Employer Guarantee of Pension Benefits

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Chapter 1

Customary Limitations on the Employer’s Commitment

It is customary for the sponsor of a single-employer, nonbargained pension plan to hedge his commitment under the plan through the inclusion of certain provisions that have become fairly standardized. The first provision, not found in all plans, makes it a matter of record that neither the establishment of the plan nor participation in the plan by a particular employee shall create any obligation on the part of the employer to provide continued employment to the employee in order that he may qualify for the proffered benefits.

The second provision, which is found in almost all plans of this genre, gives the employer the unilateral right to alter, modify, or terminate the plan at any time. However, no action under the authority of this provision can operate to curtail, modify, or terminate any pension credits already earned, except as may be necessary under IRS regulations to prevent discrimination in favor of the 25 most highly paid employees. Moreover, retroactive tax penalties may be imposed on the employer and the plan for termination during the first ten years of the plan’s existence for a reason other than “business necessity,” as construed by the IRS.
A third provision, more critical in some respects than the foregoing, reserves to the employer the right to suspend, reduce, or discontinue contributions to the plan at any time and for any reason, except that during the first ten years the reason must be "business necessity" if retroactive tax penalties are to be avoided. Implicit in this provision is the right of the employer to discontinue contributions to the plan even though the accumulated assets may not be sufficient to provide all the benefits already accrued.¹

A fourth clause implements the third by stating that in the event of termination of the plan, or the discontinuance of contributions thereunder, the employer shall have no liability for the payment of accrued benefits beyond the contributions already made. In other words, if the plan were to be terminated, the participants and their beneficiaries would have to look to the assets in the plan, including any annuities that may have been purchased from life insurers, for the satisfaction of their claims. The employer might voluntarily make additional contributions to the plan—or pay the benefits out of his own resources—but he would have no legal obligation to do so. If the plan assets proved to be inadequate—as they are likely to be for years after the plan is established or retroactively liberalized—the benefits of all claimants would have to be scaled down or priorities established, with the possibility that some participants would receive nothing. Some plans do not contain an express limitation on the employer’s liability, reliance being placed on the employ-

¹ As used in this treatise, "accrued benefits" means benefits based on creditable service prior to the time of determination.
er’s reserved right to discontinue contributions. In lieu of a specific statement that the employer’s liability shall be limited to contributions already made, some plans simply make provision for scaling down the accrued benefits to fit the assets available.

A final limitation on the employer’s undertaking, of a general nature and not found in all plans, is a statement that except for willful misconduct or lack of good faith, no legal or equitable rights against the employer shall be created or exist under the plan. The primary purpose of such a provision is to protect the firm and its agents against legal or equitable action arising out of the administration of the plan, but the language seems broad enough to be invoked against a participant or beneficiary seeking to compel the employer to make good on the benefit rights accrued under the plan.

The employer does not generally have all the foregoing rights under a pension plan subject to collective bargaining. A bargained plan cannot be altered, modified, or terminated without the consent of the bargaining agent, unless such rights have been reserved to the employer—an unlikely situation. Moreover, under some collectively bargained plans, the employer undertakes to provide a pension benefit of a specified amount to all employees who retire during the term of the applicable labor agreement. Termination of the plan at any subsequent date would not relieve him of this obligation.

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2 An employer does not need a provision in a collectively bargained plan giving him the right to alter, modify, or terminate the plan or to suspend, reduce, or discontinue contributions, since the continued existence of the plan depends upon the continued existence of a related collective bargaining agreement.