Employer Guarantee of Pension Benefits

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Chapter 3

Survey of Existing Practices and Attitudes

In order to throw much needed illumination on this neglected area of corporate practice, the author submitted a questionnaire, attached hereto as Appendix A, in July 1973 to 600 of the largest business firms in the United States. The firms were taken from the various directories of corporations compiled by *Fortune* magazine. The questionnaire went to the largest three hundred firms listed in the *Fortune Directory* of the Largest 500 Industrial Corporations and to all the companies (50 in each case) listed in the *Fortune Directories* of the largest firms in Finance, Retailing, Transportation, Insurance, and Public Utilities.

A total of 234 firms responded to the questionnaire, a response of 39 percent. Three of the respondents had no pension plan (each, however, had a profit-sharing plan) and thus did not complete the questionnaire. Six other firms refused to submit the requested information for various reasons, including the fact that they were currently engaged in labor negotiations which might involve the issue of corporate guarantee of pensions. Thus, there were 225 usable responses.

The occupational classification of the responding firms

is shown in Table 1. It will be noted that almost half of the respondents fall into the industrial classification—a natural, but gratifying, result since industrial firms constituted half of the sample. A disproportionately large percentage of insurance companies responded to the questionnaire, all but seven returning the questionnaire. This undoubtedly reflects their professional interest in the subject of pensions. Financial institutions (mostly banks) and public utilities responded well to the author's request, the response from retailing and transportation firms being disappointing.

TABLE 1

OCCUPATIONAL CLASSIFICATION OF RESPONDING FIRMS

Classification	*Number*	*Percentage of Total*
Industrial	107	48
Financial	29	13
Retailing	6	3
Transportation	15	7
Insurance	43	19
Public utilities	25	10
Total	225	100

The age of the pension plans reported is of some interest and significance and is shown in Table 2. Too much should not be read into the data since most of the respondents operate more than one plan, established at different times. For example, one company operates 54 plans. When multiple dates were given, the author recorded the date of the oldest plan. Some companies reported the date of the last major revision or the date on which several plans were merged, which probably explains why eight plans

were reported to have been established since 1970 and many others in recent years.

TABLE 2

DATE OF ESTABLISHMENT OF REPORTED PLANS

Period	*Number*	*Percentage of Total*
1970 or later	8	4
1965–69	7	3
1960–64	11	5
1955–59	16	7
1950–54	26	11
1945–49	34	15
1940–44	59	26
1935–39	17	7
1930–34	8	4
1925–29	5	2
Before 1925	16	7
Unreported	17	7
Total	225	100*

* Individual percentages do not add up to 100 because of rounding.

As might be expected, over half of the plans were established within the 15-year period from 1940 to 1955. Sixteen plans were established before 1925, one going back to 1904. Four of the plans were started in 1911, six in 1912, and three in 1913. As a group, the responding firms have had long experience with their pension plans and have had the opportunity of reaching settled positions on the various issues that impinge on the operation of pension plans.

Existing Pension Guarantees

Twenty-nine, or 13 percent, of the 225 companies that responded affirmatively to the questionnaire reported that they guarantee some or all of the benefits provided by their

pension plans. In over half of the cases, the guarantee goes back to the inception of the plan, this being characteristic of the plans reported by insurance companies. The oldest guarantee dates back to 1904, when the plan was first established; and the most recent was adopted in April 1973, the plan having been started in 1931. The second oldest guarantee was instituted in 1913 at the same time the plan was established. Most of the guarantees have been in effect for 25 years or more.

The occupational classification of the firms that currently guarantee some or all of their pension obligations is shown in Table 3. Thirteen of the firms are insurance companies and twelve are industrial enterprises, five of the latter being in the petroleum industry. Two transportation companies and two public utilities complete the list. None of the responding companies in the financial or retailing sectors guarantees its pension obligations.

TABLE 3

OCCUPATIONAL CLASSIFICATION OF FIRMS THAT CURRENTLY GUARANTEE SOME OR ALL OF THEIR PENSION BENEFIT OBLIGATIONS

Classification	*Number*	*Percentage of Responding Firms*
Industrial	12	11
Financial	None	0
Retailing	None	0
Transportation	2	13
Insurance	13	30
Public utilities	2	8
Total	29	13

By and large, the firms that have embraced the guarantee concept apply the guarantee to pension plans cover-

ing all their employees. Among the life insurance companies, the guarantee appears to cover all home office and agency office employees; and in some cases it applies to the sales representatives, sometimes through a separate plan. One industrial company includes a guarantee only in the retirement plan for salaried employees, while an airline company excludes the guarantee from the plan for pilots, all nonpilot employees enjoying the guarantee. In three industrial firms, the guarantee was negotiated by a labor union, but the guarantee seems to apply to the covered benefits of all company employees.

Benefits Guaranteed. Practices vary widely as to the classes of benefits that are made subject to the corporate guarantee. It would appear that with one or two possible exceptions, the guarantee covers all benefits that are in process of payment, whether they be payable because of age retirement, disability, or death. This, of course, is the minimum scope that one might envision for a benefit guarantee. Three companies limit their guarantee to benefits in payment status, one explicitly including benefits payable to participants eligible to retire but not actually retired. Eleven companies guarantee all accrued benefits, whether vested or nonvested and whether credited for past, or future, service. This represents the broadest possible application of the concept. Seven of these employers are life insurance companies, three are industrial organizations, and one is a public utility. Eleven firms limit the guarantee to vested benefits, including those in process of payment. Three of these guarantee only the vested benefits of *active* (as opposed to terminated or former) participants and benefits in process of payment. The other eight companies presumably guarantee the vested bene-

fits of terminated employees, since no mention was made of their exclusion.

One company guarantees all accrued benefits of employees who have had ten years of service after age 25. This sounds like a vesting requirement, but the company response did not explicitly tie the guarantee to vested benefits. Another company limits its guarantee to certain supplemental benefits that were provided for at the time of a major change in the plan to assure that no participants would receive a smaller benefit under the amended plan than would have been payable under the original terms of the plan. The supplemental (or minimum) benefits are nonvested and are paid directly out of corporate funds rather than from plan assets. Yet another firm guarantees all benefits in process of payment, irrespective of when the benefits were earned, and all benefits credited to active and terminated employees for service prior to 1960. This is the only instance brought to light by the questionnaire of a retrenchment in the scope of the guarantee. Prior to 1960, the benefits of the plan were based on career average compensation, and the company guaranteed all future service benefits[1] and all past service credits *to the extent that they had been funded.* In 1960 the plan was amended to base benefits upon final average compensation, and the company decided it did not want to guarantee benefits of indeterminate magnitude, except for service up to the date of plan amendment. Under the amended plan, it continues to guarantee all benefits in process of payment.

Finally, one of the collectively bargained plans calls

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[1] That is, all benefits related to service rendered after establishment of the plan.

for the employer to guarantee the retirement benefits, and related spouse's benefits, of each employee who retires during the term of the labor agreement. The agreement specifies that the employer must fund the benefits of a retiring employee within one year from date of retirement.

These practices are summarized in Table 4.

TABLE 4

BENEFITS SUBJECT TO EMPLOYER GUARANTEES

Scope of Guarantee	*Number of Firms*
All accrued benefits	11
All vested benefits	8
All vested benefits for active participants and all benefits in process of payment	3
Only benefits in process of payment	3
All accrued benefits of employees with 10 or more years of service after age 25	1
All benefits accrued prior to 1960 and all benefits in process of payment	1
Nonvested nonfunded supplemental benefits	1
Benefits of employees retiring during term of labor contract	1
Total	29

Source of the Guarantee. In the great majority of cases, the provision that the employer construes as a guarantee of benefits appears in the plan document. The provision is usually found in the section of the plan document dealing with termination of the plan and the consequent allocation of plan assets among the various classes of participants. This pattern was especially apparent among the plans of life insurers. As a general rule, a reference to the benefit guarantee is contained in the plan booklet or

other explanatory material distributed to the participants. However, several companies stated in the questionnaire that they have not called the guarantee to the attention of the participants, no reason being given.

In the three cases where the guarantee was the result of collective bargaining, a provision intended to embody the concept is included in both the collective bargaining agreement and the plan document. The wording of the provision in the two separate documents is not identical, however.

In one reported case, the language that the employer construes to be a guarantee appears only in the plan booklet. In the words of the secretary of the company, in a letter to the author: "The booklets are unqualified in holding out that plan participants can look to their retirement benefits as assured security after retirement." The persons responsible for administration of the plans of the company are proceeding on the assumption that the courts, faced with a conflict between the language of the plan document and plan booklet, would rely upon the language of the latter to establish a contractual obligation, even though copies of the plan are distributed to the participants. The conflict in language has not been before the courts, nor has the top management of the company itself adopted an official position on the matter.

The most recent guarantee reported in the questionnaire was brought into existence through a resolution of the board of directors and has been called to the attention of the participants only through an item in the company's newsletter for retired employees. Presumably, the plan will ultimately be amended to reflect this decision.

Manner in Which the Guarantee Is Expressed. The guarantee is expressed in a rich variety of ways, some subtle and some vague and ambiguous. The actual word "guarantee" seldom appears in the provision that the company construes as a guarantee. In some plans the intent to guarantee benefits is explicit and very clear, while in others the only basis for treating the provision as a guarantee is that the company has declared it to be such, at least in response to the questionnaire. In two cases, the guarantee rests upon the *absence* of a provision, the conventional one that limits the corporate obligation to monies already contributed. In fact, the plans of these two companies make no reference to a trust or to funding, even though in each case a trust was established to accumulate assets for the payment of pension and related benefits. It can be argued with considerable logic that any company which states its intention to provide a set of pension benefits, without restricting its obligation either to monies already set aside or in some other manner, has made a commitment to pay benefits that is enforceable against general corporate assets.

It is not feasible to reproduce the verbatim language of all the provisions that the responding firms consider to embody a corporate guarantee to provide specified classes of pension and related benefits. It is feasible and instructive to examine the approach taken by the various companies and to note some of the more distinctive provisions. Some of the provisions are distinguished by their vagueness and others by their explicitness. In each case, however, the respondent made it abundantly clear to the author—either by questionnaire, letter, or telephone—that it views

the cited provision as one that under the defined circumstances could place on the employer an obligation to make an additional financial commitment to the plan, or its beneficiaries, over and above any contributions that may have already been made.

The most subtle approach to a guarantee is simply to omit any reference to the trust or the funding process. This is not to suggest that the responding companies that use the approach deliberately sought to be subtle. The plans were established in the early stages of the private pension movement in the United States, before it had become customary to limit the employer's liability to monies already set aside.[2] The companies openly proclaim the guarantee in communications addressed to employees, and they have every intention of making good on their guarantee in the unlikely circumstance that it should become necessary.

Among the responding firms that perceive a guarantee in plan provisions that are not explicit, to say the least, is a well-known public utility that established its plan in 1913. This firm asserts that it guarantees all accrued benefits, including the vested benefits of terminated employees, on the strength of a statement in the plan that in the event of plan termination the company will undertake to "preserve the integrity" of the trust funds established and maintained for the payment of retirement and death benefits. A company officer stated in a letter to the author that from the time the plan was established, the company has regarded it as a "binding contract with the employee." This was true during the years before 1927 when the bene-

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[2] One of the plans was established in 1904.

fits were being financed on a pay-as-you-go basis and the company's obligation was not as "completely defined."

The corporate guarantee of a responding airline must be inferred from an interrelated set of plan provisions. The plan for nonpilot employees of this airline states that "the obligation of the company under the nonpilot plan shall be limited to obligations specifically assumed by it hereunder." It goes on to stipulate that the firm shall not be liable in any way as guarantor of payment of benefits obligated to be paid by any of their funding agencies (insurers and banks), so long as, in the opinion of the actuary selected by the company, the amounts set aside in trust or with life insurers "are sufficient to constitute a funding of the benefits payable hereunder on an actuarially sound basis." The strong implication of this provision is that the company would be liable only for any deficiency between actual contributions and those called for by the actuary's recommendation. By way of an exception to its general declaration of nonliability, the company indicated that it would be responsible for any benefits that did not fall within the contractual arrangements with life insurers or the terms of relevant trusts. The company has concluded that it may have a conditional liability for benefit payments under the terms of these provisions.

A life insurance company sees a guarantee in a plan provision which states that if the company should permanently discontinue contribution to the plan, the latter shall be continued solely for the purpose of paying benefits to all individuals who were already receiving benefits, or were eligible to receive benefits, and to those whose benefits had already vested. Nothing is said in the plan about additional employer contributions.

On the other hand, there are a number of very explicitly stated assumptions of corporate responsibility for benefits. In its termination section, the plan of an oil company states that the "company *guarantees* (italics supplied) that the retirement income credits already accrued on account of a participant's service prior to the date of such discontinuance . . . will be paid in accordance with this plan as it is then in effect." The plan of another oil company stipulates that "when a covered employee acquires annuitant status, he at the same time acquires a *matured right against the employer* (italics supplied) to his Noncontributory Retirement Annuity, if any." Similar language is included in the plan to cover other matured rights.

In the same vein, the plan of a large life insurance company specifies that "all payments required by the provisions of the plan shall be a *liability* (italics supplied) of the company, and shall have the same status as obligations under its policy contracts." The plan of another life insurance company stipulates that "all benefits set forth in this plan that are payable after its termination shall continue to be due and payable to, or on account of, all members as of the effective date of termination of plan, *first from the plan assets* (italics supplied) to the extent they are sufficient and after such assets are exhausted, as an *obligation* (italics supplied) of the employer." The plan of still another life insurance company provides that upon termination, the company as an insurer will deliver to each participant or beneficiary a *written contract* (italics supplied) promising to pay all the benefits that had accrued to date of termination. The plan of a fourth life insurance company states that the benefits of all "members

retired prior to the date of . . . discontinuance of the plan are *unconditionally guaranteed* (italics supplied)." For all active participants in the plan at date of termination, a paid-up deferred annuity is guaranteed in the amount, and under the conditions, stated in the plan. Finally, a fifth life insurance company, as insurer, *agrees with itself as employer* to pay the retirement and life insurance benefits provided in the pension plan.

Most of the other guarantees take the form of exceptions to the general rule that the participants and their beneficiaries must look to the plan assets for satisfaction of their claims. The exception generally appears in the section of the plan dealing with termination and allocation of available assets and states that the benefits of specified classes of claimants shall be payable despite an insufficiency of assets.

In summary, an employer may assume a corporate obligation for payment of its pension plan benefits through:

1. omission of any reference in the pension plan to the trust or other medium used to fund the pension benefits;
2. omission, deliberate or inadvertent, of a plan provision limiting the employer's liability to funds already set aside;
3. a plan provision excluding certain classes of benefits from the general stipulation that participants and their beneficiaries must look to the plan assets for the satisfaction of their claim;
4. a plan provision that describes the employer's responsibility for the payment of covered benefits as:

a. a guarantee, conditional or unconditional;
b. a liability;
c. an obligation;
d. a matured right against the employer;
e. a written contract; or
f. an agreement of a life insurance company in its dual capacity as employer and insurer;

5. a provision or set of provisions, taken as a whole, that they may be construed as imposing an obligation, imperfectly defined, beyond that associated with the traditional unilateral undertaking; or
6. an unqualified statement or statements in a plan booklet that the employer will provide stipulated benefits.

Manner in Which the Guarantee Is Implemented. The corporate guarantee of pension benefits, however expressed or conveyed, would normally become operative upon termination of a plan at a time when the assets are insufficient to provide the benefits subject to the guarantee. It is conceivable, of course, that the guarantee would become operative while the plan was still functioning, but without sufficient assets to meet currently due benefits. The presumption is that the corporate guarantor would make the necessary additional contributions to the pension plan (or to the related trust or group annuity contract), but some of the guarantee provisions explicitly state that the company will satisfy its obligation through direct benefit payments to the plan participants or their beneficiaries. In most cases, the plan is silent as to how the employer will implement his guarantee.

Life insurance companies constitute a special case. They

are both employers and professional guarantors. They typically underwrite their own pension plan, using a formal group annuity contract and issuing certificates to their participating employees. Any benefits that have been funded are guaranteed in the normal course of events, just as if they had been purchased by an independent employer contract holder. This led some insurance companies to respond in the questionnaire that they guaranteed the benefits of their pension plan when, in fact, they had not committed themselves to fund or otherwise assume responsibility for all benefits (or a class thereof) accrued at date of plan termination. These companies were excluded from the group of guarantors being discussed in this section. The real guarantors among the life insurance companies, 13 among those responding to the questionnaire, promise to pay the guaranteed benefits, either as an insurer or as an employer, making direct payments to eligible persons.

The life insurance companies are unanimous in their belief that the benefit claimants under their pension plans would have the same creditor status as claimants under their regular insurance or annuity contracts, namely, general creditors. Most of the other respondents were unwilling to venture an opinion as to the ranking or preference that should be assigned by law to persons claiming their guaranteed benefits. A few took the position that such claimants should be general creditors, while one would assign a preference below unpaid wages but above taxes.

Effect of the Guarantee on the Credit Status and Financial Policies of the Firm. None of the reporting firms felt that the guarantee of pension benefits has had any

adverse effect on their credit status; nor have they been able to discern any impact on their corporate financial policies. This favorable state of affairs is unquestionably attributable to the fact that with two exceptions, the assets in the plans are well in excess of the actuarial value of the guaranteed benefits. Among the other favorable consequences of this condition is the fact that the companies have not found it necessary to show an unfunded accrued liability in their balance sheet, as would otherwise have been required by Accounting Opinion 8 of the Accounting Principles Board. Most of the life insurance companies reflect the actuarial value of the guaranteed benefits on their balance sheets, but only as part of their policy reserves and as a consequence of their having underwritten the benefits as insurers. The company that guarantees the unfunded supplemental (minimum) benefits of its plan holds a balance sheet reserve in recognition of its liability for such benefits. Moreover, a life insurance company whose actuarial liability for guaranteed (all accrued) benefits slightly exceeds the plan assets shows the difference on the liability side of its balance sheet, without an offsetting item on the asset side.

In discussions of corporate guarantees of pension benefits, concern is frequently expressed over the relationship between the unfunded liability for guaranteed benefits and the net assets of the company. The real question, of course, is the relationship between the liability and the resources the company could marshal to meet it. Nevertheless, a comparison with net assets is indicative, and a question calling for such a comparison was included in the questionnaire. As was indicated above, the actuarial liability for guaranteed benefits was fully funded for all

the responding firms except two, so that the guarantee poses no present threat to the solvency of the companies. Even if the guaranteed benefits were completely *unfunded,* they would not constitute a threat to the solvency of most of the responding firms. For the great majority of the companies, the actuarial value of the guaranteed benefits is less than 20 percent of their net worth, the percentage being less than 10 percent for eight of the companies. In only five cases does the actuarial liability exceed 20 percent of the company's net worth, the specific percentages being 36, 45, 58, 74, and 114. In the latter company, the percentage reflects the actuarial liability for all accrued benefits rather than just the guaranteed vested benefits, no separate breakdown being available for the guaranteed benefits. In any event, all the guaranteed benefits are fully funded, as they are for all five of these companies.

Attitudes of Responding Firms Toward Mandatory Guarantee of Benefits

All the firms to which the questionnaire was sent were asked whether they favor federal legislation requiring an employer to guarantee the benefits of his pension plan (*a*) as a matter of general public policy or (*b*) as an essential element of a mandated program of plan termination insurance. The question was asked against the background of a covering letter that referred to pending legislation that would establish a program of plan termination insurance, under which employers would have a contingent liability for the unfunded portion of insured benefits. The questionnaire also contained an explanatory note

that defined "pension benefit guarantee" as used in the questionnaire. Unfortunately, the question that sought attitudes toward mandatory guarantees was faulty in that it failed to distinguish between the respondent's attitude toward plan termination insurance and his attitude toward the imposition of an employer's contingent liability for unfunded insured benefits *if a program of plan termination insurance were to be enacted.* The result was that many respondents simply answered that they were opposed to plan termination insurance, without indicating their independent attitude toward the employer's contingent liability aspect of the proposal.

Despite the faulty structure of the question, 76 companies, or 34 percent of the respondents, indicated that they favor mandatory employer guarantees, either as a matter of general public policy or as an essential feature of plan termination insurance. Specifically, 49 companies stated that they would favor mandatory guarantees *only* as an essential feature (necessary evil?) of plan termination insurance; 14 favor them as a matter of general public policy (but not as a part of plan termination insurance); and 13 favor them *both* as a matter of general public policy and as a necessary safeguard in a program of plan termination insurance. Several companies qualified their response to indicate that the guarantee should apply only to vested benefits, while others stated that it should apply only to benefits accrued for service after inception of the plan. One firm stated that the guarantee should be limited in amount and be subordinated to "most other liabilities"; another thought the guarantee should have the status of unpaid wages; another recommended that the guarantee take effect gradually; and another cautioned that the guar-

antee should be limited in such a manner as not to force the firm into bankruptcy or insolvency. A number of companies volunteered the information that they were currently considering the desirability of guaranteeing their pension benefits. It is of some interest that only 14 of the 29 companies that now guarantee some, or all, of their pension benefits favor mandatory guarantees. Nine of these fourteen companies are life insurers.

The occupational classification of the firms that favor some form of mandatory employer guarantee of pensions is shown in Table 5. Over half of the insurance companies favor the proposition, and about a third of the firms in the industrial, financial, and transportation sectors. Public utilities and retailing firms were much less receptive to the idea.

TABLE 5

OCCUPATIONAL CLASSIFICATION OF FIRMS FAVORING MANDATORY EMPLOYER GUARANTEE OF PENSIONS

Classification	*Number*	*Percentage of Responding Firms*
Industrial	32	31
Financial	10	34
Retailing	1	17
Transportation	5	33
Insurance	24	56
Public utilities	4	16
Total	76	34

Additional light on company attitudes toward employer guarantees was provided through a question on whether the omission of a guarantee from their pension plans was a result of a conscious decision not to provide such a pro-

vision or the routine inclusion of the customary limitations on the employer's obligation under the plan. About a third (73) of the respondents reported that the omission was the result of a conscious decision. One company in this category, however, revealed that when one of its pension plans was terminated with an insufficiency of assets, it voluntarily contributed enough additional monies to enable the plan to provide all accrued benefits.

Eleven companies reported that they had received formal requests from a collective bargaining unit for an employer guarantee of pensions. Most of these requests had been made within the last two years, four of them in 1973. The earliest request was in 1968.