term positive influence on retirement income in the United States. Yet its implementation has not been without problems or identified needs, including the nature of the insurable event and the nature of the pension (i.e., funding) obligation.

Among other developed countries, three--the Federal Republic of Germany, Finland, and Sweden--have pension plan insurance programs, but each differs from that of the United States. In Germany there exists an insolvency insurance program, while a credit insurance program is operational in each of the two Scandinavian countries. Although the different characteristics of each country's pension system and insurance program make extensive comparisons with the United States' system difficult, nevertheless the review of the primary elements of these foreign systems provided in this volume does suggest a few approaches of possible relevance to the United States.

One important characteristic of European insurance programs regarded favorably by conference participants is the acceptance of insolvency, rather than voluntary termination, as the insurable event. European participants found it difficult to understand why the insurable event in the United States program should be influenced by the policyholder. As a matter of fact, the Pension Benefit Guaranty Corporation (PBGC), through its current legislative proposals, already appears to be moving toward the European emphasis on insolvency in an effort to mitigate existing plan termination problems.

A second characteristic of the United States termination insurance program that was questioned repeatedly by foreign participants in the conference was the 30 percent of net worth liability limitation at the time of termination. European officials failed to understand why employer liability is not 100 percent, and, in fact, this also is recognized in the United States as a current problem of the United States system. Proposals which could move the United States system closer to the European systems in this respect are now receiving greater attention in the pension community.

The European approaches to the specification of premium payment levels also may be relevant to the United States. The United States termination insurance program is financed by a uniform per capita premium, whereas the three European systems are financed by risk-related premiums or premiums related to liability. Either of these alternatives may offer a more equitable approach to insurance program financing in the United States.

The book reserve, or internal, approaches to financing benefits that Germany and Sweden have incorporated into their respective insurance programs deserve greater attention in the United States. Interest in the

United States in adopting the book reserve approach as a funding alternative generally has been less than enthusiastic, given the current lack of actuarial and accounting standards and an incomplete understanding of the fiduciary responsibility of the plan sponsor. But, in fact, the unfunded liabilities of United States plans are similar, in many respects, to the book reserves of the German system--yet they lack the latter's tax advantages. German employers have been willing to pay the greater costs necessary to make their system a true insurance program because they, in turn, are able to benefit from the book reserve system and its associated tax benefits. Perhaps a closer look at both German and United States funding practices might suggest ways in which the United States could similarly "package" insurance program revisions.

Whether the United States should adopt a minimum retirement income target is another issue that surfaced during the conference discussions about European pension systems. In these other countries, a basic public sector retirement program and a mandatory private sector scheme generally form the basis for achieving the established wage replacement rate. The conference discussion raised the issue whether the United States also should move toward a two-tier private pension system, with the first tier mandatory (and joined with Social Security) and the second tier voluntary and used to meet the individual needs of different employment settings.

Although conference participants raised these (and other) issues regarding foreign pension insurance programs that have, to a greater or lesser degree, relevance for the United States termination insurance program, participants also continually emphasized the differences in the systems. Clearly, pension program officials and plan administrators can benefit by considering the adoption of foreign approaches in the United States program. Yet, as importantly, they must use caution as they proceed with their international comparisons.

THE PENSION REINSURANCE PROGRAM IN THE UNITED STATES*

The enactment in 1974 of Title IV (pension plan termination insurance) of the Employee Retirement Income Security Act (ERISA) has had a greater impact on retirement income in the United States than any other event since the enactment of the federal Social Security Act in 1935.

HISTORY OF PENSION PROTECTION IN THE UNITED STATES

The first pension plan in the United States was established by New York City in 1859, covering its policemen. The first plan in industry was the American Express Company plan in 1875. Another significant year was 1905 when the Granite Cutters established the first trade union (multi-employer) plan. All these plans, as well as all other plans established before 1917, were funded on a pay-as-you-go basis. No reserves were established from contributions of the plan sponsors. If a plan sponsor became insolvent or terminated the plan, the pension payments generally stopped and all benefits were lost.

Some of the early plans required employee contributions, in which case these amounts were accumulated in employees' accounts. However, it took 58 years from the establishment of the first pension plan to the establishment of the first funded plan in the United States. The first plan established on a funded basis for both the employees' and the employer's money was the Teachers' Retirement System of the City of New York, which began operating in 1917. In 1921, the first insured group annuity contract was issued by the Metropolitan Life Insurance Company of New York.

In 1935, the establishment of the federal Social Security system greatly expanded the idea of pension planning and created a floor of protection. Contributions were paid into the fund starting in 1937, although benefit payments did not begin until 1940. As a result, a fund was created from which benefits were paid. In the early days the fund and incoming contributions were sufficiently large to maintain the benefits on an actuarially sound basis. This, together with the fact that the official name of the Social Security Act is the "Federal Insurance and Contribution Act," has led most people erroneously to view Social Security as insured and actuarially sound, and to expect a relationship between their contributions and expected benefits similar to the relationship between premiums and proceeds from an insurance company.

By 1940, the private pension system in the United States covered more than 4 million persons (out of a total population slightly more than 130 million) receiving annual benefits of $140 million. Pension reserves totaled $2.4 billion in 1940, one-fifth of what they would be ten years later.

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*Presentation given by George B. Swick, Chairman of EBRI's Research Committee. Assistance in the preparation of these remarks was given by David H. Gravitz, Consulting Actuary, Buck Consultants, Inc.

There were two major causes of expansion in the private pension system in the 1940s. Inflation and taxation during World War II stimulated the expansion of private pension plans in industry. More than 2-1/4 million additional workers became covered by plans by 1945. The other major factor encouraging the spread of private pensions stemmed from collective bargaining. After World War II, many unions wanted to include pensions and other welfare benefits in the labor negotiation process. In a landmark decision, the United States Supreme Court ruled in 1949 (Inland Steel Co. v. National Labor Relations Board) that employers were required to bargain on the issue of pensions. Also in 1949, the Steel Industry Fact-Finding Board held that the steel industry had an obligation to provide its workers with pensions and other welfare benefits to take care of temporary and permanent depreciation of human machinery. From 1950 on, the unions have been an important factor in the spread and direction of pension coverage in the United States.

By 1950, more than 10 million persons (out of a total population in excess of 150 million) were covered under private pension plans. Pension reserves approached $12 billion and annual payments to beneficiaries totaled $370 million. Annual contributions to these plans exceeded $2 billion by 1950.

Concern had been expressed for many years by a growing number of observers as to how well private pension programs were functioning. While only a small percentage of pension plans had actually failed, a considerable number of workers did lose benefits even after many years of service. Vested rights for workers were far from universal, and the funding provisions for some plans were less than sound.

During the 1950s and 1960s, typical eligibility requirements for vesting for plans that had vesting were 15 years of service and attainment of ages 40 or 45, but in many cases the employee had to be laid off or lose his job through a plant closing to vest; employees who quit could not get a benefit unless they were eligible to retire. Many plans had no vesting before reaching retirement age. In short, from 1950 through 1974 employees had limited guarantees that their pensions would be paid if their plan terminated.

Some pension plans were insured. To the extent pensions were purchased from and guaranteed by an insurance company, they would be paid. Under trusteed plans and certain insured plans, however, employees could look only to the funds already accumulated for payment of their pensions. The allocation of the available funds also could vary widely from plan to plan, depending on the rules of the plan and the Internal Revenue Service (IRS) regulations. Some employees would receive their entire pension, some would receive a portion of it, and some employees would receive nothing. Companies were not legally required to guarantee pensions. Occasionally a company would undertake to provide pensions payable to the extent the pension fund was insufficient, but this was a voluntary act, not required by law.

One large union took the position that funding was not important provided the employers were contractually liable to pay pensions to the

extent the pension fund was unable to pay them. Another large union took the opposite approach. Its pension settlements did not require the employer to guarantee payments of pensions; however, the contributions were required to be actuarially determined and be at least equal to the normal cost plus 30-year amortization of the unfunded past service cost. Other unions (e.g., in the craft trades, construction industry, and maritime industry) felt there was strength in numbers and had all employers contribute to a single pension plan. Under these multiemployer plans, covered employees could move from participating employer to participating employer without loss of pension credits. Conservative funding was not considered necessary because many employers were contributing.

The "Studebaker Incident"

In 1963 an event occurred that brought to the forefront the question of pension security in the United States and led directly, 11 years later, to the passage of ERISA. In December of that year, Studebaker, a large automobile manufacturer, closed its main United States plant in South Bend, Indiana. Thousands of employees were put out of work and the pension plan was terminated. The plan had been negotiated with the United Auto Workers (UAW) and contained the 30-year funding requirement described above.

The Studebaker plan had been amended just two years before the plant was closed. The amendments increased the benefits substantially, including benefits for past service. There was insufficient time in two years to build up the assets needed to augment the new past service benefits, even though the funding of the plan was in accordance with the labor agreement. As a result, the assets in the pension fund were insufficient to meet the pension liabilities. Although there was enough money to pay the benefits to those workers already retired (including the benefits that had been increased two years earlier), there was little left for the current work force. Employees within a few years of retirement lost about 40 percent of their pension. Younger employees lost their entire pension.

There are two points of interest here. First, the loss of pension benefits occurred despite the fact that the Studebaker Company met its 30-year funding obligation to the plan. Second, scheduled contributions under the plan exceeded the minimum funding requirements to be prescribed 11 years later by law (ERISA).

In the opinion of many pension experts, the Studebaker closing was the single most significant factor leading, first, to the passage of ERISA and, second, to the inclusion of termination insurance in ERISA (Title IV).

CURRENT STATUS OF PENSION PROGRAMS IN THE UNITED STATES

Federal Government Programs

The Social Security system in the United States provides a minimal level of retirement income. Benefits are provided free of tax, except that employee Social Security taxes are paid from after-tax income. The

benefits are fully vested and fully portable, and form an important source of retirement income to all covered workers. The Social Security system benefits, however, do not provide an acceptable level of retirement income and, as a result, private pension programs cover approximately 45 million workers in the United States.

While the federal Social Security system was established as a separate and segregated trust fund, with reserve accumulations fully contemplated, its provisions, both by statute and practice, furnish retirement income solely through a redistribution of wealth using the federal tax laws to furnish the necessary funds. Thus, federal Social Security benefits are guaranteed by the power of the federal government to tax its citizens--what economists call "transfer payments." It is not surprising, then, that over the years since 1935 the Social Security system has become a conduit through which tax revenues are redistributed to the retired population without significant accumulation of reserves.

Federal governmental employees, both civilian and military, are covered under comparable "funding" arrangements--that is, an allocation of federal tax revenues without a significant accumulation of reserves.

Interestingly, the receipts and disbursements of both Social Security and the federal governmental employee plans are included in the federal budget.

There is no reinsurance protection for participants in these plans other than the taxing powers of the federal government.

<u>State and Municipal Government Programs</u>

The United States consists of 50 states. Each state consists of smaller subdivisions of local governing bodies (counties, cities, towns, or villages), often collectively called municipalities or local governments. Each state and municipality has certain revenue raising powers, within the limits established by the particular state. An important aspect of our system is that the federal government has no control or authority over most taxes levied by the states on their citizens.

Employees of state and municipal governmental units may be covered by locally adopted governmental retirement systems either supplemental to or exclusive of coverage under the Social Security system. That is, state, county, and municipal governmental units participate in the Social Security system on a voluntary basis.

As in the case of federal government systems, state and municipal government programs are financed by local tax revenues. Some of these programs are well-funded, using sound actuarial principles, while others are handled as a direct "income transfer" redistribution of current tax revenues, without a significant accumulation of reserves.

Title IV of ERISA is specifically not applicable to these plans. As in the case of the federal programs, there is no reinsurance protection for participants in these plans beyond the ability of the local governmental units to tax their citizens.

Private Sector Programs

Private pension programs are established and financially supported by one of four types of arrangements:

* a single employer, unilaterally established;

* a single employer, established pursuant to a collectively bargained labor agreement;

* a group of employers acting as a multiple employer group, unilaterally established; or

* a board of trustees, acting as a multiemployer group, established pursuant to a series of collectively bargained labor agreements.

Private sector pension programs fall into one of two important categories. Under defined contribution plans, contribution rates are specified in dollars, percentages of compensation, or percentages of profits, and the available resources are then equitably assigned among individual participants. Under defined benefit plans, participants receive defined benefits in either specified dollar amounts or specified percentages of compensation, with the plan sponsors accepting responsibility for the financial resources.

Defined Contribution Plans. Under defined contribution plans, benefits to participants are directly related to accumulated financial resources. Investment performance, good or bad, inures directly to the plan participants. No other financial resources are available, and Title IV of ERISA is not applicable.

It is of interest to note that, under defined contribution plans, the entire proceeds can be invested in securities of the plan sponsor. Indeed, the Congress of the United States has indicated, through tax legislation, that it enthusiastically supports Employee Stock Ownership Plans under which employees obtain an ownership position in their employer by means of a defined contribution plan. The Congress has also encouraged the establishment of defined contribution plans for self-employed individuals and those individuals whose employers do not provide a pension plan, again through tax legislation. The Congress has not provided any reinsurance program for such plans, however; the plan participant assumes the entire investment risk.

Defined Benefit Plans for Single Employers. Under defined benefit plans, participants receive specified benefits upon satisfying specified age and service requirements. The important issue then becomes how the financial resources are to be provided by the plan sponsor or sponsors.

Prior to ERISA, the tax laws were used to encourage adequate funding and the accumulation of adequate reserves. The plan sponsors' financial contributions were tax deductible, provided that sound actuarial principles were followed and minimum contribution levels were met. Prior to ERISA, these plans could be terminated at any time. Most plans provided

that, in the event of plan termination, the participants could look only to the available assets of the plan for fulfillment of their benefit entitlement. In certain situations, however, collectively bargained labor agreements specified that the plan sponsor would guarantee benefits, if not covered by available assets, to the extent of its available resources. In a bankruptcy situation, plan participants could expect little, if any, financial recourse beyond the assets of the plan itself.

Under ERISA, the minimum contribution levels were strengthened and a most significant reinsurance program was added in Title IV. In contrast to the situation with respect to defined contribution plans, severe restrictions were placed upon investment in securities of the plan sponsor even though the participants were, for the most part, rendered risk-free by Title IV of ERISA.

Multiple Employer Plans. Multiple employer plans are, in general, an assembly of single employer plans for the purpose of joint administration. Each employer is essentially responsible for the financial security of its own employees, and Title IV of ERISA provides the same reinsurance security. These plans cover relatively few employees, and will not be the subject of further discussion.

Multiemployer Plans. While multiemployer plans present a difficult descriptive challenge, they do represent a major sector on the United States private pension scene. For the most part, these plans are defined benefit pension plans. They are established through a series of collective bargaining labor agreements between a single labor union and a group of employers whose employees are represented by that labor union. Contributions to the multiemployer plan are set forth in the collective bargaining agreements. These plans are administered by, and have their benefits established by, a board of trustees consisting of equal numbers of union and management representatives.

Prior to ERISA, multiemployer plans were generally considered to be defined contribution plans in the sense that each participating employer had no obligation beyond the requirement that it meet the contributions required by the labor agreement. Since these plans provide specified benefits to participants, the Congress included multiemployer plans within Title IV of ERISA, so that, theoretically at least, the participants in multiemployer plans had the same reinsurance provisions as participants in single employer defined benefit plans. In actual fact, however, the effective date of the application of Title IV to multiemployer plans has been deferred three times, most recently until May 1, 1980.

A joint board of trustees tested the application of Title IV of ERISA to multiemployer plans, contending that such plans were, in fact, defined contribution plans and thus not subject to Title IV of ERISA. The federal Supreme Court affirmed (in the case of Connolly v. PBGC) that Title IV of ERISA does not apply to multiemployer plans, however, when and if coverage is allowed to become effective.

PENSION PROTECTION UNDER ERISA

The so-called "broken promise"--the failure of pension plans to pay the pensions that employees (rightly or wrongly) expected to receive--surfaced in 1964 and inexorably led to the passage of ERISA 10 years later. Congressional concerns about pensions and the philosophy behind ERISA is evident in the declaration of policy in the beginning of ERISA.

> It is hereby declared to be the policy of this Act to protect ... the interests of participants in employee benefit plans and their beneficiaries, by requiring the disclosure and reporting to participants and beneficiaries of financial and other information with respect thereto, by establishing standards of fiduciary conduct, ... by improving the equitable character and the soundness of such plans by requiring them to vest the accrued benefits of employees with significant periods of service, to meet minimum standards of funding, and by requiring plan termination insurance.

Under ERISA, five principles were established on which pension security could theoretically rest:

* disclosure of pertinent information to employees;
* fiduciary standards of conduct;
* minimum vesting requirements;
* minimum funding standards; and
* plan termination insurance.

The first principle, <u>disclosure</u>, requires plan sponsors to inform participants of their rights and obligations under the plan and to provide them with the necessary information to make proper, informed decisions. <u>Fiduciary standards</u> assure employees that they will be treated equitably and fairly and that the pension funds will be used solely for their benefit. Under most plans, ERISA's <u>vesting</u> standards guarantee an employee with at least 10 years of service that he will be entitled to a benefit starting at normal retirement age (usually 65), regardless of the age his employment terminates. This avoids some of the pre-ERISA horror stories regarding employees with 20 or 30 years of service who did not receive a pension because they left the company prior to retirement (voluntarily or otherwise) or the plan was terminated shortly before they would have been eligible to retire.

The rest of this paper will deal primarily with the remaining two principles--<u>funding standards</u> and <u>plan termination insurance</u>. The first three principles are designed to ensure that all employees who are eligible to pension entitlement actually <u>become entitled to them</u>. Funding standards and termination insurance are designed to ensure that those employees who are entitled to pensions actually <u>receive them</u>.

Legislation addressing all five principles was considered necessary because previous laws were deemed insufficient to provide the desired protection to employees. However, it should be noted that even before ERISA was passed, laws existed--at both the federal and state levels--regarding disclosure, fiduciary standards, vesting requirements, and minimum funding standards. The only new concept produced by ERISA was plan termination insurance, a concept that had never before been considered in the United States. It is not unexpected, therefore, that such hasty legislation has resulted in massive problems, both conceptual and practical.

The full realization of these problems is only now coming into focus, five years after ERISA became law, as major revisions are being proposed to the Congress by the Pension Benefit Guaranty Corporation (PBGC), the agency created by Title IV of ERISA itself. As previously indicated, plan termination insurance is still not in effect for multiemployer pension plans.

PENSION FUNDING IN THE PRIVATE SECTOR

When all issues are reduced to basics, the single underlying element is funding--when, how, and by whom.

The very nature of pensions suggests pre-funding. Benefits are earned over an employee's working career and are paid out in retirement after the career ends. Properly, the liability must be recognized while the employee is working, since pensions are in the nature of deferred compensation. The early history of pensions is rife with the failure of pension plans that were administered on a pay-as-you-go basis. The low outlay in the early years enticed many employers into promising higher pensions. These employers, after a period of time, found their pension payments increasing at such a high rate that the plan could not be financially maintained.

A "funding method" is a budgeting process that provides an orderly accumulation of funds during a worker's employment to provide benefits when due--the accountant's concept of matching revenues and expenses. Ordinarily this does not create problems for a continuing plan. Pension costs, as a percentage of compensation, can be predicted for a plan within a relatively narrow range. Problems sometimes arise, however, when a company has overall financial problems, or in cases where the work force is declining.

Reasons for Insufficient Funding

Occasionally, due to these financial problems or for other reasons, a plan--voluntarily or involuntarily--terminates. When this happens, even in plans that have been in existence for many years, plan assets may not be sufficient to provide the vested benefits. Three circumstances that can lead to an insufficiency of plan assets are: depressed value of assets, early retirement, and past service.

Depressed Value of Assets. As a result of the vagaries of the investment decisions, less assets may be available to provide benefits than anticipated.

Early Retirement. Many plans provide early retirement benefits that significantly exceed the actuarial equivalent of the normal retirement benefits. The actuary normally expects only a fraction of those workers eligible to retire early in any year to actually retire in that year. When plan termination is accompanied by the closing of the facility or other termination of employment, however, as it often is, the increased number of early retirements can add significantly to the plan's pension liability.

Past Service. Pension plans are periodically improved, often every three years in many collectively bargained plans. When pension improvements are made, they are often granted for all previous service, as well as for service after the date of change. This increase in benefits for past service creates an immediate increase in vested liabilities under the plan (for all employees who are then vested). However, the increased liability is funded over a long period of time. Therefore, if a plan (even a well-funded plan) terminates soon after a sizable benefit increase is granted, there are likely to be unfunded vested benefits. This is what happened in the Studebaker situation described earlier. In addition, the required liberalization of the vesting requirements under ERISA has substantially increased vested liabilities under many plans. (In a later section is discussed the phase-in rule in relation to this situation.)

Table 1-1 shows the percentage of the past service liability that has been funded at various elapsed times after the liability is established, depending on the past service funding period used. Ten-year funding is the shortest period that can be used to obtain a fully tax-deductible contribution. Thirty or forty years represent the minimum past service funding requirements under ERISA, whereas interest-only funding was the minimum past service requirement before ERISA. Using a 6 percent interest rate, the table shows that during the first 10 years, the liability is more than ten times better funded on the 10-year period than the 40-year period, and that it takes over 20 years on 30-year funding and about 30 years on 40-year funding to fund even half of the past service liability.

Minimum Funding Requirements

Before ERISA, the minimum required contributions were equal to the normal cost plus interest on the unfunded past service cost on a cumulative basis. As shown in Table 1-1, past service costs would not be amortized on an interest-only basis and, in this case, the continuation of a plan was an absolute necessity to ensure payments of benefits. In effect, contributions on behalf of younger workers were helping to pay the past service benefits of pensioners. Under certain funding methods before ERISA, experience gains could be used as a direct offset against the next year's contributions.

TABLE 1-1

LEVEL OF PAST SERVICE BENEFIT FUNDED OVER A PERIOD OF TIME
(BASED ON 6% INTEREST RATE)

YEARS ELAPSED	FUNDING PERIOD (YEARS)				
	10	20	30	40	Interest Only
5	43%	15%	7%	4%	0%
10	100	36	17	9	0
15	100	63	29	15	0
20	100	100	47	24	0
30	100	100	100	51	0
40	100	100	100	100	0

The funding requirements under ERISA increased the contributions required under many plans. Under ERISA, the minimum required contribution is equal to:

* normal cost, plus

* 40-year funding of pre-ERISA past service costs, plus

* 30-year (40-year for multiemployer plans) funding of post-ERISA past service costs, plus

* 15-year (20-year for multiemployer plans) funding of experience gains and losses, plus

* 30-year funding of gains and losses resulting from changes in actuarial assumptions.

ERISA requires the enrolled actuary to maintain a funding standards account, to determine the required contributions, and to certify to the Internal Revenue Service (IRS) that the assumptions used are reasonable.

Each year the funding standards account is charged with the minimum required contributions to the plan and credited with the actual contributions made. If the charges exceed the credits, a funding deficiency exists and the plan becomes subject to additional taxes and penalties and is also required to report this occurrence to the PBGC as a reportable event. If the credits exceed the charges, the net credit balance is brought forward with interest. At any time, the net credit balance indicates approximately how much extra contributions over the minimum required

payments have been paid to the plan since the plan became subject to ERISA funding requirements. If a plan has a credit balance, its contributions may be reduced below the minimum ERISA requirements by an amount up to the credit balance without creating a funding deficiency.

Under the Internal Revenue Code, as amended by ERISA, the maximum tax-deductible contribution is equal to the normal cost plus 10-year funding of the past service cost. Before ERISA, the maximum deductible contribution was the normal cost plus 10 percent of the past service base.[1]

TERMINATION INSURANCE

Basic Purposes

The extent to which accruing benefits are often not funded until many years after they have accrued or become vested in employees is illustrated vividly in Table 1-1. If the plan terminates at a time when significant unfunded liabilities exist, there will generally not be enough assets in the plan to provide the vested benefits when due. This situation may be made worse, as indicated earlier, if the termination occurs during depressed securities markets or if an unusually large number of early retirements occur.

Society, as represented by the Congress, has determined that the loss of these pension benefits should not be borne solely by the employees involved, as had been the case in the past, and that it is the duty of the federal government to provide these benefits from funds to which all covered pension plans contribute. The federal agency which administers this program is called the Pension Benefit Guaranty Corporation (PBGC).

If this were the complete issue, termination insurance would be a relatively simple concept. However, there would be nothing to prevent an employer from establishing a high level of vested benefits in a plan, terminating the plan, and walking away from his responsibility, with the PBGC and, therefore, the economy in general "holding the bag." In its attempt to inhibit such conduct, the Congress created the fundamental issue that complicates Title IV--employer liability. Employer liability gives the PBGC the right to recover from the employer up to 30 percent of the employer's net worth to offset, in part, the cost of benefits paid by the PBGC as a result of the plan termination. The United States Court of Appeals (in _Nachman_ v. _PBGC and UAW_) upheld the right of ERISA to subject employers to liability for the payment of vested benefits. A separate District Court decision (_PBGC_ v. _Ouimet Corporation and others_) held that employers under common control may be held liable for the employer liability under a pension plan of a bankrupt affiliated company (i.e., within the "controlled group").

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[1]Ten percent of the past service base is about 16-year funding on 6 percent interest. Ten-year funding of the past service cost on 6 percent interest is about 13.6 percent of the base.

The Congress went one step further and said that the requirements for pension plans should not be so onerous that employers would not create new pension plans or improve existing plans. Therefore, it established the concept of contingent employer liability insurance (CELI), whereby the PBGC would develop an insurance system under which employers could protect themselves against all or part of the 30 percent liability.

One other aspect of ERISA will be noted here but developed in a subsequent section. The law provides for a phase-in of benefits guaranteed by the PBGC over a five-year period following the establishment of the plan or an amendment increasing the benefits. The intent is to balance the need to protect the PBGC against early termination of the plan with the need of employees to receive their vested benefits.

Probably the most difficult conceptual and developmental problem under ERISA is the establishment of a viable system of termination insurance incorporatng the elements described above. The relationship among premiums, guaranteed benefits, employer liability, and CELI are extremely complex, with the development of a practical system at best difficult and perhaps impossible.

The goals of the PBGC in establishing levels of premiums, guaranteed benefits, employer liability, and CELI have been succinctly stated by the PBGC (in a paper defining the program objectives of CELI) as follows:

* to assure a financially substainable program at reasonable premium levels;

* to provide adequate protection relative to the needs of plan participants, employers, and creditors;

* to minimize abuse;

* to minimize administrative complexity; and

* to balance social and equity considerations.

Relation to Funding

It is natural to relate termination insurance to funding. Funding provides the first source to pay benefits--plan assets. Termination insurance provides the second. Although pension actuaries have been aware of the problem of termination since the advent of pension plans, no adequate solution has as yet been brought forward other than accelerated funding or conversion to a defined contribution plan.

The PBGC is, in effect, the reinsurer of pension benefits, with the pension trust the primary insurer. As a reinsurer, the PBGC thus provides excess coverage over the available assets, plus a deductible related to 30 percent of the net worth of the plan sponsor. If a defined benefit plan terminates at a time when the assets are not sufficient to provide all of the guaranteed benefits under ERISA, the PBGC (as agent for all other plan sponsors) must pay these unfunded benefits. If the plan had been better

funded, the PBGC might not have to pay benefits; if the plan had been less well-funded, the PBGC liability would be greater. Despite this, funding at the maximum tax-deductible level does not guarantee that assets will be sufficient at all times to pay guaranteed benefits. Other plans using the minimum funding level still may have sufficient assets. Nevertheless, the plan adopting a faster funding schedule would have more assets at all times than if it adopted a slower funding schedule.

Unfortunately, the design of the deductible amount violates the basic principles of insurance. This results from the fact that the deductible amount is not predetermined and is based on an unrelated condition--the net worth of the plan sponsor. In addition, the insured (including plan participants through their collective bargaining representative) can increase the insurance coverage (benefits) without the consent of the insurer (PBGC).

It is essential, therefore, that some return to these basic insurance principles be accomplished. That is, some risk must be borne by the decision-makers, be the decision-maker (a) the plan participants through establishment of higher insured amounts, or (b) the plan sponsor through the failure to maintain adequate funding or an adequate deductible (net worth). In the absence of an attempt to return to basic insurance principles (i.e., risk borne by <u>related</u> plan sponsors and their employees), the only solution can be excessive premiums (i.e., risk borne by <u>unrelated</u> plan sponsors) or application of general tax revenues (i.e., risk borne by the general taxpayer).

Levels of Guaranteed Benefits

Termination insurance under ERISA is intimately tied to the level of guaranteed benefits. Basic premium levels, PBGC liabilities, employer liabilities, and CELI will all be affected by the amounts of benefits that are guaranteed by the PBGC.

Two areas of major concern require attention in the legislated levels of guaranteed benefits. The first is early retirement benefits that exceed the actuarial equivalent of the accrued benefit payable at normal retirement age. The second is the existence and application of the phase-in rules.

<u>Early Retirement</u>. The PBGC approach on guaranteeing early retirement benefits is to compare the actual early-immediate pension with the actuarial equivalent of the maximum benefit payable at age 65. The higher of these two amounts is guaranteed. Therefore, the value of the plan's guaranteed early retirement benefit can be significantly greater than the value of the plan's guaranteed normal retirement pension if the maximum limits do not apply.

In determining the funding requirements for a plan, actuaries commonly assume--and experience bears them out--that only some of the employees eligible to retire early in any year will elect to do so. When a plan is terminated, however, the number of early retirements can be expected to increase significantly. This is especially true in the case of a complete

shutdown of operations, where--under PBGC regulations--early retirement entitlement is extended to all employees who met the requirements for early retirement, except that they did not submit an application. When this happens, if the early retirement benefit is greater than the actuarial equivalent, substantial additional liability is thrust upon the plan. Depending on the levels of plan assets and employer net worth, this burden may reduce the benefits of other plan participants or may increase the liability of the employer or the PBGC (or, more appropriately, all other plan sponsors).

Consideration should be given to limiting the maximum guaranteed benefit on early retirement to the actuarial equivalent of either the participant's accrued retirement benefit or the ERISA maximum guaranteed benefit, whichever is lower. This concept is fully in accord with the social philosophy espoused by the Congress under the Social Security system. Social Security does not provide unreduced early retirement benefits except in the case of disability. Perhaps it was recognized, when Social Security was enacted, that unreduced early retirement benefits actually are unemployment insurance--and neither Social Security nor ERISA was designed to solve the social problems of unemployment.

Phase-in Rules. ERISA provides that only a graduated portion of the benefits that have been in effect under the plan for less than five years shall be guaranteed. The gradation, or phase-in, amounts to the greater of (a) 20 percent of such benefits, or (b) $20 per month, multiplied by the number of years (up to five) they have been in effect under the plan. The phase-in concept is an obvious compromise between the need to prevent anti-selection by employers "dumping" liabilities on the PBGC (i.e., on all other plan sponsors) by adopting or improving a pension plan and soon thereafter terminating it, and the need to protect plan participants whose legitimately increased pensions are jeopardized by a justifiable plan termination.

The compromise, particularly the $20 per month minimum for each year, seems to err on the side of excessive employee protection if there is to be a viable reinsurance program. If there were no phase-in of benefits for five years, or longer, the funding of pensions would be encouraged by participants. This might be reflected in the willingness of both labor and management to allow some of the pension dollars to be used to ensure the payment of the pensions promised rather than just to increase the benefit level. This would be beneficial to all phases of society involved with a pension plan--the employee, labor, the employer, and the government.

PROBLEMS WITH TERMINATION INSURANCE

The preceding section identified some of the problems with termination insurance under ERISA--namely, (a) the violation of sound financial and insurance principles, and (b) phase-in and early retirement aspects of the benefits that are guaranteed by the PBGC. Other critical problems have been recognized by the PBGC and have been reported to the Congress with the recommendations that changes should be made in the law. Still

other problems are further away from solution. Viewed together, these problems fall basically into five areas of concern:

* contingent employer liabiity insurance (CELI);
* lack of insolvency insurance;
* lack of a reorganization scheme for troubled plans;
* nature of the pension promise; and
* nature of the pension obligation (i.e., who pays the bill?).

Contingent Employer Liability Insurance (CELI) and Insolvency

At the present time, almost five years after the enactment of ERISA, it is almost universally agreed that CELI is unworkable. The PBGC, organized labor, industry representatives, and those in the insurance and pension fields agree that CELI should be abandoned. Financial economists concur unanimously. Since CELI has never been implemented, it appears likely that the Congress will change the law and enact an alternative.

The PBGC submitted a report to Congress in mid-1978 formally recommending the elimination of CELI and presenting several alternatives.[2] A brief summary of the PBGC's current proposal, so-called Alternative C, follows. (Alternatives A and B in the PBGC paper are not, as of now, being seriously considered.)

The central feature of Alternative C involves a separation of the concepts (although not necessarily the timing) of (a) voluntary termination, and (b) insurable event. Voluntary terminations as contemplated under Alternative C are events not presently permitted under ERISA, because they involve the loss of benefits in a pension plan which would continue to be maintained by the plan sponsor. Alternative C recognizes the reality of benefit losses (which can occur today when an employer chooses to end his obligation to further fund any plan benefits--colloquially referred to as a "freeze") and redefines the notion of voluntary termination.

A voluntary termination would occur under Alternative C when the plan is amended to provide that future service will no longer be credited for any purposes. As a part of the voluntary termination, the plan would also be amended to eliminate supplemental and ancillary benefits for which various plan participants had not satisfied all the requirements (e.g., death and disability benefits).

An insurable event would occur coincident with, or subsequent to, a voluntary termination when the employer sponsor demonstrates its financial inability to provide the guaranteed benefits to which participants are

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[2]Pension Benefit Guaranty Corporation. Contingent Employer Liability Insurance: Status Report to the Congress. July 1, 1978.

entitled to receive under the terms of the plan. The demonstration of such inability (i.e., business hardship) would take place in the bankruptcy courts in a business reorganization or insolvency proceeding. A new funding standard would apply to a voluntarily terminated plan. If the plan assets were less than the value of vested benefits, the deficiency would be required to be funded over a period of not more than ten to fifteen years. Actuarial losses would have to be funded over no more than five years.

Following a voluntary termination, employers ceasing business operations would be expected to discharge their pension obligations along with those to any other creditors. If such obligations could be met from existing plan assets (e.g., through purchase of annuities or lump sum distributions), the liquidating sponsor would, of course, have no further liability. If the business were liquidating pursuant to a bankruptcy proceeding, the pension plan claim would share in the liquidated assets of the business according to its level of priority in bankruptcy. If the plan's claim could not be satisfied in an amount sufficient to provide for guaranteed benefits, an insurable event would occur. The PBGC would become trustee and provide such benefits.

If, following a voluntary termination, a plan sponsor found itself so financially distressed that it was unable to meet its funding obligations, relief could be sought by requesting funding waivers. For example, the waiver of up to $10,000 might be appropriate for employers experiencing operating losses. However, if the financial relief available to a plan sponsor through funding waivers proved insufficient, further relief would be available only through the bankruptcy reorganization process. The plan sponsor would petition the courts to reduce its general obligations, including those to the plan, to some lower and affordable level. Any reduction in the employer's obligation to the plan would necessitate the restructuring of the plan's liabilities to its participants.

The actual scope of such restructuring of plan benefits would be a by-product of the bankruptcy proceedings. If the adjustment of debt left the employer obligated for at least PBGC-guaranteed benefits, then the plan might continue--for example, as a frozen plan--even though a loss of non-guaranteed vested benefits may have resulted. Future payments to the plan could be made under the minimum funding standards, without PBGC involvement. On the other hand, if the settlement with creditors arising out of bankruptcy proceedings reduces the employer's obligation to less than guaranteed benefits, then an insurable event would occur and the PBGC would step in to make up the difference.

Reorganization for Troubled Plans

Plan termination does not often occur "out of the blue"; the signs of trouble are visible before the plan termination actually occurs. An analogy may be made to bankruptcy--a company's becoming bankrupt without signs of trouble first appearing as a warning is the exception, not the rule.

The analogy with bankruptcy may be carried one step further. Just as Chapter 11 of the United States federal bankruptcy laws provides an

opportunity for a reorganization of a company in an attempt to avoid bankruptcy, so a major function of the PBGC should be to recognize these signs of trouble in a pension plan. If appropriate statutory authority were granted, the PBGC could step in and reorganize the plan in certain ways, thereby possibly avoiding plan termination. If plan termination were averted, then plan participants, the employer, the PBGC, and the general public would all benefit, and the private pension system would be strengthened. Unfortunately, ERISA created the PBGC to guarantee benefits, but it did not give the PBGC powers to step in and reorganize a troubled plan in an attempt to avert a plan termination in the same way that a court has powers under Chapter 11 to appoint trustees to reorganize a company. Title IV only permits the PBGC to force a complete termination.

The PBGC operates as an insurance company. Its practice should be more consistent with practices underlying an insurance company. There should be underwriting rules that, consistent with good business practice, preserve PBGC remedies while limiting PBGC liabilities. Thus, most of the responsibilities should be placed on the plan sponsors, since they control the plan. The PBGC's right to compel plans to take certain action stems from the PBGC's (i.e., other plan sponsors') ultimate obligation to provide benefits to employees covered under terminated plans.

The PBGC has submitted a bill (S. 1076) to the Congress this year which incorporates a plan reorganization program for multiemployer plans. This bill would also strengthen the minimum funding requirements for such plans. The essential points of the plan reorganization program set forth in this bill include:

1. Employer Withdrawal. A withdrawing employer would be required to continue its funding for a proportionate share of the plan's unfunded vested liability.

2. Plan Reorganization. A plan would be considered in a reorganization state if contributions were not sufficient to amortize the unfunded vested liabilities for benefits in pay status over 10 years, plus amortize the remaining unfunded vested liabilities over 25 years. (Assets would be applied first to determine the unfunded vested liabilities for benefits in pay status.)

    (a) A plan in reorganization could be amended to reduce accrued benefits derived from employer contributions to the level of benefits guaranteed by Title IV.

    (b) A plan in reorganization would be required to fund at a level sufficient to amortize unfunded vested liabilities at the amortization periods used to establish a reorganization state, subject to some adjustments (e.g., to reflect a declining contribution base during the remainder of the term of the establishing collective bargaining agreements).

    (c) Benefit levels applicable to past service could not be increased until all reduced benefits have been restored.

(d) Benefit levels could not be increased in a year in which benefits are reduced.

(e) A plan would not be considered voluntarily terminated until it becomes "insolvent."

3. Plan Insolvency. A plan in reorganization would be deemed "insolvent" when benefits have been reduced to the level of benefits guaranteed by Title IV and the plan is unable to meet the required reduced benefit payments. It is anticipated that plan insolvency would be linked to sponsor insolvency by law.

These proposals for plan reorganization of multiemployer plans are most important. They deserve serious consideration by the Congress and by all students of pension reinsurance programs. In addition, consideration needs to be given to comparable provisions for single employer plans.

Nature of the Pension Promise

Virtually no informed discussion has taken place in the United States regarding one of the most fundamental questions in determining a pension philosophy. That question is: What is the pension promise? Is the entire pension always compensation for services rendered in the past, or is part of the pension compensation for services to be rendered? An example may make this clear.

Company B hires John Smith at age 25. Company B tells John Smith, "We have a pension plan giving you a pension of $10 a month for each year of service. If you work here until age 65, you will get a pension of $400 a month." John Smith works 10 years and has earned a pension of $100 a month. Company B then tells him, "We have agreed with your union to raise the pension from $10 per month to $20 per month for each year of work. Therefore, if you continue to work here until age 65 your pension will be $800 a month, because not only will your future service be credited at the $20 rate, but the new rate will apply to the past 10 years that you have been here." If John Smith is vested (and he probably is), his vested pension has suddenly doubled from $100 to $200. When was the additional $100 earned? Was it earned the instant the increase was agreed to by Company B and the union, or is it being earned ratably over John Smith's expected future working years?

Historically, workers have seemed to feel that it was earned instantaneously. Certainly the South Bend employees at Studebaker and others who have felt victimized by the "broken promise" would agree. Perhaps the employer is remiss in not letting the employee know that the employer's true intention is somewhat as follows:

> We expect our future profits to be satisfactory as a result of your continuing to work for us. Therefore, we promise to use these future earnings to pay for your increased pension, as well as your increased wages."

In applying the empirical mathematical formula used to calculate the pension, this truth is not changed, regardless of whether or not past years of service are included.

Another example occurs often during the process of negotiating an acquisition or a sale where there is an unfunded past service liability. Company X is the seller, and the buyer says that Company X has to bear some responsibility with respect to the unfunded pension obligation. The buyer wants Company X either to reduce the asking purchase price, or to give credit for the existing unfunded obligation. Company X intended to pay for that liability out of its future earnings. Company X has reflected on the economic effect of the sale to that point, the amount of money Company X has funded, and the cost of the pension plan to the point of sale. The buyer has, presumably, taken Company X's economic experience, including its projected pension expense, capitalized it, and determined a reasonable purchase price. The question, then, is whether the buyer is asking Company X to pay for the pensions twice.

Nature of the Pension Obligation

The fundamental issue confronting insolvency insurance is who should bear the cost. Any system of insolvency insurance is, by definition, inequitable. Given

* a return to basic insurance principles,
* higher funding levels,
* lower guaranteed benefits,
* prohibition of plan termination for solvent employers, and
* a plan reorganization procedure,

who pays the bill?

Title IV of ERISA looks first to the plan sponsor or sponsors, including all corporations with common ownership (i.e., the controlled group concept). This controlled group concept has been affirmed in federal District Court (PBGC v. Ouimet Corporation and others), but the issue has not yet reached the United States Supreme Court. An interesting sidelight is whether United States law can reach beyond the boundaries of the United States to foreign parent corporations.

Since the first financial resource is the plan sponsor, an interesting question is where the obligation falls with respect to other creditors in a liquidation situation. Will mortgage holders, bond holders, and other preferred creditors be displaced by a higher claim? Even more drastic, perhaps, is whether unpaid wages will be displaced. These are major issues not as yet tested in the courts nor understood by most Americans.

The second financial resource is the PBGC. But the PBGC is not a source of funding. It has no resources other than premiums received from

plan sponsors. It has a financial "call" solely upon unrelated, ongoing plan sponsors--no one else. It is, in essence, a contingent pension obligation clearing house.

Thus the ultimate reinsurer is all other plan sponsors. Yet they will find no relief from this potential burden by adequately funding their own plans. There is no relief in Title IV of ERISA for plan sponsors who soundly fund their own plans. A resource, theoretically, is again tax revenues, from which the Congress has carefully excluded the PBGC. But, Social Security has exhausted this source of revenues, with the Congress attempting to find ways to balance the still unbalanced Social Security budget.

CONCLUSION

The private pension system in the United States today continues to evolve in size and complexity (see Tables 1-2 through 1-11). New needs are recognized by society almost daily. The participants in the pension system--employers, unions, the government, practitioners--are all demanding more of the system. The ultimate fate of the private pension system depends on whether future changes will be economically and socially sound, or irrational. Decisions made in the next several years in the areas discussed here--funding, plan termination, insolvency, reorganization, the basic nature of the pension promise, and, most important of all, the ultimate financial resource--will be critical in determining the future of the private pension system in the United States.

TABLE 1-2

UNITED STATES POPULATION: 1900 to 1978

[In millions, except as indicated. Estimates as of July 1, except as indicated. Prior to 1940, excludes Alaska and Hawaii. Total population includes Armed Forces abroad; resident population excludes them. See text, p. 2, for basis of estimates. See also *Historical Statistics, Colonial Times to 1970*, series A 6-8]

YEAR	Resident population
1900	76.1
1901	77.6
1902	79.2
1903	80.6
1904	82.2
1905	83.8
1906	85.4
1907	87.0
1908	88.7
1909	90.5
1910	92.4
1911	93.9
1912	95.3
1913	97.2
1914	99.1
1915	100.5
1916	102.0
1917	103.3
1918	103.2
1919	104.5

YEAR	Resident population
1920	106.5
1921	108.5
1922	110.1
1923	112.0
1924	114.1
1925	115.8
1926	117.4
1927	119.0
1928	120.5
1929	121.8
1930	123.1
1931	124.1
1932	124.8
1933	125.6
1934	126.4
1935	127.3
1936	128.1
1937	128.8
1938	129.8
1939	130.9

YEAR	TOTAL		Resident population	Civilian population
	Population	Percent change		
1940	132.6	1.3	132.5	132.1
1941	133.9	1.0	133.7	132.1
1942	135.4	1.1	134.6	131.4
1943	137.3	1.4	135.1	128.0
1944	138.9	1.2	133.9	127.2
1945	140.5	1.1	133.4	128.1
1946	141.9	1.0	140.7	138.9
1947	144.7	1.9	144.1	143.1
1948	147.2	1.7	146.7	145.7
1949	149.8	1.7	149.3	148.2
1950	152.3	1.7	151.9	150.8
1951	154.9	1.7	154.0	151.6
1952	157.6	1.7	156.4	153.9
1953	160.2	1.7	159.0	156.6
1954	163.0	1.8	161.9	159.7
1955	165.9	1.8	165.1	163.0
1956	168.9	1.8	168.1	166.1
1957	172.0	1.8	171.2	169.1
1958	174.9	1.7	174.1	172.2
1959	177.8	1.7	177.1	175.3
1960	180.7	1.6	180.0	178.1
1961	183.7	1.7	183.0	181.1

YEAR AND MONTH	TOTAL		Resident population	Civilian population
	Population	Percent change		
1962	186.6	1.5	185.8	183.7
1963	189.2	1.4	188.5	186.5
1964	191.9	1.4	191.1	189.1
1965	194.3	1.3	193.5	191.6
1966	196.6	1.2	195.6	193.4
1967	198.7	1.1	197.5	195.3
1968	200.7	1.0	199.4	197.1
1969	202.7	1.0	201.4	199.1
1970	204.9	1.1	203.8	201.7
1971	207.1	1.1	206.2	204.3
1972	208.8	.9	208.2	206.5
1973	210.4	.7	209.9	208.1
1974	211.9	.7	211.4	209.7
1975	213.6	.8	213.1	211.4
1976	215.1	.7	214.7	213.0
1977	216.8	.8	216.3	214.7
1978:				
Jan. 1	217.7	.43	217.3	215.6
Feb. 1	217.8	.04	217.4	215.7
Mar. 1	217.9	.05	217.5	215.8
Apr. 1	218.1	.07	217.6	216.0

Source: U.S. Bureau of the Census, *Current Population Reports*, series P-25, Nos. 706 and 724.

TABLE 1-3

UNITED STATES POPULATION

PROJECTED NUMBER OF PERSONS AGE 65 AND OVER IN THE UNITED STATES

Year	Number of Persons Age 65 and Over	Percent of Total Population
1976	22.9 million	10.7%
2000	31.8 million	11.3% to 12.9%
2030	55.0 million	14.0% to 22.0%

SOURCE: U.S. Bureau of Census. Percentages for years 2000 and 2030 depend on fertility levels used in population projections.

TABLE 1-4

UNITED STATES LABOR FORCE

No. 643. Labor Force and Employment: 1947 to 1978

[**Persons 16 years old and over.** Annual averages of monthly figures, except as indicated. See also *Historical Statistics, Colonial Times to 1970*, series D 11-19 and D 85-86]

YEAR	Total non-institutional population[1] (mil.)	TOTAL LABOR FORCE[1]		CIVILIAN LABOR FORCE							NOT IN LABOR FORCE	
		Total (mil.)	Percent of non-institutional population	Total (mil.)	Female		Employed		Unemployed		Total (mil.)	Percent of non-institutional population
					Total (mil.)	Percent of civilian labor force	Total (mil.)	Percent of non-institutional population	Total (mil.)	Percent of civilian labor force		
1947	103.4	60.9	58.9	59.4	16.7	28.1	57.0	55.2	2.3	3.9	42.5	41.1
1950	106.6	63.9	59.9	62.2	18.4	29.6	58.9	55.2	3.3	5.3	42.8	40.1
1955	112.7	68.1	60.4	65.0	20.5	31.6	62.2	55.2	2.9	4.4	44.7	39.6
1960	119.8	72.1	60.2	69.6	23.2	33.4	65.8	54.9	3.9	5.5	47.6	39.8
1965	129.2	77.2	59.7	74.5	26.2	35.2	71.1	55.0	3.4	4.5	52.1	40.3
1966	131.2	78.9	60.1	75.8	27.3	36.0	72.9	55.6	2.9	3.8	52.3	39.9
1967	133.3	80.8	60.6	77.3	28.4	36.7	74.4	55.8	3.0	3.9	52.5	39.4
1968	135.6	82.3	60.7	78.7	29.2	37.1	75.9	56.0	2.8	3.6	53.3	39.3
1969	137.8	84.2	61.1	80.7	30.5	37.8	77.9	56.5	2.8	3.5	53.6	38.9
1970	140.2	85.9	61.3	82.7	31.5	38.1	78.6	56.1	4.1	4.9	54.3	38.7
1971	142.6	86.9	61.0	84.1	32.1	38.2	79.1	55.5	5.0	5.9	55.7	39.0
1972	145.8	89.0	61.0	86.5	33.3	38.5	81.7	56.0	4.8	5.6	56.8	39.0
1973	148.3	91.0	61.4	88.7	34.5	38.9	84.4	56.9	4.3	4.9	57.2	38.6
1974	150.8	93.2	61.8	91.0	35.8	39.4	85.9	57.0	5.1	5.6	57.6	38.2
1975	153.4	94.8	61.8	92.6	37.0	39.9	84.8	55.3	7.8	8.5	58.7	38.2
1976	156.0	96.9	62.1	94.8	38.4	40.5	87.5	56.1	7.3	7.7	59.1	37.9
1977	158.6	99.5	62.8	97.4	40.0	41.0	90.5	57.1	6.9	7.0	59.0	37.2
1978, Jan.-Apr[2]	160.2	101.5	63.3	99.3	41.1	41.4	93.2	58.2	6.1	6.2	58.7	36.7

[1] Includes Armed Forces. [2] Seasonally adjusted, except population figure.

Source: U.S. Bureau of Labor Statistics, *Employment and Earnings*, monthly.

TABLE 1-5

SOCIAL SECURITY COVERAGE

Old-Age, Survivors, and Disability Insurance *(000 Omitted)*

Year	Persons With Earnings Credits Year-End*	Persons Employed With Coverage in Effect Year-End	Employer and Worker Taxes in Year	Persons Fully Insured Year-End†	Persons Receiving Monthly Benefits Year-End	Monthly and Lump Sum Payments in Year
1945	72,400	39,200	$ 1,285,486	33,400	1,288	$ 273,885
1950	82,700	41,000	2,667,077	59,800	3,478	961,094
1955	98,600	56,200	5,713,045	70,500	7,960	4,968,155
1960	109,400	59,000	11,876,220	84,400	14,844	11,244,795
1965	121,300	66,400	17,205,372	94,800	20,867	18,310,676
1966	125,000	69,000	22,585,229	97,200	22,767	20,048,347
1967	127,900	69,900	25,423,792	99,900	23,707	21,406,455
1968	130,800	71,300	27,034,289	102,600	24,562	24,936,435
1969	133,500	72,700	31,545,608	105,400	25,314	26,750,841
1970	135,900	72,700	34,737,059	108,200	26,229	31,863,381
1971	138,200	73,100	38,342,721	110,600	27,291	37,170,726
1972	140,600	75,500	42,888,228	113,200	28,476	41,595,064
1973	142,900	78,100	51,907,100	116,400	29,868	51,459,310
1974	145,200	79,300	58,906,577	119,800	30,854	58,521,344
1975	148,300	78,300	64,259,394	122,800	32,085	66,922,707
1976	150,900	80,700	71,594,624	126,400	33,024	75,664,649
1977	153,000	83,400	78,710,397	128,200	34,082	84,575,800

Note: Data are revised.

*Social Security Administration estimate of persons who have ever had covered earnings.

†Beginning in 1965, figures include transitionally insured persons. Data represent number insured at beginning of following year.

Source: Social Security Administration, U.S. Department of Health, Education and Welfare. Data pertaining to the "Medicare" program are not included in this table. Data for 1977 pertaining to coverage and insured status are estimated.

TABLE 1-6

RETIREMENT PLAN COVERAGE

Number of Persons Covered by Major Pension and Retirement Programs in the United States *(000 Omitted)*

Year	Private Plans: With Life Insurance Companies	Private Plans: Other Private Plans	Government-Administered Plans: Railroad Retirement	Government-Administered Plans: Federal Civilian Employees†	Government-Administered Plans: State and Local Employees	OASDI‡
1940	695	3,565	1,349	745	1,552	27,622
1945	1,470	5,240	1,846	2,928	2,008	40,488
1950	2,755	7,500	1,881	1,873	2,894	44,477
1955	4,105	12,290	1,876	2,333	3,927	64,161
1960	5,475	17,540	1,654	2,707	5,160	73,845
1961	5,635	18,440	1,662	2,855	5,309	76,295
1962	5,770	19,370	1,643	2,943	5,654	78,953
1963	6,060	19,990	1,664	2,985	5,940	81,035
1964	6,710	20,350	1,650	3,069	6,330	83,400
1965	7,040	21,060	1,661	3,114	6,780	87,267
1966	7,835	21,710	1,666	3,322	7,210	91,768
1967	8,700	22,330	1,641	3,499	7,594	93,607
1968	9,155	22,910	1,625	3,565	8,012	95,862
1969	9,920	24,410	1,620	3,627	8,303	98,012
1970	10,580	25,520	1,633	3,625	8,591	98,935
1971	10,880	26,580	1,578	3,596	9,079	100,392
1972	11,545	27,400	1,575	3,737	9,563	103,976
1973	12,485	28,700	1,582	4,030	10,050	108,268
1974	13,335	29,240	1,589	4,052	10,835	108,854
1975	15,195	30,300	1,574	4,130	11,230	110,085
1976	16,985	31,400*	1,565	4,184	12,000*	113,724
1977	19,240	32,500*	1,572*	4,288*	12,500*	117,482

Note 1. It is not possible to obtain a total for number of persons covered by pension plans by adding together the figures shown by year. Each series has been derived separately and there are differences in amount of duplication within each series and among the various series and also differences in definition of "coverage" among the series. In addition, private plans with life insurance companies include persons covered by Keogh plans, tax-sheltered annuities and, after 1974, IRA plans, but other private plans do not include persons covered by these plans.

Note 2. These data represent various dates during the year, since the fiscal years of the plans are not necessarily the same. Trends from year to year within each series are not affected. The number of persons covered include survivors or dependents of deceased workers and beneficiaries as well as retired workers. Retirement arrangements for members of the armed forces, and provisions for veterans pensions, are not included. Persons covered by private plans and many persons covered by government-administered plans are also usually covered by Social Security. Data for "Other Private Plans", compiled by the Social Security Administration, exclude plans for the self-employed, those having vested benefits but not presently employed at the firm where benefits were accrued, and also exclude an estimated number who have vested benefits from employment other than from their current employment.

*Estimated.

†Includes members of the U.S. Civil Service Retirement System, the Tennessee Valley Retirement System, the Foreign Service Retirement System, and the Retirement System of the Federal Reserve Banks, which includes the Bank Plan and the Board of Governors' Plan.

‡Includes persons employed with coverage in effect at year-end including the self-employed, workers retired for age or disability, dependents of retired workers and survivors of deceased workers who are receiving periodic benefits.

Source: Compiled by the American Council of Life Insurance.

TABLE 1-7

RETIREMENT PLAN COVERAGE

No. 539. Private Pension and Deferred Profit-Sharing Plans: 1950 to 1975

[Includes pay-as-you-go, multiemployer, union-administered, and nonprofit organization plans, and railroad plans supplementing the Federal railroad retirement program. Plans are classified as insured and noninsured, the former underwritten by insurance companies and the latter generally funded through trustees. See also *Historical Statistics, Colonial Times to 1970*, series H 287-304]

ITEM AND TYPE OF PLAN	1950	1955	1960	1965	1970	1972	1973	1974	1975
Coverage, net[1] [2]...1,000..	**9,800**	**14,200**	**18,700**	**21,800**	**26,300**	**27,500**	**29,200**	**29,800**	**30,300**
Insured plans, gross...1,000..	2,600	3,800	4,900	6,200	8,900	9,500	10,200	10,800	11,600
Noninsured plans, gross..1,000..	7,200	11,600	16,300	19,100	22,000	24,000	25,600	26,200	26,800
Contributions:									
Employer...mil. dol..	1,750	3,280	4,710	7,370	12,580	16,940	19,390	23,020	27,560
Insured plans...mil. dol..	720	1,100	1,190	1,770	2,860	4,200	5,020	6,050	7,730
Noninsured plans...mil. dol..	1,030	2,180	3,520	5,600	9,720	12,740	14,370	16,970	19,830
Employee...mil. dol..	330	560	780	990	1,420	1,600	1,710	2,000	2,290
Insured plans...mil. dol..	200	280	300	320	350	400	440	540	690
Noninsured plans...mil. dol..	130	280	480	670	1,070	1,200	1,270	1,460	1,600
Monthly beneficiaries [1]...1,000..	**450**	**980**	**1,780**	**2,750**	**4,740**	**5,550**	**6,080**	**6,390**	**7,050**
Insured plans...1,000..	150	290	540	790	1,220	1,350	1,480	1,550	1,690
Noninsured plans...1,000..	300	690	1,240	1,960	3,520	4,200	4,600	4,840	5,360
Benefit payments [3]...mil. dol..	**370**	**850**	**1,720**	**3,520**	**7,360**	**10,000**	**11,220**	**12,930**	**14,810**
Insured plans...mil. dol..	80	180	390	720	1,330	1,700	1,910	2,190	2,480
Noninsured plans [3]...mil. dol..	290	670	1,330	2,800	6,030	8,300	9,310	10,740	12,330
Reserves [1]...bil. dol..	**12.1**	**27.5**	**52.0**	**86.5**	**137.1**	**167.8**	**180.2**	**191.7**	**212.6**
Insured plans...bil. dol..	5.6	11.3	18.8	27.3	40.1	50.3	53.4	58.0	67.4
Noninsured plans...bil. dol..	6.5	16.1	33.1	59.2	97.0	117.5	126.5	133.7	145.2

[1] As of end of year. [2] Excludes beneficiaries. [3] Includes refunds and lump sums.

Source: U.S. Social Security Administration, *Social Security Bulletin*, November 1977.

No. 540. Private Noninsured Pension Funds: 1960 to 1977

[**In millions of dollars.** Covers all pension funds of corporations, nonprofit organizations, unions, and multi-employer groups, except those managed by insurance companies. Also includes deferred profit-sharing plans; excludes health, welfare, and bonus plans. Minus sign (−) denotes loss]

ASSETS, RECEIPTS, AND DISBURSEMENTS	1960	1965	1970	1972	1973	1974	1975	1976	1977, prel.
Total assets [1] [2]...	**33,140**	**59,180**	**97,010**	**117,530**	**126,530**	**133,731**	**145,166**	**160,414**	**181,509**
Cash and deposits...	550	940	1,800	1,860	2,340	4,286	2,962	2,199	3,721
U.S. Government securities...	2,680	2,990	3,030	3,690	4,400	5,533	10,764	14,713	20,138
Corporate bonds...	15,700	23,130	29,670	28,210	30,330	35,029	37,809	39,070	45,580
Preferred and common stock...	11,510	25,870	53,480	76,060	81,850	80,448	84,842	94,609	98,152
Mortgages...	1,300	3,380	4,170	2,730	2,380	2,372	2,393	2,369	2,497
Receipts [2]...	**5,410**	**9,280**	**13,200**	**20,070**	**19,670**	**21,060**	**26,583**	(NA)	(NA)
Employer contributions...	3,520	5,600	9,720	12,740	14,370	16,970	19,828	(NA)	(NA)
Employee contributions...	480	670	1,070	1,200	1,270	1,460	1,604	(NA)	(NA)
Investment income...	1,260	2,390	3,870	4,300	4,840	5,980	6,703	(NA)	(NA)
Net profit on sale of assets...	110	570	−1,590	1,720	−920	−3,480	−1,659	(NA)	(NA)
Disbursements...	**1,370**	**2,880**	**6,180**	**8,490**	**9,540**	**11,030**	**12,597**	(NA)	(NA)
Benefits paid out...	1,330	2,800	6,030	8,300	9,310	10,740	12,334	(NA)	(NA)
Expenses and other...	50	90	150	200	230	290	263	(NA)	(NA)
Net receipts...	4,040	6,400	7,020	11,580	10,130	10,030	13,986	(NA)	(NA)

NA Not available. [1] Book value, end of year. [2] Includes other items, not shown separately.

Source: U.S. Securities and Exchange Commission, *Statistical Bulletin*, monthly.

TABLE 1-8

RETIREMENT PLAN RESERVES

ASSETS AND RESERVES OF MAJOR PENSION AND RETIREMENT PROGRAMS IN THE UNITED STATES (BOOK VALUES)

(000,000 Omitted)

Year	Private Plans			Government-Administered Plans				
	With Life Insurance Companies	Other Private Plans	Total	Railroad Retire-ment	Federal Civilian Employees	State and Local Employees	Total	Old-Age, Survivors and Disability Insurance*
1950	$ 5,600	$ 6,500	$ 12,100	$2,553	$ 4,343	$ 5,154	$ 12,050	$13,721
1960	18,850	33,100	51,950	3,740	10,790	19,600	34,130	22,613
1965	27,325	59,200	86,525	3,946	16,516	33,100	53,562	19,841
1966	29,425	66,200	95,625	4,074	17,619	36,900	58,593	22,308
1967	32,000	74,200	106,200	4,236	18,799	41,500	64,535	26,250
1968	34,975	83,100	118,075	4,245	20,224	46,300	70,769	28,729
1969	37,900	90,600	128,500	4,347	21,600	51,800	77,747	34,182
1970	41,175	97,000	138,175	4,398	23,100	58,100	85,598	38,068
1971	46,400	106,400	152,800	4,300	26,400	64,400	95,100	40,434
1972	52,300	117,500	169,800	4,100	29,200	72,200	105,500	42,775
1973	56,050	126,500	182,550	3,800	31,500	81,600	116,900	44,414
1974	60,775	133,700	194,475	3,600	34,600	89,000	127,200	45,886
1975	71,700	145,200	216,900	3,100	38,600	106,500	147,700	44,342
1976	88,400	160,400	248,800	3,100	43,500	117,200	163,800	41,133

*Beginning in 1957, assets of Disability Insurance Trust Funds are included. Health and Supplementary Medical Insurance is not included.

NOTE: Data are revised. These data are as of various dates during the year, since the fiscal years of the plans are not necessarily the same. Trends from year to year are not affected.

SOURCES: Railroad Retirement Board, Social Security Administration, Securities and Exchange Commission, other administrative agencies and the American Council of Life Insurance.

TABLE 1-9

EMPLOYMENT BENEFIT PLAN COVERAGE

No. 542. Employee-Benefit Plans—Summary: 1960 to 1975

[Coverage data refer to civilian wage and salary workers at end of year; contributions, to amounts subscribed by employers and employees, in total. An "employee-benefit plan" is any type of plan sponsored or initiated unilaterally or jointly by employers or employees and providing benefits that stem from the employment relationship and that are not underwritten or paid directly by government (Federal, State, or local). In general, the intent is to include plans that provide in an orderly predetermined fashion for (1) income maintenance during periods when regular earnings are cut off because of death, accident, sickness, retirement, or unemployment and (2) benefits to meet medical expenses. Excludes workmen's compensation required by statute and employer's liability. See also *Historical Statistics, Colonial Times to 1970*, series H 70-114]

ITEM AND TYPE OF PLAN	1960	1965	1970	1972	1973	1974	1975
Covered employees:							
Life insurance and death [1] ... mil.	34.2	41.9	51.8	55.2	57.8	60.6	62.4
Accidental death and dismemberment ... mil.	20.9	28.4	38.7	40.7	42.7	44.3	46.5
Health benefits:							
Hospitalization [2 3] ... mil.	39.3	45.7	53.1	54.2	56.8	57.6	58.2
Surgical [2] ... mil.	37.4	43.4	51.5	52.9	55.4	56.1	56.6
Regular medical [2] ... mil.	28.2	38.2	48.0	49.4	53.7	54.9	56.1
Major medical [4] ... mil.	8.8	16.6	24.6	26.4	27.6	28.2	29.6
Coverage, private employees:							
Temporary disability [5] ... mil.	[6] 24.5	24.5	29.7	31.3	32.0	31.7	31.1
Long-term disability ... mil.	(6)	1.9	7.0	9.5	10.6	11.1	11.5
Retirement [7] ... mil.	18.7	21.8	26.1	27.5	29.2	29.8	30.3
Contributions:							
All employees, total [8] ... bil. dol.	12.5	19.9	34.9	45.4	50.5	57.7	67.3
Life insurance and death [1] ... bil. dol.	1.4	2.2	3.6	4.3	4.4	4.7	5.1
Accidental death and dismemberment ... bil. dol.	.1	.1	.2	.3	.3	.3	.3
Health benefits:							
Hospitalization [3] ... bil. dol.	2.5	4.3	7.6	9.5	10.5	11.4	13.3
Surgical and regular medical ... bil. dol.	1.3	2.1	4.0	5.2	5.9	7.0	8.2
Major medical [4] ... bil. dol.	.5	1.1	2.3	3.6	4.1	4.6	5.7
Private employees:							
Temporary disability [5 9] ... bil. dol.	1.2	1.6	3.1	3.7	3.9	4.4	4.7
Retirement [7] ... bil. dol.	5.5	8.4	14.0	18.5	21.1	25.0	29.9
Benefits paid:							
All employees, total [8] ... bil. dol.	7.8	13.6	26.1	32.9	36.2	42.0	47.9
Life insurance and death [1] ... bil. dol.	1.0	1.6	2.5	2.9	3.2	3.4	3.6
Accidental death and dismemberment ... bil. dol.	(Z)	.1	.2	.2	.2	.3	.3
Health benefits:							
Hospitalization [3] ... bil. dol.	2.4	4.2	7.3	8.9	9.6	11.1	13.1
Surgical and regular medical ... bil. dol.	1.1	1.8	3.6	4.5	5.2	6.3	7.4
Major medical [4] ... bil. dol.	.4	1.0	2.4	3.2	3.4	4.0	4.5
Private employees:							
Temporary disability [5 9] ... bil. dol.	1.0	1.3	2.5	3.0	3.2	3.7	3.8
Retirement [7] ... bil. dol.	1.7	3.5	7.4	10.0	11.2	12.9	14.8
PERCENT OF WORKERS COVERED [10]							
All employees:							
Life insurance and death	57.8	63.7	69.0	71.1	71.2	73.5	77.3
Accidental death and dismemberment	35.3	43.1	51.5	52.4	52.7	53.7	57.6
Health benefits:							
Hospitalization	66.5	69.4	70.7	69.8	70.0	69.9	72.2
Surgical	63.3	65.9	68.6	68.1	68.3	68.1	70.1
Regular medical	47.7	58.0	63.9	63.6	66.2	66.5	69.5
Major medical	14.8	25.2	32.7	34.0	34.0	34.2	36.7
Private employees:							
Temporary disability	[6] 48.7	44.3	47.9	49.1	47.9	46.8	47.5
Long-term disability	(6)	3.4	11.2	14.8	15.8	16.4	17.6
Retirement	37.2	39.5	42.1	43.1	43.7	44.0	46.2
PERCENT CONTRIBUTIONS OF TOTAL WAGES AND SALARIES [10]							
All employees:							
Life insurance and death	.54	.64	.68	.71	.65	.63	.65
Accidental death and dismemberment	.03	.03	.04	.05	.04	.04	.04
Health benefits	1.63	2.15	2.64	2.98	3.02	3.11	3.45
Private employees:							
Temporary disability	.53	.54	.71	.76	.71	.73	.75
Retirement	2.46	2.86	3.25	3.74	3.82	4.14	4.73

Z Less than $50 million.

[1] Includes group and wholesale life insurance but excludes Servicemen's Group Life Insurance program.

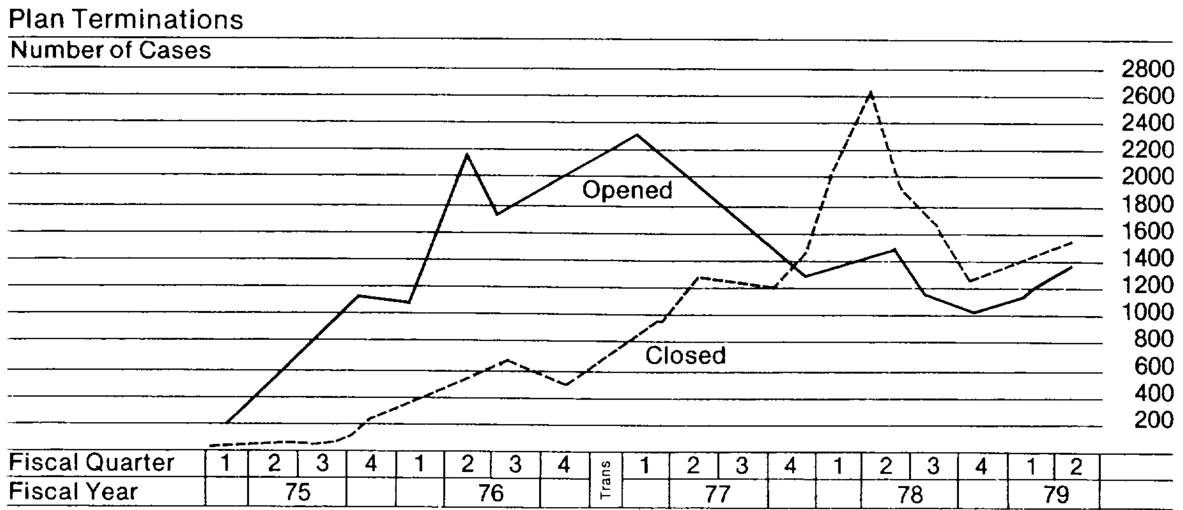
[2] Includes persons covered by group comprehensive major-medical insurance as well as those with basic benefits.

[3] Includes private hospital plans written in compliance with State temporary disability insurance law in California. [4] Group supplementary and comprehensive major-medical insurance written by commercial insurance companies. [5] Includes private plans written in compliance with State temporary disability insurance laws in California, Hawaii, New Jersey, and New York; and formal sick-leave plans. Excludes credit accident and health insurance. [6] Long-term disability policies included in temporary disability. [7] Includes pay-as-you-go and deferred profit-sharing plans, plans for non-profit organizations, union pension plans, and railroad plans supplementing the Federal railroad retirement program. Excludes plans for the self-employed and tax-sheltered annuities. Retirement coverage estimates exclude annuitants. [8] Includes data for supplemental unemployment insurance benefits, not shown separately. [9] Includes data under long-term disability policies. [10] For all employees, coverage and contributions relate to private and government full-time and part-time civilian employees and payroll; for private employees, to wage and salary full-time and part-time labor force and payroll in private industry.

Source: U.S. Social Security Administration, *Social Security Bulletin*, November 1977.

Table 1-10

PLAN TERMINATION IN THE UNITED STATES



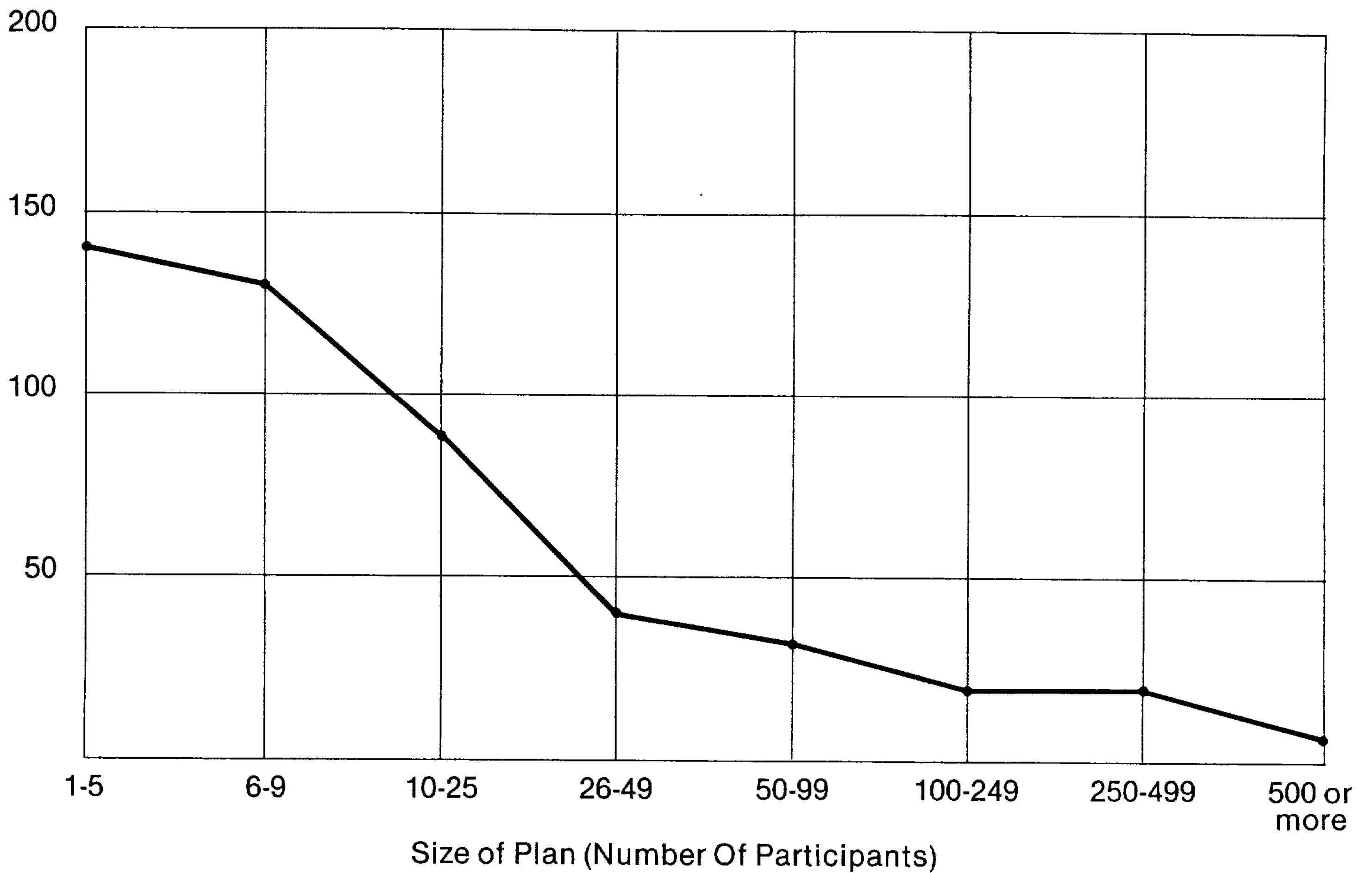
This chart shows plan termination activity since enactment of ERISA.

SOURCE: Pension Benefit Guaranty Corporation

Table 1-11

PLAN TERMINATION IN THE UNITED STATES

FREQUENCY OF TERMINATION BY SIZE OF PLAN, FISCAL YEAR 1977



SOURCE: Pension Benefit Guaranty Corporation

PENSION PLAN CREDIT AND INSOLVENCY INSURANCE: THE FOREIGN EXPERIENCE*

Three countries--Finland, Sweden, and the Federal Republic of Germany--currently have pension plan insurance programs similar to the termination insurance program in the United States. Today I shall outline the programs in these three countries, noting the basic differences among their programs and that of the United States. Table 2-1 provides a summary of these comparisons.

FINLAND

The program in Finland is neither a termination insurance program nor what the Germans would call an insolvency insurance program. It is a pure credit insurance program, providing insurance either for a pension institution itself or on a voluntary basis for employers with unfunded liabilities.

Finland is a small country, with four and one-half million people. Hence, the pension institutions in force are very small in number. Eight major insurance companies provide benefits or insure benefits; 111 pension institutions provide benefits on a private basis. Eighty-five percent of all premium income is collected by eight insurance companies; only fifteen percent is collected by the pension institutions.

It is useful to review the basic principles that have led to this system. Finland has a very small and very basic Social Security program which presently provides about $200 per month of state benefits for everybody. This basic insurance is supplemented by a mandatory private scheme, with total benefits reaching 60 to 66 percent of final pay. So the costs of benefits are borne more by the employer than by the state. In order to guarantee these benefits, the system provides for mandatory funding. There is no internal funding of benefits. An employer is required to finance his benefits by annual or monthly premium payments to either a pension institution--a pension foundation or a pension fund--or an insurance company. The financing is uniform, which means that the premium rate paid by the employer is determined annually on a nationwide basis by the administering organization.

On the basis of this system, an employer may obtain loans either through the pension institution that finances the benefits or through the insurer. Employers can take these loans under the provision that they provide guarantees (or security) for these loans. One way to do this would be through a bank guarantee; another way would be through the credit insurance. So the credit insurer only steps in as an alternative to other guarantees if the employer takes a loan. This being the case, the entire

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*Presentation given by Burkhard Fürer, Deputy Manager and Director of International Services, International Pension Consultants GmbH, Wiesbaden, Germany.

program is a voluntary one for the employer. He need not participate in this program if he takes no loans on the pension liability or the premiums payable, and he need not pay into or participate in the program if he provides other guarantees.

Another part of the program is mandatory. All pension institutions are mandatorily covered by the credit insurance program. What is covered is the loss in assets that might occur, any unfunded liability that might arise due to insufficient premium payments, or loans taken by the employer. The insured event is the insolvency of the insurer.

Another characteristic of the Finnish system that is important in this comparison with the United States system is that premiums are risk-related. Even though the credit insurer must provide credit insurance to any employer who requests it, the insurer can increase the premium to the extent that it is undesirable for the employer to take a loan. Depending on the situation of the employer, it may be quite impossible for him to take loans and to take advantage of the credit insurance program. Practically speaking, only the solvent employers have a chance of getting this credit insurance benefit. The loan that the employer can take is guaranteed at 70 percent of the annual premium payment. This must be provided by the credit insurer if the employer accepts the premium rate of the credit insurer. He can get more, but this is usually more feasible through banks. In the case of an insolvency, the insurer then has priority as a creditor. This is very important--in fact, this is the only program I shall review in which the credit insurer has first priority.

The credit insurance is consistent with the principle that the Finnish system is mandatory and that planned termination for legal reasons is practically impossible. Essentially, the only way to terminate a plan is to be insolvent and close down the business.

The system itself discourages taking loans or having underfunded liabilities, because immediately one must provide securities which might not be available. Were it not a mandatory scheme, the implementation of plans would be inhibited, because one must fully fund immediately and pay the officially calculated premium. There is no flexibility in financing the plan. It has also been demonstrated that the system favors the insurance companies, because they are regarded as secure and hence need not pay premiums to the credit insurer. If the employer decides to take a loan on the premiums, this will effect a reduction in his creditworthiness, because he must give away certain securities. In this respect, the Finnish program differs from the German program.

SWEDEN

Sweden administers two different programs: one for salaried employees and one for blue-collared employees. Because the system for blue-collared employees operates in a manner similar to the Finnish program described above, I shall comment only on the salaried employees program.

Again, this is a credit insurance program, not a termination insurance program. It does not serve to provide credit insurance for loans

taken, however, but only for internally financed benefits. In other words, Sweden is a country in which book reserves can be used by employers.

In Sweden, mandatory funding of benefits is essentially in effect across all areas of industry. Unlike the Finnish situation, no law requires it; rather, a collective arrangement is used between the confederation of employers and the trade unions. The system is uniform; every employee throughout the industry gets the same type of benefit. Benefits can be financed in either of two ways: outside the firm, through an insurance company operated under the collective agreement, or internally, through book reserves. However, financing benefits internally is restricted. An employer may create book reserves rather than pay premiums if he again is creditworthy and can convince the insurer to offer credit insurance--or, alternatively, if the credit insurer agrees that the employer should be permitted to finance benefits internally. If the credit insurer offers credit insurance to an employer, the insured event is the insolvency of the employer. Should this occur, the credit insurer must assume the accrued liability, on the basis of a uniformly prescribed, aggregate actuarial method.

As in Finland, the annual premium is determined by the official body which administers the whole system. For the past several years, the premium payable to obtain credit insurance has been 0.3 percent of one's actuarial liability, uniformly determined--whether it is a real liability one never knows until the time it becomes payable. In the event an employer has taken this credit insurance, he may book his liability. This means that, rather than paying the premium to the insurance company, he creates a book reserve in that same amount. The premium is retained in the company to be invested as the employer likes.

The problem with this system occurs when the business situation declines. Then the credit insurer may partly or wholly cancel the credit insurance, in which case one is required to pay, over a period up to ten years, the total accrued liability in cash to the insurer. If this safeguard does not help and the company still goes broke, the insurer basically has no first priority, except for such items as outstanding pensions. The remaining assets are claimed by general creditors.

Compared with the Finnish system, the Swedish system does seem to offer a more effective means of financing benefits, through the possible use of internal financing methods as alternatives to taking loans and providing securities. The system still has essential safeguards, however, which keep program costs comparatively low, even though the premium rate is perhaps higher than the premium rate used in the United States or in Germany. (It is difficult to compare these premiums and rates, because the Swedish credit insurer has substantial accrued reserves to finance future claims, whereas other schemes with lower premium rates anticipate increases in the future. For example, only solvent employers participate in the plan.)

The program has shown that, to a significant extent, large employers use the book reserve system. Small employers are usually required to use the insurance company. Whereas the Finnish system could not refuse to

give loans or credit insurance to an employer, the Swedish system can do so and can determine that the employer must finance benefits through the insurance company. As I understand the system, it is only workable if the actuarial liability is defined on a uniform and strict basis and if deficiencies on this actuarial basis which might occur over the years are made up by the collective action of participating employers. Because the system provides for final pay benefits, an employee changing from one employer to another does not lose out on benefits. There is a substantial load of prior service amortization within the premium paid by all employers, irrespective of the characteristics of their respective workforces.

One problem with the Swedish system occurs when the company encounters a bad business situation. Then the insurer has the difficult problem of determining the point in time when the credit insurance should be cancelled. Usually the insurer is very liberal and waits as long as possible until it cancels the credit insurance. On the other hand, as soon as the insurer does cancel the insurance, this action leads to an acceleration of the decline of that business. In addition to its existing problems, it now has the added burden of paying off its past service liabilities. As with the Finnish system, the Swedish system reduces the creditworthiness of the employer through its requirement that the company be a solvent employer and have at least restricted priority rights.

FEDERAL REPUBLIC OF GERMANY

The German system is totally different from the systems in Finland and Sweden. In Germany we have a pure insolvency insurance program, not a credit insurance or termination insurance program. It covers employers operating non-funded plans and--provided the employer has access to the funds--funded plans.

Most plans in Germany are single employer plans or voluntary multi-employer plans. Unlike plans in other countries, there is no uniform benefit payable. The employer has the discretion to determine, voluntarily, what he wants to provide. Another important characteristic is that plan funding is unfavorable, due to taxation. If you, as an employer, contribute to an unfunded plan by retaining earnings in your company, the employee is not assessed for personal income tax. So it is favorable to retain earnings within the company rather than paying them out to a fund. But this clearly only works if the employer assumes full liability for what he is promising. Unlike the United States, the employer is 100 percent liable for what he has promised. In fact, the pension promise that he gives to the employee becomes part of the employee's working conditions and is legally enforceable. Termination of the plan, in which the employer states that he has paid up contributions and wants to stop, is impossible. He is liable to continue premium payments, or at least to continue pension payments and the accrual of benefits, unless the employee, the work council, or the trade union, depending on what kind of plan it is, accepts changes. The employer is not only liable to give the employee the current accrued benefits, but also the accrued benefits based upon future salary increases, if the employee has a final salary plan.

Thus, from the labor law side, a planned termination is not possible through unilateral action. The only way to terminate a plan is to become insolvent or to have employees sign a contract giving up their benefits. Because the employer is not required to fund his plan, however, he is not required to earmark any assets out of his company to pay for these benefits. The issue arises, then, as to what happens when the company goes broke. Until 1974, it happened exactly as one would have expected, namely, the employee and the pensioner received nothing. They had no creditor status; they were general creditors. Since the rate of return from the bankruptcy process in German insolvency cases generally was about five percent, it is clear that most pensioners and most active employees received nothing from a bankrupt plan. In order to save the system of book reserving, Germany had to find a solution--and it found it by offering insolvency insurance, which now covers vested deferred benefits and current benefit payments. In Germany benefits vest after ten years of service and a minimum age of 35. Thereafter, a person's benefits vest on a fictitious accrued basis--namely, you work for a rate or the projected retirement benefit. In addition, disability, death, and service benefits may be vested.

The insured event is the insolvency of the employer; that is the only instance in which the pensioner might lose benefits. As long as the employer is still in existence or solvent, he is required to fulfill his obligations. The insolvency insurance is provided through a voluntary arrangement between the German confederation of employers and the insurance industry. However, it is backed up by a law providing for mandatory participation of all eligible plans.

The premium is a current-cost premium related to the liability involved. This differs from the per capita premium in effect in the United States. On the other hand, the German system premium is not risk-related in the sense that the insolvency insurer can increase or reject insurance if there is a bad risk. The current advanced rate for the year 1979 is 0.05 percent of the liability, which is determined on a uniform basis according to established rules. This rate is likely to increase to 0.07 or even 0.1 percent soon, however, due to a major claim this year.

Other than as outlined in the preceding system descriptions, the insurer has no priority as creditor. He is a general creditor, similar to the employee or pensioner.

I believe the German system is much more flexible than those of Finland and Sweden in financing benefits. It provides flexibility in funding. It offers the opportunity to finance benefits internally, thereby retaining the money in the business and still providing the necessary security for the employee. Certainly the system has higher costs than the other two systems, for there are no safeguards for the insurer other than possibly the vesting period. It covers all risks, whether bad or good, and the premium is not really risk-related. Basically, the solvent employer subsidizes the weaker employer. Yet we have had no complaints whatsoever from the major employers. They feel this is a very cheap price for having the option of financing benefits internally.

The system facilitates the implementation and maintenance of the plan. It offers to the employer a greater variety of financing possibilities. It also does not reduce the creditworthiness of the employer, because he is being insured subject to the creditor status of the employee. The system is workable because the employer is liable for what he does. If Germany only had a 30 percent of net worth liability limitation, as you have here in the United States, the system would not work. In that case, the insurable event would be easily influenced by the employer.

COMPARISON WITH UNITED STATES SYSTEM

The United States has voluntary plans, as does Germany. This is unlike the Swedish and Finnish systems, and hence requires different approaches. Unlike the German system, however, the United States system prescribes funding in principle--even though, in fact, plans are not fully funded. Given their increasingly unfunded liabilities, United States plans are already book reserving their liabilities to some extent, even though no tax credit is received.

Unlike other systems, in the United States, an employer has a 30 percent of net worth liability limitation if he terminates a plan. That 30 percent limitation is one of the problems with the United States system. The uniform per capita premium also may create problems. I shall ignore the CELI program, because it will never be implemented.

The major difference between the United States system and the other insurance approaches I have reviewed is that an employer can terminate a plan in the United States without being insolvent. The insured event is influenced by the policyholder, which is incredible to persons in the insurance business.

In reviewing the United States system, I conclude that it is viewed relatively favorably by plans which provide fairly high benefit levels with substantial prior service credits and even more substantial unfunded liabilities, because that is when the per capita premium pays off. On the other hand, it is comparatively costly for those firms that have low benefit levels, which probably includes smaller employers or companies that have taken steps to be as fully funded as possible. As in Germany, the weak employer is subsidized by the solvent employers, but on a different level. Because the insured event in the United States system is influenced by the policyholder, there is a potential for abuse. Also, restricted employer liability encourages voluntary terminations. Finally, although unintentional, funding is discouraged because better benefits can be obtained from the insurance program if one has high unfunded liability.

PROBLEMS

The only problem currently in Finland and Sweden is that each country's credit insurance system has started to have claims at a level previously unanticipated. However, these systems have adequate safeguards and reserves to cope with that problem.

The systems in the United States and Germany have more problems (see Table 2-1). You are aware of the problems facing the United States system, some of which I noted earlier, so I shall point out a few problems of the German system.

One problem shared by the United States and German systems is the danger within controlled companies that an employer will transfer liabilities to a weak employer who shortly thereafter goes bankrupt. We have had no final court cases yet, although pending cases suggest that the former employer is still liable for these benefits.

In Germany it is possible for the share-holding employee to participate in a general pension plan. In this situation, there often is a question of the effective date or ownership relation he has with respect to the insolvency insurance program. The insolvency insurer has taken the view that whenever the share-holding employee has control of the company or is in a private, fully-liable company, he cannot participate in the program; a number of litigations are currently in progress.

Other problems that must be addressed in Germany pertain to vesting requirements and indexation. One problem has been to define vesting requirements so that one fulfills ten years' membership in a plan if the plan is a promise of the employer written into the labor contract. A number of federal labor court decisions have now redefined the law, in essence stipulating only a service requirement. Another major problem has been indexation of benefits. A section in German law states that every three years an employer should review his pension plan and decide whether to increase the benefit. There is much discretion involved in this review, and employers are very reluctant to lessen their discretion. Frequent federal labor court rulings have sought to interpret that law, but there continues to exist a great deal of uncertainty. At issue is whether the PSVaG must become involved in the indexation business. Currently the insurer says no, because the law clearly stipulates that the employer must review these benefits and the insurer does not view itself as an alternative employer.

A final problem in the German system occurs whenever an employer transfers assets and liabilities to somebody else. The PSVaG takes the view that current pensioners cannot be transferred to the new employer. A pensioner is not an employee, so there is no employer. Therefore, the pensioner that is transferred to the new employer cannot be covered by the program, which means that the pensioner must stay with the former employer. This creates a problem, particularly when the former employer is liquidated.

TABLE 2-1

INSOLVENCY AND TERMINATION INSURANCE PROGRAMS

Country and Insurer Agency	Type of Insurance	Basic Principles	Conclusions
FEDERAL REPUBLIC OF GERMANY			
*Pensions-Sicherungs-Verein auf Gegenseitigkeit (PSVaG) (Pension Guaranty Mutual Association)	*Insolvency insurance for employers operating non-funded plans, insurance contracts (in certain cases)	*Voluntary plans *Funding unfavorable *Employer liability for all accrued and future benefits promised under a plan *Plan termination not possible through unilateral action *Insolvency insurance covers: vested deferred benefits; current benefit payments *Insured event: insolvency of employer *Premium: current cost premium related to liability *Current rate: 0.05% (likely to increase) *Insurer has no priority as creditor	*Offers flexibility in financing benefits *Higher cost: no safeguards for insurer; no risk-related premium *Solvent employers subsidize weak employers *Defined basis for the assessment of "liabilities" necessary *Facilitates implementation and maintenance of plans *Does not reduce creditworthiness of employer *Only workable if employer assumes 100% of the liability *Favors non-funding *Problem areas: controlled companies; owner-employees; vesting requirements; indexation; transfer of assets and takeover of liabilities
FINLAND			
*Eläketurvakeskus (Central Pension Security Institute)	*Credit insurance for pension institutions, employers with unfunded liabilities	*Mandatory pensions *Mandatory funding *Credit insurance: mandatory for pension funds and foundations; voluntary for employers *Insured event: insolvency of employer, plan sponsor, plan *Insured subjects: loans taken by employer, loans granted by pension institution, loss in assets, unfunded liabilities	*Low cost for employers: in total; in individual cases (no loan, guarantees offered, creditworthy); safeguards for insurer *Only workable if plan termination not possible *Discourages: loans or unfunded liabilities; implementation of plans (if not mandatory)

TABLE 2-1 (continued)

Country and Insurer Agency	Type of Insurance	Basic Principles	Conclusions
FINLAND (continued)			
		*Premiums: risk-related *Insurer has priority as creditor	*Favors insurance companies: reduced risk credit insurance cost; 85% of premium is collected by 8 insurers, 15% by other 111 pension institutions *Reduces creditworthiness of employer
SWEDEN			
*Forsäkringsbolaget Pensionsgaranti (FPG) (Pension Guarantee Mutual Insurance)	*Credit insurance for employers with internally financed benefits	*Collective contract on mandatory pensions *Internal financing subject to credit insurance offered by FPG *Credit insurance mandatory for internally financed plans *Insured event: insolvency of employer *Insured subject: accrued liability determined on basis of prescribed actuarial method and assumptions (aggregate method) *Premiums: 0.3% *Insurer may cancel contract partly or in whole *Insurer has priority as creditor for part of the liability	*Offers more flexibility in financing benefits *Low cost of program: safeguards for insurer; only solvent employers participate *Only workable if: actuarial liability is defined on strict basis; deficiencies in actuarial basis are made up by a mutual body *Endangers companies, if financial situation deteriorates *Reduces creditworthiness of employer
UNITED STATES			
*Pension Benefit Guaranty Corporation (PBGC)	*Termination insurance for unfunded liabilities of defined benefit plans	*Voluntary plans *Funding prescribed *Employer liability to pay normal cost plus amortization of prior service cost	*Low cost for plans with: high benefit levels; substantial prior service credits; unfunded liabilities

TABLE 2-1 (continued)

Country and Insurer Agency	Type of Insurance	Basic Principles	Conclusions
UNITED STATES (continued)			
		*30% net worth liability to make up unfunded plan liabilities *Insurance program covers: vested deferred benefits; current benefit payments *Insured event: plan termination *Current premium: $2.60 per employee single employer plans; $0.50 per employee multiemployer plans *CELI program intended to cover employer liability	*High cost for plans with: low benefit levels; insignificant prior service credits; no unfunded liability *Solvent employers (plans) subsidize weak employers (plans) *Insured event is influenced by policyholder *Covered benefits are influenced by policyholder *Abuse potential to "socialize" unfunded liabilities *Restricted employer liability encourages terminations *Funding is discouraged *Problem areas: insurable events; CELI program; coverage for multiemployer plans; early retirement and phase-in of benefits

SOURCE: Information compiled by International Pension Consultants (IPC) GmbH, for Employee Benefit Research Institute Forum, Washington, D.C., June 25, 1979.

INSURANCE PROGRAM ISSUES: A DISCUSSION*

George Swick (United States):

Before opening up our discussion on pension plan insurance programs to all participants, I wish to welcome our foreign visitors from Finland, Germany, Japan, and Sweden and provide them an opportunity to add to Burkhard Fürer's overview.

Esko Prokkola (Finland):

Burkhard Fürer's presentation was very fine. I would only add that our pension system problems are not in credit insurance, but in the pension system as a whole. As in other countries, the pension system is not fully funded, and the contributions are not as great as they should be. In this situation, when our parliaments or our political parties discuss higher benefits, they do not take into account the full cost of benefits and perhaps increase them too much.

Göran Engzell (Sweden):

In Sweden we have rather substantial social insurance. The private pension schemes supplement social insurance, covering approximately the last 10 percent of the total retirement income. In talking about problems, one potential concern is the size of the pension commitment in the big companies. It is a large part of the total financing of these companies, and increasing all the time. Thus far, however, pension debts generally are not increasing at a faster rate than other debts. There also is a problem with increasing benefits, but these are no longer increasing much. Labor market agreements have been quite stable and uniform for a couple of years, and we do not expect them to change much in the future.

Eckart Windel (Federal Republic of Germany):

I would like to add a few comments to what Burkhard Fürer has said about the German pension system. Its special characteristics permit us to enforce contributions payments by our members. In addition, I would note that the financing system of the PSVaG is a current-cost revolving system based only on the cash values of the current pensions. There is no prefinancing of the vested benefit expectations we must guarantee. These vested rights are only registered initially, and are not added to the claims volume until the year they fall due.

Jürgen Paulsdorff (Federal Republic of Germany):

I wish to add a comment, from the German viewpoint, on when a pension is earned. George Swick's example about John Smith creates no problem in

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*Moderator for the discussion was George B. Swick. Titles and affiliations of all discussants are included at the end of the volume.

the German system of book reserves or insolvency insurance. Under German law, John Smith would have a vested right to his benefits. The only exception would be if the firm became bankrupt within one year after increasing the benefits. Otherwise, the firm may increase its book reserves, extend the new level of benefit, and pay the pension premium to the PSVaG.

Paul Jackson (United States):

I want to start our general discussion with three questions. First, George Swick indicated in his presentation that we need to return to basic insurance principles. The first thought that occurred to me then was: Why? And throughout Burkhard Fürer's presentation there appeared to be a primary focus on how we can keep each country's insurance company solvent, keep its assets growing, increase the size of its home office building--but I did not hear one word about the people who lost out on benefits or about the protection of employees. There is an imbalance here, and I am puzzled by it.

Second, I do not know if it is a problem abroad, but in the United States we have public plans which serve as a standard for pension opulence. They are formulated by legislators who, despite providing higher benefits, provide much lower funding. Yet these people are setting the standards for private plans, and the higher the private cost of a private plan, the harder it is for a private company to provide reasonable benefits for the workers.

Finally, we must remember that in our discussion we are talking about benefits that are lost. Most of the remarks thus far have focused on employers who are becoming insolvent or employers who renege on their pension promises. Yet in the United States there probably was more pension value lost to inflation in the last month or two than has been lost in all pension plans terminated in the entire history of the United States. I am baffled as to how we can have a discussion of pension values in the absence of some comments on inflation and how it can be controlled.

George Swick:

Does Germany have indexing by law?

Burkhard Fürer (Federal Republic of Germany):

No. We do have a law stating that an employer should review pensions and decide whether he can afford to index them, but thus far very few employers have decided that they can afford it. As unlikely as it seems, these same employers had not even been forced to review pension plans until 1974. So there is no indexation in the sense of automatic pension increases based upon cost-of-living increases. But we do have a type of triennial review, and we are anticipating decisions in the near future to permit 50 percent of the accrued cost-of-living increase to be covered in pension adjustments every three years, which would be a type of indexation.

I was also interested to hear that within the ERISA (Employee Retirement Income Security Act) amendments, there is a provision requesting the United States Department of Labor to look into that question here in the United States.

Jürgen Paulsdorff:

In my opinion, inflation is not an insurable event. In the long run, all indexation--or adjustment, which is a better word--is simply a response to inflation. Yet pensioners are not the only people who suffer from inflation--we all do. We should try to address pension problems by ways other than indexation.

George Swick:

Does the Pension Benefit Guaranty Corporation view itself as a government agency or a more traditional insurance-type operation?

Jeff Hart (United States):

The PBGC clearly is a government agency, created by the Congress in 1974 to administer the ERISA pension plan termination insurance program. But, to a certain extent, the PBGC also views itself as an insurance entity, concerned with basic insurance principles and why they should be followed or not followed. Insurance precepts govern how the costs of the system are going to be distributed, with the direction and the amount of that spread a function of one's philosophical approach. Yet if we become too much of an insurance company in the sense that we restrict private enterprise, then we could very well eliminate the enterprises needed to provide the benefits.

I might add that, given the focus of the multiemployer proposals now before the Congress and the PBGC's contingent employer liability insurance (CELI) proposal, it is clear that the PBGC considers the insurable event to be very important. We are looking more toward insolvency, rather than voluntary termination, as the insurable event.

George Swick:

Is insolvency insurance in Germany based solely on plan sponsor and employer insolvency?

Burkhard Fürer:

Yes. The employer is 100 percent liable for what he promises.

Matthew Lind (United States):

I would like Paul Jackson to elaborate upon his earlier remarks on plan termination.

As I understand the German and Swedish systems, particularly the German system, the only way that an employer might be able to back away from

future benefits under his plan would be if the labor courts permitted such action in light of economic hardship. In general, once a plan is started, it cannot even be curtailed. Hence, what do you mean by termination when you suggest that the United States should continue a voluntary termination program? Should employers have the flexibility to reduce the obligation for benefits already accrued and vested?

Paul Jackson:

You are asking me for a technical analysis as to whether an employer should be able to back away from a pension promise.

The American system has been one in which pensions have been negotiated, primarily to get benefits to people who retire within the next three years and to people already retired. That promise, once negotiated, is one that should be kept just as much as the promise to pay wages at a certain level.

We have certain situations in the United States, however--and New York State is one illustration--where an employee who puts in one day of work is guaranteed, forty years in the future, pension benefits under the plan that was in existence on that day he worked. To me, that prohibits voluntary termination. In the case of New York State, its pension plan runs the State into bankruptcy; someone promises too much and the State can never get out of it.

Somewhere between these two extremes we must permit voluntary termination. Why should not a union be able to negotiate with an employer for higher wages and say it does not need any more pension accruals? In America we allow workers to decide the extent to which they want current income or deferred income, and if at some point deferred income is less attractive, that ought to be their choice.

Burkhard Fürer:

Even in Germany a plan can be terminated in the sense that no new employees are added to the plan if it is becoming too expensive. On the other hand, we take the view that if the employer promises something to the employee, even if it is future benefits, he should stick to that promise. Why should he promise something, if two days later he wants to back out of it? In that case, he should not have promised it in the first place.

Kenneth Houck (United States):

In Germany, is it legal to reduce current wages by agreement?

Burkhard Fürer:

Theoretically, yes, with the approval of the wage earner. Unilateral action cannot be taken, however.

Jürgen Paulsdorff:

Let me elaborate. Until a few years ago, only those persons who worked in a firm until they reached the age of, say, 65 years received a pension; they had been given a pension promise. Others who left the firm years before lost their pension rights, and this was expected. Then the parliament enacted legislation comparable to ERISA, giving employees vested rights after ten or twelve years of work in a firm under a particular pension plan. The rationale was that the years working for an employer under a pension plan are not repeatable.

For similar reasons, a voluntary planned termination should not be subject to negotiations between employers and trade unions. Our supreme labor court is very restrictive in allowing termination of a plan.

Norbert Rössler (Federal Republic of Germany):

There may be a little misunderstanding. In Germany, an employer can discontinue a plan, but only by cancelling all contracts of employment. In this way, he can restrict his liability to the vested rights. It is similar to the situation in the United States. The only difference is that in Germany, it is not possible to cancel only the pension plan; at the same time, the working relationship must be cancelled.

Matthew Lind:

Yes, but under those circumstances, the employer still must fulfill the funding obligation of the vested rights, even though no further work is being performed.

I want to return to the matter of reducing wages in the future and whether that could happen in the United States. It was unclear whether there is agreement that previously accrued vested pensions could be reduced. Is it being suggested that if you could reduce wages, you could reduce your funding commitment necessary for already accrued vested pensions?

Kenneth Houck:

No one is saying that. That is why we need to clarify what we mean when we talk about termination. If we mean that we must accrue benefits in the future, that is a concept entirely different from termination as I view it.

Matthew Lind:

Let me go back to George Swick's question concerning when a pension is earned. The expectation on the part of employees is that these pension improvements about which you have talked are earned at the moment they are granted--although that may not be the view of the insurance corporation.

I want to illustrate this issue by comparing salaried plans with hourly plans. My feeling is that the focus of retirement programs today

is on income replacement. Salaried plans have been moving in the direction of a percentage of final average pay. Actuaries, in setting up funding schedules for these plans, anticipate certain rates of wage improvement, whereas, in fact, in periods of high inflation or periods of rapid employee advancement through a corporation, there are past service liabilities which arise as a result of the unexpected inflation or unexpected growth of wages. The first question an employee in such a plan asks is: Is it unreasonable, when I am accruing benefits as a percentage of final average pay, to assume that I earn the benefits immediately at the time that I accrue them? If that is not unreasonable, then I believe the improvements in benefits that we see in hourly plans which are achieved through periodic amendments to those plans are really intended to produce the same result--namely, to keep the plans basically in line with the cost-of-living. These plans are not called salaried plans, but the goal is to provide a certain level of income replacement for a reasonable standard of living. Therefore, if we say that under a salaried plan you earn the benefits immediately, the same logic should apply to hourly plans. I would argue the periodic amendments are simply a design to achieve the same objective, and therefore benefits are earned at the time the improvement is granted. The expectation today is wage replacement, irrespective of what the plan may state.

If you accept this, the next question that needs to be addressed is the obligation of the employer with respect to a pension that is earned. Should the employer be obligated without regard to any net worth limitations? Should the employer be able to walk away, voluntarily, from some or all of that obligation? In answering that question, we must come to grips with larger questions. If we say employers must stand behind those promises, are we encouraging sounder private systems? Are we encouraging growth? Are we discouraging defined benefit plans--and, if so, is that a bad thing?

George Swick:

The United States has governmental plans--for example, the federal civil service system and state municipal systems--which are not covered by ERISA and not covered by the termination insurance program. What about governmental employees in the European countries?

Burkhard Fürer:

In Germany the civil service system has a salary continuation pension scheme which is financed not by contributions, but out of tax income. Public employees basically are covered by a Social Security system, and, in addition, they have public service pension systems--but these are not covered by the Pension Guaranty Mutual Association.

Lauri Koivusalo (Finland):

In Finland we have different systems for civil servants--and they have the best pensions in the country. When they retire, most of them receive a pension which is about 60 percent of their salary.

Esko Prokkola:

I might add that it is a pay-as-you-go system.

Göran Engzell:

There is no practical difference between pensions for the civil service workers and pensions for workers in industry. Civil service pensions are provided through a system based on government responsibility.

George Swick:

Has the Swedish government been tested as to whether it is a good creditor?

Göran Engzell:

There is no need for that today. Anything governmental is safe, so you need no safeguards.

Douglas Love (United States):

Returning to the indexing problem, Jürgen Paulsdorff made a comment about inflation being a non-insurable event that should not get lost in these proceedings. In the field of finance, one of the criteria for insurability is that an event be diversifiable. For society as a whole, inflation is not such an event.

In order to understand the problems of indexing in pensions, it helps my thinking to strip away the problem to its barest essentials. Assume we have a simple farm on which the people are living in retirement. They have claims on the output from the farm in terms of actual corn produced by the farm. That would be a fully-indexed pension. They do not have rights to pieces of paper to purchase corn; they have claims on the corn itself. Let us say that the ratio of pensioners to workers is one-to-one on the farm. A flood comes along and wipes out half of the productivity capacity of the farm. The retired people still have the same claim to the amount of corn that they previously did, which means that the entire loss of productivity of the farm now falls upon the workers and not upon the retired group. Now, if the retired people have claims only on pieces of paper to purchase corn and such a loss of productivity for the society as a whole occurs, the pieces of paper are inflated and there is a pro rata redistribution of the amount of corn that the farm can still produce. On the other hand, if both the pensioners and the workers are fully indexed against inflation, which is often the situation, what happens when productivity of the farm is decreased instantaneously? How is this loss in productivity redistributed? The answer is that it cannot be, unless there is another entity called government which raises taxes on everybody and in that way restores equilibrium. I would support Dr. Paulsdorff's remark that inflation is not an insurable event and that a 100 percent indexing of pensions would, I believe, prove to be unworkable.

George Swick:

Should the PBGC be an insurance company?

Douglas Love:

De facto the PBGC is a government agency, but de jure it is a private mutual insurance company. This creates a great deal of misunderstanding in the United States. Because the PBGC has been severed from the public purse and is unable to use tax money, its only source of funds is private industry. Hence the PBGC can only redistribute losses from insolvency. If sound insurance practices are followed, the people who have granted the benefits are stuck with paying the benefits. If unsound insurance practices are followed, the people who have granted the benfits will be bailed out by strong companies who have been more prudent in the granting of their benefits. So the issue of sound vs. unsound insurance practices in this country is simply the issue of whether the weak companies get away with less or more than they otherwise would.

Paul Jackson:

Reducing the question to its essentials, I want to discuss the point that Douglas Love raised about insurance principles. When the cost of providing benefits to people who lose out on pensions is to be assessed across the society to those employers who are promising pensions, should the cost be borne primarily by the strong companies or should more of it be allocated to the weak companies according to an insurance premium principle which recognizes the added risk that they bring to the situation?

In the United States, bankruptcy is the cause of at least 80 to 90 percent of the pension terminations. The employer goes out of business. It is simply not the case that the employer who promised the biggest pension necessarily is the one who is most likely to lose out. It is true, however, that when one company goes out of business in a given industry the continuing employers in that industry end up, on a marginal basis, with more profit. On that basis, one could construct a logical approach which says that the support for benefits lost due to bankruptcy should come from corporate income taxes.

One illustration might be the auto industry, where Studebaker closed its doors in the early 1960s. Certainly in the years following its collapse the other United States auto makers each sold more cars than they would have sold had Studebaker still been competing with them. Although the fact that this is an industry with three or four major companies makes it easier to identify impacts, nevertheless each of the surviving companies made a greater profit by reason of having driven Studebaker out of business.

When a firm in Studebaker's financial straits collapses, if it is then felt reasonable to allocate the resulting pension loss among other firms in the industry who have pension plans, then one is placed in the position of saying that any other employer who has a pension plan should contribute a substantial amount for the lost pension promise, but companies which have profit-sharing plans with the same tax advantage that pension plans have should not bear this cost at all. I am not sure that I

agree with that distribution of the burden. In this event, everybody would adopt a profit-sharing plan and forget the promise entirely: "We'll promise to put x dollars into the pension pot and let the employees go it alone. If we go bankrupt before enough money is there, it is neither our promise nor anyone else's promise."

Russell Mueller (United States):

In the earlier comparison between a negotiated fixed benefit plan and the actual operation of a salaried plan in terms of employee expectations, the question of funding was not addressed directly. In a salaried plan the actuary must take into account anticipated future increases in pay. Now, the actuary may not be right in his expectations, but nonetheless, those expectations have to be taken into account and, therefore, future salary increases will be taken into account in today's funding. That is not the case--and, in fact, it is prevented under ERISA--with respect to the fixed benefit plan. While expectations may be the same in terms of who receives what, and when, there is not parity in terms of funding. Funding of these plans would have to be increased in anticipation of future benefits, were parity to be achieved.

The question, then, is whether the fixed benefit plan is to be given the same guarantee as a salaried plan. If, ultimately, we are talking about cost--who pays it, when, and how much--the amount at risk at any point in time under identical situations in a fixed benefit plan and a salaried plan will be greater in a fixed benefit plan. Should a fixed benefit plan be given the same guarantee level as a salaried plan, when under existing funding provisions and in an inflationary environment, the salaried plan is much more responsive to the needs and to the amount of funding required to meet those needs? The fixed benefit structure is not responsive. It goes the other way--the faster inflation increases, the faster unfunded liability increases. This is a matter of equity; it is a question of how different types of plans are treated, given the fact that in the United States employers and unions can maintain different types of plans.

George Swick:

When should the employee have an expectation, and how will that expectation be funded?

Matthew Lind:

To the extent hourly plans, through amendments, are trying to meet the same expectation as salaried plans, the employee should have that expectation at the time the amendment is put into effect. Whether or not the insurance program should treat the two differently or whether funding standards should be modified to achieve greater parity are other issues.

George Swick:

In European countries, where companies can use book reserves and plan sponsors can obtain loans on the basis of book reserves, has either of these practices encouraged plan sponsors to fund benefits more quickly?

Burkhard Fürer:

I believe that this encourages faster funding, because tax rebates are provided earlier and an employer is permitted to retain more earnings in the company.

George Swick:

Am I correct that in Germany an employer is not allowed to pay dividends from its pension book reserves?

Burkhard Fürer:

The employer would have paid dividends out of the profits that are disclosed; the book reserves reduce the profit.

Kenneth Houck:

What we are doing in all the agencies represented here is trying to protect a pension promise. We all agree on that. What difference does it make when it is earned? If somebody promises it, that is it. Maybe it was never earned. I insist I have earned my salary, but certainly I did not contemplate the level of pension that I now have. Nevertheless, the company promised it to me at one point, and I expect it to observe the promise. So, if we are protecting pension promises, it makes no difference at all when it was earned. On the other hand, if the company does not have any pension plan at all, there is no pension promise. That is the key--the promise, rather than when and how and if it is earned.

Dan McGill (United States):

There are at least three aspects to this matter of when the benefit is earned or when it should be earned. First, from a legal standpoint, I agree with the previous discussants that it is earned when it is promised, if it is promised unconditionally and it is vested. From an accounting standpoint, one can ask what the benefit is worth. What is the cost? One approach, developed in a Pension Research Council-sponsored book on pension cost accounting, is to assume that a pension is earned in the same proportion as wages are earned. In other words, you calculate the total expected compensation of an individual over his expected working lifetime; you divide that into the projected pension in such a way as to produce an annual benefit of accrual; and then you value that benefit on what we call an accrued benefit cost basis. That is the cost for accounting purposes and the measuring of profit. The third aspect is what should be done in terms of funding the cost. I personally would favor funding at a rate based on an allocation of the cost (in dollars) of the total prospective benefit. That would produce a higher level of funding.

George Swick:

Several discussants seem to agree that the employee should expect the pension benefit when it is promised. What responsibility, then, do all the other plan sponsors in society--and society itself--have to reinsure that promise?

Dan McGill:

That is an excellent question.

I have been thinking about plan termination insurance since 1963 and wrote a small book on the subject several years ago while trying to identify the issues that needed to be resolved. Those of you who have read the book realize I have long believed that an employer, once he promises a pension benefit and pledges corporate assets behind that promise, should develop a funding policy that would, within a reasonable period of time, accumulate assets equal to the actual value of the benefits. I have not believed that an employer should be able to abandon a pension plan and transfer the liabilities to other employers who are attempting to carry out their promises and to fund their plans in a reasonable manner. So in the book, I did recommend that if a pension plan were terminated, the plan participants should have a claim against the plan sponsor for the full amount of unfunded vested liability without limitation with respect to net worth or any other factor. Because I knew of no other way a plan termination insurance program could operate, I was aghast when ERISA was enacted with a limitation of 30 percent of net worth and when the Congress then said that even this liability could be insured under the CELI program. It made absolutely no sense, and I was delighted that the CELI panel on which I served concluded that it was not feasible, was ill-conceived, and should not be implemented.

Tom Levy (United States):

I am concerned that restricting the pension plan promise in that way would greatly affect the design of the benefits and the ability of the plan to achieve its purpose. If making a promise on past service has a large potential penalty attached to it, then the employer simply will not do it. In that case, the person who is approaching retirement will have no inflation protection, because the employer will resist giving a benefit that will increase the claim on corporate assets for prior work.

It appears from this discussion that the United States has the most complicated pension system. What can we learn from other countries' experiences that might help us simplify our arrangements? Other than the multiemployer plan situation, we start with a system that is reasonably well-designed to serve its needs if everybody is honest and does not make unreasonable promises. The conditions that we attach to the system to cover the loopholes and to keep people from unfairly taking advantage of the system create unnecessary complications. Somehow, other countries have avoided this complication. Thus today we need to focus on what we can learn from these other countries.

George Swick:

I believe I heard that in Finland the levels of benefits are virtually uniform by law; in Sweden they are uniform by practice; and in Germany they are not uniform at all. Yet pension officials in all three countries seem to feel reasonably comfortable with their respective reinsurance programs. Is there anything for the United States to learn from this?

Burkhard Fürer:

You already have learned something, as evidenced by the recommendation in the most recent CELI alternative that insolvency, not termination, be the insurable event.

It is very difficult to say that any of the European systems could be easily adopted by the United States. We are living in a different environment. For example, how would the United States implement the Swedish or Finnish system without having mandatory pension plans?

Douglas Love:

In his earlier remarks about the European view of the United States system, Burkhard Fürer listed several characteristics that seemed anomalous from the viewpoint of the German system. Having struggled for a long time with what I perceive to be the irrationalities of the American system, including CELI and the 30 percent of net worth limitation, it appears to me that as we work to eliminate these irrationalities we are, in fact, moving closer to the German system. Each country likes to believe that it alone invented the wheel, and it is a great testimony to this conference that we are trying to learn from each other.

The German system, as I view it, has one advantage and one disadvantage. The disadvantage that I hope the United States can avoid is that the German system discriminates, in terms of taxation, against funding. An advantage of the German system is that it recognizes, because of the nature of book reserving, that a pension claim is a claim on corporate assets. What is not yet recognized in the United States is that our unfunded liabilities have all of the hallmarks of the German book reserve system. Compared to the German system, the American system is now a dual system--part funding and part book reserves, without the tax advantages of book reserves.

Göran Engzell:

From the Swedish perspective, it seems a little curious that the United States looks upon the pension liability as something other than salary. For a long time we have viewed it as a part of the salary which is not paid out. Thus, the pension definitely is earned when it is promised.

When we study the American system, we find it hard to understand why employer liability is not 100 percent. We fully believe that the pension must be paid from corporate assets; this is quite natural and quite clear for us. We are confused when you speak about a new insurance for employers' liability and about a 30 percent net worth limitation upon termination. You seem to want to avoid employer liability when a pension plan is terminated.

For us the book reserve is very natural. We look upon the book reserve system as a system in which you take into account the costs at the same time that the pension is earned. The pension is guaranteed by credit

insurance. You are just as safe with the book reserve system and credit insurance as if the liabilities were funded.

Regarding the indexation of pensions, the private pension system is not actually index-regulated. We pay pension supplements, which give a result similar to indexing, but we do not pay salaries which follow the index. Nevertheless, we try very hard to follow the index. What we shall do in the future is still not certain.

Finally, our premiums are based on the pension liability covered by the insurance. It is easier for the companies to accept this approach, in that pay is then related to liabilities.

Carol Trencher (United States):

We have discussed the need in the United States to make our pension system less complicated by addressing the problems of CELI and the 30 percent net worth limitation. But other aspects also might be looked at, and I am interested to know how the Europeans have handled them.

The first is our practice regarding guaranteed benefits. We have this basic benefits concept which leaves out death benefits; it leaves out temporary supplements, if you will. I would be interested to know if other countries have found that guaranteeing whatever is in a plan has created any problem with respect to benefits being included that should not be. Second, we have a complicated phase-in of benefits. When benefit increases are made, we have a relatively complex transition before they are guaranteed; in the German system, I understand they are guaranteed at 100 percent after one year. Have there been insolvency terminations in which that has been a problem? Do both of these practices seem to work all right?

Burkhard Fürer:

Phase-in is a potential problem, but it all comes down to the basic difference between the systems. In the United States you must use a phase-in approach, because you have termination on a voluntary basis. Here I could adopt increased benefits and then close the plan. In Germany that would mean I would have to go bankrupt, which is much more difficult. There still remains resistance to employers going bankrupt because of increased pension benefits.

Matthew Lind:

Do you have shut-down benefits in Germany? Is there anything preventing a pension plan from having special early retirement benefits for workers in the event of a plant shut-down?

Burkhard Fürer:

Yes, we do have shut-down benefits, but they are by special arrangements. In the event of a shut-down, a plan must provide workers with some special compensation or indemnity. Even in a shut-down, we have had

court decisions in which employees may have a priority right to receive these benefits.

George Swick:

In Europe, how prevalent is it in early retirement to provide benefits greater than the benefits one would receive were he to retire at age 65?

Burkhard Fürer:

That has been an interesting problem during the recent years of recession, as employers have tried to get rid of their elderly employees. The best way to do that in Germany is to make them redundant at age 59, so that they could collect early retirement from the state at age 60. To facilitate this process, they offer unreduced benefits at the time of early retirement.

John Tomayko (United States):

Could a man, on his own, leave a firm at the age of 59 and go to work for another employer?

Burkhard Fürer:

Making such a voluntary move at age 59 would be a problem, because in doing so he would not be unemployed. He would not be covered by the system. At age 59, you must be unemployed in order to receive state benefits, which are substantial, and to live on private benefits alone would be impossible.

George Swick:

Do I understand that the insurance program is tied into the availability of the state benefits?

Burkhard Fürer:

No, not the insurance programs, only the private plans. Promises in a private plan are covered immediately by the insolvency insurance programs. We even have plans that provide benefits at age 55, and they are insured.

Carol Trencher:

In the European countries, is there a restriction that only those benefits payable indefinitely are guaranteed?

Göran Engzell:

During recent years, early retirement pensions have been very common, functioning in conjunction with the labor market. If the work can be arranged satisfactorily, an employee is allowed to work only about half-time

starting at age 62, yet be compensated up to 80 or 90 percent of his full salary. In Sweden, because we have defined benefit plans, this is an increase in the benefits. But this leads to different increases in different companies, and especially the big companies, which often need to pension people because some of their businesses are closing. The companies make commitments for early pensions, usually starting at ages 60 to 62, and then book reserve the increase or insure it. But if you book reserve it, you also must ask the credit insurer if he is willing to assume that additional risk, plus the ordinary risk associated with the basic plan. So we receive special applications for these early pension commitments. After we make a credit check, we decide whether to accept them. Other early pension commitments need not be secured, because they are not in the labor market agreement; in this case, you can do whatever you want. I also want to add that it is always tax-deductible to book reserve or to set aside in foundations up to 100 percent of all commitments. We try not to force, but to encourage the employer to make pension commitments; that is why it is always tax-deductible.

Lauri Koivusalo:

In Finland, we now have an early retirement pension system like that of Sweden. But currently we have a problem, given that an employment experiment is being conducted. Politicians believe it is better that elderly people retire and younger people work. Hence, in Finland people retire at age 63, with the employer replacing them by unemployed young people under 25 years of age. Then the state pays this retirement pension until the retirees reach 65, after which pension benefits are provided through the legislated system. The greatest problem in Finland is that the companies have a need for less people. Although the state wants the companies to hire young people and to retire elderly people, the companies are not always willing to do so.

John Tomayko:

Let us assume that a man has worked for 30 years in a cold climate, and that he would like to move to Israel or the Mediterranean, where it is warm. Is there a pension system in any of these European countries in which a man can choose his date of retirement? We need to think about human dignity, about human freedom. Have any of these European plans considered that a man might have a right to leave a job? We have that in America. It is increasing, just as cost-of-living increases for pensions will become more common.

George Swick:

To follow up on John Tomayko's question, are benefits prior to age 65--or normal retirement age--given if the employee voluntarily terminates as opposed to replacement by a younger worker or unemployment?

Lauri Koivusalo:

This is possible in Finland, but to do so would require the employer to pay higher premiums. Because many employers are not willing to pay higher premiums, however, we have only a few of those pension plans.

Burkhard Fürer:

In Germany employees can always leave and receive deferred benefits, which are reduced benefits. We also have a voluntary retirement option with benefits beginning immediately, for females at age 60 and for men at age 63.

George Swick:

There have been suggestions in the United States that the Social Security system could be brought into better balance by increasing the retirement age. Has this been considered in any of the European countries?

Burkhard Fürer:

Given the recession in Germany, everybody has been concerned about how to get rid of employees earlier rather than later. But the attitude will gradually change, and later retirement will soon be encouraged again.

Matthew Lind:

It is important to remember, as we compare pension systems, that each of the Swedish and Finnish systems is not much larger than a big pension plan in the United States. That is not meant to be critical. It is also a fact that in those countries you effectively have mandatory uniform private systems which, together with the public system, are designed to achieve an explicitly articulated wage replacement rate--approximately 70 to 80 percent in Sweden and 60 to 70 percent in Finland.

Talking about simplicity, I am interested in knowing whether people feel that the time has come to rethink the structure of the private system and to think of it in two parts. This is not a new idea. The private system in this country used to be regarded as supplemental, with Social Security serving as a minimum adequacy system and the private system filling in much of the gap between minimum adequacy and maintenance of the pre-retirement standard of living. Perhaps we ought to start thinking about a mandatory private system (the first tier) which, together with Social Security, would produce a higher level of adequacy, supplemented by a voluntary private system which would function to meet the individual needs of different employment settings. It would be this supplemental system that would provide early retirement and special supplemental benefits, as well as other incentives employers may need to use to move people out of the workforce. Has the United States reached the point where we ought to call for a mandatory private system which would guarantee that workers would achieve a 60 to 70 percent income replacement rate, with the money staying in the private sector to be invested?

Paul Jackson:

On the matter of mandatory private pensions, there is a semantic problem--what is mandatory is no longer private. If you are going to mandate adequacy in the private sector, then you are suggesting that we

ought to pass a law giving everybody what good union members have--especially pensions. In our country, when people want more pensions, they go out and get them; if employers do not voluntarily give their employees what is good, they soon have a union and the union gets it for them.

Another aspect of this discussion is also intriguing--namely, the concept of a minimum retirement income target which some of the other countries have. They have mandatory pensions up to a pre-retirement income level of, say, 60 percent, while we have Social Security which now provides 40 percent or perhaps less. We ought to look at the people who have no private pensions at all, rather than focusing only on people who do have private pensions. If you move to a system with 100 percent company liability, which in my judgment is fair, the company that promises the pension agrees to pay for its pension promise to the extent possible. That employer should not be saddled with some other company's pension promise, when there are people in the United States who are getting away with hiring, working, and retiring their employees with no pension consideration at all. Hence, I could visualize bankruptcy termination insurance working in such a way that the cost is loaded on the firms who do not provide private pensions. In theory, these firms have more profits. They are making more money, and this pension cost would be a type of excess human profits tax.

Wages are equally a part of this issue. When the Studebaker plan terminated, the workers age 60 and over received their pensions and the workers under age 60 received only 15 cents on the dollar. But a subsequent study conducted at Notre Dame indicated that five years later, the workers in their twenties and thirties had generally gone somewhere else to work; it was the older worker who had lost out and who was still unemployed.

In our country, the focus of pension plans has shifted away from something intended to support old people who cannot work or older workers who cannot find jobs. A worker with five or ten years of service who is age 25 or 30 now has an equal claim on these dollars. As a general objective, that is probably wrong, not in terms of the general equity of the situation--obviously, if the employer can pay, everybody ought to receive his benefit--but in terms of an individual being able to reconstruct his future lifetime income prospects. The worker who is 25 or 30 years old is obviously in better shape to do this than the one who is 55 or 60 years old.

George Swick:

Some workers in the agricultural and apparel industries might take issue with their supposed well-being. If a firm has a hard time paying its workers the minimum wage, which is low in this country, it seems a little unreasonable to tax them for the pensions for the people who work for highly profitable corporations.

Paul Jackson:

I believe the plan termination insurance should be limited. I see no reason termination insurance of up to $1,000 a month is needed when most

pensions are down to $200 or $300 a month. We should put a dollar limit on the coverage.

George Swick:

This has been a fascinating discussion, and I am grateful to all of you who have participated. We are particularly thankful to our visitors from abroad who have shared their observations and wish them success with their pension systems.

CREDIT AND INSOLVENCY INSURANCE PROGRAMS:

SUPPLEMENTAL COMPARISONS*

An overview of the pension program credit or insolvency insurance approaches in the Federal Republic of Germany, Finland, and Sweden provides a useful comparison with the United States termination insurance program administered by the Pension Benefit Guaranty Corporation (PBGC). This section supplements the prior remarks (and Table 2-1) in this volume through descriptive summaries of these European countries' programs and through responses to two sets of common questions posed to program administrators.

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*Summaries and responses in this section were prepared by Kenneth W. Tolo from material submitted to the Employee Benefit Research Institute in May 1979.

FEDERAL REPUBLIC OF GERMANY*

The Pensions-Sicherungs-Verein auf Gegenseitigkeit (PSVaG) was founded on October 7, 1974, by the Federation of German Employers' Associations (BDA), the Federation of German Industries (BDI), and the Federation of Life Insurance Companies. The starting date for PSVaG activities was January 1, 1975.

The legal status of the PSVaG is that of a Mutual Insurance Association (VVaG), with the employers as members. Employers are subject to compulsory insurance, if they have granted employee retirement benefits to their employees using certain financing instruments and if these benefits are in pay status or vested rights according to the law.

Insolvency insurance was introduced by the "law on the improvement of private employee retirement benefit programs" (Gesetz zur Verbesserung der betrieblichen Altersversorgung, BetrAVG), enacted December 1974. Sections 7 to 15 of this law cover insolvency insurance, with section 14 designating the PSVaG as the carrier of the insolvency insurance. The law authorized the PSVaG to collect premiums on a compulsory basis, thereby acting similar to a government corporation (a so-called "endowed enterprise").

The following sections describe the insolvency insurance system and its underlying concepts.

Insurable Events

Insurance provided by the PSVaG is payable only upon the insolvency of an employer. That is, an insurable event (or, condition for payment of a claim) occurs when:

(a) bankruptcy proceedings have been instituted against an employer's assets or his estate;

(b) the application for the institution of bankruptcy proceedings has been rejected for lack of assets;

(c) legal adjustment procedures for the avoidance of bankruptcy have been initiated;

(d) subsequent to a suspension of payments by the employer, there has been an out-of-court adjustment with his creditors with the consent of the PSVaG;

(e) in the case of complete termination of business activity within the Federal Republic, an application for the institution of

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*Information on which this section is based was provided to the Employee Benefit Research Institute by Dr. Eckart Windel, PSVaG, in May 1979. Additional background information on the German pension system is included in Mr. Burkhard Fürer's remarks and in Appendix A in this volume.

bankruptcy proceedings has not been made and would have been obviously out of the question for lack of assets; or

(f) pension claims have been reduced or cancelled because of financial difficulties of the employer <u>and</u> this reduction or cancellation has been approved by a legally valid court judgment or, exceptionally, by the PSVaG.

Termination of a private employee retirement benefit program is not an insurable event.

The employer's pension program is subject to the law (BetrAVG) and to special labor jurisdiction, whatever financing instrument is used.

Normally, a pension program is established by the employer voluntarily, and it is up to him to decide about the level of expenditures he will devote to this particular field, about the outlay of the benefit system, and about the financing instruments he will use. Once these decisions have been made, the employer cannot at his discretion terminate the program or decrease the benefit rights unless he obtains the consent of the shop committee or--in the case of financial difficulties--the approval of the labor court or the PSVaG.

Except for these examples, the main reason for a termination is the liquidation of the employer's firm, not only of a plant. In this case, the employer is expected to secure the present value of the accrued and current benefits, which normally will be transferred to a life insurance company on a single premium basis.

In case of financial trouble, the employer may wish to cut back benefits for his relief. The employee may then sue the employer at the labor court, where the employer then must prove the strict necessity of such a cutback for the maintenance of the employer's firm and the jobs. If, exceptionally, the PSVaG makes the decision, it is based on the same (restricted) principles applied by the federal supreme labor court. Generally, the decision will not approve a termination or partial termination, but only a temporary suspension of benefit payments.

<u>Financing Instruments Requiring PSVaG Insurance</u>

The law provides for insolvency insurance coverage only in those cases where the employee's or beneficiary's rights would be affected if the employer became insolvent. This lack of security with respect to benefits occurs with the use of the following financing instruments:

(a) pension promise by the employer (i.e., book reserve system);

(b) support fund; or

(c) direct insurance with revocable entitlement only or charged with policy loans.

Any employer using one of these instruments and having pension liabilities either in pay status or as vested rights according to the law is subject to compulsory insurance with the PSVaG.

Pension funds in Germany are subject to strict control by the Federal Insurance Supervisory Authority, particularly with respect to pre-funding, actuarial standards, and investment. Therefore, an employee's claims will not be affected by his employer's insolvency, and there is no obligation for the employer to join PSVaG and furnish insolvency insurance coverage when using pension funds.

It should be noted that the prevailing instrument of private employee retirement benefit programs in Germany is the book reserve system (i.e., pension promise by the firm). As there was no segregation of assets to put them beyond the reach of creditors in case of insolvency, there was a considerable lack of security for the employees and beneficiaries before the insolvency insurance was introduced.

Since the implementation of the insolvency insurance program, this instrument has been particularly advantageous for large employers and for their program participants. The main advantage for the employer is that his cash flow is not affected, because he can use the book reserve like an additional bank credit at favorable conditions without conceding any security. The annual net addition to the book reserve is tax-deductible if the tax law's conditions are met. That is primarily an actuarial calculation according to a defined entry age normal method, the financing not starting before the age of 30. The assumed rate of interest is to be 5.5 percent. Thus the employer can take advantage of full advance financing (except for future adjustments of benefits due to cost-of-living rises, which cannot be taken into account as actuarial assumptions).

As for the employee, he finds favorable tax conditions as well. There are no tax problems at all until he is a pensioner. At that time, his pension will be taxable after a 40 percent deduction (current maximum: 4,800 DM per year).

<u>Payment of Claims</u>

Normally, the PSVaG will not pay the benefits itself, but will purchase annuities from a consortium of German life insurance companies.

As the carrier of insolvency insurance, the functions of the PSVaG include the registration of members, the administration of membership, the setting and collection of premiums, the collection of insolvency and benefit data, and the determination of benefits. It is also responsible for payments to beneficiaries (exceptional) or the purchase of annuities on a single premium basis from the "consortium for the PSVaG" (in accord with section 8, subsection 1 of the BetrAVG).

The "consortium for the PSVaG" executes the payment of benefits determined by the PSVaG; distributes corresponding insurance certificates which give the beneficiaries a direct entitlement to claim the benefits from the consortium; and pays annuities under deduction and transfer of withholding income tax, where applicable.

Financing System

The financing system used by the PSVaG is a modified current-cost revolving system based upon the cash values of new benefits coming due during the current year. There is no pre-financing of benefit entitlements in the year of insolvency. The approach is that of terminal funding.

The modification in the system, imposed by law, establishes an "equalization fund" equalling one year's claims' volume according to a five years' average.

Premium Calculation

There is a uniform premium regardless of any possible differences in risk for the insurer. The uniform contribution rate is based upon the actuarial present values of the vested rights and the cost values of the current benefits covered by insolvency insurance on the date the rate is determined. Calculations occur in November each year, with factors updated on the whole year.

The total amount of necessary premiums is calculated to be expenses less income, where the relevant factors include:

(a) expenses

- claims volume (primarily single premiums to the consortium for benefits due from the vested entitlements of former years' insolvencies);
- administrative costs of the PSVaG;
- interest on foundation share capital (initial and transitionary provision of capital by guaranteeing members in order to set up the PSVaG);
- addition to the equalization fund; and
- addition to a loss reserve;

(b) income

- interest earned on investments (only of limited importance, given the modified current-cost revolving system);
- profit distribution from the consortium for the previous insurance year; and
- receipts from bankruptcy proceedings, takeover of assets of support funds, and other actions.

The premiums necessary are then related to the total premium base reported by the members for that year. The calculated rate is the final premium rate.

In March of each year there is an on-account payment; the final payment each year is due in December.

FINLAND*

Statutory pension protection in Finland consists of the national basic pension and the employment pension. The national basic pension provides a minimum level of subsistence to persons who have not been gainfully employed or whose employment pension is small; the amount of the basic pension decreases as the employment pension rises.

Employment pension protection covers approximately 2.2 million persons, 1.7 million of whom belong to the private sector. (Total population of Finland is about 4.7 million). Costs for private sector employees are defrayed by the employers through insurance premiums and for the self-employed by themselves. The state also participates in funding the pension protection costs of the self-employed.

Under Finnish pension regulations, credit insurance is only permissible with respect to employment pension protection in the private sector. The statutory employment pension protection of the private sector is set out in four laws:

Employees' Pensions Act (TEL)
Temporary Employees' Pensions Act (LEL)
Self-Employed Persons' Pensions Act (YEL)
Farmers' Pensions Act (MYEL)

The most important, indeed almost exclusive, field of credit insurance activity is the TEL, which covers nearly 1,065,000 employees.

Although some 130 pension institutes administer the activity under these four pensions acts, a central institute is required for the management of the statutory system. This agency is the Central Pension Security Institute (see Table 2-1). One activity of the Institute is credit insurance, which in a bookkeeping sense is maintained separate from other activities.

The following sections describe the credit insurance program and the institutional framework within which it is administered. The description relates primarily to the TEL system.

Types of Employment Pension Protection

The employer must arrange employment pension protection for his employees. This the employer does either by taking out employment pension insurance with a pension insurance company or by establishing a pension foundation within the enterprise into which he must transfer funds as "cover" for the pension protection. A group of employers jointly may also

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*Information on which this section is based was provided to the Employee Benefit Research Institute by Herr Lauri Koivusalo, Central Pension Security Institute, in May 1979. Additional background information on the Finnish pension system is included in Appendix B of this volume.

establish a pension fund into which they pay the contributions needed for pension protection.

The partial funding system is followed in the financing of private sector employment pension protection. In contrast, the national basic pension scheme and the pension schemes of the public sector operate almost exclusively on the "pay-as-you-go" principle, i.e., they collect yearly insurance premiums to cover the pension expenditures for the year.

Pension Insurance Companies

If the pension security is arranged by taking out employment pension insurance with a pension insurance company, the employer is liable to pay annually an insurance premium that is determined on the basis of the salaries/wages paid to the employees. The premium is enterprise-specific for major employers, whereas for small employers (i.e., less than 50 employees) it is determined in accordance with an average percent fee (11.7% in 1979). Employees make no contribution; however, they can improve the pension protection through voluntary additional arrangements. When this is done, employees may also contribute to the costs of the additional arrangement. The share of insurance companies in the total TEL insurance is about 85 percent of the premium income. A part of the insurance premium is used immediately for pension payments and a part is retained for future use.

The funds that are not used immediately flow back to trade and industry as loans. Employers have the right to receive back automatically a certain part of their insurance premiums during each year in the form of re-lending and only a part must be paid in cash. The refundable amount is at present 69.5 percent of the premium sum, and the remainder is paid in cash. Pension insurance companies also provide investment loans in accordance with the normal regulations and conditions governing lending.

These loans must be secured by adequate guarantees. One form of guaranteeing is the credit insurance given by the Central Pension Security Institute to the borrower. Another commonly used guarantee is the "cover" provided by a bank or mortgage against fixed assets. Credit insurance then becomes an elective alternative for the borrower. On the other hand, the Central Pension Security Institute must give this guarantee if the borrower so requests. Approval of unfavorable guarantees can then be avoided primarily through the magnitude of the payment due under the credit insurance.

Pension Foundations

Employment pension protection may also be arranged by the employer establishing his own pension foundation to which he transfers funds for payment of the pensions. However, the employer may borrow back the funds or transfer funds to the foundation at a slower rate than is foreseen by the growth of the pension liability. It is in cases like these that unfunded liability originates.

If the company gets into financial straits, difficulties often ensue for the pension foundation. The pension foundation cannot try to recover

the unfunded liability from the enterprise as there is no instrument of debt in existence. Even real property credited to the pension foundation may involve it in losses; the property is so closely associated with the activity of the enterprise that it has full value only as long as the enterprise continues to operate.

When the employment pension laws were enacted and pension foundations joined the system, it was imperative to eliminate such factors of uncertainty. The Central Pension Security Institute was therefore assigned the task of guaranteeing the pension foundations through credit insurance, for which it collects an insurance premium.

Credit insurances are obligatory under law for a pension foundation. Three types of credit insurances are needed: one compensates the loss of value of the pension foundation's property; the second guarantees the loans that the pension foundation may perhaps not be able to recover from the employer; and the third covers the unfunded liability. The sum total of these three credit insurances is the amount of the pension liability of the TEL system as a whole.

Pension Funds

If the employer has provided pension protection by joining a pension fund, he is responsible for paying annually to the pension fund a contribution which is determined in proportion to the liability arising for the pensions. For the same reasons given in the case of a pension foundation, an employer belonging to a pension fund must have corresponding credit insurances to cover the pension liability.

Credit Insurance Premium

The central issue in selecting the premium basis of any credit insurance is the choice between the flat-rate charge according to the magnitude of the risk, and staggering the payment according to the financial status of the party insuring. When Finnish credit insurance activity was started, it was decided that the Central Pension Security Institute should be liable to grant credit insurance to all applicants. The Institute thus has no way of protecting itself through anti-selection by refusing to grant insurance. This leaves the insurance premium as the only instrument for regulating the writing of insurance.

The credit insurance premium depends on the liability, the amount of the guarantee, and the financial standing of the enterprise. The guarantee includes, in this connection, both the guarantee given to the Central Pension Security Institute and the pension foundation's real property which is valued at the Central Pension Security Institute on the same bases as guarantees. The financial standing of the enterprise, on the other hand, is assessed from the information in its balance sheet.

When no guarantee is attached to the credit insurance, the minimum credit insurance premium is 0.4 percent of the loan sum. If the insurance premium is high because of the company's indebtedness, it can be lowered

by giving security to the Central Pension Security Institute. In comparison, the price of a bank guarantee in Finland is 1.5 to 2 percent, in addition to which a bank requires full security.

A special feature of pension foundations is that the pension liability must be assessed in advance. Hence, a prepayment is collected from the pension foundation, with subsequent adjustment in the final premium.

Liability Distribution

The Finnish employment pension system is partially funded, as differentiated from "pay-as-you-go" funding. The parts of the pensions for which insurance premiums are collected in accordance with the funding technique are the responsibility of the pension institutions. The employer's insurance premium, fixed yearly, includes a component for these pensions that are a joint responsibility. About 70 percent of the annual pension expenditure at present is a joint liability, which shows the relatively low degree of funding.

Several institutions belong to the system. The pensioner, however, receives his pension from a single institution, i.e., from the pension institution which covered him before his retirement on pension. Because of the financing arrangements, this institution must then also pay such parts of the pension which are the responsibility of an institution which belongs to the other system. The clearing of costs between the pension institutions caused by this and by the payment of jointly defrayable pension costs is carried out yearly by the Central Pension Security Institute. This is what is called liability distribution.

Credit Insurance Terms

The credit insurance agreement is a civil law contract subscribed to by the party insuring (the borrower), the beneficiary (the lender), and the insurer (Central Pension Security Institute). The rights and liabilities of the parties are decided not only on the basis of contractual laws, but also under credit insurance terms. These include:

Insurable Event. From the 1960s until 1975, only a bankruptcy or other officially confirmed insolvency was the event insured against, i.e., the basis for payment of credit insurance compensation. Under the current terms, compensation can be paid "when the total loan, according to the loan terms, has fallen due for repayment and has not been paid within 60 days of the repayment date." The aim of the amendment of the terms was the desire to approach the bank guarantee as a form of security and to simplify collection of the loan.

The change in the occurrence of the event insured against has led in practice to transfer of the collection measures from the lender to the Central Pension Security Institute. After the receipt of the insurance compensation, the pension establishment must transfer its receivables to the Central Institute.

Insurance Compensation. Briefly, the lender is compensated for the unpaid part of the loan sum, the unpaid interest, the interest on

arrears, and the collection costs. Compensation is usually paid within a month of application, but there is a reservation in the terms stating that in the event of liquidity problems the loss will be compensated in installments in accordance with the loan terms.

Insurance Period. The insurance begins with notification to the Central Pension Security Institute and ends when the lender announces that the insurance is no longer necessary, either because the loan has been repaid or because some other security has been obtained. The insurance period normally changes six months after the end of the borrower's financial year.

Insurance Premium. The terms include no detailed regulations on calculation of the insurance premium. Reference is made to the payment bases approved by the Central Pension Security Institute (see previous section).

Other Regulations. The borrower may provide, for the evaluation of the insurance risk, detailed information about his financial status. Therefore, the Central Pension Security Institute is bound to keep this information confidential.

The Central Pension Security Institute is allowed in this part of the terms the possibility of demanding security for the risk that the lender may have to call in the full loan sum. The demand for security can be made "if the borrower has failed to provide the information requested by the Central Pension Security Institute on his business and finances, or if the Central Pension Security Institute considers the repayment of the loan is at risk."

Finally, the Pension Security Institute reserves the right to change the insurance terms from the beginning of the following insurance period after giving at least four months notice of this intention to the other parties.

Countersecurities for Credit Insurance

Countersecurity is not always required for the credit insurance of the Central Pension Security Institute, but the Institute usually demands security if the premium would otherwise exceed 5 percent.

Securities generally used in banking are accepted by the Central Pension Security Institute. These include: mortgaged promissory notes, shares in housing companies, bank guarantees, bonds, shares quoted on the Stock Exchange, and credit insurance policies.

When a security is given to the Institute, either voluntarily or on request, the Institute calculates its value, which is then deducted from the credit insurance risk when the credit insurance premium is calculated. The premium percentage is applied only to the part of the risk that is not covered by the security given. At the most, 99 percent of the risk can be covered by securities. A credit insurance program is thus always collected for at least 1 percent of the amount of the risk. This method of calculation has been adopted for cost reasons, as no separate pledge management fee is collected.

SWEDEN*

Pension Insurance for Salaried Employees in Private Sector

As early as in the beginning of the 20th century, the Federation of Swedish Industries and the Swedish Chambers of Commerce, in cooperation with a few organizations of salaried employees, raised the question of establishing a common pension fund for salaried employees in industry and commerce. Thus, the Swedish Staff Pension Society (SPP) came into being and commenced operations in 1917. Other pension funds were established, either common to an entire line of trade or associated with a large company. Some of these pension funds had indeed been established earlier. There were also non-insured pension plans, which signified that the companies themselves were responsible for the payment of the pensions promised, usually via a pension fund in the form of a trustee fund.

When, in the late 1950s, the parliament decided to improve the national basic pensions gradually and to introduce a national supplementary pension (ATP) in 1960, it became necessary to adapt salaried employees' pensions to the national pensions. In this process, a uniform pension plan was the target.

As far as salaried employees in industry were concerned, the issue of designing the complementary pensions became the subject of negotiations between the Swedish Employers' Confederation (SAF) and the salaried employees' organizations. It was then agreed that a uniform plan for salaried employees' pensions was to be recommended to industrial companies. Thus, in 1960 the complementary pension for salaried employees in industry (ITP) was drawn up. In that same year, the ITP plan was extended to cover also salaried employees in commerce. The ITP plan has later been amended on several occasions, and since October 1, 1969, it has had the status of a collective contract. The plan described below was agreed upon by the SAF and the top organization for salaried employees (PTK) in September 1976, and came into force on January 1, 1977.

The ITP plan has served as a model for pension plans for salaried employees within the cooperative movement and for certain other groups of salaried employees, among them those in banking and insurance, ship's officers, and journalists. These plans agree almost entirely with the ITP plan.

Financing and Administration. The complementary pensions for salaried employees in the private sector are arranged through insurance with an insurance company or a mutual benefit society, or through a non-insured system with allocations for pensions. Allocations are made either as a book reserve in the employer's balance sheet or to a pension fund.

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*Information on which this section is based was provided to the Employee Benefit Research Institute by Mr. Göran Engzell, Pension Guarantee Mutual Insurance Co. (FPG), in May 1979. Additional background information on the Swedish pension system is included in Appendix C.

Allocations to special accounts in the balance sheet or to pension funds are governed by the law on safeguarding pension commitments. According to this law, a pension fund shall have the status of a pension fund with real assets, which means that the assets must be separated from the employer's business. Allocations to a special account--the book reserve system--means that the employer retains the pension capital within his business until it is needed for pension payments.

In industry and commerce, salaried employees' pensions under the ITP plan are arranged through insurance with the SPP, or--as far as the main part, the retirement pension is concerned--through the FPG/PRI system described below.

Retirement pensions and survivors' pensions under the ITP plan and corresponding plans are financed according to what is usually called the level premium method. This implies, among other things, that pension money is appropriated as pension rights are earned. Disability pensions and certain special benefits which are included in the ITP plan are financed according to a risk premium system.

The principle of the vested pension right was adopted very early. The employee shall be entitled to that pension which corresponds to his salary and period of service, irrespective of whether he keeps working with one and the same employer up to retirement age or transfers to another employer or becomes self-employed.

The ITP system is financed entirely by the employers.

The employer has to secure the retirement pension under the ITP system either through taking out an insurance with the SPP or through a book reserve system combined with guarantee insurance, the FPG/PRI system.

FPG/PRI System. The FPG/PRI system as an alternative to pension insurance was partly an employers' wish to retain liquid assets in the business instead of paying them to a pension institution, and partly the employees' wish for pensions which were safeguarded just as well as was the case for insurance. (Here FPG is short for the Pension Guarantee Mutual Insurance Company; PRI is short for the Pension Registration Institute.) In 1960 the ITP agreement was supplemented by an agreement on a book reserve system with guarantee insurance. The FPG/PRI system implies that each company is itself responsible for paying out the retirement pension under the ITP plan, insofar as pension rights have been earned in the company's service. The present value at each time of the pension rights, together with the so-called "surplus interest," i.e., the employer's pension debt, is entered in the company's balance sheet under the heading "Allocated for pensions." The final pensions cost for the company will, on an average, be the same as if the company had insured the retirement pensions with the SPP. The cash payments will, however, not take place until the employees reach retirement age.

The system is applied mainly by large and medium-sized companies. In the case of very small companies, there is a risk that the final pensions cost will differ too much from the average.

The administrative duties pertaining to the pension commitments are performed by the special registration institute PRI, which is administered jointly with the SPP. The pension commitments are registered with the PRI. The employers discharge their payment obligations through the intermediary of the PRI, which charges the money required for this to the employers. The PRI also calculates the pension debts and provides the employers with data on them as well as on the extent of the individual commitments. Certain fees are charged to the employers in order to cover the PRI costs.

Pensions which are paid out by the PRI shall be increased by the same pension supplements as the pensions paid out by the SPP. In order to ensure that the funds required for such pension supplements are also available, a so-called "surplus interest" is included in the pension debts calculated by the PRI. The amount of the "surplus interest" is fixed annually on the basis of appreciations of the future inflation rate and taking into account the amount of the surplus funds held by the SSP for those pension insurances which have been taken out there.

The pension commitments toward the employees are covered by guarantee insurance with the FPG. Only companies which the FPG considers as creditworthy can obtain guarantee insurance and thus join the system.

As a rule, the FPG does not require collateral as a condition for insurance. In some cases, however, a security given may render insurance possible for a company which, according to the FPG's judgment, does not enjoy a fully satisfactory economic position. For subsidiary companies in a group, a guarantee or another specified type of commitment is always required from the parent company by the FPG. In the case of so-called family enterprises, there may also be a requirement for a personal guarantee from the owner or owners.

Guarantee insurance is granted for a contract period, the duration of which is usually five years. If the company or the FPG gives notice of termination of the insurance at the end of the contract period, the pension debt on account of pension rights earned during the contract period shall be discharged by successive purchases of pension insurance with the SPP, over a maximum period of 10 years. The notice of termination can also be limited and stipulate that the guarantee insurance shall not comprise pension rights being earned after the end of the contract period, but that guarantee insurance shall continue to cover those pension rights which have been earned during the contract period, and that for these pension rights no pension insurance with the SPP shall be purchased.

If the financial situation of the company should deteriorate severely during the contract period, the FPG is entitled to give notice of termination of the insurance also during the validity of a contract period, and with effect 6 months from notification. Also, in this case the notice implies that the pension debt shall be discharged in steps over 10 years.

If the company should cease its business activities, pension insurances within the SPP shall be purchased within 6 months for the entire pension debt covered by the guarantee insurance. If the company's business has been taken over by another company enjoying guarantee insurance,

however, an agreement may be reached that the pension debt shall be transferred to the latter company, subject to the approval of the FPG.

In the event that the company suspends payments or is declared bankrupt, pension insurances for the entire pension debt shall be purchased within 6 months.

If a company should not fulfill its obligation to purchase pension insurances with the SPP or if it should not fulfill its payment obligations toward the PRI, the FPG will make the payment in lieu of the company. In doing so, the FPG acquires (up to 100 percent) the corresponding right of subrogation against the company.

The premium for the guarantee insurance has so far been 0.3 percent of the pension debt. If the assets of the FPG should not be sufficient to cover its costs for claims occurred, the FPG may also charge, as an extraordinary measure and during a period of five consecutive years, a maximum of 3 percent of the company's pension debt as last fixed, apart from the premiums. Thus, the mutual responsibility of the companies is limited to this amount.

At the end of 1978, more than 1,800 companies with pension commitments to approximately 400,000 employees were affiliated with the FPG/PRI system. Out of the total number of employees who were earning pension rights under the ITP plan, approximately two-thirds were covered by the FPG/PRI system. The remaining third had their retirement pensions insured with the SPP.

Pension Insurance for Workers in Private Sector

Before the ATP system was introduced, workers were, in the majority of large companies, covered for certain pensions. But as a rule, the pension amounts were small, and pension rights were usually lost if the employee left the company before retirement. These pensions were gradually replaced by the ATP system. It was not until 1971 that the SAF and the Swedish Trade Union Confederation (LO) reached an agreement on complementary pensions for workers and other employees in the SAF-LO sector. The ITP plan for salaried employees in industry and commerce now has its counterpart for workers, in an insurance for complementary pensions (STP) where the retirement pension is concerned, and in a sick pay and disability pension insurance (AGS) where the disability pension is concerned. As workers' wages exceed the social security ceiling (7.5 times the base amount) only in exceptional cases, the survivor benefits for workers have been considered to be satisfactorily arranged through the national basic and ATP pensions systems. The same as for salaried employees, the pensions are supplemented by lump sums under an occupational group life insurance (TGL).

The agreements on the STP and the AGS systems were concluded by the SAF and the LO in May 1976 and replaced the previous agreements. The new agreements came into force on July 1, 1976, at the same time as the retirement age under the national pensions systems was lowered from 67 to 65 years. The agreements are subject to six months' notice by either party, but they cannot be subject to expiration notice before January 1, 1982.

Financing and Administration. The STP is financed by the employers through insurance according to a terminal funding method.

For all employees who reach retirement age in a certain calendar year, the capital value of their future pensions is calculated. The necessary capital will then be levied on the entire body of employers in the STP sector (thus also on those employers who do not have any new STP pensioners among their employees). The pension contributions are calculated on a group basis and fixed in terms of a certain percentage of the wages accounted for by the employees in the STP sector. The percentage will be the same for all companies.

The STP pensions are insured with a company established by the SAF and the LO--Labour Market Insurances, Pension Insurance Company Limited, usually called the AMF Pension Insurance. This company is administered by the SPP.

STP Loans. In connection with the payment of contributions to the AMF Pension Insurance, a company can obtain a loan (STP loan), provided that guarantee insurance for such a loan has been granted by Labour Market Insurances, Mutual Credit Insurance Company (AMF Credit Insurance). The administration of the guarantee insurance is handled by the FPG.

In principle, all those funds held by the AMF Pension Insurance which are not needed during the year to cover pension payments and administration costs are available for STP loans. The loans represent a uniform percentage of the provisional contributions which have been debited to the company for the year. The percentage will depend on the extent to which the loan system has been utilized by the companies. During most of the period in which STP loans have been granted, the years 1974-1979, the loans have amounted to 100 percent of the company contributions. Although a certain increase in the number of borrowing companies takes place, this percentage is expected to remain unchanged.

The loans are paid out through balancing in connection with the contribution payments. Each year's loans are paid off during 15 years. The interest is fixed for each year's loan and remains unchanged for the duration of the loan. The interest shall, in principle, equal the interest for insurance company investments at the point in time concerned, against best security and with the same duration. (Special rules apply according to law, and also recommendations from the Bank of Sweden, for insurance company investments.)

As has been mentioned before, a company must have obtained guarantee insurance with the AMF Credit Insurance in order to get an STP loan. Only those companies which the AMF Credit Insurance considers financially sound will obtain guarantee insurance. Some further formal requirements for guarantee insurance are that the company is carrying on business as a legal person, and has been doing so for at least three years.

The AMF Credit Insurance does not normally require collateral for the guarantee insurance. However, the AMF Credit Insurance as a rule requires a guarantee or some similar commitment from the parent company for a subsidiary company in a group of companies.

A company which has been granted guarantee insurance for an STP loan for a certain year can usually expect to obtain an extension of the insurance to cover further loans. The issue whether or not such an extension can be granted is annually reconsidered.

Premiums and so-called additional premiums, the latter consisting of a variable and a fixed part, are charged for the guarantee insurance. Until the present time, the annual premium has come to 0.4 percent of the amount of the loan, and the annual variable part of the additional premium has come to 0.12 percent of the amount of the loan.

If the assets of the AMF Credit Insurance should not suffice to cover costs for claims, the AMF Credit Insurance can levy, as a non-recurring measure and during each successive five-year period, a maximum of 3 percent of the company's total amount of STP loans at the time of levying. The mutual liability of the companies toward the AMF Credit Insurance is thus limited to this amount.

If a company should not fulfill its payment liability toward the AMF Pension Insurance, the AMF Credit Insurance is obliged to pay in lieu of the company. The AMF Credit Insurance will then have a corresponding claim for recovery on the company.

At the end of the year 1978, this loan system was utilized by 1,300 companies altogether. The total credit amount at the point of time mentioned was 1,799 million kronor. As the loan system has been in existence only since 1974, it may be assumed that the number of borrowing companies will increase gradually. The credit amount will increase by this and by the fact that new loans are granted to companies which are already borrowers. For the individual company, the total credit amount will normally increase during at least 15 years, since any new loan during the year will exceed the total of amortizations of previous loans. As a consequence of wage increases, which lead to increases of the bases for assessment of premiums, it may, however, be assumed that the credit amount will increase thereafter also.

The system of STP loans may be considered as a counterpart to that method of financing which the FPG/PRI system represents with respect to ITP pensions for salaried employees. Through this lending system pension funds may remain within the companies until they are required for pension payments.

Relevance to United States

Difficulties exist in adopting the Swedish guarantee insurance system to the United States. It is a book reserve system more or less tailored as a part of or a complement to two nationwide uniform pension schemes covering most of the Swedish labor market, in which there is only a very small number of organizations. The safeguarding of pensions is regulated in labor market agreements. There are practically only two pension financing alternatives, the book reserving with guarantee insurance system and the pension insurance system. Only employers whose credit standard has been examined are allowed to use the guarantee insurance system.

Components which might be adopted, in whole or in part, in the United States are insolvency as the insurable event, book reserving as an alternative to funding, expansion of the right of subrogation, modification of the pay-as-you-go system and premiums only related to the guaranteed liabilities, complete registration of business sales and reorganizations, control of transfers of pension liabilities, and coordination of actuarial calculations.

Scope. The Swedish guarantee insurance system has mainly been adopted to safeguard the pension commitments and to facilitate the reinvestment of pension capital according to the two general pension agreements on the private labor market. However, it is also used for covering some other kinds of pension liabilities on the private market regarding special additional pensions, pensions for employees in service abroad, and so forth. The application of the system is limited to the private occupational pensions.

Coordination. The homogeneous private complementary pension system is fully coordinated to the national pension system according to a net method. Even if the general conditions for a total integration of the private and national systems could be considered as comparatively favorable, there have been no serious proposals in that direction. Private occupational pensions are still a matter for the labor market.

Consequences. The possibility to reinvest pension capital through the guarantee insurance system has significantly contributed to the capital procurement of industry and commerce. The system also has aided in increasing the employers' willingness to extend the pension commitments and to accept the general pension schemes. These are positive consequences. The excessive indebtedness and thus the misstatement of resources that may be the consequence of the very high staff intensiveness of some employers has sometimes been regarded as a negative effect. But the guarantee insurance system is flexible. The guarantee insurance company is entitled to refuse applications for insurance policies, and to refuse expansion of and sometimes to call for the successive reduction of the pension debt covered by the insurance. The non-covered liabilities then have to be safeguarded through an ordinary pension insurance.

Benefits. All old-age benefits under the ITP scheme are normally covered by the guarantee insurance, and the present value of the commitments, including the surplus interest, always has to be book reserved. The actuarial calculation methods are uniform and legally regulated.

It is still possible to change from the FPG/PRI system to the SSP pension insurance system or vice versa for the financing.

Reporting. Terminations or sales of business, staff changes, changes of ownership, and reorganizations involving transfers of pension liabilities are controlled primarily through compulsory reporting by the employer in accordance with the insurance terms.

Premiums. The premiums are based on the pension liabilities covered by the insurance. The rate is decided each year for the following year

and on a uniform basis for all policyholders. Hitherto the premiums have exceeded the costs of claims every year and reserves have been built up in accordance with the level premium method.

The investments of the two guarantee insurance companies are not legally regulated, but there are official credit regulations influencing the allocation of money.

Insurable Event. In the Swedish system the insurable event is the insolvency. No voluntary termination of the plan declared by the employer is in practice acceptable. It usually is a question in which the labor market organizations have to be involved. In the event of the sale of the business, or if the guarantee insurance company has given notice, or in the event of a bankruptcy, it is the employer's duty to take out pension insurance covering all accrued pension rights. Only if he is unable to fulfill this duty will the guarantee insurance be payable. The guarantee insurance company has to take out the pension insurance and will then have a 100 percent subrogation against the employer as a result of taking over the pension claim.

Priority. The bankruptcy priority is limited to an amount corresponding to the pension rights earned during the last year and the pensions paid out during six months.

Sometimes collateral has also been pledged and as a rule parent companies have signed a surety bond or a letter of intent for their subsidiaries. This also means some reimbursements for the guarantee insurance companies.

Employer Liability. A 100 percent employer liability when terminating a pension plan seems to be necessary to avoid speculation against the system. The employer's insolvency seems to be the proper point for the insurance to become payable.

JAPAN*

The compulsory public pension program in Japan is composed of eight schemes, the two primary systems being Employees' Pension Insurance (for employees in general) and National Pension (for the rest of the nation in general). Employees' Pension Insurance is compulsory for employees working for any company (with a few industry exceptions) which constantly employs not less than five people. The six other systems are for persons in specific occupations and include Seamen's Insurance and National Public Service Mutual Aid Association.

There are three types of occupational pension plans in Japan: the plans of the Employees' Pension Fund (EPF), tax-qualified pension plans, and unqualified private pension plans. As of 1977, approximately 10 million people, or 40 percent of the total number of so-called "employees" in Japan (this excludes such groups as farm workers, self-employed workers, and public officials), were covered by these plans: about 5,400,000 as members of EPF and about 4,600,000 as members in tax-qualified pension plans. (Unqualified plans currently have an insignificant role.) The Employees' Pension Fund Association (EPFA), established by law, pays benefits to those who withdraw from EPF plans in a short time and generally coordinates the development and management of the plans.

In addition to their occupational pension responsibilities, the EPF system also assists the government in the administration of the Employees' Pension Insurance program. Old-age benefits under this public program include both a flat amount and an amount proportionate to the average monthly standard remuneration of the insured person. The EPF system administers this latter part of the benefits in the government's place and, as a result, also collects the remuneration-proportionate portion of the compulsory premium.

A program of pension plan insolvency (or credit) insurance such as exists in the Federal Republic of Germany, Finland, or Sweden does not now exist in Japan. Proposals for an insurance program which is consistent with the Japanese pension systems are receiving increased attention, however.

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*Additional information on the Japanese pension system is included in Appendix D.

PENSION SYSTEM CHARACTERISTICS: QUESTIONS AND ANSWERS*

QUESTION 1.

WHAT HAS BEEN YOUR COUNTRY'S POLICY OR OBJECTIVE FOR INCOME REPLACEMENT IN RETIREMENT?

Federal Republic of Germany

It is felt that the total retirement income of an employee who has been employed for approximately 45 years--his remuneration not exceeding the social security contribution ceiling--should aim at approximately his final net income at retirement age. This is equivalent to approximately 65 to 70 percent of his final gross income, because the deductions of income tax and social security contributions will amount to approximately 30 to 35 percent.

Finland

The target level of Finland's pension protection is 60 to 66 percent of the former income. Expressed in pension legislation, this target includes both the statutory and private pension arrangements. The excessive pension amount is deleted, normally from the private pension arrangements, provided it also is financed by the employer.

Sweden

The policy under the Swedish system has been to provide partial compensation for loss of income from gainful employment. The total old-age pension amounts to about 65 to 70 percent of the final salary. Until 1976 the retirement age was 67 in the national pension system and 65 in the private system. Since then it has been 65 in both systems.

Japan

The benefit level of old-age pensions under the Employees' Pension Insurance system has been 60 percent of average remuneration, which covers earnings up to an upper limit equal to about twice the average wage. Replacement of earnings above the upper limit and temporary wage allowances is not the objective of social security. The replacement of this kind of earnings is expected to be realized by private plans.

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*Responses in this section are based upon information provided to the Employee Benefit Research Institute in May 1979 by pension officials in the Federal Republic of Germany (Dr. Eckart Windel), Finland (Herr Lauri Koivusalo), Sweden (Mr. Göran Engzell), and Japan.

QUESTION 2.

WHAT ARE THE RESPECTIVE ROLES OF THE PUBLIC AND PRIVATE SYSTEMS FOR PROVIDING RETIREMENT INCOME?

Federal Republic of Germany

The German pension system, under the so-called "three column approach to retirement benefits," consists of (i) the social security system; (ii) the private employee retirement benefit programs; and (iii) the employee's own efforts to achieve retirement income (e.g., through savings). The social security system is the basic system; (ii) and (iii) are supplemental and cover the so-called retirement income deficiency not covered by the basic system.

The employee whose remuneration has never exceeded the social security contribution ceiling is expected to receive approximately 45 to 50 percent of his final gross income as social security pension. Thus he will face a retirement income deficiency at normal retirement age of approximately 10 to 20 percent of his final gross income. (See Question 1.) It is felt that about one-half of this deficiency should be covered by a private employee pension benefit program, with the rest covered by the employee himself or left uncovered.

An employee whose former remuneration exceeded the social security contribution ceiling faces a greater retirement benefit deficiency, because the percentage of the social security pension as compared with his former gross income decreases with increasingly higher remuneration levels. Thus many private pension programs seek to help these higher compensated employees lessen their retirement income deficiencies. This is primarily done by granting better rates of pension on salary portions in excess of the social security contribution ceiling.

Finland

The role distribution of Finnish statutory and private pension systems is not unambiguous. The statutory employment pension system of the private sector, for example, contains features of voluntary private pension schemes.

In Finland, all pension systems are in large part statutorily organized. If all the statutory pension protection is then said to be in the public sector, this sector clearly has the most important role. The private schemes exist primarily to improve the pension protection in those cases where statutory protection does not reach the level considered adequate.

On the other hand, the Finnish national basic pension system, the main task of which is to provide the minimum pension protection, is not very important to those persons who get a pension under the private sector employment pension scheme. This is because the amount of the national basic pension is rapidly decreasing when the level of employment pension protection gets to its 60 to 65 percent target level. Nevertheless, in

Finland the purely private pension systems still play an important role in providing supplementary pension protection, because the statutory pension will be in its build-up state until the turn of the century.

Sweden

Statutory social insurance forms the foundation for social security and retirement income. Since 1960, the statutory pension system has been divided into a national basic pension (flat rate) and a national supplementary pension (earnings-related). A national partial pension, linked to part-time employment, also has existed since 1976.

Occupational pension systems, which emerged initially for state and local government employees, constitute an important complement to statutory pensions. Pensions for salaried employees and other workers in the private sector were discussed in the preceding sections of this volume.

Japan

Social security provides standard and basic benefits to the nation, whereas private or occupational pension programs provide benefits which meet the specific needs of each industry, profession, company, or employee. In terms of benefits, private plans ease the transition into retirement by maintaining one's income level at a level as close as possible to what it was prior to retirement.

QUESTION 3.

WHAT IS YOUR COUNTRY'S POLICY TOWARD THE INTEGRATION OF PRIVATE PENSION PLANS WITH SOCIAL SECURITY?

Federal Republic of Germany

According to the situation described in the German response to Question 2, a pension formula was used in some German industries which resulted in full integration of private plans with social security. As long as the social security level was likely to increase at least as much as the level of pensionable income, there was no risk of the employer's cost getting out of control. However, two recent changes in social security have made it necessary to review this approach:

(a) the social security formula for the annual adjustment of pensions according to average income increases was suspended for several years and replaced by (lower) fixed percentages in order to make up for deficits; and

(b) the supreme labor court decided that, even in the case of a fully integrated pension formula, the employer is not allowed to take increases in social security into account when checking if he is obliged to raise his pension payments because of a rising cost of living.

For these reasons, it is expected that integrated systems will be revised into private pension programs which are not affected by changes in social security pensions.

Finland

Finnish pension programs are largely based on legislative statutes. In spite of its statutory nature, however, the employment pension program of the private sector also contains some features of a private pension program (e.g., its administration has been entrusted to private pension insurance companies, pension foundations, and pension funds). In Finland there also are fully private pension programs which in part pre-date the enactment of employment pension protection and in part supplement the statutory employment pension protection which (in the private sector) frequently fails to reach its target level of 60 to 66 percent of wages. As a rule, private pensions are integrated with general social security so that the level of the former decreases proportionately as the statutory protection reaches its full level.

In 1978, about 530 million FM in pensions were paid out under the voluntary pension programs and about 3,520 million FM under the statutory employment pension programs of the private sector.

Sweden

The homogeneous private complementary pension system is fully coordinated with the statutory national pension system according to a "net benefits" criterion (recall previous comments on the Swedish system).

Japan

There is no specific policy toward the integration of private plans with social security. The Employees' Pension Fund (EPF) system, however, is supervised with respect to benefits and financing by the Minister of Health and Welfare, because the EPF provides a part of social security benefits on behalf of the Employees' Pension Insurance program. For instance, the EPF must provide those benefits over the earnings-related component of old-age pension provided in the Employees' Pension Insurance Act, and they must be financed by the advance funding method, with amortization of unfunded liability within 20 years.

On April 18, 1979, the Advisory Committee on Pension Reform Problems for the Minister of Health and Welfare reported that the pensionable age should be delayed from 60 years to 65 years old in the future. Most employees, however, must leave their primary employment at 57 to 60 years of age, by traditional retirement agreements. They then would be unable to draw social security benefits for 5 to 8 years, if the Committee's proposal were adopted. Under these circumstances, private pension plans may be expected to provide the additional benefits to supplement income between the retirement age and the pension age. The government will encourage these forms of integration in the future.

QUESTION 4.

HAVE BENEFIT CUTBACKS EVER BEEN NECESSARY? ARE THEY FORESEEN IN THE FUTURE?

Federal Republic of Germany

This problem does exist in the social security system. A few years ago, this system faced a severe deficit. Among the various solutions it considered, the government did not choose real cutbacks but rather chose the deterioration of initial conditions for the fixing of the social security pensions, the suspension of a due adjustment based on average income increases, and the alteration of the adjustment formula for several years, combined with a rise in the contribution rate for employers and employees. Similar problems are likely to occur in the future (see Question 5 response).

Finland

The level of pension protection and the cutting back of some promised benefits were actively discussed during the recent economic recession. Although thus far no cutbacks have been implemented, alternatives for easing the pressure of pension protection costs have been proposed.

Two separate measures have been taken. The index adjustment system, enacted to protect the pensions system from inflation, was reformed by replacing the former pure wage index by an average of wage and price indexes. In addition, the rules determining the pension wage were readjusted. In the long run, these measures should produce considerable savings in pension costs without directly decreasing an individual's pension protection.

Sweden

It is possible that the pension supplements may be reduced in the future. As for the main pension benefits, however, cutbacks are not anticipated as long as the employer's capacity to pay is not generally diminished. Accrued pension rights cannot legally be decreased. On the other hand, in the private systems index increments are not promised but are reviewed annually.

Japan

Benefit cutbacks, at least in the face value, have not occurred either in social security or private plans, because of the economic growth accompanying the rise in the consumer prices and wages. In the future, the benefits of private pension plans will not be decreased, but they may indirectly be lowered in value by inflation. Moreover, the recent proposal of the Advisory Committee on Pension Reform Problems to delay the pensionable age to 65 years might reduce prospective heavy burdens of plans through future benefit cutbacks.

QUESTION 5.

WHAT IS YOUR VIEW OF THE RELATIVE MERITS AND CONSEQUENCES OF A PAY-AS-YOU-GO SYSTEM VERSUS A PRE-FUNDED SYSTEM VFRSUS DEFINED CONTRIBUTION SYSTEM?

Federal Republic of Germany

It is of primary importance that in private pension programs the expenses be allocated to the active time of the employee; otherwise, there will be problems with the profit-and-loss account. This does not require pre-funding, but it does require pre-financing.

The pay-as-you-go approach is only appropriate if the system is run by a carrier provided with the power to collect mandatory contributions or taxes. Thus, private pension programs should not be administered on a pay-as-you-go basis. This approach is more acceptable with social security systems, but even there severe problems can arise, if the ratio of contribution payers to beneficiaries declines. Germany is facing and will continue to face this situation.

Defined contribution systems can be regarded as a type of pre-funding.

Finland

In funding pension protection under the private sector system, the starting point is that each generation finances its own pensions. It is not possible to realize this objective without at least partial pre-funding, and that method has been adopted in the Finnish employment pension system.

The national basic pension system and the public pension systems of the state and local government employees are financed on a pay-as-you-go basis. This approach is well-grounded, because the funds primarily come from general taxation. In a country like Finland that is short of capital, however, it has not been possible to finance a high level of pension protection through a pure pay-as-you-go approach, because then the annual pension costs would burden the national economy more heavily than if an alternate funding method used. Obviously, the long-term application of a pure pay-as-you-go method would lead to a considerably higher pension cost included in a ton of goods produced in Finland than in a ton of goods produced in European competitor countries. On the other hand, in a funding approach the value of the funds must be secured, i.e., their return must be adequate.

Fixed premiums as such are not used in the Finnish employment pension system. Nor would this be possible, since apparently that arrangement would precondition a rather high premium level to finance a pension system in which pension costs are substantially increasing every year due to the system's gradual build-up.

may find it necessary to call on advisors with financial or investment expertise to develop a rational strategy to meet those needs. Legal advisors may be consulted as to general legal standards, but lawyers should not be expected to pass upon such primarily factual questions as the suitability of particular investments for the portfolio. In addition, it is usually more helpful to have the lawyer review the strategy after it has been developed than to have the lawyer describe at the outset what should not be done.

A key feature in the defense of any investment is the development of a rationale for the investment decision at the time it is made.177/ The Labor Department's prudence regulation, in focusing on the reasonableness of the procedures and information used by fiduciaries in making investment decisions, indicates that the Department is developing a rule based on the fiduciary's conduct at the time of decision rather than a "hindsight" test determined by economic results. Thus, prior to undertaking any socially sensitive investment, the plan should have completed an analysis showing how it will contribute to the achievement of the plan's investment objectives. Moreover, the fiduciary also should develop empirical support for his view that the investment will further the retirement interests of the beneficiaries. In the event of challenge, a social investment supported by such a contemporaneous rationale is more likely to be characterized by a court as socially sensitive (and permissible) than socially dictated (and impermissible).

Some fiduciaries may prefer to avoid such documentation on the ground that it makes it easier for a challenger to establish that social investing has occurred. Apart from the duplicity of this approach, it seems naive to think that any effective policy of social investing can be hidden from discovery. On balance, a policy of social investing is better protected by a documentary foundation which permits an effective defense than by efforts at concealment which are likely to provoke the curious to investigate.

This principle of developing contemporaneous support does not mean that every decision to include or exclude an investment must be supported by a separate,

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177/ *Cf.* In re Morgan Guaranty Trust Co., 396 N.Y.S. 2d 781, 784 (1977); Stark v. United States Trust Co., 445 F. Supp. 610, 680 (S.D.N.Y. 1978).

QUESTION 7.

(A) WHAT IS YOUR NATION'S TAX TREATMENT OF EMPLOYER AND EMPLOYEE CONTRIBUTIONS?

(B) WHAT EFFECT HAS THIS POLICY HAD ON THE PROVISION OF BENEFITS BY THE PRIVATE SECTOR?

Federal Republic of Germany

(A) The German approach is significantly different from the American, since in Germany financing instruments without funding are much better off than those with funding.

In the case of a pension promise (i.e., book reserves) and a support fund, the net additions are tax-deductible for the employer, who also receives considerable financing advantages. The employee cannot participate in raising contributions. He pays no taxes until he actually receives his benefits; then his pension payments in excess of 40 percent of total benefits (current maximum: 4,800 DM per year) are subject to income tax.

Direct insurance and pension fund employer contributions are actual expenses for the employer and hence tax-deductible, but at the same time they are subject to an income tax assessed against the employee, who can participate through contributions. An employee's allowances are primarily used up by such contributions as social security. Under certain conditions, the income tax on the employer's contributions can be replaced by a low flat rate tax paid by the employer, but only within a limited range. On the other hand, pension payments received are taxed at a very low rate so that in most cases they remain tax-free; payment of capital sums out of direct insurance also will be tax-free.

(B) Primarily because of these German taxation principles, the pension promise (i.e., book reserves) system and support funds are unquestionably dominant in large companies. This dominance also is due to existing financing advantages and to the fact that the pension promise approach is the only German system in which tax regulations do not require a limitation on the amount of the pension. This is important, because in Germany there are no discrimination regulations similar to those of ERISA in the United States and the retirement income deficiency of highly compensated employees requires special measures. As for direct insurance, it is particularly common in smaller businesses and in combined pension systems.

Finland

Pension insurance premiums are tax-deductible. Hence, in determining their taxes, the employers can deduct the pension insurance premiums as company costs in the same way as employees' wages. As noted in an earlier response, for all the age groups the target level of the statutory pension protection has not yet been achieved; this means that private arrangements are necessary to cover the pension deficiencies.

Sweden

Employers' contributions are tax-deductible within the framework of the ITP system (i.e., the private pension plan for salaried employees in the private sector) or up to an equivalent cost, whether they are premiums or allocations for pensions. For tax reasons, benefits above the ITP level are rare. Current pensions are taxable income for the recipient.

The book reserve system permits the company to "book" the cost of pensions at the right moment--i.e., when pension rights are earned--without disposing of any real assets. Because of the deferred payment, tax advantages also are granted. Continuous reinvestment is advantageous for the company, provided it is profitable.

Japan

Neither employees' nor employers' contributions to social security are taxable.

Employees' Pension Insurance contributions are treated in the same way as those to social security. The system's investment yields are not taxable to the same extent as those of the Mutual Aid Association for National Public Service (a smaller public system).

With respect to the qualified pension plans, employees' contributions are in principle taxable and are treated in the same way as life insurance premiums. Employers' contributions can be treated as a loss of company income, but the fund itself is assessed a one percent corporation tax. Other types of private pension plans are taxable; these contributions are given no favorable tax treatment. Under current tax regulations, then, the Employees' Pension Fund system is favored more than the qualified pension plans; the latter, in turn are treated more favorably than other private pension plans. On the other hand, supervision by authorities on plan benefits and financing is more rigorous in reverse order.

Traditionally, Japan's employee retirement benefits have been paid in lump sums and have not been financed on an actuarial basis. Since the introduction of tax regulations for qualified pension plans in 1962 and the establishment of the Employees' Pension Fund system in 1966, however, increasing numbers of employers and groups of employers want to use these systems for retirement benefits.

Yet some problems exist. Most benefits of the qualified pension plans take the form of an annuity paid in installments over 10 to 15 years rather than a life annuity. The Employees' Pension Fund system is required to provide benefits in the form of a life annuity, which can be paid in a lump sum should the recipient so choose--and a large number of persons entitled to pensions have so chosen. These benefit trends provide inadequate income security for retired employees, but perhaps they are encouraged by tax practices which favor lump sum payments over pensions.

QUESTION 8.

DOES THE GOVERNMENT PROVIDE ANY TYPE OF SUBSIDY BEYOND TAX DEDUCTIBILITY? IMPACT?

Federal Republic of Germany

With respect to private employee retirement benefit programs, the only government subsidy is the tax deductibility of the corresponding expenses. In the social security system government subsidies are used, primarily to compensate previous wartime burdens. However, these subsidies have been decreasing for years.

Finland

In the private sector employment pension systems, the employers alone meet their employees' pension insurance costs. Excluding tax deductibility, the government provides no subsidy.

On the other hand, the government is rather heavily involved in the financing of the self-employed persons' pensions. The government has been paying one-half of the farmers' pension costs since their pension system became effective. In the same way, the government will be subsidizing the pension protection of other self-employed persons. The need for this government support results from the fact that the age distribution of the self-employed is very unfavorable relative to their costs of pension protection. Yet thus far the premium contribution level for the self-employed has been set no higher than that for employees (in 1979, an average contribution of 11.7 percent of the wages), even though it should be about twice as high if all pension costs were to be met by contributions. Since the start of the system, however, it has been clear that this would be impossible. Hence the government covers those pension costs not covered by the pension contributions of the self-employed.

Sweden

See the preceding comments on the Swedish system.

Japan

The government uses general revenue to subsidize the administrative costs of the Employees' Pension Fund system, which has the effect of lowering slightly the burden of employers. However, this provision has little impact on employers' decisions to establish funds in this system.

QUESTION 9.

WHAT ARE THE ADVANTAGES AND DISADVANTAGES OF THE BOOK RESERVE SYSTEM VERSUS TRADITIONAL FORMS OF PRE-FUNDING?

Federal Republic of Germany

The book reserve system offers the employer excellent financing advantages. In a profitable business, it replaces bank credits otherwise necessary--and at favorable conditions. In a loss situation, this system widens the scope of financing; the effects are similar to additional open bank credit without the need for securities. As no funding outside the employer's firm takes place, however, the book reserve concept holds risks for the insolvency insurer with respect to declining industries. In this case, the pension liabilities may not be met by the employers when the pension payments are due in the course of the years, thereby leading to insolvency.

On the other hand, in the case of pre-funding approaches, the funding instruments may be insufficient to compensate for the inflationary trend. The book reserve system assumes that the benefits will be paid from the cash flow based on the constant producing power of the employer who has granted the pension promise and who has financed in part his productivity advances by means of the book reserves.

Finland

Pension foundations and pension funds can have a liability deficit which helps the company to balance its accounts. Although the book reserve method is not applied in Finland, this liability deficit resembles the book reserve method.

Sweden

See the preceding comments on the Swedish system.

Japan

Japan's pension plans have rarely adopted the book reserve system; thus comments about the system reflect general observations and concerns.

Under the book reserve system, plans can be operated with flexibility in benefits and financing, although there are disadvantages relative to the guarantee of benefits in the case of bankruptcy or decline of the firms sponsoring the plan. In the book reserve system, the firm, as a sponsor of the plan, can automatically borrow the capital directly from the pension fund, so that the rate of interest and the stability of money supply will be important factors as to whether the firm decides to adopt this system or not. However, if the firm goes bankrupt, the plan will terminate at the same time.

In the pre-funding approach, the levels of contributions are determined on the basis of prospective benefits. The firms pay contributions

to the plans' funds which are estimated to meet accrued liabilities. Therefore, there are few problems relative to the guarantee of benefits compared with the book reserve system, while there are some advantages of making the plan provide level contributions over long periods. However, it is difficult for such pre-funded plans to adjust their benefits in line with inflation.

INSOLVENCY AND CREDIT INSURANCE: QUESTIONS AND ANSWERS*

QUESTION 1.

HOW DOES YOUR COUNTRY'S INSURANCE PROGRAM (AND ITS COMPONENTS) FIT WITH OTHER PARTS OF THE TOTAL RETIREMENT INCOME SYSTEM?

Federal Republic of Germany

There are no specific problems. Because insolvency insurance only replaces the benefits otherwise lost in the event of employer insolvency, this question is encompassed in the broader question about the relationship between private employee retirement benefits and social security benefits (see the German responses to the previous set of pension system questions).

Finland

When the earnings-related pension systems of the private sector were established, employers had the opportunity to arrange employment pension protection with one of three pension institutions: a pension insurance company, a single-employer or multi-employer pension foundation, or a single-employer or multi-employer pension fund. These same pension institutions had been used earlier to administer the voluntary pension protection program.

The employer-based pension foundations and pension funds were the economically weakest pension institutions. Pension protection was especially poor in the foundations, because at that time the Pension Foundations Act did not require the employer to transfer to his foundation the assets to match his pension liabilities. Moreover, he could borrow from his pension foundation without any securities. An employer's insolvency or bankruptcy clearly risked the earned pension benefits. The subsequent use of these employer-based foundations and pension funds to administer the statutory employment pension protection required, therefore, that all pension liabilities be covered by the credit insurance of the Central Pension Security Institute. In addition to the compulsory credit insurance, the investment credit insurance of the Central Pension Security Institute was made an alternative form of insurance for the loans of pension insurance companies.

The credit insurance of the Central Pension Security Institute also covers the loans of (a) the Employment Pensions Fund, which administers

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*Responses to these supplementary questions on insolvency and credit insurance are based upon information provided to the Employee Benefit Research Institute in May 1979 by pension officials in the Federal Republic of Germany (Dr. Eckert Windel) and Finland (Herr Lauri Koivusalo). Except when included, the Swedish perspective (as provided by Mr. Göran Engzell) is presented in prior sections of this volume.

the pensions under the Temporary Employees' Pensions Act and (b) the Farmers' Pensions Institution, which administers the farmers' earnings-related pension system. With respect to this latter institution, however, the Institute's role as a guarantor has remained very small. The credit insurance of the Central Pension Security Institute cannot be applied to guarantee the funds of the Social Insurance Institution (a parliament-supervised institution which administers the national basic pension system) or public (i.e., state, church, and local government employees) earnings-related pension systems.

QUESTION 2.

WHAT HAVE BEEN THE POSITIVE AND NEGATIVE CONSEQUENCES OF THE INSURANCE PROGRAM (AND ITS COMPONENTS) FOR YOUR COUNTRY AND YOUR RETIREMENT INCOME SYSTEM?

Federal Republic of Germany

Positive consequences prevail. Primarily for reasons of favorable taxation, for years the predominant financing approach has been the book reserve system. Its only disadvantage had been the lack of security for employees' benefits, but this disadvantage was eliminated by the insurance program. In this way the existing retirement income system was stabilized. The insolvency insurance premium charge paid by employers is insignificant relative to the tax relief brought about by altering the applicable actuarial calculating method toward full advance-financing (except for future benefit adjustments related to cost-of-living increases, which cannot be included as actuarial assumptions).

In the direct insurance sector, a great many contracts have been changed to contracts with irrevocable entitlements, thus removing from these pension programs the obligation for insolvency insurance coverage.

Finland

Through the use of credit insurance, several existing types of pension institutions could be adapted to administer the statutory pension insurance.

Other positive effects of credit insurance are less obvious. Perhaps it is most important that the pension foundations have been able to develop as solvent pension institutions. Insured pensions in foundations are now as secure as in pension insurance companies. Moreover, the pension institutions are important now in the financing of companies, and any changes in this financing system would cause the companies great difficulty.

The credit insurance system in Finland has not been observed to produce any negative consequences.

QUESTION 3.

(A) WHAT ARE THE MAJOR COMPONENTS OR ASPECTS OF YOUR COUNTRY'S INSURANCE PROGRAM THAT MIGHT BE APPLICABLE TO THE UNITED STATES?

(B) WHAT MIGHT BE THE POSITIVE AND NEGATIVE CONSEQUENCES OF ADOPTING YOUR SYSTEM (OR ITS COMPONENTS) IN THE UNITED STATES?

Federal Republic of Germany

It is difficult to understand why--as in the United States--an employer should be allowed to terminate a pension plan at his discretion, unless he meets his unfunded liability at least with respect to current pensions and vested rights. It might be preferable if, as in Germany, the universe of contribution payers were charged with all or part of these liabilities only in the insolvency situation.

The United States may wish to change its funding approach in the future (e.g., to a book reserve system). The starting point might be the acceptance of the view that an employer can be liable for paying annuities in the future for different reasons (e.g., credit, purchase of a plant, employee retirement benefit). He would have to show this liability in his balance sheet. The social impact of the pension liability would be given by the insolvency insurance. Hence there would be a necessity for funding pension liabilities outside the employer's firm.

It is not clear why an employer (i.e., plan sponsor) should at his discretion be able to terminate a plan, particularly if the plan is not fully financed or funded. A better approach might be to have him secure the full present value of his pension liability--current pensions and vested rights--upon the liquidation of his firm, making up any possible deficiency of the plan. However, this probably would necessitate tax relief for full financing. Compulsory contributions paid to the Pension Benefit Guaranty Corporation (PBGC) might better be used to provide coverage only in the event of insolvency.

Finland

The principle underlying the Finnish credit insurance program does not depend upon the administrative structure of the pension program. Credit insurance covers pension arrangements insured with a pension insurance company as well as with pension foundations and pension funds. It has not been tied to the structure of pension systems, nor is it dependent upon the definition of the insurable event. Hence, a similar credit insurance system may be applicable in the United States.

Sweden

Difficulties exist in adopting the Swedish guarantee insurance system to the United States. It is a book reserve system more or less tailored as a part of or a complement to two nationwide uniform pension schemes covering most of the Swedish labor market, in which there is only a very small number of organizations. The safeguarding of pensions is regulated

in labor market agreements. There are practically only two pension financing alternatives, the book reserving with guarantee insurance system and the pension insurance system. Only employers whose credit standard has been examined are allowed to use the guarantee insurance system.

Components which might be adopted, in whole or in part, in the United States are insolvency as the insurable event, book-reserving as an alternative to funding, expansion of the right of subrogation, modification of the payas-you-go system and premiums only related to the guaranteed liabilities, complete registration of business sales and reorganizations, control of transfers of pension liabilities, and coordination of actuarial calculations.

QUESTION 4.

WHAT IMPACT HAS YOUR COUNTRY'S INSURANCE PROGRAM HAD ON THE FORMATION AND EXPANSION OF PRIVATE PENSION PLANS?

Federal Republic of Germany

Clearly the German insolvency insurance program and the establishment and operation of the PSVaG as the carrier of insolvency insurance have affected the formation of private pension plans.

Expansion of these plans cannot be judged without viewing the other three important changes brought about by the new law, namely:

(a) regulations concerning vested rights;

(b) regulations concerning compulsory reviews every three years to determine whether an adjustment of current pensions to reflect the rising cost-of-living is possible; and

(c) improvement of tax relief for the pension promise (i.e., book reserve) system and, to a lesser extent, for direct insurance deduction of tax relief for employers using support funds.

As compared with the cost burden imposed by changes (a) and (b), the costs of the insolvency insurance have proven to be very low. Particularly in the case of the pension promise system (see (c)), they are far outweighed by the tax relief improvements (which exist as long as the employer is profitable).

By introducing insolvency insurance, the pension promise system has lost its only earlier disadvantage--the lack of security for the employees' benefits. Hence in the formation of private pension schemes a trend toward the pension promise system and--insofar as small businesses are concerned--direct insurance contracts exists.

Finland

It is significant that when the credit insurance arrangement was adopted, the pension foundations and pension funds could be adapted to administer the statutory employment pension protection. Most of the foundations and funds are working as before. A few have been terminated, but a few others have been established. On the other hand, the need to create new private pension arrangements to operate outside the statutory protection is increasing due to the system's gradual implementation.

QUESTION 5.

WHAT EFFECT DOES YOUR INSURANCE PROGRAM HAVE ON THE LONG-TERM GROWTH OF PENSIONS IN YOUR COUNTRY?

Federal Republic of Germany

This is a difficult question, because the insurance program is neither the only nor the most important factor influencing the long-term growth of pensions. As noted in the German response to the preceding question, it is likely that the German insolvency insurance program has had little substantive influence, because the costs of insolvency insurance have been so low compared with the costs of private employee benefit programs in total, or with the costs of vesting and the costs of adjustments to cost-of-living increases in particular. The administrative burden on employers caused by reporting requirements also is low in the German system.

The most important factors affecting the long-term growth of pensions will be future labor market conditions, together with future business conditions, plus resolution of the issue as to whether supreme labor court jurisdiction on the adjustment of pension payments according to cost-of-living increases will make it impossible for the employer to calculate future costs of pension programs.

Finland

The credit insurance system has no direct effect on the long-term growth of pensions, because in Finland the pension benefits and their financing have been prescribed by law.

QUESTION 6.

IS SPONSOR INSOLVENCY THE PROPER POINT FOR GOVERNMENT INVOLVEMENT IN PLAN TERMINATIONS?

Federal Republic of Germany

Yes. It is strongly felt that the insurable event must be insolvency and equivalent situations, but neither the termination of pension programs nor the liquidation of the plant or the employer's firm.

The establishment of a pension scheme is voluntary. Once it has been established, any cutbacks of benefits must be agreed to by the shop committee or--in the case of severe financial difficulties--by a labor court. The German attitude is that the employer must make his own arrangements in the event of liquidation; accrued pension liabilities are not inferior to other liabilities. Hence, if an employer wants to liquidate, he must raise the present value of the current benefits and of the accrued vested benefits and finance them (for example, through a life insurance contract with single premium payment for the employees and beneficiaries).

Finland

When the earnings-related private sector employment pension system was introduced, the employers were given several alternatives for arranging the statutory pension protection for their employees. It could be arranged through pension insurance companies, pension foundations, or pension funds. The latter two forms of pension institutions can cover one or several employers, while pension insurance companies are obliged to grant pension insurances to all the employers who want to use them. At the moment there are 8 pension insurance companies, 14 pension funds, and 105 pension foundations.

The establishment, operation, and termination of pension insurance companies, pension foundations, and pension funds are prescribed by law. To establish a pension institution, an application for a license is required. From the start of operations the institutions are supervised by authorities. In practice this is done by the Insurance Department of the Ministry of Social Affairs and Health. The solvency of insurance companies is subject to special scrutiny. Owing to legislation and public supervision, it is difficult for a pension insurance company to become insolvent. With regard to the pension foundations and pension funds, the supervision of solvency is not that strict. However, in the statutory pension protection, their total pension liabilities are covered by the credit insurance of the Central Pension Security Institute. When a pension foundation or pension fund becomes insolvent, it must be terminated, which in practice means that its pension liabilities are transferred to a pension insurance company and the financing deficit is paid from the credit insurance assets of the Central Pension Security Institute. By law, pension institutions are jointly responsible, in accordance with certain principles, if due to a bankruptcy the pension would be left totally or partly unsecured. Owing to the state's active supervision, the joint responsibility of pension institutions prescribed by the

employment pension legislation, and the mandatory credit insurance, the insolvency of the private sector employment pension system is practically impossible. Therefore, in Finland the state's involvement in the operations of the system seems more or less theoretical.

In Finnish credit insurance, the insolvency is the main insurance event. Then, for payment of the compensation, it is sufficient that the employer who had taken the loan guaranteed by credit insurance fails to repay it within the prescribed time once the loan has been called in. Of course, the pension insurance company which had granted the loan does not arbitrarily call it in. The termination in repayments is the starting point. The Central Pension Security Institute pays the loan to the pension insurance company concerned and assumes its place as creditor.

For pension foundations and pension funds, the event insured against can formally be the termination of the pension institution. In practice, even that is usually caused by the employer's insolvency. Final compensation costs for the Central Pension Security Institute are then due to the employer's insolvency. Compensation is paid to the pension insurance company, which in turn takes over the pension liabilities of the terminated pension foundation or fund. Thus the Central Pension Security Institute does not actually pay the pensions or continue the terminated pension arrangement.

QUESTION 7.

WHAT PROGRAM CONTROLS ARE NECESSARY TO PREVENT ABUSE OF THE INSURANCE PROGRAM?

Federal Republic of Germany

In the insolvency insurance approach--and even more so in the plan termination approach--employers must not be given advantages they can realize at the expense of the contribution payers. Incentives for producing insurable events at the employer's discretion must be avoided. There also must be provisions to ensure that employees' and beneficiaries' rights are not improved at the expense of the total insurance program. Therefore, in the German system the PSVaG can refuse claims if they result from increases in the last year before insolvency or if any recent improvement in benefit levels has been made primarily in an attempt to transfer the resulting costs to the PSVaG.

Finland

In accordance with the nature of the insurance business, the credit insurance premium of the Central Pension Security Institute is based upon the risk that the Institute takes in each case when granting the credit insurance and in the annual adjustment of the risk. In practice, that means that solid companies in which the risk is minor manage to have a small premium, while the companies in which the risk is great must pay a high premium or convey real security to the Central Pension Security Institute. As of 1979, the statistical figures obtained from each company's financial data sheets have been used in the estimation of the risk. The company's financial state can be easily determined by these figures. Weak companies are thus excluded from credit insurance.

Before the credit insurance agreement is approved, the credit of the companies and the persons behind them are checked as a routine operation with credit information companies. The abuse of credit insurance is also being prevented by the easy collection of premiums. When a company fails to pay the premiums, their collection can be sent directly from the Central Pension Security Institute to executory offices; the court's or any other authority's decision is not required. In loss cases, the receivables compensated by the Central Pension Security Institute often can be collected, at least partly, either from the bankrupt's estate or from the debtor, because the premium loan receivables enjoy priority second only to the wage receivables. Possibly for these reasons there has been observed no systematic attempt to abuse the credit insurance of the Central Pension Security Institute.

QUESTION 8.

HOW ARE INSURANCE PREMIUMS SET AND INVESTED?

Federal Republic of Germany

In the German system, a terminal funding approach is used in the setting of premiums. In the year of the insolvency, all current benefits have to be financed through the purchase of annuities from a consortium of German life insurance companies. The single premium payments are based on an assumed rate of interest of 3 percent, so that there will be actuarial gains in future years. The PSVaG is participating in these future profits at a 98 percent rate.

PSVaG's investments are subject to the regulations given by the law and the Federal Insurance Supervisory Authority. With respect to PSVaG's insurance being compulsory on a cost-revolving system, assets to be held are limited but must be able to be liquidated in due course if necessary. Therefore, PSVaG's investment has been limited to bonds of several kinds; no stocks and equity securities and no real estate are purchased.

Finland

Credit insurance premiums are determined by the following three factors:

(a) the amount of credit insurance liability (either the amount of the loan guaranteed by credit insurance or--for instance, in pension institutions--the amount of the pension liabilities calculated by an actuary);

(b) the risk premium percentage, calculated on the basis of the company's balance sheet data; and

(c) the value of the security conveyed to the Central Pension Security Institute or the cover value of the property possessed by a pension foundation (if necessary, with evaluation based on a statement made by an outside expert).

The insurance premium is calculated by deducting the value of the security or the cover value of the real property from the loan or from the pension liabilities. The premium percentage calculated for the company is applied to the difference.

The Central Pension Security Institute invests the assets accumulated by credit insurance mainly in loans to companies.

QUESTION 9.

WHAT BENEFITS ARE GUARANTEED?

Federal Republic of Germany

Coverage is granted only for pensions or lump sum payments after retirement which have been promised to an employee because of his employment. The typical covered benefits are old-age benefits, disability benefits, and surviving dependents' benefits.

With respect to self-employed persons, considerable thought has been given to fix the limits. As the premium system is a cost-revolving system and not an actuarial computed equivalent premium system, which would reflect individual risk, most of the self-employed cannot be covered.

There is a limit of three times the actuarial contribution ceiling of social security (1979: 3 times DM 4,000 = DM 12,000; this is approximately US $6,000 monthly).

Finland

The task of credit insurance is to guarantee the funds in amounts required by the law and by principles of funding. If the credit insurance guarantees a loan, it works as a security for its repayment to the pension institution. If a pension foundation or pension fund is terminated, the credit insurance guarantees the funds in the amounts calculated by an actuary authorized by the Ministry of Social Affairs and Health. The credit insurance also guarantees a so-called funding deficit of a pension foundation if that cannot be covered with its realized assets.

Hence, credit insurance indirectly guarantees the preservation of pension benefits insured in different pension foundations and pension funds even when the foundation or fund is terminated or an employer fails to repay his loan. Credit insurance does not directly pay the pensions, but their costs are met by the pension institution which has the responsibility for the pension benefits concerned.

QUESTION 10.

WHAT REQUIREMENTS EXIST FOR THE REPORTING AND MONITORING OF PLANS AND EMPLOYERS?

Federal Republic of Germany

There are practically no such requirements as far as insurable pension programs are concerned. (Only pension funds, which are not subject to insolvency insurance because they are subject to federal insurance supervision, have many requirements of this kind with respect to the Federal Insurance Supervisory Authority.) The only obligation for reporting is to submit the premium basis by September 30 each year. This is the actuarial value of the pension liability computed for the employer's most recent commercial year according to the tax regulations. These reports are monitored by the PSVaG and verified according to certain measures.

Finland

For pension foundations and pension funds:

(a) balance sheet data are submitted to the Central Pension Security Institute;

(b) pension liabilities are calculated by an actuary who has been authorized by the Ministry of Social Affairs and Health; and

(c) information on property covering the pension liabilities is submitted to the Central Pension Security Institute for determining the value of the property.

For the employer:

(a) balance sheet data are submitted to the Central Pension Security Institute; and

(b) sufficient information on the property acting as security is submitted to the Central Pension Security Institute for calculating the security value of the property.

In addition, the Central Pension Security Institute verifies separately that the employers have met their obligations to insure the pension protection prescribed by law.

QUESTION 11.

WHAT IS THE LIABILITY OF PARENT CORPORATIONS AND AFFILIATED EMPLOYERS FOR THE LIABILITIES OF AN INSOLVENT PLAN SPONSOR?

Federal Republic of Germany

Legally, there is no liability of this kind so far. Actually, there have been several well-known large German companies who saved their subsidiary companies from insolvency to maintain their standing in the market. Thus, they did not let the insurable event occur.

There do exist, however, certain situations similar to that raised in the question. At present a case is pending in the labor court concerning a multiemployer support fund of a controlled group of corporations. Here the parent corporation went bankrupt and the affiliated corporation denied its liability to maintain the current pensions and vested benefits of its own employees.

Finland

The parent company is not responsible for the liabilities of its subsidiary company, provided it has not made a separate commitment to them. This also concerns the subsidiary's responsibility for the liabilities of its parent company. However, if the company is a personally responsible business partner in a parent or subsidiary company whose corporate form is a limited partnership, it is in this capacity responsible for the liabilities of its parent or subsidiary company. In addition, the company is responsible for the liabilities of its parent or subsidiary company if they are partners in a general partnership or have a joint concern.

One method to arrange the statutory pension protection is that two or more companies establish a joint pension foundation. Then the rules of the foundation have to include a statement by which each partner is responsible both for its own and for its partners' liabilities of the pension foundation. This way the parent company and subsidiary may have to assume the responsibility for each other's liabilities.

QUESTION 12.

WHAT IS THE BANKRUPTCY PRIORITY OF LEGAL PENSION LIABILITY?

Federal Republic of Germany

With respect to the pension claims, the law assigns to the PSVaG the legal status of the former employee. Legal pension liability in Germany is in the last (6th) category of bankruptcy priority. Therefore, in the majority of cases, receipts out of bankruptcy proceedings for the PSVaG are very low.

Finland

If the company has arranged its employees' pension protection in a pension insurance company, the pension liabilities cannot be secured in the bankruptcy at all, but they are guaranteed by the pension insurance company concerned. On the contrary, the unpaid pension insurance premiums for the year of bankruptcy and the prior year enjoy the same high priority as the prepayments of taxes. Only the right of pledge and lien, as well as the employees' wages and other receivables for the year of bankruptcy and the year before that, enjoy a better priority. Receivables based on pension insurance premium loans have the same priority as the pension insurance premiums, irrespective of the time period involved. Other pension insurance company loans and the liability of pension foundations do not have any special priority in an employer's bankruptcy.

If the bankrupt company had a pension foundation or pension fund, it has to be terminated in the course of bankruptcy. Normally, the pension liabilities are then transferred to a pension insurance company. The receivables of the pension insurance company required for the costs of the transfer of pension liabilities have the same high priority as the employees' wage receivables, as well as receivables based on pension payments.

QUESTION 13.

WHAT CONTROLS EXIST OVER BUSINESS SALES AND REORGANIZATIONS INVOLVING THE TRANSFER OF PENSION LIABILITIES?

Federal Republic of Germany

There is no obligation to report such events when they occur. But such events will become known in the course of checking the report on the pension basis after September 30 of each year. At that time, further inquiries may be made.

Legally, it is understood that in the case of business sales, the established pension program is to be maintained by the new owner as far as active employees are concerned.

There are, however, considerable doubts about whether the same is true for current pension benefits, because the law defines the employer's insolvency as the insurable event for the PSVaG, and the buyer of the business has never been and is not the employer of the pensioners. In this case, the liability for current benefits will remain with the former employer. To a high degree, the PSVaG's judgment depends upon the special legal route chosen by the transactors.

Finland

Business sale and reorganization do not normally lead to any changes in the arrangement of pension protection. If a general partnership or a concern changes owners and the company concerned has arranged the employees' pension protection by taking out pension insurance with a pension insurance company, the only change is that the responsibility for the insurance and premiums is transferred to the new owner with the ownership. The Central Pension Security Institute ensures that the legal obligation to insure will be realized.

If the pension protection has been arranged in a pension foundation or pension fund, it is possible that in conjunction with the business sale or reorganization the pension foundation or fund will be terminated. Normally, then, the pension liabilities are transferred to a pension insurance company. Ultimately, however, the Central Pension Security Institute is responsible for the pension liabilities of these terminated pension institutions, because in accordance with the Employees' Pensions Act (TEL), the pension liabilities of pension foundations and pension funds must always be covered by the credit insurance of the Central Pension Security Institute.

The legality of the transfer of liabilities is supervised by both the Ministry of Social Affairs and Health and the Central Pension Security Institute.

APPENDIX A: FEDERAL REPUBLIC OF GERMANY

DEVELOPMENT OF THE PSVaG AS OF
JANUARY 1, 1975 UNTIL APRIL 30, 1979*

Year	Members	On Account Premium-Rate	Final Premium Rate	Total Premium Income	Insol-vencies	Beneficiaries		Vested Entitle-ments	Total Balance Sheet Amount	Invest-ments	Equal-ization Fund	Members of PSVaG Staff
						Total Amount of Claims (Cash Value)						
	Number (Dec.31)	%	%	mio.DM	Number	mio.DM	Number	Number	mio.DM (Dec.31)	mio.DM (Dec.31)	mio.DM (Dec.31)	Number (Dec.31)
1975	31,045	0.15	0.15	110.6	249	74.7	5,060	7,290	93.2	82.9	34.4	36
1976	31,685	0.15	0.19	159.5	265	163.6	8,495	8,795	120.7	99.6	35.0	41
1977	32,102	0.17	0.19	170.9	243	128.2	4,734	5,793	198.6	175.0	88.3	42
1978	32,778	0.17	0.07	71.3	175	77.6	4,697	6,638	295.3	285.2	101.6	43
				512.3	932	444.1	22,986	28,516				
TOTAL (Jan.1 -April 30)		0.05			56	53.5	2,901	4,680				45
							25,887	33,196				
							59,083					

*This information was provided to EBRI by Dr. Eckart Windel, Executive Director, PSVaG, in May 1979.

THE THREE PILLARS OF EMPLOYEE WELFARE IN THE FEDERAL REPUBLIC OF GERMANY*

Introduction

The object of this booklet is to give the reader a working knowledge, expressed in simple terms, of the legal and voluntary employee benefit systems in Germany.

In deciding upon the content, we realised that there are numerous existing guides on the same subject and, in order to present a more global picture, we have developed themes which are often omitted from these other sources. The complexities of German labour law, taxation and employee co-determination are all, for instance, problems of current concern to employers.

We do not profess that this booklet will answer every conceivable question; the consideration of length alone would prevent it. We will be pleased to answer any specific questions you might have.

The Past

The first concerted efforts to relieve the financial hardship of retired employees were made by private companies such as Krupp and Siemens in the 1850s.

This resulted in the "Imperial Decree" of 1881 which marked the introduction of State participation in the employee welfare field with health, accident and, eventually, retirement, death and disability benefits. From such beginnings, Social Security developed until, in 1957, the basis of the present system was created with the transition to earnings related pensions.

Despite these developments, Social Security benefits are nevertheless inadequate for the considerable majority of employees and they can be regarded as merely the foundation stone of employee welfare. Today, an employee's needs will be met from three sources:

- Social Security;

- Company pension plans;

- Personal savings.

These represent the three pillars of employee welfare in Germany.

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*Prepared by International Pension Consultants GmbH (IPC), Wiesbaden, Germany, 1977. Reprinted in its entirety by permission of the International Pension Consultants.

SOCIAL SECURITY - THE FIRST PILLAR OF EMPLOYEE WELFARE

Eligibility

Since 1968 employers have been required by law to cover all employees including apprentices, irrespective of income, although employees who had previously exercised an option not to participate in the State system were permitted to retain their pre-1968 status. Until 1974 these employees were entitled to revoke this decision and enter the State plan.

An employee may now be exempted from Social Security membership only if his expected length of service in the country is of short duration; for example, a foreign national temporarily seconded to a German company.

Retirement Pension

The amount of retirement pension depends on the number of years of Social Security membership and the employee's total earnings during his entire active career. These earnings are revalued by an index related to the average earnings of all covered people.

It is difficult to assess the amount of State pension accurately in advance, but the pensions which emerge are normally between 45 percent and 55 percent of final earnings up to a Social Security earnings ceiling. This ceiling for 1977 amounts to DM 40,800.

A Government survey of salaried employees in 1974 showed that the relationship between the State retirement pension and final earnings had declined from an average 62.7 percent in 1961 to 52 percent in 1974.

The normal retirement age for men and women is 65 although women may, and invariably do, apply for early retirement from age 60. Men may now retire from age 63 and even, under certain circumstances, from age 60.

Disability Pension

The basis for calculating the disability pension is similar to that for retirement, although the amount of disability pension will also depend on whether the employee is prevented from carrying out his qualified profession--"occupational disability"--or whether he is incapable of performing any work whatsoever.

The pension can vary anywhere from about 30 percent of earnings for a young man who is occupationally disabled to 50 percent or more for someone who is totally disabled ten years or so from normal retirement age. The earnings ceiling described above also applies to disability pensions.

Death Benefits

The widow of a retired employee will receive a pension of 60 percent of her husband's pension.

If he dies before retirement, the widow's pension, depending upon her circumstances, will be 60 percent of the pension which he would have received for total or occupational disability.

These benefits will be increased by orphans' pensions.

Adjustment of Pensions

Pensions in course of payment are readjusted each year by an index related to the average earnings of those within the State Social Security system.

Financing

Social Security is financed essentially on a pay-as-you-go basis by contributions from the employer and employee, although there are substantial Government subsidies.

The current contribution for retirement, disability and death benefits is 18 percent on earnings up to the Social Security contribution ceiling (1977: DM 40,800).

Contributions for medical care are between 10 percent and 12 percent, depending on the fund, on incomes up to DM 30,600 and, for unemployment, 3 percent on incomes up to DM 40,800.

All the above contributions are divided equally between the employer and employee.

The rate of contribution for workmen's compensation depends on the type of occupation; the cost is borne wholly by the employer, and amounts on average to 1.5 percent of payroll.

PRIVATE PENSION PLANS - THE SECOND PILLAR

The growth in private plans since the end of the last war has been considerable, due to the competition among employers for labour and the substantial gaps left by the Social Security system. A Government survey conducted in 1973 showed that of companies with more than 200 employees, 75 percent had private plans.

Many of the older plans vary considerably in their benefit design but it is possible to identify certain trends among the newer plans.

Eligibility

There are no statutory requirements governing the employee eligibility conditions, although an employer may not discriminate between employees in the same category.

Blue- and white-collared employees are normally included in the same plan.

Benefits

There are no restrictions on the maximum or minimum benefits which may be provided.

The implications of the German taxation system should be studied closely as old age relief is far more generous than in most other countries, with the result that the total net income after retirement can substantially exceed net pre-retirement earnings if sufficient care is not taken in the benefit design of the plan.

Retirement

Considering the very high fixed living costs in Germany, the philosophy of well designed, modern plans can be summarised as follows:

> To ensure that the total net retirement income, after tax, of the average employee is roughly equivalent to his net pre-retirement earnings.

This would include both Social Security and personal savings.

There are various methods which can be adopted to achieve this objective but the most effective, which stands the tests of both fairness and simplicity, provides a low rate of pension on that part of gross earnings which qualifies for a State pension and a higher percentage of any excess earnings.

The rate of pension accrual and the maximum number of years of service which are pensionable will depend on the type of company and the labour which it employs.

Disability

Disability benefits are an integral part of most plans. The better employers provide a disability pension equal to, or a percentage of, the pension which the employee would have received at retirement had he continued to work.

The pension would commence at the same time as the State disability benefit.

Plans which promise a disability pension expressed as a fixed percentage of salary could not operate satisfactorily in Germany.

Death

Lump sum death benefits are almost unknown and widow's and orphans' pensions are strongly preferred. It is normal to provide them on death both after and before retirement or disability.

The widow's pension might be as high as 60 percent of the pension which the husband was receiving at the date of death or, if he died before

retirement age, that amount which he would have received had he become disabled.

Orphans' pensions would generally amount to 10 percent per child of the employee's pension.

Preservation of Rights (Vesting)

The Company Pension Plans Act of 1974 made several crucial changes in labour law and one of them was the introduction of compulsory vesting. An employee leaving service now has an entitlement to a deferred benefit if he has reached age 35 and has been a member of the plan for 10 years, or has completed 12 years' service with the company including 3 years' plan membership.

The deferred benefit must normally be calculated on a pro rata basis by taking into account the prospective retirement benefit, the length of service to the date of withdrawal and the total prospective service to retirement.

Death and disability benefits must also be vested.

Adjustment of Current Pensions

The same Act also requires employers to make a three yearly review of all pensions in course of payment and decide on an adjustment compensating the effects of inflation. This does not mean, however, that all benefits are automatically indexed to the cost of living as the employer still has certain discretionary powers.

Company Insolvency

Prior to 1975, the plan members' entitlement could be lost on insolvency of the company. The above Act now requires employers to effect insolvency insurance for all pensions in course of payment as well as those which have been legally vested, with an organization known as the Pension Guarantee Association.

The premium is currently 1.5 per mille of the current value of the benefits.

Financing

Pension plan financing in Germany is substantially more complex than in, for instance, North America or the United Kingdom, as the employer has a choice of four totally different methods. Each of these methods has its own legal status and tax assessment of not only contributions but also benefits.

The majority of plans are wholly financed by the employer as the methods which are most commonly used are prohibited from charging employee contributions.

Retirement Benefit Pledges

Retirement benefit pledges do not usually involve much, if any, funding outside the company and the benefits are financed internally by annual transfers within the profit and loss account, known as "book reserves."

It is not necessary to earmark any specific assets against the pension liabilities and the emerging funds may be used for general corporate purposes. When the benefits become due, they are paid from current income.

The reserves are tax deductible provided their basis of calculation meets with certain requirements.

Since 1975, companies which have made insufficient taxable profits against which to offset the tax deductible book reserves may, within certain limits, defer them until a claim arises.

Although it is not compulsory to fund the benefits outside the company, small and even large companies may face a large and sudden reduction in profits if a pre-retirement death or disability claim were to arise.

To cover this risk, it is possible to insure these benefits on a selective or global basis.

As book reserving is an internal accounting method, employee contributions are forbidden even if insurance contracts are used. Neither the reserves nor the insurance premiums are, however, regarded as additional income of the employees.

The benefits are taxed as earned income but, as there are very generous old age reliefs, the average pensioner will not incur a tax liability.

Prior to payment of benefits, the only cash outgoings of any consequence might at most be insurance premiums for death and disability benefits, and the company's cash flow is therefore improved not only by the retention of the contributions but also by tax deferment on the book reserves which can amount to as much as 60 percent. Companies are thus able to finance some of their long term capital needs internally.

Book reserving was originally introduced to alleviate the cash flow problems of private industry after the Second World War. It soon became a very popular method among both German and foreign-owned companies and, today, about 80 percent of the expenditure for pension plans is book reserved.

Direct Insurance

With this method the employer establishes policies on the lives of his employees who are defined as the beneficiaries (as opposed to insurance contracts under book reserved plans where the employer is the beneficiary).

Employee contributions are permitted and are tax deductible as "Special Expenses," although this may not be of any value to higher paid employees whose allowances might already have been used up by other tax deductible expenditure.

The employer's premium is tax deductible but is regarded as additional income of the employee. There is limited relief on premiums up to DM 2,712 per annum (2,400.--DM taxed at a global rate of 10.7 percent, 312.--DM tax free) if the employer meets the liability. But the employee will be tax assessed on any excess premium. If the employer meets the liability on the excess premium, the tax paid will also be regarded as additional income and subject to further tax.

Pensions are subject to favourable tax treatment but, for reasons already mentioned on page 114, there is no advantage to be gained for the average pensioner.

Because of the tax liability on the premiums, it is normally inadvisable to finance the entire plan by this method unless the benefits are on a flat rate basis. In view of the favourable tax treatment of the pension, however, it can be used to a limited extent for executives, who will usually have a post-retirement tax liability, to secure the first portion of their benefits under a plan providing benefits related to final or near final earnings.

Support Funds

A Support Fund is administered through an independent body in the form of a limited liability company or a registered association which is formed by the employer and, in this respect at least, it can be compared to the North American or United Kingdom trust concept.

It may finance its benefits in one of the three following ways, or by a mixture of each:

1. Contributions invested in a form other than insurance;

2. Advance contributions to an insurance contract;

3. Pay-as-you-go.

Support Funds are not subject to statutory control and if, for example, method 3 is used there is no restriction on the investment of contributions which may even be loaned back to the employer.

If insurance contracts are used to finance the benefits the level annual premium is tax deductible, otherwise the maximum tax deductible amounts each year are largely limited to the actuarial reserves of the benefits which commence in that year, increased by a reserve cushion for employees still in active service. Full advance funding of the benefits is therefore only possible with insurance contracts.

The tax regulations stipulate that the employees must not be given a legal entitlement to the benefits which should be revocable at any time

on a retrospective basis. Recent rulings of the Federal Labour Court have, however, partly contradicted this regulation.

As the employees have no legal entitlement they are neither taxed on the employer's contributions nor are they permitted to make a personal contribution.

Taxation of the benefits is the same as for book-reserve plans.

Support Funds have a number of special applications which are not always appreciated. As an example, companies with a consistently erratic profit record can use them to advantage by selecting years of high profits to inject contributions into the plan up to the tax deductible limits, but elect to pay little or nothing in other years.

Privately Invested Funds

Privately Invested Funds come within the jurisdiction of the Federal Insurance Supervisory Authority and are subject to the same controls on investments, actuarial methods, etc. as life assurance companies.

The employer's contributions are tax deductible provided they match the liabilities of the fund or if they are made following a demand from the Supervisory Authority.

Employee contributions are permitted.

The tax status of private funds vis-a-vis the taxation of contributions and benefits is almost identical to that for direct insurance.

The applications of this method are very limited as the employee's tax liability on the contributions alone prevents adequate benefits being financed at reasonable cost. In addition, the considerable expense of establishing and administering a private fund (much higher than in other countries) and the inflexibility created by strict Supervisory Authority control are further arguments which will deter most employers.

Those funds still in existence were invariably founded by older, larger companies, or for industry-wide plans.

Deciding on the Financing Method

From their experience in other countries, international employers are usually well acquainted with the use of insurance contracts and privately invested funds as financing vehicles. The criteria by which these methods are assessed in other countries, however, do not apply to Germany as the system of taxation is totally different, in addition to which there are two other methods--Book Reserves and Support Funds--which must be considered.

The method which an employer uses will depend on several factors including the benefits, the company's capital requirements and its profit potential, and it is sometimes necessary for a combination of methods to

be adopted in order to arrive at a satisfactory conclusion to the financing problem.

Companies which adopt "simple solutions" in Germany almost always have plans which are unnecessarily expensive and which are eventually more difficult to administer than the alternatives which are available.

N.B.--Multi-national employers with insurance arrangements which pool the costs and risks of their individual plans in different countries, to achieve a multi-national dividend, can also apply them to advantage in Germany for death in service and disability benefits. However, their effectiveness for retirement benefits (which invariably represent the major part of the cost) is normally very limited.

PRIVATE SAVINGS - THE THIRD PILLAR

Private savings are widespread and the State has offered a number of tax and other incentives to encourage them. It is endeavouring to stimulate them even further as the third pillar of employee welfare but experience has shown that current preferences are for short term savings.

This is largely due to the public fear of committing itself to long-term savings in an inflationary environment, which is demonstrated by the change in fixed interest and gilt-edged stock investments from a long to a short term basis--up to 10 years. Investment in equities does not hold much attraction for the average person, as dividends, mainly for tax reasons, are low and because the stock market is not as active as in some other countries. Although mutual funds exist, there is a lack of faith in them and their principal clients are institutions.

The classical endowment contract, though frequently used, provides an average capital sum less than one half annual salary.

As a result, personal savings can be expected to provide an average retirement income of no more than 5 percent of earnings up to the Social Security ceiling, and about 10 to 15 percent on any excess income.

The Future

The future of private pension plans has been assured by the Company Pension Plans Act of 1974 which recognized that they have an important part to play as the second pillar of employee welfare.

There are at present, however, two problems uppermost in the minds of employers; co-determination and the adjustment of current pensions.

Following a recent decision by the Federal Labour Court, all types of pension plans are now subject to co-determination. Although employers are allowed considerable discretionary powers before they are required to negotiate with the Works Council, some regard co-determination as a weapon which will be used against them.

If difficulties arise they will probably be self-inflicted as many German companies in the past have been reluctant to discuss their pension plans with the employees, or even provide simple booklets, with the result that mistrust has sometimes occurred on the employees' part.

Some employers have now come to accept, however, the value of employee education in this area and there has been noticeable growth in the use of sophisticated employee communication programmes of the type found in North America and the United Kingdom.

As secondary wage costs in Germany now represent about 60 percent of prime wage costs, the need to "Act benevolently and talk about it" was never truer than in today's circumstances.

The adjustment of current pensions is confusing employers as the above Act merely requires them to undertake a three yearly review but does not lay down a specific assessment basis. Labour Court judgments given to date have not been of a sufficiently general application to enable a precedent to be created for future cases and, in the absence of more definite regulations, employers will need to equip themselves with assessment models which are acceptable to retired employees (to avoid the involvement of the Labour Courts) but do not impose a heavy financial strain upon the company.

The future of Social Security is not, however, as reassuring. Forecasts of contribution income were too optimistic due to the economic recession, in addition to which Germany, like other countries, is experiencing a decline in the birth rate. Both of these factors are leading to a contribution deficit.

For political reasons, it is unlikely that the obvious solution of increasing contributions will be adopted and it is probably the benefits which will suffer.

Of various suggestions currently being discussed, one of the most likely to be adopted would link Social Security benefits in course of payment to the net and not the gross incomes of active participants. Although several minor improvements to the State system, such as an increased pension for a dependent wife, have recently been suggested, most of them can probably be ruled out until such time as Social Security is placed on a financially secure basis.

APPENDIX B: FINLAND

BASIC FEATURES OF FINLAND'S PENSION SCHEMES

DEVELOPMENT OF THE PENSION SCHEMES

A national pensions scheme covering the population as a whole, has been in force since 1939. Under it a pension is paid to all old persons and the disabled. Until 1956 these pensions were based on the contributions paid which, in turn, depended on the annual income of each beneficiary. The scheme was radically reformed in 1957, the contributory principle was abandoned, and a flat-rate system was introduced. Survivors' pensions to widows and children were introduced to the benefits in 1969, and unemployment pensions in 1971.

The change to flat-rate national pensions made it necessary to increase the pension protection of the wage-earning population. Another pensions scheme in which the pensions are proportional to the insured person's past earnings was created to complement the national pension scheme. This new scheme which entered into force in July 1962, covers wage and salary earners with the exception of civil servants, local government officers and seamen, who have long had their own special systems.

Since the beginning of 1970 earnings-related pensions have been extended to farmers and other self-employed persons.

THE NATIONAL PENSIONS SCHEME

Under the National Pensions Act all old and disabled persons receive a pension regardless of any other pension that they might receive.

The old age and invalidity pension consist of two parts. The basic amount is the same for everybody, and the assistance amount is in the nature of an assistance grant. Entitlement to and size of the assistance amount depend, among other things, on the beneficiary's other income and place of domicile.

The pensions are automatically adjusted to movements of the cost of living index.

The general age of entitlement to the old age pension is 65 years. The invalidity pension is aid to persons aged 16-64 incapacitated for work. In connection with these two pensions, helplessness supplements are paid to those requiring continuous assistance and care.

According to the law, old age assistance is paid to single women aged 60-64; provision is made for a funeral grant.

An assistance supplement is paid (since 1966) to persons who have practically no income in addition to their national pension. A housing allowance can be paid (since 1970) to pensioners who are entitled to the

assistance supplement. A child's supplement is paid to all pensioners with a child under 16.

The unemployment pension is paid to an unemployed person aged 58-64 who during the last 60 weeks has received a daily benefit for at least 200 days from an unemployment scheme and who cannot find work suitable for him/her. The benefit equals the invalidity pension payable to the beneficiary.

Survivor's pension is paid during the first six months after the husband's death to all widows below the age of 65, provided that she is supporting a child or she was married to him before he reached the age of 60. After that period the pension is paid only to a widow supporting a child under sixteen and to a widow aged 40-59 years and married for at least three years. The size of the pension during the first six months is the same as the full old age pension; after that period it is subject to a means test.

A child is entitled to the pension until the age of 16 or 21 if continuing studies. A full-orphan receives 40 percent and a half-orphan 20 percent of the total amount of the basic amount and the full assistance amount.

A care allowance is paid (since 1970) to children under 16 who need a special care of some other person because of illness, disablement or injury.

The costs of the scheme are jointly defrayed by the insured persons, employers, the State and local authorities.

The scheme is administered by the Social Insurance Institution, which is subordinate to Parliament.

THE EMPLOYMENT PENSIONS SCHEME

Wage Earners

The wage-earners' employment pensions scheme is based on two acts: the Employees' Pensions Act (TEL) and the Temporary Employees' Pensions Act (LEL). The latter is a special law for those employed in forestry, agriculture, construction and dock work, in which short-term contracts are common. TEL covers all other employees.

The compulsory pension protection under the acts consists of old age, full and partial invalidity, unemployment and survivor's pensions. The survivor's pensions were introduced to the benefits in 1967, unemployment pensions in 1971, and partial invalidity pensions in 1973.

Entitled to the old age pension is an employee of 65 years of age.

Entitled to the unemployment pension is an unemployed employee aged 58-64 who during the last 60 weeks has received a daily benefit for at least 200 days from an unemployment scheme and who cannot find work suitable for him/her.

Entitled to the full invalidity pension is an employee whose working capacity has gone down by at least three-fifths. If the decrease is less but at least two-fifths, the employee is entitled to the partial pension. When assessing employee's working capacity, his training, earlier work, age, housing conditions, and other comparable factors are taken into account.

Entitled to the survivor's pension are the widow and the children of the employee. The children are entitled to the survivor's pension after the death of both the female and the male employee.

The survivor's pension is payable to a widow, provided that she was married to the employee before he reached the age of 65. A further condition is that the widow has reached the age of 40 and that the marriage has lasted for three years. Also a widow under 40 years of age may receive the pension, if she has a dependent child who is entitled to the survivor's pension; the paying of the pension will continue even if the child's entitlement to the pension would cease. The pension will be payable to the widow until her death. The paying of survivor's pension ceases if the widow remarries, but she then receives a lump-sum equal to the amount of two years' pension.

A child is entitled to the pension until he reaches the age of 18 and even after this age, if he is disabled.

The size of the pension is governed under both acts by the wages paid and the period of service completed. Earned entitlement to a pension benefit continues when the job is changed or when the employee ceases to work.

The size of the old age pension is determined by taking 1.5 percent of the wage or salary and multiplying by the number of years of service. The wage or salary is the average annual earnings of the two most average years of the last four years of work. For seasonal workers the wage is the average of all pay received during the years employed.

Persons being retired since July 1975, get a minimum pension of 36 percent of the salary. That percentage will be 37 from 1982. Persons retired before July 1975, get 28 (29 from 1982) percent of the salary.

The maximum pension is 60 percent of the salary. However, combined with the basic amount of the national pension and some other pensions, the pension may not exceed 60 percent of the final pay. These limits are raised for persons in the lower wage brackets. Since July 1975, high employment pension has decreased the size of means-tested parts of the national pension.

The size of the invalidity pension is determined on the same bases as the old age pension. However, also the time between the event entitling to the pension and the age entitling to old age pensions is counted as time of service. The size of the partial pension is one-half of the full pension, however, at least 21 percent of the salary for persons retired before July 1975, but 52-66 percent if retired since July 1975.

The size of the unemployment pension equals the invalidity pension payable to the beneficiary.

The old age, invalidity and unemployment pensions are increased by the child's supplement; at the most 20 percent of the pension for one and 40 percent for two or more children under 18.

The size of the survivor's pension is calculated on the basis of the old age pension or invalidity pension the employee received or would have been entitled to at the time of his death. If there are at least three persons eligible for survivor's pension, they will receive a full pension, which is equal to the deceased employee's old age or invalidity pension. If there are two beneficiaries, the size of the pension is three-fourths of the full pension. If there is only one beneficiary, the size of the pension is one-half of the full pension.

Automatic linkage with the TEL-index (calculated by the average of changes occurred in general earnings and prices levels) is applied in employment pensions. It is applied in calculating the pay of earlier years and adjusting the annual pension payable.

Pension protection accumulates according to certain regulations also during the periods when the employee is out of work through no fault of his own and when he receives unemployment benefit from his unemployment fund.

Employers alone finance the compulsory minimum pension protection. The current contribution under the TEL and LEL is 11.7 percent of the salary of insured employees.

The employer may provide for his employees additional voluntary benefits, creating even better pension benefits than the minimum level guaranteed by law. Benefits that come into question here include a higher pension, lower pensionable age and funeral grant. Employees generally participate in the costs of such additional benefits.

The administrative organization of the employment pensions scheme is decentralized. Employers may elect the type of arrangement they wish for realization of the pension scheme. It may be done by taking out an insurance with an approved pension insurance company or by founding a pension fund or pension foundation in the employer's business. This choice does not apply as regards seasonal workers for whom the scheme comprises one special employment pension fund.

The work of the various pension institutions is coordinated by a central organ, the Central Pension Security Institute. It keeps the registers of the insured and their pension benefits. It will also keep a register of pensions covered by special pensions schemes. The general development of the scheme has also been entrusted to the Central Pension Security Institute.

The insured and the employers participate in the administration of the scheme through their representatives in the administrative organs of the Central Pension Security Institute. The highest authority under the scheme is the Ministry of Social Affairs and Health.

The Self-Employed

The self-employed persons' employment pensions scheme (closely connected with TEL) is based on two acts: the Farmers' Pensions Act (MYEL) and the Self-Employed Persons' Pensions Act (YEL). MYEL covers farms with cultivated area of at least 2 hectares, professional fishermen, and reindeer-owners. YEL covers other self-employed persons.

The benefits and qualifying conditions are like TEL. Old age pension is paid independently of whether or not the self-employed continues with his entrepreneurial activity.

The size of the pension is calculated like in TEL.

The added pension basis of farmer and his wife is (in 1979) 1 697 Fmks per hectare of cultivated land up to 12 hectares, and 694 Fmks per hectare for the following 10 hectares and 386 Fmks per hectare for the next 10 hectares and 154 Fmks per hectare for the last 10 hectares--altogether for 42 hectares. Pension basis of farmer's wife is Fmks 6 790 (in 1979), at the most one-half of the above-mentioned basis. Pension basis of assisting family member is the wages paid to him, at the most farmer's pension basis. Pension basis in YEL is fixed according to the salary the self-employed should have to pay if he hired some other person with corresponding qualifications to run his business, at the most 154 315 Fmks a year (in 1979).

Persons born before 1927 get greater pensions as they otherwise would be entitled to. Their amount of pension is 36 percent (future increase like in TEL) of the income. In YEL the age-class increment is calculated for annual income up to a maximum of 61 726 Fmks a year (in 1979).

Schemes are financed by the insured and the State. In MYEL the contribution of the insured is 4.8 percent of the income up to the amount of 24 690 Fmks a year (in 1979) and 12 percent of the income exceeding this limit. In YEL the contribution of the insured is 12 percent of the income. The percentage is smaller for the self-employed with low income. The State pays 50 percent of the costs of MYEL and in both systems the costs the contributions of the insured do not cover.

The administration of MYEL belongs to the Farmers' Pension Institution. The other self-employed have to take out pension insurance either in some of the pension insurance companies or pension funds taking care of TEL or in some pension fund or insurance company established by the self-employed. The Central Pension Security Institute is the central organ of MYEL and YEL as it is that of TEL.

Farm Closure Schemes

Farm closure pensions are paid (since 1974) to 55-year-old farmers who cease farming and sell the whole farm or the arable land--farm closure compensations can be paid to younger closures.

The pension is 137 Fmks per hectare up to 5 hectares and 31 Fmks per hectare for the following 10 hectares--altogether for 15 hectares. At the

age of 65 the pension is decreased because of farmer's receipt of MYEL and national pensions.

Costs of the closure pensions are met by the State; claimants under 65 pay a lump sum premium.

Administration belongs to agricultural authorities and the Farmers' Pension Institutions.

Change-of-generation pensions are paid (since 1974) to 58-64-year-old male and 55-64-year-old female farmers who transfer their farm to a close relative.

The pension is composed of a basic amount and a supplement. Basic amount equals the farmer's pension under MYEL, and the supplement under the basic and full assistance amounts of national pension. The pension is ceased at 65 when the farmer receives his MYEL and national pensions.

Pensions are financed by the contributions of farmers and the State to the farmers' MYEL-pensions scheme.

Administration belongs to--agricultural authorities and the Farmers' Pension Institution.

PUBLIC SECTOR AND OTHER PENSIONS SCHEMES

The regulations concerning the pension protection of persons in the employment of the State cover old age, invalidity, unemployment, and survivor's pensions and funeral grants. These benefits are financed by the State alone. The administrative organ is the State Treasure Office.

The pension protection of local government officers is based on the pension act which entered into force in 1964 and was modelled on the employment pensions act. The financing is managed by the local government and associations of communes. The Local Government Pensions Authority was founded for the administration of the scheme.

The persons covered by the Seamen's Pensions Act receive old age, invalidity and survivor's pensions and funeral grants. The insured and the employers jointly pay the contributions approved by the Ministry of Social Affairs and Health. The State also participates in the financing of the scheme. The scheme is administrated by the Seamen's Pension Fund.

Persons employed by the Evangelical-Lutheran and Orthodox Churches have separate pension schemes of their own.

SOME POPULATION DATA ON FINLAND

Finland's total population is 4.7 million (1976) of which 2.2 million are gainfully employed.

The distribution of the gainfully employed population by occupation is: agriculture and forestry 14 percent, industry and construction 35 percent, commerce 15 percent, transport and communications 8 percent and service industries 28 percent (1976).

Five percent of the total population are disabled and 11 percent over 65 years of age.

THE CENTRAL PENSION SECURITY INSTITUTE
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PENSION FIGURES 1978

THE INSURED UNDER THE EARNINGS-RELATED PENSIONS ACTS, Dec. 31, 1978

Employment pensions scheme (TEL 1 065 000, LEL 230 000 YEL 95 000, MYEL 260 000)[x)]	1 650 000 persons
State's pensions scheme (VEL)	240 000 "
Communes' pensions scheme (KVTEL)	300 000 "
Other pensions schemes	27 000 "

Simultaneous coverage of several pensions acts is possible.

NUMBER OF PENSIONS AND PENSIONERS, Dec. 31, 1978

	Employment pensions TEL, LEL, YEL, MYEL	State VEL	Communes KVTEL	National pensions
Old age pensions	242 000	49 000	22 000	554 000
Disability pensions	176 000	23 000	14 000	251 000
Unemployment pensions	5 000	0	0	4 000
Survivor's pensions	79 000	21 000	5 000	67 000
(Widows and children)	(106 000)	(26 000)	(6 000)	(67 000)
All pensions	502 000	93 000	41 000	876 000
All pensioners	529 000	98 000	42 000	876 000

NUMBER OF PENSIONS AWARDED IN 1978

	Employment pensions TEL, LEL, YEL, MYEL	State VEL	Communes KVTEL	National pensions
Old age pensions	31 000	7 000	3 000	44 000
Disability pensions	22 000	4 000	2 000	29 000
Unemployment pensions	3 000	1 000	0	2 000
Survivor's pensions	11 000	3 000	1 000	21 000
Total	67 000	15 000	6 000	96 000

AVERAGE MONTHLY PENSIONS, Dec. 31, 1978, FM

	Employment pensions TEL	LEL	YEL	MYEL	State VEL	Communes KVTEL	National pension
Old age pension	754	392	969	218	1 965	1 471	542
Disability pension	875	538	826	246	1 040	1 393	508
Unemployment pension	664	494	711	430	164	168	425
Survivor's pension	629	288	551	173	855	1 087	180

x) TEL = the Employees' Pensions Act
LEL = the Temporary Employees' Pensions Act
YEL = the Self-Employed Persons' Pensions Act
MYEL = the Farmers' Pensions Act

A TOTAL PENSION EXAMPLE;
- AVERAGE EMPLOYMENT PENSION +
- NATIONAL PENSION: single, no other income, second grade expense commune.

	Employment pension TEL	LEL	YEL	MYEL	State VEL	Communes KVTEL
Old age pension	1 224	1 009	1 333	966	2 140	1 646
- employment pension	754	392	969	218	1 965	1 471
Disability pension	1 286	1 046	1 262	973	1 369	1 568
- employment pension	875	538	826	246	1 040	1 393

EMPLOYMENT PENSIONS PAID IN 1978

	Mill.FM
Old age pensions	1 533
Disability pensions	1 415
Unemployment pensions	20
Survivor's pensions	420
Total, Minimum pension protection	3 388
Registered supplementary pensions	133
Grand total	3 521

STATUTORY PENSIONS PAID IN FINLAND IN 1978 (estimate)

	Mill.FM
Employment pensions (TEL, LEL, YEL, MYEL)	3 520
State's pensions	2 370
Communes' pensions	1 100
Other earnings-related pensions	170
Total	7 160
National pensions	5 520
Military, third party motor insurance and employment accidents pensions	940
Grand total	13 620

In addition voluntary pensions paid amounted to 530 mill.FM.

AMOUNT OF THE EMPLOYMENT PENSION BY INCOME AND PENSION PERCENTAGE

Pensions act	Average income in 1978, FM/month	Employment pension FM/month when pension percentage is 35 %	60 %
TEL	2 700	945	1 600
LEL	1 550	543	930
YEL	2 200	770	1 320
MYEL	800	280	480

PREMIUM INCOME IN 1978

	Mill.FM
TEL	3 455
LEL	475
YEL	270
MYEL	130
Total income for minimum protection	4 330
Premium income for registered supplementary pension protection	130
Grand total premium income	4 460

SOCIAL SECURITY EXPENDITURE IN FINLAND IN 1978 (estimate)

	Mill.FM	%
Sickness and health	7 200	24
Employment accidents	700	2
Unemployment	2 200	8
Old age and disability	13 000	43
Family and children	5 200	17
Pensions to military and war casualties	1 000	3
Others	1 000	3
Total	30 300	100

Social security expenditure amounted to 22.3 % of the GNP in market prices

LIABILITIES DEBT, Dec. 31, 1978

	Mill.FM
TEL	14 170
LEL	2 350
YEL	100
MYEL	70
Total, Minimum pension protection	16 690
Registered supplementary pension protection	1 140
Total liabilities debt	17 830

AVERAGE PREMIUMS IN 1979

TEL	11.7 %
LEL	11.7 %
YEL	10.8 %
MYEL	4.9 %

Liabilities deficit of 0.5 % under TEL and LEL arising in 1979 is to be levied back in 1980-1982.

AVERAGE TEL-PREMIUM IS DIVIDING IN 1979 AS FOLLOWS:

	%
old age pension part	2.9
disability pension part	2.7
survivor's pension part	0.9
equalizing part	4.9
others	0.6
total	12.0
liabilities deficit	- 0.5
amortization of 1978 liabilities deficit	+ 0.2
premium in 1979	11.7

STATUTORY PENSIONS AS PERCENTAGES OF THE GNP IN MARKET PRICES

Employment and public employees pensions	5.5 %
All pensions	10.4 %

STATUTORY PENSIONS AS PERCENTAGES OF WAGE BILL

Employment and public employees pensions	12.3 %
All pensions	23.4 %

CREDIT INSURANCE, Dec. 31, 1978

	Mill.FM
Gross liabilities	4 284
Net liabilities	1 536
Liabilities debt	145

GROSS NATIONAL PRODUCT IN 1978

	Mill.FM	
Wages	58 286,6	
Employers' social expenditure	14 191,7	
Income of private entrepreneurs	10 719,2	
Agriculture		3 707,0
Private forest proprietors		2 029,3
Others		4 982,9
Profits of corporate enterprises and surplus of public corporations	7 731,6	
Interest and rent income	10 107,2	
National Income	101 036,3	
Factors of productions income to foreign countries	2 447,8	
Deprivations	13 063,1	
Indirect taxes	20 068,7	
Less subsidies	5 839,6	
GNP in market prices	130 776,3	

POPULATION 1970-1985, in thousands

	Total population		Over 65 years		Disabled		20-64 years	
	1 000	Index 1970=100	1 000	Index 1970=100	1 000	Index 1970=100	1 000	Index 1970=100
1970(Dec. 31)	4 598	100	427	100	172	100	2 631	100
1975	4 720	103	509	119	249	145	2 786	106
1978	4 763	104	565	132	251	146	2 833	108
1980	4 787	104	574	134	255 (+ 4 %)	148 (+ 4 %)	2 869	109
1985	4 874	106	603	141	275 (± 10%)	160 (± 10%)	2 980	113

APPENDIX C: SWEDEN

FPG--PENSION GUARANTEE MUTUAL INSURANCE COMPANY (ANNUAL REPORT 1979)

The FPG is a non-profit mutual insurance company. It:

works in close collaboration with the Pension Registration Institute (PRI), which is jointly administered with the Swedish Staff Pension Society (SPP);

was established by the central pensions agreement of 1960 between the Swedish Employers' Confederation (SAF), the Swedish Industrial Salaried Employees' Association and the Swedish Foremen's and Supervisors' Association, thereafter under subsequent agreements, the latest being between SAF and PTK (the Salaried Employees' Negotiation Cartel for the Private Sector) in 1976;

has the object of guaranteeing pension commitments and contributing to the supply of capital to the policyholders;

fulfills these objects by writing credit insurance policies, in order to guarantee the pensions commitments in accordance with the said agreements or similar agreements, and to guarantee other pensions commitments to groups of employees;

had issued credit insurance policies at the end of 1978 covering pension commitments corresponding to a pension reserve of Skr 16.9 billion on behalf of some 1,850 policyholders.

FPG/PRI SYSTEM: 5-YEAR REVIEW

The past five-year period has seen rapid growth in FPG's insurance commitments, from Skr 7.5 billion at the end of 1973 to Skr 16.9 billion at the end of 1978, a total of 124 percent. During the same period the premium income has risen from Mkr 19.7* per year to Mkr 43.4 per year, or 120 percent, and the premium reserve has expanded from Mkr 97.1 to Mkr 220.8, some 128 percent.

The volume of claims during the period has been negligible, with the exception of the last two years, when FPG made disbursements in settlement of claims amounting to Mkr 21.1 and Mkr 32.5 respectively after recoveries through the right of subrogation. After deducting the reinsurers' share of the disbursements FPG's disbursements in settlement of claims amounted to Mkr 19.2 in 1977 and Mkr 28.7 in 1978.

The tables and diagram on the next pages show the principal data about FPG's commitments and financial progress during the past five years.

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*Mkr = million Swedish kronor.

SCOPE OF FPG COVERAGE

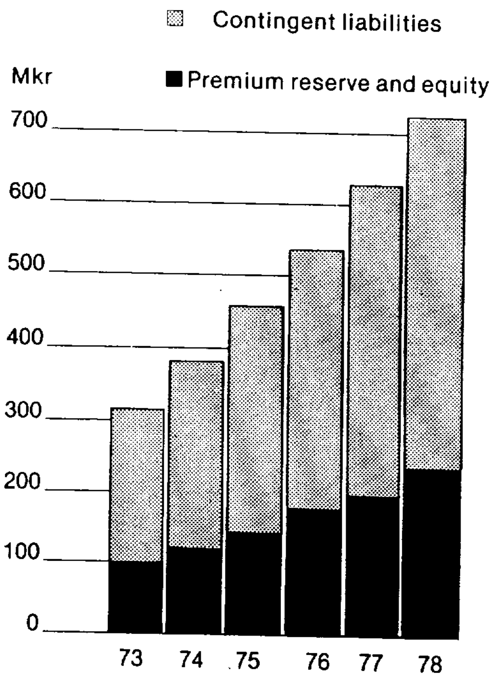
	1973	1974	1975	1976	1977	1978
Number of policies	1,715	1,713	1,697	1,717	1,804	1,855
Number of active employees in pension-earning age groups	226,000	234,000	244,000	252,000	258,000	259,000
Number of persons in receipt of sickness pensions	4,000	4,000	5,000	6,000	6,000	7,000
Number of persons with paid-up pension rights	90,000	94,000	96,000	100,000	104,000	108,000
Number of pensioners	25,000	27,000	30,000	33,000	37,000	40,000
Gross premium income, Mkr	+ 19.7	+23.1	+27.0	+31.8	+37.1	+43.4
Reinsurance premiums, Mkr	- 2.1	- 3.7	- 4.1	- 5.1	- 5.7	- 7.1
Premium income on own account, Mkr	+ 17.6	+19.5	+22.9	+26.7	+31.4	+36.3
Number of claims	9	5	4	4	23	27
Cost of claims, Mkr	- 2.7	- 1.1	- 1.3	- 0.9	-21.7	-42.1
Recovered through right of subrogation, Mkr	+ 0.6	+ 1.0	+ 1.0	+ 0.9	+ 0.6	+ 9.7
Received from reinsurers, Mkr	0.0	+ 0.2	0.0	+ 0.1	+ 1.9	+ 3.7
Net disbursements on own account, Mkr	- 2.1	+ 0.1	- 0.3	0.0	-19.2	-28.7

*Mkr = million Swedish kronor

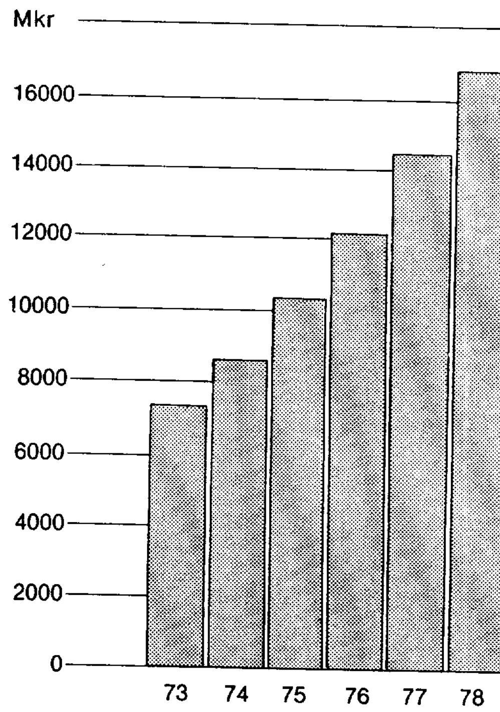
FINANCIAL STATUS OF FPG

	1973	1974	1975	1976	1977	1978
Investment income including capital gains, Mkr	+ 6.7	+ 8.4	+11.1	+14.3	+19.1	+21.0
Administration, net, Mkr	- 1.7	- 2.1	- 2.3	- 2.7	- 2.7	- 3.1
Transferred to premium reserve, Mkr	-17.9	-22.5	-27.3	-32.7	-19.3	-21.9
Result before write-downs and taxes, Mkr	- 2.7	+ 3.3	+ 4.0	+ 6.7	+ 9.2	+ 3.7
Premium reserve, Mkr	99.1	125.2	146.9	179.6	198.9	220.8
Equity, Mkr	1.1	1.1	1.1	1.1	1.1	1.1
Policyholders' contingent liabilities, Mkr	226.5	264.1	313.9	366.8	432.1	508.4
FPG's insurance risk, Mkr	7,549	8,805	10,462	12,228	14,404	16,945
Premium reserve + equity as % of FPG's insurance risk	1.33	1.43	1.43	1.48	1.39	1.31
Premium reserve + equity + policyholders' contingent liabilities as % of FPG's insurance risk	4.33	4.33	4.33	4.48	4.39	4.31
Premium reserve + equity + policyholders' contingent liabilities cover as % of FPG's insurance risk	4.38	4.48	4.48	4.53	4.49	4.48

FPG'S PREMIUM RESERVE, EQUITY AND CONTINGENT LIABILITIES 1973 - 1978



FPG'S INSURANCE RISK 1973 - 1978



AMF CREDIT INSURANCE - (ANNUAL REPORT 1978)

is a non-profit mutual insurance company;

was established as the result of the agreement in 1971 between the Swedish Employers' Confederation (SAF) and the Swedish Trade Unions' Confederation (LO) concerning special supplementary pensions for workers (STP);

has the object of making possible the reinvestment of pensions provisions and thereby contributing to the supply of capital to the policyholders;

achieves this object by writing credit insurance policies for employers' loans (STP loans) from the Labour Market Insurances Mutual Pension Insurance Company (AMF Pension Insurance);

has provided credit insurance at the end of 1978 for STP loans totalling Skr 1.8 billion, for 1,300 policyholders;

has entrusted the administration of credit insurance to FPG - the Pension Guarantee Mutual Insurance Company.

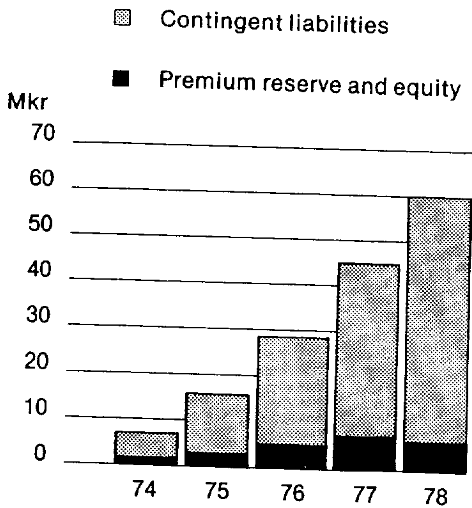
STP LOAN SYSTEM - 5-YEAR REVIEW

During the AMF Credit Insurance Company's first five years of business (1974-78) the volume of STP loans has risen rapidly. They - and therefore the insurance commitments of AMF Credit Insurance - had reached Mkr 1,800) by the end of 1978 - and are expected to reach Mkr 2,400 in 1979. In 1978, the premium income was Mkr 4.5. At the end of the year the premium reserve was Mkr 3.9.

During the first four years the claims volume was negligible, but in the fifth year, 1978, it exceeded the premium income. In 1978 the disbursements in settlement of claims of AMF Credit Insurance amounted to Mkr 5.9, after recoveries through the right of subrogation.

The tables and diagrams on the next pages show some principal data about AMF Credit Insurance's commitments and financial progress during the past five years.

AMF CREDIT INSURANCE'S PREMIUM RESERVE, EQUITY AND CONTINGENT LIABILITIES 1974 - 1978



	1973/74	1975	1976	1977	1978
Number of policies	714	853	967	1,145	1,298
Premium income, Mkr*	+0.2	+0.9	+1.8	+2.9	+4.5
Number of claims	0	1	1	5	19
Disbursements in settlement of claims, Mkr	0.0	-0.2	0.0	-0.8	-7.3
Recovered through subrogation, Mkr	0.0	0.0	0.0	0.0	+1.4
Net disbursements, Mkr	0.0	-0.2	0.0	-0.8	-5.9
Investment income, Mkr	+0.1	+0.1	+0.2	+0.5	+0.6
Premium supplement, Mkr	+0.3	+0.7	+1.1	+1.5	+1.9
Administration, Mkr	-0.4	-0.8	-1.1	-1.2	-1.4
Transferred to premium reserve, Mkr	-0.2	-0.8	-1.8	-2.2	+1.1
Result before write-downs and taxes, Mkr	0.0	0.0	+0.2	+0.7	+0.7
Premium reserve, Mkr	0.2	1.0	2.8	5.0	3.9
Equity, Mkr**	1.1	1.5	1.6	1.7	1.7
Policyholders' contingent liabilities, Mkr	5.7	13.8	23.4	38.2	54.0
AMF Credit Insurance's exposure, Mkr	197	461	781	1,275	1,799
Premium reserve + equity as % of exposure	0.66	0.50	0.55	0.51	0.31
Premium reserve + equity + policyholders' contingent liabilities as % of exposure	3.66	3.50	3.55	3.51	3.31

*Mkr = million Swedish kronor

**Equity includes the general reserve of Mkr 1.5 (In 1973/74 the equity was less than Mkr 1.5 on account of activated organizational costs of Mkr 0.4).

PENSIONS IN SWEDEN

PENSIONS IN SWEDEN

	National Plans	
	National Basic Pensions (AFP)[1]	National Supplementary Pensions (ATP)
Persons covered	All resident nationals, and non-nationals covered by social security convention	All salaried employees and wage-earners; self-employed may contract out
Pensionable income	(Flat-rate pension, irrrespective of income)	Income (incl social security sickness benefit and national partial pension) between the base amount for January (B) and 7.5 B
Old age pension: normal retirement age		
service period for full pension	—	30 years; reduction by 1/30 for each missing year; pension rights, expressed as pension points are earned between 16 and 64 (but not before 1960)[5]
amount, p.a.	Single pensioner: 95% of current B = Skr 12,445[2] Married couple, both entitled to basic pension: 155% of current B = Skr 20,305[2]	60% of the average of the pension points during the 15 "best" years, times the current B; maximum 0.60 × 6.5 × 13,100 Skr 51,090
early retirement	As from age 60, subject to reductior of 0.5% for each month short of age 65 when pension commences[3]	As from age 60, subject to reduction of 0.5 % for each month short of age 65 when pension commences. Early drawing of full pension may also cause loss of "pension point years"[3]
postponed retirement	Up to age 70; increase 0.6% for each month of postponement[3]	Up to age 70; increase 0.6% for each month of postponement[3]
Partial pension (National benefit under separate Act)	**Persons covered:** Salaried employees and wage earners with ATP pension points for 10 years from age 45, having worked 5 of the previous 12 months, reduced weekly working hours by 5 and being working at least 17 hours per week. **Pensionable income:** Amount of difference between sickness-allowance-carrying income before and after transfer to part time. **Amount of pension:** 65% of pensionable income. Partial pension payable between ages 60 and 65.	
Disability pension: conditions	Permanent disability of at least 50% (milder medical test for those over age 60)[4] or permanent unemployment after age 60	Permanent disability of at least 50% (milder medical test for those over age 60)[4] or permanent unemployment after age 60
amount in case of total disability	Amount of old age pension[2]	Amount of projected old age pension; maximum Skr 51,090 p.a.
Widow's pension: conditions	The widow has a dependent child under 16; or the widow had reached 36 at the time of her husband's death and the marriage had lasted for at least five years; replaced by old age pension at age 65	Mutual child is left; or the marriage had lasted for at least five years, and had taken place before the husband reached age 60.
amount, p.a.	Full pension: 95% of current B = Skr 12,445[2] A full pension is payable to: i) a widow with dependent child under 16; ii) a widow who had attained 50 when the husband died or the youngest child reached 16. In other cases reduction by 1/15 for each year short of age 50	If there is no child with entitlement to pension, 40% of the husband's projected or actual old age or disability pension; otherwise 35%
Child pension: conditions	Up to age 18	Up to age 19
amount, p.a.	If one of the parents had died: Normally 25% of current B = Skr 3,275 If both parents have died: Normally 50% of current B = Skr 6,550 If no ATP child pension, or only a trival one, is payable, amounts may be increased to a maximum of 40 (60) % of current B	If there is a widow with entitlement to pension, 15%, otherwise 40%, of the deceased's projected or actual old age or disability pension; this refers to the first child; for each additional child the percentage is inceased by 10
Indexation of current pensions	According to consumer price index, via current B	According to consumer price index, via current B
Vesting of old age pension	*Normal conditiion: residence in Sweden*	*After three years*
Contributions: employer	8.3% of payroll	11.75% of pensionable income
employee	None	None
Funding method	assessment system (over the national budget)	Assessment system, combined with considerable funding

Private Complementary Plans (according to collective agreements)	
ITP (sick pay insurance and complementary pensions[6]	**AGS (sick pay insurance) and STP (special complementary pension)**
Salaried employees	Wage-earners
Salary up to 30 B	AGS: Wages up to 7.5 B STP: Average of wages up to 7.5 B in the three "best" years during the five years in age 55-59; pensionable income is expressed as pension points
65	STP: 65
30 years and contribution payment up to pensionable age; reduction by 1/360 for each missing month; pension rights are earned from age 28.	STP: 30 STP years (1 STP year = 1 year with 832 hours worked); reduction by 1/30 for each full STP year missing; pension rights are earned from age 28[7]
10% of (final) salary up to 7.5 B plus 65% of salary between 7.5 B and 20 B plus 32.5% of additional salary up to 30 B; maximum pension in 1979 Skr 129,035	STP: 10% of pensionable wages (lower percentages for those retiring before 1981); maximum pension in 1979 Skr 8.843
As from age 55. Actuarial reduction if early drawing starts before age 62. If it starts at age 62 or later, the pension is fully paid, its amount being related to the extended payment period.	STP: None
Possible; actuarial increase	STP: UP to age 70; increase 0.6% for each month of postponement
Same conditions as for national partial pension. Covers income up to 30 B. Amount: 65% of income loss in the band 7.5-20 B +32.5% of loss in the band 20-30 B. Contributions for full ITP continue until age 65.	STP: No partial pension
Disability of at least 50%; waiting period 3 calendar months (may be shortened in the event of repeated sickness periods)	AGS: Disability of at least 50%; waiting period 30 days (may be shortened in the event of repeated sickness periods)
For salary up to 7.5 B: 95 (80) %, less social security sickness (disability) benefit. For salary band excessing 7.5 B, amount of projected retirement pension as of 1981	AGS: Sickness allowance period: Skr 3 daily; Disability pension period: Depending on covered income in national health, min Skr 90 monthly. Retroactively as from 8th day
Widow's or widower's pension. The marriage had taken place before the employee reached age 60 or had lasted for at least five years, or mutual child is left.	No survivor's pensions. However, national survivor benefits are supplemented by group life isnurance (TGL). TGL provides a lump sum of 6 base amounts in the event of death before age 55. If death occurs later, the benefit is reduced in inversed ratio to the employee's age at the time of death, and amounts to 1 base amount if death occurs between 64 and 65. No such reduction takes place if there are children under 17. Additional benefits are payable for children. Full benefits are payable if the employee was working at least 16 hous per week. If the employee was working less than 16 but not less than 8 hours per week, benefits are payable at the half rate. The base amount used for calculating benefits is the current B for November, the year before the year of death (current B for November, 1978 = Skr 12,600). TGL expires at retirement.
Widow(er) alone = 100% of a "basic amount": 32.5% of salary between 7.5 B and 20 B plus 16.25% of salary between 20 B and 30 B; max. in 1979: Skr 59,605. For salary up to 7.5 B normally no widow's or chid pension (but widower's pension of 20% of salary) is paid in addition to national pensions. Survivors are also protected through a group life insurance (TGL), about the same as for wage-earners (see square to the right).	
Up to age 20	
Widow(er) and children: Widow(er) + 1 child 130% of the basic amount, widower(er) +2 children 150%, for each additional child another 10%. Children only: 1 child 75% of the basic amount, 2 children 110%, 3 children 135%, 4 children 150%, for each additional child another 10%.	
Through annual decisons surplus is used to finance bonus supplements, which may not exceed increases in consumer price index In addition there is a special fund to be used in the event that surplus does not suffice to give full compensation for inflation	AGS: After 2 years' incapacity, indexation according to consumer price index via B; max. 4% p.a., calculated from beginning of sickness period. Max. may be exceeded if surplus allows. STP: Through annual decisions surplus is used to finance bonus supplements, which may not exceed increases in consumer price index
Immediately (as from age 28)	STP: Condition for entitlement to pension: i) 3 STP years from age 55 up to and including the year when age 64 is reached, or ii) totally 3 STP years, of which at least 0.25 STP year for each of the two years when ages 63 and 64 are reached
Individually calculated. On an average 10.4% of pensionable income. For each employee limited	AGS: 1.45% of pensionable wages STP: 2.85% of pensionable wages
None	None
Insurance (through SPP): Old age pension (above 7.5 B) survivor's pension, level premium system, other pensions on a risk premium basis. Book reserve system with credit insurance (through FPG): Old age pension	

Notes

The base amount for each month (current B) is calculated by the Central Bureau of Statistics and is linked to the consumer price index. The base amount for January (here abbreviated B) is applicable for the whole year to ITP, AGS, and STP, as well as for calculating pension points and contributions after ATP. Only **current** national pensions are affected by base amount changes during the year.

B for 1979	=	Skr 13,100
75 B	=	Skr 98,250
20 B	=	Skr 262,000
30 B	=	Skr 393,000

Current B for February, 1979 Skr 13,100

All benefits in this survey, except AGS and TGL, are taxable.

[1] Wife's supplements, child supplements, municipal housing supplements, handicap allowances, and allowances for disabled children are in some cases payable in addition to or instead of the national basic pensions.

[2] If a person who draws a national basic pension (single pensioner or spouse) is not entitled to any ATP (supplimentary pension) or is entitled only to a trivial ATP, his basic pension will be increased by 33% of current B (0.33 × 13,100 = Skr 4,323). The percentage is doubled for disability pensioners.

[3] Basic and supplementary pension must be drawn simultaneously. However, they may be split in halves which may commence at two different dates anywhere between ages 60 and 70.

[4] The payment of a disability pension is ussually preceded by payment of a sickness allowance under the national health insurance. Income up to 7.5 B is covered. In the event of total incapacity for work, the daily sickness allowance is 1/365 of 90% of covered income. In 1979, the maximum daily allowance is Skr 242. If a person's incapability for work is not total but amounts to at least 50 per cent, one half of the sickness allowance is paid.

[5] Nationals of Nordic Countries born in 1914, 1915, etc, will need only 20, 21, etc "pension point years" for full pension. For each missing year the reduction will be: 1/20 for those born 1896-1914 (incl), 1/21 for those born 1915, etc. For those born 1911-1927 pension points can be earned until age 65 inclusive.

[6] The pension percentages mentioned here represent the target levels set out in the 1976 ITP plan and to be achieved, after gradual increases, in 1981. The maximum pensions in Swedish kronor for 1979, after the third percentage increase of the 1976 plan are indicated.

[7] According to transitional provisions applying to those born June 1911-Dec 1931, 9-29 STP years are required for entitlement to full pension. STP years may be calculated as from 1965.

[8] The cost for limiting the individual contributions thus is spread out on all employers through a separate contribution calculated on a group basis.

100 Skr (Sw kronor) = 23.00 US dollars = 11.51

APPENDIX D: JAPAN

CHARACTERISTICS OF PUBLIC PENSION PROGRAMS
IN JAPAN

As of March 30, 1978

Schemes	Number of the Insured Persons	Number of the Old-age Pensioners	Monthly Average Amount of Pension
	thousand	thousand	yen
Employees' Pension Scheme (EPS)	23,903	1,437	76,000
Seamens' Insurance	288	29	100,000
Mutual Aid Association for National Public Service	1,172	232	106,000
" for Local Public Service	3,079	449	118,000
" for Public Corporation Staffs	805	232	113,000
" for Private School Teachers & Employees	293	8	85,000
" for Staffs of Agriculture, Forestry & Fishery Institution	458	47	72,000
National Pension Scheme (NPS)	27,198	3,920	18,000
Welfare Pension (non-contributory)	-	4,170	15,000
TOTAL	57,136	10,524	-

SOURCE: Annual Report on the Statistics of Social Security by the Office of the Prime Minister.

COVERAGE OF OCCUPATIONAL PENSION FUNDS IN JAPAN

Fiscal Year	(A) Number of the Insured Persons	(B) Number of Employees' Pension Fund	(C) Number of the Participants of Employees' Pension Funds	(C) / (A)
	thousand		thousand	%
1967	19,922	305	1,230	6.2
1968	20,720	453	2,083	10.1
1969	21,582	581	3,004	13.9
1970	22,260	713	3,861	17.3
1971	22,514	811	4,643	20.6
1972	23,112	853	4,930	21.3
1973	23,746	892	5,250	22.1
1974	23,654	917	5,309	22.4
1975	23,649	930	5,327	22.5
1976	23,847	938	5,388	22.6
1977	23,903	945	5,427	22.7

SOURCE: Annual Report on Social Insurances by the Social Insurance Agency.

OCCUPATIONAL PENSION SCHEMES IN JAPAN*

Outline of Occupational Pension Schemes in Japan

There are three types of pension plans in Japan: the plans of Employees' Pension Fund (EPF), tax qualified pension plans and unqualified private pension plans.

The history of these pension plans is not so old in comparison with that of European or American countries. Describing them in the historical order, the original of occupational pension plans began to appear at the end of 1950s in the form of unqualified private pension plans. This type of pension plan, however, neither exists widely nor has much significance today, because it contains no favorable points on taxation.

Then tax qualified pension plans were adopted in the light of an American plan, to be institutionalized in 1962. In order to clarify the purpose of this type of pension plan, an account will be given of retirement benefits in lump-sum which is peculiar to Japan.

The history of this kind of benefit itself is very old and dates back to Edo era, regardless of its name if ever changed.

It was not, however, until the W.W. II was over that these benefits became important as a system widely seen in companies in general.

While the public pension scheme from the pre-war period had nearly lost its function due to the fierce post-war inflation, the retirement benefits in lump-sum were revived corresponding to the firms' actual requirements with the idea of postponed payment of wages or of security for old age.

This program, combined with the post-war movements of trade unions, popularized itself very rapidly.

Although the retirement benefits in lump-sum are multi-functional, reflecting the needs and requirements of each age, and cannot be described in a word, the main functions are to support the life after retirement, to reward an employee for his or her service to the firm, or to provide for the immediate expenses at the time of retirement such as house purchasing expenses.

This type of plan has not only spread but also raised its benefit levels parallel to the employees' rising wage levels, because the structure of these benefits was linked to the wage at the time of retirement. That is the reason why employers could no longer ignore these problems nor see them as they go.

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*Prepared by Employees' Pension Fund Association for the Employee Benefit Research Institute, 1979.

First, they felt it necessary to standardize the annual amounts of payments.

Second, they wanted to decrease the burden of tax.

The tax qualified pension plan was institutionalized under the combination of the two requirements, the above mentioned employees' needs, and needs to secure employees' life after retirement.

As we can see in the process of introducing this type of pension plan, in many cases it means a reserved fund for providing the retirement benefits in lump-sum. Actually, 90 percent of employees choose to be paid in lump-sum, not as annuity, as status quo.

Finally institutionalized was EPF started in 1966 with which our organization, Employees' Pension Fund Association, is directly concerned.

Before this type of scheme was introduced, in the course in which the government had been trying to improve benefits and raise contribution rates, there arose a strong request from employers as follows.

It would be an excessive financial burden or double responsibility for employers to increase their share in contributions to public pension, because many employers already have had the burden of raising retirement benefits in lump-sum or of occupational pensions. Therefore some adjustment measures should be taken between the public sector and the private sector, partly because there are some good examples of such adjustments in foreign countries. EPF was institutionalized, taking account of this kind of request from employers and employees' response to it.

EPF is a public juridical person established under the authorization of the Minister of Health and Welfare to the extent that it fulfills the requirements of law, keeping strong relationship with the sponsor companies or the sponsor organizations of the same industries or professions. The benefits of EPF are composed of two sectors; one is a part of public pension, the sector which is administrated by the fund in place of the government, and the other is the sector to be provided by companies themselves in addition to the former (i.e., occupational pension's sector).

What was aimed at by this system was to adjust both the private and the national sectors--for instance, occupational pension benefits may be cut back in case public pension level is raised. Nevertheless, almost no adjustments have been made in reality with the help of long-continued high and rapid growth. And this pension scheme has been grown up as a vessel to develop both sectors in each direction.

Popularity of Occupational Pension in Japan

A research by the Ministry of Labor shows that in terms of the number of companies, 29 percent of those which employ not less than 30 workers have occupational pension plans as of 1975. (The same research shows 85 percent of the companies of that scale have retirement benefits in lump-sum.) Also, according to the recent inquiry carried out by one of the

leading newspapers, an increasing number of companies are considering about future adoption of occupational pension plans, which gives us an outlook of further popularization of the scheme.

In terms of the number of employees, the scheme covers some 10 million people. This figure occupies about 40 percent of the total number of what we call "employees" except farm workers, self-employed workers and public officials, etc. These 10 million people are constituted of 5,400,000 members of EPF and 4,600,000 members in qualified pension plans as of 1977.

Outline of Public Pension

Among 8 schemes of Japan's public pension program such as "Employees' Pension Insurance," "National Pension," "National Public Service Mutual Aid Association" or "Seamen's Insurance," the two major schemes are "Employees' Pension Insurance" and "National Pension." The former scheme is for employees in general, and the latter for the rest of the nation in general. The following is a survey of "Employees' Pension Insurance" which is related to occupational pension in terms of its membership.

(1) membership: compulsory to employees working for any company which constantly keeps not less than 5 employees, regardless of the kinds of industry except some particular ones.

(2) benefits: old-age pension, survivorship pension (both including transferred annuity from other pension schemes), invalidity pension, invalidity grant and withdrawal grant.

(3) benefits of old-age pension:

Occupational pension in Japan, either EPF, or tax-qualified pension, provides only old-age pension benefits and withdrawal lump sum. Therefore old-age pension will be explained in detail as follows.

a) requisites for entitlement:

1. 20 years of service.

2. pensionable age of 60 (55 in case of women).

3. retirement.

(Persons with low-income or of the age of 65 or more are entitled without retirement.)

b) benefits: composed of (1) the basic pension which is the sum of the fixed part and the wage-related part, and (2) the additional part which is to be added if the pensioner has a family to support. The wage-related part is to be calculated on the basis of his average wages while he had been employed. The model amount of benefits is 104,380 yen as

of 1978, for a person who had worked for 28 years with his average monthly wages of 136,000 yen.

(4) premiums: present rate is 91/1000 of earnings (women 73/1000).

(5) protection against inflation: earnings as the basis of calculation are revalued, and the amount of benefits in payment is adjusted in line with the price increases.

Outline of EPF

(1) motivation for establishment

EPF is a kind of occupational pension, but unlike tax qualified pension, it is essentially required to administrate a part of public pension in place of the government. A company or companies which are going to set up a fund find the merits in several ways. First, they get more favorable treatment in taxation than in case of qualified pension not only in return for the transferred part but also for the part of occupational pension. Second, they can get several merits from the entire reserved fund largely formed with the transferred part. Third, the system excels in guarantee and equity because it is administrated by an independent, public juridical person.

Despite these merits, there still remain some demerits such as government's strict control even over the occupational part, and a good deal of complicated work for fund affairs. They are open to future studies.

(2) requisites for establishment

In order to be authorized by the Minister of Health and Welfare, a fund must:

1. keep not less than a thousand employee members all the time,
2. have consent of the labor union,
3. provide two kinds of benefits, the transferred part, and the occupational pension part whose level shall be not less than 30 percent of the former part,
4. have an organization for independent decision and administration,
5. have a long-range and stable financial balance in prospect.

(3) types of funds

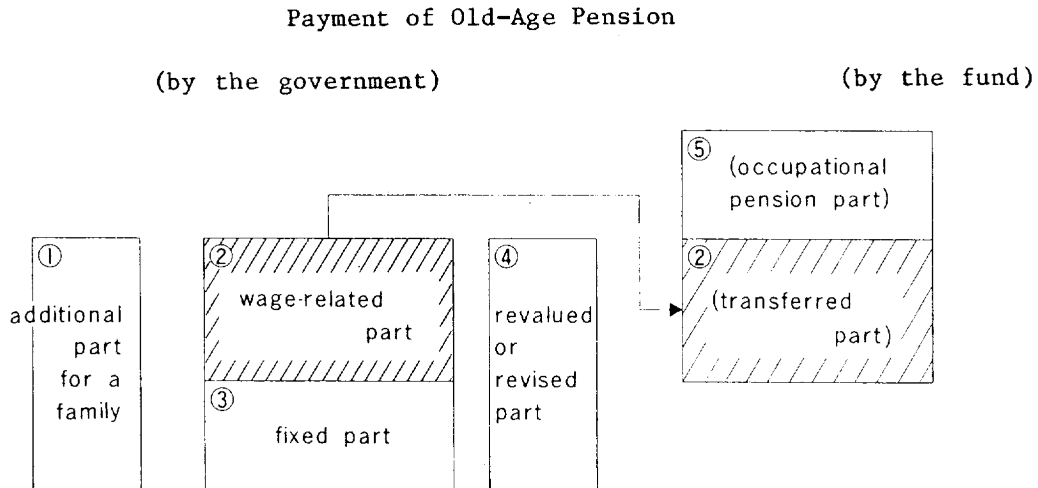
There are three types of funds. (1) one established by a single company, (2) one established by several companies bonded by capital, (3) one established by multi-companies of same industry or same profession.

(4) benefits

EPF provides old-age pension. Invalidity pension and survivorship pension are not paid from the fund.

As mentioned before, old age pension is composed of two parts. The transferred part corresponds to the wage-related part of public pension and the occupational part. As for the revalued part for members and revised part for pensioners against inflation, it is not the fund but the government to be responsible. This system is illustrated in the following chart.

Payment of Old-Age Pension



N.B. at present "the price-sliding system" is scarcely applied to the occupational part (5).

(5) contribution, government's subsidy

a) contribution

The fund is exempted from paying a part of the premiums on public pension mentioned in section 3 (men 30/1000 out of 91/1000, women 26/1000 out of 73/1000), in return for its administrating a part of public pension for the government. Instead, the fund itself collects necessary premiums from the employer and employee through the employer. The premiums on the transferred part are to be paid equally by the employer and the employee. As for the occupational part, the employer's share must be equal to or more than the employee's share. Extra premiums for repayment of the past service liabilities are to be paid only by the employer.

b) government's subsidy

The government subsidizes 20 percent of the payments of the transferred part, following the cases of public pension for

which the government also subsidizes 20 percent. There is no subsidy for the occupational part.

(6) administration and performance of reserved fund

The law requires that reserved fund shall be delegated to trust companies or insurance companies which are specialists of financial administration and performance of assets.

These trustees invest the funds to loans, bonds, stocks, etc. Practically, the highest share is to loans, next to bonds, the lowest to stocks. It is interesting to see that the order is quite reversed from the case of the United States.

This tendency in Japan seems affected not only by a somewhat conservative, and security-oriented posture of the trustees but also by the government's control over the investment such as i) at least 50 percent of the fund should be used for the capital-secured, ii) at most 30 percent for stocks, iii) at most 20 percent for real estate.

(7) finance

The fund is administered by the prefunding system. In order to maintain a sound financial status based on this prefunding system, the fund is put under the supervision of the government office in charge, regardless of the distinction between the transfered part and the occupational part.

a) strict examination of basic rates

All basic rates other than the expected rate of interest and the rate of mortality are to be fixed depending on the results of each company or fund. As for the expected rate of interest, 5.5 percent, a rather lower rate compared with the general market rates, is adopted.

b) adoption of adequate financial methods and early repayment of the past service liability

The major actuarial method adopted by the fund is the aggregate cost method (open) and the minor one is the entry age normal method. Especially in the former method, actuarial calculation is done under the appraisal of the proper number of the prospective members for each company or fund.

The past service liabilities, brought about either at the time of or after the establishment of the fund, must be amortized in not shorter than 7 years and not longer than 20 years, and ad hoc measures for extention of the period are seldom or never permitted.

c) financial control by means of closing of accounts and recalculation

The fund closes accounts on the annual basis, and looks into the financial status of the interim, contrasting the policy reserve with the reserved fund.

Unlike financial recalculation, the closing of accounts is not specifically aiming at the revaluation of the various basic rates to raise or cut the rate of premiums, but simply intends to check up the policy reserve. However, if the result of closing accounts shows a certain, excessive amount of insufficiency, an advance recalculation is to be carried out.

A financial recalculation is carried out every 5 years or less. At that time the basic rates such as the expected rate of withdrawal or the expected salary scale are reconsidered, and according to them is calculated the new standard premium to be put into implementation.

At the same time, a new and special premium is to be fixed and implemented for the purpose of redeeming the past service liabilities brought about at the time of and after the establishment of the fund.

(8) steps to take at the dissolution of a fund

The law provides that the following steps shall be taken when a fund is dissolved. A voluntary dissolution is also possible as well as a dissolution caused by the bankruptcy of the sponsor companies.

a) transferred part

Dissolution excuses a fund from the duties to provide its members and pensioners with annuity or a lump-sum. Instead, the government takes responsibility to pay public pension including the transferred part which used to be administrated by the fund, as if the fund had not existed at all.

This kind of case is accompanied by a liquidation step of retransferring the resources of the transferred part (which is called "Minimum policy reserve") to the government. But as far as this part is concerned, there is no insufficiency in securing the entitlement for the pension because the government is to take over the obligation unconditionally under the law, apart from such a step of liquidation.

b) occupational part

In case of dissolution, a fund is also exempted from the duties of paying annuity or a lump-sum to its members and pensioners.

Instead, the fund's remaining assets (which is the last amount after transferring the minimum policy reserve to the

government and paying the unpaid annuity for the past, and also settling the fund's debt if any) must be fairly distributed to members and pensioners, but with no repayments to the employers.

Here we have two problems.

i) Are remaining assets equivalent to the benefits pledged by the time of dissolution?

ii) Is it proper to pay that amount in lump-sum, instead of annuity?

The problem we are currently most concerned about is i), while ii) is only a matter of discussion if we should set up a national-scale organization to take care of financial administration and payment affairs of pension for the advantage of withdrawers or pensioners of the liquidated funds.

Now let us define the balance between the actual amount and the due amount supposed to be reserved by that time as "unfunded liabilities." A general tendency of the fund's liabilities will be as follows.

a) past service liabilities arisen at the time of establishment of a fund

As for the benefits of the occupational part, funds of a single company or of a unit of coalitional companies usually take the past service period into consideration. Therefore, with the immature history of the fund system, many of the existing funds as well carry unfunded past service cost more or less. On the other hand, few of the multi-employers' plans take account of past service period, which gives them very little trouble of this sort.

b) past service liabilities arisen afterward

This term will be used to mean inclusive of both past service liabilities, accompanied by the improvement of benefits and additional liabilities caused by the error in some of the basic figures or some of the basic rates of actuarial calculation.

The problems cannot be slighted in the former sense, because considerable number of funds make improvements in benefits.

As for the liabilities in the latter sense, serious problems are not likely to happen, because even the occupational part is strictly controlled in administering the finance, as is mentioned in (6) of section 4. But in case of such a firm as is in the wrong way in business, one cannot get blood out of a stone, whatever strict a control it may be imposed upon. Now more flexibility in finance is needed so as to meet the pace of funding to the company's economical situation. When this comes true, the

necessity of this kind of security measures will increase accordingly.

c) financial loss in performing the reserved fund

Since the trustees, at present, give priority over security and stability in their investment just as mentioned in (6) of section 4, there have been almost no trouble of financial loss. But now, the demand for more profitable performance is increasing. And if in practical side they lay more stress on such policy as to pursue capital gain through investing in stocks and so on, in proportion to the increase of danger will increase the necessity of some security measures.

Outline of Tax Qualified Pension Plans

Tax qualified pension plans are another kind of occupational pension, which is qualified by the government as suitable to the requests of law or ordinance. In this case, there exists no organization like EPF, and the ground of entitlement is not the pledge envisaged in such a regulation as an EPF's, but a direct contract between the company and an insurance company or a trust company. This is where qualified pension plans differ from EPF. The company, as the trustor, contributes premiums to the trustee who administrates and invests the resources and pays pensions to pensioners. Qualified pension plans enjoy some favorable treatments on taxation, but not as many as EPF does, due to the systematic differences from it, such as having no public pension part. Qualified pension plans are more flexible in planning, financing, etc. and simpler in procedures.

Employees' Pension Fund Association

In this final section we briefly deal with the structure and the functions of our organization, Employees' Pension Fund Association (EPFA).

EPFA is an association of the individual funds, and a body established directly under the provisions of the law, in order to pursue common interests of the funds. EPFA functions in the following three ways.

(1) payment of annuity to early leavers from EPF

EPFA pays due benefits in place of each fund to those who withdrew in under 10-year membership period. The transferred part is not whole but mainly the public pension part which is transferred to EPFA. Also on the request of a fund, benefits to persons with under 15-year membership can be provided by EPFA. In those cases EPFA takes over the amount of policy reserves.

Thus, EPFA has the function of co-ordinating center by providing benefits to early leavers from funds, for the convenience of both the funds and ex-members.

(2) performance of the following tasks for the development of the funds

a) promotions and communications on the fund affairs

b) supply of information about the funds

c) researches and studies on the fund affairs and pension plans

d) other necessary services for the development of the funds

(3) management of Pension Fund Center, "Seven-City"

EPFA operates "Seven-City." This center is equipped with such facilities as athletic equipments, big and small halls, rooms for study and training, a hotel, and a conference room with booths for simultaneous interpretation. These facilities are contributing to promotion of welfare for the members and the pensioners of EPF.

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EBRI Research Committee
United States

Vance Anderson, Director
Trust Division
American Bankers Association
United States

Charles R. Anding
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Dr. Emily Andrews
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