

A Pension Primer

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Most ICSOM orchestra members currently participate in either a privately trustee pension plan which covers only employees of their particular orchestra, or by the AFM-EP Pension Plan, a multi-employer plan covering AFM members employed by many employers. Either in addition to, or instead of, one of these plans, many musicians have access to a tax-deferred annuity, a 403(b) or 401(k) to which both the employer and the employee may contribute.

In any event, it is helpful for those covered by any of these plans to have some understanding of the basics of pension plans in general, for purposes of negotiations, contract administration, and even simply to understand their own rights and entitlements.

Generally, pension plans take one of three forms: *defined benefit* or *defined contribution* or *hybrid* plans. Most unions, and most employees, prefer defined-benefit plans which, as their name implies, guarantee a certain level of benefits to eligible participants, unrelated to the fluctuations of the stock market or, in many cases, the amount of their earnings.

So, for example, if an employee is covered by a plan which defines the benefit he or she will receive at a certain age, and after a certain number of years of service with the employer, it is the obligation of the sponsoring employer to make whatever contribution to the plan that is actuarially required to assure the employee of that benefit when he or she achieves the two eligibility requirements, e.g., age 65 with 30 years of service.

A defined-contribution plan merely requires the sponsoring employer to contribute a certain amount to the plan on the employee's account, which is usually expressed as a percentage of earnings. In that situation the employer's obligation is limited to making that contribution, which is then invested by the direction of either the employee or the investment advisors of the plan. The employee, as the participant, receives whatever is in his or her account when he or she has achieved any eligibility requirements set by the plan.

A hybrid pension plan is a plan that combines the features of both defined benefit and defined contributions plans. These types of plans are generally cash balance or pension equity plans that express the benefit as the value of a hypothetical account balance. In a typical type of cash balance plan, for example, each year an employee works for the employer, the employer contributes a percentage of salary and provides an interest credit. At retirement, the benefit is based on the amount in a participant's hypothetical account.

The AFM-EPF Plan

As with many other multi-employer plans (one plan, many different contributing employers), the AFM-EPF benefit formula is defined in the plan document, but the employer's obligation is limited to merely making the contribution required by the collective bargaining agreement, or in the plan. Currently, \$1.00 times each \$100 in the employee's account equals the monthly benefit payment but earlier periods had different multipliers. The benefit is reduced for every year an employee retires prior to age 65. The benefit formula is changed periodically by the AFM-EPF trustees as circumstances warrant. (The law requires an equal number of Union and Employer

Trustees). Because of changes in rules regarding the funded status of pension plans, first enacted in 2006 under the Pension Protection Act, right now, the AFM-EP Plan is in “Critical” or Red Zone status and has adopted a “Rehabilitation Plan” that changed benefits and features for employees not yet retired in order to increase the funded status of the Plan. These changes did not affect anyone who was already retired or submitted an application to retire as of June 1, 2010 but affect anyone who plans to retire after that date. The changes include reductions in benefit levels and early retirement, elimination of the benefit guarantee for a single life annuity that provided that for any portion of the benefit earned prior to 2003, if the participant dies before 100 payments are made, the employee’s designated beneficiary would receive the balance of that amount, elimination of the pop-up and guarantee features of the 50% Joint and Survivor annuity and other changes. Any current employees should have received notices regarding these changes and should check with the AFM-EP plan to see how their pension benefits will be affected.

Other Terms of Importance

Vesting

Vesting refers to the concept of guaranteed entitlement. Under the Employee Retirement Income Security Act (ERISA; see below), there are two kinds of vesting;

- a) *Cliff*, whereby a participant has no entitlement at all until and unless he or she works for a contributing employer for five years, the maximum waiting period permitted by law. Upon completing five years in a defined benefit plan, the participant is 100% vested in some benefit as determined by the plan or by the actuaries for the plan. In a defined contribution plan, a participant is always fully vested in his or her own contributions and upon completing three years in a defined contribution plan, the participant is 100% vested in all contributions.
- b) *Tiered or Staged Vesting*, whereby vesting comes in stages, e.g., 20% vested after 3 years, 40% after 5 years, and so on up to 100%. In a defined benefit plan, vesting comes in stages from 3 to 7 years and in a defined contribution plan, vesting requirements in stages are from 2 to 6 years

If a participant becomes vested but has not met any of the eligibility requirements for the receipt of benefits, he or she is referred to as “deferred vested,” meaning that upon achievement of some minimum eligibility he or she will be entitled to receive some benefit, albeit not a full or “normal” benefit.

Normal Retirement Benefit

This is the amount of pension benefit a participant receives when he or she retires at the time of meeting the Plan’s eligibility requirements of age and service. It is also the benefit amount from which a reduction is made for early retirement. That is, typically, if the plan allows for an early retirement (for disability or otherwise), there is an actuarial reduction factor that is usually between 4% and 6% per year for each year that one is younger than the “normal retirement age,” usually 65 or Social Security retirement age. There is also an actuarial reduction factor in some cases wherein the participant has fewer than the number of years of service than that which is needed for the full “normal” benefit.

ERISA

ERISA is the acronym for the 1974 pension reform act, the Employee Retirement Income Security Act, which contains virtually all of the rules and regulations under which most pension plans and other benefit plans operate. The Internal Revenue Code also contains provisions relevant to pension plans.

The Act is administered by many federal agencies, including the Treasury and Internal Revenue Service, the Department of Labor and the Pension Benefit Guaranty Corporation (PBGC), which collects insurance payments from covered plans to be used to pay benefits to the vested participants of any plan which dissolves or is otherwise unable to provide benefits from its assets.

Actuary

An actuary is a professional expert in calculating the costs of providing benefits to a group of employees, using mathematical and other assumptions about longevity, mortality, retirement age, funding methods, investment yield, and other factors.

In addition, actuaries normally supply an annual “state of the pension” report, called an “actuarial valuation” as well as funding reports known as AFTAP (Adjusted Target Attainment Percentage). The actuarial valuation provides important information about the participants and funding status of the plan needed to negotiate the pension. In addition, the actuary must certify information filed on the Form 5500 report, the annual return required to be filed by every plan with the Department of Labor.

Actuarial Assumptions

The annual cost of assuring that the defined benefit will be available when each employee becomes eligible to receive it is determined based on certain methods known as actuarial assumptions.

These assumptions include the age at which participants will actually retire (as opposed to the age at which they are eligible to retire), how long they will live after they begin receiving benefits, and, most important, how much income will be earned through the investment of the contributions made by the employer(s) and, in some cases, by the participants.

Very slight changes in any of these assumptions as negotiated and agreed by the parties and the actuary can have a significant impact on the amount of required contributions and/or the amount of the pension benefit. For example, a 1% increase in the investment income assumption, e.g., from 6% to 7%, could either reduce the amount of contribution required by as much as 30% or increase the normal retirement benefit by a like amount without any additional money being received by the plan.

Of course, it must always be remembered that these are merely “assumptions,” and when they turn out to be wrong for a period of years the contribution level needs to be increased or the benefit level reduced. Reductions in benefit accruals, however, may only be made prospectively except under certain limited circumstances; usually, vested participants may not suffer any reduction in benefits retroactively.

SPD

Plan sponsors are required by ERISA to issue a Summary Plan Description (SPD) and to update it at least every five years, and make it available upon request to any participant. If information required to be in an SPD has changed, a plan sponsor must provide a “summary of material modifications” setting forth the changes. Usually, this must be provided within 210 days of the close of the plan year in which the changes are adopted.

Unlike the actuarial valuation, the SPD must be written in plain English so that lay people can understand it. If there are still questions, most employers have someone on staff, e.g., in human resources, whose job includes answering such questions. ICSOM delegates are also invited to call Counsel’s office for explanations and other assistance.