Recent developments in benefits, such as the Affordable Care Act and a shift toward defined contribution plans, have reduced employers' challenges in offering phased retirement.

by | **Allen T. Steinberg**

Rethinking Phased Retirement

Over the past decade, interest in phased retirement has ebbed and flowed, following the path of the U.S. economy. During the stock market boom that preceded the Great Recession, employers were eager to retain experienced skilled employees—But these employees were more interested in complete retirement and were emboldened by high 401(k) balances and the "wealth effect" created by high real estate values. Following the stock market crash of 2008 and the ensuing recession, employees were feeling less secure about their retirement resources, and employers felt far less need to adopt programs to retain employees.

takeaways >>

- A survey found more than half of employers are concerned that an upcoming increase in retirements will create shortages of key skills.
- Before considering a phased retirement program, an employer needs to identify its HR and workforce management needs and define its objectives.
- Defining the targeted group is very important to developing a phased retirement plan.
- A formal phased retirement plan gives the employer the ability to publicly define the criteria for eligibility.
- Phased retirement programs can raise issues for DB plan sponsors, including providing ongoing accruals, definitions of *final pay,* access to early retirement subsidies and lump-sum payments, and nondiscrimination requirements.
- The Affordable Care Act makes individual health care coverage more attractive.

With gains in both the stock market and the overall economy, and with more baby boomers reaching traditional retirement age, there seems to be renewed interest in phased retirement. And this increased interest may be mutual, reflecting both employer and employee desires. A recent survey found that 53% of employers are concerned that an upcoming increase in retirements will create shortages of key skills (including 24% who are "very concerned").[1] Another survey, sponsored by the Society of Actuaries, concluded that 53% of preretirees anticipate gradually decreasing the number of hours they work as a transition to retirement.[2]

This article will review some key issues regarding phased retirement and look forward to assess whether it might be time for a renewed focus on the potential value of phased retirement programs.

Perspective and Definition

Phased retirement has no specific legal definition. It may mean something different to an individual worker (such as leaving full-time employment to take a part-time job elsewhere) than to an employer (looking to phased retirement as a vehicle to retain skilled workers who might retire or otherwise leave). So some definitions and a point of view are in order.

Employees nearing their desired retirement age have always had the ability to leave full-time employment and seek part-time employment elsewhere. From employees' perspective, this is phased retirement.

However, this article will consider phased retirement from the perspective of employers, which might be interested in retaining experienced workers with key skills—workers who might be in a position to "retire" from their current employment and whose retirement would represent a loss of talent to the employer.

I define phased retirement through a historical lens. In the era dominated by the defined benefit (DB) plan, the traditional notion of retirement was that individuals were employed full-time, ceased employment and were then retired full-time. Phased retirement creates a new status between full-time employment and full-time retirement—a status of partial employment/partial retirement. Moreover, from the employer's perspective, that new status is attained by retaining current employees and having those employees voluntarily seek this new status.

Although this article views phased retirement from the employer perspective, it is also important to focus on some larger implications of phased retirement. Today's 65-year-olds will live, on average, until the age of 85, and an increasing number of them will live until the age of 90. Extending engagement in the workplace may provide intellectual, social and emotional benefits for individuals. Extending a career can help individuals defer commencement of Social Security benefits (allowing them to increase their monthly benefits upon commencement) and allow additional accumulations to finance postretirement health care costs. So, if phased retirement is a win/win, what do employers need to think about before proceeding?

Some Considerations

Earlier discussions about phased retirement were often caught up in discussions about employee benefits—particularly questions about payments and accruals under DB pension plans. See, for example, Internal Revenue Service regulations proposed in 2004 offering partial, pro-rata pension payments for individuals who reduced employment with the plan sponsor.[3] However, qualified plan issues should not lead discussions of phased retirement. Rather, it is important first to identify an employer's human resources (HR) and workforce management needs and define the employer's objectives. The following are some specifics that should be understood before considering qualified plan compliance.

What Are the Employer's Talent Concerns?

Typically, phased retirement programs are not about providing incentives to all employees near retirement age to stay. Rather, employers are likely to have a segment of the workforce that is the focus of any phased retirement discussions. This can cover a wide range of key skills—I have had conversations with employers concerned about engineers, sales staff, accountants, client managers and utility field workers. Defining the targeted group is very important to developing a phased retirement plan.

Also, employers have different timing needs. Some employers want to keep these phased retirees indefinitely, while others are more concerned with training and knowledge transfer over a more limited time frame.

What HR Programs Are Already Available?

Over the past few decades employers have adopted a range of programs and policies to facilitate part-time employment. Many of these programs were "branded" as tools to support employees with child-care or elder-care responsibilities. However, the same part-time program adopted for employees with these caregiver responsibilities can work perfectly well as a framework for phased retirement.

Formal or Informal Approach?

Some employers seek to create formal programs defining the criteria and parameters of their phased retirement programs. Other employers prefer a more casual approach, based on individual conversations. There are pros and cons to both approaches, but from a legal perspective it is preferable to have clearly communicated parameters governing a phased retirement program. In particular, this avoids the potential age discrimination claims that may emerge if an employer targets individuals for phased retirement discussions.

If a formal approach is used, the employer has the ability to publicly define the criteria for eligibility into the phased retirement plan. Key criteria can include:

- Defining specific departments and job classes covered
- Age and service requirements
- Minimum standards on recent performance evaluations
- Manager consent
- Knowledge transfer requirements.

What Are the Work Schedule and Other Terms for Phased Retirements?

Phased retirement can be implemented in a number of ways, such as reduced weekly hours, extended leaves of absence and telecommuting. The schedule should reflect the nature of the employer's business and the roles of phased retirees.

Also, phased retirement can be open-ended in duration or can be for a finite length of time. The retiree and employer must also agree to the employee's status at the end of this term, with some employers treating the expiration of the term as a voluntary termination of employment.

Is There Buy-In From Leadership?

The greatest challenge to adopting a phased retirement program may be the reluctance of leadership to embrace phased retirement as a valuable HR initiative. It is critical that an organization's leadership is on board with phased retirement—and conveys that message to the rest of management. And employees need to understand that they will not be stigmatized or shunted off to less desirable opportunities if they move to phased retirement.

Employee Benefit Plan Issues

Once these basic issues are addressed, it is time to introduce the employee benefits design and compliance discussion. It should be emphasized that recent developments have reduced the challenges posed by employee benefit plan rules.

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Rick Garnitz. LifeSpan Services. 2011.
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DB Plan Issues

There is an inherent tension between the employment paradigm behind DB plans and phased retirement. This is true even with changes to the law allowing in-service distributions to employees who have attained the age of 62 (under Code Section 401(a)(36)). Pensions typically are designed around the old retirement paradigm: A person works full-time, leaves work and is retired full-time. As a result, phased retirement programs can raise a number of issues for DB plan sponsors. These issues can include providing ongoing accruals to phased retirees, definitions of *final pay*, access to early retirement subsidies, access to lump-sum payments and nondiscrimination requirements.

However, the decline of the DB plan means that most employers do not even need to deal with DB issues in designing a phased retirement plan. (And, a word of advice to employers that have ongoing DB plans: Leave the DB plan alone in designing a phased retirement plan. Rather, treat phased retirees the same as any other part-time employees for DB plan purposes.)

DC Plan Issues

The 401(k) plan (or 403(b) plan, if appropriate) is well-situated to support a phased retirement plan. Employer contributions—typically a percentage of employee pay or employee deferrals—automatically adjust to decreases in pay caused by the shift to phased retirement. Under a defined contribution (DC) plan, phased retirees can decide whether they need any DC resources to supplement their regular income; the partial paycheck received in phased retirement may be sufficient for an employee's needs, and there is no need for the employer to define any particular level of distribution.

If phased retirees do seek to supplement their paycheck, in-service distributions can be offered (without tax penalty) at the age of 59½ (rather than the 62 Rule imposed on DB plans under Code Section 401(a)(36)). Also, in-service distributions offered to a broad (nondiscriminatory) class of participants can be accessed by phased retirees—with none of the compliance issues raised by DB plans.

Health Care

Historically, health care has been a challenge in developing phased retirement plans. Employers were reluctant to offer phased retirees (who have transitioned from full-time employment into some form of part-time status) the same subsidy as full-time employees. At the same time, retiree medical programs (where available) were not really well-suited for phased retirees.

Under the Affordable Care Act (ACA) employers are even less eager to offer health care to part-time employees—any part-time employees—based on concerns about employer mandates and the requirement that employer-sponsored health care be "affordable." However, individual coverage is now much more attractive. Under ACA age-rating bands (limited to a maximum 3:1 ratio), insurers will not be able to charge an adult aged 64 (or older) more than three times the premium they charge a 21-year-old for the same coverage. ACA also offers federal tax subsidies to individuals with income under 400% of the federal poverty level and eliminates restrictions based on preexisting conditions. This means that employers can direct phased retirees (who are no longer eligible for employer coverage) to purchase individual coverage. Both employers and employees will need to consider premium costs in developing the phased retirees' total compensation package.

There is no single employee benefit plan "formula" to support a phased retirement program. However, there is sufficient flexibility to allow employers to create a formula that works for them.

The Federal Government: A Trendsetter?

As employers consider phased retirement, it should be noted that the federal government has also started down this path. The Moving Ahead for Progress in the 21st Century Act (MAP-21), Public Law 112-141, authorizes the director of the Office of Personnel and Management (OPM) to implement a phased retirement program for federal employees, and in June 2013 OPM issued proposed regulations governing this phased retirement program.[4] The federal government's approach to phased retirement covers a number of issues that should be addressed by any employer considering such a program, for example:

- **Eligibility:** The federal program imposes minimum age/service requirements for eligibility (55/30 or 60/25), requires three years of full-time employment for the period immediately preceding phased retirement and excludes certain classes of employees (such as law enforcement officers and firefighters).
- **Election agreement:** Employees must apply for phased retirement and receive approval from an authorized official. The employee

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and official will then enter into a formal agreement; this agreement may specify the length of the phased retirement and that the phased retiree is considered as separating from service at the end of the term.

- **Phased percentage:** The federal program is starting with a requirement that phased retirement be defined as a 50% reduction in an employee's working percentage, although different percentages may be adopted over time.
- **Knowledge transfer:** At least 20% of the hours worked by a phased retiree must be allocated to mentoring.
- **Employee benefits:** The statute and proposed regulations also contain detailed rules governing pension, health care benefits and other benefit programs covering the phased retiree.

The federal program has not yet been implemented, and the decisions reached by OPM in finalizing these regulations may prove a helpful touchstone for other employers considering phased retirement.

Conclusion

In the right situation a properly constructed phased retirement program can truly represent a win/win for employers and employees. The challenge for employers is in identifying the right situation, developing the appropriate design and successfully implementing that design.

Endnotes

1. *Retirement Plans May Leave Employers Shorthanded,* Challenger, Gray & Christmas, available at www.challengergray.com/press/press-releases/survey-53-employers-concerned-about-retirement-plans-brain-drain.
2. *2013 Risks and Process of Retirement Survey,* Society of Actuaries, available at www.soa.org/Files/Research/Projects/research-2013-retirement-survey.pdf.
3. Prop. Reg. Section 1.401(a)-3, 69 *Federal Register* 65108 (November 10, 2004).
4. 78 *Federal Register* 33912 (June 5, 2013).