

***Phased Retirement Programs  
For The  
Twenty-First Century Workforce***

***Symposium on the  
Future of Employee Benefit Law***

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# *The origins of the problem.*

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- **Demographic pressures:**
  - Falling fertility rates
  - Increased life expectancies
  - Trend toward early retirement
  - Aging of the Baby Boom generation
- **Economic pressures:**
  - Labor force issues: critical shortages of qualified workers
  - Financing retirement: inadequate personal savings; pension coverage shortfall; pressure on Social Security
- **One possible solution: inducing people to work longer.**

## *Is longer work feasible?*

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- **Work is less physically demanding.**
- **Age at retirement now rising?**
- **Increasing interest in continued work.**
  - AARP study, *Staying Ahead of the Curve* (2002)
- **Need for health care benefits.**
- **Shift to defined contribution plans with “do it yourself” (401k) funding and self-directed investments.**
  - Retirement income more exposed to stock market risk
  - Increased vulnerability to market downturns
  - Postponed retirements and returns to work?
  - Center for Retirement Research study, *Are Older Workers Responding to the Bear Market?* (2002)

# ***Wanted: flexible work arrangements.***

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- **In an ideal world, phased retirement programs would:**
  - Facilitate a gradual transition to full retirement through adjusted work hours and responsibilities
  - Provide flexible compensation and benefits structures
  - Provide employers with reasonable and predictable costs, minimal administrative responsibilities, and legal protection from age discrimination claims
  - Enable employees to make informed decisions about participation
  - Maintain current law protections for older workers, especially for those who work out of financial necessity

## ***The reality.***

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- **Employers express interest in phased retirement but only a small minority try to implement it.**
- **There is no uniform model for current employees.**
- **Rehiring retirees for part-time and temporary work is the most common arrangement.**
- **Private employers lag far behind public and not-for-profit employers in sponsoring phased retirement programs.**

# ***Obstacles to phased retirement programs.***

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- **The Internal Revenue Code.**
  - Anti-discrimination rules limit flexibility in plan design
  - Restrictions on in-service payments from plans
  - Irrational tax treatment of distributions
  - Disincentives to continued work in defined benefit plans
  
- **ERISA.**
  - Age and service rules
  - Uniformity and standardization in treatment of employees and benefits
  
- **The Age Discrimination in Employment Act.**
  - What is a “bona fide employee benefit plan?”
  - When does a plan which satisfies the tax code and ERISA discriminate on the basis of age?

# *Maneuvering around the obstacles.*

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- **Make individual arrangements.**
  - Ability to retain employees with specialized skills and expertise
  - Flexibility in structuring work arrangements, choosing eligible employees and setting pay
  - But at some point there's a "plan"
- **Offer reduced hours or work schedules to a larger group.**
  - It's not a "plan."
  - But part-time work, without more, is not always an attractive option.
- **Adopt a broad-based program.**
  - Minimizes legal liability under ADEA and state law.
  - Creates a design nightmare.

## *Examples of design obstacles.*

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- **In its retirement plans, can an employer**
  - Provide special increased benefits in its retirement plan for phased retirees?
  - Limit the program just to employees in certain jobs or with years of service?
  - Require phased retirees to retire fully after 5 years?
  - Make distributions from a db to supplement pay?
  - Make distributions from a dc to supplement pay?
  - Stop accruing benefits or making contributions for phased retirees?
  - Require phased retirees to waive participation in plans?
  - Permit phased retirees to choose between plan participation and increased pay?
  - Promise to pay phased retirees more after full retirement but not through its plan?
  - Promise to pay phased retirees more now?

## ***Other employer alternatives.***

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- **Hire retirees only.**
  - Attract employees with specialized skills and expertise
  - Flexible employment arrangements
- **But benefit plans can be problematic.**
- **Issues with your own retirees – “retire/rehire.”**
- **Consulting contracts – misclassification issues.**

# ***Risks for employees.***

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- **Protecting pension expectations.**
  - Problems with final average pay plans – what are the rules?
  - Restrictions on payments from pension plans
  - Suspended benefits
- **Drawbacks of reduced hours.**
  - Loss of health insurance?
  - Loss or reduction in life and disability insurance?
  - Less paid vacation time?

# ***Policy recommendations.***

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- **Regulatory guidance.**
  - When does a bona fide termination of employment occur?
  - How is final average pay calculated for part-time employees?
- **Statutory changes.**
  - Permit distributions from pension plans before normal retirement age?
  - Permit distributions from 401k plans before age 59 ½?
  - Liberalize pension distributions after normal retirement age?
  - Rationalize the penalty tax regime?
  - Provide employees with more benefits information near retirement age?

## ***Probably a special statute is needed.***

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- **The precedent for early retirement programs.**
  - Similar legal issues: uniform benefits; employer discretion; ADEA concerns
  - A compromise solution:
    - Participation is voluntary
    - Minimum age and service requirements permitted
    - Plan can be short-term
    - Only select employees are eligible
    - Older workers are protected

## ***An example from academia.***

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- **The Higher Education Amendments to ADEA in 1998 created safe harbor phased/early retirement plans for faculty.**
  
- **The faculty member works part-time but receives:**
  - Enhanced benefits
    - DC contributions or DB accruals based on full-time work
    - Healthcare contributions based on full-time work
  
  - Enhanced pay
    - 60% pay for 50% work

# *An example from government.*

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- **Deferred Retirement Option Plans (DROP plans).**
- **Employees set a future retirement date and work part-time.**
  - Benefit accruals under the DB plan cease.
  - Benefit payments begin but are held in a separate DC account.
  - DC accounts earn interest and, often, a cost of living adjustment.
  - Some employers contribute to the account too.
- **At retirement, employees receive**
  - A lump sum distribution from their accounts
  - Annuity payments from the DB plan.

## ***Basic elements of a statute.***

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- **Some suggestions:**
  - ADEA protection for employers
  - Some exemption from qualified plan compliance rules
  - Standardized “core” benefits
  - Minimal administrative structure
  - Short-term plans
  - Flexible eligibility criteria – both age and service
  - Disclosure and informed consent standards for employees

## ***Some additional features.***

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- **Permit safe harbor benefits and plans.**
  - Permit innovative plan designs such as DROP plans
  - Permit special plans and benefits packages just for phased retirees.
- **Add flexibility to existing plans for post-normal retirement age work.**
  - Add late retirement features to db plans
  - Exclude phased retirees from 401k testing
- **Add incentives for both employers and employees.**
  - Create a basic benefits package – with alternatives
  - Provide an exemption from non-discrimination testing for such plans

## ***A longer-term issue.***

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- **It's not age; it's part-time work.**
- **Flex-time, tele-commuting, just-in-time workers are here but ERISA can't cope.**
- **Revise ERISA for the 21<sup>st</sup> century.**
- **Phased retirement programs can serve as a model.**