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Statement on

Pension Accruals for Older Workers

Before the United States Senate
Committee on Labor and Human Resources
Subcommittee on Aging

Hearings on Pension Accrual and
the Older Worker
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of

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INTRODUCTION

Mr. Chairman, my name is Emily Andrews. I am research director at the Employee Benefit Research Institute (EBRI). I am pleased to appear before this Subcommittee during its consideration of pension accruals and the older worker.

EBRI was formed in 1978 as a nonprofit, nonpartisan, public policy research organization to conduct research and educational programs. EBRI is committed by charter to the premise that the nation is served in social and economic terms by the existence of employee benefit programs. We are aware that there may be limits to what can and should be provided and that changes in the system may be necessary to ensure benefit adequacy. Consequently, EBRI undertakes studies and provides statistics so that informed decisions can be made upon the assessment of documented costs and benefits.

My comments are set within this framework. They should not be construed as endorsing any particular policy to encourage or discourage pension plan accruals for older workers.

The issue of whether employer-sponsored pension plans should be required to continue pension contributions beyond normal retirement age has received increasing attention over the past two years. After the passage of the 1978 Age Discrimination in Employment Act (ADEA) in 1978, which prevented mandatory retirement before age 70, the Department of Labor (DOL) was directed to issue comprehensive interpretation of the ADEA Amendments with respect to employee benefit plans. In May 1979 the Labor Department issued a bulletin stating that the ADEA Amendments did not alter existing ERISA provisions allowing employers to freeze pension accruals after the plan's normal retirement age, which is frequently set at age 65. These provisions were intended to encourage employers to hire and retain older workers. Employees under 18 years of age and those working fewer than 1,000 hours in any year also do not have to be included in the firm's pension plan.

After the Equal Employment Opportunity Commissions (EEOC) assumed jurisdiction over the administration of ADEA, it started to review all DOL interpretations of the Act. In early 1985, the EEOC approved draft regulations that would require continued pension contributions, and hence larger monthly retirement benefits, for employees who work beyond normal retirement age.

Legislation has also been proposed to amend the ADEA to require post-65 accruals. On April 4, 1984 Representative Mario Biaggi (D-NY) introduced legislation which would require post-65 accruals; new legislation with additional provisions regarding plan participation provisions for older workers was introduced by Representative Biaggi on June 11, 1985. In addition, on July 11 1985 Senator Charles E. Grassley (R-IA) introduced legislation to amend the ADEA to ensure continue pension accruals under both defined benefit and defined contribution plans.

I plan to discuss four topics in my testimony today:

- How pension plans currently treat post-65 accruals;
- How many workers would benefit from requiring post-65 accruals;
- How much workers may lose without continued accruals;
- What are the nationwide costs of continued accruals.

PLAN PROVISIONS FOR POST-65 EMPLOYMENT

Post-65 pension accruals primarily are an issue for defined benefit and target benefit private pension plans. In defined benefit plans, the employer agrees to provide a specified monthly benefit at retirement which is usually tied to the employee's earnings and length of service. A target benefit plan is a defined contribution plan in which contributions are scaled to meet a specified retirement benefit. Post-65 benefit accruals are not usually an issue for other defined contribution plans in which future benefits are determined by the employers annual contributions.

One half of defined benefit plan participants in medium and large firms are covered by plans which offer some type of provision for post-65 service, whether in the form of credits for post-65 service, actuarial adjustments to the benefit earned at retirement, or both (table 1). About 45 percent of all plans surveyed credit post-65 service (although they make no actuarial adjustment to ensure that the present value of benefits received over retirement will be the same for later retirement ages even though life expectancies are shorter for those who retire later). Most participants receive credits for all years of service or for service to a maximum age and number of years. Seventeen percent of participants receive credits only to a specified maximum age or years of service. A small number receive credits based on a different benefit formula.

About 5 percent of plan participants receive actuarially adjusted pensions at delayed retirement. These adjustments increase the participant's pension payments so that the present value of the benefit at normal retirement age is the same as the value of the benefit at delayed retirement. 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 even though that retiree's expected life span will be shorter. In other words, the participant does not lose any of the asset value of the pension annuity. Legislation currently being proposed would credit service to those working past normal retirement age but would not require that benefits be actuarially adjusted to ensure that their discounted value be equal or better to that received at normal retirement.

While half of all participants in medium and large firms receive some type of pension adjustment for post-65 employment, many elderly are employed by smaller firms. Nearly 28 percent of employees 65 and older participating in a pension plan are employed by firms with fewer than 100 employees compared to nearly 18 percent of those under age 65. Older workers are also more likely to be employed by smaller firms than younger workers (64 percent to 39 percent) although they are nearly as likely to be covered by a plan. A lack of information about the prevalence of post-65 accruals among these smaller plans will affect the accuracy of our estimates of the extent to which participants receive continuing accruals.

EMPLOYMENT AND PARTICIPATION: THE EFFECT OF POST-65 ACCRUALS

Whatever the size of firm providing employment, we know that relatively few elderly choose to work after age 65, and that this proportion has been declining steadily since Social Security was enacted 50 years ago. The labor force participation rate of men 65 and over has declined considerably, from

33.1 percent in 1960 to 16.3 percent in 1984. A recent study by the Department of Labor has shown that men born in each successive year between 1903 and 1923 have had lower labor force participation rates at practically every age from 55 to 74.[1] Among men born in 1903, 11.9 percent were no longer in the labor force by age 60. Among men born 20 years later, 28.4 percent were no longer working by age 60. The average age of workers receiving Social Security benefits has declined substantially since the beginning of the program. In 1940, men were first awarded Social Security retirement benefits at an average age of 68.8. By 1980, the average age of award for men was reduced to 63.9 years.

Among all workers 65 years of age and over (including the self-employed), only 1.2 million persons worked 1,000 hours or more 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 included in the pension plan if one is offered.

Elderly employees with pension coverage often appear to be working for their career employer. Most older workers worked for their current employer more than three years and 80 percent worked for their current employer for more than five years. This latter group is 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. 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.

Within a framework in which many may be still working at career employment, how many older workers would be affected by standards to require continued pension accruals on the worker's 65th birthday? Out of an estimated 365,000 nonfarm plan participants in the private sector in 1985, 182,000 are likely to be in plans that do not currently accrue benefits past 65 (table 2). Of these, only 151,000 are entitled to benefits. This relatively small group would be helped by post-65 accruals Those who are participating but have not qualified for vested benefits are unlikely to be affected since the most prevalent vesting standard under a defined benefit plan is 10-year cliff vesting. Those who are not vested at age 65 are quite unlikely ever to meet a 10-year vesting standard.

Out of 2.9 million workers 65 years of age and over, considerably less than 10 percent would benefit from post-65 accruals. Out of 25.2 million persons age 65 and over, less than 1 percent would benefit. In sum, a very small percentage of the population 65 years and older is likely to be affected by continuing pension accruals primarily because the majority of workers retire well before they reach that age. Since this is the case, the key statistical issue appears to be the effect of such accruals on the income of the future retirees affected, on labor force participation, and on the firms providing these benefits.

PARTICIPANT LOSSES AT LATER RETIREMENT AGES

Depending on the plan's provisions, an employee delaying retirement for two years can lose from 4 percent to 23 percent of the present value of accrued lifetime benefits compared to normal retirement unless the benefits are actuarially adjusted to make up for delayed retirement. An employee delaying retirement for five years can lose from 10 percent to up to half the value of pension benefits accrued at age 65 in present value terms because of the shorter payout period expected at later retirement ages.

The participant's losses are lowest in terms of the present value of lifetime benefits if the plan credits both additional service and salary increases in determining the amount of the pension benefit (table 3). This is what the EEOC and proposed post-65 pension accrual legislation would do. Proposed legislation does not demand that benefits be made actuarially "fair," that is, that retirees sustain no losses in present value terms no matter their retirement age. If service and salary increases are credited, the employee retiring at age 67 loses only 4 to 8 percent of the present value of accrued benefits, however, while the employee retiring at age 70 loses only 10 to 18 percent compared to the present value of benefits that would have been received had retirement taken place at the plan's normal retirement age. Without continued accruals, these losses are much larger.

If the plan credits only additional service and not salary increases, the participant's losses can range from 14 to 19 percent of present value of accrued benefits retiring at age 67, and 30 to 41 percent retiring at age 70 compared to retirement at age 65. Losses are greatest in present value terms 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 compared to the present value of benefits .

However, if individuals value their pensions correctly, they will retire when the present value of their pensions is at its highest. By this argument, those who have not retired at that point must have some other reason to continue their employment. They may particularly enjoy their work or they may receive other benefits which offset the decreased value of their pensions. If continued pension accruals change the age at which the present value of pension benefits peaks, more older workers can be expected to stay on the job. Unanticipated later retirement would reduce the pension costs to employers. But employer costs for other benefits may be higher for older workers. For instance, now that TEFRA requires that an employer's health plan be primary to Medicare payments, employer-provided health insurance costs and benefits are greater for older workers. In addition, life insurance costs are likely to be higher for workers past 65. Consequently, if post-65 accruals are made mandatory, younger workers could argue that older workers are receiving more than their fair share of compensation. More likely, employers could ease the pressure of other benefit costs for any particular older worker by reducing the salary share of compensation. As long as such adjustments are possible, the effect of continued accruals on the compensation package or on employment cannot be fully evaluated. Nevertheless, the employment effects are not likely to be large given the tendency towards earlier and earlier retirement. For instance, studies have show that even the recent 1983 Social Security provisions will not have much affect on retirement ages.

COSTS TO EMPLOYERS OF CONTINUED ACCRUALS

Since the present value of pension benefits differs according to retirement age, pension accruals for employees continuing to work after age 65 will not necessarily increase employers' pension costs compared to the costs they would have incurred had the worker retired at age 65. Of course, many economists suggest that pension plans are specifically designed with that result in mind in order to encourage retirement at normal retirement age. Post-65 accruals require increased employer pension costs for those employees working past normal retirement, however, compared to the pensions that would be paid without continued accruals.

It could be argued that requirements to continue pension accruals for additional service simply reduce the size of the employer windfall. Alternatively, it can be argued that the employer does not receive a windfall, but that the reduction in pension costs just compensates the employer for the higher costs of other benefits or for the reduced productivity of the older workers. In any case, abstracting from plan practices, employer costs for added accruals for those retiring past normal retirement age can be calculated under several reasonable assumptions to produce a range of cost estimates on a nationwide basis assuming that the late retirees continue to retire at the same expected age.

EBRI's October 1984 Issue Brief provided an estimate of post-65 accrual costs under the assumptions that the average wage for elderly workers is just under $14,000 and that the average pension costs is about 8 percent of payroll. This provides a minimum accrual cost of $280 million per year. EBRI estimates presented in The Changing Profile of Pensions in America indicate higher costs. In these estimates pension costs are estimated to be nearly four times as high for workers age 65 to 69 as they are for those age 45 to 49.[3] Pension costs for employees age 65 to 69, including post-65 accruals and actuarially equivalent benefit increases, are more than 20 percent higher than those needed for workers age 60 to 65. Assuming defined benefit plan contributions of 5 to 10 percent of earnings, estimated actuarial costs for 1985 range from $638 million to $1.3 billion (table 2).

These costs could be less in practice. About 55 percent of defined benefit plans are integrated with Social Security; contributions for older workers earning below the Social Security taxable maximum would be smaller. Other plans limit the number of years of credited service allowed and may have maximum benefit provisions. These practices would also tend to lower costs. Even given these provisos, contributions for post-65 accruals could total $1 billion in 1985 or only about 1.5 percent of the $65 billion in pension contributions made by private-sector employers in 1983. Whether additional contributions would be made by any particular plan would depend upon how retirement ages were factored in before accruals were required and whether actuarial study indicated that retirement age should be treated differently after post-65 accruals were required. Actual dollar contributions would probably not have to be increased for plans that never anticipated anyone working past normal retirement age.

CONCLUSIONS

Compared to the 1984 Retirement Equity Act, post-65 accruals benefit fewer workers at potentially higher additional contribution costs.[4] Increased pension benefits may be quite important to workers affected by the legislation increasing the present discounted value of lifetime benefits by 15 to 50 percent. Those receiving post-65 accruals would have their retirement income enhanced when they left the labor force. Some workers might decide to retire at later ages because of this benefit inducement. The impact of continued accruals for particular workers would depend on salary, years of service, number of years working after normal retirement age and the particular provisions of the plan. While the cost of this legislation may be high for some employers who employ a large percentage of workers age 65 and over, on a nationwide basis, using the highest or lowest of our estimates, additional costs are minimal.

Because relatively few employees are affected since most older workers have retired by age 65, it could be argued that the legislation ought to be evaluated primarily from a civil rights perspective. Nevertheless, the secondary effects of post-65 accruals could lead to a decrease in the salaries of some workers over age 65. Salary reductions would probably be implemented through reduced salary increases at salary review time. Furthermore, if the incentives towards later retirement found in the 1983 Social Security Amendments were eventually ratified by private-sector initiatives which also encouraged later retirement for workers in the baby boom, the number of persons receiving post-65 accruals could increase over the next 20 to 40 years. In its debates over this issue, Congress will have to balance the advantages to older workers from requiring accruals against these potential disadvantages. EBRI is currently developing a monograph on older workers which we will share with you upon completion.

NOTES

1 See Phillip L. Rones, "Using the CPS to track retirement trends among older men," Monthly Labor Review, 1985, pp. 46-49.

2 As reported in the May 1983 EBRI/Health and Human Services Current Population Survey pension supplement.

3 The primary methodological differences are in the estimated number of participants affected by the provision and the percentage of salary needed to fund the pension. More participants were assumed in our first estimate at lower per participant costs.

4 See EBRI Issue Brief #39 (February 1985) for an analysis of the effects of the Retirement Equity Act.

Table 1

Full-time Participants in Private Pension Plans by Provision for Service Credit After Age 65, in Medium and Large Firms, 1984

Provision	Percent of Participants
No adjustment	50
Pension deferred with no change in amount	49
Pension begins at age 65	1
Pension adjusted actuarially	6
Pension deferred only	5
Pension deferred and all service credited[b]	1
Service credited to maximum age or service	a
Credit for service with no actuarial increase	45
Pension deferred and increased by percent for each additional year of service[c]	2
All service credited[b]	25
Service credited to maximum age	17
Service credited to maximum years of service	a

Source: EBRI tabulations based on U.S. Department of Labor, Bureau of Labor Statistics, Employee Benefits in Medium and Large Firms, 1984, 1985, p. 53.

[a] Less than 0.5 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.

Table 2

Estimated Effect of Post-65 Pension Accruals
1985

Older Workers[a]	
Affected workers	
Participants	182,000
Entitled to benefits	151,000

Illustrative Estimates of Annual Costs[b] (millions of dollars)	
At average annual cost of[c]	
$3,500 per participant	$638
$7,000 per participant	$1,276

SOURCE: EBRI estimates based on May 1983 EBRI/HHS CPS Pension Supplement and estimates of actuarial costs from Anna M. Rappaport and Malcolm M. Morrison, the Costs of Employing Older Workers (Washington, D.C.: Employee Benefit Research Institute and U.S. Senate Special Committee on Aging, 1984).

[a]According to the Bureau of Labor Statistics one-half of all plans credit service after age 65 but without an actuarial increase so benefits do not increase after age 65. Estimates of those affected by post-65 benefit accruals are equal to 50% of the imputed number of all private sector nonagricultural wage and salary workers participating and entitled to retirement benefits under a pension plan in 1983. These figures are brought forward to 1985 by assuming a 10.0 percent gain in employment for older workers over the figures for 1983.
[b]Does not include administrative costs.
[c]Derived from Appendix Exhibits A-1, A-6, and A-11, Anna M. Rappaport and Malcolm M. Morrison, the Costs of Employing Older Workers (Washington, D.C.: Employee Benefit Research Institute and U.S. Senate Special Committee on Aging, 1984). Based on approximate pension costs for participants aged 65 to 69 in defined benefit plans earning between $10,000 and $25,000 with employer contributions of 5 percent and 10 percent of total salary costs. Dollar values equal the number of participants affected times the per-participant cost.

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.