IMPROVING INCENTIVES FOR RETIREE COST-OF-LIVING SUPPLEMENTS

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Recent federal legislation and administrative rulings liberalize the constraints a private pension plan sponsor must observe when providing cost-of-living pension supplements to retirees. Like many other aspects of federal laws affecting private pension plans, these changes involve rules administered by three separate federal agencies: the Internal Revenue Service, the Department of Labor and the Pension Benefit Guaranty Corporation.¹ The divided administration of federal laws affecting cost-of-living supplements requires continuing attention to the combined effect of policies created by each of these agencies.

This article evaluates the interaction of recent legislative and regulatory changes affecting retiree cost-of-living supplements of private pension plans and recommends additional measures to improve the opportunities for retirees to receive appropriate cost-of-living pension supplements.

Inflation statistics demonstrate the importance of cost-of-living pension supplements to retirees. For example, over the five-year period beginning January 1976 and ending December 1980, the value of a dollar measured by the Consumer Price Index had fallen to 64.5 cents.² The social security benefit has been automatically adjusted for cost-of-living increases annually since 1975,³ but these increases affect only a portion of retirement income for most Americans.⁴ Also, the ability of


² The Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §§ 1001-1381 (1976) calls for the Secretary of Labor to administer the requirements in Title I of ERISA, the Secretary of the Treasury to administer the requirements of Title III of ERISA and the Pension Benefit Guaranty Corporation (PBGC) to administer the requirements of Title IV of ERISA.


³ Social security benefits are adjusted each June 1st to account for increases in the Consumer Price Index. 20 C.F.R. § 404.221 (1981).

⁴ Most retirees receive about 40 to 50% of their retirement income from social
the social security system to continue to keep pace with inflation is in doubt. Private pension supplements can provide an important hedge against inflation for retirees.

Three major, recent changes in federal laws affect cost-of-living pension supplements for retirees: a 1980 amendment to the Employee Retirement Income Security Act of 1974 (ERISA), a Department of Labor regulation that has been proposed to implement the 1980 ERISA amendment and a revenue ruling that controls the deductibility of contributions to fund cost-of-living pension supplements. The 1980 ERISA amendment authorizes the Secretary of Labor to prescribe rules by which employers may provide cost-of-living pension supplements to retirees without satisfying the extensive requirements that ERISA normally imposes on pension plans. The ERISA amendment could provide private pension plan sponsors valuable flexibility in the design of pension supplements to help retirees cope with inflation. In proposed regulations, the Secretary of Labor has recommended limiting the annual amount of such supplements to a specified percentage of the retiree's benefit for each year of retirement, a percentage equal to the greater of three percent or one-third of the cost-of-living increase for years after 1980. Independent of the ERISA amendment and Department of Labor regulation, the Internal Revenue Service issued Revenue Ruling 81-195, clarifying the circumstances in which an employer may make deductible pension contributions to fund cost-of-living supplements for retirees.
The combined effect of the ERISA amendment, the Department of Labor regulation and the 1981 Revenue Ruling is to promote the use of retiree cost-of-living supplements. An appraisal of the interaction of these three major developments in federal pension laws indicates, however, that the Department of Labor regulation should be significantly liberalized to provide pension plan sponsors adequate flexibility in designing cost-of-living supplements for retirees.

I. PRIOR LAW GOVERNING COST-OF-LIVING SUPPLEMENTS FOR RETIREES

ERISA created a comprehensive set of minimum standards for private pension plans. As originally defined, the private pension plans subject to ERISA included "any plan, fund or program . . . established or maintained by an employer or by an employee organization, or by both, . . . [which] provides retirement income to employees . . . ."\(^{12}\) The chief purposes

12. 29 U.S.C. § 1002(2) (1976), prior to amendment by Pub. L. No. 96-364, § 409, 94 Stat. 1208 (1980). ERISA requirements applied to this broad category of retirement income plans, whether or not tax qualified. The tax qualified status of a pension plan depends on satisfaction of requirements in Internal Revenue Code § 401. Contributions made to a tax qualified pension plan are deductible in the tax year for which they are contributed and earnings on qualified pension plan investments are tax free, with only limited exceptions. For example, a tax may be imposed on unrelated business income of qualified plan investments in accordance with I.R.C. §§ 511-513.

The scope of the original ERISA requirements applicable to pension plans varied according to whether the plan was a defined benefit plan, which promises a specified benefit amount such as a percentage of compensation or a dollar amount per year of service, or a defined contribution plan, for which the benefit depends on the value of the participant's plan account. The ERISA definition of "defined benefit plan" states merely that a defined benefit plan is a plan other than a defined contribution plan. 29 U.S.C. § 1002(35) (1976). ERISA states that a "defined contribution plan" is "a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account." 29 U.S.C. § 1002(34) (1976). The application of these definitions has been particularly troublesome in the case of collectively bargained multiemployer pension plans. See, e.g., Connelly v. Pension Benefit Guar. Corp., 581 F.2d 729 (9th Cir. 1978), cert. denied, 440 U.S. 935 (1979).

ERISA imposed more stringent requirements on defined benefit plans in order to reduce the risk that plan participants might lose promised benefits due to inadequate plan funding. A defined benefit plan promises a benefit that is not secured by the value of plan assets in a participant's account. ERISA's special requirements for defined benefit plans attempt to provide adequate funding to secure the promised benefits. A good example of the problems the ERISA defined benefit plan rules are
of ERISA were to establish rules of fiduciary conduct for those who deal with retirement plans and to improve the equitable character and soundness of such plans.\textsuperscript{15} ERISA was designed primarily to promote retirement income security by protecting pensioners against unexpected loss of benefits due to circumstances beyond the pensioners' control, such as employer insolvency or imprudent investment of plan assets. Cost-of-living pension supplements for retirees have a similar purpose, to protect pensioners against loss in the value of pension benefits due to inflation.

Most large employers that sponsor pension plans offer pension cost-of-living supplements for retirees, which the employers fund through their existing pension plans.\textsuperscript{14} These retiree benefit supplements follow a variety of benefit formulas. They are usually adopted in separate increments, rather than tied automatically to increases in the Consumer Price Index.\textsuperscript{16} The typical period between improvements in retiree supplements by large employers is two to four years.\textsuperscript{16} The prevailing formula offers a specified percentage increase in the retiree's pension benefit, with the percentage varying according to the number of years since retirement.\textsuperscript{17} Because such re-
Retiree benefits promise a stated benefit amount, such supplements fell within the original ERISA definition of a defined benefit plan. As a defined benefit plan, a supplemental benefit has to satisfy ERISA vesting, benefit accrual, funding and plan termination rules. ERISA vesting rules require a pension plan to provide a participant with a nonforfeitable, or vested, future right to receive a retirement benefit upon the attainment of normal retirement age or, if earlier, the completion of a period of vesting service not to exceed ten years. ERISA benefit accrual rules generally prohibit reductions in a pension plan participant’s accrued benefit, which is the benefit the participant would be entitled to receive at normal retirement age if fully vested. ERISA minimum funding standards require advance funding of pension plan liabilities according to minimum amortization schedules. ERISA plan termination rules impose liability on an employer that terminates a pension plan at a time when the value of the plan benefits guaranteed by the Pension Benefit Guaranty Corporation (PBGC) exceeds the value of plan assets.

The chief effect of these ERISA rules on the design of the retiree supplemental benefit plan is that each cost-of-living benefit supplement creates a vested benefit for the retiree and a permanent funding commitment for the plan sponsor. The plan sponsor may not reduce or eliminate the cost-of-living supplement at will once it takes effect, because this would cause an impermissible reduction in accrued benefits.

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Flat percentage increase in pensions for all retirees; a flat dollar increase in pensions for all retirees; a percentage increase in pensions for all retirees who retired within a specified period, e.g., five years; a dollar increase in pensions, dependent on the year of retirement or the number of years of active service; a pension increase reflecting a change in the benefit formula for active employees; a cost-of-living increase tied to the Consumer Price Index. Corporate Pension Plan Study, supra note 14, at 52-54.

18. 29 U.S.C. § 1002(35) (1976). See note 11 supra. All of the supplemental benefit formulas described in note 16 supra are defined benefit plans.


20. Id. § 1054(b).

21. Id. §§ 1081-1086.

22. Id. § 1362(b).

23. It is possible to avoid this restriction temporarily by specifying at the time the cost-of-living supplement is adopted that it shall be of limited duration, such as three years. However, IRS representatives have indicated in conversations on this subject that an extension of a cost-of-living supplement beyond this initial period would
may the plan sponsor avoid the obligation to fund the cost-of-living supplement by terminating the plan. With certain exceptions, ERISA provides that continued payment of vested pension benefits is guaranteed upon plan termination and this guarantee is funded at least in part by the plan sponsor.\textsuperscript{24}

The Internal Revenue Code contains requirements for tax qualified retirement plans\textsuperscript{25} that follow the ERISA participation, vesting, benefit accrual and funding rules and also expand upon those rules.\textsuperscript{26} Generally, an employer who sponsors a pension plan that adheres to the Internal Revenue Code requirements for tax qualification may enjoy two tax advantages: (a) deductions for plan costs are taken at the time the employer contributes to the plan, rather than when the plan pays benefits;\textsuperscript{27} and (b) earnings on contributions held in trust for the plan are tax exempt.\textsuperscript{28} The size of the tax deductible contributions to a pension plan depend, however, on the IRS interpretation of what constitutes a reasonable pension funding method.

Pension plans require the projection of costs and benefits over the relatively long period of a worker's lifetime. Thus, there is a danger that, without IRS restrictions, a pension plan sponsor may fund the plan either too slowly to protect

\textsuperscript{24} ERISA created the Pension Benefit Guaranty Corporation (PBGC) to administer the benefit guarantee program for terminated defined benefit pension plans. PBGC guarantees do not apply to multiemployer pension plan benefits that have been in effect for fewer than 60 months. 29 U.S.C.A. § 1322a(b)(1)(A) (West Supp. 1976-1980). For nonmultiemployer pension plans, PBGC guarantees are phased in at the rate of 20% for each year that the benefit has been in effect. 29 U.S.C.A. § 1322a(b)(7) (West Supp. 1976-1980). In addition, the PBGC benefit guarantees are subject to a maximum monthly amount. For nonmultiemployer plans terminating in 1981, this amount is $1,261.36, according to a December 10, 1980, PBGC News Release. For multiemployer plans, this amount is 100% of the first $5 per year of service plus 75% of the next $15 per year of service. 29 U.S.C.A. § 1322a(c)(1)(A) (West Supp. 1976-1980). Employer liability for these guarantees is limited to 30% of net worth for nonmultiemployer plans. 29 U.S.C. § 1362(b)(2) (1976).

\textsuperscript{25} For purposes of this discussion, a tax qualified pension plan is a defined benefit pension plan that satisfies the requirements of I.R.C. § 401(a) and qualifies as a trust exempt from tax under I.R.C. § 501(a).


\textsuperscript{27} I.R.C. § 404(a).

\textsuperscript{28} Id. § 501(a).
its financial stability or too quickly to justify tax deductible contributions. In order to strike a balance between the opposing extremes of inadequate funding of pension plans and excessive deductible contributions to pension plans, IRS regulations prescribe standards for reasonable actuarial valuation methods and reasonable pension funding methods. A pension contribution for a retiree cost-of-living supplement is tax deductible only if it satisfies these IRS standards.

II. RECENT CHANGES IN THE LAWS GOVERNING COST-OF-LIVING SUPPLEMENTS FOR RETIREESE

The 1980 amendment to ERISA authorizes the Secretary of Labor to issue regulations exempting from the ERISA definition of “pension plan” any “supplemental retirement income payments, under which the pension benefits of retirees or their beneficiaries are supplemented to take into account some portion or all of the increases in the cost of living (as determined by the Secretary of Labor) since retirement” provided that the “principal effect” of such payments is not “the evasion of the standards or purposes of this Act applicable to pension plans . . . .” The purpose of this amendment is to permit a liberalization of the rules governing supplemental retiree benefits so that ERISA does not discourage employers from offering such supplements.

The payments to which the new rule applies will be treated as “welfare plans” rather than “pension plans” under ERISA. As welfare plans, the payments must be administered in accordance with ERISA fiduciary standards and must satisfy certain reporting and disclosure requirements. However,

29. Treas. Reg. § 1.412(c)(3)-1 (1980). The introduction to this regulation as originally proposed acknowledges this need to balance conflicting interests: The regulation would define the outer limits of acceptability for funding methods by balancing conflicting interests. On the one hand, there is the need to foster soundness and stability among plans by preventing underfunding. On the other hand, there is the need to limit abuses of preferential tax treatment for plans by preventing overfunding.


33. 29 U.S.C. §§ 1021 and 1022 require distribution of summary plan descriptions
the more restrictive ERISA vesting, benefit accrual, funding and plan termination rules for pension plans do not apply to welfare plans. This means that the plan sponsor may offer the supplemental retiree benefit for an indefinite time period and may discontinue or reduce the benefit at will, subject only to general fiduciary obligations and to the constraints specified in the regulation to be issued by the Secretary of Labor.

The amendment takes effect only if the Department of Labor issues implementing regulations. The Secretary of Labor has proposed a regulation that would require a supplemental retiree benefit plan to meet the following conditions in order to qualify as a welfare plan:

A. Payment must be made out of the general assets of the employer;

B. The employer must not be obligated to make the payments for more than 12 months at a time;

C. No payment may be made until a date two years or more after the beginning of the first month for which the pension benefit of the participant or beneficiary was in pay status; and

D. The monthly amount of the supplement must not exceed the payee's monthly pension benefit multiplied by a percentage for each year of retirement, where the yearly percentage is not more than three percent for years before 1980, four percent for the year 1980 and, for years after 1980, the greater of three percent or one-third of the percentage of the cost-of-living increase for that year.

The Department of Labor explains that this proposed regulation "is intended to lessen the likelihood that too large a percentage of a retiree's retirement income will consist of discretionary payments which are not afforded the protections of a pension plan." Independent of the creation of this exception to the ERISA definition of "pension plan," the Internal Revenue

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34. 29 U.S.C. §§ 1051(1), 1081(a)(1), 1321(a)(1).
36. Id. at 11,293.
Service issued Revenue Ruling 81-195 to clarify the application of reasonable funding standards to cost-of-living supplements for retirees. This Revenue Ruling provides an important exception to a general rule, previously announced in treasury regulations, that "a reasonable funding method does not anticipate changes in plan benefits that become effective, whether or not retroactively, in a future plan year or that become effective after the first day of, but not during, a current plan year."\(^{37}\) Read literally, this treasury regulation would mean that an employer could not make a deductible contribution to a pension plan to fund a cost-of-living benefit increase until the year in which the increase takes effect. If that were true, a contribution to a pension plan would not be deductible until the year in which the benefit increase is paid. This is the same year in which the deduction is available if the employer chooses to pay the retiree cost-of-living benefit through a welfare plan, as permitted by the 1980 amendment to ERISA, rather than a pension plan.\(^{38}\)

Revenue Ruling 81-195 rejects this broad prohibition on deductible contributions for advance funding of post-retirement cost-of-living supplements. With an exception only for very large annual pension benefits,\(^{39}\) the Ruling specifically states that if a pension plan provides for an annual cost-of-living increase in a retiree's benefit, "plan costs must also take into account the post-retirement cost of living adjustments." This Revenue Ruling is significant because it approves the general use of advance deductible contributions to fund post-retirement cost-of-living supplements.

\(^{37}\) Treas. Reg. § 1.412(c)(3)-1(d)(1)(i)(1980). The regulation exempts from this rule “benefit increases scheduled to take effect during the term of the collective bargaining agreement applicable to the plan.”\(^{38}\) Id. § 1.412(c)(3)-1(d)(1)(ii).

\(^{38}\) I.R.C. § 162.

\(^{39}\) The Ruling disallows a deduction for advance funding of a cost-of-living increase that would cause the pension benefit to exceed a specified dollar amount, which is the same amount that the IRS prescribes under I.R.C. § 415 as the maximum benefit a tax qualified pension plan may pay any participant during the year in which the advance contribution would be made. As of January 1, 1981, this amount was $124,500. I.R.-81-16. Thus, for example, an employer could not make a deductible contribution to a tax qualified pension plan for a plan year ending in 1981 to fund a projected post-retirement cost-of-living increase in a pension benefit that would cause the annual benefit amount to exceed $124,500.
III. THE INTERRELATIONSHIP OF IRS AND DEPARTMENT OF LABOR RULES GOVERNING RETIREE COST-OF-LIVING SUPPLEMENTS

Although they were adopted separately and serve different purposes, when they are considered together, the 1980 legislation permitting a welfare plan to provide cost-of-living supplements for retirees and the 1981 Revenue Ruling permitting deductions for advance funding of such supplements through a pension plan have a common result. They encourage pension plan sponsors to provide retiree supplements, either as a year-to-year, pay-as-you-go welfare plan or through advance deductible contributions to a tax qualified pension plan.

It is desirable to offer pension plan sponsors the alternative of providing cost-of-living supplements on a year-to-year basis. This option permits employers to supplement benefits on a temporary basis when the cost of a permanent benefit supplement would be unacceptable. The 1980 amendment to ERISA could undoubtedly allow some pensioners to enjoy benefit supplements that they would never receive if ERISA vesting, funding and plan termination rules applied.

At the same time, Revenue Ruling 81-195 offers an important and desirable incentive for employers to provide post-retirement cost-of-living supplements through qualified retirement plans. The Ruling assures pension plan sponsors that they may deduct advance pension contributions to fund projected future cost-of-living retiree increases. This tax advantage offers employers a potentially significant financial reward for providing cost-of-living supplements as permanent benefits subject to full protection of ERISA funding, vesting benefit accrual and plan termination rules.

Revenue Ruling 81-195 requires a reappraisal of the Department of Labor’s proposed definition of a “welfare plan” for purposes of providing retiree cost-of-living supplements. The proposed Labor regulation flatly prohibits pension plan sponsors from providing post-retirement supplements that exceed, as a percentage of the retiree’s initial pension benefit,

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40. A cost-of-living adjustment for retirees can be a very costly addition to a pension plan. For example, annual increases compounded at 3% will increase the long-run cost of the plan by about 25%. D. McGill, Fundamentals of Private Pensions 225 (1979).
the number of the retiree's years of retirement multiplied by the larger of three percent or one-third of the cost-of-living increase per year, unless the supplements are backed by all of the ERISA protections that must apply to pension benefits in general. This approach had some merit before the IRS issued Revenue Ruling 81-195. Then, employers had no assurance that the advance contributions required to fund a retiree supplement through an ERISA pension plan would be deductible at the time of the contribution.\textsuperscript{41} In this tax setting, an employer had little reason to choose to provide the retiree cost-of-living supplement through a tax qualified pension plan. The only potential tax advantage a pension plan offered was the ability to tax shelter earnings on the nondeductible advance contributions.\textsuperscript{42} However, within certain limits, this tax advantage is available whether or not the employer uses the pension plan to provide the cost-of-living supplement.\textsuperscript{43} Thus, before Revenue Ruling 81-195, the apparent unavailability of a tax deduction for contributions to fund future cost-of-living benefits left no tax incentives favoring use of a pension plan for retiree cost-of-living supplements.

The Department of Labor had some justification for proposing a restrictive definition of the cost-of-living retiree welfare plan when employers lacked countervailing tax incentives to provide retiree supplements through ERISA pension plans.

\textsuperscript{41} See text accompanying notes 36 and 37 supra.

\textsuperscript{42} Rev. Rul. 74-467, 1974-2 C.B. 132, states that an employer may contribute more than the deductible amount for a plan year to a pension plan without jeopardizing the tax qualified status of the plan. Thus, earnings on the excess contributions will be tax exempt although the excess contributions are not deductible.

\textsuperscript{43} An employer may generally use a pension plan as a tax shelter for contributions in excess of the amount of tax deductible contributions. The only limitation the employer must observe is that excess contributions to the plan must not be so large as to violate the rule that the plan must be maintained for the "exclusive benefit of employees and their beneficiaries." I.R.C. § 401(a). IRS Private Letter Ruling 8002084 (October 19, 1979) warns that although an employer may contribute more than the deductible amount to a tax qualified pension plan, [it] is possible to contribute funds of such magnitude that the employer would have tax deferred growth on a planned reversion [\textit{i.e.}, a planned reversion to the employer of excess plan assets upon plan termination]. Contributions to such an extent could result in a violation of the exclusive benefit role and result in the possible disqualification of the plan.

The IRS might consider the presence in the plan of a cost-of-living benefit supplement a justification for larger excess contributions to a pension plan, but the IRS has not considered this issue in a published ruling.
The danger that employers would use the welfare plan exception to evade ERISA pension rules was greater in the absence of clear authority that an employer could gain a tax deduction by adding cost-of-living supplements to a pension plan. Revenue Ruling 81-195 now provides such tax incentives and thus permits a liberalization of the proposed welfare plan definition.

As proposed, the Department of Labor regulation significantly restricts the freedom of private pension plan sponsors to design retiree cost-of-living benefits to suit different needs and preferences. Given limited resources to fund cost-of-living pension supplements, there is necessarily a trade-off between the size of a supplement and its permanency. The proposed regulation dictates the extent to which retirees may exchange the security of a permanent pension benefit supplement for the protection of a supplement that provides a larger hedge against current inflation. Beyond a maximum annual benefit supplement equal to the retiree's original pension benefit times three percent or one-third of the cost-of-living increase for each year of retirement, the regulation would prevent pension plan sponsors and retirees from trading benefit permanency for larger current benefits.

The proposed regulation should be revised to permit a welfare plan to provide an annual retiree supplement of up to the full amount of the cost-of-living increase for the year preceding the increase. A welfare plan supplement greater than the maximum permitted by the proposed regulations may be desirable from the standpoint of retirees, as well as from that of pension plan sponsors. For example, older retirees may be less concerned about the long-term permanence of a cost-of-living increase than the size of the current increase. Also, retirees who are concerned that the plan sponsor may terminate the plan before benefits are fully funded or guaranteed by the PBGC may prefer a larger current welfare plan benefit increase to a smaller pension benefit increase that is of doubtful permanence. The Department of Labor should not attempt to "protect" retirees by prohibiting the use of welfare plans to

44. See text accompanying note 29 supra.
45. See note 23 supra.
provide full cost-of-living pension supplements in a variety of situations such as these.

The ERISA requirements applicable to welfare plans provide an additional reason to liberalize the proposed Department of Labor regulation without fear of abuse by pension plan sponsors. If an employer offers a cost-of-living supplement as a welfare plan, the employer must provide each plan participant with a “summary plan description” explaining the terms of the plan in language “calculated to be understood by the average plan participant.”46 This explanation of the plan must include a description of any circumstances in which benefit payments may be curtailed or discontinued.47 An employer who offers a retiree cost-of-living supplement through a welfare plan must, therefore, disclose to the plan participants that the supplement is not permanent and may be reduced or eliminated at any time permitted by rules adopted by the employer. Willful failure to make this disclosure to plan participants upon request subjects the employer to a fine of up to $100 per day.48 In addition, there is ample precedent to support a successful suit by plan participants to require the employer to continue benefit payments permanently, if the employer’s representations could reasonably lead employees to believe the benefit would be permanent.49 The employer’s obligation to accurately disclose the terms of a welfare plan supplement to retirees significantly reduces the opportunity for abuse of the welfare plan. Retirees must be forewarned that

47. Id. § 2520.102-3(1).
49. See Valle v. Joint Plumbing Indus. Bd., 623 F.2d 196, 206 (2d Cir. 1980); Burroughs v. Board of Trustees, 542 F.2d 1128, 1131 (9th Cir.), cert. denied, 429 U.S. 1096 (1976) and Harris v. Joint Plumbing Indus. Bd., 474 F. Supp. 1284 (S.D.N.Y. 1979), which held that a pension benefit could not be denied on the basis of a plan amendment that was never communicated to the plan participant; Horn & Hardart Co. v. Ross, 58 A.D. 2d 518 (N.Y. App. Div. 1977), which upheld a decision by a New York State industrial commissioner that a company which terminated its pension plan remained liable for pension payments to retired employees because the company had distributed to its employees a booklet promising “lifetime pensions” which did not advise employees that the company had the power to terminate the plan; and Lix v. Edwards, 82 Cal. App. 3d 573, 147 Cal. Rptr. 294 (1978), which held that retirees were entitled to continued pension benefit payments because the plan’s trustees failed to give them written notice of the effect on their right to pension benefits of a transfer of assets from one corporation to another.
the supplement does not provide the security or permanence of a pension plan.

The ERISA fiduciary standards applicable to welfare plans provide additional protections to retirees covered by a cost-of-living welfare plan. The employer, as a fiduciary, must administer the plan "solely in the interest of the [plan] participants and beneficiaries . . . ." These fiduciary requirements offer protection against an arbitrary exercise of discretionary authority under any ERISA welfare plan by the employer maintaining the plan. One court has applied ERISA fiduciary standards to prevent an employer from terminating a severance pay plan shortly before the employer planned to discharge employees who could collect severance benefits from the plan. Extending this reasoning to a retiree cost-of-living welfare plan, the employer could not terminate the plan for reasons inconsistent with the employer's fiduciary relationship to the plan participants. Thus, even if the employer complies with the ERISA disclosure requirements and advises retirees that cost-of-living welfare plan payments are terminable at the employer's discretion, the employer is not free to exercise its discretion without regard to the retirees' interest.

IV. Conclusion

By limiting the size of retiree cost-of-living supplements that may be provided outside of a pension plan, the Department of Labor would use an outright prohibition to protect retirees from certain risks. The cost of this protection, however, is significant. It may force retirees to forego larger current cost-of-living pension increases for smaller, permanent increases. Rather than prescribe a uniform national standard of risk for cost-of-living pension supplements, the Department of Labor should permit individual pension plan sponsors to decide what portion of such supplements shall be provided through pension plans and what portion shall be provided through welfare plans. Tax incentives favoring the use of a

52. Legislation mandating this change in the ERISA definition of "pension plan" has been proposed. H.R. 4334, 97th Cong., 1st Sess. § 3101 (1981). It would require the Secretary of Labor to issue regulations permitting a welfare plan to pay a retiree benefit not to exceed
pension plan, as well as ERISA disclosure and fiduciary requirements applicable to a welfare plan, provide retirees sufficient protection against abuse of the discretion this approach would provide to pension plan sponsors. Unless the proposed regulation permits plan sponsors to exercise such discretion, federal laws intended to protect retirees will in fact discourage employers from offering meaningful cost-of-living retiree benefit programs.

the amount necessary to account for increases in the cost of living (as indicated by the Consumer Price Index for Urban Wage Earners and Clerical Workers published monthly by the Bureau of Labor Statistics) since the date of the commencement of payment of benefits under such existing pension plan... to the extent that such increases have not been accounted for since that date through increases in benefits under such plan.