

COMPANY ANNUITY PLANS AND FEDERAL OLD-AGE INSURANCE

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Old-Age Assistance

Strong arguments can be made for providing pensions in a systematic way to aged persons who have no means of subsistence. Almost everyone is agreed that the old-age assistance plans which have been adopted by over thirty states are a more humane method of taking care of the indigent aged than the poor-house system, and also more economical. It would be a serious mistake, however, if we in this country depended only upon this method of government old-age assistance for taking care of the old-age problem.

The Social Security Act provides that the federal government will pay half of the cost of the state old-age assistance plans, with a maximum contribution by the federal government of \$15 per month. It is estimated by the actuaries that this plan for old-age assistance will in 1965 cost the federal government \$1,250,000,000 and the state governments a like amount. We are going to have a much larger number of older people in the future than we now have and it has also been found in other countries that with a plan of this type in operation a large proportion of the aged will be on public assistance. It is bad in principle to have a system under which we tell those who do not save that they will be provided for by the state but those who have saved for their old age will receive nothing and will be taxed to provide pensions for the others.

To avoid these results it is necessary that a governmental contributory annuity plan be established under which employees and employers would begin gradually building up a fund which could provide annuities in their old age without their being dependent upon the government for support. It would, of course, be better if annuity plans could be adopted on a wide enough scale by individual companies so that it would not be necessary for the government to enter into this field, but for a number of reasons this could not be expected.

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Federal Old-Age Benefit Plan

Under the old-age benefit plan set up by the Social Security Act, the employers and employees will each contribute 1% for the three years beginning January 1, 1937; the rate is increased to 1½% for each in 1940 and continues to increase at three-year intervals until a maximum of 3% for each is reached. With these rates of contribution and the benefits provided under the plan, a tremendous reserve would be built up amounting by 1980 to over 45 billion dollars. Practically all the actuaries and other students of the subject are agreed that it is impractical and unsound to attempt to set up a governmental annuity plan on this basis and that it is much better for a number of reasons to have a plan on a pay-as-you-go basis.¹

The dangers inherent in the present plan will not arise for a few years but it is very important that these dangers are realized so that the system can be changed in the meantime. The plan could easily be changed by having the rates of contribution increased at intervals of five or six years instead of three years as now provided, and also by fixing the maximum rate at 2½% instead of 3%. By postponing the increases in the contribution rates, the amount of the reserve will be reduced considerably and it would not become larger than is necessary for contingencies. During the next three years there should be sufficient opportunity to convince the Social Security Board and Congress of the desirability of this change.

Adjustment of Company Annuity Plans

Companies which have had sound, adequate pension plans for a number of years have found that it is good business to have such plans. They have been enabled to retire workers after they have passed their period of usefulness and replace them by more efficient workers.

The Federal Act should be of assistance to the companies which have not yet established pension plans because the benefits which will be paid to the present older workers are greater than could be obtained with the same contribution paid to an insurance company. Thus the government plan assists the companies in meeting the accrued liability. The companies which already have adequate pension plans will find that the cost in the future will not be any greater than in the past. Those with plans which are not adequate will find that this is an opportunity to put their plans on a sound basis.

The government plan, however, is intended more to meet the social problem and not the industrial pension problem. Employers therefore cannot assume that the government plan is going to solve their pension problem. In the first place, no annuities will be paid under the federal plan until 1942 and for several years after that the workers who retire will not receive very large pensions. For instance, the person receiving a salary of \$100 a month who retires in 1942 will receive a pension of \$17.50 a month, and one who retires in 1947, \$22.50 a month. The person who has

¹For a description of this reserve and a criticism of its economic effects, see Modlin, *The Old-Age Reserve Account and its Economic Implications*, *supra*, p. 221.

average earnings of \$200 a month will receive \$22.50 upon reaching 65 and retiring in 1942 and \$32.50 if retired in 1947.

Many companies will therefore find it necessary to supplement these annuities. The extent to which it is necessary to supplement the federal plan depends to a large extent upon the ages and wages of the personnel. If the employees of a company are for the great part young and in the lower wage groups, the government plan will go a long way toward meeting the pension problem because by the time these younger men reach retirement age the benefits payable under the government plan might be sufficient. The pensions are weighted so that the employees in the lower wage groups receive considerably higher benefits in proportion to their contributions than those in the higher wage groups. On the other hand, if a company has many older employees or employees in the upper wage groups and in the salary group over \$3,000, the government plan will not meet that company's pension problem, and it would be necessary to provide a supplementary plan.

It should be clearly understood that a governmental plan should always provide only minimum benefits.

(a) Adjustment to Foreign Governmental Plans

The Eastman Kodak Company covers employees under pension plans in several foreign countries in which there is a governmental plan. The methods we have adopted depend upon the type of governmental plan. For instance, in England when we inaugurated our annuity plan we disregarded the governmental plan entirely because the benefits were so low. On the other hand, in some of the South American countries, such as Brazil and Uruguay, the governmental plans were so drastic and required such a large contribution from the workers and employers that it was necessary for us to abandon the pension plans which we had had in operation for several years.

In France the governmental plan is more nearly comparable to the plan set up under the Social Security Act and our experience there is of interest in considering the adjustments to be made in the company plans in this country.

In France we have operated our pension plan as a supplement to the governmental plan for several years and it has worked out quite satisfactorily. Under the governmental plan employees who earn less than 25,000 francs, or about \$1,600, are eligible. A basic wage is set up which is an annual wage of a maximum of 10,800 francs, or \$720. Both the employee and employer contribute 4½% of the basic wages. The normal retirement age is 60. Because the annuities to be paid for a number of years were not very large and because many workers were not covered at all, we found it necessary to supplement this plan. Otherwise our pension program would not have been adequate and we would not have been able to retire all types of workers after they had passed their period of usefulness.

We had previously had a plan in operation which provided an annuity of 1% of

salary for each year of past service and 2% for each year of future service. When the governmental plan became effective we changed our plan so that the employee would receive from the insurance company which had underwritten our plan an annuity of 2% of his salary, less a specified percentage of the basic salary as defined by the law. The result was that our total payments to the insurance company and the government were practically the same as they had been before. The employee's contribution to our plan was also reduced by a formula which resulted in his total contributions being about the same as they had been previously.

(b) Adjustment to the Social Security Act

We have decided to adopt the same policy in this country. Our retirement annuity plan was underwritten by the Metropolitan Life Insurance Company with whom we took out a group contract in 1929. In addition to making a substantial payment for the accrued liability at the inauguration of the plan, we have been making payments to them each year for the current liability. The payments which are being made currently to the insurance company are in excess of the initial payments which we shall have to make under the pension provisions of the Social Security Act. This excess is due to the fact that the benefits payable under our plan are higher than the benefits which will be paid under the Social Security Act for a number of years, and also because the Social Security plan is limited to the first \$3,000 salary. When the full 3% rate becomes effective under the government plan, the difference between our present rates on the first \$3,000 salary and the government rates will not be so great.

The modifications which we shall make in our plan on January 1, 1937, due to the enactment of the Social Security Act, will have no effect upon money which we have already paid to the insurance company or upon the annuities which have already been earned by employees for service prior to January 1, 1937. Thereafter the annual payments to the insurance company will be reduced because of the old-age annuity tax payments the company will make to the federal government. The objective will be to have the sum of the annuities provided by the company's payments to the government and to the insurance company provide a combined annuity practically the same as under the present company annuity plan. The total cost to us in the long run will be approximately the same as it would have been under our present plan. During the first few years the combined cost will be somewhat lower because the benefits payable to those who retire in the next few years will be greater than could be purchased for the same payments to the insurance company. This advantage is later offset by the higher cost of the benefits purchased fifteen or twenty years from now.

Our retirement annuity plan is somewhat different from the ordinary pension system in that we arranged to finance to a large extent the current cost by reducing the wage dividend which we had been paying to employees for several years.

We shall therefore arrange our plan so that the part of the annuity which the present employee will accumulate in the government from his own contributions will be added to the annuity which he would have accumulated under our own plan. The new employee, however, will accumulate a combined annuity of 2% for each year of service, with the employee paying part of the cost as provided under the Social Security Act and us paying the balance. We feel that for new employees a 2% annuity is adequate—the older employees of our present force received only 1% annuity for their service prior to 1929.

We have not yet worked out the exact formula that we shall use in making the necessary adjustments in our plan when the government plan becomes effective. The federal plan provides in effect a benefit of 1% of salary for the first \$45,000 of total salary received and ½% for salary in excess of \$45,000, plus a flat addition of \$150 a year. Our plan provides for 1% of salary prior to 1929 and 2% thereafter. As indicated above, our formula for the present employees would be different than it would be for the new employees or for companies which already have a contributory plan in effect.

The method we shall probably use for new employees is to have our plan provide benefits equal to 1% of the annual salary of workers earning less than \$3,000, and for those receiving over \$3,000, 1% of the annual salary up to \$3,000 and 2% of the salary in excess of \$3,000. This plan would result in a combined annuity from the insurance company and from the government of 2% of salary for each year's service, and the employee would contribute toward the cost to the extent of his payments to the federal government.

Adjustments will have to be made for women under our plan which provides for their retirement at 60 instead of 65 as under the federal plan. An arrangement can probably be worked out for temporary annuities running from 60 to 65.

From our experience in several foreign countries, we are convinced that it is feasible to operate a company annuity plan as a supplement to the governmental plan, and we are therefore not concerned about the effects of the federal annuity plan on our own plan.