

Designing a Plan for Phased Retirement



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5/12/2017

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We've all thought about it -- some are closer to that day than others. What will retirement feel like? What will it look like? How will we react to not working another day? As more and more employees contemplate these questions, many are realizing that they don't want- or can't afford - to just pack up and walk away from their jobs completely. Some employees are worried about being bored; some simply realize that with average life expectancy increasing, they need to figure out how to stretch their retirement accounts even further during retirement. A 2014 Transamerica Center for Retirement Studies survey of workers found that "most workers envision a transition into retirement during which they will continue working, reduce hours, or work in a different capacity that is less demanding and/or brings greater personal satisfaction". Only 22% expect to immediately stop working when they retire. 40% of workers plan to work part-time and 12% full-time.

But what about employers? How do they view the older employee who is nearing retirement age? Not all employers seek to keep older workers on the job. Older workers can be more costly than younger workers because of higher absenteeism, higher wages, higher pensions, and an increased use of health care and other benefits. For jobs that are physically demanding, like construction or firefighter, there may be a required retirement age, where workers are forced out of their jobs because of concerns about their health and safety. And some employers believe that older workers are less productive and that retaining them prevents younger employees from advancing in the company.



However, a 2012 National Healthy Worksite brief notes that, overall, employers have positive views of older workers. Employers report that older workers have greater knowledge of the job tasks they perform than their younger colleagues, willingly learn new tasks quickly, bring wisdom and resilience to work, and are able to keep up with the physical demands their jobs require. Many employers do not want to abruptly lose an older, experienced worker with specialized skills that are the result of many years of workplace

investment. And, a declining birth rate in the US means lower growth in the labor force, and therefore a smaller pool of potential new worker replacements.

For employers who do want to keep older workers employed for as long as they are interested in working, an alternative to the traditional retirement model of working on a full-time basis to suddenly being completely retired is to allow the employee to opt for a "phased retirement" arrangement. In phased retirement, the worker can stay engaged at work on a limited basis, which allows time for other outside interests, like volunteer work, traveling and hobbies. By continuing to work part-time, employees can retain some workplace benefits and have the ability to increase their retirement savings. According to a 2013 American Association of Retired Persons (AARP) survey of older workers, 53% cite the opportunity to gradually phase into retirement as an essential

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element of their ideal job. A 2012 AARP/Society for Human Resource Management (SHRM) survey of adults age 50+ who are employed full or part-time or who are looking for work found that formal phased retirement programs were “very important” or “somewhat important” to the majority of workers surveyed.

Phased retirement programs can vary significantly from one employer to another, depending on the type of business involved and the needs of each specific employer. Some phased retirement arrangements may involve regularly working a set number of days or hours per week; some may involve signing up for specific projects which may require a full-time work schedule for several weeks, and then several weeks of not working. Some employers have a “busy season” where the worker might be engaged full-time for a period, and then take off for many months.

According to a 2008 ERISA Advisory Council report on issues facing employers who wish to create phased retirement plans, “phased retirement can ... be viewed ... in two different directions from normal retirement age”. Some employers may allow employees to start phasing into retirement prior to the employer’s normal defined retirement age, for example, allowing an employee to start scaling back his hours at age 55 with the intention of being fully retired around age 65. Other employers might view phased retirement as working full-time up to age 65, and then working on a reduced schedule after age 65. Although some employers have implemented formal phased retirement programs, it is more common for employers to negotiate the terms of the phased retirement arrangement on an informal one-to-one basis with each worker. A 2014 Employee Benefits survey by SHRM cited that 11% of organizations offer some type of phased retirement: 4% offer a formal phased retirement program and 9% offer an informal program.

On August 8, 2014, the Office of Personnel Management (OPM) provided guidance that allows federal employees to choose a “Phased Retirement” option. According to Katherine Archuleta, OPM Director, “Phased Retirement offers an innovative alternative to traditional retirement for the 21st century workforce.” Under the program described by the OPM, workers work half-time and must spend at least 20% of their time mentoring co-workers to pass on knowledge and skills. Federal workers can fully retire at any time, or they can choose to return to a full-time work schedule, with the agency’s approval. Many experts believe that private businesses and organizations will begin to follow suit after the government’s benefit offerings.



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Businesses face many decisions regarding compensation and benefits when negotiating a phased retirement arrangement for workers. An additional area that needs to be considered is the design of the company's retirement plan. What can a Plan Sponsor do to help retirees who are considering a phased or partial retirement? There are several areas of plan design that should be reviewed. Employers that have employees who are entering into a phased retirement may want to talk to their attorney or Third Party Administrator (TPA) about the following plan design features:

- Hours requirement for contribution purposes. Many plans require a participant to work a specific number of hours in a plan year to be eligible for a profit sharing contribution (1,000 hours is the highest requirement that is allowed). For a retiree looking to phase into full retirement, 1,000 hours a year may not be that big of a burden – it basically requires someone to work about 20 hours per week. But employers will want to consider how many hours per year they expect partially retired workers to work in order to share in the contribution, and may adjust the hours requirement for the contribution depending on whether they do or do not want to provide the contribution to the partially retired employees.
- In-service distribution options. Many plans already allow distributions at age 59 ½, even for employees who are still working. However, if the plan does not allow a distribution prior to actual retirement, then the plan sponsor should consider amending the document to allow partially retired employees to be able to start taking withdrawals from the plan after a certain age or after a certain amount of service. *Keep in mind that 401(k) and safe harbor contributions cannot be withdrawn prior to age 59 ½, except 401(k) contributions may be withdrawn for financial hardship.* But other money types, like profit sharing and matching contributions, can be withdrawn prior to age 59 ½ if certain withdrawal conditions are met, usually based on years of service or the length of time the money has been invested in the plan. It might also be necessary to add installment or partial (multiple) payment options, so participants are not forced to take a complete distribution.
- Waiting periods for withdrawals. Some plans require that the employee must be terminated for a certain period of time before he can take a withdrawal. Again, these provisions may need to be amended to allow a partially retired participant to have immediate access to money from his account if he needs to supplement his income after he reduces his hours.
- Enhanced contribution formulas. Employers who want to encourage older workers to stay employed may consider changing the company contribution so that it is age-weighted to



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provide a greater percentage of compensation to older participants. This type of contribution formula does require additional nondiscrimination testing, so employers will want to have their TPA run some projections before committing to this type of formula.

- Roth deferrals. There may be tax reasons for an older participant to choose to contribute to the plan on an after-tax, Roth basis. The plan sponsor may want to consider adding this contribution option to the plan, if it is not currently available.
- Changes in deferral elections. Partially retired employees with fluctuating income may need more flexibility on how frequently they can change their deferral elections. Plan sponsors may want to consider allowing for more frequent changes to the deferral withholding election.
- Rollovers into plan. Employees who have multiple retirement plan balances from various employers may want to consolidate the accounts to allow for easier oversight. Plan sponsors will want to be sure that the plan document allows for rollovers in from other plans.
- Nondiscrimination testing. ADP/ACP testing may be impacted if older workers reduce their contributions to the plan. When an employee quits, he is no longer in the testing. But if he continues to work and reduces or stops his contributions, he will lower the average deferral rate for his testing group. If he is highly paid, that will be beneficial for testing. However, if he is not highly paid, that will hurt the test results. If there are a significant number of employees who enter phased retirement and reduce their contributions, the plan sponsor will want to monitor the testing during the year to be prepared for the potential impact. It may become more apparent to the employer that a safe harbor contribution is the best answer to testing issues.

With some creative plan adaptations, plan sponsors can assist employees as they make retirement a real possibility. Design studies are a great way to research what effects a growing older population of employees may have on the retirement plan, its function, and testing - especially when combined with a shrinking younger workforce - and can help the plan sponsor be proactive to any future issues.

Retirement plans are subject to the Age Discrimination in Employment Act (ADEA), so it is important to discuss any design changes with the plan's TPA or attorney to check for compliance



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in all areas of the law. Plan sponsors should also communicate any plan changes to the plan participants.

Partial/Phased retirement is growing in popularity. Plan sponsors can help to make this transition a reality by being proactive in their plan designs and analyzing the plan document to see the impact that the plan features have on employees in each demographic. By effectively updating the plan document, possibly only once, plan sponsors can help these new age retirees successfully transition in a comfortable manner while still reaping the benefits of their years of experience and high level of work output.



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