Options to Keep Employees Working Longer

Reasons Why Employees are Hard to Keep after Retirement Eligibility

In order to understand how retirement benefits can be modified to keep employees, you have to understand the incentives they have to leave. Simple economic analysis explains a large part of it, as seen in this example:

Assumptions
Age: 55
Service: 30
Salary: $50,000
Rate of salary increase: 5% per year

<table>
<thead>
<tr>
<th>Assumption</th>
<th>Keep working</th>
<th>Retire</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Salary</td>
<td>$50,000</td>
<td>? (depends on job opportunities elsewhere)</td>
</tr>
<tr>
<td>2) Employee contribution to retirement system</td>
<td>-$3,000</td>
<td>$0</td>
</tr>
<tr>
<td>3) Larger benefit due to extra year of service</td>
<td>$11,000 (approximate)</td>
<td>$0</td>
</tr>
<tr>
<td>4) Larger benefit due to increased average final compensation</td>
<td>$16,000 (approximate)</td>
<td>$0</td>
</tr>
<tr>
<td>5) Improvement in early retirement factor</td>
<td>$0 (already unreduced)</td>
<td>$0</td>
</tr>
<tr>
<td>6) One year of benefits</td>
<td>$0</td>
<td>$27,000 (approximate)</td>
</tr>
<tr>
<td>7) Total</td>
<td>$74,000</td>
<td>$27,000 + salary in another job</td>
</tr>
</tbody>
</table>

For state employees, health care is the same whether you keep working or retire and can thus be ignored.

If we assume that this individual can get a job with the same salary in the private sector or another state, then retiring provides value of $27,000 + $50,000 = $77,000 and, considering only the financials, the individual should leave. If that other job also provides accruals in a new pension, the decision may be even easier. When pay increases are minimal, the incentive to leave goes up further because the $16,000 under #4 above goes away.

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1 Present value factor is roughly 12, so value is roughly 12 x 1.82% x $50,000.
2 Benefit is roughly $50,000 x 1.82% x 30 = $27,300, so value is roughly 5% x $27,300 x 12.
The retirement benefit design can also send a cultural signal. If employees and HR staff talk repeatedly about retirement after 30 years of service, employees are likely to take that as a signal that they should leave when they hit that mark.

Of course, other factors come into play as well. The nature of the work, the people with whom you have to work, and your physical and mental ability to do the work all play a role in the decision to stay or leave. However, all of these factors are independent of the retirement benefit design.

All of the methods of retaining retirement-eligible employees work by modifying one or more of the items in the table above.

**Eliminate Unreduced Retirement Service Requirements**

Unreduced retirement can mean the age, years of service or a combination of both that an employee must meet to qualify to receive unreduced retirement benefits. This can take the form of an “x years and out” provision, which allows an employee to retire at any age or a minimum age as long as they have reached “x” years of service or a “rule of y” where the number of years of service plus age equals a specified number, “y”. For one of the requirements, North Carolina uses a “x years and out” provision that allows all employees to retire at any age after 30 years of service.

If North Carolina were to eliminate the 30 year of service retirement provision, then employees would have to wait until age 60 (with 25 years of service) or age 65 (with 5 years of service) to retire unreduced. This would change the math in the table by eliminating the $27,000 under the “Retire” column for item #6 and/or adding an amount under the “Keep Working” column for #5. This would be a powerful incentive to stay.

One system that does not have a service-based qualification for retirement is the Minnesota Teachers Retirement Association. Vested members cannot receive full retirement benefits until they are entitled to receive unreduced retirement benefits under the Social Security system, but no later than age 66. Eligibility does not depend on the number of years of service\(^1\). Several other systems have recently eliminated service-based eligibility for new hires, including Illinois, Rhode Island, Vermont, and Virginia.\(^1\)

**Change Benefit Formula to Encourage Working Longer**

Keeping the retirement benefit the same for all employees regardless of length of service discourages employees from continuing to work past retirement eligibility. Another option is to change the formula to reward employees who have a long record of service encouraging them to remain working longer.
Members of the Massachusetts Teachers Retirement System are eligible for normal retirement after 20 years of creditable service regardless of age. To encourage teachers to work longer, Massachusetts Teachers Retirement System uses a system called RetirementPlus. While all employees contribute a flat 11% of salary, participating members’ retirement benefits are increased by 2% each year, up to the statutory maximum of 80% of final compensation, for each full year of creditable service in excess of 24 years after completing 30 years of service. This method has worked to keep employees in service past the normal retirement eligibility of 20 years. The number of members that are eligible to retire (those with 20 or more years of service or age 55 and over with 10 years of service) and are still working is now 30% of the total population of active members.

This method works by increasing item #3 under the “Keep Working” column in the table.

**Implement a Phased Retirement Program**

Phased retirement allows an employee who is approaching normal retirement, to continue working, usually with a reduced workload, in transition from full-time work to full-time retirement. An example of this in North Carolina is the University of North Carolina Phased Retirement Program for Tenured Faculty.

This program allows faculty to enter into a contract to work half time for 50% of their salary during their last year of full-time employment. They must meet the following criteria to qualify:

- over age 62 if in TSERS and over age 59-1/2 if in ORP;
- tenured full-time faculty member;
- at least five years of service at the current institution; and
- eligible to receive retirement benefits either through the North Carolina Teachers’ and State Employees’ Retirement System (TSERS) or under the UNC Optional Retirement Program (ORP)

Faculty responses to a 2003 Phased Retirement Program survey indicated that the program was fulfilling its dual purposes of providing UNC faculty members an opportunity to transition into retirement gradually and improving UNC institutions’ personnel planning related to retirements. The overwhelming majority of respondents to the survey are satisfied with the program: 93% would make the same decision again, and 90% would recommend the program to colleagues.

This method works by making item #6 the same under the “Keep Working” column as under the “Retire” column, although this is somewhat offset by cutting item #1 in half.
Deferred Retirement Option Plan (DROP)

Another form of Phased retirement is a Deferred Retirement Option Plan or DROP. A DROP allows an employee to continue receiving a salary after becoming eligible for retirement while the retirement allowance that would have been paid is credited to a DROP account.

A typical DROP comes into effect when the employee becomes eligible for retirement. If the employee chooses to enter the DROP, they are usually only allowed to utilize the plan for a specified amount of time, in many cases, between three and five years. At the time of actual retirement, the employee can choose to receive the amount of money in his DROP account in one lump sum or to receive installment payments from the account. In addition, the member receives his regular monthly pension from the retirement system after actually retiring.

This method works by making item #6 under “Keep Working” the same as in the “Retire” column. While the employee is not immediately receiving the benefit, they are receiving the financial value of the benefit in their account.

Implement a Defined Contribution Only Plan

Defined contribution plans completely change the math in the table:

<table>
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<tr>
<th>Item</th>
<th>Keep working</th>
<th>Retire</th>
</tr>
</thead>
<tbody>
<tr>
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<td>$50,000</td>
<td>? (depends on job opportunities elsewhere)</td>
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<tr>
<td>2) Employee contribution to retirement system</td>
<td>-$3,000</td>
<td>$0</td>
</tr>
<tr>
<td>3) Larger benefit due to extra year of service</td>
<td>$3,000 + employer contribution</td>
<td>Employer contribution in another job</td>
</tr>
<tr>
<td>4) Larger benefit due to increased average final compensation</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>5) Improvement in early retirement factor</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>6) One year of benefits</td>
<td>$0</td>
<td>$27,000 - $27,000 = $0</td>
</tr>
<tr>
<td>7) Total</td>
<td>$50,000 + employer contribution</td>
<td>Salary + employer contribution in another job</td>
</tr>
</tbody>
</table>

Item #6 under the “Retire” column requires some explanation. In a DC plan, the employee can retire and withdraw $27,000, the same as under the DB plan. However, this $27,000 is the employee’s own money. By withdrawing it now, he reduces the value of his account and eliminates the opportunity to withdraw the $27,000 at some
point in the future, thus the net impact is $0. Another way of saying this is that the benefit was earned long ago when the contribution was made that led to the $27,000 in the account and it cannot be taken away now.

Allow Employees to Return to Work

Current North Carolina policy allows retirees who are receiving a pension check to also work for an employer in the same retirement system. This is subject to certain restrictions such as:

- a six month (TSERS) or one month (LGERS) break in service,
- no pre-existing arrangement to return,
- work in a position not participating in the retirement system
- earning restrictions.

This method works by making item #6 the same under the “Keep Working” column as under the “Retire” column, although this is somewhat offset by cutting item #1.

While this policy has Human Resources advantages such as allowing employers to only rehire the best employees, there are legal issues. The state and federal positions are that a pension is a post-employment benefit, an income replacement, to be drawn when an employee stops working for an employer which conflicts with receiving a pension while working for the same employer\(^v\). In addition to legal issues, return to work policies are expensive because employees retire earlier than expected, and are only a temporary solution to the problem as the employee will not remain under the arrangement for long.

Increase salaries for key retirement-eligible employees

This method works directly by increasing item #1 under the “Keep Working” column and indirectly by increasing item #4 under the “Keep Working” column. This policy has Human Resources advantages such as allowing employers to only offer higher salaries to the best employees.

\(\text{i} \) http://www.tra.state.mn.us/FORMSPUB/WelcomeTRABro.htm
\(\text{ii} \) http://www.nasra.org/resources/SustainabilityChanges.pdf
\(\text{iii} \) http://www.mass.gov/mtrs/2members/20active/20retpl.htm
\(\text{iv} \) http://www.northcarolina.edu/reports/index.php?page=download&id=632
\(\text{v} \) http://www.nasra.org/resources/NC%20Return%20to%20Work%20Study.pdf