EARLY RETIREMENT

Time is on our side

Research shows early retirement on the decline; programs must be well-communicated to maintain viability for future workers

BY **ANDREA DAVIS**

In its annual retirement confidence survey released last year, the Employee Benefit Research Institute found that 20% of workers intend to retire at a later age than they had planned. Of those who said they will retire later, the main reasons cited were the poor economy, a lack of faith in Social Security or the government, a change in employment situation or, simply, that they can't afford to retire.

Given the economic upheaval many employees have faced in recent years, the decision to delay retirement is perhaps not a surprising one. But for employers with defined benefit plans, there may be times when offering employees a voluntary early retirement program makes sense, both financially and from a workforce management perspective.

"Early retirement programs are still very viable from a defined benefit perspective. It's possible for companies to implement them and achieve workforce management strategies through them," says Phil Oreto, director of defined benefit services with The Standard. "That said, we're seeing much less activity there in the past several years than there was, say, 10 to 15 years ago."

As the pension landscape has generally shifted away from DB plans because of the market volatility and costs associated with maintaining them, so too have employers shifted away from offering early retirement windows because they can be expensive both from an immediate cash perspective and an accounting perspective. In particular, the low interest rates of recent years have made DB plan management more difficult because costs have spiked, even without adding in the extra costs of benefit enhancements such as early retirement programs.

The Pension Protection Act of 2006 created certain restrictions on benefit enhancements and funding those benefit enhancements, says Oreto, and "I think that worked against employers offering these types of programs because there can be situations where, because of the funded status of the plan itself or the structure of the plan, the ability to offer these is restricted under the funding rules."

Plans that are less than 80% funded aren't allowed to enhance benefits, so if an employer wants to consider offering an early retirement window as a way to reduce its workforce, the plan must be at least 80% funded. "The alternative is that the plan must be able to immediately fund the cost of the window, which is likely to be prohibitive," says Oreto.

Another hurdle is that even if the plan is funded well enough to enact an early retirement window, the cost of doing so must be paid over a seven-year period. "That's a fairly short amount of time in comparison to the mid-2000s, when something like this could be funded over 30 years," notes Oreto. "So [plan sponsors] really need to consider that impact of cost, in addition to the volatility around that cost."

If going down this path is something the plan can afford, the program must be written into the legal plan documents. "It needs to clearly define who is eligible for the program and who is not," Oreto says. "And you need to make sure that whatever program you're going to roll out is nondiscriminatory and passes all the necessary testing requirements — IRS testing requirements — to make it a nondiscriminatory program."

Oreto works with some employers — mainly credit unions — who still maintain DB plans and implement early retirement windows as a viable workforce management strategy.

"The credit unions we work with are typically well over 100% funded and, in fact, they pre-fund benefits," he says. "So they have dollars in the plan that aren't assigned to any benefits yet, so to the extend they need this tool to manage their workforce, we've seen that be very effective."

Other industries such as health care, for example, might not "see this as a viable solution because they're typically looking to retain late career talent and phase them into retirement, rather than move them out faster," he adds.

Ken Himmler, president of Integrated Asset Management, worked with a local school system in Florida years ago to implement an early retirement program for teachers. "One mistake we made is we were too confident in the ability of teachers to understand what it meant for them," he recalls. "Initially we thought they'd be able to understand the benefit to this and the present value of these lump-sum payments and the ability for them to go and find other employment or to get rehired but without the same benefit, when they really didn't understand it. They weren't financial experts."

Himmler's experience points to the importance of communicating these programs in a way that's easy for employees to understand. But unlike other benefits initiatives where the "communicate early and often" mantra is important to the program's success, in the case of early retirement windows, it's best to keep them under wraps until you're ready to roll it out.

"You want to involve the key decision-makers and key players within the company and the appropriate consultants outside the company, but as far as internal communications, the best plan is to have a good communications strategy and have all the right people in the know and then roll it out all at once," says Oreto. "The last thing you want is to have people come back and question their decision to retire two days before the window or something like that."

In communicating the program, plan sponsors may even want to go beyond presenting the financial implications of taking early retirement to eligible employees. Brooks Mosley, president of Independent Pension Solutions, says there's a huge emotional component to retirement that many workers don't contemplate.

"If you're one of those people who happen to be offered a package — even if it's a really good package and you think you can get by financially — if you do not have something to do with your life, I personally think it's a mistake to take that," he says. "People who've been working their whole lives can actually see their quality of life go down because they don't feel like they're being productive." ■

Top 10 priorities for DB sponsors

Offering an early retirement window didn't rank as one of plan sponsors' priorities for 2012; rather, volatility and funding concerns were top of mind for DB plan sponsors, according to a recent poll conducted by SEI.

The poll surveyed 50 executives overseeing U.S. corporate DB plans that range from $25 million to $10 billion in assets. Here's a list of their main priorities:

1. Controlling funded status volatility.
2. Improving the plan's funded status.
3. Managing duration moving forward.
4. Implementing a liability-driven approach using long duration bonds.
5. Providing senior management with long-term pension strategies.
6. Stress-testing the portfolio to gauge its ability to withstand extreme macroeconomic environments.
7. Conducting an asset-liability study.
8. Implementing an asset allocation process aimed at exploiting shorter-term market inefficiencies to add return and/or mitigate risk.
9. Changing funding policies and timelines.
10. Defining fiduciary responsibilities for trustees and investment consultants.