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The Changing Retirement Landscape

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Introduction

Older workers must determine the desired age of retirement from their career employer and whether they wish to continue working at some other job or retire completely. The timing of retirement depends on an individual's health status, family situation, household wealth, annual earnings, personal preferences, and whether they are covered by a pension plan. Throughout most of the twentieth century the retirement age of men declined; however, since the mid-1980s, labor force participation rates of older men have remained relatively constant. The proportion of older women in the labor force has always been lower than that for men. During the last half of the twentieth century, the participation rates of younger women increased rapidly. This has gradually increased the number of older women who are now deciding on retirement from career jobs. In this paper, we describe some of the important changes that have occurred in the timing of retirement and explore the reasons for the shift in retirement practices.

Employer-provided pension plans play a major role in the retirement decisions of many employees. Until the mid-1970s, most pension plans were defined benefit pensions. In these plans, workers are promised a benefit in retirement that is a function of their years of service and final earnings. These plans tend to cover all qualified employees and the company bears the investment risk associated with saving for retirement. For the past 25 years, there has been a sharp and continuing movement away from defined benefit plans and toward greater utilization of defined contribution plans. In these plans, the company and employees make periodic contributions into an individual account for the employee. Income in retirement depends on worker decisions to make contributions, the investment choices made by the individual, and a willingness to use plan funds for retirement purposes.

This change in plan type has altered retirement decisions and hence the timing of retirement for many workers. Defined benefit plans foster career employment and encourage early retirement while defined contribution plans are much more age neutral. This change has been in response to increased government regulation that raised the cost of offering defined benefit plans, shifts in employment away from large and well established businesses, and worker preferences for individual account plans that are more portable. The low levels of unemployment that have prevailed during the last five years have been created severe shortages of some types of workers, especially those with special skills. This has made attracting and retaining employees more difficult for many firms and increased their desire to retain older workers.

Since 1985, the age at which men leave the labor force has gradually increased. Women, who do not have the same histories in the labor force as men, are also gradually increasing the time when they leave the labor force. This year the first wave of baby boomers will reach the traditional early retirement age of 55. A number of employers will face a markedly older worker force and a significant talent drain if baby boomers elect to retire at early ages. The average age of employees in many utilities is in the mid-40s. Hospitals have a general nursing shortage and are concerned as many nurses near retirement age.

Individuals are choosing to leave the workforce in steps, often by retiring from one job, and taking a bridge job before leaving the labor force entirely.

Currently, few employers facilitate leaving the company in steps, but phased retirement is getting increased attention today. Often, it is viewed as a way to get people to stay on the job longer. In other cases, such as in universities, offering these programs to tenured faculty is a way to encourage people to leave. In this article, we will review basic patterns of retirement and key trends, retirement plan trends, and present the results of a William M. Mercer, Incorporated survey on phased retirement and compare these results to other national data.

Economic Determinants of Retirement

Retirement decisions are influenced by a variety of socio-economic factors. Key determinants of retirement include an individual's health status along with the health of one's spouse, children, and parents. The primary economic factors affecting the retirement age are annual compensation, household wealth, pension coverage and benefit accruals, and access to health insurance. Individual preferences for leisure activities and the onerousness of work also play a role. Research findings indicate that retirement is more likely among those with poor health, higher wealth, and relatively stable annual earnings.

Pension coverage is typically associated with earlier retirement, especially if there is coverage by a traditional defined benefit plan. These plans provide large economic incentives for workers to retire at particular ages, i.e. when the worker qualifies for early and normal retirement benefits. In contrast, defined contribution plans are more age neutral in their retirement effects. Individuals covered by these plans tend to have higher total wealth that provides an incentive for retirement; however, benefits continue to accrue under these plans and future annual benefits can increase rapidly as retirement is delayed until older ages.

Workers covered by health insurance through their employer may be reluctant to retire and have to purchase health insurance in the private market. Most individuals will become eligible for Medicare at age 65 so that this is primarily a problem facing early retirees. In an effort to support early retirement, some companies provided retiree health insurance so that early retirees would retain their access to the company's health insurance plan. This benefit can be of considerable value to many individuals especially those considering early retirement.

Workers with rapidly increasing annual earnings will be more likely to remain on the job while employees whose nominal earnings have plateaued are more likely to retire. This effect is even more important when the worker is a participant in a defined benefit pension plan. Workers in poorer health are more likely to retire; however, access to health and disability insurance may influence this decision. Health problems of a spouse, parents, or children may also influence retirement decisions. The need for additional income and health insurance coverage will tend to prolong worklife while the need to provide care to ill and disabled family members may hasten retirement. The importance of these effects typically differs by gender.

Trends in Retirement Age

Throughout most of the twentieth century there was a long-term trend toward earlier retirement. The labor force participation rates of older men fell dramatically during this period. In 1950, one out of every two men 65 and older was in the labor force. By 1985, only one out of six older men remained on the job. Declines in the proportion of men in the labor force were also reported for men aged 45 – 64. For example, the labor force participation rate of men 55 – 59 years of age fell from over 90% in the early 1960s to less than 80% by 1985 while the rate for men aged 60 – 64 dropped from 80% to almost 50% during the same period. However, the decline in the participation rates for men 45 and older ended in the mid-1980s. The labor force participation rates of older men in 2000 is slightly higher than it was in 1985.

The trend toward earlier and earlier retirement has been primarily a male dominated event. In contrast, the proportion of older women who are in the labor force remained relatively stable during the 1960s and 1970s and has been increasing throughout the past two decades. This is a reflection of the increased proportion of each succeeding cohort of women who have established more permanent working careers.

What has caused the ending of the trend toward early retirement among men? Several economic factors seem to be playing a role in this change. First, changes in pension coverage from defined benefit plans to defined contribution plans means that fewer workers are covered by pension plans with early retirement incentives. The more recent growth in cash balance plans also means that participants in these plans do not face the early retirement incentives that are imbedded in traditional defined benefit plans.

Second, important changes in Social Security have also provided increased incentives for older persons to remain employed. The reduction in the earning test for persons over 65 and then its elimination means that older workers are able to continue working and still receive their Social Security benefits. More recently, the gradual increase in the age of normal retirement is lowering the benefits for all retirees thus encouraging older persons to delay retirement.

Third, rapid economic growth of the past decade has changed the attitudes of many employers toward retaining older workers. Instead of encouraging early retirement through buyouts and early retirement windows, some companies are now trying to actively retain older workers because they were having difficulty finding replacements for retirees. Low unemployment rates, rapid economic growth, increased demand for workers combined with a more slowly growing labor force forced companies to reconsider their human resource policies. The shift toward defined contribution and cash balance pension plans is just one manifestation of such changes.

Fourth, increasingly companies are attempting to entice workers to remain on the job at least part time with the adoption of formal and informal phased retirement programs. These programs allow workers to remain on their career jobs while working fewer hours. Some workers find such options appealing. Still other workers are moving from career jobs to bridge jobs with new employers in order to delay complete retirement.

Is the current pattern of a more stable retirement age a permanent change from the trend toward early retirement or merely a pause in an inevitable decline in the age of retirement? Some argue that the current situation is merely a pause associated with the economic expansion. These analysts predict that as economic growth slows companies will once again resort to encouraging older workers to retire and retirement ages will begin to fall. Other researchers point to the structural changes in pensions, social security, and increasing life expectancy and argue that these changes are real and will continue to encourage older workers to remain in the labor force.

Trends in Plan Design

As noted above, there has been a major shift away from defined benefit plans, largely with final average pay formulas, to defined contribution and cash balance plans. Large employers usually provide a multi-layer retirement program, featuring a combination of a base benefit offered to all employees and paid for by the employer supplemented by a matched savings program, such as a 401(k) or 403(b) program Exhibit I shows the benefit pattern by type of employer. The base layer is increasing cash balance or defined contribution.

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Exhibit I
Retirement Plan Trends - Benefit Pattern by Type of Employer

Type	Large	Medium	Small
Public Sector	Traditional pensions plus retiree health	Same	Traditional pensions in pooled arrangement
Business- Stock owned by public	Employer paid benefit plus 401(k) plus some stock ownership and retiree health (in about half of companies)	*Defined contribution plan including 401(k) features* May allow continuation of medical to age 65	Possible chance for ownership of business If pension, probably defined contribution
Business – privately owned	Employer paid benefit plus 401(k) and retiree health (in about half of companies)	Defined contribution plan including 401(k) features May allow continuation of medical to age 65	Possible chance for ownership of business If pension, probably defined contribution
Not for profits	Pension plan plus tax sheltered annuity	Tax sheltered annuity	Tax sheltered annuity

Exhibit II shows the type of plan based on the 2000 summary of William M. Mercer's Trebase database. This database includes over 600 companies, and includes medium and larger companies, with the minimum size being 500 employees. 34% of *Fortune's* top 250 organizations and 28% of the *Fortune* 500 are included. The database consists primarily of Mercer clients, and is not a random sample of all businesses. The database would include companies in the first two columns of Exhibit I, and would be largely for-profit businesses.

Exhibit II

Retirement Plan Trends – Types of Plans

DB and DC Plans	1995	1996	1997	1998	1999	2000
Both DB and DC Plans	74%	73%	74%	71%	67%	64%
DB Only	3%	3%	2%	2%	1%	1%
DC Only	21%	23%	24%	27%	32%	35%
Unknown	2%	1%				

Traditional defined benefit plans, particularly those with liberal early retirement subsidies encourage retirement at specific ages, whereas cash balance and defined contribution plans are much more age neutral. Exhibit III shows the trend away from traditional final average pay defined benefit plans to cash balance. It shows types of defined benefit plans from the Mercer database. Another trend is to move more money into the matched savings program and decrease the size of the base retirement benefit.

Exhibit III

Retirement Plan Trends - Distribution of DB Plans by % of Plans

Type of Plan	1997	1998	1999	2000
Final Average	74%	68%	65%	65%
Career Average	9%	9%	8%	7%
Career Average with Upgrade	4%	4%	4%	3%
Cash Balance	7%	12%	14%	15%
Service Credit	5%	6%	7%	7%
Retirement Equity	1%	2%	2%	3%

Mercer Survey Results

In 2000, William M. Mercer, Incorporated surveyed employers to learn about their goals with regard to an aging workforce, and about their programs for supporting phased retirement. In our survey, more than half of the respondents (55 percent) said they have no specific goals with regard to the employment of older workers. Other respondents cited multiple goals. Those organizations with older workforces were no more likely to have specific goals than those with younger workforces. The incidence of particular goals is shown on the next page. Many of the companies in the survey are pursuing both types of targeted retention efforts listed in the table. The need to retain quality older workers is important to many employers in the current period of economic growth.

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Exhibit IV Goals With Regard to Employment of Older Workers	
Target retention efforts to workers with special expertise or key relationships	30%
Target retention efforts to individuals or groups with hard-to-replace skills	29%
Encourage all older workers to stay on	16%
Enable early retirement	10%
Target early retirees from other companies to fill open positions	7%

Phased Retirement Programs

Although formal phased retirement programs are quite rare, they seem to be of growing interest to employers. A variety of approaches can be used to help people phase out before collecting retirement benefits. Twenty-three percent of employers offered at least one program to help people phase out. These programs were generally also made available to other employees seeking alternative work schedules so that there were not exclusively phased retirement programs. Some organizations are using multiple programs. There are the programs being used by the 23 percent of respondents who provide at least one program.

Exhibit V Approaches to Supporting Phased Retirement — Respondents with Formal Programs	
Reduced hours or schedules	*47%*
Special assignments	*45%*
Temporary work	*42%*
Consulting work	*42%*
Job sharing	*17%*
Telecommuting	*10%*

Rehiring Retirees

Thus far, we have focused on phasing out work before retirement benefits are collected. An alternative would be to allow employees to retire and collect benefits, and then return to work later. Some businesses have been quietly rehiring retirees, often as consultants, temporary or part-time employees. A company considering rehiring retirees as a method of phased retirement needs to be sure that a bona fide employment termination took place, and that the arrangement is not simply a continuation of the prior job. In the Mercer study, 41 percent of the surveyed organizations said they have no policy regarding the rehire of retirees. Rehiring policies were most prevalent among government (89 percent) and higher education organizations (88 percent). Of the 59 percent of the entire survey group that reported having a policy:

- 63% will rehire retirees as part-time or temporary workers (benefits-eligible if sufficient hours are worked);
- 61% will rehire retirees as independent contractors or consultants (not benefits-eligible);
- 24% percent will rehire retirees full-time after a waiting period;
- 15% maintain a pool of retirees for temporary work; and
- 4% prohibit rehire of retirees.

Retirement Benefits for Rehired Retirees

When a company with a defined benefit or cash balance plan rehires retirees on a benefit-eligible basis, the company needs to address the issue of suspending any pension benefits already in payment, as is legally required in the case of early retirees (rehired before they have reached the plan's normal retirement age). Of the 117 respondents in this category that provided details about suspension of benefits:

- 51% suspend benefits both before and after normal retirement age;
- 21% pay lump-sum benefits, hence suspension is not an issue;
- 19% do not suspend benefits for those after normal retirement age;
- 2% let rehires choose between suspension and waiver of plan participation; and
- 7% use a combination of strategies.

Comparisons with Other Studies

Other studies have also found rehiring to be much more common than programs designed to help people phase out on the front end. A 1999 AARP/EBRI study conducted by Mathew Greenwald included telephone interviews with 65 companies included in the 100 best companies for working mothers, listed in *Working Mother* magazine. This is what it found:

Exhibit VI

Comparison of Mercer Survey with AARP Results

Experience	Number of Companies
Currently offers phased retirement	1
Had phased retirement in the past	3
Considered phased retirement	4
Hires back retirees	40
Offers part-time and/or flexible schedules	20
Reports no related experience	13

Benefits of Phased Retirement Programs for Employer and Employees

Looking at these patterns, businesses are now seeing an opportunity to address the labor shortage by cultivating the fastest-growing segment of the population—older workers—through flexible phased retirement programs. The benefits for both employers and employees are significant. Programs provide a way of retaining institutional knowledge and specialized skill, boosting productivity by keeping highly experienced workers rather than hiring lower-skilled ones, lowering hiring and training costs, as well as attracting the best employees over time. Benefits to employees include a greater sense of control over the transition from work to retirement, lower risk of economic insecurity, and more social support.

Conclusion

As the Baby Boom cohort ages, Americans are increasingly choosing to leave the labor force in steps. Individuals are creating their own personalized phased retirement programs either with their career companies or through finding new jobs. Businesses facing long-term labor shortages find that they need to adapt to the aging workforce. At present, the preferences of individuals and the formal phased retirement programs offered by businesses are out of step. At the same time, an increasing number of businesses are rehiring retirees one at a time and introducing general flexible work options.

This is an area of human resource management which is evolving and where there is a great deal of uncertainty. Formal phased retirement may very well become much more important in the future. Regulatory constraints make it difficult to offer formal phased retirement programs in conjunction with some types of retirement plans. However, there is substantial interest in making policy and regulatory changes to allow the development of phased retirement programs. There is a great potential for innovative approaches. The area should be watched closely and businesses need to evaluate what approaches will best meet their needs.

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