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The absence of pension accruals can be costly to older employees. An employee delaying retirement can lose up to half the value of benefits accrued at age 65.

Pension Accruals for Older Workers

In September, the Labor-Management Relations Subcomittee of the House Education and Labor Committee held hearings on the issue of requiring pension plans to grant benefit accruals for employees who work beyond normal retirement age. Earlier this year, the Equal Employment Opportunity Commission (EEOC) voted to propose new regulations requiring pension accruals for older workers. The EEOC action rescinds previous Department of Labor opinions that such accruals were not required.

Many older employees already receive pension accruals. More than half of defined-benefit pension plan participants in medium and large firms are covered by plans that offer some adjustment for service after the plan's normal retirement age, commonly 65. The adjustment may be in the form of an actuarial increase to the benefit earned at delayed retirement age, credits for post-65 service, or both.

The absence of accruals can be costly to older employees. Depending on a pension plan's provisions, an employee delaying retirement for two years can lose from 4 to 23 percent of the value of accrued lifetime benefits, while an employee delaying retirement for five years can lose up to half the value of pension benefits accrued at age 65.

Relatively few elderly, however, choose to work after age 65, and this proportion has been declining steadily. Liberalized early retirement provisions in the Social Security program as well as in employer-sponsored pension plans have contributed to this trend.

Analysis by the Employee Benefit Research Institute (EBRI) suggests that postretirement pension accruals would affect very few persons. For those persons whose retirement benefits would be affected, however, and for their employers, the impact could be large. Elderly employees would benefit significantly if service after age 65 were credited for pension purposes. Requiring such accruals, however, could discourage some employers from hiring older workers and from maintaining defined-benefit pension plans.

Introduction

The Equal Employment Opportunity Commission (EEOC) recently voted to require pension contributions for employees who worked beyond normal retirement age (generally 65). The decision revokes existing Department of Labor (DOL) rules which had allowed employers to discontinue pension benefit accruals for postretirement-age workers.

The EEOC decision marks the culmination—but not the end—of considerable controversy surrounding the employee benefit plan sections of the Age Discrimination in Employment Act (ADEA) Amendments of 1978. The Amendments required continuation of employee benefit coverage beyond normal retirement age on a nondiscriminatory basis until age 70, but left unclear the potential conflict with pension coverage requirements under the Employee Retirement Income Security Act (ERISA).

As part of the 1978 legislation, Congress directed the Labor Department to issue comprehensive interpretations of the ADEA Amendments with respect to all forms of employee benefit plans. In May 1979, the DOL issued the "Interpretative Bulletin on Employee Benefit Plans" (henceforth, the "Bulletin") stating that the ADEA Amendments did not alter existing ERISA provisions allowing employers to freeze pension accruals for post-65 employees. After the EEOC assumed jurisdiction over the administration of ADEA, it began conducting in-depth reviews of all existing DOL interpretations (including the "Bulletin"). Until the EEOC action in June, there had been no final decision on DOL's benefit accrual rules.

In testimony September 5th before the House Education and Labor Committee/Subcommittee on Labor-Management Relations, EEOC Chairman Clarence Thomas said that the Commission staff have completed a draft of the new proposed rules. After the Commission's approval, said Thomas, the rules will be forwarded for review to the Internal Revenue Service, the Department of Labor, and the Office of Management and Budget. They will then be issued for public comment, probably by this fall.

The impact of requiring employers to accrue pension benefits for those employees who continue to work beyond normal retirement age has been debated since the 1978 ADEA Amendments. On the one hand, some have argued that halting pension accruals results in a substantial loss of retirement benefits to employees who choose to work beyond retirement and can constitute a strong disincentive to work.[1] Others justify it on the grounds that accruals would be costly to the employers and discourage them from hiring or retaining older workers.

This *Issue Brief* discusses some of the questions involved in the issue:

- How do pension plans currently treat older employees and what is the effect of this treatment?
- Who are the employees affected by this issue?
- What would continued pension accruals cost employers?
- Is the issue of postretirement accruals likely to become more or less important in the future?

Plan Provisions for Post-65 Employment

Post-65 pension accruals cause problems primarily in defined-benefit and target-benefit plans. In a defined-benefit plan, the employer agrees to provide the employee with a specified benefit at retirement tied to the employee's earnings, length of service, or both. A target-benefit plan is a defined-contribution plan in which contributions are scaled to achieve a specified retirement benefit. Other defined-contribution plans, whose benefit payments are usually determined as a percentage of the employee's earnings, are unrelated to the employee's age and thus pose no problem to continued benefit accrual beyond age 65.

More than half of defined-benefit pension-plan participants in medium and large firms are covered by plans that offer some type of provision for post-65 service, whether in the form of actuarial adjustments to the benefit earned at retirement, credits for post-65 service, or both (see table 1). About 5 percent of plan participants in these firms receive actuarially adjusted pensions at delayed retirement. Actuarial adjustments increase the participant's pension payments so that the present value of the benefit at normal retirement age is the same as the benefit's value at delayed retirement.[2] If the actuarial increase fully reflects the shorter period the participant draws benefits, the participant receives the same lifetime benefits (the same present discounted value of benefits) at the delayed retirement age as at the normal retirement age. In

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[1] U.S., Congress, House, Select Committee on Aging, *End of Mandatory Retirement, Hearing before the Select Committee on Aging,* 97th Cong., 2nd sess., 1982.

[2] As defined in "Equal Employment Opportunity Commission Staff Analysis on Proposal to Require Pension Accrual After Normal Retirement Age," *Daily Labor Reporter,* June 27, 1984.

Table 1
Full-time Participants in Private Pension Plans by Provision for Service Credit After Age 65, in Medium and Large Firms, 1983

Provision	Percent of Participants
No adjustment	45
Pension deferred with no change in amount	45
Pension begins at age 65	[a]
Pension adjusted actuarially	5
Pension deferred only	4
Pension deferred and all service credited[b]	1
Service credited to maximum age or service	[a]
Credit for service with no actuarial increase	50
Pension deferred and increased by percent for each additional year of service[c]	3
All service credited[b]	29
Service credited to maximum age	18
Service credited to maximum years of service	[a]

Source: U.S. Department of Labor, Bureau of Labor Statistics, *Employee Benefits in Medium and Large Firms, 1983*, August 1983, p. 52.
[a] Less than 1 percent.
[b] Credit computed under the plan's regular benefit formula.
[c] Credit computed by a method that is not part of the plan's regular benefit formula.

that instance, the participant does not lose benefits as a result of delaying retirement.

While actuarial adjustments keep the benefits earned at age 65 from eroding, the benefit earned does not reflect added service unless post-65 service is credited. Crediting service after age 65 is the most consistent with the goal of replacing a given proportion of preretirement income. Half of participants in medium and large firms are covered by pension plans that credit post-65 service, with no actuarial increase (see table 1). Nearly all (47 percent) of these persons receive credits for all years of service or service to a maximum age and number of years. A little over 18 percent of the participants receive credits only to a specified maximum age or years of service. A small number receive credits based on a different benefit formula.

While most participants in medium and large firms receive some type of pension adjustment for post-65 service, the elderly[3] are somewhat more likely than the labor force as a whole to be employed in smaller firms. Nearly one-third of the elderly are employed in firms with fewer than one hundred employees, compared with 17.6 percent of the entire working population (see table 2). Because there are no data, however, on small-plan pension provisions, we know less about the pension-plan coverage of employees over age 65 than we know about the labor force as a whole.

Table 2
Pension Coverage of All Employees and Elderly[a] Employees by Firm Size, 1983[b]

Firm Size	All Employees (Percent)	Elderly Employees (Percent)
Under 100 employees	17.6	32.9
100 to 499	15.1	22.7
500 and over	67.2	44.5

Source: EBRI tabulations of the May 1983 EBRI/HHS *Current Population Survey* Pension Supplement.
[a] Age 65 and over.
[b] Detail may not add to 100 percent due to rounding. Totals exclude respondents who did not know the size of their employing firm.

Although benefit accrual based on continued service is the most prevalent type of post-65 pension benefit adjustment, it will nevertheless result in a decline in the participant's lifetime pension benefits. (Only actuarially adjusted benefits do not suffer some erosion in their lifetime value.) The decline is a function of the formula used to compute postretirement accruals. Most defined-benefit plans compute benefit formulas based on average salary, final pay and/or years of service.

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An employee delaying retirement for two years can lose from 4 percent to 23 percent of the value of accrued lifetime benefits. An employee delaying retirement for five years can lose up to half the value of pension benefits accrued at age 65.

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[3] Elderly is defined here as age 65 and older.

How Current Provisions Affect Participants

Depending on the plan's provisions, an employee delaying retirement for two years can lose from 4 percent to 23 percent of the value of accrued lifetime benefits. An employee delaying retirement for five years can lose up to *half* the value of pension benefits accrued at age 65.

Service and Salary Credited

The participant's losses are lowest if the plan credits both additional service and salary increases in determining the amount of the pension benefit (see table 3). The employee retiring at age 67 loses 4 to 8 percent of the value of accrued benefits, while the employee retiring at age 70 loses 10 to 18 percent.

Table 3
Percent of Lifetime Pension Benefits Lost Due to Delaying Retirement until Age 67 and 70 under Alternative Plan Provisions

Plan Provision	Age at Retirement 67	70
	Lifetime Pension Benefits Lost (Percent)	
Benefits frozen at age 65	19 to 23	41 to 47
Additional service credited only	14 to 19	30 to 41
Additional service and salary increases credited	4 to 8	10 to 18
Benefits actuarially adjusted	0	0

Source: EBRI calculations based on data presented in "Equal Employment Opportunity Commission Staff Analysis on Proposal to Require Pension Accrual After Normal Retirement Age," *Daily Labor Reporter*, June 27, 1984.

Service Only Credited

If the plan credits only additional service and not salary increases, the participant's losses can range from 14 to 19 percent of accrued benefits retiring at age 67, and 30 to 41 percent retiring at age 70.

No Service Credited

The losses are greatest if benefits are frozen at age 65 with no service credits and no actuarial adjustments. In this instance, the participant can lose 19 to 23 percent of total benefits retiring at age 67, and 41 to 47 percent retiring at age 70.

These calculations compare the value of accrued benefits at delayed retirement age with the lifetime benefits that would be received if the participant retired at age 65. It could be considered that employees over age 65 lose not only a share of the benefits accrued at age 65, but also the benefit accruals they would receive if they worked the same number of years at a younger age. If benefits available at age 65 are actuarially increased to reflect delayed retirement, and if post-65 service and salary increases are also credited for benefit purposes, an individual retiring at age 67 would have 17 percent to 25 percent higher lifetime benefits than at age 65, and an individual retiring at age 70 would have benefits 47 percent to 76 percent higher.[4]

Employment and Pension Coverage Among the Elderly

Relatively few elderly choose to work after age 65, and this proportion has been declining steadily. In 1970, for example, 3.3 million persons or 16.6 percent of those age 65 or older reported that they were in the labor force (see table 4). In that year, the elderly made up 3.9 percent of the labor force. In 1983, the number of persons age 65 or older had increased to 25.2 million, but the number of elderly persons in the labor force had dropped to 2.9 million or 11.5 percent of all those 65 or older and 2.9 percent of the total labor force.

Numerous factors have contributed to the decline in elderly labor-force participation, the most important of which is probably the availability of actuarially reduced and fully indexed Social Security benefits at age 62.

This decline has taken place in the face of steady improvement in objective measures of the elderly's health as well as steady increases in life expectancy. The trend in employer-sponsored plans to steadily lower early retirement ages, and

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The trend in employer-sponsored plans to steadily lower early retirement ages, and the inability of many pension participants to safeguard or increase their retirement benefits by working longer, have contributed to this decline [in elderly labor-force participation] as well.

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[4] EBRI calculations based on data presented in "Equal Employment Opportunity Commission Staff Analysis on Proposal to Require Pension Accrual After Normal Retirement Age," *Daily Labor Reporter*, June 27, 1984.

Table 4
Employment Among the Elderly,[a] Selected Years

Year	Elderly Population (millions)	Elderly Employees (millions)	Elderly as % of Labor Force	Elderly Employees as % of Elderly Population
1970	19.9	3.3	3.9	16.6
1980	25.5	3.0	3.0	11.7
1983	25.2	2.9	2.9	11.5

Sources: Data for 1970 through 1980 from U.S. Bureau of the Census, *Statistical Abstract of the United States 1984*, tables 33 and 671. Data for 1983 from EBRI tabulations of the March 1983 *Current Population Survey* and the May 1983 EBRI/HHS *Current Population Survey* pension supplement.

[a] Age 65 and over.

the inability of many pension participants to safeguard or increase their retirement benefits by working longer, have contributed to this decline as well.[5]

But how important are pension considerations in the retirement decision? About 34 percent of persons age 65 or older reported receiving pension income in 1983.[6] Additionally, about 40 percent of very recent retirees receive pension income. In contrast, fewer than 20 percent of elderly employees are covered by pensions. Of the 25.2 million persons who were 65 years or older in 1983, 2.9 million, or 11.5 percent, reported in the May 1983 EBRI/Health and Human Services (HHS) *Current Population Survey* (CPS) that they were employed in 1983 (see table 4). Less than half of these persons, or 1.2 million, worked 1,000 or more hours during the year and had worked at least one year for their current employer.

In general, ERISA requires that an employee who meets these criteria and is more than five years younger than the plan's normal retirement age must be covered under a pension plan if his or her employer offers one. Of the persons in the survey working 1,000 hours per year and with at least one year of service with current employer, 0.5 million, or 42 percent of all employed elderly meeting the same criteria reported that they were covered by a pension plan. Since elderly persons with pension coverage are somewhat less likely to work after age 65 than persons without pension coverage, the availability of pension income seems to discourage labor-force participation after age 65. This, however, could be due to the fact that elderly persons with pensions may have enough income to choose leisure as much as the fact that delaying retirement costs them significant foregone retirement benefits.

Most elderly employees with pension coverage appear to be working for their career employer. Nearly all have worked for their current employer more than three years, and 80 percent have worked for their current employer more than five years (see table 5). This latter group are those most likely to be continuing with the same employer they worked for before age 65. Those who have worked less than five years for their current employer are likely to have changed jobs at or after age 65. Those changing jobs at or near retirement would not be affected by pending federal or legislative proposals, which provide pension accruals only for continuing employees.[7] Those changing jobs at or near retirement could still be excluded from participation in the plan under the provisions of ERISA that allow employers to exclude employees hired within five years of the plan's normal retirement age. Of those working with a new employer at or after retirement age, therefore, only those participating in defined-contribution plans would be eligible for pension coverage.

Those elderly individuals who work more than part-time and have pension coverage are relatively "well off" compared with the elderly population, but they are less "well off" than the working population as a whole. Thirty-three percent of the working elderly have annual earnings from employment of more than $20,000 (table 6).

Among pension participants as a whole, 41 percent earn more than $20,000.[8] Of the employed elderly, almost 49 percent have total personal incomes that exceed $20,000 (table 6). By comparison, only 9 percent of all elderly persons report total incomes over $20,000.[9]

In addition to earnings and other income, more than 13 percent of the employed elderly are receiving a pension benefit from a previous job while employed. This total does not include pension benefits that the employee might be collecting from his or her current employer. This latter amount, however, is likely to be very small, since only 1 percent of pension participants are covered by plans that allow them to receive a pension benefit at or over age 65 if they continue to work full-time for the plan sponsor.

[5] The steady liberalization of early retirement provisions over the last 20 years is described in *Corporate Pension Plan Study: A Guide for the 1980s* (New York: Bankers Trust Company, 1980), pp. 18-24.

[6] EBRI tabulations of U.S. Bureau of the Census, Current Population Survey, March 1983.

[7] See H.R. 5346, Age Discrimination in Employment Act of 1967 Amendments, introduced April 4, 1984, by Representative Mario Biaggi (D-NY).

[8] Statement of Sophie M. Korczyk on "Tax Incentives for Pensions and Flexible Compensation Plans," for the record of the United States Senate Committee on Finance, Subcommittee on Taxation and Debt Management, July 26, 27, and 30, 1984.

[9] EBRI tabulations of U.S. Bureau of the Census, *Current Population Survey*, March 1983.

Table 5
Employment and Pension Coverage Among the Elderly,[a] 1983

Group	Number (millions)	Percent
All elderly	25.2	100.0
All employed elderly	2.9	11.5
Elderly working:		
more than part-time[b]	1.2	5.2
three years or more with current employer	0.5	2.0
five years or more with current employer	0.4	1.6
and covered by a pension	0.5	2.0

Source: EBRI tabulations of the May 1983 EBRI/HHS *Current Population Survey* Pension Supplement.
[a] Age 65 and over.
[b] Working more than 1,000 hours per year and at least one year with current employer.

Table 6
Earnings, Income, and Pension Benefits Among Employed Elderly, 1983

Group	Number (millions)	Percent
Total elderly working more than part-time[a] with pension coverage	0.5	100.0
Annual earnings		
$20,000 or less	0.3[b]	66.4
Over $20,000	0.2[b]	33.6
Total income		
$20,000 or less	0.3[b]	51.2
Over $20,000	0.2[b]	48.8
Receiving a pension benefit		
Yes	0.1	13.8
No	0.4	86.2

Source: EBRI tabulations of the May 1983 EBRI/HHS *Current Population Survey* Pension Supplement.
[a] Working more than 1,000 hours per year and with at least one year of service with current employer.
[b] Numbers of persons are presented as rounded totals, while percent breakdowns are calculated before rounding.

◆ The Costs to Employers of Continued Pension Accruals

Pension accruals for employees continuing to work after age 65 do not necessarily increase pension costs for employers. Plan costs generally rise only if the provision is in the form of a credit for service plus an actuarial benefit increase, which is not common practice nor consistent with income replacement goals. (Plan costs are highest when an employee retires at normal retirement age. The plan must then begin paying out accrued benefits.) If employers were required to continue accruals based on credits for service for employees over age 65, the net addition to pension costs would be less than the cost savings to the plan from delayed retirement because benefits would be paid for fewer years. Most plans, therefore, would not experience increased aggregate costs from post-65 accruals. However, employers would still have higher cash outlays to reflect the added pension contributions that would have to be made during the post-65 service years. These added accruals can be estimated, though the small numbers of employees affected means that the estimates are very sensitive to alternative assumptions about plan characteristics and wages of affected employees. The following estimates are based on the potential increased outlays from post-65 accruals of those plans not currently making any adjustments for service after age 65.

It has been estimated that for a representative defined-benefit pension plan, a continued service credit combined with an actuarial benefit adjustment would cost about 20 percent more for an employee age 65 to 69 than for an employee age 60 to 64 and about 25 percent more than for an employee age 45 to 49.[10] About 500,000 employees age 65 or older are covered by employer-sponsored pension plans (see table 5). Available information on plan provisions suggests that about half of these persons may be covered by pension plans that make some adjustment for post-65 service (see table 1).

Based on the EBRI/HHS CPS, the average wage for elderly workers with pension coverage is just under $14,000. If we assume that the average cost for pension plans is about 8 percent of payroll (which is the average cost for large firms),

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[10] Anna M. Rappaport and Malcolm M. Morrison, *The Costs of Employing Older Workers* (Washington, D.C.: EBRI and U.S. Senate Special Committee on Aging, 1984), Appendix Exhibit A-1.

post-65 pension accruals would total $280 million per year. This is approximately the cost to employers of complying with the EEOC decision. If pension accruals for older workers are 20 to 25 percent more expensive than for younger workers, accruals would rise to between $336 and $350 million per year. If more older workers choose to continue employment after age 65, the accruals would be larger. The increased tendency of employees to retire at age 62 or younger suggests, however, that the availability of post-65 pension accruals may not encourage many more workers to remain employed.

◆ Prospects for the Future

It is difficult to predict the future impact of requiring pension accruals past the normal retirement age. On the one hand, as the population ages, increasing numbers of employees would be affected and employer costs for providing such benefit accruals would grow in the future. As the work force ages, increasing numbers of current workers will be covered by pensions and will have to choose between pension benefits and continued employment at age 65.

While increasing pension coverage rates combined with increased longevity could make post-65 pension accruals costly, there are also reasons to believe that these costs could be low in the future. Labor-force participation among men has been declining consistently at all ages, with the most dramatic declines occurring in the ten years prior to age 65. Among men age 55 to 59, labor-force participation dropped from 91.3 percent in 1959 to 82.2 percent in 1979, and among men age 60 to 64, it dropped from 82.8 percent in 1959 to 61.8 percent in 1979.[11] While many of those leaving the labor force are ill or disabled, nearly half of those age 60 or over who are not in the labor force report that they are retired. It is possible that these early retirements are based on the employee's comparison of his lifetime pension benefits with and without post-65 employment, but this is not likely. It is more likely that employees with adequate incomes from pensions and saving are choosing leisure over continued employment. Raising the normal retirement age for receiving Social Security benefits to age 67 could slowly reverse this trend, but it will have no effect on the increasing numbers who wish to retire in their fifties.

The future costs of these accruals also depend on whether or not employers continue to use early retirement as a way to manage their labor needs during periods of economic retrenchment. In recent years, employers have offered attractive early retirement packages as an alternative to laying off employees. While such "buyouts" may leave the employee with more retirement income, they probably still save the employer money compared with the alternative of laying off younger, lower-cost, and possibly more productive (according to some employers) employees.

If post-65 accruals are mandated, these early retirement packages may have to be even more attractive to outweigh the added retirement benefits an employee could earn by continuing employment. In addition, employers may choose to enforce mandatory retirement at age 70 (if it is not abolished by pending legislation), may decide not to hire workers at or near retirement, or may pay older workers less in cash than they would normally to make up for the added outlays required to finance their benefit accruals.

◆ Conclusion

Employees with pension coverage who continue to work after age 65 may suffer a significant reduction in the lifetime value of pension benefits compared with those available at age 65. The number of persons affected by this issue is very small, but the potential losses of lifetime benefits to these persons can be large. Congress and the EEOC are now considering whether plans that do not offer pension accruals for service after age 65 discriminate against the elderly in a fashion prohibited under the Age Discrimination in Employment Act.

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The opportunity to continue working and not suffer erosion of pension benefits could encourage older workers to remain in the labor force longer. On the other hand, continued pension accruals could make both older employees and defined-benefit pension plans expensive to retain.

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Postretirement pension accruals allow the plan to replace a specified proportion of preretirement income even if the employee continues to work after normal retirement age. The opportunity to continue working and not suffer erosion of pension benefits could encourage older workers to remain in the labor force longer. On the other hand, continued pension accruals could make both older employees and defined-benefit pension plans expensive to retain.

In its debates over this issue, Congress will have to balance the advantages to older employees from requiring accruals against these potential disadvantages.

[11] Wayne Vroman, *Employment Termination Benefits in the U.S. Economy* (Washington, D.C.: EBRI, 1983), pp. 150-151.

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