General Considerations Relating to Funding, Reinsurance and Portability

Funding, reinsurance and portability, together with vesting which has been discussed, are closely related. Any need for reinsurance arises from lack of funding, and portability presupposes adequate funding for individuals going from one employment to another.

Pension plans typically involve conditional promises. The first condition is that a pension will be paid only if the employee lives to receive it after completing a specified term of employment and attaining a certain age. A second condition is the possibility that the plan will be discontinued. Frequently a third condition is that payment of the pension, if the plan is discontinued, will depend on sufficient money in a trust fund to provide the pension. It is this last condition which causes the concern with a minimum funding requirement, reinsurance and portability.

One basic problem in the funding of pension plans arises from the necessity for providing adequate pensions for employees at or close to retirement when a plan is established. The same problem usually recurs whenever the plan is amended to provide additional benefits. As the period of time is short before payment of the pensions to employees at or close to retirement, a very large proportion of the contribution in the early years must ordinarily be devoted to building financial protection for these pensions. Consequently, only a small portion of the early contributions are available to build any financial protection for the younger employees.

Since the money required to secure financially the increase in employees' future pension expectations at the time a plan is established, or improved, is usually far too great to be met by any immediate payment into a fund, financial security can be attained only by payments spread over a number of years. Moreover, if plan improvements are too frequent and too liberal, it may not be possible to achieve financial security. Even if a business is financially able to meet the cost of immediate funding, current Internal Revenue Code limitations as to the maximum payment deductible as a business expense for tax purposes make it more difficult to provide early financial security for employees' pension expectations.

This problem and the gradual funding method have important implications as to the equities of individuals if a plan is terminated during the first two or three decades after its inception or after a substantial increase in its scale of benefits. A pension plan is a *conditional* promise to pay benefits. It is not necessarily inequitable, therefore, if the intent cannot be fully realized with respect to employees who have worked only a few years under the new or improved plan.

Money to defray pensions under most private pension plans is not set aside year by year in the name and for the benefit of individual workers. Neither is it so apportioned under social security or under plans for governmental employees.

The plan will provide an order of application of the funds if the plan is terminated. Those with the first claim to full payment will be individuals already retired on pension or eligible to retire at their own request. This is socially desirable because such individuals are