When Retirement Comes Too Soon

MANAGING RETIREMENT DECISIONS SERIES
When Retirement Comes Too Soon

Sometimes people encounter an unexpected barrier along the road to retirement. One barrier is the realization that they must retire earlier than expected. This can be due to job loss, illness, disability, caregiving responsibilities or other factors. This often forces people to make a host of decisions very quickly so they can change direction. The nature of those decisions is the focus here.

The financial questions that early retirees must address are the same as those for anyone entering retirement. Where will the money come from? Where will it go? But because retirement came suddenly, early retirees have an urgent need to find answers.

This urgency may lead to quick but ultimately inappropriate decisions. For that reason, retirees will be smart not to panic—and not to sign anything immediately.

**Important:** This period in life can throw a monkey wrench into the best laid retirement plans. But those who deal with the decision points carefully will increase the odds of making a smooth transition. Consulting with other resources, such as life counselors and employer-provided assistance, can provide valuable assistance in making these important retirement decisions.

**Benefits Questions and Decisions**

Early retirees will want to ask about benefits that are available to them. These may include severance pay, retiree health care or health continuation insurance, and unemployment compensation, among many others. Here is an overview.

**Severance Pay**

Many employers provide dismissed workers with severance pay, which is typically a package of money and/or benefits. The Older Workers Benefit Protection Act (OWBPA) does not require this, but severance pay does lessen the pain of dismissal. Severance “packages” are common in cases of layoffs or “exit incentive programs” involving several employees. Even when the employer does not offer a package, some workers may be able to negotiate a payment.

Terminated workers may find it helpful to take a close look at who has been let go and who has been retained. This is especially important if they suspect discriminatory treatment based on age, sex, race or some other protected category. Even when discrimination is not an issue, it is wise to read carefully anything the employer asks the worker to sign. It is usually worthwhile—and prudent—to have a lawyer review these materials.

**Time Limits**

Time limits provide protection for terminated older workers who are asked to sign waivers. The federal Older Workers Benefit Protection Act (OWBPA) says:

- An employee must have at least 21 days to review an agreement before signing.
- An employee must have seven days to revoke the agreement after signing.
- A worker must be given at least 45 days to review and sign a waiver the employer has requested as part of an exit incentive program offered to a group of employees.
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Some workers may need to decide whether to sign a “waiver.” This is a document that employers sometimes ask dismissed workers to sign as a condition for receiving special benefits. The waivers typically say the worker agrees not to hold the employer liable for claims associated with the employment relationship.

Waivers are legal, but the law offers protection against improper use. The OWBPA law requires waivers to be “knowing and voluntary.” That means waivers must meet several requirements such as those shown in the box regarding time limits.

Involuntary job termination can generate bitterness and hard feelings in dismissed employees. But early retirees have positives to consider too, such as the advantages they have gained by maintaining good relationships with their former employer and coworkers.

For instance, unless the worker has been terminated for cause or has sued the employer, reemployment or temporary contract work with the former employer may be possible. In addition, employers and a worker’s personal network may provide references and job leads.

Health Insurance

Workers who retire before the Medicare-eligible age of 65 will need to arrange health insurance. Employers sometimes pay continuation health benefits for a period of time, or the worker might negotiate for this.

Early retirees may also consider using the Consolidated Omnibus Budget Reconciliation Act (COBRA) to obtain coverage that helps them bridge from early retirement to age 65.

Another possibility for early retirees is to consider securing health care insurance through insurance companies that participate in the health care insurance exchanges established in accord with the Affordable Care Act. These choices vary by geographic area and may be quite limited. However, legislative proposals regarding the Affordable Care Act may alter available options, so early retirees will need to keep an eye out for changes here.

Early retirees will also want to find out:

• Does the employer offer retiree health benefits? Some do, even though this is far less common than in the past.

Health Insurance Tip

Another important health care opportunity for early retirees is the Consolidated Omnibus Budget Reconciliation Act (COBRA).

This law helps many departing workers continue their group health insurance for a temporary period—if they pay for it. Some pointers:

• The law applies to workers in firms with 20 or more employees. (Some states apply COBRA to smaller firms as well.)
• Employees can continue health coverage with the employer at the group rate plus a premium for up to 18 months or, in some situations, for up to 36 months. (Some firms augment COBRA benefits.)
• The cost is generally less than workers would pay if they bought a policy in the open market.
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- Can a spouse or partner add the premature retiree to his/her health insurance policy?
- Does a premature retiree qualify for continuation coverage from the employer?

Under the exchanges, some of those who cannot afford their health insurance premiums will get help. For example, persons with income at or below 138 percent of the federal poverty level (FPL) will be eligible for Medicaid. Those with income between 138 percent and 400 percent of FPL will be eligible for subsidies in the new health care exchanges. The exchanges are marketplaces that will offer health insurance at competitive rates.

As mentioned earlier, people generally become eligible for Medicare—the federal health insurance program for seniors—at age 65. To qualify, they or a spouse must have worked for at least 10 years in a job where they paid into the Medicare system.

Early retirees will want to factor Medicare into their decision-making, especially if they are very close to age 65. The window for applying for Medicare is three months before through three months after turning 65. If they apply after the window closes, Medicare will add a permanent penalty to their cost for coverage. The penalty equals 10 percent of the Medicare Part B premium for each year the person is over age 65.

Finally, disabled workers who have received Social Security Disability Insurance benefits (SSDI) for 24 months are eligible for Medicare even if under age 65.

Unemployment Insurance
Employees who have lost a job through no fault of their own may be eligible for unemployment insurance (UI) benefits. Some points for them to keep in mind:

- UI benefits replace a portion of lost wages, generally for up to 26 weeks, as long as the recipient is looking for work.
- In some states, eligibility for UI benefits could be reduced or eliminated for workers who begin to receive their pension benefits. There may be different effects on UI benefits based on whether the person takes the pension as a lump sum or an annuity.
- In high unemployment states, UI benefits may be extended for an additional 13 weeks. Another seven weeks may be available in states with voluntary extended benefit programs during periods of extremely high unemployment.
- In an economic downturn, Congress typically extends UI benefits, but workers who are let go during “normal” times will not see an extension.

Start the Job Search Right Away
While applying for UI benefits, unemployed workers will be smart to update their resumes and start a job search. They generally must be looking for work to maintain eligibility for UI.
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- The state unemployment offices provide information on UI benefits. Workers can apply online, over the telephone, or in person.

Replacement Income
When people stop working prematurely, they must suddenly come up with replacement income. The transition will require them to set up a new budget and make decisions about which financial sources to tap. Some can turn to savings but others have little savings to tap.

Severance pay, early retirement incentive money, and unemployment insurance can help bridge the gap between earnings and retirement income. However, this bridge money will not last forever so seeking work may need to be an option, too.

If that is the case, starting a job search becomes a priority. Several resources are available for older workers to help refresh their job skills and resumes. While older workers can face difficulties in finding employment, many do eventually find jobs. They may need to adjust their pay expectations, consider alternative careers and consider more flexible positions, especially if they have caregiving responsibilities.

IRA and 401(k) Plans
Early retirees might be able to access the money in their retirement plans. If they are at least age 59½, they can withdraw money from their IRA or 401(k) without penalty. In some cases, they may be able to access the money even earlier without penalty.

Deciding to tap these funds requires careful thought, because IRA and 401(k) distributions are taxable as income. Is the retiree prepared for the tax impact? Would it be better to start distributions later?

Older people will also want to keep in mind that retirement plan money is intended to help them get through perhaps 25 or more years of retirement. Will they be able to manage the money to last a retirement lifetime?

Income Annuities
These are insurance products that people can buy. A person does this by depositing a lump sum into the annuity. The annuity then pays a monthly income stream for life. The younger the buyer, the lower the monthly annuity payouts will be, because the monthly payments will stretch over more years than for older buyers. Still, early retirees can use these products to increase peace of mind and reduce the risk of outliving their money.

The Dual Income Advantage
If there is a second income in the household, that may ease the transition from work to retirement. It may enable early retirees to refrain from taking early Social Security or pension benefits, or from tapping into IRAs or 401(k) plans at an early age.
Defined Benefit Plans

Also called traditional pensions, defined benefit plans pay a monthly amount to retired workers as well. Some employers still offer them. Workers who are vested can collect the monthly benefits when retired. (Vesting means the person has worked at the employer for enough years to qualify for pension benefits.) If a premature retiree claims earlier than full retirement age, the plan may reduce the size of the monthly benefits. However, employers sometimes augment benefits to encourage workers to leave.

The big question for early retirees is how much, if anything, they will lose by claiming benefits now instead of later. Addressing this with their human resources director and/or a financial planner will provide important insights on this issue.

Disability

A worker who is ill or disabled may be eligible for disability benefits from various sources:

- Workers’ compensation (WC) if injured on the job
- Supplemental Security Insurance (SSI) disability benefits if disabled and on very low income
- The employer’s short-term disability (STD) and/or long-term disability (LTD) insurance plan
- Social Security Disability Insurance (SSDI) if a disability is severe (i.e., likely to last two years or more or result in death)
- A pension from an employer’s defined benefit plan

Furthermore, the Americans with Disabilities Act (ADA) as amended in 2008 makes it easier for persons with disabilities to establish disability under the ADA.

Social Security

Retired workers can start collecting Social Security retirement benefits as early as age 62. Early retirees may have little choice but to do this if they are eligible for the benefits.

However, retirees need to be aware of the financial consequences of this decision.

- Social Security reduces the benefits if the retiree starts collecting them before full eligibility age, which is now 66 and will eventually rise to 67. If benefits start at age 62, for example, Social Security will pay 75 percent of the benefits payable at a full eligibility age of 6.
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- The Social Security benefit amount increases each month a worker delays collecting the benefit. Workers who hold off receipt until after their full retirement age will see their benefit increase by 8 percent for each year of benefit postponement up to age 70.

Married workers who postpone receipt of Social Security benefits may also be increasing the survivor protection available to their spouses.

Minimizing the Consequences

Workers do not have much control over most factors that cause them to retire earlier than planned. Nonetheless, all workers can take some steps while still employed to minimize the financial consequences of premature retirement.

- Establish emergency funds: Create an emergency fund equaling at least three and preferably six months of living expenses. Those who find themselves unexpectedly out of a job can draw from this fund to pay bills and emergency expenses while looking for new work. Having such a fund means early retirees might not have to tap into Social Security or retirement funds right away and, if they do find work, perhaps not until their planned retirement.

- Eliminate or reduce debt: Keep debt to a minimum. It is difficult to take care of day-to-day expenses and credit card or other debts when no money is coming in.

- Update skills: Employers have reservations about older workers’ flexibility, adaptability and ability to learn new skills and approaches. Voluntarily engaging in training, retraining, lectures, and education programs can help older workers counter these reservations and enhance their value to the business. That could work to their advantage when the employer is determining whom to let go. It can also help workers acquire skills that will aid them in a future job search.

- Network: While employed, workers can help themselves by nurturing their network of business contacts as these can prove invaluable in the event of a job search. Participating in social media technology is important for sharing career interests and achievements as well as making contact with employers.

- Hone job-seeking skills: Looking for a job today is very different from what it was many years ago. A good strategy for older workers is to keep job-seeking skills up to date by periodically applying and interviewing for jobs. This will put them a step ahead if faced with an unexpected job search. They might also stumble upon a great job opportunity they can’t resist. In addition, seek assistance from organizations that specialize in helping older workers remain employed.

Workplace Modifications

The Americans with Disability Act (ADA) requires employers to consider workplace accommodations or modifications under certain circumstances.

Such changes might make it possible for ill or disabled workers to shift to another job with the same employer or to scale back work hours rather than leave employment.

Action item for workers: Before retiring, discuss these possibilities with the employer.
Additional Resources

For the website entries, please go to the website and enter the name of the article or author into the search box.

- "Understanding Waivers of Discrimination Claims in Employee Severance Agreements" provides information and a checklist on what to do when an employer offers a waiver agreement. Find it at the Equal Employment Opportunity Commission (EEOC) at [www.eeoc.gov](http://www.eeoc.gov).
- "Health Plans & Benefits: Continuation of Health Coverage—COBRA" provides helpful information on COBRA. Find it at the U.S. Department of Labor website at [www.dol.gov](http://www.dol.gov). This website also has a useful “Frequently Asked Questions” section on COBRA.
- Resources to help older people search for work may be available at Forty Plus ([www.retirementjobs.com](http://www.retirementjobs.com)) and AARP ([www.aarp.org/work](http://www.aarp.org/work)).
- The U.S. Department of Labor website provides a handy United States map that enables visitors to click on a state to learn about its unemployment benefits program. Find it at: [https://www.careeronestop.org/localhelp/unemploymentbenefits/unemployment-benefits.aspx](https://www.careeronestop.org/localhelp/unemploymentbenefits/unemployment-benefits.aspx)
- The Americans Disability Act website offers a wealth of information about work and disability. Go to: [www.ada.gov](http://www.ada.gov)

The Society of Actuaries Post Retirement Needs and Risks committee has other Decision Briefs providing additional information on the major decisions encountered in retirement. All of the briefs can be located at: [https://www.soa.org/research-reports/2012/research-managing-retirement-decisions/](https://www.soa.org/research-reports/2012/research-managing-retirement-decisions/)

The Society of Actuaries would like to acknowledge the work of its Committee on Post-Retirement Needs and Risks in producing this series.

The committee’s mission is to initiate and coordinate the development of educational materials, continuing education programs and research related to risks and needs during the post retirement period. Individuals interested in learning more about the committee’s activities are encouraged to contact the Society of Actuaries at 847-706-3500 for more information. Additional information and research reports may be found at [http://www.soa.org](http://www.soa.org).

DISCLAIMER
This Decision Brief is not intended to provide advice for specific individual situations and should not be construed as doing so. It is an information tool for general guidance. Individuals needing advice should seek the services of a qualified professional. Keep in mind that the tax code can change, the taxation of products and strategies vary, and individual tax needs and issues are unique. Consideration of tax issues is beyond the scope of this work.