Parental Leave and Dependent Care Issues in Congress

As federal lawmakers try to wrap up major budget and deficit issues before the close of the first session of the 100th Congress, they will leave much work unfinished—but still on the agenda. Two issues—parental leave and dependent care—are likely to receive a good deal of attention in 1988.

Parental Leave

Legislation to require employers to offer new parents unpaid leave from work (the Family and Medical Leave Act, H.R. 925) will probably be up for a floor vote in the House of Representatives early next year, congressional staff advise.

The full House will be considering an amended version of the bill, which the House Education and Labor Committee approved Nov. 17. As amended, the bill would require firms with 50 or more employees to offer 10 weeks of unpaid leave over a 24-month period for the birth, adoption, or serious illness of a child. The leave could also be used for the serious illness of an elderly parent. After the first three years following enactment, the require-
businesses should recognize the
need of parents to balance the
demands of work and home, and
that providing this leave plainly
makes good business sense (i.e., it
helps employee morale and in-
creases productivity).

Opponents of the legislation, such as
the U.S. Chamber of Commerce, the
National Association of Manufac-
turers, and the National Association of
Wholesale Distributors, generally
believe parental leave is a good idea
but are opposed to federal and state
mandates. They argue that mandat-
ing leave will reduce an employer's
flexibility in designing employee
benefit packages to fit individual
needs and will actually reduce the
value of benefit packages for some
employees by necessitating the
exclusion or reduction of other
benefits. Many firms, especially
smaller ones, also expect their costs
of doing business would be greater
if parental leave were mandated.
(For a review of research in this area,
see EBRI Issue Brief 73, "The Impact
of Government Regulation on the
Labor Market: A Survey of Research
Findings," December 1987.)

The costs of federal parental leave
legislation are disputed. The
General Accounting Office (GAO)
estimates the annual cost would be
less than $500 million, which repre-
sents the cost of providing health
insurance to employees on leave.
GAO found that less than one in
three employees on leave is re-
placed, so it included no costs in its
estimate for employee replacement.
The U.S. Chamber estimates the cost
at between $2.6 billion and $16.2
billion, the latter including the
assumption that all employees on
leave would be replaced.

Dependent Care

Congress has also shown increased
interest in legislating federal de-
dependent care policies. Most recently,
Rep. Dale Kildee (D-MI) and Sen.
Dodd introduced a far-reaching
national child care bill supported by
95 national organizations. The
legislation, known as the Act for
Better Child Care Services (H.R.
3660), would help low-income
families pay for care and expand day
care services across the country.
The bill also would establish the first
minimum federal child care stan-
dards, including limits on the
number of children one adult could
care for at home, staff-to-child ratios
at day care centers, day care pro-
vider training, and health and safety
requirements. Prior legislative
proposals have been more piecemeal
in their approach. Congress passed
comprehensive child care legislation
in 1971 but it was vetoed by then-
President Nixon.

The Kildee bill carries a price tag of
$2.5 billion for fiscal year 1989,
which is considered an obstacle to
the bill's success in a Congress that
must wrestle with trimming the
federal deficit. A more modest
proposal by Sen. Orrin Hatch (R-UT)
calls for $875 million over three
years to provide incentives to state
governments to establish local child
care programs.

Much of the recent public and
congressional focus on dependent
care in the U.S. has stemmed from
reports of the lack of adequate day
care facilities and workers to staff
them, the quality of care in the
centers, and the high costs. In a
move that may heighten sensitivity
to dependent care issues in this
country, the Canadian government
has proposed a $4 billion program to
expand day care centers and provide
tax relief for working parents. The
plan would increase child care
services to cover more than 400,000
children and would increase the tax
deduction for payments for child
care for children under age 6.

The U.S. allows a 30 percent tax
credit for child or dependent care
expenses up to $2,400 per dependent
or $4,800 for two or more children,
although the Senate Finance Com-
mittee in its deficit reduction pack-
age has proposed limiting the type
of services for which the credit
would be available.

In EBRI-ERF's new book, Govern-
ment Mandating of Employee
Benefits, authors Sara Rix of the
Women's Research and Education
Institute and Gwen Morgan of
Work/Family Directions discuss the
effects mandated parental leave
would have on work and family
and review employer and govern-
ment involvement in dependent care
issues.

Asset Reversions
Slow Considerably

New data from the Pension Benefit
Guaranty Corporation (PBGC) show
that asset reversions resulting from
the termination of defined benefit
pension plans are occurring less
frequently in 1987 than they did in
1986.

In the first half of 1987, there were 85
terminations with asset reversions in
excess of $1 million; 36 of those cases
were pending as of June 30. The
terminations resulted in reversions
of nearly $880 million and affected 106,000 participants. In contrast, there were 253 such terminations in 1986 (14 are still pending), with total reversions of nearly $4.2 billion (table 1).

The rate of terminations involving large asset reversions increased dramatically between 1981 and 1985, then declined in 1986. The 1987 numbers confirm that the decline in 1986 was not an isolated phenomenon. In contrast, the average size of reversions was fairly level at about $10.7 million in 1984 and 1985. This figure jumped to $16.8 million in 1986, then fell to $10.3 million during the first six months of 1987.

The new PBGC data categorize terminated plans by the type of plan that replaces them. Since the passage of the Single Employer Pension Plan Amendments Act of 1986 (SEPPAA), nearly 50 percent of terminated plans have been succeeded by a replacement defined benefit plan: approximately 30 percent simply reestablished a defined benefit program while nearly 20 percent recovered excess assets through a "spin-off" termination. In a spin-off termination, one defined benefit plan is divided into two, the first covering active participants and the second covering retirees and other beneficiaries. Excess assets are placed in the latter plan, which is then terminated.

Although only one-fifth of terminated plans were replaced by a spin-off arrangement, this group accounts for nearly 50 percent of the total assets of terminated plans (table 2). This indicates that plans choosing the spin-off option tend to be larger; these plans had average assets of $95.2 million, nearly three times the average of plans in other replacement categories. However, spin-off terminations accounted for only 25 percent of terminated-plan participants. Thirty-one percent of all terminated plans, covering nearly 40 percent of participants, were simply

<table>
<thead>
<tr>
<th>Year of Termination</th>
<th>Plans</th>
<th>Participants</th>
<th>Assets</th>
<th>Benefits</th>
<th>Reversions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>9</td>
<td>22,242</td>
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<td>$40.0</td>
<td>$18.5</td>
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<td>1981</td>
<td>35</td>
<td>30,512</td>
<td>341.5</td>
<td>182.9</td>
<td>158.5</td>
</tr>
<tr>
<td>1982</td>
<td>82</td>
<td>123,587</td>
<td>1,136.8</td>
<td>732.9</td>
<td>403.9</td>
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<tr>
<td>1983</td>
<td>165</td>
<td>167,030</td>
<td>3,414.1</td>
<td>1,811.7</td>
<td>1,602.3</td>
</tr>
<tr>
<td>1984</td>
<td>331</td>
<td>384,882</td>
<td>7,444.9</td>
<td>3,889.6</td>
<td>3,575.3</td>
</tr>
<tr>
<td>1985</td>
<td>577</td>
<td>668,721</td>
<td>13,803.7</td>
<td>8,056.9</td>
<td>5,746.8</td>
</tr>
<tr>
<td>1986</td>
<td>238</td>
<td>238,976</td>
<td>8,396.1</td>
<td>4,312.2</td>
<td>4,083.9</td>
</tr>
<tr>
<td>1987</td>
<td>49</td>
<td>51,503</td>
<td>1,215.1</td>
<td>747.3</td>
<td>467.8</td>
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<td>Total</td>
<td>1,486</td>
<td>1,687,453</td>
<td>$35,810.8</td>
<td>$19,753.5</td>
<td>$16,057.0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year of Termination</th>
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<th>Assets</th>
<th>Benefits</th>
<th>Reversions</th>
</tr>
</thead>
<tbody>
<tr>
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<td>68</td>
<td>27,092</td>
<td>0.7</td>
<td>0.4</td>
<td>0.3</td>
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<tr>
<td>1981</td>
<td>11</td>
<td>16,918</td>
<td>907.7</td>
<td>355.3</td>
<td>552.4</td>
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<tr>
<td>1982</td>
<td>14</td>
<td>54,883</td>
<td>1,259.8</td>
<td>847.4</td>
<td>412.1</td>
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<tr>
<td>1983</td>
<td>222</td>
<td>98,961</td>
<td>$2,605.7</td>
<td>$1,467.8</td>
<td>$1,137.9</td>
</tr>
<tr>
<td>Total</td>
<td>62</td>
<td>98,961</td>
<td>$2,605.7</td>
<td>$1,467.8</td>
<td>$1,137.9</td>
</tr>
</tbody>
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</tr>
<tr>
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</tr>
<tr>
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<td>13,803.7</td>
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<td>8,396.1</td>
<td>4,312.2</td>
<td>4,083.9</td>
</tr>
<tr>
<td>1986</td>
<td>49</td>
<td>51,503</td>
<td>1,215.1</td>
<td>747.3</td>
<td>467.8</td>
</tr>
<tr>
<td>Total</td>
<td>1,549</td>
<td>1,786,414</td>
<td>$38,416.5</td>
<td>$21,221.3</td>
<td>$17,194.9</td>
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</table>

Source: EBRI tabulations based on Pension Benefit Guaranty Corporation data.
Table 2
Pending and Completed Post-SEPPAA Asset Reversions
in Excess of $1 Million, as of June 30, 1987

<table>
<thead>
<tr>
<th>Provisions for Replacement Plan</th>
<th>Plans</th>
<th>Participants</th>
<th>Assets (millions)</th>
<th>Average Plan Size (millions)</th>
<th>Assets Per Participant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spin-off</td>
<td>60</td>
<td>93,668</td>
<td>$5,712.2</td>
<td>$95.2</td>
<td>$60,983</td>
</tr>
<tr>
<td>Reestablishment</td>
<td>107</td>
<td>149,662</td>
<td>3,854.5</td>
<td>36.0</td>
<td>25,755</td>
</tr>
<tr>
<td>Defined contribution</td>
<td>98</td>
<td>86,282</td>
<td>1,254.1</td>
<td>12.9</td>
<td>14,535</td>
</tr>
<tr>
<td>No new plan</td>
<td>75</td>
<td>52,811</td>
<td>1,214.3</td>
<td>16.2</td>
<td>22,993</td>
</tr>
<tr>
<td>Total</td>
<td>340</td>
<td>382,423</td>
<td>$12,035.1</td>
<td>$160.3</td>
<td>$124,266</td>
</tr>
</tbody>
</table>

Source: EBRI tabulations based on Pension Benefit Guaranty Corporation data.

reestablished as defined benefit plans.

Nearly 30 percent of the terminated defined benefit plans were replaced with a defined contribution plan, accounting for 10 percent of terminated plan assets and 23 percent of participants. Assets per participant in this group are lower than in any other replacement category and 40 percent lower than cases in which terminated plans were not replaced by a new plan. Thus, plans that choose the defined contribution option may be less mature, less generous, or less overfunded (chart 1).

Approximately 20 percent of terminated plans were not replaced by a new plan; such terminations account for 13 percent of participants in terminated plans.

Growth in Number of Pension Plans Since ERISA

New EBRI tabulations of data from the Internal Revenue Service (IRS) and the Department of Labor (DOL) indicate there were 849,000 pension plans in mid-year 1986, a 3.3 percent increase from 822,000 plans at year-end 1985. Since 1974, the number of pension plans has grown at an average annual rate of 7.1 percent.

These revised year-end estimates, based on a new tabulation method-
ology, provide a more accurate portrayal than previous estimates of the number of plans in operation.

Table 3 details the increase in the number of plans since 1974 and includes revised estimates for the years 1974–76, 1985, and 1986. During the first half of 1986, the number of plans grew at an annual rate of 6.6 percent. Although this rate is lower than the 9.8 percent increase observed in 1985, it is only marginally below the average annual rate of 7.1 percent. The absolute number of pension plans has increased every year since 1974; the lowest increase was 1.1 percent in 1983 and the highest 12.6 percent in 1977.

Chart 2 illustrates the growth in defined benefit and defined contribution plans since 1974. Between January and June 1986, defined benefit plans increased 2.6 percent to 242,000, or 28.6 percent of all pension plans. Defined contribution plans, including 401(k) plans, grew 3.5 percent to 606,000 by mid-year 1986, representing 71.4 percent of all plans.

Since the passage of the Employee Retirement Income Security Act (ERISA) in 1974, the ratio of defined benefit and defined contribution plans to the total number of plans has been an issue of particular interest. Many believed that ERISA’s changes, including minimum funding requirements and mandated insurance for defined benefit plans, would result in a significant decrease in the number of these plans. Because defined contribution plans are considered to place greater risk on plan participants than defined benefit plans, in which the sponsoring firm and the Pension Benefit Guaranty Corporation (PBGC) bear most of the risk, many were concerned that a decrease in the relative value of defined benefit plans in response to ERISA would threaten future workers’ retirement income security.

Table 3 shows that, with the exception of 1976 and 1984, the absolute number of defined benefit plans has risen every year since the passage of ERISA. Between 1974 and 1986, defined benefit plans grew at an average annual rate of 5.6 percent. As a proportion of all plans, how-

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Plans (thousands)</th>
<th>Percent Growth</th>
<th>Defined Benefit</th>
<th>Defined Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total plans</td>
<td>Percent growth</td>
<td>Total plans</td>
<td>Percent growth</td>
</tr>
<tr>
<td>1974</td>
<td>371</td>
<td>—</td>
<td>126</td>
<td>34.0%</td>
</tr>
<tr>
<td>1975</td>
<td>381</td>
<td>2.7%</td>
<td>125</td>
<td>31.6%</td>
</tr>
<tr>
<td>1976</td>
<td>401</td>
<td>5.1%</td>
<td>127</td>
<td>29.3%</td>
</tr>
<tr>
<td>1977</td>
<td>451</td>
<td>12.6%</td>
<td>132</td>
<td>28.1%</td>
</tr>
<tr>
<td>1978</td>
<td>496</td>
<td>9.8%</td>
<td>139</td>
<td>27.5%</td>
</tr>
<tr>
<td>1979</td>
<td>539</td>
<td>8.7%</td>
<td>146</td>
<td>26.8%</td>
</tr>
<tr>
<td>1980</td>
<td>590</td>
<td>9.5%</td>
<td>179</td>
<td>28.4%</td>
</tr>
<tr>
<td>1981</td>
<td>663</td>
<td>12.4%</td>
<td>203</td>
<td>30.6%</td>
</tr>
<tr>
<td>1982</td>
<td>729</td>
<td>9.9%</td>
<td>220</td>
<td>30.2%</td>
</tr>
<tr>
<td>1983</td>
<td>767</td>
<td>1.1%</td>
<td>226</td>
<td>30.1%</td>
</tr>
<tr>
<td>1984</td>
<td>748</td>
<td>1.6%</td>
<td>216</td>
<td>28.8%</td>
</tr>
<tr>
<td>1985</td>
<td>822</td>
<td>9.8%</td>
<td>236</td>
<td>28.7%</td>
</tr>
<tr>
<td>1986</td>
<td>849</td>
<td>3.3%</td>
<td>242</td>
<td>28.6%</td>
</tr>
</tbody>
</table>

Source: Department of Labor benchmark series and EBRI tabulations of Internal Revenue Service determination letter statistics.

*Values for 1974–1985 are year-end estimates; 1986 estimates are through June.
ever, defined benefit plans decreased 5.4 percentage points over the past 12 years, from 34.0 percent to 28.6 percent. Although the growth rate of defined benefit plans is slightly lower than that for defined contribution plans (7.8 percent), this does not necessarily indicate that ERISA has had an adverse effect on the number of defined benefit plans.

Data for 1977–84 are based on DOL tabulations of 5500 forms, the ERISA-required reporting instrument for employer-sponsored pension plans. DOL's benchmark plan count is believed to be highly accurate, but release of the data is delayed for three years.

IRS data on net determination-letter activity provide information for 1974–76, 1985, and 1986. Upon request, the IRS issues letters of determination to pension plan sponsors that intend to establish, amend, or terminate a pension plan. A determination letter indicates to the sponsor whether the plan in question meets ERISA requirements. Because ERISA-qualified plans receive favorable tax treatment, plan sponsors have an incentive to know in advance whether the plan meets ERISA's standards. Although sponsors are not required to file for letters of determination, it is believed that most do so before establishing, amending, or terminating a plan.

Net determination-letter activity—new plan qualifications less plan terminations—provides a reasonable estimate of the number of plans in operation since the DOL benchmark. To correct for IRS processing delays, EBRI tabulations offset the determination letter series by one year. EBRI estimates for years other than 1977–84, therefore, are based on determination letter activity reported in the subsequent year.

Of the 27,000 net new plans established between January and June, 1986, 23 percent were defined contribution and 77 percent were defined benefit (chart 3). Most of the 21,000 new defined contribution plans (77.4 percent) were profit sharing plans. Money purchase plans were the next most frequently
established plans (19.4 percent of new defined contribution plans), followed by stock bonus, employee stock ownership plans, and target benefit plans, each representing about 1 percent of new defined contribution plans.

Retiree Health Benefit Liabilities: Implications for Employers and Public Policymakers


Continuation of employer-provided health insurance into retirement has been a relatively common provision of medium and large employer plans during the past 20 years. In 1986, 76 percent of full-time health plan participants in medium and large establishments had coverage continued after early retirement; 90 percent of these had coverage continued after age 65.

EBRI began working on the issue of retiree health insurance some years ago. When the Deficit Reduction Act of 1984 initially called for a study by the federal government, and the Tax Reform Act of 1986 extended the report's due date, EBRI decided to undertake research that might assist in that effort. Milliman & Robertson, Inc., agreed to perform an actuarial study of the liability question, focusing on how employers might deal with the issue through funding and how much alternative approaches might cost.

The issues addressed in this study have major implications for employers that offer retiree health benefits, for policymakers concerned about the future of these programs, and for labor unions and organizations that represent the millions of active and retired workers who benefit from retiree health programs. Several major conclusions can be drawn from the summarized actuarial analysis and projections:

The new accounting standards under development by the Financial Accounting Standards Board (FASB) are likely to have a significant impact on the reported earnings of companies that have retiree medical plans covering all or most of their work force.

Companies should carefully review the impact of such standards on their earnings to determine whether modifications in their current programs are appropriate.

Public policymakers should determine whether corporate-sponsored retiree medical benefits should be encouraged and, if so, they should remove the current legal restrictions that prevent companies from prefunding the benefits.

Impact on Financial Statements

Utilizing the actuarial projections from the study, as well as the results
of a survey published by Charles D. Spencer & Associates, Inc., regarding the current pay-as-you-go costs for 34 Fortune 500 companies, Milliman & Robertson has estimated the impact the FASB requirement would have on earnings for companies that have such programs.

If FASB were to apply accounting rules to retiree medical plans similar to the rules that now apply to pension plans, the additional annual expense per employee for a typical company might be approximately $2,000. Under these same rules, the accrued liability ("projected benefit obligation") for future benefits might be approximately $10,000 per employee. Actual expenses and liabilities vary significantly by company; these amounts are, however, typical of many companies.

Table 4 summarizes the range of 1986 net income and stockholders' equity per employee for all Fortune 500 companies. The 75th percentile company is the one whose value is greater than or equal to that of 75 percent of all companies and less than the value of the remaining 25 percent.

Possible Plan Redesign

For those companies that find that the additional costs would make their current program unaffordable, several aspects of the plan could be changed to bring it into line with the company's available resources. Several issues that might be considered are discussed below.

Variations in Benefits by Length of Employment — Most companies that provide medical benefits for retirees provide the same level of coverage for all retirees who qualify. This differs from pension benefits, which generally vary depending upon the length of employment. Some employers are now beginning to explore alternative approaches to designing retiree medical coverage, such as providing lower benefits for short-service employees than for long-service employees.

How Benefits Coordinate with Medicare — Most employer-provided retiree medical plans coordinate benefits with the payments made by Medicare for plan participants age 65 and over. The two most common methods for coordinating benefits are: (1) a carve-out provision; and (2) a coordination-of-benefits provision. The coordination-of-benefits provision is more generous and more expensive for the employer. In view of the high costs of their programs, a number of employers are now taking a look at the methods used to coordinate their plans with Medicare.

Paying a Fixed Dollar Amount toward Retiree Coverage — Most employers that provide retiree medical coverage pay for the coverage in full or contribute a percentage of the actual cost. Therefore, employer costs rise each year in proportion to increases in medical care costs and utilization of benefits. To make future expenditures more predictable and less susceptible to medical care inflation, employers may choose to define their benefit promise to retirees as a fixed dollar amount. This amount would be contributed each year toward the cost of coverage and would increase only if the company chose to liberalize the payment. Under this approach, the retiree would be required to pay the balance of the cost of coverage and would bear all, or a portion, of future increases in costs.

Retiree Medical Accounts — Proposals have been made to allow employers to fund retiree medical coverage through an individual account. This account would be funded in the same manner as a defined contribution pension plan.

Table 4
1986 Net Income and Stockholders' Equity Per Employee, Fortune 500 Companies

<table>
<thead>
<tr>
<th>Company Rank</th>
<th>Net Income Per Employee</th>
<th>Reduction in Net Income If Expense Increased $2,000</th>
<th>Stockholders' Equity Per Employee</th>
<th>% of Equity Required to Cover Accrued Liability of $10,000</th>
<th>% of Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>90th percentile</td>
<td>$14,300</td>
<td>14%</td>
<td>$101,000</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>75th percentile</td>
<td>$7,600</td>
<td>26%</td>
<td>$67,000</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td>Median</td>
<td>$4,200</td>
<td>48%</td>
<td>$39,000</td>
<td>26</td>
<td></td>
</tr>
<tr>
<td>25th percentile</td>
<td>$1,200</td>
<td>167%</td>
<td>$24,000</td>
<td>42</td>
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</tr>
<tr>
<td>10th percentile</td>
<td>-2,200</td>
<td>-</td>
<td>$14,000</td>
<td>71</td>
<td></td>
</tr>
</tbody>
</table>

Source: Milliman & Robertson, Inc.
The employer would make predetermined contributions annually during a worker's employment and the account would accrue for the employee's benefit at retirement. While not currently allowed under the tax law, this approach may be considered more seriously in the future. It would also provide a vehicle for employees to save for their retiree medical expenses by allowing them to contribute to their accounts on a tax-favored basis.

Program Restructuring if Catastrophic Legislation Enacted — The Medicare catastrophic legislation moving through Congress would increase the extent of Medicare coverage and, therefore, decrease the need for benefits payable by employers for retirees age 65 and older. If this legislation is enacted, it would offer an opportunity for employers to consider restructuring their programs, perhaps reducing benefits for acute care and extending coverage for long-term care.

Need to Allow Funding

The third implication has to do with the need for policymakers to determine whether these programs should be encouraged. If so, current law should be revised so that companies can adequately fund them. To illustrate the restrictions inherent in the current rules, chart 4 shows the liabilities a model company would incur if it ceased operations and the fund that would have accumulated if no future medical cost inflation had been anticipated (as is required under current law).

As chart 4 illustrates, if employers are prevented from anticipating the...
impact of the continuing high level of medical care cost inflation, they will not be able to accumulate sufficient funds to provide these lifetime benefits even for people already retired at the time operations cease. Hence, no funds would be available to provide benefits to the group of active employees, many of whom would be eligible to retire.

If Congress agrees that retiree health benefits are important, then companies should be encouraged to accumulate funds to pay for them while the companies are financially healthy. Alternatively, if retiree medical benefits are not considered important enough to justify such a tax expenditure, companies should be permitted to restructure their programs in an orderly manner to a long-term affordable level.

Investment Manager Liability

[This column, a regular feature of Employee Benefit Notes, was prepared by EBRI's legal counsel, Arnold & Porter, under the supervision of K. Peter Schmidt. In litigation related to the case discussed herein, Arnold & Porter represents certain trustees of the plan in question.]

In Lowen v. Tower, Nos. 87-7205, 87-7289, slip op., Sept. 17, 1987, the Second Circuit Court of Appeals affirmed a grant of summary judgment against an investment manager and, in doing so, addressed two issues of first impression under the Employee Retirement Income Security Act (ERISA).

First, the court held that where a plan's investment manager receives any consideration from a party dealing with the plan, the manager has the burden of proving that such transaction does not violate ERISA section 406(b)(3).

Second, the court held that an investment manager cannot avoid liability for investment decisions on grounds that the decisions were directed by the trustees who appointed the manager.

Prohibited Transactions

Section 406(b)(3) of ERISA prohibits a fiduciary from receiving consideration from a third party "in connection with" a transaction involving plan assets. In Lowen, the trial court found that an investment manager violated this prohibition by receiving fees and stock from companies in which it had invested plan assets. (The court also found violations of section 406(b)(1).)

On appeal, the investment manager argued that whether such consideration was received "in connection with" the plan's investment constituted an issue of fact. The Second Circuit upheld the district court's decision, holding that the investment manager had the burden of establishing the legality of its payments—a burden that the court found had not been met.

The Second Circuit noted Congress' conclusion that plans could be unduly restricted by the common law's flat prohibitions on transactions with parties in which the trustee has its own interest. For example, a flat prohibition could prevent plans from utilizing the services of major financial institutions whose operations are so large "as to preclude the complete isolation of transactions demanded at common law." Congress, the court explained, had modified the traditional rule by adding the "in connection with" language referred to above, and by providing, for certain practices, statutory and administrative exemptions from the prohibitions of section 406.

The court held that a fiduciary charged with violating section 406(b)(3) must either: (1) prove by a preponderance of evidence that the consideration in question came within one of the statutory or administrative exemptions; or (2) prove by clear and convincing evidence that the consideration was not received "in connection with" a transaction involving plan assets.

The court reasoned that the burden of proof properly fell on the fiduciary because: (1) the "in connection with" language should not be allowed to create a loophole permitting self-dealing; and (2) the fiduciary, having a monopoly of information concerning the transaction, is best positioned to demonstrate the absence of such self-dealing. The higher "clear and convincing" standard applies when the fiduciary does not claim an exemption but instead asserts that the consideration was not received "in connection with" the investment of plan assets.

The court cites, for example, section 170(1) of the Restatement (Second) of Trusts, comment to which states that a trust company or bank commits a breach of trust under the common law when it makes in its own banking department a general deposit of funds held by it as trustee.
exemption process should be the ordinary manner by which a fiduciary receives payments which would otherwise be proscribed by section 406(b): "[T]ransactions that fall outside these exemptions deserve exacting scrutiny."

Fiduciary Status

The Second Circuit also rejected the investment manager's defense that it was ordered to make the investments in question and, therefore, lacked the discretionary authority of a fiduciary. The court reasoned that ERISA is carefully structured to clearly allocate responsibility for investment decisions. The statute expressly permits trustees to delegate these responsibilities to an appointed professional investment manager. Where a manager has been appointed, the trustees are not generally responsible for the investment decisions.

Viewed against this background, the court held that, even if the trustees had ordered the manager to make certain investments, the manager was obligated to make its own independent judgment as to the wisdom of the investments. If it had determined that the investments were inappropriate, the manager was required to so advise the trustees. In short, the court concluded, "an investment manager's fiduciary obligations may not be turned on and off like running water." Thus, whether the trustees directed the investments was seen as irrelevant to the investment manager's liability.

The court's opinion serves as a warning to investment managers and others designated as fiduciaries with respect to investment decisions.

Under the court's opinion, the fiduciary may be held responsible for decisions specifically delegated to it, regardless of any directions it receives from other sources, including trustees, counsel, or plan sponsors.

Legislation & Litigation

Most Benefit Items Unresolved

As the 100th Congress neared adjournment, members were primarily occupied with attempting to reach agreement on the proposed 1988 federal budget, and many employee benefit issues were still unresolved at press time. It appeared likely that proposed technical corrections, including those affecting the Tax Reform Act of 1986 and the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), would be pulled from the budget bill and taken up next year.

Next month Employee Benefit Notes will feature a review of 1987 congressional action and a forecast of what 1988 holds for employee benefits. Following are highlights of the major areas in question as this issue went to press.

Pension Plan Funding — Taxation of contributions to pension plans with assets exceeding 150 percent of termination liabilities appears as a new revenue source in both the House and Senate budget bills and is likely to end up in the final legislation. Increased Pension Benefit Guaranty Corporation (PBGC) premiums and PBGC funding reforms were also likely to end up in the reconciled budget bill, although precisely in what form was an open question.

Catastrophic Health Care — Med- icare's catastrophic health care legislation will not be completed by year's end. A conference committee to resolve differences between the House and Senate versions will meet early next year, probably in January.

Section 125 Cap — The House version of budget reconciliation places a $500 cap on the tax-free benefits available in cash from a cafeteria plan; contributions to a flexible spending account could not exceed $500 in any year for an employee. Many observers believe the proposal's outcome is too close to call.

Mandated Health Insurance — A scheduled December markup of the bill (S. 1265) introduced by Sen. Edward Kennedy (D-MA) was postponed by the Senate Labor and Human Resources Committee. Staff advise that it may take place early next year. Others predict some form of mandated health coverage will eventually be passed, but not until the 101st Congress. The House will hold hearings in 1988 on its version of the measure—H.R. 2508, sponsored by Rep. Henry Waxman (D-CA).

The only specific types of care the Kennedy legislation currently would require employers to cover are prenatal and well-baby care, but mandated coverage of mental health services will almost certainly be added to the bill.

COBRA — While it may be several months before the final COBRA regulations are out, the House approved technical corrections that would provide for the following: (1) health coverage could not be terminated when a qualified beneficiary
receives new coverage if that new coverage includes a preexisting condition provision; (2) the definition of covered employee would be amended to mean anyone covered under the health plan; (3) the loss-of-deductibility penalty for noncompliance would be replaced with an excise tax; and (4) there could be joint and several liability for violations. As noted earlier, these corrections were included in the House budget bill but may be dropped.

Retiree Health Insurance — In 1987 Congress extended the expiration date of a provision passed in 1986 temporarily barring companies that file for protection under Chapter 11 of the federal Bankruptcy Code from terminating retiree health benefit plans. The measure was extended pending enactment of permanent legislation.

During this session the Senate passed S. 548, introduced by Sen. Howard Metzenbaum (D-OH), while the House approved H.R. 2969, introduced by Rep. Peter Rodino (D-NJ). Both versions would bar companies from terminating postemployment health benefits unless an agreement is first reached with beneficiaries or the bankruptcy court orders it. As the session approached adjournment, congressional negotiators were attempting to reconcile their differences over what standards should apply to cases already "in the pipeline."

Floor Action Set for Long-Term Care Bill

The Medicare Long-Term Home Care Catastrophic Protection Act (H.R. 3436), introduced by Reps. Claude Pepper (D-FL) and Edward Roybal (D-CA), has been cleared for floor action by the House Rules Committee, of which Pepper is chairman.

The bill is likely to be considered on the House floor in early 1988. It would finance a home care benefit under Medicare through elimination of the cap on income subject to the Medicare payroll tax, $45,000 per worker in 1988.

Regulations

Post-65 Accruals

The Equal Employment Opportunity Commission (EEOC) has proposed rules requiring many employers to continue making pension plan contributions on behalf of employees who work beyond normal retirement age. The rules would implement amendments to the Age Discrimination in Employment Act passed in 1986 and generally would be effective for plan years beginning in January 1988. Comments will be accepted through Dec. 28. Contact Executive Secretariat, EEOC, Room 507, 2401 E St., NW, Washington, DC 20507. (202) 634-6423. See the Nov. 27, 1987, Federal Register, pp. 45360-45363.

Multiemployer Plans: Allocating Unfunded Vested Benefits

The Pension Benefit Guaranty Corporation (PBGC) has proposed rules for determining unfunded vested benefits allocable to employers that withdraw from a multiemployer pension plan after the plan has merged with another (see the October 1987 Employee Benefit Notes, pp. 3-4). Comments must be submitted by Jan. 8, 1988, to Office of the General Counsel (22500), PBGC, 2020 K St., NW, Washington, DC 20006. (202) 778-8850. See the Nov. 9, 1987, Federal Register, pp. 43082-43089.

Nursing Home Regulations

The Health Care Financing Administration (HCFA) has proposed regulations implementing survey and certification requirements recommended by the Institute of Medicine affecting nursing homes that participate in the Medicare and Medicaid programs. Comments must be received before 5 p.m. on Feb. 16, 1988, addressed to HCFA, Department of Health and Human Services, Attn: HSQ-142-P, P.O. Box 26676, Baltimore, MD 21207. (202) 594-3813. See the Nov. 18, 1987, Federal Register, pp. 44300-44312.

Affiliated Service Groups, Employee Leasing

The Internal Revenue Service (IRS) has announced a public hearing Feb. 25, 1988, at 10 a.m. on proposed regulations affecting affiliated service groups, employee leasing, and other arrangements. The hearing will be in the IRS Auditorium, 7th Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Ave., NW, Washington, DC. Requests to speak and outlines of oral comments should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (EE-111-82), Washington, DC 20224. (202) 566-3935. See the Dec. 2, 1987, Federal Register, p. 43835.

Litigation

PBGC/LTV Dispute Goes to District Court

A federal judge ruled Nov. 24 that a dispute between the Pension Benefit Guaranty Corporation (PBGC) and the LTV Corporation concerning
who should be responsible for three LTV pension plans will be heard in federal district court rather than in bankruptcy court, where LTV is in Chapter 11 reorganization. (See the November 1987 Employee Benefit Notes, p. 12.)

**Investment Managers Liable for Losses**

A pension fund’s investment management firm and its president are liable for investment losses that resulted from their failure to comply with the asset diversification requirements in the firm’s management agreement with the fund, ruled a U.S. District Court in the Southern District of New York. Damages were measured by the difference between what the fund actually earned and what it would have earned if the assets had been properly diversified (Dardaganis v. Grace Capital, Inc., 8 EBC 1939 [SDNY 1987]). (Also see “Investment Manager Liability,” this issue.)

**Pension Obligations of Successor Companies**

Since a successor company did not explicitly or implicitly adopt the predecessor’s pension plan, the company was not obligated to fully fund vested benefits upon termination of its plan, the Third Circuit Court ruled in United Steelworkers of America, AFL-CIO v. New Jersey Zinc Co., Inc., No. 86-5756.

**Announcements & Publications**

**Maximum PBGC Guarantee**

The Pension Benefit Guaranty Corporation (PBGC) announced it will guarantee a maximum monthly benefit of $1,909.09 for participants in defined benefit pension plans terminating in 1988, up from $1,857.95 in 1987. The maximum guaranteed amount is adjusted annually based on changes in the Social Security contribution and benefit base.

**Lebowitz Named to DOL Post**

Assistant Secretary of Labor David Walker has named Alan Lebowitz, deputy assistant secretary for program operations of the Pension and Welfare Benefits Administration in the Department of Labor (DOL).

**Weizmann to Head APPWP**

Howard Weizmann will be the new executive director of the Association of Private Pension and Welfare Plans (APPWP) effective Jan. 4, 1988. Weizmann, a member of APPWP’s executive committee, was manager of benefits planning and design at the Sun Co. in Radnor, PA.

**Registry to Track Progress of Transplant Recipients**

The U.S. Department of Health and Human Services has awarded a $1.7 million contract to the United Network for Organ Sharing to establish a patient registry to evaluate progress in organ transplantation.

**Mortgage-Related Pension Investments Decline**

Results of the latest quarterly survey by the U.S. Department of Housing and Urban Development (HUD) indicate that $45.5 billion in private pension assets were invested in mortgage-related instruments as of the end of June 1987, a drop of $2.2 billion compared to the first quarter of 1987. Such investments were 5.2 percent of the total private pension fund assets, HUD said.

“Survey of Pension Fund Investment in Mortgage Instruments” covers corporate and multiemployer defined benefit and defined contribution plans with assets of at least $5 million. Current survey results are reported in release number 87-112, available free from HUD, Office of Public Affairs, Room 9246, 451 7th St., SW, Washington, DC 20410. (202) 755-5277.

**AIDS Commission Meets**

Records of the Dec. 17-18 meeting of the Presidential Commission on the Human Immunodeficiency Virus Epidemic will be available for public inspection at 655 15th St., NW, Suite 901, Washington, DC 20005. At the meeting federal, state, and local experts and private-sector physicians and researchers discussed AIDS and drug abuse. For information call (202) 245-AIDS.

**Government Publications**

*Long-Term Care and Personal Impoverishment: Seven in Ten Elderly Living Alone Are at Risk*  
U.S. Congress, House of Representatives, Select Committee on Aging

This report, developed in cooperation with the Urban Institute and the Villers Foundation, compares income data from the Census Bureau’s 1984 Current Population Survey and nursing home cost data compiled by the Health Care Financing Administration for 22 states. The report found that one-half of elderly couples in which one spouse entered a nursing home became impoverished within six months and 70 percent of single elderly people in...

Individual Retirement Arrangements (IRAs) and
New Rules for Individual Retirement Arrangements, Internal Revenue Service

These publications discuss the new rules under the Tax Reform Act of 1986 that affect a taxpayer's IRA deduction. The former, publication no. 590, contains a comprehensive explanation of old and new IRA rules; the latter, publication no. 923, is a pocket-size overview of the new rules under tax reform. Both may be obtained from the Internal Revenue Service by calling (800) 424-FORM (3676). Free.

Federal Workforce: Information on Employee Benefits, U.S. General Accounting Office

This fact sheet responds to a congressional request to determine the prevalence of personalized employee benefits statements in the federal government. Ten of the 23 federal agencies studied provide such statements to employees. Request publication GAO/GGD-87-112FS from U.S. General Accounting Office, P.O. Box 6015, Gaithersburg, MD 20877. (202) 275-6241. First five copies, free; additional copies, $2.

Medicare and Medicaid: Strong Enforcement of Nursing Home Requirements Needed, U.S. General Accounting Office

Based on a survey of 26 nursing homes in five states, the General Accounting Office concluded that "nursing homes can remain in the Medicare and Medicaid programs for years with serious deficiencies that threaten patient health and safety by taking corrective action to keep from being terminated each time they get caught." Request publication GAO/HRD-87-113 from U.S. General Accounting Office, P.O. Box 6015, Gaithersburg, MD 20877. (202) 275-6241. First five copies, free; each additional copy, $2.

Nongovernment Publications

Be Your Own Financial Planner: Total Money Management in 21 Days, Dorlene V. Shane

A step-by-step guide to organizing and managing personal finances, this book features 1986 tax law strategies. Readers of Employee Benefit Notes may examine a copy free for 60 days. Contact Dorlene V. Shane, 625 Biltmore Way, Coral Gables, FL 33134. (305) 446-8888. Cost $27.95 clothbound, $14.95 paperbound; quantity discounts.

Directory of International Benefits, Interben

This guide lists benefit organizations and consultants, insurance companies, accountants, lawyers, financial and property managers, computer specialists, communication consultants, and benefit publications in 27 countries, including the U.S. Contact Interben Publications, P.O. Box 896, Southport, CT 06490. Cost $80.

The Responsive Workplace: Employers and a Changing Labor Force, Sheila B. Kamerman and Alfred J. Kahn

The growing number of women in the U.S. work force has helped to bring about improvements in employee benefits, but the sectors of the economy that employ the most women have been the least responsive to women's needs, according to the authors, who present the results of a three-year national survey to gauge employer responses to changes in the work force. Contact Adrienne Macauley, Columbia University Press, 562 W. 113th St., New York, NY 10025. (212) 316-7128. Cost $35 hardcover.

Employee Ownership Plans: How 8,000 Companies and 8,000,000 Employees Invest in Their Futures, Bureau of National Affairs, Inc.

Published in cooperation with the National Center for Employee Ownership, this report provides comprehensive information about employee ownership plans, including how to set up and administer them. Contact Bureau of National Affairs, Inc., Circulation Department, P.O. Box 40947, Washington, DC 20077-4928. (800) 372-1033. Cost $50; quantity discounts.

Flexible Benefits and Employee Choice, David E. Bloom and Jane T. Trahan

This publication summarizes the body of literature on issues related to flexible compensation and presents case studies of seven organizations. Abstracts and recommended readings are included. Request publication number 46 in the series "Work in America Institute Studies in Productivity: Highlights of the Literature" from Publications Department, Work in America Institute, Inc., 700 White Plains Road, Scarsdale, NY 10583. (914) 472-9600. Cost $35.
Investing in Employee Health: A Guide to Effective Health Promotion in the Workplace, Richard P. Sloan, Jessie C. Gruman, and John P. Allegante

This guide to establishing health promotion programs includes examination of the potential ethical conflicts and offers guidelines for dealing with such issues as privacy and discriminatory use of employee health data. Contact Jossey-Bass Inc., Publishers, 433 California St., Suite 1000, San Francisco, CA 94104-2091. Cost $27.95.

The Many Faces of Managed Care, Health Resources Information Services

Managed care will have an impact on health care through the next decade, primarily because of its effectiveness in saving employers money, according to this report, which forecasts less inpatient care as one effect. Contact American Business Publishing, P.O. Box 1442, Wall Township, NJ 07719. (201) 681-1133. Cost $49.50.

Strategies for Managing Disability Costs, Michael E. Carbine and Gail E. Schwartz

This discussion of employer innovations for managing disability costs is based on the first National Disability Management Conference. Disability expenditures reportedly are becoming increasingly costly for employers because a growing proportion of people are becoming disabled during their most productive years. Contact Missshay R. White, Institute for Rehabilitation and Disability Management, 102 Irving St., NW, Washington, DC 20010. (202) 877-1196. Cost $25.

Employee Benefits for Part-Timers, 2nd ed., Association of Part-Time Professionals

Employers and their part-time workers can gain ideas on how to prorate employee benefits from this handbook, revised to reflect the impact of the Tax Reform Act of 1986. Also addressed are legally required benefits, paid and unpaid leave, group insurance, retirement plans, flexible benefits, and federal and state legislative developments. Contact Association of Part-Time Professionals, P.O. Box 3419, Alexandria, VA 22302. (703) 734-7975. Cost $18.95.

Surveys

Mandated Health Insurance for U.S. Workers, William M. Mercer-Meidinger-Hansen, Incorporated

Eighty-three percent of the 5,682 human resource, employee benefit, and compensation managers responding to this recent survey said they oppose mandated health care as proposed by Sen. Edward Kennedy (D-MA) in S. 1265. The most frequently cited reasons for opposition to the bill were the cost of providing coverage to part-time workers and the possible elimination of many part-time jobs. Survey results will be summarized in the January 1988 issue of The Bulletin, Mercer-Meidinger-Hansen's monthly publication, available from the firm's 47 offices; or contact William M. Mercer-Meidinger-Hansen, Incorporated, 1500 Meidinger Tower, Louisville, KY 40202. (502) 561-4654. Free.

Health Care Program Management Survey, Illinois State Chamber of Commerce

This survey of 1,300 Illinois State Chamber of Commerce (ISCC) members reveals coverage availability, program provisions, and employer attitudes about various aspects of health coverage, including the congressional proposal to mandate employer health coverage. Contact Pamela D. Mitroff, Health Care Cost Management Department, ISCC, 20 N. Wacker Drive, Suite 1960, Chicago, IL 60606. (312) 372-7373. Free.


Information from the 1987 proxy statements of 50 large U.S. firms details the benefits they provided to company executives during 1986, including pension, profit sharing, savings, nonqualified, stock purchase, and deferred compensation plans. Survey participants are identified. Request Research Report No. 290-3 from Charles D. Spencer & Associates, Inc., 222 W. Adams St., Chicago, IL 60606. (312) 236-2615. Cost $15.


The rate of decline in salary increases has slowed to the lowest in three years, in part because of a slight rise in U.S. inflation, this survey of 2,500 employers concludes. Employers project average salary increase budgets of 5.3 percent in 1988, lower than those for 1987. Contact William M. Mercer-Meidinger-Hansen, Incorporated, 1500 Meidinger Tower, Louisville, KY 40202. (502) 561-4654. Cost $50.
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