

who have been in the service for a long period of years or who are close to the retirement age there has been no opportunity to accumulate funds to their credit prior to the beginning of the pension system. It is an injustice to these employees either to omit them from eligibility under the pension law and begin the payment of benefits at some distant date, or to expect of them the payment of contributions, during the few remaining years of their employment, in amounts sufficient to pay the costs of their retirement. The financial difficulty is substantially the same as would be involved in attempting to purchase annuity insurance at age 65 for benefits to begin at age 67. Such purchase could be made, but the costs would be prohibitive to the annuitants.

On the other hand, failure to make provisions for past service nullified one of the most important advantages to the governmental unit of establishing a pension plan; namely, the improvement of the service by removal of superannuated employees. It is reasonable to assess upon the employee a part of the cost for prior service by graduating the contribution rate according to the age of entrance into the service, but employee groups generally insist that the larger portion of this burden must be met by the employing unit.

Customarily, both in private and public pension plans, the employer assumes all or the largest part of the burden of financing benefits based on service prior to the adoption of the pension act. Accordingly, every pension plan normally begins with a large liability on account of prior service, which the employer is obligated to liquidate.

This obligation for prior service may be met in one of several ways. It is, of course, possible to appropriate immediately the entire amount needed to fund this prior service liability, but this is

seldom done because of the large sums involved. Second, it is possible to make no provision for funding the prior service liability, and to pay benefits for prior service out of current revenues, as is done under cash disbursement plans. Third, it is possible to liquidate the liability over a period of years by making annual contributions on account of prior service in addition to the contributions on account of current service. Finally, in a large public retirement plan it may be considered feasible simply to recognize this prior service liability and to maintain modified reserves adequate to pay obligations as they fall due, but without creating the large reserve that would be necessary to liquidate the prior service liability.

This last alternative, the maintenance of modified or limited reserves, may take several forms. Either the reserve may be a fraction of the total liability, or the reserve may be almost non-existent insofar as the employer's contributions are concerned, being replaced by annual contributions in the nature of interest on the admitted liability. Such a limited reserve basis, whether for prior or current service or both, has many advantages. The smaller reserve reduces the possible losses from investment risks and diversion of funds, while still furnishing a reasonable safeguard against the necessity for greatly increased public contributions in some years. Then, too, the costs under this plan are less in the early years than would be the case under the full reserve basis. It should be noted, however, that most actuaries would support the maintenance of limited reserves only in the case of those tax-supported pension systems which are of a substantial size.

The extent of the governmental unit's obligation for prior service and the size of the benefits which can be

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