GOVERNMENT REGULATION OF PENSION PLANS THE AMERICAN EXPERIENCE

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The purpose of this article is to provide sufficient background and details regarding pension regulation as it now exists in the United States of America to permit interested persons from other countries to appraise its general thrust and effectiveness. Any other country that considers increasing the degree of pension regulation should benefit from the U.S. experience and avoid some of the excesses and complexities of the U.S. regulation of pensions. [1]

Rather than concentrate solely on the technical details, an effort has been made to set out the thinking of the various parties involved in developing the legislation and accompanying regulations. The Pension Reform Act of 1974 was a bill of some 300 plus pages and the regulations are indeed complex, voluminous and even at this late date, only about two-thirds complete. Thus, it was necessary to select a number of specific topics to discuss in some detail in order to give some general appreciation of the problems involved.

Background

The arrangements made by private companies in the United States for retirement of their employees commenced with the American Express Company Plan in 1875. This Plan provided a retirement income of 50% of pay to employees who were age 60 or more, totally and permanently disabled and who had more than 20 years of service. From this rather limited beginning, about a dozen pension plans were adopted by private companies, railroads and public utilities by 1900. In the 1920's the tax laws were clarified so that employer contributions toward the normal cost of pension programs were deductible when paid, payments towards past service liabilities could be deducted up to 10% of the original liability per year, the employees were taxed when they received the benefits and the interest earnings on the accumulated funds if held in trust or by an insurance company were essentially tax exempt. By 1930 there were only 393 private pension plans in operation and fewer than half of the 200 largest corporations had plans. The adoption of pension plans was seriously retarded by the depression in the 1930's but the wage stabilization rules and excess profits taxes during the 1941-45 war encouraged the adoption of a substantial number of "war baby" plans.

In 1942, the Internal Revenue Code was amended and the favored tax treatment was restricted to pension plans which met new and stricter requirements of the Internal Revenue Code, chief of which were that such plans must cover 70% of all employees (or 80% of eligible employees if 70% or more are eligible) and must provide benefits that do not discriminate in favor of officers, shareholders, supervisors, or highly compensated employees. The legislative history clearly indicated that a plan that provided uniform percentage of pay to retiring workers, including their Social Security benefits, would meet this test. From this simple legislative requirement, the Internal Revenue Service over the following 25 years developed a fairly extensive set of regulations which retirement plans were required to meet in order that they not be considered discriminatory. Furthermore, the 1942 Code set forth certain limits on the amount of contribution that an employer could deduct for tax purposes. Essentially an employer was permitted to deduct up to 5% of payroll, the aggregate cost of the plan as a level dollar amount or percent of payroll or the normal cost plus 10% of the initial past service liability. The Internal Revenue Service concentrated primarily on making certain that employers did not over-deduct and understate their tax liabilities. While the Internal Revenue Service did set minimum funding standards at normal cost plus interest on a cumulative-to-date basis as a test of the permanence of the pension commitment, there was little effective testing done as to whether actual contributions had met this minimum or whether the actuarial assumptions were overly liberal. The entire thrust of U.S. pension regulation, therefore, up until the passage of ERISA in 1974, centered about the coordination of benefits with Social Security, (called "integration"), prohibiting discrimination in favor of highly compensated or shareholder employees and limiting maximum tax deductions by disallowance of overly conservative assumptions.

The real growth in private pensions in the U.S. dates back to 1948 when the courts decided, in the Inland Steel case, that pensions were a condition of employment and thus, the proper subject for collective bargaining. The Auto, Steel and Rubber industries shortly thereafter negotiated pension plans for their hourly workers and private pension plans experienced a very rapid growth through the 1950's and 1960's as plans were adopted for salaried employees to parallel those negotiated for union members.

While private pension plans had been primarily "private" arrangements in the sense of being designed by each employer-employee group to meet their own requirements, the United States Government had always been very interested in private pensions because of the loss or deferral of tax revenue which they involved. Treasury Department, for example, in the early 1960's made an

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[1] As a consulting actuary I have been closely following and commenting on pension regulations in the United States for many years. Since I opposed the original legislation and indeed some of the original objectives set forth in the Report of the President's Committee, some personal biases no doubt developed. Indeed, when ERISA was finally passed, I observed in a published article in Pension and Welfare News that "The Employee Retirement Income Security Act of 1974 represents an important benchmark on the downward slope to the totalitarian state". Even 3½ years removed from the passage of ERISA it is likely that some bias remains. On the other hand as a citizen of a democratic country, I agree that it is proper to drop opposition once legislation has passed and that it is everyone's obligation to try to make things work as well as possible for the good of the nation. Hopefully, I will be pardoned for any remaining bias evidenced in this article.

estimate that $1,000,000,000 in revenue was lost by permitting employers to deduct their contributions while exempting the employees from a current tax and exempting the pension funds from tax on interest earnings. In 1962 President Kennedy appointed a Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs. Its purpose was to conduct a review of the implications of the rapid growth of retirement and welfare funds for the financial structure of the economy as well as a review of the role and character of the private pension and other retirement systems in the economic security system of the nation and consideration of how they might contribute more effectively to efficient manpower utilization and mobility. The Committee completed its investigation and published a Report on private employees retirement plans in January, 1965.

The major recommendations of the President's Committee were:

1) Require vesting graded on service after five years.
2) Require 30-year funding of past service liability.
3) Have the Internal Revenue Service set the permissible actuarial assumptions.
4) Set up a public institution to accept pension credits and promote portability.
5) Provide plan termination insurance.
6) Restrict waiting periods for entry into qualified plans to a maximum of three years.
7) Prohibit "salaried only" plans that exclude hourly employees.
8) Impose a maximum dollar limit on the amount contributed for any employee's pension.
9) Limit the investment in employer common stock to 10% of the fund.
10) Require greater disclosure.
11) Reduce the amount of Social Security an employer can take credit for in setting the benefits for a qualified plan.

When pension legislation was finally passed almost 10 years later, all of the above items with the exception of 3, 4, and 11 were covered in some fashion by the final law. Furthermore, President Carter's 1977 tax reform proposals included Item 11 and Items 3 and 4 are still being studied.

"Pensions" in the United States

In the United States, a variety of different programs have been included under the heading "Pension Plan". First of all, there are plans providing pensions upon retirement either through a trust fund, an insurance contract or paid by the employer as part of payroll cost. These plans have generally been referred to as "defined benefit pension plans". In addition, trust funds have been set up on a basis where a share of current year profits is allocated to employees with definite accounts being set up for each employee to determine the current cash balance. Some of these profit sharing plans have been set up with the intention of providing the retiring employee with a substantial cash amount with which he can purchase an annuity or provide for his own income needs after retirement. In some instances, profit sharing plans permit the election to take the proceeds in a life income or in installments over a fixed period of years as alternative methods of distribution from the trust fund. Also qualified under the same section of the Internal Revenue Code are the employee savings plans or thrift plans which many major companies offer in addition to pension plans. Usually these are contributory arrangements under which the company will match employee contributions at a rate of 50¢ on the dollar, or perhaps at a higher rate, with company contributions being vested after a few years of service. Some thrift plans are set up so as to permit the employees to purchase the employer's common stock, and usually these stock purchase plans provide for vesting on a "class year" basis; i.e., the stock purchased by employer money that is issued in a given calendar year might become vested, say, three years later. Also, there are "defined contribution" pension plans under which the employer contributes a specified amount for each employee regardless of profits. One recent modification of this type of program is to set the employer contribution at a level that is intended to provide a specific retirement income so that larger amounts can be contributed for older employees and such plans are called "target benefit plans". All of these programs in the United States are lumped together under the general heading "Pension Plans".

The larger companies frequently offer their own retirement plan for salaried employees, and sometimes a separate program for hourly or unionized employees. Small companies frequently provide pensions through the use of individual insurance policies either with the policy itself providing all of the retirement income or with a standard "whole life" insurance policy being coupled with a separate bank account to accumulate additional amounts so that, together with the cash value, the desired pension can be provided.

The major unions in a good many areas have also negotiated with the employers in a given industry a common "multi-employer" fund covering all employees working in the industry in that area. One of the earliest of these plans was the mineworkers fund which provided a pension of $100 per month to an employee retiring after twenty years in the industry provided that the last year worked was with a contributing employer. Some Teamster union programs have provided $100 or $200 monthly pensions after 20 years of continuous service. Other multi-employer funds use certain minimum hourly requirements each year, such as 300 or 500 hours paid, to preserve membership in the plan.

The 1942 legislation was sufficiently vague and general that it could be applied to this wide variety of programs. The IRS did, of course, develop special regulations in order to fit the law more precisely to the various types of programs involved. The law and all of the regulations relating to employee pension, annuity, profit sharing, stock bonus and bond purchase plans (including plans for self-employed individuals) was published by IRS in a 170 page booklet.

As to the actual pension practices in the United States during the 1965-74 period in which pension legislation was developed, by far the largest number of plans were single employer programs and these plans did not provide for any transferability of benefit credit to a new program. Indeed, as to many of the newer programs, it was fairly common to find no benefits available at all in the event of termination of employment before the early retirement age, except occasionally in the case of total disability. The programs covering hourly employees generally provided flat dollar pensions such as $100 or $200 monthly or a flat benefit such as $5 monthly per year of

service. Plans covering salaried employees on the other hand usually provided benefits on the basis of total career earnings, but throughout the 1950's and 1960's there was a strong trend to convert those programs over to benefits based on final five year average earnings. It was customary for single employer funds to have annual actuarial valuations in order to justify completely the deductibility of the employer contribution.

Other than public employee retirement plans (the Federal Civil Service Retirement program, and programs covering policeman, firemen, teachers, and other employees of state and local governments), pension benefits after retirement were rarely indexed for cost of living increases. Social Security benefits were increased from time to time by legislative amendment but in 1972 they were formally indexed by cost of living adjustment. Under private plans, however, increases for employees already retired have been voluntarily adopted by individual companies when it seemed right to do so and certain companies agreed in union negotiations from time to time to increase the benefits for retired employees under their hourly plans.

The private retirement plans operating in 1965-74 were based on pension plan documents which were generally quite simple. The plans, for example, might provide a benefit of 1-1/2% of final average pay for each year of service with service being defined merely as "continuous service with the employer". What to do about such matters as service for only part of a year or breaks in continuous service were frequently not covered in the plan document but left up to the discretion of a pension committee. In any case, the simplicity of the plan documents meant that a good many unusual situations had to be decided upon outside the written plan document and the employer or a pension committee was usually given the right to settle, once and for all, any pension questions.

Even though the plan documents themselves were kept relatively short and simple, the concept of a pension is a fairly complex one and to avoid confusion and unnecessary questions employees were frequently not given the details of a pension plan until they had reached an age where they might retire and apply for benefits. Furthermore, while a 1959 law required some disclosure of the investments held by pension funds, there were some fairly rare instances where the funds were invested in the employers business, used to purchase land, buildings or equipment for the employer, or, in the case of union funds, invested in companies recognizing the given union or in mortgages on union built homes, etc.

The Reform Movement

During the late 1960's, there was a growing mistrust of private institutions in the United States. Ralph Nader launched into the pension field starting with the basic principle that anything so secret or so complex must be crooked. Paul Harbrecht wrote a book on the unlimited economic power of pension funds and Merton Berstein, an economics professor, wrote one based on the contention that the younger employee when hired might only have one chance out of ten of remaining in service to retire and collect a benefit. Clearly one of the problems was a lack of communication. Many of these reformers felt that, if the total cost of a pension plan in a given year is divided by the total hours worked in that year, then that precise number of cents per hour must have been taken from each employee's wages so that any employee who receives less than that amount with interest will have been cheated in the process. This belief is held even now, despite explanations that the cost of purchasing a pension benefit for a younger person might be only 1/10 or 1/100 of the cost for an older person. In any case the growing mistrust of private institutions was compounded by the deceptively simple pension plan documents which required lots of interpretation.

Any concept as complicated as pensions tends to gather over the years certain analogies that are intended to explain the concept in simple terms. Many people, for example, held the general belief that pensions are really current wages that each employee is merely deferring for his own retirement years. Then too, pensions can be thought of as a collective form of personal savings or even as a gratuitous gift for long service from an appreciative employer. Pensions have been considered to be a type of transfer payment from young workers to old ones. Pensions can be thought of by an employer as the means of maintaining a young and efficient work force. Actually, a pension plan is a useful and fairly flexible tool that can provide scheduled benefit objectives that are not attainable with the use of savings accounts, annuity contracts or other personal savings devices. A pension plan is clearly not a desirable tool with which to give a little bit to a lot of people like a pay raise. On the other hand, a pension plan is an excellent means of providing, at minimal cost, adequate income to the relatively few long service employees who are too old to continue working. Most employers in the United States tend to view the private pension plan as an item that they have to justify to stockholders as a necessary and reasonable business expense and, therefore, it must offer some business advantages. On the other hand pension reformers and perhaps even employees view pensions as deferred personal income and thus they tend to emphasize complete accountability as to the money that was, in their view, taken from employees' pay.

Legislative History

The report of the President's Committee aroused the interest of Congress in private pension plans and as early as 1966 Senator Javits submitted a bill that would have required vesting, minimum funding, portability and plan termination insurance. The Javits bill was opposed by the employer community and in general failed to attract much support. In each succeeding session of Congress, however, new pension legislation was introduced, effectively starting off from the prior years unpassed legislation, modifying it to meet the major criticisms leveled against it and adding to it new areas of reform brought out by the congressional hearings and the newspaper and magazine articles calling for pension reform. At the Congressional end, most of the effort was devoted to bringing in individuals to testify about unreasonable treatment in their specific circumstances – individuals employed for 30 years or more who were covered by a pension plan which terminated with insufficient assets and with largely frustrated employees' expectations. For example, in the Studebaker case, some 3,000 retired employees and active workers age 60 and over received full benefits but 20,000 employees under age 60 were given a lump sum settlement for only 15% of the value of their accrued benefit due to lack of sufficient assets in the pension fund (the

Studebaker plan was set up in 1950 and amended in 1955 and 1958 with the past service liability established at the outset and in the two subsequent amendments being amortized over 30 years). After this sort of testimony, the business community would try to counter the complaints with a statement that some pension for older workers is certainly better than none at all, or that the emphasis in cases like Studebaker's should have been on the positive aspects of pension benefits for the older retired worker as compared with what the retired employees would have had if the employer contributions to the plan had been put into savings accounts for each of them.

Underlying the entire reform process was a basic suspicion of the motives of a pension plan sponsor on the part of Congress and the pension reformers. Indeed, one of the authors of the original Javits bill, at a meeting of the American Pension Conference pointed his finger at the assembled plan sponsors and said, "You have cheated your employees out of their pensions and we are going to get you". In this somewhat nasty climate the sponsors of private pension plans were viewed as being interested primarily in tax evasion and not in the provision of pensions to older workers, other than top executives. In fact, when Ralph Nader commenced his digging into the pension problem, one of his investigators asked me if I would tell them how the major companies sponsoring pension plans expected to get their money back out of the program! Nader was convinced that these substantial pension contributions were merely a temporary diversion of company funds into a tax exempt trust for the long term benefit of the stockholders. The state of mind that is required to even pose such a question is one of complete mistrust, but that attribute may be necessary for a true reformer.

This basic mistrust of pension plans and plan sponsors was undoubtedly responsible for the particular form of the final legislation which requires extensive disclosure of benefit details, legally enforcible rights and financial transactions and imposes an unbelievably detailed set of requirements on plans as to how service and breaks in service are to be determined, what benefit formulas will be permitted and what participation requirements can be used. Thus, from simple plan documents requiring extensive employer interpretation we have now moved all the way over to extensive plan documents that spell out the treatment accorded to every possible case so that no employer discretion remains.

Prior to the 1974 legislation, there had never been any question of an employer's right to supplement a pension with out-of-pocket payments or to simply pay a retired, disabled or terminated employee an income or lump sum amount intended to correct an inequity and make things right. The desire to require minimum funding standards for pensions, viewed from the distrustful outlook of the reformers, meant that employers should not be permitted to pay pensions "out of pocket" or they will avoid all pension requirements, including funding, by paying a few select retirees arbitrary amounts instead of having a plan. In testimony before the Senate Finance Committee in 1973, I commented on this point as follows:

"The Williams-Javits bill and some of the other proposals would make it impossible for an employer without a pension plan to pay, out of pocket, an adequate pension to a single old employee who is retiring currently without first establishing a plan that covers everyone from age 25 on, provides vested rights, is funded at some minimum level, and pays a reinsurance premium on the initial large unfunded vested liabilities. The cost of such a program at the outset is clearly so much higher than it has been in the past, that the end result can only be lower benefits for the older people. Where the promise of a pension is going to involve an employer in financing problems and in a possible government claim against his entire net assets in case of plan termination, this surely must operate as a terrible deterrent to the adoption of a pension plan."

One of the natural forms of pension plan development in the United States heretofore has been for an employer upon the retirement of his first truly long service employee to make some arrangement to pay a pension to that individual out of payroll. Gradually as the organization matures more and more employees retire and individual special treatment becomes less and less desirable. Eventually some general formula, or rule of thumb for benefits, is decided upon and eventually the employer finds himself with a pension plan which for cost accounting reasons, he feels called upon to fund over the working years of the active employees. By prohibiting the employer from paying a benefit in the first instance of retirement, clearly some plans that would have evolved will never develop in the future. In my 1973 testimony, I concluded with the following:

"The major problem facing pension plans today is not the occasional loss of benefit at plan termination but rather the annual catastrophic loss of pension purchasing power through the ravages of uncontrolled inflation. Where employers have responded to the loss of benefits due to inflation, by providing greater current pensions under their plans, they have at the same time added considerable past service liabilities which, under proposed legislation, would be subject to reinsurance premium tax and, at plan termination, to assessment against the stockholders' interests. There are some well meaning critics of the private pension system who have pointed to money purchase programs that are fully vested in each individual as representing the ideal solution here. If we could be sure that the world in which we live would be so stable that the price of gold will be $35 an ounce in the year 2000, as it was in the years 1935 and 1965, then their suggestions might have some merit. However, the supplementation of any such arrangements by defined benefit pension plans that can be tailored to meet the real needs of those retiring each year would seem to be even more desirable in an unstable future than in the past.

"While it is true that some private pension plans have not paid benefits to some of the younger workers who considered themselves entitled thereto, there have been no instances that I have read about where it has been clearly shown that the actual assets in those pension funds have been paid to individuals who were not deserving of or entitled to benefits. There will be no increase in market value of the assets up to the level of full pension expectation for everyone simply because of the passage of comprehensive pension legislation. By insisting on greater prospective benefit rights for younger workers to be paid decades in the future under private pension plans, the legislators must accept the responsibility for depriving the older workers today and tomorrow of badly needed retirement income. It is for this reason that sharp changes

in the operating rules and legal requirements for these plans should not be made.

"The private pension system is by and large a good one, as the 5 million senior citizens now collecting benefits should confirm. There is an element of social adequacy inherent in these plans that should not be sacrificed on the selfish principle that each worker must get back no less than the cents per hour cost times the hours that he worked. The possibility of forfeiture, or of contributing to the well being of others, may, in fact, be the only rational argument for not taxing employees on the current contribution and investment income. Too great an emphasis on individual equity may reduce these programs to an inflexible collection of individual bank accounts at the very time in our nation's history that we appear to be in the greatest need of flexibility and compassion."

Rash words on my part, I confess, but perhaps prophetic.

ERISA

The major legislation in the United States regulating private retirement plans is the Employee Retirement Income Security Act of 1974, generally referred to as ERISA. This law regulates both pension and welfare plans and makes it illegal for an employer to adopt a pension plan and pay for it as part of payroll. The bill requires the following:

1) Annual reports and short descriptions of the benefits are to be disclosed to employees and filed with the government.
2) Participation must be permitted no later than age 25 and one year of service.
3) Full vesting at 10 years of service; or partial vesting graded from 25% at five years of service to 100% at 15 years of service; or 50% vesting when age plus service equals 45 provided there is five years of service, with 10% additional each year thereafter.
4) Benefit formulas must meet one of three rules:
   (i) The benefit percentage earned in one year can not be more than 133-1/3% of the benefit earned in any prior year.
   (ii) The benefit earned at termination of employment is a portion of the benefit at normal retirement age pro-rated on service.
   (iii) The benefit earned at any point is not less than 3% of the normal retirement benefit for each year of service up to 33-1/3 years.
5) The benefit at normal retirement age must be automatically paid on a joint and 50% survivor basis for married employees unless the employee elects something else in writing.
6) Optional survivor benefits must be made available while eligible for early retirement but employees electing can be required to pay for the cost by receiving reduced pensions.
7) Unfunded past service on the 1976 plan anniversary must be amortized over a minimum of 40 years; past service arising out of subsequent amendment must be amortized over 30 years for a single employer plan (40 years for multi-employer); experience gains and losses must be spread over 15 plan years (20 years for multi-employer plans); actuarial assumptions must be on a "best estimate" basis.
8) The plan sponsor and administrator are required to discharge their duties "with the care, skill, and diligence that a prudent man would use".
9) The acquisition or holding of employer securities and buildings is limited to 10% of the fund.
10) Self-dealing transactions are prohibited.
11) Pension benefits are limited to $75,000 annual pension for pension plans or $25,000 annual contribution for profit sharing plans, with both limits to be adjusted by subsequent cost of living increases. Where an employer provides both pension and profit sharing plans, the percentage of the limit for each plan that has been used up, when added to the percentage for the other plan cannot exceed 140%.
12) Violation of the foregoing may subject the plan sponsor to fines up to $10,000 or one year in jail or both.
13) Plan termination insurance is established for benefits up to $750 monthly, adjusted by cost of living increases, at a cost of $1 per plan participant per year (50¢ for multi-employer plans).
14) Individual retirement savings accounts (IRA's) are authorized with tax exemptions for persons not covered by private pensions.

Even a boiled down summary of this lengthy bill is enough to illustrate its extensiveness.

Fiduciary Obligations

The Pension Reform Act was intended to prohibit and prevent self-dealing, profiteering and mismanagement of plan assets in connection with the investment of the funds, benefit payments, and hiring of administrators, attorneys, actuaries and the like. The law, therefore, requires that each benefit plan must have a written plan document and that the plan must provide for a "named fiduciary" who has authority to control and manage the operation and administration of the plan. The named fiduciary is required by the Act to discharge all duties with respect to a plan "solely in the interest of the participants and beneficiaries, and for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan". This is to be accomplished "with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims". The law states that this will require the diversification of the investments of the plan so as to minimize the risk of large investment losses. The fiduciary must make certain that the plan does not engage in any prohibited transactions such as selling or buying any property from the employer or any employees, lending money to the employer, etc. Not only is such a fiduciary personally liable for any improper activities or mistakes in judgment, but also the law makes him personally liable for any breach of fiduciary responsibility of any other fiduciary for the same plan if he has any knowledge of the breach and failed to act. One month following the passage of the Act, Congressman John Erlenborn reported to an actuarial meeting that a literal interpretation of this set of requirements would prohibit a plan from paying benefits to an employee otherwise entitled to them because all employees of the employer are parties-in-interest and, as such, their receiving any assets from the plan is a prohibited transaction. Needless to say this was not intended and has been cleared up by regulation.

These fiduciary requirements were a matter of great concern to members of Boards of Directors who in the

normal operation of a company would rarely see pension transactions or investment details and yet a Board usually has the final authority and responsibility in all corporate matters. Since ERISA, therefore, there has been a trend to relieve the Board of Directors of certain of these fiduciary responsibilities and to delegate them to specific executives or committees in the company. When this is done, the Board is then merely responsible for following up on its initial appointment to make sure things are working out right. In a 1976 survey, the Banker's Trust Company reported that out of 100 leading corporations 42 of them had reallocated administrative responsibilities and 35 had added new pension committees. Of the 69 plans which had named a fiduciary, 3 had named individual executive positions, 24 had named a retirement committee, 9 had designated two committees, 13 had designated committees and executives, and only 20 plans had left the responsibility with the Board of Directors either by naming the company itself as the named fiduciary or by naming the Board plus certain specified individuals. For a considerable period of time, the sponsors of private pension plans wrestled with this question as to who they should name as fiduciary. Generally, there was a strong aversion on the part of all individuals to take on such onerous responsibilities.

The requirement that the fiduciary must see that the assets of the plan are invested in a prudent manner and are diversified so as to minimize risk of loss, has led to a considerable amount of attention being focused on the investment performance. Even though market values rise and fall with unpredictable irregularity most fiduciaries have concluded that they will have a better defense when the market has dropped if they can demonstrate that they have indeed been following the investment results and analyzing and appraising the performance of the parties actually doing the investing. In addition to this, there has been a side effect of pension funds shifting more heavily into bonds as opposed to common stocks and into blue chip securities. Here the argument runs that while better investment returns can be achieved by investing in a diversified array of risky securities,the fiduciary is not permitted by the United States law of trusts to point to the total results. Legally, a loss on a given investment must stand alone and cannot be offset by a gain on another one. If the purchase of each individual security must be defended on its own, the easiest way to do this is to restrict the investments to those securities which managers of other pension funds are also holding (since they presumably are the other prudent men which the given fiduciary is supposed to emulate). All told, these fiduciary requirements are the cause for considerable concern because they are vague and ill-defined and apparently have differing implications as the facts change ever so slightly.

Supplemental Payments

Since ERISA requires that a pension plan must be established pursuant to a written document with the assets held in trust and with minimum funding standards and participation, vesting and accrual of benefit requirements all complied with, the Act effectively prohibits an employer from establishing a plan that does not meet all these requirements with the sole exception of "top hat" plans restricted to a select group of highly compensated employees. Following passage of the Act, many employers asked the Department of Labor about programs that they were operating on a pay-as-you-go basis, covering severance payments and supplemental pay practices. Supplemental payments on an unfunded basis had been made, for example, under the following circumstances:

As the legislation progressed slowly through the United States Congress, the Senate and the House of Representatives each had a somewhat different approach to this matter of prohibited transactions. The House-passed legislation did not prohibit any transactions but required that fair value be paid or received. The House version was rejected, however, and the Senate version of the prohibited transactions was included in the final legislation and it has indeed proved bothersome. For example, a welfare fund in Florida which had exhausted its assets requested permission to borrow money from the labor union whose members were covered by the plan under an interest-free loan to be repaid after the next labor negotiations. The purpose of the loan was to permit the continuation of health insurance benefits to the workers even though the fund was broke. Clearly, this would be advantageous for the plan participants and the union was obviously charging less interest than it could have but ERISA prohibited the transaction itself and the union had to petition the Department of Labor for permission to engage in this arrangement which, after ten months of deliberation, was finally granted.

1) Employees being separated from service before they are eligible for early retirement benefits.
2) Employees being separated before they are eligible for full benefits at normal retirement age with the supplement intended to meet a perceived employer obligation such as at plant shutdown.
3) Supplements to retired employees to increase total benefits to offset cost of living increases.
4) Special offers made to induce early retirement because of poor business conditions or cutback in staff.
5) Supplements to early retirement income to permit transition to a "second career".
6) Gratuitous supplements to retirees to correct for unexpected inequity such as failure to qualify under any of a corporation's pension plans despite reasonably long service.

Clearly, such situations represent cases where companies feel a moral obligation to bring benefits up to a reasonable level. The process at the company end might be described as "reviewing individual cases on their own merits and making things right". For example, one major United States employer operated plants in Cuba for many years. A number of their Cuban employees who entered the United States as refugees sought to obtain work with the company and did so. By reason of their late age at hire and their loss of Cuban Social Security and ineligibility for United States Social Security, the company's benefits were inadequate and so it paid a supplemental benefit to them. Employers have observed that unusual situations of this sort cannot be predicted in advance and cannot be covered properly under any long range written plan. The pension reformers on the other hand now argue that liberal rules permitting plan sponsors to provide supplemental benefits will merely encourage the provision of benefits through unqualified arrangements of

that sort, thus evading the intent of ERISA. Although employers continue to make such arrangements and to pay such benefits, there are as yet no regulations available which would make the process a legitimate one.

Joint and Survivor Regulations

During the gradual development of the Pension Reform Act, the congressional staffs responsible for the details in the legislation came upon certain undesirable pension provisions. For example, a few plans had no provision for joint and survivor options so that the employee reaching retirement age and dying a few months later would lose all pension rights after collecting only a few months' benefits. Thus the first step was to incorporate in the proposed law a requirement that each plan must offer a joint and 50% survivor annuity to retiring employees. Somewhat later in the legislative development, the staff personnel learned of certain negotiated programs under which joint and survivor options were automatically assumed to be elected at retirement unless the employee signed a form choosing some other option. The auto workers' pattern plan, for example, incorporated such an automatic election in 1970, possibly because the survivor option was so heavily subsidized (a retiring worker by having his pension reduced by only 5% would leave his surviving spouse 55% of the reduced benefit and, furthermore, if the spouse died first, his pension would be restored to the 100% level). ERISA incorporated this automatic election feature even though plans were permitted to charge full actuarial costs for the election.

Having solved the problem of death benefits after retirement, the staffs concerned themselves next with the loss of pension that might result from death in service while eligible to retire early. A few plans in the United States had offered pre-retirement spouses' options on a basis where the electing employee agreed to pay the cost by a required reduction in his pension upon retirement (these were called "dead-horse" options since the only people paying for it would be the survivors who did not receive any benefit from it). Other programs provided such survivor options with the employee agreeing to pay a monthly contribution. Of course, some programs provided widows' pensions during the early retirement period entirely at company cost while in other cases, substantial death benefits for active workers have been provided under group life insurance plans with no death benefits under the pension plan. ERISA requires that every pension plan must either provide a 50% pre-retirement survivor benefit at company cost or offer the employee an option for 50% surviving spouses coverage on the "dead-horse" basis commencing on the date he is first eligible for early retirement (but coverage can be restricted to the ten year period prior to normal retirement age).

The joint and survivor section of the law is fairly detailed and, to illustrate the complexity of ERISA, is reproduced in full in Appendix A. Regulations were to be issued by the Secretary of Treasury and proposed regulations were issued on October 3, 1975, 13 months after passage of the law. As first proposed, these regulations would have required offering automatic survivor options in plans having disability retirements, say after 10 years service, which would cover death after retirement but with the benefits to the surviving spouses deferred to the date the employee would have been eligible to elect a pre-retirement spouses' option had he lived and continued in service (generally the date the deceased employee's bones reach age 55). The proposed regulations required that pre-retirement spouses' option elections must be made available on the basis of a reduction in the pension only, as opposed to permitting cash contributions. The regulations clearly stated that joint and survivor annuities with benefit ceasing upon the remarriage of the surviving spouse would not satisfy the Act. The regulations for the pre-retirement spouses' option required that the employee be permitted to elect the coverage whenever he wished and to elect out whenever he wished and to do so as many times as he wished. Finally, the 1975 regulations required offering the option to spouses other than the employee's spouse at retirement.

After public hearings and extensive comment, final regulations on the joint and survivor option requirements were issued January 7, 1977. Apparently as a result of the public comment, the final regulations provide that for disability retirements, the election of joint and survivor option can be deferred to those retirees surviving to age 55, i.e., the automatic option with deferred benefit is not required on earlier disability. This requirement in the regulation now parallels a provision that had been included for a number of years in the auto workers pattern plan. Joint and survivor annuity can be restricted to participants' spouses who have been married throughout a period of one year on the annuity starting date. The right of election of pre-retirement spouses coverage and revocation of that election as many times as desired has been continued in the final regulations and it is possible for an employee to elect the coverage when in ill-health and revoke it upon recovery; however, a plan is permitted to defer the effective date of such election for up to two years providing that the plan must make the election effective in case of accidental death within the two year period.

The end result of the law and regulation is a monstrous complexity. Some sponsors of pension plans already maintain group life insurance plans or survivor income plans providing substantial benefits for death in service. Some of these employers, therefore, could not take the "simple" way out by providing the survivor benefit at company's expense but rather had to offer the pre-retirement spouses option on the "dead-horse" basis. Of course, the law requires that each participant be given a complete explanation of all options available to him "written in non-technical language calculated to be understood by the plan participant". This has proven to be quite a challenge. For example, when an employee is eligible to retire early at age 55 when normal age is 65, an option to reduce retirement income for pre-retirement spouses' coverage must of necessity relate to the reduction in income if the individual retires at normal retirement age. If the early retirement benefits are available on an actuarially reduced basis, then the cost of the pre-retirement option will also be actuarially reduced since it is incorporated into the normal retirement benefit determination. On the other hand, if early retirement benefits are available on a basis more generous than actuarial equivalence, such as with reduction by 3% for each year short of age 65 or alternatively unreduced after age 62 with actuarial reduction from age 62, then

there must be a corresponding adjustment in the reductions for the pre-retirement spouses' options. Most of these complications could be eliminated by the use of a pre-retirement spouses' option requiring a cash contribution from the employee. The final regulations do permit such a cash option but only if the plan "provides another option under which an out-of-pocket expense by the participant is not required". This means that the plan sponsor who believes the benefit reductions under the "dead-horse" option are simply too complicated for anyone to understand, may offer the option on a cash basis provided that he complicates the plan still further since he must offer the "dead-horse" option too! As a practical matter, since the employees must be given the right to shift from one form of option to the other, in addition to shifting in and out of the coverage, this means effectively that cash options will not be used very often even though they are far simpler to explain. This is unfortunate since it has been demonstrated that the covered employees far prefer the cash type option. For example, in public testimony on the proposed regulations before the IRS and the Department of Labor, the Ford Motor Company stated that from 1965 through 1971 their plan had provided a "dead-horse" option with about 8% of eligible employees electing that option. In 1972 their plan was changed and the "dead-horse" option was replaced by a cash payment option and from 1972 to 1974, 32% of eligible employees elected the pre-retirement option.

One further complication with the joint and survivor requirements will arise if Congress should pass legislation, now being considered, which would permit mandatory retirement only at or after age 70. The joint and survivor regulations may require the provision of a survivor benefit at company cost in any case where death occurs in active service after the normal retirement age has been attained and ERISA defines the normal retirement age as being no later than age 65 for employees with 10 years service. The IRS has not as yet confirmed whether the 50% spouses coverage must be provided at company cost after age 65 or whether benefit reduction charges can be actuarially increased for later retirements to make up for their reductions not collected from 65 to actual retirement. In any case, the details appear to be compounding into n-dimensional complexity.

Service Requirements

Since ERISA requires participation after age 25 and one year of service or vesting after five or ten years of service it was necessary to incorporate a definition of a year of service. For purposes of participation, ERISA says that a "year of service means a 12 month period during which the employee has not less than 1,000 hours of service". For vesting, the term "year of service" means a calendar year, plan year or other 12 consecutive month period designated by the plan during which the participant has completed 1,000 hours of service. Thus in each case, an employee working more than 1,000 hours in a particular 12 month period is considered to have one full year of service for participation and one full year of service for vesting. For the accrual of pension benefits, an employee with fewer than 1,000 hours of service need not be given any benefit credit at all but an employee with more than 1,000 hours must as a minimum be given a pro rata benefit based on his actual hours worked and the hours of service customarily worked in a year.

Multi-employer pension funds in the United States have usually kept track of the number of hours worked because contributions to the plan on behalf of each covered employee are almost always determined on a cents-per-hour basis. Thus, it is both efficient and accurate to divide the total contribution credit to an employee by the contribution rate per hour to arrive at the number of hours worked for purposes of continued eligibility or pension credit under such plans. On the other hand, there has been nearly a universal practice in single employer plans to credit service as the total time elapsed from date of hire to date of termination.

Length of service determined in this manner is very often a requirement for eligibility to participate in many other employer sponsored programs such as insurance plans and for the duration of other benefits such as vacation, sick leave, etc. Thus, in the private sector, length of service is interwoven with a host of other benefits or entitlements all of which generally are related to elapsed time from date of hire. Certainly, workers in America generally think of their length of service in terms of elapsed time. From a record-keeping standpoint, the employer crediting service on the basis of elapsed time must simply keep track of date of hire for each employee until his final termination at which point that date and the date of termination uniquely define length of service. The ERISA requirement that hours of service be recorded for each calendar or plan year adds considerably to the record-keeping and furthermore, presents the covered participant with an amount of service which he cannot readily check from his own personal records and certainly not from memory.

At the heart of the year of service definition in ERISA is an "hour of service" which under ERISA means "a time of service determined under regulations prescribed by the Secretary of Labor". ERISA was passed in September, 1974. In september, 1975, the Secretary of Labor published proposed standards. These standards would have required each pension plan to specify three "computation periods" one for eligibility, one for vesting and one for the accrual of benefits. A computation period was to be a 12 month period designated by the plan and for which the plan administrator would record the number of hours of service. Further, the proposed regulations would have defined two different kinds of hours of service- - - first for participation, vesting and benefit accrual, an hour of service was to be each hour for which an employee is directly or indirectly paid or entitled to payment by the employer for performance of duties during the applicable computation period plus hours for which backpay has been awarded. Second, for the purpose of break in service determinations, an hour of service, in addition, was to include each hour for which the employee was directly or directly paid for reasons *other* than for the performance of duties such as vacation, sickness or disability. The proposed regulation set forth in great detail the various requirements if the computation periods were to be changed, such as by using the year commencing with date of hire for eligibility but shifting to a calendar year basis thereafter for any employee with

insufficient hours (less than 1,000) in the first year of employment. To prevent unfair treatment of part-time workers, there was a prohibition of "double proration" of the benefit amount- -i.e., reducing an employee's service for partial years and at the same time using the partial year's pay in determining a lower final average pay, thus taking the partial year into account in both service and final pay to the disadvantage of the employee. The regulations ended with some arcane reference to contiguous non-covered employment and non-contiguous covered employment which, while no doubt clever, was simply undecipherable.

The 1975 requirements were so complex and confusing and so different from previous practice and record-keeping that plan sponsors objected strenuously and emphasized the need to simplify these rules substantially. In particular, the practice under single employer plans of counting service on the basis of time elapsed from date of hire to date of termination of employment or alternatively counting periods of time "on the payroll" were suggested as practical and simple alternatives. In June of 1976, the Department of Labor issued three technical releases announcing their decision to set forth in the final regulations certain equivalences such as counting weeks or months and converting them into hours by formula and also certain rules for counting service by elapsed time. Final regulations (temporary as to the elapsed time portion) were finally issued December 28, 1976. The final regulations unfortunately are even more cumbersome and impractical than the original ones. A brief excerpt (about 1 page out of the 36 printed in the Federal Register) from the regulation defining an hour of service is attached as Appendix B.

Under the final regulations, an hour of service for *all* purposes is defined to be each hour for which an employee is paid for the performance of duties, including back-pay awards, plus in addition each hour for which an employee is paid or entitled to payment by the employer on account of a period of time during which no duties are performed, and irrespective of whether the employment relationship has terminated, for reasons such as vacation, holiday, illness, incapacity, disability, layoff, jury duty, military duty, or leave of absence (these non-work hours have been called "soft" hours). Where payments are made to an employee for reasons other than the performance of duties they must be converted into hourly credits either by dividing the payment by the employee's last hourly rate of pay or by crediting the normal number of work hours for the period of time for which the payment is made. In this process payments made to an employee for medical expenses such as hospitalization, surgical bills and the like need not be included. On the other hand, payments from insured sickness and accident plans would have to be converted into hours of service based on the periods of absence paid for, and lump sum disability payments from group life insurance plans would have to be converted by dividing by hourly rates. No more than 501 of these "soft" hours need be credited during any single continuous period of absence but clearly the plan administrator must keep a record of all such hours, and allocate them to separate continuous periods of absence before any limit can be applied. This standard approach is obviously so complex that it is expected that very few plans will be able to use the precise method as set out in the regulation.

Certain equivalencies are now permitted so that a plan, for example, could count only hours worked by the employee if, instead of 1,000 "hours of service" for a year of vesting and participation, the plan used 870 hours worked. Alternatively, a plan is permitted to use just regular time hours if the plan grants a year of service for 750 regular time hours. Under either of these two approaches service can be determined from payroll records alone. In addition, employers are permitted to count service on the basis of periods of employment by crediting an employee with 10 "hours of service" for each day for which the employee would be required to be credited with at least one hour of service under the regular rules; or on the basis of weeks with 45 hours of service for each week; or on the basis of months with 190 hours of service per month; or on the basis of shifts with credit for the regular number of hours per shift. If an employer credits service by periods of employment, however, an employee must be credited with a day, week, month or shift whenever an "hour of service" would have been credited by the regular rules, including "soft" hours. How this would be done is not clear.

The new regulations permit the crediting of service on the basis of elapsed time from date of hire to date of severance from service. The severance from service date is defined as the earlier of the date on which an employee quits, retires, is discharged or dies or the first anniversary of the first day of absence for any other reason. Thus employees on layoff or furlough must be credited with service up to one year following the date last worked for vesting and benefit accrual both. In addition, an employee who leaves service and is reemployed within one year must be given credit for the period of absence for vesting purposes but not benefit accrual. While these rules appear to be very generous, the elapsed time rules are reasonably in line with the practice adopted by the largest private employers in connection with absence due to disability, except that crediting time not worked as service for benefit accrual under final pay pension plans has not been customary heretofore. Of course, under career pay plans the career average pay can be defined as total pay from the employer divided by the number of years of service by these peculiar rules and, when the benefit is determined by multiplying that career average pay by, say, 1% times the number of years of service, the peculiar service cancels out leaving 1% of total pay from the employer. The crediting of service up to one year on layoff or leave of absence goes considerably beyond current practice, although the employer apparently is not required to grant layoff in any particular case.

Even after publication of the final regulations, considerable criticism has been levelled at the Department of Labor which, by regulation, has botched up plan administration to a point where it is so complicated that nobody's benefit can be determined correctly. In March, 1977, President Abel of the United Steelworkers appeared at a public hearing to protest the regulations because they would require a considerable amount of change in the steelworkers' pattern plan, a negotiated program which bases service on a fairly generous form of elapsed time. A representative of the autoworkers also appeared and objected to the complexity of the regulations.

On the matter of record-keeping, it is much more time consuming and costly to keep track year by year

of the hours of service relating to direct employer payroll payments than to keep track of a date of hire adjusted for subsequent absences and rehires. A second order of difficulty comes about from the "soft" hours represented by benefit payments from employer sponsored vacation funds, group life plans, sickness and accident plans or long term disability plans. There is even the novel problem that payment of a disability pension from the plan itself may require the crediting of further hours of service and an increase in the benefit amount. This requirement that the amount of pension benefit must be increased because of another benefit is most disturbing to plan sponsors and led to the saying "under ERISA, no generous act goes unpunished". Anyway, the various funds and insured plans maintain their records on a plan year basis and the coordination of those benefit payment records with the employer's payroll records in order to reconstruct a given employee's "hours of service" for a given 12 month period would involve considerable effort, if indeed it could be accomplished at all. Since the counting of days, weeks, months or shifts requires the counting of a full period in which an employee would be credited with even one "soft" hour of service it would also be impossible to base the record keeping on payroll sources alone. This leaves only the hours worked and regular time hours as practical alternatives, along with the elapsed time rules which are only proposed at this point and which may, in their final form, be modified to bring in more "soft" hours too.

Many plan documents now drafted by attorneys specify that an hour of service will be any hour for which the employee is paid directly or indirectly either for the performance of duties or for other reasons. These plan documents do coincide beautifully with the regulations which in turn fit the requirements of the law very specifically. The basic problem is that very few plan sponsors have the administrative ability to maintain accurate records on that basis. Thus, one practical result of the law and regulation is the development of very lengthy and very precise legal documents which are reviewed carefully by IRS and the Department of Labor for compliance with the statute but which are largely incomprehensible to plan sponsors and which cannot be administered as written because the basic records called for by the plan document, as expanded in the regulations, are simply not available. In the long run, of course, this is likely to lead to a considerable amount of litigation and complaint. Certainly, the covered participants have had a new source of confusion and dissatisfaction substituted for the previous "vagueness of plan – employer interpretation" problems because they are now provided with all of the documents, but are unable to understand them.

Reporting and Disclosure

ERISA requires pension plan sponsors to provide extensive information about plan provisions and financial operations to the federal government as well as to the employees. Whenever the provisions of a plan are to be changed not only must the material be filed with IRS for approval, but also within 7 to 21 days in advance of the date the material will be submitted to IRS, the employee must be notified and given an opportunity to review the changes so that he can take the employer to court to prevent or modify the change, or ask the Department of Labor to sue the employer on his behalf. Also, because the Pension Benefit Guaranty Corporation is concerned about the possibility of substantial losses resulting from their getting into a termination situation too late, ERISA requires that PBGC be notified whenever certain "reportable events have taken place" and these include: (i) a 20% reduction in the number of plan participants over one plan year or a 25% drop over two plan years; (ii) when one plan merges with another; (iii) when the plan is unable to pay benefits which are due; (iv) when the plan fails to meet minimum funding standards; (v) when the plan is to be amended in such a way as to decrease the benefit payable as respect to any participant, or (vi) "when any other event occurs which the PBGC determines may be indicative of a need to terminate the plan".

Annual reports to the Department of Labor and IRS must be made on Form 5500, a copy of which is attached as Appendix C. Briefly, the annual reporting form requires information as to the type of plan, name and address of plan sponsor, the number of participants, the type of funding and other incidental information. Item 12 on this form requires a reporting of the name of any person who rendered services to the plan and the amount of any salary or allowances paid by the plan, any fees and commissions paid by the plan and the disclosure of any relationship with the employer or employee organization or other person known to be a party in interest. Item 13 requires a listing of the market value of assets and liabilities as of the beginning and end of the year, the acquisitions and dispositions during the year, and a separate section for party-in-interest investments such as debts, securities, or common stock of the plan sponsor, real estate mortgages or loans to the employer, etc. Item 14 is another full page statement of income and expenses with questions as to transactions involving plan assets with a person known to be a party-in-interest, and a question as to whether any loans are in default or any leases classified as incollectable. Further, if there has been any change in the appointment of any trustee, accountant, insurance carrier, actuary, administrator or investment manager, this must be reported together with an explanation. To give an example of the idea behind this requirement, if an accountant were to insist on certain appropriate accounting changes, he might be less subject to firing because the plan sponsor would have to report the discharge and give a reason for it and the Department of Labor could check with the fired accountant to make sure there was no improper handling of or accounting for plan funds, etc. Schedule B of the Annual Report sets forth actuarial information along with the status of the "Funding Standard Account" which is a mechanical means of determining whether the plan has met ERISA funding standards or not. A credit balance in the funding standard account means that the plan has been funded at a level higher than the ERISA minimum. A funding deficiency would call for a prompt payment of that amount into the fund by the employer together with the payment of an excise tax equal to 5% of the deficiency. If the funding deficiency is not made up within a 90-day period after the employer has been given notice of the deficiency, there is a further excise tax imposed equal to 100% of the deficiency and the employer must still make up the deficiency! Thus, the minimum funding requirements have some teeth in them.

Reporting to employees consists of booklets summarizing the benefits in the plan which must be updated

whenever the plan is amended (but at least every five years) and annual reports summarizing the financial condition of the plan. The accounting profession through the Financial Accounting Standards Board has proposed a standard form for this annual financial report to plan participants which would follow "general accepted accounting principles" and would also include an analysis of the change in the actuarial status of the plan from one year to the next. Because of objections to the expense of completing this statement, as well as its general uselessness to the plan participants, the FASB has withdrawn its original proposal and is currently studying the matter.

The regulations for disclosure to employees were not issued in final form until March, 1977. There has been a considerable amount of employer objection to the requirement that each booklet describing a plan to employees must contain a statement of the employee's rights under ERISA. This "ERISA RIGHTS STATEMENT" must follow the prescribed language in the regulations which goes:

> "As a member of the ABC Company Pension Plan, you are entitled to certain rights and protections under the Employee Retirement Income Security Act of 1974 (ERISA). ERISA provides that all plan participants shall be entitled to:
>
> - Examine, without charge, at the plan administrator's office, all plan documents, including copies of all documents filed by the plan with the U.S. Department of Labor, such as detailed annual reports and plan descriptions.
> - Obtain copies of all plan documents and other plan information upon written request to the plan administrator. The administrator may make a reasonable charge for the copies.
> - Receive a summary of the plan's annual financial report. The plan administrator is required by law to furnish each participant with a copy of this summary annual report.
>
> In addition to creating rights for plan participants, ERISA imposes duties upon the people who are responsible for the operation of the employee benefit plan. The people who operate your plan, called "fiduciaries" of the plan, have a duty to do so prudently and in the interest of you and other plan participants and beneficiaries.
>
> No one may discriminate against you in any way to prevent you from obtaining a pension benefit or exercising your rights under ERISA.
>
> If your claim for a pension benefit is denied in whole or in part you must receive a written explanation of the reason for the denial. You have the right to have the plan review and reconsider your claim.
>
> Under ERISA, there are steps you can take to enforce the above rights. For instance, if you request materials from the plan and do not receive them within 30 days, you may file suit in a federal court. In such a case, the court may require the plan administrator to provide the materials and pay you up to $100 a day until you receive the materials, unless the materials were not sent because of reasons beyond the control of the administrator. If you have a claim for benefits which is denied or ignored, in whole or in part, you may file suit in a state or federal court. If it should happen that plan fiduciaries misuse the plan's money, or if you are discriminated against for asserting your rights, you may seek assistance from the U.S. Department of Labor, or you may file suit in a federal court.
>
> The court will decide who should pay court costs and legal fees. If you are successful, the court may order the person you have sued to pay these costs and fees. If you lose, the court may order you to pay these costs and fees, for example, if it finds your claim is frivolous.
>
> If you have any questions about your plan, you should contact the plan administrator. If you have any questions about this statement or about your rights under ERISA, you should contact the nearest Area Office of the U.S. Labor-Management Services Administration, Department of Labor."

The foregoing material has been generally viewed by plan sponsors as inflammatory and intended to incite litigation against the plan sponsor (heretofore called "barratry"). In any case, while substantial disclosure has been required and the voluminous material has been sent on to covered employees, very little of it has been read or understood up to this point.

Plan Termination Insurance

In a separate Title IV, ERISA established the Pension Benefit Guaranty Corporation which is to insure benefits under defined benefit pension plans in event of termination of the plan. Profit sharing, stock bonus, savings and thrift, money purchase and target benefit plans are *not* covered by the insurance. Benefits insured are limited to $750 monthly, subject to increase after 1974 for cost of living increases. Benefit increases resulting from plan amendment are insured in full after five years but during the first five years the insurance phases in at 20% per year or $20 per month in benefit whichever would be greater for a given participant. The program is supported by premiums paid by plan sponsors which at the outset were $1 annually per covered employee (50¢ per employee for multi-employer plans). In case of plan termination, assets are allocated first to employee contributions, then to benefits in pay status at least three years (or which could have been in pay status if the employee had retired), then to other guaranteed benefits under the Act and finally to vested benefits and all other benefits. In this process if plan assets fall short of covering the insured benefits, the PBGC has the right to recover from the plan sponsor the entire deficiency up to a maximum of 30% of the plan sponsor's net worth. Annual reports are being combined with the reports to the Department of Labor and IRS. The PBGC has moved into a new office building in Washington and now employs some 400 technical and professional workers. It is estimated that by the end of the 1979 fiscal year, the program will have assets amounting to almost $1,000,000,000, largely made up of assets from terminated plans. PBGC premium income from plan sponsors in 1979 will be about $70,000,000 and administrative expenses will run appromately 40% of the premium.

Individual Retirement Accounts

Apart from regulating private pension plans, ERISA established Individual Retirement Accounts (IRA's)

through which eligible individuals could create their own retirement plans through tax incentives. Contributions to such plans are deductible up to $1,500, or 15% of compensation if less, for federal income tax purposes, and no federal tax must be paid on those funds or the earnings thereon until they are withdrawn from the program. Withdrawals can be made without penalty after age 60. To be eligible, a person must have worked throughout a tax year without being a participant in any qualified pension, profit sharing or stock bonus plan.

The savings institutions and insurance companies have widely advertised IRA's. To the extent that the tax advantages are considered highly desirable, their existence means that there is, for the first time, a possible disadvantage for an employee who is covered under a non-contributory pension plan, because a short service, younger employee may be so likely to withdraw without benefit that he might prefer establishing his own IRA. Congress is currently considering the possibility of establishing limited IRA's for persons covered under pension plans where the employer contribution is less than the deductible IRA limit. This, of course, would require allocation of the employer contribution to each plan participant.

IRA's are not without their problems, of course. To begin with annual reporting to the government is required. Then too, if an employee deposits money into an IRA and then later in the year changes jobs and goes to work for an employer who has a plan, his contribution must be withdrawn within a certain period following year end or else a 10% penalty on the withdrawal will be required and in any case, the 10% penalty applies to the interest earnings accrued on the "ineligible contribution". IRA's are also supposed to serve as vehicles whereby participants leaving a plan can transfer their vested rights by "roll-over". Values established by employee contributions, however, are not permitted in this roll-over process and there have been instances where employees have transferred their pension rights into an IRA and then been forced to withdraw their own contributions and pay a 10% penalty on their own money. Finally, some of the financial institutions offering IRA programs do not permit the withdrawal of the funds except after age 60 and some individuals, who thought that IRA's are merely tax favored savings accounts, find when they are faced with a pressing need for cash, that they cannot get their own money back – even with a penalty! Federal regulation regarding advertising procedures, restrictive provisions and the like is expected shortly from the Federal Trade Commission.

Dual Jurisdiction

Pension reform legislation was originated in the labor committees of the Senate and House of Representatives. Since pension plans involve tax advantages and IRS regulation, the final legislation also had to go through the tax committees and in the process the administration of the law was split into Title 1, affecting labor law, and Title 2, affecting the tax code. Thus, the regulation of pensions was put into both the Departments of Labor and the Treasury. This "dual jurisdiction" has resulted in considerable delays in matters such as obtaining waiver for certain prohibited transactions. Congress currently is considering several bills to solve this problem – one would split the various responsibilities between Labor and IRS rather than having both of them involved on the same matters, and another would established a separate pension regulatory agency into which all pension matters would be placed. Since this aspect of ERISA is about the only one getting any active legislative consideration at the moment, it appears that Congress may be more sensitive to the problems of efficient government operations than to the problems that ERISA has imposed upon plan sponsors. A good deal of the pressure to eliminate the dual Labor-IRS regulation of private pensions seems to be dissipating, however, and legislation appears unlikely in the near future.

Subsequent Developments

Within a few months following the passage of ERISA, the employer community had conducted seminars, discussions and appraisals sufficient to point out the substantial administrative burden being faced by plan sponsors together with the cost of termination insurance and the obligation of 30% of company net worth to back a plan. The plan termination insurance took effect for single employer plans terminated after July 1, 1974 so there was no "grace period" during which employers could drop plans "free of charge". Anyway, following passage of the Act, there was first a considerable amount of discussion and dismay followed by an ever increasing number of plan terminations. The table on the following page shows the number of new pension plans established and the number of old plans terminated in various years together with the experience in 1975 and 1976 following passage of ERISA. Apart from the substantial increase in terminated pension plans, there has also been a substantial shift away from regular pension plans and toward the establishment of profit sharing or money purchase plans.

As a result of the unexpectedly heavy terminations, the PBGC operated at a substantial deficit. Indeed, for the fiscal year ending September 30, 1977 the administrative expenses alone amounted to about 60¢ per covered employee out of the $1 they were collecting for termination insurance. In late 1977, Congress enacted legislation increasing the $1 premium to $2.60 and deferring the January 1, 1978 effective date for termination insurance coverage on multi-employer plans. The multi-employer plans are substantial in size and several are currently in such poor financial condition that their termination would require an immense increase in PBGC premium probably sufficient to encourage the termination of many sound pension plans and to cause a collapse of the termination insurance system as presently constituted.

Some very significant court cases have arisen within the last two or three years affecting private pension plans. In the Alabama Power case, the court required that pension credits be granted for military service on a retroactive basis, presumably going all the way back past World War II. In the Manhart – Los Angeles case, the court held that a plan requiring higher contributions from females than males, even though the difference can be justified on the basis of lower mortality and higher pension costs, is discriminatory and thus contrary to the provisions of the Equal Employment Opportunity Act. In addition, several court cases have voided mandatory retirement provisions and as a result Congress is about to pass a bill which would make it illegal to apply mandatory retirement provisions to individuals below the age of 70.

Calendar Year	Pension Plans (1) #New Plans Qualified	#Plans Terminated	Profit-Sharing & Money Purchase Plans (2) #New Plans Qualified	#Plans Terminated
1956	3,175	192	2,072	111
1957	3,527	180	2,898	171
1958	3,883	224	3,071	179
1959	3,824	270	3,442	204
1960	5,011	300	4,946	258
1961	4,919	374	4,468	361
1962	5,188	476	5,030	383
1963	5,840	441	5,304	453
1964	6,581	509	5,127	532
1965	7,495	512	6,037	524
1966	10,124	603	8,059	607
1967	11,292	602	9,229	705
1968	12,896	672	10,886	771
1969	14,692	868	13,383	861
1970	16,512	1,142	16,062	1,164
1971	22,493	1,605	18,171	1,730
1972	28,265	1,745	21,070	1,775
1973	33,830	2,222	25,775	1,908
1974	32,579	2,577	26,806	2,207
1975	15,319	4,550	14,720	3,558
1976	4,790	9,100	21,030	6,971
(Jan.–Sept.) 1977	5,415	4,385	22,570	8,100

Perhaps the most significant court case in terms of its effect on regulation is the matter of Daniels vs. Central States Teamsters. Daniels was a truck driver who worked for 24 years with the exception of four months of involuntary layoff, but by the terms of the Central States Plan, he did not have 20 years of continuous service and thus was denied a pension. The District court, in looking at this admittedly sad state of affairs and seeking to find a way to help Mr. Daniels, ruled that the non-contributory pension plan operated by the Central States Conference of Teamsters was in reality a "security" and thus subject to the rules and regulations of the Securities Exchange Commission as they relate to the disclosure requirements which must take place prior to a sale. The court concluded that at each point in time when Mr. Daniels elected to continue working rather than leaving employment, he was, by that decision, electing to "purchase" the pension security so that a "sale" had indeed taken place. Furthermore, the court felt that with such "sales" each employee should be told the actuarial probability of reaching retirement age and collecting a benefit so that he could properly judge the risk involved in the security he was purchasing. This decision has been upheld by the court of appeals and the Supreme court is now considering it. If the Daniels case is upheld and not reversed by subsequent legislation, then pension plans will be required to meet the provisions of the Security Act of 1933, the Security Exchange Act of 1934, and the Investment Company Act of 1940. These acts require the registration of securities with the SEC, delivery of a "prospectus" to the potential investor prior to sale with periodic updates thereafter, annual reports on financial operations and publication of the registered information. Also, the SEC would have the power to make whatever investigations it feels would be proper for the enforcement of these investment laws and to bring action in the courts to force compliance. The sponsors of private pension plans who are already faced with more rules and regulations than they can possibly read and understand from the Treasury Department, Labor Department and PBGC – thus may be faced with a new and different set of rules and regulations to be issued by the Securities Exchange Commission!

Current Problems

Despite a substantial and serious effort on the part of the Departments of Labor and Treasury, only about two-thirds of the regulations which ERISA calls for have been issued up to this time. The Department of Labor still has to issue regulations on top-hat plans, severance pay, supplemental pay, record-keeping, mergers and consolidations, divestiture, involuntary terminations, contingent employer liability insurance, limits on contributions, suspension of benefits, assignment of benefits, variations from vesting and benefit accrual requirements, distribution of assets upon plan terminations, extension of amortization periods, and amounts of civil penalties. The Treasury has yet to issue regulations on excise taxes, rules on maintaining the funding standard account, treatment of amendments and changes in benefits, actuarial rules, annual registration, periodic reports of actuaries, excise taxes on prohibited transactions, procedures in absence of records for periods prior to ERISA, maximum limitations on contributions and benefits, and discrimination between several plans of the same employer. In addition to these missing regulations, "tax reform" measures are now being proposed to Congress which would reduce the maximum benefits permitted under qualified pension plans and decrease the extent to which private plan benefits could be "integrated" with Social Security benefits.

Apart from the government activity, private pension plans in America, as around the world, face the basic

problems of inflation in wages, the loss of purchasing power in fixed benefit payments, and substantial declines in market values of common stocks and bonds. Matters such as the oil embargo and energy problems, pollution controls and other restrictions instituted by environmental protectionists, consumerism, and a growing emphasis on legal rights to benefits as opposed to earning them, all will have a double impact on the sponsors of private retirement plans. Their ability to support a pension plan will be reduced and the yield on the equity securities in the pension fund will also be reduced. Finally, the Social Security program has become much more costly both to covered employees and their employers. Increases in Social Security benefits since 1971 have reduced the need for private pensions in some areas and the heavy costs required to support them clearly reduce the plan sponsor's ability to support additional benefits through a private pension plan. Finally, general social pressures appear likely to force the plans to provide equal benefits regardless of sex and, perhaps in a few more years, even regardless of age. The expected increase in the age 65 mandatory retirement age to 70, or its elimination entirely, will probably reduce costs but create further problems. Despite the rather gloomy outlook in the way of real world problems, and irritating government regulation, those major employers now sponsoring private pension plans are likely to continue them in the future because of the strongly-felt moral obligation to do something for the long-service, older worker who has given the employer a lifetime of service, but who can no longer work and support himself.

Summary and Conclusions

Private pension plans in the United States are now seriously over-regulated. The law contains far too much detail and the regulations issued under the law thus far are terribly long and almost incomprehensible. Very few plan sponsors are capable of understanding and complying fully with the law and regulations, and very few government employees are capable of understanding them and enforcing them fairly. In short, what is now in place is essentially unworkable, but that reality has yet to be faced. Quite probably, a much more satisfactory result could have been developed if the discussions on pension plan reform had concentrated on general principles rather than details and if there had been a greater willingness to trust a plan sponsor rather than suspecting him of cheating all of his low paid employees and using the pension fund only as a tax shelter for corporate funds. After all, the employer who really wants to cheat his employees out of their pensions can do so with 100% efficiency by not having any plan at all. And that decision then exempts him from all record keeping and fiduciary obligations as well.

Compliance with the regulations will add an immense amount of executive time and expense for the smaller employer in the filling in of government forms, the filing of massive detail for government approval, the maintaining of records over extended periods of time that are not self-checking and will not be complete or accurate, the offering of special pre-retirement spouses' options on a very complicated basis or alternatively providing pre-retirement death benefits at substantial expense, and in the time spent worrying about fiduciary responsibility by everybody connected with the plans. The fiduciary responsibility, for example, means that the employer who cannot determine the exact amount of pension for a particular individual by reason of lack of records or employment facts, can no longer take refuge in the alternative of providing the employee with the highest benefit that might reasonably have been developed. The employer is no longer operating his own plan and taking on added costs for himself but rather is handling money in a fund which is now considered to belong to the entire employee group so that making extra benefit payments is comparable to stealing money from the fund.

The administrative burden of regulation, is pretty much independent of the size of the plan, including such costs as developing the computer programs to maintain employee records, considering the benefit provisions required by various regulations, hiring lawyers to draft complex plan documents, etc. This constant burden increases relatively to the advantages gained in having a pension plan at all, as the size of the group decreases. Thus it is likely in the long run that smaller companies will have to drop their plans entirely or shift to fairly simple defined contribution plans where the individual account balances can be maintained by a bank or insurance company.

All of the reforms are not bad, of course. The limit on the amount of employer securities a fund can hold, the requirement that benefits vest under one of three reasonable schedules, the requirement to fund past service liabilities over 30 years using realistic actuarial assumptions, annual financial reporting of some sort and the limiting of maximum benefits by a CPI indexed amount might be considered desirable, altbough they could have been accomplished with a lesser burden. On the other hand, details such as participation, vesting and benefit accrual rules, hour and year of service rules, special rules for seasonal and maritime industries and corporations under common control, prohibition of specific transactions, creation of a broad class of parties-in-interest, joint and survivor rules and pre-retirement spouse option requirements are all much too complicated to be considered good, even if they work, and they won't.

Norbert Weiner predicted that Western civilization will not come to an end in any highly dramatic manner, such as an atomic holocaust or natural disaster, but rather by the gradual process of making the ways in which we conduct our daily lives more and more complicated to a point where, like a giant snow ball which has grown so large that it can roll no further, our entire society simply slows to a halt. In the pension area in America, we are coming perilously close to this undesirable condition. There may be a few employers with more limited administrative capacities who now require more than a year to finish up all the things that have to be done annually and who will thus simply fall further and further behind as time goes on. More worrisome to me, however, an increasing number of these smaller companies, upon receiving their new supply of government forms, may simply put them in the waste basket, drop their pension plans and forget about the whole dreary business. It might well be said, without fear of contradiction, that things are certainly getting to be a good deal more like they are now than they were in the "good old days".

APPENDIX A
Joint and Survivor Annuity Requirement

Act Sec. 205. (a) If a pension plan provides for the payment of benefits in the form of an annuity, such plan shall provide for the payment of annuity benefits in a form having the effect of a qualified joint and survivor annuity.

Act Sec. 205. (b) In the case of a plan which provides for the payment of benefits before the normal retirement age as defined in Section 3(24), the plan is not required to provide for the payment of annuity benefits in a form having the effect of a qualified joint and survivor annuity during the period beginning on the date on which the employee enters into the plan as a participant and ending on the later or –

(1) the date the employee reaches the earliest retirement age, or

(2) the first day of the 120th month beginning before the date on which the employee reaches normal retirement age.

Act Sec. 205 (c) (1) A plan described in subsection (b) does not meet the requirements of subsection (a) unless, under the plan, a participant has a reasonable period in which he may elect the qualified joint and survivor annuity form with respect to the period beginning on the date on which the period described in subsection (b) ends and ending on the date on which he reaches normal retirement age if he continues his employment during that period.

(c) (2) A plan does not meet the requirements of this subsection unless, in the case of such election, the payments under the survivor annuity are not less than the payments which would have been made under the joint annuity to which the participant would have been entitled if he had made an election under this subsection immediately prior to his retirement and if his retirement had occurred on the date immediately preceding the date of his death and within the period within which an election can be made.

Act Sec. 205. (d) A plan shall not be treated as not satisfying the requirements of this section solely because the spouse of the participant is not entitled to receive a survivor annuity (whether or not an election has been made under subsection (c) unless the participant and his spouse have been married throughout the 1-year period ending on the date of such participant's death.

Act Sec. 205. (e) A plan shall not be treated as satisfying the requirements of this section unless, under the plan, each participant has a reasonable period (as prescribed by the Secretary of the Treasury by regulations) before the annuity starting date during which he may elect in writing (after having received a written explanation of the terms and conditions of the joint and survivor annuity and the effect of an election under this subsection) not to take such joint and survivor annuity.

Act Sec. 205. (f) A plan shall not be treated as not satisfying the requirements of this section solely because, under the plan there is a provision that any election under subsection (c) or (e), and any revocation of any such election, does not become effective (or ceases to be effective) if the participant dies within a period (not in excess of 2 years) beginning on the date of such election or revocation, as the case may be. The preceding sentence does not apply unless the plan provision described in the preceding sentence also provides that such an election or revocation will be given effect in any case in which –

(1) the participant dies from accidental causes,

(2) a failure to give effect to the election or revocation would deprive the participant's survivor of a survivor annuity, and

(3) such election or revocation is made before such accident occurred.

Act Sec. 205. (g) For purposes of this section:

(1) The term "annuity starting date" means the first day of the first period for which an amount is received as an annuity (whether by reason of retirement or by reason of disability).

(2) The term "earliest retirement age" means the earliest date on which, under the plan, the participant could elect to receive retirement benefits.

(3) The term "qualified joint and survivor annuity" means an annuity for the life of the participant with a survivor annuity for the life of his spouse which is not less than one-half of, or greater than, the amount of the annuity payable during the joint lives of the participant and his spouse and which is the actuarial equivalent of a single annuity for the life of the participant.

Act Sec. 205. (h) For the purposes of this section, a plan may take into account in any equitable fashion (as determined by the Secretary of the Treasury) any increased costs resulting from providing joint and survivor annuity benefits under an election made under subsection (c).

Act Sec. 205. (i) This section shall apply only if –

(1) the annuity starting date did not occur before the effective date of this section, and

(2) the participant was an active participant in the plan on or after such effective date.

APPENDIX B
Relationship of the Act and Internal Revenue Code of 1954

Section 2530.200b-2 Hour of Service

(a) General rule. An hour of service which must, as a minimum, be counted for the purposes of determining a year of service, a year of participation for benefit accrual, a break in service and employment commencement date (or reemployment commencement date) under Sections 202, 203 and 204 of the Act and Sections 410 and 411 of the Code, is an hour of service as defined in paragraphs (a) (1), (2) and (3) of this section. The employer may round up hours at the end of a computation period or more frequently.

(1) An hour of service is each hour for which an employee is paid, or entitled to payment, for the performance of duties for the employer during the applicable computation period.

(2) An hour of service is each hour for which an employee is paid, or entitled to payment, by the employer on account of a period of time during which no duties are performed (irrespective of whether the employment relationship has terminated) due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence. Notwithstanding the preceding sentence,

(i) No more than 501 hours of service are required to be credited under this paragraph (a)(2) to an employee on account of any single continuous period during which the employee performs no duties (whether or not such period occurs in a single computation period);

(ii) An hour for which an employee is directly or indirectly paid, or entitled to payment, on account of a period during which no duties are performed is not required to be credited to the employee if such payment is made or due under a plan maintained solely for the purpose of complying with applicable workmen's compensation, or unemployment compensation or disability insurance laws; and

(iii) Hours of service are not required to be credited for a payment which solely reimburses an employee for medical or medically related expenses incurred by the employee.

For purposes of this paragraph (a)(2), a payment shall be deemed to be made by or due from an employer regardless of whether such payment is made by or due from the employer directly, or indirectly through, among others, a trust fund, or insurer, to which the employer contributes or pays premiums and regardless of whether contributions made or due to the trust fund, insurer or other entity are for the benefit of particular employees or are on behalf of a group of employees in the aggregate.

(3) An hour of service is each hour for which back pay, irrespective of mitigation of damages, is either awarded or agreed to by the employer. The same hours of service shall not be credited both under paragraph (a)(1) or paragraph (a)(2), as the case may be, and under this paragraph (a)(3). Thus, for example, an employee who receives a back pay award following a determination that he or she was paid at an unlawful rate for hours of service previously credited will not be entitled to additional credit for the same hours of service. Crediting of hours of service for back pay awarded or agreed to with respect to periods described in paragraph (a)(2) shall be subject to the limitations set forth in that paragraph. For example, no more than 501 hours of service are required to be credited for payments of back pay to the extent that such back pay is agreed to or awarded for a period of time during which an employee did not or would not have performed duties.

(b) Special rule for determining hours of service for reasons other than the performance of duties. In the case of a payment which is made or due on account of a period during wich an employee performs no duties, and which results in the crediting of hours of service under paragraph (a)(2) of this section, or in the case of an award or agreement for back pay, to the extent that such award or agreement is made with respect to a period described in paragraph (a)(2) of this section, the number of hours of service to be credited shall be determined as follows:

(1) Payments calculated on the basis of units of time.

(i) Except as provided in paragraph (b)(3) of this section, in the case of a payment made or due which is calculated on the basis of units of time, such as hours, days, weeks or months, the number of hours of service to be credited shall be the number of regularly scheduled working hours included in the units of time on the basis of which the payment is calculated. For purposes of the preceding sentence, in the case of an employee without a regular work schedule, a plan may provide for the calculation of the number of hours to be credited on the basis of a 40-hour workweek or an 8-hour workday, or may provide for such calculation on any reasonable basis which reflects the average hours worked by the employee, or by other employees in the same job classification, over a representative period of time, provided that the basis so used is consistently applied with respect to all employees within the same job classifications, reasonably defined. Thus, for example, a plan may not use a 40-hour workweek as a basis for calculating the number of hours of service to be credited for periods of paid absenses for one employee while using an average based on hours worked over a representative period of time as a basis for such calculation for another, similarly situated employee.

(2) Payments not calculated on the basis of units of time.

(i) Except as provided in paragraph (b)(3) of this section, in the case of a payment made or due, which is not calculated on the basis of units of time, the number of hours of service to be credited shall be equal to the amount of the payment divided by the employee's most recent hourly rate of compensation (as determined under paragraph (b)(2)(ii) of this section) before the period during which no duties are performed.

(ii) For purposes of paragraph (b)(2)(i) of this section an employee's hourly rate of compensation shall be determined as follows:

(A) In the case of an employee whose compensation is determined on the basis of an hourly rate, such hourly rate shall be the employee's most recent hourly rate of compensation.

(B) In the case of an employee whose compensation is determined on the basis of a fixed rate for specified periods of time (other than hours) such as days, weeks or months, the employee's hourly rate of compensation shall be the employee's most recent rate of compensation for a specified period of time (other than an hour), divided by the number of hours regularly scheduled for the performance of

duties during such period of time. For purposes of the preceding sentence, in the case of an employee without a regular work schedule, the plan may provide for the calculation of the employee's hourly rate of compensation on the basis of a 40-hour workweek, an 8-hour workday, or may provide for such calculation on any reasonable basis which reflects the average hours worked by the employee over a representative period of time, provided that the basis so used is consistently applied with respect to all employees within the same job classifications, reasonably defined.

(C) In the case of an employee whose compensation is not determined on the basis of a fixed rate for specified periods of time, the employee's hourly rate of compensation shall be the lowest hourly rate of compensation paid to employees in the same job classification as that of the employee or, if no employees in the same job classification have an hourly rate, the minimum wage as established from time to time under Section 6(a)(1) of the Fair Labor Standards Act of 1938 as amended.

(c) Crediting of hours of service to computation periods.

(1) Except as provided in paragraph (c) (4) of this section, hours of service described in paragraph (a) (1) of this section shall be credited to the computation period in which the duties are performed.

(2) Except as provided in paragraph (c) (4) of this section, hours of service described in paragraph (a) (2) of this section shall be credited as follows:

(i) Hours of service credited to an employee on account of a payment which is calculated on the basis of units of time, such as hours, days, weeks or months, shall be credited to the computation period or computation periods in which the period during which no duties are performed occurs, beginning with the first unit of time to which the payment relates.

(ii) Hours of service credited to an employee by reason of a payment which is not calculated on the basis of units of time shall be credited to the computation period in which the period during which no duties are performed occurs, or if the period during which no duties are performed extends beyond one computation period, such hours of service shall be allocated between not more than the first two computation periods on any reasonable basis which is consistently applied with respct to all employees within the same job classifications, reasonably defined.

(3) Except as provided in paragraph (c)(4) of this section, hours of service described in paragraph (a) (3) of this section shall be credited to the computation period or periods to which the award or agreement for back pay pertains, rather than to the computation period in which the award, agreement or payment is made.

(4) In the case of hours of service to be credited to an employee in connection with a period of no more than 31 days which extends beyond one computation period, all such hours of service may be credited to the first computation period or the second computation period. Crediting of hours of service under this subparagraph must be done consistently with respect to all employees within the same job classifications, reasonably defined.

(d) Other Federal Law. Nothing in this section shall be construed to alter, amend, modify, invalidate, impair or supersede any law of the United States or any rule or regulation issued under such law. Thus, for example, nothing in this section shall be construed as denying an employee credit for an "hour of service" if credit is required by separate federal law. Furthermore, the nature and extent of such credit shall be determined under such law.

(e) Plan document. A plan which credits service on the basis of hours of service must state in the plan document the definition of hours of service set forth in paragraph (a) of this section, but is not required to state the rules set forth in paragraphs (b) and (c) of this section if they are incorporated by reference.