

NATURE OF THE EMPLOYER'S UNDERTAKING

The obligation assumed by an employer in establishing a pension plan may take one of two forms: an undertaking to set aside funds on a specified basis or an undertaking to provide benefits in accordance with a specific schedule. Under the first approach, the employer does not undertake to provide retirement and other benefits in accordance with a fixed scale of benefits, although the scale of contributions will normally be set in the light of an anticipated level of benefits. The contribution commitment may be stated as a percentage of the compensation of covered employees, as an amount per hour or day of work, or in terms of some productivity factor. Regardless of how the commitment is expressed or determined, the employer's obligation to the plan is deemed to be completely fulfilled when he pays over the appropriate sums, even though the assets of the plan eventually prove insufficient to provide the projected level of benefits.

Under the second approach, the employer ostensibly commits himself to contribute whatever sums are necessary to provide the benefits payable pursuant to a formula or schedule set forth in the plan. The plan may call for a unit of benefit for each year of credited service, a composite benefit equal to a specified percentage of compensation (for the entire period of employment, or the years immediately preceding retirement), or a composite benefit expressed as a flat dollar amount. The plan usually recognizes, and gives credit for, some or all of the service performed for the employer in question prior to the inception of the plan, and subsequent benefit liberalizations are generally made retrospective as to years preceding the plan amendment, both practices giving rise to an unfunded accrued liability that would be the primary source of loss to any guaranty arrangement. Except for collectively bargained plans, the employer reserves the right to alter, modify, or terminate the plan at any time—and for any reason.⁴ Moreover, he generally reserves the right to suspend, reduce, or discontinue contributions to the plan, whether or not previous contributions have been sufficient to provide all benefits credited to date. Finally, it is customary for the employer to limit his obligation, in the event of plan termination, to contributions already made to the plan. In other words, if the plan terminates, the participants and pensioners must look to the accumulated assets for the satisfaction of their claims. In a relatively small number of cases, largely confined to the petroleum and steel industries, the employer guarantees to provide all accrued benefits (sometimes only vested benefits) in the event of plan termination, in effect pledging the corporate resources to the satisfaction of accrued pension claims.

METHODS OF FINANCING

In order to meet the benefit commitments, explicit or implicit, generated under a pension plan, the employer generally sets aside funds

⁴ During the first few years of a plan's existence, it can be terminated without retroactive tax penalties only for reasons of "business necessity."