

# RPPTL Employee Benefits Group Workshop

*ABA Tax/RPPTL Fall 2005 Joint CLE Meeting*

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## Phased Retirement & Other Strategies for Retaining or Attracting Older Employees

**Peter M. Kelly**  
Chicago, IL  
RPPTL Employee Benefits Group Chair

**Friday September 16, 2005**  
San Francisco, California

# Session Highlights

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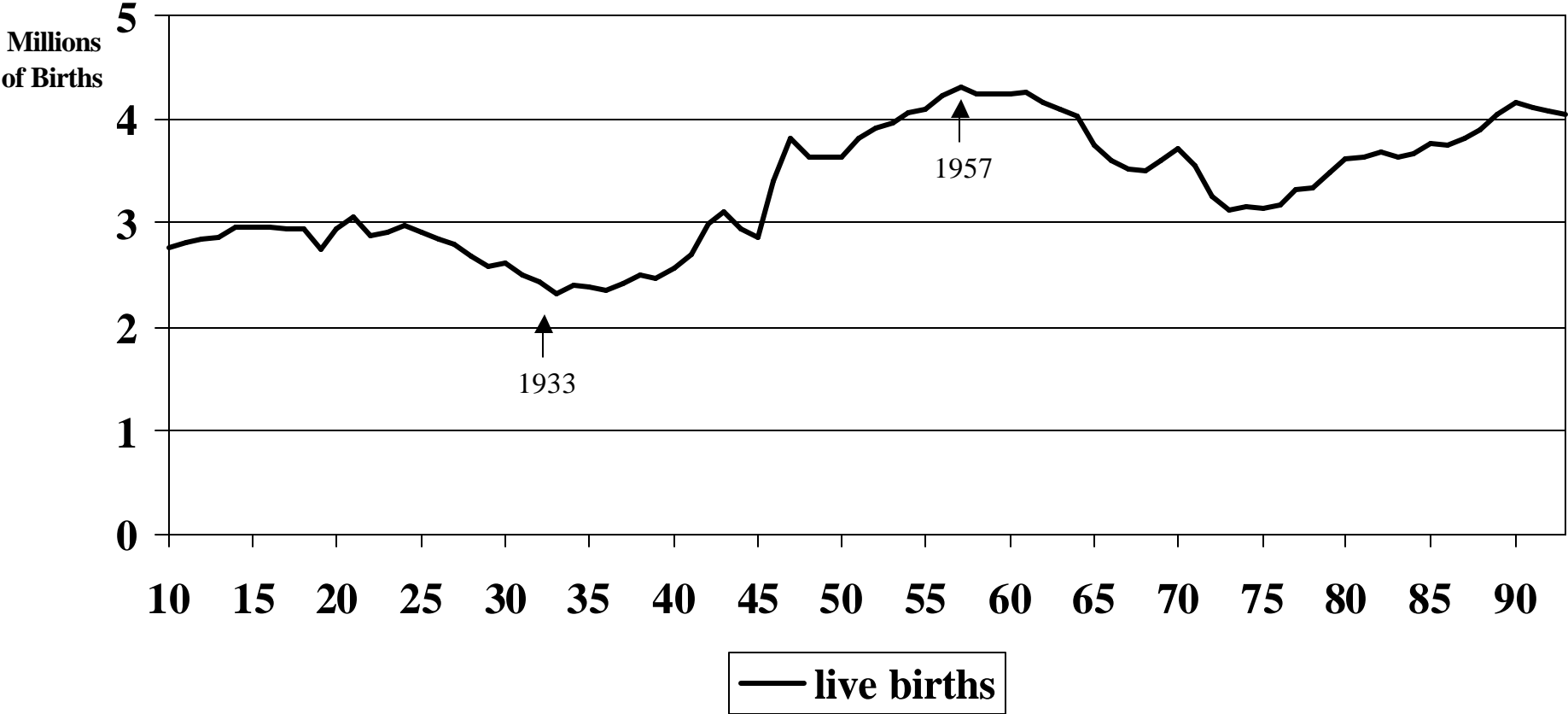
- Situation Analysis
  - Demographic Trends
  - Older employees' retirement intentions
- Legal Constraints
  - Pension rules
  - ADEA
- Impact of Retirement Plan Design on Older Employee Retention
  - One size does not fit all
  - Circumstances & plan designs that may frustrate or foster desirable retention

# Demographic Trends

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- Paradoxically, due to their numbers (apx 78 million) Boomers will swell both retiree ranks & ranks of the working aged
- Dependency ratio increasingly unfavorable
  - Shift due to abruptness of change in relative sizes of 3 generations
    - Pre-Boomers (1925-1945) : lowest birth rate in a century
    - Boomers (1945-1965) : highest birth rate in a century
    - Post Boomer (1965-1985): birth rate only appears low compared to Boomers
- Over 55 Share of Workforce Dramatically increasing

# Live Births in USA



Source: Census Bureau

# Do Employers and Older Employees Have Mismatched Expectations?

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- Unstated Employer Value Proposition
  - Older employees perceived as more costly
    - Younger workers seen as adding more value
  - Older workers should be given an incentive to leave
    - Benefit plans encourage early retirement
    - Exit packages conditioned on ADEA waivers
- Some Boomers offer an alternative Value Proposition based on an entirely new paradigm
  - Boomers face a future of extended good health
  - Significant shift in attitudes
    - In significant numbers, Boomers with valuable experience & strong desire to remain active are beginning to “retire” retirement

# Retiring Retirement

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- Boomer attitude shift favoring working past retirement age
  - Complex web of motives
    - Inadequate savings or desire for more retirement security
    - Loss of retiree health safety net
    - Continued good health & extended life expectancy
    - Evidence of health benefits from continued activity

# Measuring Tax Qualified Defined Benefits

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- Regardless of payout time & method, DB benefit measured with reference to normal retirement age
  - actuarial adjustment for different payment methods
  - actuarial reductions for early payment
- Benefits continue to accrue if remain employed past normal retirement age
  - But may cap accrual service (e.g., 30 years)
- Can give retirement incentive by “subsidizing” early retirements (i.e., either lesser or no actuarial reduction)

# Paying Tax Qualified Defined Benefits

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- DB distribution restrictions (based on pre-ERISA IRS regs)
  - May only pay benefits on account of:
    - (i) retirement; (ii) termination of employment; (iii) disability; (iv) death; or (v) plan termination
  - In-Service distributions to participant
    - Only permitted upon attainment of normal retirement
    - Requires express plan provision
    - Highly unusual in past until 70 ½ mandate; many plans kept 70 ½ exception after mandate removed)
- QDRO alternate payee exception
  - plan may permit in-service payments
  - plan must allow after earliest retirement age after age 50

# IRS Phased Retirement Proposal

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- Pre-normal retirement age in-service distributions if:
  - Written phased retirement program
  - Participation Limits
    - Volunteers who could retire if they quit
    - key employees ineligible
    - Non-discrimination rules apply
  - Prorated partial distributions permitted after 59 ½ up to limit
    - Portion of full benefit (% reduction in normal work schedule)
  - Treated as partially retired
    - at least 20% reduction in hours
  - Accrual & final pay updates for full “imputed” service & earnings

# ADEA Prohibitions

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- Age Discrimination & Employment Act (“ADEA”)
  - Protects employees over age 40 from discrimination based on the fact that they are older than other employees
    - Protects roughly one-half of all employees
  - Age related prohibitions
    - Failure or refusal to hire
    - Discharge
    - Other age discrimination in compensation or in terms, conditions or privileges of employment
    - Segregation or classification in manner that deprives or tends to deprive of opportunity or otherwise affect adversely
    - Wage reduction to comply with costs of ADEA

# ADEA Burden of Proof Developments

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- Policies/practices not overtly targeting age
  - May be flawed if “disparate impact” on older employees
- Recent Supreme Court Expansion of ADEA
  - intent not part of burden of proof if employees:
    - Prove disparate impact
    - plus
    - Show nexus between impact & a specific practice

# Selected Age Discrimination Exceptions

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- Top Executive exception
- Bona Fide Employee Benefit Plan exception
- Older Workers Act ADEA waivers in exchange for benefit & other enhancements
- Early Retirement Incentive Rules

# Interplay Between ADEA & ERISA

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- Age discrimination policy changed ERISA
  - Mandatory retirement
    - initially ADEA only outlawed pre-70, now any age
    - Accrual cessation based on age prohibited
  - Post 70 ½ required actuarial adjustments
- ERISA policies changed ADEA
  - Interplay between ADEA Bona Fide Employee Benefit Plan & ERISA has the effect of permitting:
    - Cost justified benefit variance
    - Service based caps on accrual
    - Age based normal retirement benefit formulae
    - HCE restrictions that impact older employees

# Stubborn Perception Older Employees are Disfavored

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- Skepticism a full generation after ADEA enacted

“Employers do discriminate. And they continue to do so even though there have been numerous studies and books and articles about how important it is to overcome that prejudice ever since the implications of the coming retirement of the baby boomers have become clear. I know all about that because I’ve written one of those books explaining ways to keep older workers in the workforce. But the barriers to rewarding employment after fifty remain in place and show no sign of disappearing.”

Beverly Goldberg, Let’s Get Real About the Working Old, News & Commentary, The Century Foundation (June 21, 2005), available at [www.tcf.org](http://www.tcf.org).

# Revisit Central Question: Do Employers and Older Employees Have Mismatched Expectations?

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# Employers' Goals & Concerns

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- Continued access to talents & efforts of dedicated employees of any age for “long haul”
  - Presumption that older employees may not remain available
    - Pension caps and early retirement incentives may frustrate this goal once these “plateaus” have been achieved
  - Presenteeism concern
    - Benefit plateaus not yet satisfied may be a contributing factor

# Impediments to the New Paradigm

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- Legal barriers to removal of old incentives
  - Back loading restrictions
  - Nondiscrimination rules
- IRS Phased Retirement regulations too modest
- Decline in traditional low cost defined benefit plans just when they are needed most
  - Much of the decline may be attributed to:
    - Too much success in past efforts to make DB plans more like DC plans
    - Generous early retirement incentives
    - PBGC premium increases
    - Funding restrictions

# Practical Insights Founded on Recognition of Individual Differences

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- Older Employees & applicants not homogenous
  - Old presuppositions remain accurate as applied to some
    - Sheer numbers of new retirees mask other trends
      - Viewed in isolation support stereotypes of the old
  - But large & increasing number wishing to remain fully engaged is the real story of the boomer generation
    - Significant shift suggests stereotypes no longer broadly valid
    - Shift is the challenge and opportunity we address today
- Older Employees attitudes/aspirations depend upon individual values, lifestyle, health and financial circumstances

# What do Older Employees Want

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- Health Insurance goals
  - Prime Concern: keeping coverage until Medicare eligible
- Income Security
  - Maintain pre-retirement age income
  - Retirement Income goals
    - Sufficient retirement assets or retirement income for immediate future
    - Long term income sufficient to address superannuation & inflation risks
- Lifestyle & health goals (one size does not fit all)
  - Continued full-time work (related or different field)
  - Full time leisure
  - Blend of reduced work & increased leisure

# Feasibility of Post-55 Lifestyle Goals

Where Your Employees Fit on the Grid Suggests Relevant Strategies

<p>All leisure (retired) + Sufficient pension &amp; retiree health benefit</p> <p><b>Goal Feasible</b></p>	<p>Reduced Work Hours + Sufficient pension &amp; retiree health benefit</p> <p><b>Work goal depends on Employer &amp; Phased Retirement would help</b></p>	<p>Full-time Work + Sufficient pension &amp; retiree health benefit</p> <p><b>Work goal depends on Employer &amp; Phased Retirement option appreciated but not critical</b></p>
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# Feasibility of Post-55 Lifestyle Goals

Retention Focus on Productive Older Employees who Wish to Contribute

<p>All leisure (retired) + Sufficient pension &amp; retiree health benefit</p> <p><b>Goal Feasible</b></p>	<p><b>Reduced Work Hours</b> + <b>Sufficient pension &amp; retiree health benefit</b></p> <p><b>Work goal depends on Employer &amp; Phased Retirement would help</b></p>	<p><b>Full-time Work</b> + <b>Sufficient pension &amp; retiree health benefit</b></p> <p><b>Work goal depends on Employer &amp; Phased Retirement option appreciated but not critical</b></p>
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# Feasibility of Post-55 Lifestyle Goals

## Older Employees Hired Recently

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# Feasibility of Post-55 Lifestyle Goals

## Biggest Risk of Older Employee Presenteeism

<p>All leisure (retired) + Sufficient pension &amp; retiree health benefit</p> <p><b>Goal Feasible</b></p>	<p>Reduced Work Hours + Sufficient pension &amp; retiree health benefit</p> <p><b>Work goal depends on Employer &amp; Phased Retirement would help</b></p>	<p>Full-time Work + Sufficient pension &amp; retiree health benefit</p> <p><b>Work goal depends on Employer &amp; Phased Retirement option appreciated but not critical</b></p>
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# Feasibility of Post-55 Lifestyle Goals

Phased Retirement will Likely Only Attract Certain Employees

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# Feasibility of Post-55 Lifestyle Goals

## Typical Goals of Long Service Older Employees

<p>All leisure (retired) + Sufficient pension &amp; retiree health benefit</p> <p><b>Goal Feasible</b></p>	<p><b>Reduced Work Hours</b> + <b>Sufficient pension &amp; retiree health benefit</b></p> <p><b>Work goal depends on Employer &amp; Phased Retirement would help</b></p>	<p><b>Full-time Work</b> + <b>Sufficient pension &amp; retiree health benefit</b></p> <p><b>Work goal depends on Employer &amp; Phased Retirement option appreciated but not critical</b></p>
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# Plateau Effect of Typical 30 Year Service Cap

## Same Benefit at 30 & 35 Years of Service

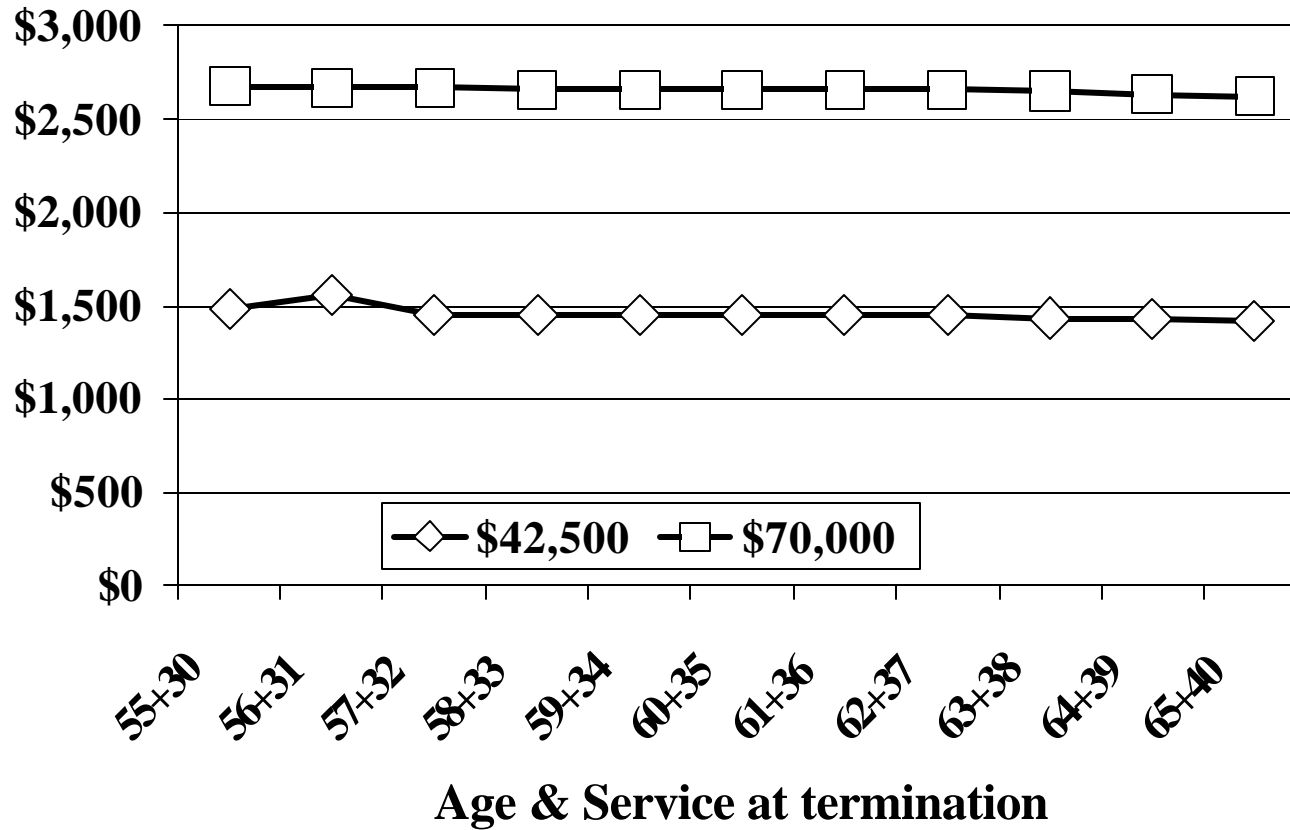
	(1)	(2)
FAE*	\$70,000.00	\$70,000.00
<b>Service</b>	<b>30</b>	<b>35</b>
<b>Age at Termination</b>	<b>57</b>	<b>57</b>
Age at Commencement	57	57
Age 65 SSB**	\$20,484.00	\$20,484.00
FAE	70,000.00	70,000.00
Times 60%	X <u>60%</u>	X <u>60%</u>
	\$42,000.00	\$42,000.00
Less 50% Age 65 SSB	- <u>10,242.00</u>	- <u>10,242.00</u>
Annual Benefit	\$31,758.00	\$31,758.00
Times Service Fraction (yrs./30)	X <u>30/30</u>	X <u>30/30</u>
Annual Age 65 Lifetime Benefit	\$31,758.00	\$31,758.00
Monthly Age 65 Benefit	2,646.50	2,646.50
<b>Early Retirement Reduction Factor</b>	<b>X <u>.6000</u></b>	<b>X <u>.6000</u></b>
Monthly Benefit Commencement	\$ 1,587.90	\$ 1,587.90
Early Retirement Reduction method	8% / 4%	8% / 4%
	(55-62)	(55-62)

\*FAE = Final Average Earnings \*\*SSB = Annual Social Security Benefit

# Plateau Effects of 30 Year Service Cap

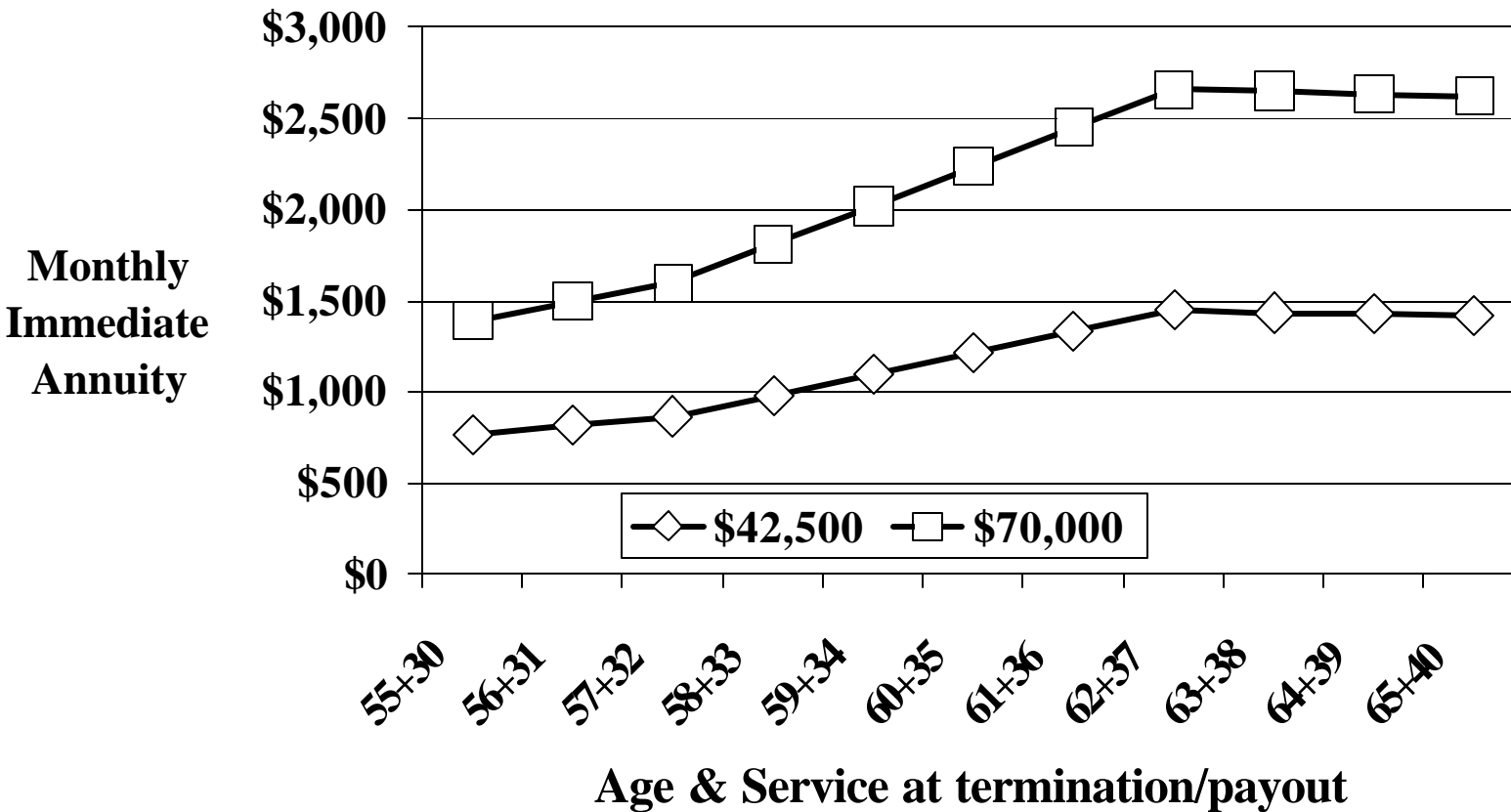
Age 65 Annuity Earned at 2 Steady Final Pay Levels (\$42,500 & \$70,000)

Monthly  
Age 65  
Annuity



# Plateau Effect of 30 Year Service Cap

Monthly Immediate Annuity at 2 Steady Final Pay Levels (\$42,500 & \$70,000)



# Typical Experience Replacing Productive 30 year Employee Age 55

	<b>Retain</b>	<b>Replace</b>	<b>Typical Outcome of Replacement</b>
<b>Salary</b>	Pay incumbent	Pay 1 or more FTEs	May or may not be a savings; depends on skills, recruiting costs & salary demands
<b>DB</b>	Accrual continues unless capped; Final Earnings increase	DB accrual for replacement(s) (?)	Cost often less; new employees may not even be eligible for DB; some savings may be offset in part if incumbent eligible for DB early retirement incentives
<b>401(k)</b>	Matching contribution	Matching contribution for replacement(s)	May or may not be a savings
<b>Health cost</b>	Cover incumbent	Cover replacement(s) + retiree health for incumbent 10 years until 65	Increased costs if cover incumbent either way
<b>Life &amp; LTD</b>	Cover incumbent	Cover replacement(s) + retiree life for incumbent	Increased costs for life; slight increase in LTD incidence for incumbent offset by duration risks for younger replacements <sup>28</sup>

# The Future

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- Older employee incentives are in their infancy (no pun intended)
  - Developing on the run
  - New practices represent an abrupt about face
    - Old practices/rules reflect very different assumptions about desirability of maintaining employment bond with older employees
- Money is fungible
  - Phased retirement objective may be satisfied from other sources
  - Example: DC Plans that qualify as profit sharing plans
    - Post-59 ½ In-Service Distributions may be as available or unavailable as the plan design permits
    - Most 401(k) plans are profit sharing plans