Disability benefits for employees in private pension plans

Although benefits vary, for many 20-year employees aged 55, a private pension and social security would replace about one-half of the worker's pre-disability earnings

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Although private pension plans are thought of primarily as a source of cash income for the elderly, they typically serve other functions as well. For example, they usually contain early retirement features and often provide pensions to workers who lose their jobs because of disability.

The high proportion of pension plans with disability retirement features is dramatized in data from the Bureau of Labor Statistics' annual survey of the incidence and characteristics of employee benefit plans in medium and large establishments.[1] Of the 1,002 private pension plans found in the 1980 survey, 86 percent had disability retirement features.[2] This article analyzes the various eligibility requirements for disability retirement and typical benefit levels, as found in these plans.

Disabled workers may have other protection as well. They often are eligible for social security benefits and also may be covered by private long-term disability insurance plans. This study includes retirement benefits and related long-term disability and social security benefits. However, excluded from the study are separate long-term disability plans which would be the only source of private disability income, and general early retirement provisions without specific disability features.

Two-thirds of the 861 pension plans with disability provisions offered immediate disability benefits. The remaining third deferred benefits until the employee reached the early or normal retirement age stipulated by the plan. However, immediate long-term disability insurance benefits were typically available to employees under deferred disability retirement plans. (Long-term disability benefits were less common when immediate disability pensions were paid.) Such private benefits are provided in addition to payments under the social security system when a worker is incapacitated.

Under retirement plans providing immediate disability pensions, benefits were available to workers meeting plan definitions of disability; commonly, service or age requirements, or both, were specified as well. Employees covered by deferred-benefit plans also had to reach the stipulated early or normal retirement age to receive benefits.

Illustrative benefit levels from all potential sources—disability retirement, long-term disability insurance, and social security—were calculated as a percent of pre-retirement earnings for a hypothetical worker disabled at age 55, with 20 years of service. Under these conditions, combined private pension and social security benefits tended to replace about half of pre-disability earnings in instances when private pension plans provided immediate retirement benefits. Replacement rates in many cases were more liberal where retirement packages furnished deferred pensions integrated with long-term disability benefits. As a rule, social security, rather than private plans, was the larger income source for the disabled worker.

Immediate and deferred benefits

Sixty-eight percent of the 861 disability retirement plans examined offered immediate pensions. The balance (32 percent) deferred benefit payments until the normal

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retirement age or in some instances, at the employee's option, until the early retirement age.

A key element in any pension plan is the formula included for calculating benefits. (Common formulas involve percentages of an employee's career or terminal earnings and dollar amounts per year for which an individual is covered by the plan.[3]) Most of the pension plans studied used the same basic formula to calculate disability and normal retirement benefits.

Immediate disability retirement. Of the 583 plans with immediate disability retirement provisions, nearly three-fourths used an unreduced normal benefit formula for disabled workers. (See table 1.) That is, beneficiaries received pensions calculated as if disability occurred at the normal retirement age;[4] no reduction in benefits was made solely because of the early retirement age. Nevertheless, these disability pensions tended to be lower than those for normal retirement because benefits typically were based on shorter service.

An additional 15 percent of plans with immediate disability benefits reduced pensions because of the relatively young age of those who retire on disability. Nearly half of these plans provided for actuarial reductions; pensions for retirement at age 55 usually were about 61 percent below those for normal retirement at age 65 with the same service. The remainder of these plans provided for less than actuarial reductions, the average benefit for disability at age 55 being approximately 43 percent less than that for normal retirement at age 65.

The remaining 14 percent of the plans with immediate disability pensions based benefits on formulas designed to temper reductions caused by shortness of service or to yield higher returns than under the normal retirement formula.

Generally, plans do not provide for later modification of the benefits determined at the time of disability retirement. However, 7 percent of the immediate disability retirement plans specified a recalculation of benefits at age 65, mainly either to increase compensation for persons whose benefits were reduced because their disability occurred before normal retirement age or to raise benefits for those with short service at the time of disability retirement. Four percent recalculated benefits at age 65 based on the normal retirement formula and service at the date of disability; 3 percent recalculated on the basis of credited service at the time of disability plus the period of disability.

Deferred disability retirement. In sharp contrast to the typical practice under plans providing immediate benefits, only 16 percent of the deferred disability retirement plans based benefits solely on service at the time of disability. (See table 2.) Benefit calculations under most of the deferred plans granted service credit for all or part of the period between disability and the initiation of pension payments. Thus, 77 percent of these plans allowed service credit to accrue during all of the deferral period, while 7 percent allowed partial credit, usually for 1 or 2 years.

Table 1. Pension plans with immediate disability retirement provisions by type of benefit formula, medium and large establishments, 1980

Benefit formula	Plans with immediate disability retirement	Percent of: Plans with immediate disability retirement	Percent of: All disability retirement plans
Total	583	100	68
Unreduced normal benefits	418	72	49
Reduced normal benefits	85	15	10
Actuarially reduced formulas	39	7	5
Same as early retirement	29	5	3
Percent per year reduction between retirement and specified age	17	3	2
Other than normal benefits	80	14	9
Flat amount formulas	19	3	2
Dollars times years of service	24	4	3
Percent of unreduced benefit minus social security	20	3	2
Percent of earnings minus social security	12	2	1
Percent of earnings in highest of last years worked	5	1	1

NOTE: Because of rounding, sums of individual items may not equal totals.

Coordination of pensions and social security. Benefits under private pension plans may be coordinated with those under the social security system. This occurs through either offset or integration provisions in the private plans. Under the former approach, private benefits are reduced by all or part of the social security payment. Integration provisions apply separate benefit formulas to earnings above and below the social security taxable wage base; for example, 1 percent of earnings up to the social security tax base and 1.5 percent of earnings above that tax base for each year of service. Thirty percent of all pension plan participants in the 1980 study were covered by offset provisions; 16 percent were in plans with integrated formulas for normal retirement benefits.[5] Such coordination typically was applicable to disability retirement, too.

Long-term disability insurance

A review of disability benefits must also consider long-term disability insurance, which often supplements or serves as an alternative to disability pensions. Generally, these payments begin after sick leave and accident and sickness insurance are exhausted and continue as long as a disabled employee remains incapacitated, or until retirement age is reached. Forty percent of persons covered by the Bureau's 1980 survey of employee benefit plans participated in long-term disability plans. Specified benefits, including payments from social security and other government programs such as workers' compensation, were usually a fixed percent of monthly earnings. Almost two-thirds of the participants were in plans designed to provide 50 to 60 percent of pre-disability earnings; however, resulting dollar benefits were often limited by maximum coverage restrictions so that persons with high earnings may receive a lower percent of earnings for disability benefits.[6]

As expected, long-term disability insurance plans were more prevalent where retirement pension plans provided deferred disability benefits. Table 2 shows that 89 percent of deferred plans were in establishments with long-term disability plans financed either solely by the employer or jointly by the employer and employees. Nine percent of the deferred disability retirement plans were in establishments providing an optional long-term disability plan paid for entirely by the employees. Thus, only 2 percent have workers who cannot receive immediately available disability benefits from private sources related to their employment.

Long-term disability insurance plans were less prevalent when pension plans provided immediate disability retirement benefits. Twenty-seven percent of these pension programs were tied in with the insurance plans.

Coordination of long-term disability benefits with disability pensions and social security was almost universal. The most common method of coordination was by offset; long-term disability benefits were reduced by the amount of private pension and social security a disabled worker received. The total benefit received by an employee covered by such a program was the amount specified by the long-term disability plan, generally 50 to 60 percent of pre-retirement earnings. Offset provisions were in four-fifths of the long-term disability plans in establishments with either immediate or deferred disability retirement benefits. Substantially all of the remainder specified an overall maximum benefit from all sources, most often 70 or 75 percent of pre-retirement earnings.

Table 2. Pension plans with deferred disability retirement provisions by service credited and integration with long-term disability insurance, medium and large establishments, 1980

Characteristic	Plans with deferred disability retirement	Percent of: Plans with deferred disability retirement	Percent of: All disability retirement plans
Service credited:			
Total	278	100	32
Service when disabled	44	16	5
Service plus credit to normal or early retirement	215	77	25
Service plus partial credits	19	7	2
Integration with long-term disability insurance:			
Total	278	100	32
Insurance paid by employer or jointly by employer and employee	248	89	29
Insurance paid entirely by employee	25	9	3
No insurance	5	2	1

NOTE: Because of rounding, sums of individual items may not equal totals.

Eligibility requirements

To qualify for a disability pension, a worker must meet the plan's definition of total and permanent disability and, frequently, a service requirement. A minimum age may also be specified. These requirements often differ from those applicable to social security disability benefits.

Definitions of disability. As a rule, definitions of disability are designed to make benefits available only to workers whose incapacities require them to withdraw from the labor force. About three-fourths of the disability retirement plans defined disability either in the same way as social security (25 percent) or more restrictively (48 percent). The Social Security Act defines disability as incapacity for substantial gainful work at any job that exists to a considerable extent in the U.S. economy; such incapacity is expected to result in death or to last for a year or more.[7] Many private plans have a more restrictive definition, stating that persons must be disabled for "any type of occupation or employment." Consequently, workers meeting the eligibility requirement of nearly three-fourths of the private plans also met the social security test.

However, one-fourth of the disability retirement plans defined disability as occurring when an employee was unable to continue in his or her job with the company. Individuals meeting this criterion would not necessarily qualify for social security disability benefits.[8] But, half of the plans containing this relatively liberal definition offered a supplemental benefit which continued until eligibility for social security disability or retirement benefits or a specified age, such as 65, for persons not covered by social security. In this manner, they provided benefits more comparable to those obtained by employees eligible for social security disability payments.

Age and service requirements. Comparison of findings of this study with those of a 1966 Bureau analysis[9] indicates a growing emphasis on service rather than on age in defining eligibility for disability pensions. This brings private plans closer to the social security approach, which now includes only a service requirement. (A minimum age requirement for social security disability benefits was removed in 1960.) The following tabulation summarizes the various age and service requirements made by the plans.

Requirements	*Number of plans*	*Percent of plans*
Total	861	100
No age or service	138	16
Service only	499	58
Age only	9	1
Age and service	112	13
Meets qualification for long-term disability benefits	103	12

Almost three-fifths of the disability retirement plans in the 1980 study included a service requirement, but did not specify a minimum age for benefits. The average length of service required by these plans was 11 years. This was more restrictive than the social security stipulation which stated that an individual must be fully insured[10] and work in covered service 20 of the last 40 quarters (5 of the last 10 years).

Only 14 percent of the plans specified a minimum age; most combined age and service requirements, commonly age 45 with 10 years of service or age 50 with 15 years of service. The average age requirement in these plans was 46 years. Just 1 percent of the plans had only an age requirement, averaging 54 years.

The remainder of the plans (241) did not specify either an age or a service requirement *per se*. However, more than 40 percent of this group required that the eligibility for associated long-term disability plans be met, which most often had a minimal service requirement.

Waiting periods. Immediate disability retirement and long-term disability benefits typically were payable after an initial waiting period, usually 5 or 6 months. The waiting period, similar to the 5 months imposed by social security, is designed to ensure the validity of a claim before initiating payment of long-term benefits. However, most of the employees in the study were covered during all or part of the waiting period by sick leave or short-term accident and sickness insurance.[11]

Illustrative benefits

The following replacement rates illustrate typical disability retirement benefits among various types of plans and relate benefit levels to pre-disability earnings. Replacement rates—ratios of disability benefits to pre-disability earnings—were calculated for a hypothetical employee, age 55, retiring on a disability pension after 20 years of service under his or her current private pension plan. This is in contrast to assumed normal retirement at age 65 after 30 years. The hypothetical employee also had been covered for 30 years under social security, and met the social security definition of disability. Earnings equaled the average in the broad industry group in which employed, and followed a typical growth pattern over the years.

As noted, the majority of private pension plans giving immediate disability benefits were not coordinated with long-term disability plans and provided pensions unreduced solely for early disability retirement age. These plans, under the hypothetical conditions, would provide a pension estimated to average 21 percent of pre-retirement earnings. Adding social security payments—32 percent—total benefits would be just over half of earnings before disability.[12]

Replacement rates would vary under alternative benefit formulas. For example, a small portion of immediate disability retirement plans actuarially reduce benefits for early retirement age. These plans would commonly replace only 8 percent of the earnings of the hypothetical worker,[13] resulting in combined private pension and social security benefits of two-fifths of pre-retirement earnings. (In practice, replacement rates would deviate from those calculated here, depending on the actual age-service status of individual disabled workers.)

Replacement rates in the immediate disability benefit plans studied would generally continue unchanged after normal retirement age, except for the 50 percent increase in social security benefits provided for married employees with one wage earner in the family.[14]

Table 3. Full-time participants in private pension plans by provisions for disability retirement, medium and large establishments, 1980

[In percent]

Characteristic	Participants			
	All	Professional and administrative	Technical and clerical	Production
Total with disability retirement benefits	87	85	81	91
Minimum requirements for disability retirement				
Total	100	100	100	100
No age or service	16	18	21	13
Age only	1	1	1	1
Service only	61	51	48	70
Age and service	11	9	11	12
No age or service - meets qualification for long-term disability benefits	11	21	18	5
Benefit provisions				
Total	100	100	100	100
Immediate disability retirement	70	52	51	84
Unreduced normal formula	55	41	39	67
Reduced normal formula	7	6	7	8
Other than normal formula[1]	8	6	5	10
Deferred disability retirement	30	47	49	16
With benefits based on:				
Service when disabled	5	6	7	4
Service plus credit to normal retirement date	24	39	38	12
Service with some credit	2	3	4	1

[1] Includes flat amount benefits, dollar amount formulas, percent of unreduced normal benefits less social security, and percent of earnings formulas both with and without social security offsets.

NOTE: Because of rounding, sums of individual items may not equal totals.

The discussion of replacement rates under immediate disability retirement plans has ignored long-term disability benefits which are available to only a small fraction of the workers affected. However, these benefits are the primary private source of pre-retirement age earnings when deferred disability pensions are provided. In these instances, long-term disability payments—combined with social security—commonly yield either 50 or 60 percent of pre-disability earnings.

Under deferred disability pension plans, replacement rates change at the normal retirement age, both because of the addition of spouse's benefits under social security and the switch from long-term disability to private pension benefits. As observed above, pension benefits normally reflect service credit for the period of long-term disability benefits. For a worker retiring at age 55, an additional 10 years of credit would, on the average, raise the pension at age 65 from 21 to 30 percent of pre-retirement earnings; total yield—including social security—would then be 62 percent for a single employee and 78 percent if married.[15] Deferred and long-term disability benefit packages were more prevalent among non-negotiated plans for salaried personnel than among collectively bargained plans for hourly rated employees; therefore, white-collar workers tended to enjoy higher replacement rates than blue-collar employees when retiring on disability.

Participants in pension plans

Estimates of the extent of worker participation in pension plans of medium and large establishments are found in *Employee Benefits in Industry, 1980*, Bureau of Labor Statistics, Bulletin 2107. Table 3 contains pertinent findings of that study. The findings, it should be stressed, are based on review of the same data source as was analyzed for the current article. As shown in the table, 70 percent of all participants in pension plans with disability retirement provisions could receive immediate retirement benefits. The present analysis found immediate benefits specified in 68 percent of the plans. The closeness of the two calculations is striking, even after recognizing that both percentages were derived from the same survey data.

A breakdown of findings by occupational group is available for plan participant data only. Among the findings is that deferred disability benefit plans are markedly more common for white-collar than for blue-collar employees. □

——— *FOOTNOTES* ———

[1] The survey is conducted in a sample designed to represent all private sector establishments in the United States, excluding Alaska and Hawaii, employing at least 50, 100, or 250 workers, depending on the industry. Industrial coverage includes: mining; construction; manufacturing; transportation, communications, electric, gas, and sanitary services; wholesale and retail trade; finance, insurance, and real estate; and selected services. For additional details on the survey, see *Employee Benefits in Industry, 1980*, Bulletin 2107 (Bureau of Labor Statistics, 1981). See also Robert Frumkin and William Wiatrowski, " Bureau of Labor Statistics takes a new look at employee benefits" in this issue of the *Review*.

While the bulletin contains information for a universe of employees, data tabulations in this article are simple counts of the number of pension plans containing the characteristics under analysis. The data relate solely to the specific plans included in the study. No attempt has been made to project findings to the entire universe of pension plans.

[2] For an independent source of data on the incidence of disability retirement plans, see Jonathan Sunshine, *Disability*, Office of Management and Budget Staff Technical Paper, 1979, p. 113. An earlier BLS study of disability benefits, which excluded both related long-term disability insurance and deferred disability benefits, is reported in Stanley S. Sacks, "Disability Benefits Under Private Pension Plans," *Monthly Labor Review*, April 1966, pp. 389–95.

[3] *Employee Benefits*, pp. 6, 25.

[4] Normal retirement is the point at which a worker can retire and immediately receive all accrued benefits by virtue of service and earnings, without reduction because of age.

[5] *Employee Benefits*, pp. 6, 25.

[6] *Ibid.*, p. 3.

[7] For a more complete definition see *Social Security Programs in the United States*, (Department of Health, Education, and Welfare, Social Security Administration, January 1973), p. 31.

[8] There may be differences among private plans and the social security system with respect to coverage of disabilities associated with nervous conditions, alcoholism, drugs, self-inflicted injuries, and criminal activity.

[9] Sacks, "Disability Benefits."

[10] Generally, to be fully insured a worker must have one quarter of coverage for each year from age 21 to date of disability.

[11] *Employee Benefits*, pp. 2–3.

[12] Coordination of private disability and social security benefits is accounted for in the calculation of the replacement rate for private benefits.

[13] The 8-percent replacement rate was derived by multiplying the unreduced normal retirement formula replacement rate of 21 percent by 39 percent. (As described above, plans actuarially reducing pensions for early retirement usually lowered benefits about 61 percent for quitting work 10 years before the normal retirement age.)

[14] Social security benefits are increased after each year in which the Consumer Price Index rises 3 percent or more. Such escalation is ignored in this analysis, because price changes cannot be accurately forecast.

[15] Both the 21-percent replacement rate for employees retiring under private pension plans with 20 years of service and the 30-percent rate for retirement after 30 years were derived by BLS from data in a study by James H. Schulz, Thomas D. Leavitt, Leslie Kelly, and John Strate, *Private Pension Benefits in the 1970's* (Bryn Mawr, Pa., McCahan Foundation, 1982). Schulz and his associates calculated replacement rates for retirements after varying lengths of service, for men and for women. Their calculations were based on an analysis of all pension plans in the 1979 BLS survey of employee benefit plans. The study calculated replacement rates for normal rather than disability retirement. However, because normal and disability retirement benefits are commonly based on the same formula, separate computations for disability retirement would not, in general, be appreciably different. For an earlier Schulz study, see James H. Schulz, Thomas D. Leavitt, and Leslie Kelly, "Private pensions fall far short of preretirement income levels," *Monthly Labor Review*, February 1979, pp. 28–32.