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RETIREMENT AT 70

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1. What redesign of group life, disability, and health plans is necessary as a result of raising the minimum mandatory retirement age to 70? What is the cost effect of these changes? How do you handle benefit design in states with no mandatory retirement age?

2. How should pension and profit-sharing plans be changed to conform to the new law? What changes in cost are implied? Other considerations.

3. What are plan sponsors actually doing?

4. The outlook for future regulation.

MR. HARRISON GIVENS, JR.: We have a subject which links conceptually to the one this morning on sex discrimination. The difference might be that we do not yet have the clear rules for benefit plans and retirement at 70 that we seem to have in the area of sex discrimination. We had thought when the program was being designed that the word would be out by the early part of April, but it is not. We will try to cover the subjects here from three points of view; the experiences of a large life insurance company acting as a vehicle for welfare plans, the experience that consulting firms have with their clients on reacting to the recent change in the Age Discrimination Act, and thirdly what qualified pension plans are doing.

MR. ALEXANDER D. BRUNINI: You may recall, it was a year ago this week, that President Carter signed into law the 1978 Amendment to the Age Discrimination in Employment Act (ADEA). This act has since that time extended the protection of the Act to employees between 65 and 70. The original 1967 Act had already provided that protection to employees between 40 and 65.

As a result of this change, of course, many employers, particularly large ones, are faced for the first time with active employees working beyond age 65. It is a change--and you are aware a change can be difficult and traumatic. We will be discussing the changes that are necessary in employee benefit plans. The nature of them, of course, is that age 65 was a cornerstone in many employee benefit plans, not only retirement plans expressing it as a normal retirement age, but many group life insurance, group health insurance plans also key into this.

In the one year since the Act was signed, many of the regulatory problems and questions have not been answered. I will quickly summarize the regulatory situation for you. The Act in general makes any discrimination with respect to pay, compensation or conditions of employment illegal. However, when the Congress originally passed the Act, and again when it was amended, they took note of the fact that certain fringe benefits, insurance and pensions in particular, tend to be very expensive to provide to older

workers. This expense could have amounted to a disincentive to employ older workers which, of course, would not be consistent with the purposes of the Act. Therefore, a paragraph was inserted in the law which has become known as the paragraph 4(f)(2) exemption, and it reads as follows:

> "It shall not be unlawful for an employer to observe the terms of any bona fide employee benefit plan such as retirement, pension, or insurance plan which is not a subterfuge to evade the purposes of this Act."

All the open questions about benefits revolve around the interpretation of this particular language. A little bit of history is perhaps in order.

The Department of Labor (DOL) is the agency which is currently responsible for administering this Act. In September of last year, the DOL issued a proposed version of an Interpretative Bulletin (IB). Comments were solicited, both written and oral testimony, in October and further written comments were accepted into November of last year. A fair amount of comment did ensue and as a result of the issues which were raised in this process, no subsequent version of this Bulletin has emerged, as Mr. Givens indicated. We understand informally that the substantive issues involving group life insurance and group long-term disability insurance are perhaps, among others, the reasons for this delay. This situation is further complicated because on July 1st of this year the responsibility for administering the Act shifts from the DOL to the Equal Employment Opportunity Commission (EEOC). We are also informed informally that quite reasonably the DOL intends to allow the EEOC to have a look at the next version of the IB before a final one is publicly released. We have divided the subject into five areas. I am going to deal with two of them; one is group life insurance and one is medical care plans. The remaining three subjects will be dealt with by succeeding panelists.

Let me get started on medical care. In many respects, this appears to be one of the simplest. The whole thinking is dominated by the fact that whether active or retired the employee does become eligible for Medicare at age 65. The DOL's approach in their IB to reflect this was to take a benefits-oriented approach; namely, that the total benefits payable to an active employee above 65 would have to be not less than the benefits provided to the younger employees, albeit that they will be coming from two sources: Medicare and the plan benefits. You are probably all familiar with the plans already in existence which accomplish this approximately or exactly. There is little disagreement, I think it is safe to say, in principle with this approach. The problems arise in the methods which have been used in the past to accomplish this goal. Very briefly, the direct carve-out approach of Medicare benefits is one which was implicit in the IB. The other method which is also quite common is the one where the carve-out is indirect and it is in fact implicit in the plan design. The design actually incorporates the benefits which are not recognized or payable by Medicare and, therefore, the carve-out is an approximate one. The problem was that the IB did not reflect this second approach and a relatively large number of people and organizations who submitted testimony pointed this out to the DOL and, of course, it remains to be seen whether this emerges in the final version. The advantages to the second approach are that claims can be paid relatively quickly and without having to wait for the exact adjudication of the claim by the Medicare carrier(s).

I would say there are perhaps two areas that are indistinct at this point. One is--What happens if the employee does not march down to the Social Security office and enroll in Medicare? Can the plan carve-out the benefits on a paid or payable approach? The other question is relatively a simple one--What about the $100 a year in Medicare Part B premiums? Neither of these was directly addressed in the IB although, as far as the first is concerned, about enrollment or non-enrollment, the language in the Bulletin clearly conveyed the impression that enrollment or eligibility for Medicare was implied. I do not think anybody is proceeding under the assumption that this would not be true; however, I mention it because it could be a very significant matter; the value of Medicare is now approaching $1,000 per year per individual covered and it does have other ramifications in that eligibility for Medicare is tied in, to some extent, with eligibility for cash benefits. The other question is an interesting one in the following context. If a medical care plan is completely non-contributory for the active employees under 65, would it, therefore, constitute discrimination to require the active employees over 65 to pay the $100? I do not know that there is any answer to that. There, again, is no formal indication that this position (that the employer would have to pay these premiums) is being advocated by any particular party.

Now what are the cost implications? Obviously, for those employers who are pretty much doing this already with a supplemental plan to the Medicare coverages, neither a great change in their plan nor a great expense is involved. There are a couple of areas which I might mention in terms of cost; they are benefits which are simply not covered by Medicare. Examples are dental, vision care, and the prescription drug coverages which are excluded from Medicare. These are going to cost something. For dental, the cost to an older employee is typically not greater than it is to the younger employees. The same, unfortunately, cannot be said for the drugs and the vision, so this will be an area where the cost impact will definitely hit employers.

Now I am going to move on to life insurance. There are, again, a couple of particular problems; they deal with the reduction formula that is common in group life insurance, almost universal for that matter, and in the area of the disability provisions that are commonly written into these plans. However, for just a minute, I want to talk about a more fundamental issue that is common throughout the IB. It goes under the name of the concept of cost equivalency. Very briefly, the position was taken in several benefit areas by the proposed Bulletin that non-discrimination consists of providing equally costly benefits to various groups of employees. Now, how you define the groups of employees is a bit undetermined at this point, but through some mechanism one arrives at a grouping of employees by age, and the principle of cost equivalency is that the same amount of money has to be channelled into each one of these. In effect, what this amounts to is starting with the cost distribution by age and letting the benefits payable turn out to be the chips that fall wherever they may. Metropolitan and other commentators have taken exception to this approach in written comments to the DOL. Our objection is not so much that the cost equivalent benefit is discriminatory. I do not think it is. Our objection is that that should not be the only criterion for establishing whether a plan amounts to a discriminatory subterfuge or not. We point out that traditional approaches to group insurance plan design start with the benefits. You determine the level of benefits and, of course, determine how much the

whole thing is going to cost. Certainly, cost is a factor in the sense that the plan sponsor may have to scale down the whole thing if his financial position does not justify the expense, but the cost distribution by age is not typically something that anybody pays a great deal of attention to and in effect may never actually have been calculated at all. It amounts to a kind of a mathematical result that falls out of the actuarial nature of the benefits. To take the opposite approach of establishing the cost distribution in advance, letting the benefits be the result of the formula, naturally runs the risk of having benefits which do not make a lot of sense in the context of the employee's needs.

An example of this, to get back to life insurance, arose in the area of the reduction formulas. The DOL's Bulletin introduced the concept of the 8% reduction. They stated it as follows:

> "In the case of employees between 65 and 70, standard actuarial tables justify about an 8% yearly reduction in coverage in any one year, and the Department would not assert a violation where the reduction is no greater than this amount."

It is not our intention to quibble about whether the 8% is right or whether it should be 9% or 10%. Again, the objection is that if 8% were to be called an appropriate reduction, the implication is that reductions greater than 8% are not appropriate, or perhaps even discriminatory. This logic simply gives no account to whether 92% of last year's insurance is an amount that the employee wants or needs, or the beneficiary wants or needs, or that the plan sponsor feels is appropriate in connection with other death benefits that are available. For example, the need for group term life insurance at the older ages may in general be substantially less than it is for younger employees. Look at the facts that (1) Social Security survivorship benefits are payable, (2) if there is a qualified pension plan, survivorship benefits are payable from that, (3) there are typically no younger children who are dependent upon the employee, (4) the mortgage, if any, is either paid off or getting closer than it is for younger people, (5) a whole career has elapsed in which personal financial assets can have been accumulated. All of these, again, obviate the need for group term life insurance. It just seems reasonable that this lesser need in the context of a certain employee group might be applied to the plan design and that the flat 8% reduction rule would not allow for that. Another peculiar result of the cost equivalency idea arises for plans which provide ultimate amounts of insurance; that is, following a reduction formula there is an amount of group term life which is left in force for life. The IB did not take this into account. I think I can probably quantify this by talking about two particular plans. One is the plan that is implicit in the IB. That would reduce the amount of insurance that was in effect at age 65 by 8% per year until such time as the employee retired, at which time the group term life would go to zero. That meets the tentative requirements of the proposed IB. The other plan would be one which reduces much more quickly on the 65th birthday, namely by 25%, and on the two succeeding birthdays it would reduce, again, by 25%. Here I mean 25% of the original amount, not on the declining balance. So that in effect, after three years of reductions you are left with 25% of insurance in force but that insurance remains in force <u>for life</u>. Now, if you followed that incomplete description of these two plans, you probably sense that plan #2 is considerably more expensive. Yet, applying the logic which was advanced in the Bulletin, that expense is not reflected. It is a technicality. Because the Law deals only with

employees, not with retirees, the benefits in a lifetime plan, which will in the large majority of cases become payable after retirement, are not reflected in this strict comparison. It is a relatively narrow view, and it ends up reaching the ironic conclusion that plan #2, which is the more expensive of the two plans, does not meet the non-discrimination test and it does not meet it because it fails to provide sufficiently costly benefits to the older workers. I think it just makes more sense to recognize the fact that the employee and the future retiree are really the same person, and that the plan design should incorporate that kind of thinking.

As I mentioned, the other area of concern has to do with disability provisions. The disability provisions incorporated in group life plans typically fall into either a waiver of premium type, where coverage is continued at no explicit premium payment by the employer, or the installment total and permanent disability benefit, whereby the face amount of the life insurance is actually paid out over a five-year period or so. The point of all of this is that these benefits generally have an upper age limit written into the insurance contracts--and, in many cases, that upper age limit is 60. Were it to become necessary to remove that limit or extend it perhaps to age 70, the cost implications could be significant. In the case of a waiver benefit, one would almost have to look at the individual plan to see whether additional benefits would eventually become payable. If that were the case, obviously to the extent that they did, an additional cost would be incurred. For the installment type total and permanent disability benefits, which generally cut off at age 60, I feel certain that it would have a fairly significant cost impact if those benefits were to be extended beyond age 60, particularly in the case where these benefits are not directly recognized or carved out of other disability income plans for which the employee is insured.

So now, after this bit of philosophy, what does the plan designer do? What is the plan sponsor faced with? Let's take for example a plan which had provided insurance equal to some percentage of salary up to age 65, and had terminated insurance at that point. What is one to do? There are a couple of safe statements which I think could be made. One is that if the plan continues to provide zero to people who continue to work beyond age 65, most reasonable people would probably view that as discriminatory and that plan would need amendment. The other extreme would be to provide full plan benefits beyond age 65. I think, again, most reasonable people would consider that to be non-discriminatory; however, some plan sponsors would consider it to be unnecessary, and anybody familiar with the cost impact would probably agree that it was expensive. In between is the sensitive area where a lot of the discussion is taking place. One should keep in mind in this context that the law is in effect--it has been so since the beginning of this year--and some of these plan design questions exist quite independently of whether another IB ever emerges from the DOL or the EEOC. In any event, when the IB does emerge, I am advised by counsel, that it will not have the full force of a regulation. Presumably, it would be taken into account in any litigation which arose out of the Act. It is probably also a safe assumption for the plan sponsor to assume that the final version will take a relatively liberal interpretation of the requirements of the Act. The question, therefore, and perhaps unfortunately, tends to be a legal one, and it is: How much in the way of benefits to provide in order to avoid legal difficulties, at the possible compromise of traditional benefit-oriented approach plan design?

Thus far, the open questions that I have been talking about are matters that would have existed whether there was a Bulletin or not. There are, in addition, a few technical items which did not exist in real life but they exist now, ever since we have to deal with this Bulletin. Once the idea of cost equivalency has been proposed, it becomes necessary to reach some conclusions about mechanically how one is going to apply it. Three questions have surfaced. Naturally, the cost is an actuarial concept and it should be based on valid actuarial data. So the first logical question is: What constitutes valid actuarial data? Another question is: When one applies the cost equivalency principle, what sort of age brackets or groupings are reasonable? Must it be year by year, age by age, or can one impose a reasonable bracketing arrangement? I am not going to deal with these two questions. The third question, however, is a fairly interesting one and I might phrase it as follows: When one intends to establish equivalency or non-equivalency, which benefits do you take into account? Is it, for example, sufficient for a plan sponsor to say, my whole fringe benefit package costs $4,000 a year for each employee at age 66. I got myself an actuary and he told me that. Then he looked at an employee at some other age, perhaps 62 or 64, and he got the same answer, $4,000. Can I, therefore, wash my hands of this entire affair? The IB took the position that no, this employer may not. They espoused what is being referred to as a benefit-by-benefit approach. The benefit-by-benefit approach simply means that group life insurance is analyzed separately, accidental death is analyzed separately, the short-term disability is analyzed separately, etc. Perhaps in some situations this kind of analysis would not create difficulties although I should point out that there are categories of benefits for which this does not seem an appropriate course of action. For example, disability benefits are usually provided from more than one source. We have short-term disability, followed perhaps by a long-term disability plan, Social Security disability benefits, and maybe a disability provision in the retirement program, and the employer may have one of the group life insurance plans that I referred to earlier that pays installment disability benefits. It simply is not logical to pick these things apart and analyze them one by one. They were designed and conceived as a package. They are all coordinated and interrelated, and I think it would be very, very difficult to look at each one individually, and probably would not lead one to the right conclusion. Again, it remains to be seen whether the benefit-by-benefit approach which was addressed by many commentators will be forthcoming in the final version of this IB.

MR. WILLIAM E. NEAL: You have referred to a comparison based on equal costs rather than equal benefits to all groups of employees, but I had the impression from the session this morning that equal cost is not a sufficient application, that you must provide equal benefits. Now, I think we are talking about relatively the same area here--and these are completely opposed ideas, are they not?

MR. BRUNINI: The law does have an explicit exception for bona fide employee benefit plans. The same benefits need not be provided. Now, of course, it is incumbent upon the plan sponsor to prove that it is a bona fide plan, and this plan is not a subterfuge, but this principle of not providing the identical benefits is actually written into the law, so it becomes a question of interpretation from that point on. The interpretations that equal cost must be provided is one possible interpretation reflecting the higher cost at the older ages.

MR. GIVENS: That's a fair question. The fatal flaw to it, though, is that you are postulating that there is logic behind all this--and there isn't. Now, the reason we got into this particular box is historical rather than logical. There was extended colloquy in the Senate (Senators Williams and Javits in particular) and also in the House. The attention paid to qualified plans was on the whole quite good. The attention paid to welfare plans, unfortunately, was more notable for its good intention than for its understanding of the subject. So there were many comments spoken about what this new amendment was supposed to do and what it was not supposed to do, many assurances given, and 90% of them were on the subject of cost and, therefore, when the DOL came out with its proposed IB it focused exclusively on cost. Now, one of the problems is that this matter will be handed to the EEOC in July. EEOC does not like this, and we have nothing. You are quite right; that is a logical inconsistency. That is not to say that one agency of the government will not require you to do something which another agency will forbid you to do.

Let me back up and underline a couple of things that Mr. Brunini said. The law which we are talking about came to be in 1967 and until 1978 you did not have this amendment that changed the area of protected coverage from the range 40-65 to 40-70. All they did was add five more years of protection. Before that, and now, today, you can discriminate all you want to up to age 39 and you can resume your discriminatory treatment after age 70, but don't do it between 40 and 70. The IB addressed only the rules for 65-70. They did not say anything about 40-65. No one had ever said anything about 40-65 from the day the 1967 law was passed. Therefore, you had plenty of plan provisions specific to ages in the protected range 40-65 that were obviously discriminatory and, therefore, illegal unless they came within 4(f)(2), such as vesting at 35, or early retirement at 55. Mr. Brunini's discussion of premium waiver and disability income features on group life have been cutting off at 60. The DOL was not paying any attention to that, they were focusing single-mindedly on the five-year extension, which in effect assumed that you got to 65 in whatever way you have been, and now we are going to regulate you from 65-70. Again, don't criticize it on the basis of logic.

Mr. Brunini made a good illustration, which is well worth driving home, on the significance of this 8% per year reduction. If you looked at the unloaded group life minimum premium rates that New York State has been using, you'd find that the ratio of the q's is fairly constant, 8% from 65-70, or for that matter from 40-70. Basically, we are saying that the q's are proportional to 1.08 to the x power. If they were therefore going to generalize, they could use 8% every year. Now, which is better for the employee, Plan A, which provides two times earnings until 65 and nothing thereafter, or, one that provides two times earnings to age 40, and reduces by 8% a year thereafter? Which would the employee prefer to have? As Mr. Brunini pointed out, the first one is standard practice and spends a lot more money on employees; the second one is right from a cost equivalence point of view. That raises an interesting question in connection with every one of these welfare benefit plans. Suppose it is more socially correct, as Washington sees it, to have a specific set of benefits, such as 8% a year reductions for group life, or as Mr. White will get to, LTD should go to age 70. But suppose you give the employee the choice, between having rich benefits to 65 and zero thereafter, versus fringe benefits until 70. Do you dare allow him the choice? There are reasons to suppose you might; Congress allowed the employee to choose in the case of qualified

joint-and-survivor protection; Congress allowed employees to choose in the case of HMOs; maybe they would even allow him to choose here. If you let the employee choose voluntarily, would you let the union representing employees choose for him? There is a tremendous skein here to unravel, and the DOL up to now and the EEOC in the future really haven't come to address it in a logical way, and I just warn you against the frustration of asking questions regarding the logic of the situation.

MR. STEPHEN E. WHITE: Lex Brunini has discussed several problems regarding the design of group term life insurance. In addition to their benefit design proposals, the DOL has proposed modifications to the employee contribution schedules of many contributory life insurance plans.

Plans that provide for increasing contributions with advancing age often do so in five-year age brackets. In its proposed IB, Labor's position suggests that two modifications to these plans will be necessary:

1. Rates must increase yearly, not just every five years.

2. The employee must be given the option to decrease coverage instead of having contributions increased.

There are two significant problems with this approach:

1. The administration of these plans would become quite complex. The annual election of increased contributions or decreased coverage would produce a myriad of potential benefits that might be impossible to adequately explain to employees as required by ERISA. In addition, many of these plans have been designed to coincide with Section 79 rates so that the reporting of imputed income either is simplified or eliminated altogether.

2. Labor's position ignores sound benefit design. Many carriers will not write such a plan due to the anti-selection that would evolve.

If Labor retains this position on contributory life insurance plans, it may become necessary to revise these plans to provide only for level contributions and reducing amounts of insurance. It is not clear that this is the benefit design that is desired by the employees.

The coverage that presents the most perplexing problems is long-term disability. The purpose of LTD is to partially replace income that the employee would have earned had he not become disabled--a very simple objective. The benefit period can be for a fixed number of years, such as five or ten, or to a specified age. The major problem arises with the latter plan design where the specified age is less than 70. The DOL has asked for comments on two proposed alternatives for these plans and has admitted to a certain amount of uneasiness with each:

1. Any plan that provides benefits to a specified age must provide coverage and benefits to at least age 70.

2. Those employees who are disabled prior to age 60 would receive benefits to age 65, while those disabled between 60 and 65 would receive benefits for five years following disablement, and those between 65 and 70 would receive benefits to age 70.

Labor's reasoning for Alternative (1) was that the Act protects the expectation of employment to age 70 and, therefore, prohibits cessation of income replacement benefits prior to age 70. Since the employee can work to age 70, the LTD plan must assume that he will work to age 70.

Labor was uncomfortable with this approach and, therefore, developed Alternative (2). Their underlying reasoning was that most workers expect to retire by age 65. However, based on a recent DOL study, those age 60 and older who are still working will work, on average, another five years. Thus, the LTD plan must provide a five-year benefit to those over age 60 except that retirement can be assumed at age 70.

The problem with both of these alternatives is that they are not consistent with the purpose of LTD. LTD plans which provide benefits to age 65 have generally been designed to meet the need for an income replacement benefit until the age at which an unreduced pension benefit is payable. This plan design reflects the fact that disabilities extending beyond this age are assumed to be permanent. The person is not expected to return to work; he is assumed to be retired. Actuarial projections support this assumption; and in fact projections of recoveries of Social Security beneficiaries between ages 60 and 65 show that, after one year of disability, only one disabled employee out of a thousand above age 65 will recover and be able to return to work.

Employers providing this very costly protection sought to design plans which would meet benefit needs. Such designs were certainly not developed to discriminate by age and, therefore, should not be considered a subterfuge to evade the purposes of the Act.

It would appear that both of the LTD alternatives contained in the proposal would lead to undesired results. Both would entail payment of additional benefits above and beyond retirement benefits to persons who are effectively retired. Under either alternative, the financial incentive to qualify as disabled rather than retired would be substantial. Unfortunately, at these ages disability can be a very subjective matter. The number of disability claims in this category would therefore increase rapidly and the cost of the insurance at these ages could very well become extremely high. Reasonable projections of recoveries and disablement past age 65 would indicate that the impact of Alternative (1) on the premium rate would likely be an increase on the order of 35% to 45%, while the impact of Alternative (2) would be roughly 10% to 15%.

Several states have enacted age discrimination laws, with California's and Connecticut's laws prohibiting involuntary retirement at any age, at least in the private sector. The Federal ADEA does not preempt more liberal state age discrimination laws. However, the argument has been made that ERISA preempts any impact that these state laws might have on employee benefit plans. This would appear to be a risky position, but it may account for the generally passive attitude toward the state laws. If, for example, cessation of LTD coverage at 65 or even 70 is determined by a state court to be discrimination in employment practices, it will make little difference

that the LTD benefits are funded through a welfare plan that is covered under ERISA.

Quite understandably, plan sponsors are confused. The majority have made no formal changes to their welfare plans. With Wage/Price, the Civil Rights Act amendments, and ADEA all becoming effective within a six-month period, a wait-and-see attitude has become pervasive. Some plan sponsors feel that the legislative history clearly supports no impact on welfare plans. However, the majority of sponsors feel that some modifications will be necessary and they are waiting for some consensus to be reached among the experts, the regulators, and the courts.

Among the Fortune 100 companies there has been some movement toward change. At least one large corporation has announced that age 70 will replace age 65 in all personnel practices and all benefit plans except, notably, LTD. Another corporation has already modified its benefit plans to satisfy the proposed IB and have included LTD Alternative (2). But most of the larger corporations have limited their action to analysis and planning:

1. They have prepared contingency plans.

2. They have pinpointed the most probable course of action.

3. They have formally notified their older employees that benefit plans will be modified retroactively to January 1, 1979, as soon as the impact of ADEA is known.

Most of these larger corporations already provide short-term disability and Medicare supplement benefits to employees age 65 and older. Consequently, only LTD and life insurance are particular problems. At this point, it would appear that most employers are expecting some minor changes in their post-65 life insurance reductions, but they are not receptive to changes in LTD.

As mentioned earlier, many plan sponsors are waiting for a consensus to be reached regarding the impact on benefit plans. I cannot overlook this opportunity to encourage actuaries to be a significant and constructive part of this process. It would be unfortunate if a consensus were reached by a collection of parties that was not adequately represented by the experts in the field.

MR. NEAL: Does the speaker feel that the increase of the mandatory retirement age to age 70 will have much effect on rates of retirement? Social Security data indicates that most people retire before 65 anyway. Secondly, should we worry about the effect of these regulations if there is in fact no significant effect on the retirement rates?

MR. WHITE: Many employers feel that the Act will have little impact on their retirement rates. Consequently, the cost impact may be very small for death benefits, Medicare supplement, and short-term disability. However, LTD is another matter. All but about 5% of the 35% to 45% increase in the LTD rate under Alternative (1) would be due to the increased benefits for those workers under age 65.

MR. GIVENS: It is true that most people are retiring early. Look at the Social Security figures showing the percentage of men and women who are starting a reduced benefit. Now, a reduced benefit is something you do very carefully. There is no sense in applying to start Social Security if you plan to continue working. So the people whose initial award is a reduced benefit, are doing it because they do not plan to work. And 90% of the men and 90% of the women today are drawing initial reduced benefits, before age 65. So, if that doesn't change, what's all the noise about? But it might change. There are two possible reasons for change. If you are thinking about retiring at 62, it is one thing to give up three years of employment, but quite another to give up eight years of employment. If you know you can work on til 70, we may find the interest in early retirement taking place at 67 instead of 62. Secondly, a very emotional reason and probably a very sound one, too, in a period where sustained prolonged high inflation is in prospect, you are scared to go out on a fixed income. As long as you work, your income will keep pace with inflation more or less, certainly a lot better than if you went out on a fixed dollar income--people are afraid to retire early. So you may very well see a distinct reversal of that unanimity of opinion that everyone wants to retire early in the years ahead. One answer to this is to adopt a hedge--a defined benefit pension plan. Then, as everybody stays on until 70, you've made up in your actuarial gains in the pension plan what you've lost in the group life continuation!

MR. BRUNINI: The fact that over the population as a whole, people are tending to retire earlier, or the average age is 62 or whatever, is of little consolation to the employer who knows that for his own employees 60% or 70% of them are staying to what is now normal retirement at 65.

MR. LAURENCE R. WEISSBROT: I think we are going to see a change in that trend toward early retirement. When the current group of workers in their 20s and 30s begins to approach retirement, I believe this is the period in the early part of the 21st century, when we will have a large percentage of your population above age 50. We will actually have a shortage of workers at the younger ages and just to meet the needs of the economy we'll have to have people working longer into the 60s, possibly into the 70s. Also, the cost of the Social Security system with two workers working for every one retired is going to become untenable unless we extend the length of time that the people work. So I think this trend is going to reverse, and there will actually be a trend to later retirement.

MR. GIVENS: You are talking now about the turn of the century; we were talking earlier about the next few years--they are complementary points.

MR. CLAUS S. METZNER: I think this topic of LTD coverage and the impact on cost is quite fascinating. Unless we put it into the relationship of an income maintenance system, we may get down the wrong path. The point is that if LTD coverage deteriorates, you'll save it on pensions. However, we also have the social insurance systems, both Workers Compensation and Social Security, and the Workers Compensation system is basically an LTD system. It is certainly employer financed, (involuntarily, let us say) and it has become much easier for people to claim those LTD types of benefits. On top of that, given private LTD benefits, the potential for collecting both Social Security LTD benefits and Workers Compensation (and both are indexed to some extent--Workers Compensation less, but rapidly changing), you could find an employee in the early 60s could end up getting in excess

of 100% of their previous take-home pay. I think that's probably an undesirable situation, and I don't see any real resolution because the laws are set up such that integration in any meaningful sense, except for the LTD or pension benefits, is impossible.

MR. WHITE: I think that this is one of the primary concerns that many of us have, that this may very well be the first step to the demise of the LTD plan as we know it today. The cost may become prohibitive and the design just plainly unsound.

MR. GIVENS: As we bring to a close our comments on welfare plans, maybe Lex, you'd give us some ideas on what your policyholders are doing. I know in our own case our strong encouragement is that they do nothing. There is no way you can amend your various employee benefits in a way that you will not have to touch, when and if any further guidance comes out. We have had oral indications from the DOL that they are likely to give up on this 8% a year reduction and they are likely to indulge us in the five-year age groups instead of the year by year. They seem to have a hangup on LTD. But it is mystery wrapped in an enigma as to what they are going to come out with finally, if they do come out with anything at all.

MR. BRUNINI: Our experience has been very similar to what Steve related. The number of plan changes actually made as a result of this is quite small, almost insignificant. We have been fairly active in discussing this matter with our policyholders. We have attempted to get policyholders active at the hearing stage. The cost eventually falls on the plan sponsors, so there is no question about who plays for whatever eventually materializes. Of course, we have made all our technical information available to the policyholders, and we have in fact been making cost estimates on tentative changes for large policyholders, who did tend to get concerned over this thing. But the number of actual contractual changes is just not large at all. No one wants to do something which in retrospect would appear to have been too much of a change.

MR. PAUL H. JACKSON: The DOL received some 500 letters, mostly complaints, on their proposed treatment of benefits in the age range 65-70. Most of these were on the matters of the benefit-by-benefit and year-by-year approaches. The comments on pensions were primarily ones asking for clarification of the fact that accrual of benefits arising from pay and services after age 65 would not be required. Final regulations are not expected by the DOL before July 1. My guess is that it would probably be later this year or possibly early next year before final regulations are out. Under pension plans there are a number of alternatives available to plan sponsors. First, you can freeze the accruals at age 65. This constitutes what is generally referred to as "minimal compliance." In the case of some larger firms, their point of view is simply that they have decided through their personnel departments or through negotiations with their union precisely the type of benefits that they want to provide, and the fact that the U.S. government comes along and suggests still others does not change their view that the additional benefits are not desirable or not needed. Therefore, they make the minimum change necessary to comply. The freezing of accruals at age 65 is held to encourage retirement at that age because the individual does not earn more pension on his subsequent service. The plan sponsor is probably going to be forced to freeze the option factors at age 65 if he freezes the accruals; otherwise, the individual retiring, for example, at age 70, electing a joint-and-survivor

option would receive a lower benefit than would have been available at 65. The same thing, of course, is true of lump sum option factors. If an individual retires at age 70 and takes a lump sum, his benefit having been frozen at 65, and he actually gets a smaller amount for it because the actuarial equivalent at 70 is lower, he could claim that he has forfeited part of a benefit that is required to be nonforfeitable.

Besides just freezing accruals at normal retirement age, the employer can credit service after 65 but not count pay increases, particularly in order to meet some minimum service requirement. The employer alternatively can credit pay increases but not service, or credit both pay and service after age 65. Of these alternatives, the more popular ones are either to freeze the accruals on the one hand, or to continue crediting both pay and service on the other. Interestingly enough, the companies which credit both pay and service do so on the grounds that it will encourage the employee to retire earlier, the theory being that the individual who does not retire at 65 probably couldn't retire because his pension was too small to live on, and if the benefit were frozen he won't be able to retire at 66 or 67 or 68, and so on for the same reason. So, the argument that we want people to retire as early as possible, or at least at the earliest point where they begin losing their skills, is an argument that has been used to support both the freezing of accruals and the continuing of accruals.

One other alternative that has been occasionally made available is to increase the benefit after age 65 by actuarial equivalent factors. If you were to use sex-segregated mortality tables, the value at age 70 for a male might be, for example, 182% of the age 65 benefit; for a female, 168%. If you use unisex tables with 20% female in the group, the benefit at 70 would be about 178%. That's a fairly sharp increase from 65 to 70, and if you have a plan that does not have actuarial reductions below 65, suddenly the individual upon reaching 65 starts earning pensions more rapidly.

Finally, there's the question of whether benefit improvements that are made under the plan for active workers should be extended to people over 65, and there are plans which have gone either way in this regard.

Now, what are plan sponsors doing? Well George Buck and T.P.F. & C. have both conducted surveys which they have published in the Employee Benefits Review and so I decided to conduct my own survey of ten large plans covering some three million employees. Four freeze the accruals at 65, one freezes service but counts pay increases, four credit service and pay in the regular fashion, and one increases actuarially. These results are not too different from the Buck and T.P.F. & C. surveys, but I think those surveys indicate that smaller firms are probably more inclined to freeze than the 50/50 ratio which I came up with.

Under profit-sharing, thrift, or savings plans, only base plans can freeze. Plans that are supplemental to retirement plans must continue accruals. Most savings plans, of course, are supplemental, and freezing at age 65 is equivalent to an actuarial increase in the benefit. Continued contributions after 65 simply make the age 70 comparison to age 65 even more pronounced than the actuarial equivalent under a defined benefit plan and may encourage continued work and the postponement of retirement.

Plan sponsors have some problems with all of this. I'll give you some idea of these problems, although I have no answers myself, or at least no one single answer. First, should the company's purpose be to adopt minimum personnel policy and benefit plan provisions keeping just within the letter of the law, the so-called minimal compliance, or should more liberal revisions be adopted in line with the spirit of the law and in anticipation of the fact that the EEOC assumes enforcement of the Act in July, 1979 and may not agree with some things which the DOL has accepted? Should continuation of the existing age at retirement profile be encouraged or should company employees be encouraged to work to older ages? What will be the impact upon employee relations of each of these courses of action? Or upon Affirmative Action plans and promotional opportunities for younger workers? What are the effects on cost? What effect, if any, should modifications in personnel policies on benefit plans required in the United States under the revised ADEA have on personnel policies and benefit plans in subsidiaries operating outside the United States, such as in Canada? Will an employment action or policy initiated in the United States be subject to challenge under the Act even if it is effective only in a foreign operation? Should the exemption be invoked to retire at age 65 bona fide executives in high policy making positions receiving $27,000 or more in annual retirement income, since such treatment may be perceived by some of these executives as being inequitable? If so, should special arrangements be made for the retirement of other executives who may not meet the dollar criterion, such as a short service officer? Will the $27,000 amount eventually be cost indexed? It isn't in the Bill as it stands, and as the cost of living increases, eventually all rank and file people will meet the test. Is the exemption likely to be eliminated by future legislation? Incidentally, the DOL has indicated that profit-sharing balances or the income equivalent therefrom can be added to pensions to count toward the $27,000. How is a bona fide executive or high policy making employee going to be defined in the future? Can retirement benefits from other than the last employer be considered, if there is a controlled group of companies? On the matter of regulations, should the letter from Assistant Secretary of Labor Donald Ellisberg to Senator Williams be relied upon as sufficient authority for not providing credited service beyond currently existing pension plan provisions? Can it be relied upon after the EEOC takes jurisdiction? If the provisions of regulations, IBs or guidelines implementing the ADEA appear to conflict with ERISA or its regulations, should the ADEA publications be followed in benefit plan modifications, and if not, how will any conflicts between ADEA and ERISA be resolved? If only IBs or guidelines, as opposed to regulations, are issued by the DOL, what degree of authority should be afforded to them since they are not subject to formal notice and public comment? Will regulations or IBs be sufficiently broad to allow employers the continued flexibility to design employee benefits on a needs-oriented basis which may result in varying levels of benefit coverage for varying age groups? Will it be necessary to submit for IRS approval pension plan revisions that are made solely to comply with the ADEA modifications? Should sick leave and disability benefits be continued beyond 65 for an employee who may be known to be permanently disabled, or should such employee be retired on regular age retirement pension after six or twelve months of disability? Finally, as to possible additional legislation, what is to be done about the Bill recently introduced by Mr. Pepper which would eliminate the executive exemption and remove the age 70 mandatory retirement cap, and what is to be done in those states, such as California, where age 70 is not permitted as a mandatory retirement age, even now? That's an indication of a few of the questions that arise

in the pension area where effectively there are fewer problems than these gentlemen have discussed earlier.

As to the potential impact, figures in the March, 1977 Social Security Bulletin indicate that of those retiring in 1971 a full 28.7% retired at age 65 or older. The survey of newly entitled beneficiaries published in Research Report 47 in 1976 showed that of all retirees who receive initial benefits in the period studied and who were not employed, 56% did not want to retire. Even among those who stopped work before compulsory retirement age, 38% did not want to retire, and among those who had no compulsory retirement age, 64% indicated that they did not want to retire, and this is of the group that has actually started collecting. Furthermore, of all those surveyed, over 50% stated that they could continue working without limitations. In short, there is substantial evidence that increasing the mandatory retirement age to 70 could very easily affect the retirement plans of many workers. Sears Roebuck and Company provided an employment impact statement to Congress in connection with their consideration of the Act showing the reduction in job openings and the increase in unemployment as a result of raising the mandatory retirement age from 65 to 70. In their projections they assumed that 1/3 of the employees who would have retired at age 65 continue to work. I believe it is probably reasonable to use 1/5 or 1/4 instead of 1/3. Now, their projections indicated that by 1982 the cummulative increase in the unemployment rate resulting from an extension of retirement age to 70 would be a full 1%. In other words, if the estimated unemployment rate in 1982 was 6.5%, the effect of the Act would be to raise it to 7.5%.

Harrison has already commented on the effect on employee attitude. When age 65 retirement is mandatory, the employee approaching age 60 is thinking of retirement and perhaps is planning on it and arranging his financial affairs. People who are age 40, 45, and 50 do not normally make such plans. When the mandatory retirement age is lifted to age 70, or when it is eliminated entirely, a good many people will not be thinking of retirement and will not be planning on it and will be financially unable to survive on the retirement benefits offered by their employers. Accordingly, it seems likely that this shift will have a substantial effect on the number of individuals working past age 65 and we'll just have to wait and see.

Now, what are the long-run implications of this? Well, on July 1 the DOL turns over the reins on this matter to the EEOC and the freeze of accruals which is based on the Ellisberg letter to Senator Williams immediately comes up as a question. It is interesting to note that the original draft, not the September 22 material which the DOL put out, but the draft of that material which was available to some of us on the inside, as early as August, would have required that pay and benefit improvements after age 65 would have to be taken into account in retirement plans. On the basis of this, I would say that in the long-run it is most likely that these plans will eventually accrue full retirement benefits up to the date of actual retirement without regard to age. In other words, when we end up lifting age 70 or maybe raising it to 80 as a compromise, which only Congress could think of as being reasonable, it seems to me that the employer who is operating a plan that has age 65 in there somewhere is likely to raise questions with his employees as to the significance of age 65.

Compounding the problems is the matter of the reemployment of retirees. The DOL has proposed some rather complex rules relating to the suspension of pension benefits under a plan. They would prohibit the suspension of

any benefits derived from employee contributions, they would prohibit the suspension of benefits in excess of the life annuities so that in the case of an employee retiring with a Social Security level-out option the excess could not be suspended, and this is a very real problem facing employers now because there are people who retired a year or two ago when they reached age 65, who didn't want to retire but had to, and who may now reapply for employment, and they cannot be refused employment on the grounds of age. Employers cannot adopt the policy that they will refuse to rehire a retiree, someone receiving benefits under the plan, because the DOL has indicated that this is automatic age discrimination since retirement benefits require a minimum age for payment. An employer can, however, refuse to rehire ex-employees who have one or two or more years of service if they wish to accomplish the same end.

In the long-run, it is likely that retirement is going to be ranging from perhaps as low as age 50 up to perhaps age 80 or even higher in the future, with the employees working as long as they can continue to do so effectively. The serious problems in this area relate to personnel practice and the types of tests that the employer applies to the employees to see whether they are performing efficiently or not. These tests, of course, cannot be restricted simply to the older worker, because that would be age discrimination as well. It is going to be interesting to see if employers develop tests that are fair and that retire people at the desired rate. If such tests have to be applied to every worker in the work force and 80% of the teen-agers fail it, I guess they'll simply have to be discharged and the employer will have more job openings.

MR. GIVENS: You mentioned the idea of freezing the joint-and-survivor factor to avoid the situation in which the person who had $1,000 a month at 65, which would have been translated to $750 a month on a joint-and-survivor basis, would find himself at age 70 getting not $750 but $700. But I have heard the opinion that not only should the factors not be frozen, but that you should continue to charge the employee for the cost of the pre-retirement qualified joint-and-survivor protection and, in short, do everything else you can to harass him into retiring early.

MR. JACKSON: If I may just comment on that one, there are companies--and fairly generous companies as to employee benefits--who have put in the pre-retirement spouse option that is required under ERISA on an employee pay-all basis simply because they had outside plans, survivor income plans, or group life insurance plans which in their judgement provided ample benefits. Now, these companies are reducing pensions year by year for the coverage. In one case that I know of, they have tried to describe this in a separate booklet; these are people who are good in communicating to the employees, yet the description of the pre-retirement spouse option is a nightmare. That company also felt that a good many of their people, rather than wanting to have their pension reduced, might prefer to pay cash. The pension reduction option used to be referred to by consultants jokingly as the "dead horse option" because the only person paying for the coverage was the one for whom it was of no value at all. But in that case, where they did offer this option of contributing cash in addition to the reduction in pension, the IRS required that they offer both, that they could not simply offer something that cost the employee money. The company, wishing to accommodate itself to the employee's needs and desires, also agreed that an individual could shift back and forth between the options, and the

complications here are rather immense. Now, when the individual does not retire (in this case, by the way, benefits are available on early retirement down to age 60 on a basis that is not reduced), because the benefit is not reduced, the reduction has to be reduced actuarially or you would be collecting too much from the employee's pension. On the other hand, if the individual retires after age 65, there has to be an actuarial increase in the reduction in the pension that would have been made had he retired at 65 because that's what the pension plan gets to cover the cost of the pre-retirement coverage which obviously at 65 has one lump-sum value. Undoubtedly, in the long-run the benefits will be smoothed out some way because I doubt that anyone can continue to operate satisfactorily like that. But these are benefits that are required essentially by statute, and this company, as to that type of benefit, cuts the minimal compliance rule. They already had had enough and would provide only what was required.

MR. GIVENS: Paul, on that earlier draft version that was circulated which did say that it would be required to update earnings, criticism was received. As you pointed out, it can be understood what they are trying to say in the case of final pay plan because the employee has higher earnings in the late 60s--and you update that--but it doesn't make any sense at all for a career average plan where the accrual stops at 65. Earnings beyond 65 have no relevance to the benefit. So it did come out, but I understood from the DOL that we should not take any long-lasting comfort from that. The fact that it was taken out doesn't mean we won, but only that they were brooding about it.

MR. JACKSON: Harrison, I am trying to figure out the details of how to get it back in.

MR. GIVENS: Here's a thought that applies to the welfare benefits, at least as much as to pensions. Maybe all of these regulations, the sex discrimination issue of this morning as well as the mandatory retirement topic this afternoon, are pushing the larger employers, at least the ones that can administer it, more into the area of what's been variously called flexible or cafeteria compensation, where each employee is given a certain number of points to spend, depending on his age, if that's still permissible, and earnings, perhaps, and he can choose which benefits he wants--and if the male employees don't choose to buy maternity benefits, or if they don't choose to buy surgical coverage, that's their business. It is very hard to see how that isn't a shelter that employers could retreat into, putting the decisions of benefit design on the employee and be left alone for a while. Any comment on that?

MR. JACKSON: Well, it would be nice to think that you could get away with a cafeteria approach with minimal federal bungling super-imposed on it. But they are already hard at work in the area, for example, of options where I would have thought that they are all inclined to permit the cafeteria approach. They could have very easily taken the position that as long as the life annuity is an accrued benefit under the plan and the employee has the right to take it and chooses something else that better suits his own purpose, then that would be permitted. However, the IRS has come out and stated that it is not a defined benefit under a defined benefit plan unless you so state in the plan document and the EEOC people have already said that while it is an elected type of thing it cannot be based on sex-segregated tables. What has probably happened here is that not only Congress but also various other branches of the United States

government have found out how interesting it can be to design benefits for other people when you don't have to pay the costs. I suspect they will have some interesting comments on cafeteria plans if and when they become more prevalent--something comparable to the integration rule.

MR. WILLIAM J. SOHN: I've had no reason to ever have any contact at all with the EEOC, and I've heard a lot about them (none of it good) and I'd be curious to know from the people who have worked with the EEOC if the situation from the traditional actuary's point of view is completely hopeless.

MR. JACKSON: Well, I cannot speak as an expert because I have had little contact with the EEOC people other than to read their releases and to appear before them to answer questions on several occasions. I would say that their objectives are certainly different from those of the IRS and the DOL, and that any actuary who is approaching them is going to have to take that different orientation into account in marshalling arguments. There are a good many arguments that can be given to the DOL or the IRS. For example, based solely on the cost of doing something, it would cost too much or it would add to our cost, and we would have to add it to the price of the cars that we make, and everything we add to the price of the cars we make means more cars sold by Toyota, Datsun, and Volkswagen, and means more unemployment and increase in the cost of living. Arguments of that sort fall on deaf ears with the EEOC. These are people who are dealing with a fundamental principle. It is almost a matter of religion. Everyone is created equal. Further, it seems to me that as to some of their rulings in the area of maternity leaves and the pregnancy disability thing, they make the fundamental assumption that if there is any difference at all, women are treated worse than men and they, without knowing what they are doing, impose certain requirements which prohibit employers who have treated women better than men (let's say in maternity leave cases) from continuing that treatment. So I think it requires a reorientation on our part as actuaries to figure it out.

The EEOC looks at things differently, and given a set of reasons which would lead the IRS or the DOL to one conclusion, may reach a completely different conclusion--and historically has. The EEOC has been well ahead of the DOL on the requirement of equal benefits and on the requirement of equal option values. Just to give you an indication of what's involved here, we have a law that says you cannot discriminate between employees on the basis of age, and on the basis of a letter written by the DOL you have employers who say: if you work for me I will credit you with 1½% of your final average pay for each year of your service, except if you work for me after the age of 65, I will credit you with nothing. The DOL's letter said that is not age discrimination. I don't think it would be very difficult at all to have an attorney and the EEOC simply say, after allowing the matter to rest so that they don't embarrass another governmental unit: if you do one thing for an employee under 65 and you don't do it for someone over 65, you are discriminating.

MR. GIVENS: Paul, I don't disagree with that, but I think it may take an extra 18 months to get there because we were careful to get that statement by Ellisberg written right into the record by Williams and Javits and have them both say what a great idea it was and how reassuring it is, and that, predicated on this assurance, let's go ahead with the amendment.

MR. JACKSON: Let me just observe and add to your comment that when the Civil Rights Act was passed in 1964, Senator Humphrey, who was the sponsor, put in some very clear language that this wasn't going to apply at all to pension plans, and the court's view was that legislative intent is irrelevant. If the statute says something which cannot be interpreted, then we'll go to legislative intent. I agree with you. But I am talking about a danger five or ten years down the road. I would think at the very least the EEOC would allow Under-Secretary Ellisberg to retire gracefully from his government position before they come out with something pulling the rug out from under this.