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Summary of statement by Sophie Korczyk
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Under current statutes and regulations, employers offering a pension plan do not have to accrue benefits for employees who continue to work after the plan's normal retirement age. The Congress is currently debating proposals to require such accruals.

Many older employees already receive 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 age 65. These adjustments may be in the form of actuarial adjustments to the benefit earned at age 65, credits for post-65 service, or both.

The absence of accruals can be costly to older employees. 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, while an employee delaying retirement for five years can lose up to half the value of pension benefits accrued at age 65.

Labor force participation among the elderly is declining. Relatively few elderly choose to work after age 65, and this proportion has been declining steadily over time. Liberalized early retirement provisions in the Social Security program as well as in employer-sponsored plans appear to have contributed to this trend.

The availability of pensions seems to encourage early retirement. Elderly persons with pension coverage are less likely to work after age 65 than persons without pension coverage. This, however, could be due to the fact that elderly persons with pensions may have enough income to retire comfortably as much as the fact that delaying retirement costs them significant foregone retirement benefits.

Elderly employees with pension coverage are better off than other elderly but not as well off as the working population as a whole.

Requiring accruals could bring both gains and losses. Elderly employees would benefit significantly if service after 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.

--Statement Follows--

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Statement on

Pension Accruals for Older Workers

Before the
United States House of Representatives
Committee on Education and Labor
Subcommittee on Labor-Management Relations

September 5, 1984

by

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Mr. Chairman, I am pleased to submit this statement on pension accruals for employees over age 65.

The Employee Benefit Research Institute (EBRI) was formed in 1978 as a non-profit, non-partisan, public policy research organization to conduct research and educational programs. EBRI is committed by charter to the premise that the nation is served positively in both social and economic terms by the existence of employee benefit programs; they can be clearly shown to improve economic security. EBRI undertakes to provide the studies and the statistics that will allow informed priority decisions to be made based upon assessment of documented costs and benefits.

My statement today will cover four issues:

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

BACKGROUND

The issue before this committee concerns the impact of requiring employers offering pension plans to accrue benefits for employees continuing to work after the plan's normal retirement age. Under the Employee Retirement Income Security Act of 1974 (ERISA), a defined-benefit plan and a target-benefit plan may exclude certain older individuals from participation when first employed. Employers have also been able to discontinue making contributions under these plans for employees continuing to work after the plan's normal retirement age. Pension costs in a defined-benefit plan may be up to 10 times as high for an employee at age 60 as at age 30.[1] Exempting employers from the requirement of covering employees at or near retirement age reduces plan costs and removes pension-plan costs as a barrier to hiring older employees.

The Equal Employment Opportunity Commission (EEOC) voted on June 26, 1984 to rescind Department of Labor regulations affecting the treatment of employees continuing to work after age 65 and to issue new regulations in the summer of 1984. Rep. Mario Biaggi (D-NY) of this subcommittee has introduced a bill (H.R. 5346) that would also require these accruals.

Our analysis of this issue suggests that it affects very few persons. For those few persons whose retirement benefits would be affected, however, and for their employers, the impacts could be large. Accordingly, this issue deserves the careful scrutiny this committee is giving it.

PLAN PROVISIONS FOR POST 65 EMPLOYMENT

The issue of post-65 accruals affects only participants in defined-benefit and target benefit plans. Defined-contribution plans do not impose higher costs for older workers and thus are subject to the same ERISA eligibility requirements that affect all other employees.

More than half of defined-benefit pension-plan participants in medium and large firms are covered by plans that offer some adjustment for post-65 service, whether in the form of actuarial adjustments to the benefit earned at age 65, credits for post-65 service, or both (table 1). About 5 percent of plan participants in these firms receive actuarially adjusted pensions for delayed retirement. If the actuarial adjustment fully reflects the reduced period of pension recipiency, the participant receives the same lifetime benefits (same present discounted value of benefits) at the delayed retirement

Table 1.

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

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 benefit formula.
[c] Credit computed by a method that is not part of the plan's benefit formula.

as at normal retirement age, and 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 the added service unless post-65 service is credited. Crediting post-65 service is most consistent with the goal of replacing a given proportion of pre-retirement income. Half of participants are covered by pension plans that credit post-65 service with no actuarial increase. Nearly all of these persons receive service credits under the plan's regular formula. About one-third of these persons receive credits only to some specified maximum age or years of service. A small number receive credits based on a formula that is different from that used to calculate pre-65 benefits.

While most participants in medium and large firms receive some pension adjustment for post-65 service, the elderly 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 100 employees, compared with 17.6 percent of the working population as a whole (table 2). This difference means that we know somewhat less about the features of pension plans covering elderly employees than we know about the labor force as a whole.

HOW CURRENT PROVISIONS AFFECT PARTICIPANTS

Pension accruals for employees continuing to work after age 65 do not increase pension costs for employers if an actuarial benefit adjustment is not also offered. Rather, the most costly decision an employee can make from the point of view of plan costs is to retire at age 65. Even if a plan offers accruals based on continued service, salary increases, or both, these accruals do not offset the decline in the present discounted value of pension benefits that results from a decreased period of benefit recipiency.

Table 2.

All Employees and Elderly Employees
with Pension Coverage,
by Firm Size, 1983[a]
(in percents)

Firm Size	All Employees	Elderly Employees
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 EBRI-HHS Pension Supplement, May, 1983 U.S. Census Bureau Current Population Survey.

[a] Detail may not add to 100 percent due to rounding. Totals exclude respondents who did not know the size of their employing firm.

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, while an employee delaying retirement for five years can lose up to half the value of pension benefits accrued at age 65 (table 3). The participant's losses are lowest if the plan credits both additional service and salary increases for pension benefit determination. The employee retiring at 67 loses 4 to 8 percent of the value of accrued benefits while the employee retiring at 70 loses 10 to 18 percent. If the plan credits only additional service and not salary increases, the participant's losses can amount to 14 to 19 percent of accrued benefits retiring at age 67 and 30 to 41 percent retiring at age 70. If benefits are frozen at age 65 with no service credits and no actuarial adjustments, the participant can lose 19 to 23 percent of total benefits retiring at 67 and 41 to 47 percent retiring at 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. If the plan is designed to replace a specified part of the participant's pre-retirement income, it could instead be considered participants 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 <u>and</u> if post-65 service and salary increases are also credited for benefit purposes, an individual retiring at age 67 would have 17 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.[2]

Table 3.

Decrease in Lifetime Pension Benefits
Resulting From Delaying Retirement
Until Age 67 and 70
Under Alternative Plan Provisions

Plan Provision	Age at Retirement 67	70
Benefits frozen at 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
Actuarial adjustment made	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.

EMPLOYMENT AND PENSION COVERAGE AMONG THE ELDERLY

Relatively few elderly choose to work after age 65, and this proportion has been declining steadily over time. In 1970, for example, 3.1 million persons or 15.4 percent of those age 65 or older reported that they were in the labor force (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 elderly and 2.7 percent of the total labor force.

Numerous factors have contributed to this decline, 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 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 trend as well.[3]

But how important are pension considerations in the retirement decision? About 29 percent of persons age 65 or older reported receiving pension income in 1983.[4] In contrast, fewer than 20 percent of elderly employees are covered by pensions. Of the 25.2 million persons who were 65 years old or older in 1983, 2.9 million, or 11.5 percent, reported in the May, 1983 CPS that they received earnings in 1983 (table 5). Fewer than half of these persons, or 1.2 million, worked 1000 or more hours during the year and had worked at least one year for their current employer. In general, the Employee Retirement Income Security Act of 1974 (ERISA) provides that an employee who

Table 4.

Employment Among The Elderly,

Selected Years

(numbers in millions)

Year	Elderly Population	Elderly Employees	% of Labor Force	% of Elderly
1970	20.1	3.1	3.9	15.4
1980	25.7	3.0	3.0	11.7
1983	25.2	2.9	2.9	11.5

SOURCES: Data for 1960 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 March, 1983 and May, 1983 U.S. Bureau of the Census Current Population Survey.

Table 5.

Employment and Pension Coverage
Among the Elderly, 1983
(numbers in millions)

Group	Number	Percent
All elderly	25.2	100.0
All employed elderly	2.9	11.5
Elderly working more than part-time[a]	1.3	5.2
.....covered by a pension	0.5	2.0
.....three years or more with current employer	0.5	2.0
.....five years or more with current employer	0.4	1.6

SOURCE: EBRI tabulations of EBRI-HHS Pension Supplement, May, 1983 U.S. Census Bureau Current Population Survey.

[a] More than 1000 hours per year
[b] Working more than 1000 hours per year and at least one year with current employer.

meets these criteria and is more than five years younger than the plan's normal retirement age has to be covered under a pension plan if his or her employer offers one. Of the persons meeting these criteria, 0.5 million, or 17 percent of all employed elderly and fewer than 2 percent of all elderly, report that they are 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 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.

Nearly all employees who have 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. This latter group are those most likely to be continuing employment 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. Current discussions over this issue do not comtemplate that employers offer defined-benefit pension coverage to new employees hired at or after age 65. Of those seeking new employment at 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 less well off than the working population as a whole. Thirty-three percent of the working elderly have annual earnings from employment over $20,000 (table 6).

Table 6.

Earnings, Income, and Pension Benefits
Among Elderly Employees, 1983
(numbers in millions)

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

Source: EBRI tabulations of EBRI-HHS Pension Supplement to May, 1983 Current Population Survey.

[a] Numbers of persons are presented as rounded totals, while percent breakdowns are calculated before rounding.

Among pension participants as a whole, 41 percent earn more than $20,000.[5] Of the employed elderly, 49 percent have total personal incomes from all sources that exceed $20,000 (table 6). By comparison, only 9 percent of all elderly persons report total incomes over $20,000.[6]

In addition to earnings and other income, 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 total, however, is likely to be very small, since only one percent of pension participants are covered by plans that allow them to receive a pension benefit at age 65 if they continue to work for the plan sponsor.

COSTS OF CONTINUED ACCRUALS TO EMPLOYERS

Unless pension benefits are adjusted actuarially to reflect delayed retirements, employees who continue to work after age 65 suffer some erosion in the lifetime value of their accrued pension benefits. Therefore, even if all employers were required to continue accruals for these employees, the net addition to pension costs would be less than the cost savings to the plan from delayed retirements. However, employers would still have higher cash outlays to reflect the added contributions for post-65 employees. These added outlays 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.

It has been estimated that for a representative defined-benefit pension plan, continued benefit accruals 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.[7] About 500,000 employees age 65 or older are covered by employer-sponsored pension plans. 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. Based on the 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, the cost to employers of allowing post-65 pension accruals would be $280 million per year. If pension accruals for older workers are 20 to 25 percent more expensive than for younger workers, this cost would rise to $336 to $350 million per year. If more older workers choose to continue employment after age 65, this cost could rise further. However, the increased tendency of employees to retire at age 62 or younger suggests that the availability of post-65 pension accruals would not be likely to encourage 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, it would appear that as the population ages, increasing numbers of employees will be affected and that employer costs for providing such benefit accruals could be very high in the future as well. 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 last decade before retirement. Among men aged 55 to 59, labor force participation dropped from 91.3 percent in 1959 to 82.2 percent in 1979, and among men aged 60 to 64, it dropped from 82.8 percent in 1959 to 61.8 percent in 1979.[8] While many of those leaving the labor force are ill or disabled, nearly half of those aged 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 are choosing leisure over continued employment.

The future costs of these accruals also depend on whether or not employers continue to use early retirements 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 employees. If post-65 accruals are mandated, these early retirement packages may have to be even more attractive in order 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, may decide not to hire workers at or near retirement, or may pay older workers less than they would have otherwise to make up for the added cash outlays required to finance their benefit accruals.

CONCLUSIONS

Employees with pension coverage who continue to work after age 65 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 very large. The Congress and the EEOC are now considering whether plans that do not offer accruals for service after age 65 discriminate against the elderly in a fashion prohibited under the Age Discrimination in Employment Act.

Post-retirement pension accruals allow the plan to replace a specified proportion of pre-retirement 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. This could make both older employees and defined-benefit pension plans expensive to retain. In its debates over this issue, the Congress will have to balance the advantages to older employees from requiring accruals against these potential disadvantages.

NOTES

[1] 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), p. 76.

[2] 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.

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

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

[5] 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.

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

[7] 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.

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