

# Senza Sordino

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## A Tsorris with a Fringe on Top: A Primer on Employee Benefits

by Robert Levine, Guest Editor

Although every ICSOM orchestra provides some employee benefits for its musicians, very few members of those orchestras really understand their benefits package. This series is intended as a primer on the most important of these benefits.

The subject of employee benefits is immensely complex, and a veritable inferno of devils lies within the details. These articles are not intended as a legal guide to using employee benefits, but rather as an overview of the most important benefits, both for musicians and for committees charged with negotiating employee benefits for their members.

### A Very Brief History Of Employee Benefits

The fundamental rationale for employee benefits is "to promote economic security by insuring against uncertain events and to raise living standards by providing targeted services." (*Fundamentals of Employee Benefit Programs*. Employee Benefit Research Institute, 1990.) Employee benefit programs have been a part of the American economic scene for over 350 years. Most of the early programs were pension or profit-sharing programs, although other benefits have become more prominent in response to societal changes. The development of truly effective medical technology, for example, has dramatically increased the average lifespan, but at the same time has also radically increased medical costs. Probably the two most important influences in the expansion of employee benefits were the increasing involvement of the Federal government and the rapid expansion of the economy after World War II. The Federal government began to provide employee benefits, such as Social Security, directly, and also began to regulate and encourage employee benefits in the private sector by means of the tax code. The government did this primarily by making employer-paid health insurance premiums tax-exempt to employees and by deferring taxes on retirement programs until retirement, as well as by providing more limited tax exemptions for many other employee benefits. Meanwhile, the post-war boom led to a demand for labor that increased the pressures on companies to provide better wages and benefits and also allowed labor unions to bargain more effectively for both. By the last decade of the twentieth century every employed American was covered by Social

Security and most by workers' compensation, and it appears likely that some form of health insurance will also be extended to all citizens in the near future, either by the Federal government directly or as a result of Federal mandates.

The first known example in the orchestra field of an employer-provided benefit was an annuity program instituted by the Philadelphia Orchestra in 1936 but funded entirely by the musicians. Today, every ICSOM orchestra but one provides some form of health insurance, and most provide a private pension plan as well.

### The Range of Employee Benefits

The Employee Benefit Research Institute lists as possible benefits eight government-mandated benefits, five taxable benefits, and twenty-seven tax-exempt or tax-preferred benefits. This series will not try to explain all forty of these benefits; some, such as vacations, are self-explanatory, while others, such as cafeteria facilities and stock bonus plans, are not commonly seen in the orchestra world. The most important benefits to orchestra musicians, and the ones on which this series will focus, are pension benefits, health insurance, and disability insurance. Not coincidentally these are also the benefits presenting the most complexity to those using them or negotiating them.

### Pension Benefits

By far the most complex employee benefit, at least in terms of the legal restrictions and requirements placed on the employer as well as the range of options available in providing the benefit to the employee, is the pension benefit. It is also the oldest benefit provided by both the private sector and the government. The first known private pension plan in this country was the Plymouth Colony's military retirement program in 1636, while the first social security program in the world started in the nineteenth century in Bismark's Germany. Social Security in the United States dates back to 1935 and now covers all working Americans, while forty-four million people, including the members of all but two ICSOM orchestras, are also covered by private pension plans.

Although the range of pension options is large and the regulatory burden on the employer very heavy, the pension benefit in the orchestra field is actually one of the simpler ones both for the musician desiring to use it and for the committee attempting to negotiate it. (This is not to say that negotiating a pension plan, or anything else for that matter, is easy.) This seems to be a result of most ICSOM orchestras not only having chosen the same type of program, the defined benefit plan, but having structured the plan in very similar ways. In addition, the regulatory burden on management, though heavy, is well-defined and understood and is often "contracted out" to an insurance or annuity company, so that the management's responsibility is little more than periodically writing a large check to the insurance company to fund the program and keeping the personnel records updated.

### Pensions and the Law

The major regulations governing pension benefits are contained in the Employee Retirement Income Security Act, known as ERISA, that was signed into law by President Gerald Ford on Labor Day 1974. Although primarily written to solve problems and correct abuses in the private pension system, many other employee benefits, including health insurance and long-term disability insurance, are at least partially regulated by ERISA.

ERISA contains the following provisions:

- **Reporting and disclosure requirements:** the pension plan is required to provide accurate, timely, and understandable information to the employee participants, the beneficiaries, and the government. For the employee, the most important form this information takes is the Summary Plan Description, which must be provided annually. ERISA also requires that all participants and beneficiaries must be provided with a summary of financial information about the plan, which is drawn from information provided to the Internal Revenue Service. The full report is available from the Department of Labor. Participants and beneficiaries may also request annually a written statement of accrued and vested benefits.

- **Fiduciary Requirements:** ERISA requires that fiduciaries (who are essentially those who manage the assets and administer the plan) must act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." This is called the "prudent man" standard, and is considered so strict that it is often referred to as the "prudent expert" rule.
- **Minimum Standards:** ERISA sets minimum standards for such variables as participation standards, vesting, pre-retirement survivor benefits, how benefits in defined benefit plans accrue to participants, and funding standards, as well as limits on how much money can go to funding plans and still be tax-deductible to the employer, although the latter issue is likely to remain an academic one until orchestras start paying corporate income taxes.
- **Plan Termination Insurance:** ERISA established a new federal agency, the Pension Benefit Guaranty Corporation. This agency's purpose is to insure the payment of at least some benefits to participants in a private-sector defined benefit plan in the event that such a plan terminates with insufficient funds to pay those benefits. ERISA also provided a premium on pension plans as a funding source for the PBGC, which premium has been periodically raised by Congress from the original figure of \$1 per year per plan participant to the current figure of \$19. As well, ERISA established conditions for the termination of plans provided by a single employer, which are allowed, in the case of underfunded plans, only in distress conditions, such as a Chapter 11 bankruptcy, or when the plan is fully funded and capable of paying all the plan's benefit liabilities to plan participants. There is a limit on the maximum benefit guaranteed to participants and beneficiaries of terminated plans, which is adjusted annually to reflect inflation. This limit is the maximum dollar amount payable to beneficiaries of a terminated plan, regardless of what the plan was actually supposed to pay. The limit in 1990 was \$25,977.

This issue of *Senza Sordino* has been edited and produced by Robert Levine, Milwaukee Symphony Orchestra ICSOM Delegate. That his résumé includes having played in six different ICSOM orchestras is best explained by the fact that he is a violist.

It is important to realize that the benefits that are protected by the PBGC are only those vested benefits that the employee has accrued in a defined benefit plan. Contributions made under a defined contribution plan are not protected by the PBGC, but this would not be a problem for an orchestra with a

Section 403(b) defined contribution plan, as the contributions would already "belong" to the employee.

- **Protection of Employee Rights:** In addition to the rights that participants and beneficiaries have regarding information and disclosure, ERISA also protects the participants from discrimination by the employer on account of the exercise of their legal rights under ERISA.

### **Types of Pension Plans**

All ICSOM orchestras with pension plans have one of two types: a defined-benefit plan or a defined contribution plan.

#### **Defined Benefit Plan**

A defined benefit plan is one which the amount of benefit to the participants at retirement is defined in the plan, and in which the employer is responsible for funding the plan so as to provide that benefit. This is the type of plan usually sought by labor unions, as the employee is guaranteed a benefit amount and the employer assumes the risk and burden of adequately funding and managing the assets of the plan so as to provide that benefit amount.

Another form of defined benefit plan is the multi-employer pension plan, which is one that covers the workers in several different enterprises generally working under a collective bargaining agreement. The American Federation of Musicians' and Employers' Pension Fund is such a plan, and is used by fifteen ICSOM orchestras.

#### **Defined Contribution Plan**

A defined contribution plan is one in which the employer's contribution, rather than the benefit at retirement, is defined by the plan, so that the employee participants assume the risk of managing the assets so as to produce an adequate retirement benefit. This is not to say that the participants necessarily manage the investment portfolios; generally that will be done by an investment firm or insurance company. Nevertheless, the participants bear all of the risk that the invested assets will not produce an adequate income at retirement.

Some non-profit organizations, including orchestras, have access to what is known as a "Section 403(b) pension plan," after that part of the tax code which defines and regulates such plans. This can be set up either as an institutional

pension plan or as an individual tax-deferred savings account under a voluntary salary reduction agreement. Although there are other kinds of defined contribution pension plans, the Section 403(b) plan is generally considered most advantageous to employees of eligible non-profit organizations such as orchestras.

The maximum amount that can be contributed to a Section 403 (b) plan, called the "exclusion allowance," is determined by a complex calculation that factors in the employee's taxable income, length of service with the employer, and past contributions through that employer. The absolute maximum amount that can be contributed under a salary reduction agreement is \$9,500 annually, although there are some very narrow exceptions to that limit.

In addition to the standard rights that participants have under ERISA, participants in a Section 403(b) plan have the right to select from among various types of investment accounts offered by the plan and the right to select from several settlement options at retirement or other termination of the plan.

Employers generally prefer defined contribution plans because their financial responsibility to the participants is limited to making the contribution required by the plan. There are some advantages to the employees too, at least in theory, but also fewer protections against not having an adequate income at retirement. For example, the fact that the plan participant "owns" the assets of the plan means that some participants will raid those assets to finance current spending. In addition, many musicians have neither the knowledge nor the time to properly supervise the management of their invested contributions. The assets of defined contribution plans are also not protected by the PBGC.

#### **Accrual and Vesting**

Accrual is the process of accumulating credits that will determine the size of the pension benefit. Accrual is usually on the basis of length of service after the employee becomes a participant in the plan. In a defined benefit plan, accrual is generally in the form of a benefit that increases with length of service, while in a defined contribution plan, accrual is the accumulation of funds in the employee's individual account.

Vesting is the process of receiving a non-forfeitable right to accrued benefits at retirement. It is not the same as accrual. An employee can accrue benefits from the start of participation, while even partial vesting can be delayed for years. ERISA provides that benefits must vest at least as fast as one of these schedules:

- cliff vesting, defined as full vesting after 5 years participation, with no vesting prior to that;
- graded vesting, defined as 20% after 3 years of service and 20% per year thereafter until 100% vesting is achieved in the seventh year of service.

Employers are free to vest employee pensions on a faster schedule, and of course unions are free to negotiate faster vesting.

### Negotiating the Pension Benefit

Negotiating a defined contribution plan is quite simple, at least conceptually. The only variable is the contribution management makes every year to the plan.

Negotiating a defined benefit plan is a little more complex. The musicians are most concerned with the amount of pension available at retirement and at what age, or combination of age and years of service, the musician is eligible to receive the benefit. Management will be most concerned with the cost of funding the plan. At the intersection of these competing concerns is the actuary, whose responsibility is to determine what level of funding by the employer will produce the benefit desired by the musicians. The actuary makes this determination by a complex set of calculations buttressed by some informed guesses about things such as future rates of return on the assets of the pension plan, when the musicians are expected to die and stop receiving benefits, and the like. The guesses that the actuary makes (usually called "assumptions" in polite company) are thus **extremely** important in determining whether management will be able to fund the plan to produce the desired benefit.

One sought-after provision in defined benefit plans is known as the "rule of 85." This allows the musician to receive a full retirement benefit when his/her age plus years of service equal 85. Unfortunately the rule of 85 is a very costly benefit to provide, because each year that the musician is able to retire before normal retirement age increases the total benefit payable by a year. At the same time, early retirement reduces the number of years that management has to fund the plan to provide the benefit, thus increasing the required annual contribution. This double whammy can produce some startling increases in annual funding requirements, which is why the rule of 85 is still more the exception than the rule.

### Disability Income Plans

Disability plans are intended to provide income and/or medical care to the employee who is unable to work because

of accident or illness. There are two major public disability income programs, Social Security and workers' compensation. There are also private disability income programs that are not mandated by government but that are valuable benefits nonetheless, and that fall into the two general categories of short-term and long-term disability insurance.

### Social Security

Social Security will pay benefits to workers with long-term disabilities (defined as lasting at least one year) who meet a rather daunting set of criteria. In particular, the definition of "disability" used is a very strict one. The Social Security Act defines disability as "the inability to engage in any substantial gainful activity by reason of medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months." In plain English, this means that Social Security will not help you if all you did was to lop off a finger with your hedge trimmer. The maximum benefit payable by Social Security, when combined with any benefits paid by Workers' Compensation, may not exceed 80% of the individual's maximum annual earnings in the preceding six-year period.

### Workers' Compensation

Worker's compensation is a state-mandated program which compensates workers disabled by occupational injury or illness for lost wages and medical expenses. Prior to the adoption of workers' compensations laws by the states in the first part of the twentieth century, workers could only recover lost wages and medical costs by pursuing their employers through the courts and proving that the employer was negligent or at fault.

Although all fifty states have workers' compensation programs, coverage is elective in six states (Colorado, Louisiana, New Jersey, Pennsylvania, South Carolina, and Texas), and in other states coverage is not universal. If you are not covered, your only remedy for lost wages and medical costs due to occupational illness or injury is to sue your employer.

While workers' compensation programs vary by state, they typically provide that you must be an employee to be covered, that negligence and fault are irrelevant to whether you receive benefits, that you waive your right to sue your employer in exchange for the workers' compensation benefits, and that the employer pays the entire cost of the coverage. The benefits typically provided are a weekly disability income, medical expenses (which may include rehabilitation expenses), so-called "scheduled benefits" for the loss of various bodily

parts, and death and burial benefits.

There are some important restrictions on workers' compensation. The first is that only diseases and injuries "arising out of the course of employment" are covered. Workers' compensation is no more helpful than Social Security if your hedge trimmer bites off more finger than fungus. Workers' compensation will also not cover injuries caused by your own willful misconduct, injuries that do not affect your ability to work, or "pain and suffering," unless the pain affects your ability to work. Perhaps most strangely, in many states there is no legal protection against discipline or even discharge by your employer for filing a claim, although most collective bargaining agreements would provide some protection against such discipline.

The states of California, Hawaii, New Jersey, New York, and Rhode Island also require employers to provide "nonoccupational temporary disability insurance," under which benefits are paid after a short disability period, in some cases one week.

It is widely felt in the legal community that workers' compensation has become more of an employers' protection plan than one that actually benefits employees. The reason for this is that the worker, to receive benefits, must waive his/her rights to claim damages if the employer was negligent or at fault. Given the fact that such damages can be enormous, many lawyers feel that there are many injured workers who, while they received relatively modest amounts from workers' compensation, could have been awarded millions of dollars in damages by the courts. Some creative lawyers have bypassed the protections employers enjoy under workers' compensation by suing the manufacturer of the product that caused the injury, rather than the employer.

### Private Disability Programs

Private disability programs generally divide into short-term and long-term programs. Short-term programs are generally only seen in workplaces where the amount of sick leave is limited to a few days a year. In many orchestras the number of sick days available is enough to cover the average musician until the long-term disability program kicks in, if there is one. Some orchestra managements have negotiated language that separates sick leave from short-term disability leave, at least in concept. Whether this is advantageous to the musicians depends on many local variables, including how long short-term disability will run and the language defining which illnesses and injuries fall under sick leave and which under short-term disability.

Long-term disability is a very important benefit to orchestra musicians, as I argued in an article in *Senza Sordino* last year. Its importance lies both in its ability to supplement coverage available under workers' compensation for occupational illness or injury and in its coverage of disability caused by non-occupational illness or injury. A private long-term disability (LTD) program is the only form of disability insurance that will cover you in the event of the unfortunate incident with the hedge trimmer previously referred to. (It is not true that a short course of instruction on the viola / trombone / bassoon / triangle is adequate protection against this kind of disability.)

### Negotiating Disability Plans

Long-term disability insurance is notorious for its complexity and general squirrelliness. Many of the problems lie buried deep under layers of legalese in the actual insurance contracts. For example, virtually all long-term disability contracts will provide for benefits to be paid for an initial period (generally two years) if the employee is unable to perform normal occupational duties. After that period, however, benefits will continue to be paid only if the employee is unable to perform any occupation that the person is "reasonably suited for by his/her training, education, or experience," or language to that effect. What this language actually signifies will determine whether you are going to receive a benefit or not. If your LTD carrier decides that flipping burgers is a career path that the mere absence of a finger will not prevent you from pursuing, you might not be receiving a benefit at all after two years. If, on the other hand, the phrase "reasonably suited for by his/her training, education, or experience" includes language defining that as the ability to earn a pre-disability income in your new line of work, then you might get a benefit at least partially plugging the gap between what you used to earn and what you are making in your new career. Also important is the issue of "offsets." An offset is the amount that the LTD benefit is reduced by payments from Social Security, workers' compensation, or any other source of income. Although virtually all policies provide that the LTD benefit is offset by a Social Security benefit, any other offsets can, and should be, negotiated. The last caution about long-term disability insurance is that the reputation and financial strength of the carrier are critical. A musician disabled at age 35, for example, might be depending on that disability benefit for decades, and it will not be comforting for that musician to see the carrier's name in the business section of the morning paper under "Recent Bankruptcy Filings." A reputation for reasonableness will also be an indication of whether the carrier will provide the benefit gracefully or under expensive legal duress.

### ICSOM Conference Highlights

This year's ICSOM Conference will be held in the beautiful surroundings of Park City, Utah. Featured speakers at the 1993 Conference will be:

- J. Richard Hackman of Harvard University and Jutta Almendinger of the Max Planck Institute, who will be talking about their joint research project comparing how orchestras are structured, supported, and managed in the United States, Great Britain, and Germany;
- Marion Godfrey from the Pew Charitable Trust, who will be talking about how the foundation world views orchestras;
- ICSOM labor advisor Bill Roehl, who will offer comments and observations about the ICSOM internal organizing project piloted in San Antonio;
- ICSOM Legal Counsel Lennie Leibowitz, who will present the ever-popular negotiating workshop.

I look forward to seeing many old friends and meeting new orchestra activists.

Brad Buckley, ICSOM Chairperson

The other key issues in negotiating a long-term disability benefit are the percentage of pre-disability income paid as benefits (usually between 60% and 70%), the age to which the benefit is payable (usually 65, but older is possible), the waiting period before benefits are paid, and the absolute maximum benefit. It sometimes happens that the maximum benefit, which is always expressed as a dollar amount, will remain unchanged for several negotiations, while the income being protected has risen substantially. Ideally, the maximum benefit amount should be high enough to provide the nominal benefit percentage to all members of the orchestra, including those whose salaries are higher than scale.

Another area of concern for orchestras with seasons shorter than 52 weeks is to ensure that the LTD contract covers injuries or illnesses during the unemployment period.

Further articles in this series will cover health insurance, instrument insurance, and some of the newer benefits appearing in orchestra contracts.

### Further Reading

*The Rights of Employees*, by Wayne N. Outten with Noah A. Kinigstein, Bantam Books, 1984. ISBN 0-553-23656-3

*Fundamentals of Employee Benefit Programs*, Employee Benefits Research Institute, 1990. ISBN 0-86643-069-5

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