United States General Accounting Office

GAO

Briefing Report to Congressional Requesters

February 1990

AGE DISCRIMINATION

Use of Age-Specific Provisions in Company Exit Incentive Programs

GAO/HRD-90-87BR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Human Resources Division

B-234436

February 27, 1990

Congressional Requesters:[1]

On December 11, 1989, you requested information on the use of age-specific provisions in company exit incentive programs. These provisions either bar a certain group of older workers from program participation or exclude these workers from enhanced benefits available to younger eligible workers. Whether older workers can be either excluded from benefits under exit incentive programs or offered lower benefits than eligible younger workers has concerned many. Your request indicated that this information would be important to deliberations on proposed legislation to amend the Age Discrimination in Employment Act of 1967 (ADEA) in the wake of a 1989 Supreme Court ruling[2] affecting exit incentive programs with age-specific provisions.

Companies sometimes use short-term exit incentive programs to reduce their work forces when downsizing their operations. Under these programs, eligible workers are offered enhanced benefits, often through the company pension plan, as inducement for early departure. In this way, younger workers eligible for the program are given improved status in the company pension plan so that they may receive benefits comparable to those received by older workers who are already at or near the pension plan's normal retirement age.[3]

Exit incentive programs can offer various kinds of enhanced benefits. These include (1) additional credits that improve early retirement benefits under the company pension plan; (2) some other specially designed incentives, such as a one-time severance allowance, not connected with the pension plan; (3) continued or improved health or life insurance coverage; or (4) a combination of these enhancements.

ADEA forbids employers from arbitrarily discriminating against workers on the basis of age. However, under the act, company exit incentive programs may have age-specific provisions that offer benefits that either decrease with age or cut off at a certain age provided that a program is

[1]See appendix I for a list of the requesters.

[2]Public Employees Retirement System of Ohio v. Betts, 109 S. Ct. 2854.

[3]Older workers who are eligible for retirement under the company pension plan get an unreduced pension benefit. In addition, workers 62 and over are entitled to receive social security benefits, and workers 65 and over are entitled to Medicare benefits.

not a scheme to evade the general purpose of ADEA. For example, a program could offer eligible workers a retirement supplement until they reach age 62.

To determine whether exit incentive programs with age-specific provisions conform to ADEA, employers were formerly required to satisfy a cost-justification test. Under this provision, a plan that provided lower benefits for older employees was prohibited unless the employer could show that this was due to greater costs or other economic considerations.

Congressional concern about the use of age-specific provisions heightened following the 1989 Supreme Court ruling. Under the ruling, an employer is not required to meet a cost-justification test when providing lesser benefits to older workers. Among other things, the proposed legislation seeks to prohibit age discrimination against older workers in all employee benefit plans except when age-based reductions are justified by significant cost considerations.

As agreed with your offices, this briefing report provides information on the use of age-specific provisions for eligibility and enhanced benefits in exit incentive programs. We compiled information on the provisions of these programs from three data sources: (1) programs sponsored by Fortune 100 companies between 1979 and 1988; (2) data obtained from Charles D. Spencer and Associates,[4] a private-sector publishing firm; and (3) the Bureau of Labor Statistics.[5] Our work focused on determining the prevalence of programs that (1) excluded a particular group of older workers by applying an age cap or age bracket on program eligibility and (2) offered certain enhanced benefits only to workers in a specific age group because an age cap or bracket was applied. We interviewed selected officials from Fortune 100 companies who were familiar with their companies' programs to gain perspective on employers' motivations for using or not using exit incentive programs with age-specific provisions.

Results in Brief

Although very few of the exit incentive programs we identified had age-specific provisions for eligibility, most used age-specific provisions for enhanced benefits. Specifically, we found that:

[4]See Charles D. Spencer and Associates, "Early Retirement Incentives Offered by 24 Percent of Companies in 1986," Spencer's Research Reports on Employee Benefits (1987).

[5]Department of Labor, Bureau of Labor Statistics, Employee Benefits Survey (1988).

- Only 5 percent (3 of 62) of Fortune 100 company exit incentive programs used age-specific eligibility provisions (see fig. 1, p. 12). These programs used age brackets or set a cap on the age of workers to which the incentive offer was extended. Two programs set age brackets and one had an age cap. The age brackets used were 55 to 65 years and 55 to 62 years. Age 62 was the cap applied in the one program that used it. For each program, the bracket's upper boundary or the applied cap was the normal retirement age under the company pension plan. None of Spencer's exit incentive programs had age-specific provisions for eligibility.[6]
- A majority of exit incentive programs offered workers age-specific enhanced benefits, according to results from the three surveys (see fig. 2, p. 14). In these programs, certain enhanced benefits were provided to younger eligible workers so that they could receive benefits comparable to those received by older workers already at or approaching normal retirement age.

Officials of some companies that used age-specific exit incentives indicated that cost considerations played a role in their companies' decisions (see p. 16). Some others commented that before deciding to target the program to younger workers, the company considered the number of older workers approaching the pension plan's normal retirement age. They believed that the company could not have met its work-force-reduction goal by relying on attrition.

Officials of companies not using age-specific provisions in exit incentive programs generally told us that they believed such provisions were unfair. Some also mentioned the desire to avoid an ADEA age-discrimination lawsuit as a significant factor. Several company officials emphasized that the purpose of exit incentive programs had been to reduce staff in general, not to retire older workers.

We are sending copies of this report to other interested congressional committees, and we will make copies available to others who request them. If you have any questions concerning this report, please call me

[6] The Bureau of Labor Statistics' Employee Benefit Survey did not report information on program eligibility provisions in a manner that allowed us to determine the incidence of age-specific provisions.

on (202) 275-6193. Other major contributors to this report are listed in appendix II.

Joseph F. Delfico

Joseph F. Delfico
Director, Income Security Issues

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Abbreviations

ADEA	Age Discrimination in Employment Act of 1967
BLS	Bureau of Labor Statistics
EEOC	Equal Employment Opportunity Commission

Age Discrimination: Use of Age-Specific Provisions in Company Exit Incentive Programs

Background

In recent years, mergers, competition from abroad, or a general decline in sales have caused many companies to cut back their work forces. To reduce employment, companies sometimes use exit incentive programs, which offer employees financial incentives for early departure. These programs are generally instituted for a fixed period of time (e.g., 2 months) during which each eligible employee can accept or decline the exit incentive offer. Companies view these programs as alternatives to layoffs, and consider them as one way to cut labor costs in the long run.

Exit incentive programs are frequently offered through company pension plans. To encourage departure, younger workers who are eligible for the program are given improved status in the company pension plan so that they may receive benefits comparable to those received by older workers already at or near the pension plan's normal retirement age.[1] In this way, employers enhance the provisions of the company pension plan so that younger eligible workers will get higher pension benefits than normally would be available to them. The following are examples of enhanced benefits.

1. Liberalized early retirement benefits—Monthly benefits are increased by diminishing or eliminating the actuarial factor that is normally used to reduce benefits of workers who have not yet reached the pension plan's normal retirement age.

2. Retirement supplements—A fixed cash amount is added to monthly pension benefits and may be discontinued after workers become eligible for social security benefits at age 62.

3. Age and service credits—Workers receive additional credits to their age and years of service. This permits younger workers to meet the pension provisions for eligibility and increases the amount of benefits they would have otherwise received.

Exit incentive programs can provide workers accepting the offer with other forms of enhanced benefits. These include one-time severance allowances—which are usually based on years of service—and continued or improved medical and life insurance coverage.

[1] Older workers who are eligible for retirement under the company pension plan get an unreduced pension benefit. In addition, workers 62 and over are entitled to receive social security benefits, and workers 65 and over are entitled to Medicare benefits.

Exit incentive programs have become widespread in recent years. We estimate that 80 percent of the Fortune 100 companies sponsored an exit incentive program at least once during 1979 through 1988.[2] A study conducted by Hewitt Associates shows that about 55 percent of a sample of large companies (25,000 or more employees) offered such programs at least once between 1981 and 1985.[3] The Hewitt study also reports that companies with 50,000 or more employees were most likely to use exit incentive programs.

Age-Discrimination Issues in Exit Incentive Programs

Protecting the rights of elderly Americans has been a policy goal of the Congress for many years. In 1967, the Congress passed the Age Discrimination in Employment Act (ADEA), which protects the employment rights of workers age 40 and over. ADEA generally precludes an employer from discriminating against workers on the basis of age with respect to compensation, terms, conditions, or privileges of employment.

ADEA does not forbid an employer from having an employee benefit plan that differentiates on the basis of age, so long as the plan is not a scheme to evade the general purpose of ADEA. Under the act, employee benefit plans may have benefits that either decrease with age or cut off at a certain age.

Similarly, exit incentive programs may use certain so-called age-specific provisions. For example, a program with age-specific eligibility provisions could extend the exit incentive offer only to workers within a specified age bracket or below a certain age. A program with age-specific enhanced benefits could extend the exit incentive program to all workers but offer certain enhanced benefits only to workers in a specified age group. The Congress permitted age-specific provisions in part to avoid making older workers more expensive to employers than younger workers because of age-related costs.

The Equal Employment Opportunity Commission (EEOC), the agency charged with implementing ADEA, issued regulations pertaining to age-specific provisions in employee benefit plans. Under EEOC regulations, a plan which provided lower benefits for older employees was prohibited

[2] See Age Discrimination: Use of Waivers by Large Companies Offering Exit Incentives to Employees (GAO/HRD 89-87, Apr. 1989).

[3] See Hewitt Associates, "Plan Design and Experience in Early Retirement Windows and in Other Voluntary Separation Plans" (1986).

unless the employer could justify the difference by showing increased costs or other economic considerations.

In 1989, the Supreme Court invalidated the EEOC cost-justification test and established a new test.[4] Under the Supreme Court ruling, an employer is not required to meet a cost-justification test when providing lesser benefits to older workers. Instead, a worker must show that an employee benefit plan was intended to discriminate against the employee in hiring and firing, wages and salaries or, in the words of the Supreme Court, in some other "nonfringe-benefit aspects of the employment relationship."

Concern about the use of age-specific provisions heightened following the Supreme Court decision. In response, some congressional members have proposed the Older Workers Benefit Protection Act (S. 1511 and H.R. 3200) to amend ADEA. If passed, the legislation will, among other things, prohibit age discrimination against older workers in all employee benefit plans except when age-based reductions are justified by significant cost considerations.

Objective, Scope, and Methodology

On December 11, 1989, the Chairman of the Senate Subcommittee on Labor and others requested that GAO review the use of age-specific provisions in company exit incentive programs. We agreed to provide information on age-specific provisions for eligibility and enhanced benefits offered to workers under these programs.

To respond to the congressional request, we compiled information on the provisions of exit incentive programs. We relied primarily on information for programs sponsored by Fortune 100 companies between 1979 and 1988, which we obtained for a previous GAO study. These companies were the largest 100 companies in Fortune magazine's listing of the top 500 industrial corporations for 1987. The number of Fortune 100 exit incentive programs varies throughout this report because programs were omitted when information was not available.[5]

To observe the use of age-specific provisions across different data sources, we compared the information for Fortune 100 companies with

[4] Public Employees Retirment System of Ohio v. Betts, 109 S. Ct. 2854 (1989).

[5] We reviewed eligibility provisions for 62 Fortune 100 exit incentive programs and enhanced benefit provisions for 42 programs.

that gathered from (1) Charles D. Spencer and Associates, a private-sector publishing firm, on 45 exit incentive programs offered in 1986[6] and (2) our analysis of information collected by the Department of Labor's Bureau of Labor Statistics (BLS) on 100 exit incentive programs sponsored by medium and large employers from 1983 through 1988.[7] Because of time constraints associated with this request, we did not verify the accuracy of the Spencer and BLS information.

We identified the prevalence and characteristics of age-specific provisions for eligibility under exit incentive programs. To do this, we (1) categorized eligibility provisions and (2) looked for evidence of age bracketing (for example, exit incentive programs offered only to employees ages 50 to 55) or age capping (for example, programs extending eligibility only to employees under a certain age). For purposes of this report, we did not consider eligibility provisions with an age floor and no upper limit to be age-specific.

We also focused on identifying programs offering enhanced benefits only to workers within specific age groups or under a certain age. We identified the use of bracketing and age caps that limited the availability of liberalized retirement benefits, supplemental retirement payments, and other forms of employee benefits provided as part of the exit incentive program.

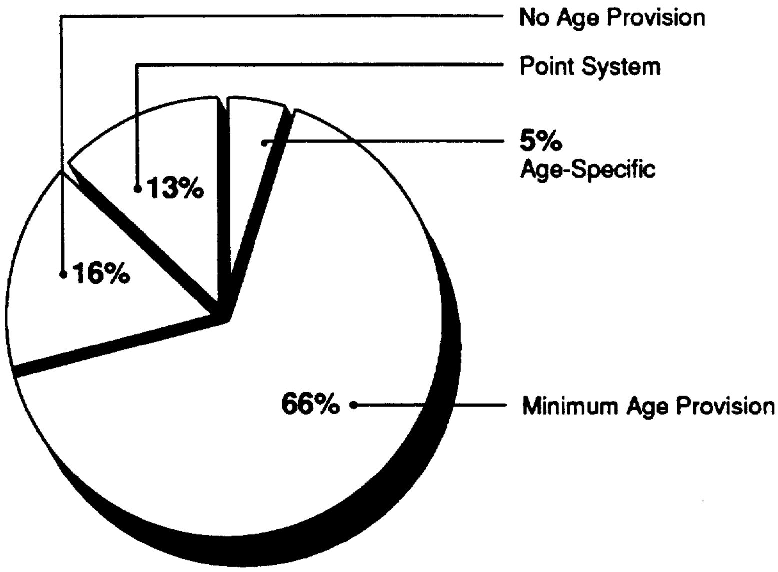
For our analysis, we did not attempt to compare the cost to the employer of providing benefits under exit incentive programs to older and younger workers. Nor did we ascertain whether some of the benefits offered as part of an exit incentive program were also included as part of a company's routine employee benefit package.

To gain perspective on employers' motivations for using or not using age-specific provisions for eligibility and enhanced benefits under company exit incentive programs, we interviewed officials from several Fortune 100 companies who were cognizant of their company's program features.

[6]See Charles D. Spencer and Associates, "Early Retirement Incentives Offered by 24 Percent of Companies in 1986," Spencer's Research Reports on Employee Benefits (1987).

[7]Department of Labor, Bureau of Labor Statistics, Employee Benefits Survey (1988).

Figure 1: Eligibility Provisions for Fortune 100 Exit Incentive Programs



N = 62 programs

Age-Specific Eligibility Provisions Rarely Used

We found very few instances where exit incentive programs used age-specific provisions for eligibility. Only 3 of 62 Fortune 100 programs used these provisions (see fig. 1). Two programs set age brackets and one had an age cap on the age of workers to which the incentive offer was extended. The age brackets used were 55 to 65 years and 55 to 62 years. Age 62 was the cap applied in the one program that used it. For each of the three programs with age-specific provisions for eligibility, the age bracket's upper boundary or the applied cap was the normal retirement age under the company pension plan. One of the programs with an age bracket was offered repeatedly during the 10-year period from 1979 through 1988. None of the exit incentive programs in the Spencer study had age-specific provisions for eligibility.[8]

[8]BLS's Employee Benefits Survey did not report information on program eligibility provisions in a manner that allowed us to determine the incidence of age-specific provisions.

Additional Information on Eligibility Provisions for Exit Incentive Programs

Our analysis of eligibility provisions for Fortune 100 company programs also showed that:

- Two-thirds of programs offered exit incentives to employees over a certain age, normally to those at least age 55, with some specified years of service;
- just under 20 percent of programs had no age provision; and
- 13 percent of programs used a point system that coordinated workers' ages and service to determine eligibility. For example, a program could require that workers have combined age and service totalling 75 points.

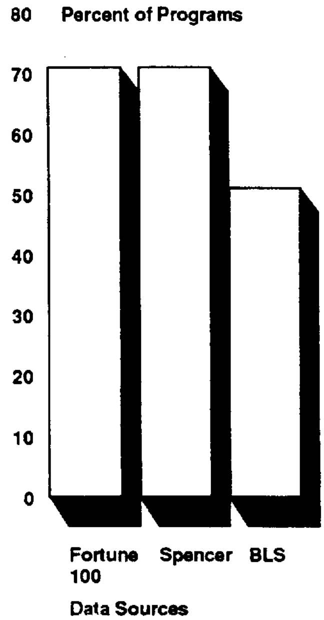
Similarly, most of Spencer's programs (84 percent) offered exit incentives to employees over a certain age, 55 on average, with some specified years of service. Seven percent of the programs had only a service provision for eligibility, while the remaining 9 percent used other criteria (for example, a point system based on a combination of workers' age and years of service).

Age-Specific Enhanced Benefits Used in Most Programs

A majority of exit incentive programs offered age-specific enhanced benefits to eligible workers (see fig. 2). In these programs, certain enhanced benefits were provided exclusively to younger eligible workers so that they could receive benefits comparable to those received by older workers who were already at or near the pension plan's normal retirement age. Programs with age-specific enhanced benefits generally offered workers at certain ages at least one of the following provisions.

- Liberalized early retirement benefits. This provision lessens or eliminates the actuarial reduction factor usually applied to early retirement benefits. It does not apply to workers who have reached normal retirement age.
- Age credits. This provision credits additional years to workers' actual age to make them eligible for retirement benefits, or to liberalize early retirement benefits, or both. Of course, workers above the pension plan's normal retirement age are not helped by this provision.
- Retirement supplements until a specified age. This provision gives workers below the specified age a benefit not available to older workers.
- Health or life insurance coverage until a specified age. This provision provides benefit coverage for workers below the age limit but not above it.

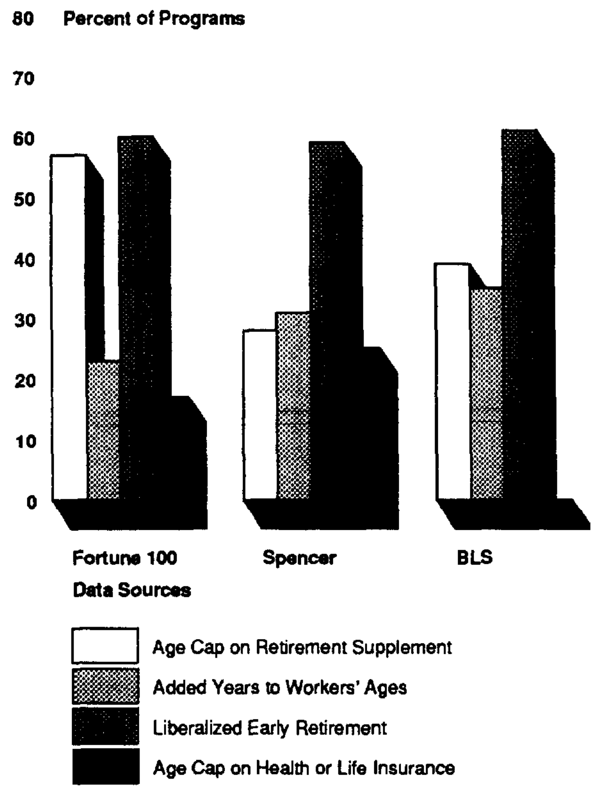
Figure 2: Exit Incentive Programs With Age-Specific Enhanced Benefits



Similarities exist among the various sources regarding the use of age-specific enhanced benefits. As shown in figure 3, most programs with age-specific enhanced benefits, about 60 percent, liberalized the pension plan's early retirement provisions. A substantial portion of programs, from 28 to 57 percent, placed an age cap on retirement supplements, usually 62 or 65. Less than 40 percent gave age credits. Also, a minority of programs imposed an age cap on health or life insurance coverage, normally age 65.

A few exit incentive programs in BLS's Employee Benefits Survey gave workers age credits and offered retirement supplements that capped at a certain age. Our analysis shows that only 8 percent of these programs offered the two enhancements concurrently. None of the programs among the Fortune 100 or those reported on by Spencer did this.

Figure 3: Use of Various Age-Specific Enhanced Benefits



BLS did not inquire about age caps on health and life insurance coverage.

Additional Details on Age-Specific Exit Incentives

We found several programs that used age-specific enhanced benefit provisions in unique ways when compared with other programs. A brief description follows.

In two programs, enhanced benefits were graduated by discrete age brackets. One such program, which provided a retirement supplement and liberalized early retirement benefits, allowed workers ages 55 to 59 to receive a supplement totalling up to 18 months of their base salary. Workers in the under-55 and those in the 60-and-over age groups, however, were allowed supplements of only up to 15 months of their base salary. The other program provided workers in lower age brackets a greater number of enhanced benefits than older workers. Although this program offered all eligible workers a basic cash supplement, workers ages 55 to 60 could receive two additional enhanced benefits—a retirement supplement and cash allowance. Those ages 60 and 61 could receive the retirement supplement but not the cash allowance. Those ages 62 and over were offered only the basic cash supplement.

One Fortune 100 company program based the enhanced benefit on an age and service point system. Under this system, if workers had below the requisite points, the pension plan's actuarial reduction factor normally associated with early retirement was not applied.

For purposes of calculating pension benefits, another program provided employees with service credit equal to one-half the difference between their actual ages and age 65. In operation, this program would give fewer service credits to older workers.

Comments of Company Representatives

Company officials were asked to explain the rationale for using or not using age-specific exit incentives. Officials of some companies that used age-specific exit incentives indicated that cost considerations played a role in company decisions. Others commented that before deciding to target the programs to younger workers, the company had considered the number of older workers approaching normal retirement age. They believed that the company could not have met its work force reduction goal by relying on attrition. Typical comments were:

- "Workers at or above normal retirement age did not need an incentive to leave since they were entitled to full benefits under the pension plan."
- "The program was intended to encourage employees below the plan's normal retirement age to leave."

Officials of companies that applied age caps on retirement supplements or insurance coverage stated that the caps were instituted at the point when workers were eligible for government sponsored programs. Officials of companies with an age cap on retirement supplements commented that the payments were programmed to stop approximately when workers became eligible for social security benefits. Officials of companies with a cap on health coverage said that they wanted to extend company benefits until workers reached age 65 and were eligible for Medicare benefits. Other comments were:

- "The retirement supplement would allow retirees to receive approximately the same retirement income before social security payments began as they would afterwards."

- "It was not considered a cap, but the age that coordinated with the Social Security Administration's age for starting social security payments."
- "The idea was to make younger workers whole until normal retirement."
- "We capped health benefit coverage at age 65 because we didn't want to give early retirees an advantage over those who normally retired at 65, since we didn't extend coverage for them."
- "The age bracketing in the exit incentive program was identical to that in the regular pension plan. We wanted to show employees what more they could gain from the exit incentive program."

Officials for companies not using age-specific provisions generally told us that they believed such provisions were unfair to older workers. Some also mentioned the desire to avoid an ADEA age-discrimination lawsuit as a significant factor. Several company officials emphasized that the purpose of exit incentive programs had been to reduce staff in general, not to retire older workers. Other statements follow.

- "It isn't fair to tell someone age 65 they can participate, but someone age 67 cannot."
- "Morally, so to speak, you owe more to people who have been with the company longer."
- "It would get us into more hot water in that it sounds like a pretty good basis for an ADEA age discrimination case."
- "If misconstrued, establishing age brackets or age caps might have adversely impacted on the program objective of reducing the total head count."
- "A program that discriminated against older workers would not be cost effective because, generally, the older the employee, the more they earn."

Congressional Requesters

The Honorable Howard M. Metzenbaum
Chairman, Subcommittee on Labor
Committee on Labor and Human Resources
United States Senate

The Honorable James M. Jeffords
Ranking Minority Member, Subcommittee on Labor
Committee on Labor and Human Resources
United States Senate

The Honorable David H. Pryor
Chairman, Special Committee on Aging
United States Senate

The Honorable John Heinz
Ranking Minority Member
Special Committee on Aging
United States Senate

The Honorable William Clay, Chairman
Subcommittee on Labor-Management Relations
Committee on Education and Labor
House of Representatives

The Honorable Augustus F. Hawkins, Chairman
Committee on Education and Labor
House of Representatives

The Honorable Edward R. Roybal, Chairman
Select Committee on Aging
House of Representatives

The Honorable Matthew G. Martinez, Chairman
Subcommittee on Employment Opportunities
Committee on Education and Labor
House of Representatives

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