October 3, 1950

Board of Governors

Division of Personnel Administration

Integration of the Retirement System of the Federal Reserve Banks with Social Security

CAUSE FOR MEMORANDUM:

Attached is a report of the Retirement Committee to the Board of Trustees of the Retirement System of the Federal Reserve Banks dated September 8, 1950, which outlines a program for integrating the benefits of the Retirement System of the Federal Reserve Banks with those provided in the amended Social Security Act which will be applicable to the employees of the Federal Reserve Banks on January 1, 1951. This report has been approved by the Conference of Presidents, and it has requested advice as to whether or not the Board of Governors will give favorable consideration to the proposed program prior to a meeting of the Board of Trustees. The plan, if approved, will go into effect January 1, 1951.

Under the Social Security Act as amended, the employee, as well as the employer, must make contributions on the first $3,600 of annual salary at the rate of 1 1/2 per cent up to January 1, 1954, and thereafter at increasing rates until January 1, 1970, when contributions of 3 1/4 per cent will be required. It was not believed feasible to add the costs of Social Security benefits to the present costs of our Retirement System, and, therefore, an attempt was made to work out a plan which would not increase costs materially.

Inasmuch as the details of the proposed plan are outlined in the attached report, it is not proposed to discuss fully each change in this memorandum, however, it might be helpful to point out some of the general provisions of the proposal.

At the present time, employees of the Banks contribute a percentage of their salary to the Retirement System. The rate of contribution, which is based on the age at entrance, averages approximately seven per cent. These contributions purchase an annuity at the time of retirement. The proposed plan provides that the employee will continue his same rate of contribution but the amount credited to the Federal Reserve Retirement System will be reduced by the amount of Social Security tax. Accordingly, his accumulations in the Retirement System for the purchase of an annuity will be reduced.

The Banks' contributions to the Retirement System at the present time provide a pension for employees on a straight life basis equal to one per cent of final average salary for each year of service. It is proposed that the pension benefit on the first

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$3,600 of salary be reduced to 1/2 of 1 per cent of final average salary for each year of service with the provision that in no case is the reduction in pension to excees 50 per cent of the Social Security primary benefit. The theory behind this proposal is that the employee and the employer each purchase 1/2 of the Social Security benefits.

Reference to the tables submitted with the attached report will show that the proposed integration plan will provide employees, particularly those in the lower brackets and with short service, with materially increased benefits, and in no case will the benefits be less than they now are. The increases for the short service employees in the lower brackets are very substantial because Social Security benefits do not increase as the length of service increases.

Employees of the Federal Reserve Banks will generally become eligible for Social Security benefits after 18 months of service, and, therefore, anyone retiring after July 1, 1952, will be eligible for such benefits. In view of the substantial benefits which employees will receive from Social Security, it is proposed that the Board's policy of requiring employees to retire upon attaining age 65 be suspended until July 1, 1952, so that anyone reaching retirement age before July 1, 1952, may, at the discretion of the Reserve Bank, be continued in service until he is eligible for Social Security benefits. This will prevent the unfortunate situation of requiring an employee to retire shortly before he becomes eligible for Social Security benefits, and thereby receive an allowance which would be substantially less than that of a person retiring after July 1, 1952. The proposal also provides that an employee reaching age 65 during this period who does not wish to stay in service until July 1, 1952, may have his allowance supplemented in an amount which would provide the same benefits to which he would have been entitled had he not been covered by Social Security. The cost of such supplemental payments in an individual case will be small.

The Social Security Act makes no provision for the payment of any allowance prior to age 65. Inasmuch as under the Federal Reserve Retirement System a person can receive a retirement allowance as early as age 50, a problem is created with respect to employees who are separated from a Reserve Bank prior to age 65 and who elect an immediate retirement allowance. In those cases the Bank has no moral obligation, but when the retirement is suggested by the Bank because it feels such action would be mutually beneficial, there is a certain responsibility in regard to the adequacy of the employee's retirement allowance. In recognition of this fact the Board has authorized the Banks to supplement the allowance of an involuntarily separated employee in an amount not to exceed 1/2 of a month's salary for each year of service with a maximum equal to six months' salary or, in cases of employees with 25 years of service and who are 55 years of age, by an amount sufficient to raise the benefit to what it would have been if the actuarial reduction were only 2 1/2 per cent for each year the member lacks being age 65.

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Because the proposed integration plan materially reduces the Federal Reserve allowance, the amount received by an employee will be very small when Social Security benefits are not being received concurrently, as will be the case when an employee who is separated prior to age 65 elects an immediate allowance. The Retirement Committee has recommended that the Board of Governors review its authorizations for supplemental retirement benefits in such cases in order that the allowances may be adequate.

The proposed plan of integration does not affect the benefits which have accrued to present employees, and inasmuch as the proposed reduction in pension applies only to future service, an employee involuntarily separated from service within the next few years will not be affected materially by the changes resulting from integration. It is felt, therefore, that the present authorizations to supplement retirement allowances may take care of the few cases that arise, and, as at present, the Banks can present to the Board for consideration any unusual cases where additional supplemental contributions are deemed necessary.

There are seventeen members of the Board's staff who are also members of the Bank Plan. It would obviously be an injustice to apply the revised benefits to these employees since they will not have Social Security coverage. Therefore, it will be necessary to make provision in the rules and regulations so that the proposed changes will not effect these members of the Bank Plan. The problem of handling this small group on the Board's staff will be presented to the Board for consideration at a later date.

In connection with the plan of integration with Social Security, the Retirement Committee has also considered the proposal of the Chairmen's Committee that consideration be given to increasing the active service death benefit in cases where an employee dies in active service before retirement. At the present time, when an employee dies in active service, his beneficiaries receive a refund of his contributions to the Retirement System together with a payment equal to his salary during the previous 12 months of service. The Chairmen's Committee has recommended that this death benefit be increased on a sliding scale to a maximum of two years' salary and the Retirement Committee in its report recommends that after sixteen years of service the present death benefit be increased by five per cent for each year of service with a maximum equal to two years' salary. In most cases the maximum death benefit would not be attained until after completion of 36 years of service, and this would eliminate the present disparity where a person dies shortly before reaching retirement age as compared with benefits accruing in the case of a person who dies shortly after retirement.

Under present rules the maximum death benefit payable is $25,000. It is proposed that this maximum be eliminated but that in computing the death benefit any salary in excess of $25,000 be disregarded. This proposal, which will benefit only a few of the top

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officers, has the effect of raising the maximum to $50,000. The Committee, in recommending this change, felt it would be inconsistent to raise the basis of payment from one to two years without making a corresponding adjustment in the maximum limit.

As shown in the report, the proposed plan of integration will result in a reduction in the Banks' average rate of contributions to the Retirement System from 10.23 per cent to 9.47 per cent of pay roll, but that when consideration is given to the Social Security tax to be paid, the over-all costs to the Banks will be 10.97 per cent. It should be kept in mind, however, that .43 of 1 per cent of this increase is accounted for by the costs of the additional active service death benefit, which also will require a lump sum payment of $2,532,258. For the first three years, therefore, the over-all costs to the Banks under the proposed plan due to integration will not be materially higher than present costs. However, as the Social Security taxes increase over the next few years, the cost to the Banks will increase likewise.

RECOMMENDATION:

It is recommended that the Presidents and the Chairman of the Board of Trustees be informally advised that the Board of Governors will give favorable consideration to the proposed plan of integration with Social Security and the necessary changes in the rules and regulations to effect the plan if formally approved by the Board of Trustees.

It is also recommended that the Board approve the proposed change in the active service death benefit and authorize the Banks to make lump sum payments to cover the additional accrued liability incurred by such change.

It is also recommended that the Board suspend until July 1, 1952, its letter of February 4, 1946, S-895, which requires specific approval of the Board in cases of retention of employees in service after age 65 and that the present authorizations with respect to supplemental payments to employees leaving the Banks (letters S-741 and S-905) be continued without modification.

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