Mr. Eccles

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

October 6, 1950.

To: Governor Szymczak

Subject: Integration with Social Security

From: Division of Personnel Administration

In accordance with your oral request there follows a brief discussion of the four points which you felt should be emphasized when the Board considers the proposed plan of integration with Social Security.

Employees Who Become 65 Before Qualifying for Social Security Benefits - Retirement Committee indicates uniform treatment desirable but states retention should be at discretion of Banks.

Under the amended Social Security Act present Reserve Bank employees will be eligible for substantial benefits after only eighteen months of coverage following January 1, 1951. Because these benefits will be so substantial, it is felt that practically all employees attaining age 65 during that period will prefer to continue in active service until July 1, 1952. In order that all employees attaining retirement age in the next eighteen months might be accorded the same benefits, the Retirement Committee has recommended that the Banks might continue in service until July 1, 1952, all employees who would otherwise have retired before that date.

It is possible, of course, that a few employees might not desire to remain the additional time and provision is made in the integrated program for them so that they will not suffer a reduction in benefits because of contributions made to Social Security which cannot be recaptured.

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It is further provided in the recommendation of the Retirement Committee that the continuation in service of any employee attaining retirement age before July 1, 1952, be at the discretion of the employing Banks. The modification appears to be necessary in order that the Banks not be deprived of managerial prerogatives which are essential to their day-to-day administration. It appears to be undesirable for the Board to say to the Federal Reserve Banks that irrespective of their own wishes, or the conduct of an employee, such employee must be retained until a specified date. To advise the Banks that all employees should be kept until July 1, 1952, and that any separations must be cleared through the Board of Governors also seems to place the Banks in the awkward position of not being able to release an employee unless the Board approves. This is an impairment of a right which the Banks have always enjoyed. The recommendation of the Retirement Committee is stated in such a way that the desirability of uniform action throughout the System is emphasized but it is felt that this savings clause is desirable because it is possible that some employee in the Bank might otherwise take advantage of a requirement that he must be retained in service until a certain designated time.

Supplemental Payments in Cases of Involuntary Separation Before age 65 - Retirement Committee requests Board to review present authorizations with view to liberalization. (No change recommended.)

When an employee is involuntarily separated from service before age 65, a Bank under present authorizations from the Board may pay into the Retirement System on his behalf one-half of a

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month's salary for each year of service with a maximum not to exceed six months' salary. For an employee who separates involuntarily at or after age 55 with at least 25 years of service the Bank may provide supplemental contributions which will raise his allowance from the actuarial reduction to a reduction of only 2-1/2 per cent for each year he is under 65.

After the integration with Social Security, the pension portion of the Federal Reserve allowance will be reduced by half, from one per cent to one-half per cent for each year of service. Since the Social Security Act does not provide for the payment of any allowance prior to age 65, an employee who is separated from the Reserve Banks before that age will receive only his retirement allowance from the Retirement System which may be too small for him to live on without his securing another position. In view of this situation the Retirement Committee feels that whenever a separation before age 65 is at the request of the employing Bank, the Bank be permitted to make supplemental contributions in addition to those already authorized in order that the employee may receive an adequate retirement income.

Although, as stated above, the retirement pension of an employee from the Federal Reserve Retirement System will be greatly reduced, this reduction applies only to service after December 31, 1950, so that employees retiring in the next few years will receive one per cent for the majority of their service and one-half per cent for only a small portion of their total service with the System. Accordingly, even though Social Security benefits are not received

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concurrently, the retirement allowance received will not be materially different from what it is under the present Rules and Regulations. As time passes and the number of years after 1950 increases, the situation might call for some further action because the large part of an employee's service will be at the reduced pension rate. However, for at least the next five years the reduction will be small and it is felt that the current authorizations will permit the payment of adequate allowance in practically all cases of retirement before age 65. If, however, the Bank feels that a hardship will result from an involuntary separation, it may, as at present, present the facts to the Board of Governors for specific action.

For these reasons it is recommended that the Board not change its current authorizations with regard to supplemental allowances at this time.

Costs - Retirement Costs to increase for Banks; Remain stationary for Employees

It is estimated that the net result of the proposed integration plan will be an increase of .16 per cent in the annual payroll contributions of the Federal Reserve Banks to the Retirement System. In addition, a lump sum payment of slightly in excess of two and a half million dollars and an estimated increase of .43 per cent in payroll contributions will be required because of the adjustment in the active service death benefits. It should be kept in mind that the rate of contribution is an estimate by the actuary and is not based upon a full reevaluation of the System or any previous experience.

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The Social Security Act provides for increases in the amounts contributed by the employer and the employee until 1970, when the tax will be 3-1/4 per cent. Since the plan of integration provides for the employee's contribution to the Federal Reserve Retirement System to be always decreased by the amount of his contribution to the Social Security System, there will be no increase in retirement costs to an employee and he will continue to contribute the same percentage of his salary as he contributes at the present time. The cost to the Reserve Banks, however, will rise periodically during the next twenty years. For example, ten years from now the contribution of the Reserve Banks may rise from 10.82 per cent of payroll to 11.97 per cent of payroll as the Social Security tax increases. The ultimate cost to the Bank, to be reached in twenty years, may be 12.72 per cent of payroll, or an increase of 2.49 per cent over the current cost of 10.23 per cent. Employees, on the other hand, will still be contributing at their present rate, although a larger portion will be going to Social Security and a correspondingly smaller amount to the Federal Reserve Retirement System.

It would be next to impossible to devise a plan of integration which would result in a level cost to the Banks over the next twenty years by reason of the periodic increase in the Social Security taxes. If the present rate of cost to the Banks were to be reduced by the full 3-1/4 per cent which ultimately will have to be paid to Social Security, it would result in smaller benefits to most employees than they now receive.

The plan of integration proposed is one used by a number of industrial concerns. No one knows just what the future of Social

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Security will be; it may be that the present tax program will be inadequate, but since we will be in, we will have to abide by the changes that might occur in the Act.

The estimated costs by the actuary are no doubt conservative and we may well find that with experience the increase in cost will not be as large as now indicated.

<u>Active Service Death Benefit</u> - <u>Increase from one to two years' salary; Limit raised from $25,000 to $50,000.</u>

The current recommendation of the Retirement Committee that the active service death benefit be increased by five per cent for each year of service after sixteen, with a maximum equal to two years' salary, is the culmination of two years' discussion on the part of individuals interested in the Federal Reserve Retirement System. During this two years the Retirement Committee and committees of the Conference of Chairmen and the Presidents' Conference have recommended adjustments in the active service death benefit. A subcommittee of the Presidents' Conference and a committee of the Chairmen's Conference went on record at one time as favoring a death benefit equal to the amount of the pension reserve at the time of death. This formula is much more liberal than the one proposed at this time by the Retirement Committee. In considering the adjustment of active service death benefit the committees felt that it was a pressing matter but in view of the question with regard to Social Security coverage for Bank employees it was generally agreed that action should be deferred until the question of Social Security coverage was resolved.

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The adjustment in the active service death benefit is not necessarily a part of the Social Security integration plan but because the death benefit payable by Social Security is now known there seems to be no reason to defer any longer action on adjusting this benefit.

There are two principal reasons which can be advanced to support a change in the active service death benefit:

(1) The present protection to families of employees dying in service is inadequate.

(2) The inequity caused by a member's death shortly before retirement after long service.

Because the amount received by the family upon death of an employee in active service varies greatly according to the particular circumstances, it is impossible to categorically state that Civil Service gives greater benefits than the Social Security-Bank Plan, or vice versa.

Under Civil Service a widow receives, at age 50, one-half of the allowance due her husband at his death. If there are minor children, she receives her allowance immediately and in addition receives an allowance for each child but not to exceed $900 per annum in the aggregate for the children. There is no limit on the widow's allowance.

Under Social Security a widow receives, at age 65, three-fourths of her former husband's primary insurance benefit. Her allowance may vary from $15 to $60 per month. If there are minor children, the widow's allowance is paid during their minority and in

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addition there is a liberal allowance for the children. However, the total amount a family may receive is $150 per month.

Under Social Security there is usually a period of time when nothing is payable to the widow and it is partly in recognition of this fact that an increase is proposed in the active service death benefit given by the Retirement System. The widow must be 65 years of age or have minor children in her care to qualify for Social Security benefits. When the youngest child attains age 18, the widow's allowance ceases until she is 65. In many cases this will be a substantial period of time.

One of the most forceful arguments which can be advanced for increasing the death benefit is that under the present provisions the Bank contributes very little to the individual who dies in active service. The one year's salary when divided by the total years of service usually comes to a rather small figure for each year. On the other hand the same years of service would reap substantially more in benefits if the employee lived to retire. While, certainly, these benefits should not be equal, they might have a more reasonable relationship.

The inequity that presently exists between the amounts payable to an employee dying just prior or just after retirement can best be illustrated by reference to two actual cases which occurred recently and which undoubtedly gave impetus to the feeling of the Chairmen and Presidents that some adjustment should be made:

(1) Mr. C. R. Shaw, an officer of the Seattle Branch, died in active service and his beneficiaries received, in addition

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to Mr. Shaw's own funds, $13,000 representing one year's salary. If Mr. Shaw had retired and died shortly thereafter, his beneficiaries would have been entitled, in addition to his own funds, to approximately $45,000 or a difference of approximately $32,000.

(2) Mr. R. O. Webb, an officer of the Federal Reserve Bank of Dallas, died in service and his beneficiaries received, in addition to the return of his own funds, approximately $7,200, or the equal of one year's salary. If Mr. Webb had retired, as he had contemplated, and had died shortly thereafter, the death benefit in addition to his own funds would have equaled approximately $27,500; a difference of more than $20,000.

The change in the Rules and Regulations last year which placed the pension portion on a straight life basis will eventually eliminate this difference because an employee will not be entitled to his pension reserve. However, it will be a good many years before this will be accomplished. In the meantime it is felt that some action should be taken to mitigate the loss suffered by a family of a long service employee who dies in the last few years before retirement.

The action of the Retirement Committee recommending that the maximum limit receivable because of death in active service be increased from $25,000 to $50,000 was prompted by the feeling that it would not be consistent to increase the limits for employees and make no increase in the benefit for officers. It should be noted that a long period of service is required before any officer or employee will receive equivalent to two years' salary.

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As illustrated below an officer whose salary is $12,500 will receive no benefit from the increased maximum; an officer whose salary is $15,000 must have more than 29 years of service before he will benefit from the increase; and an officer whose salary is $25,000 must have in excess of 16 years of service before he will receive any benefit from the increased limitation and he must have 36 years of service before the maximum of $50,000 will be payable.

Salary	Years of Service Necessary Before Benefit Under New Limit Will Begin
$12,500	36
15,000	29
18,000	24
20,000	21
25,000	16

Since Social Security limits the amount which one family may receive to $150 per month, the active service death benefit received by the beneficiaries of a high-salaried employee bears a much less favorable relationship to salary than in the case of a low-salaried employee.

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