NOT JUST A PHASE

With the first cohort of baby boomers (born between 1946 and 1954) now reaching the age when they’re eligible to retire and engaging in some form of retirement planning, phased retirement programs are being discussed more than ever before. While the increased prevalence of these discussions is encouraging, many organizations are asking, Do we have tangible programs to manage the inevitable—the departures of highly knowledgeable and skilled employees who will leave the organization with a big hole that we might not be able to fill?

Many industries are already feeling the effects of this dilemma as more and more baby boomers decide to take the pension and call it quits. It is well documented that Canada, as well as most other industrialized nations, is experiencing a labour crisis. That’s the big picture on the minds of organizations across the country.

Recent changes to pension legislation relating to phased retirement may or may not support this big-picture challenge: implementing a viable program to retain valued employees. However, organizations need to understand how it works if they are serious about incorporating a phased retirement strategy into their pension plans.

What is Phased Retirement?
In practice, phased retirement plays out through one of two basic scenarios:

**Scenario 1:** The employee gradually reduces the number of hours worked on a weekly basis within the same organization.

**Scenario 2:** The employee takes part-time work with one organization while collecting a pension from another organization.

If the goal of your phased retirement program is to hold on to valued employees who would otherwise decide to retire—and to do so without increasing costs—then clearly, Scenario 1 is optimal and Scenario 2 is undesirable. Unfortunately, Scenario 2 often becomes the preferred choice for disengaged employees, as well as those with significant pension or post-retirement medical benefits that would otherwise be left on the table.

More frequently now, the solution to Scenario 2 seems to be to allow the employee to retire and collect the pension, then have him or her rejoin the organization as an independent consultant or contractor. The number of hours, flexibility of hours worked and level of responsibility can all be negotiated. The drawback to this scenario is that the overall cost is often higher than the pre-retirement arrangement, and the organization is left with little, if any, negotiation power.

What the Legislators Say
With the abolition of mandatory retirement at age 65 and recent changes to phased retirement legislation, the regulatory landscape is slowly progressing toward becoming a viable part of a broader phased retirement program. Let’s take a look at pension legislation to date.

**Québec and Alberta** – Québec can certainly take credit for engineering the birth of phased retirement in Canada. In 1997, the province of Québec came up with an innovative legislative solution that allowed an employee (with the employer’s agreement) to reduce his or her work hours and receive financial compensation from the pension plan. The legislation was originally conceived to allow an employee to work reduced hours and make up for the resulting reduced wages by drawing a portion of his

Phased retirement could have a huge impact on the way employers attract and retain employees in the future.

**By Kevin Sorhaitz, Charlene Moriarty and David Blundell**
PENSION PLANS AS AN HR TOOL

Defined benefit pension plans facilitate attraction (through competitive benefits packages), retention (through “golden handcuff” provisions) and early retirement (through supplemental/bridge payments to age 65 and/or unreduced pensions before age 65, sometimes as early as age 50).

In contrast, defined contribution pension plans facilitate employer cost and risk containment, the portability of benefits and employee control. Many of today’s plans don’t accommodate the concept of phased retirement very well and, in practice, frustrate efforts to retain highly knowledgeable and skilled employees who happen to be eligible for retirement. If your employee benefits programs are working against your phased retirement objectives, then a review of your programs is overdue.

The other provinces will need to articulate how phased retirement under a DC pension plan will work for employees in their jurisdictions. Employers that want to offer phased retirement must amend their pension plan documentation to provide for this.

A word of caution: while we expect that the concept of phased retirement will eventually be embraced on a national basis, we can be sure that each jurisdiction will want to put its own spin on the minimum standards legislation. Consequently, it may be a challenge for organizations to design and implement a national phased retirement policy.

Important Considerations

The introduction of a workable framework for phased retirement within the organization’s pension plan should be a welcome tool for companies trying to retain key employees and skilled workers. Phased retirement will allow these employees to continue working, accrue more benefits and collect a pension income. The new legislation should also provide a cleaner approach to addressing both the organization’s and the employee’s needs.

But this comes at a price—especially if organizations simply amend the pension plan to utilize the federal phased retirement maximums without appropriate restrictions and cost controls. And that price could be quite high: since “free” money tends to attract people, phased retirement could actually become too popular.

If the DB pension plan is amended for phased retirement, resulting in increased benefits, the plan sponsor will need to take a hard look at the implications. For example, there will be increased cash costs, as well as profit and loss and balance sheet implications for prior service costs. A revised actuarial cost certificate will need to be filed. Pension administration systems may need additional programming, and there will be new forms and procedures for administration. There will also be increased member disclosure requirements. For some plans, the impact of any one of the above changes could be significant.

From a DC pension plan perspective, phased retirement benefits are cost-neutral for organizations. However, it is important to note that there will be increased administrative and compliance costs for these plans.

To meet the objective of the phased retirement program—to retain valued employees who would otherwise have retired and do so without significantly increasing costs—effective cost-control mechanisms will become important in the design of a phased retirement option within the pension plan.

or her pension from the plan. It also enabled the employee to continue accruing benefits in the plan while working those reduced hours. At the point of full retirement, the employee’s pension would be reduced to account for the pension payments made during the phased retirement period. In 2000, Alberta followed Quebec’s lead with its own version of phased retirement.

Unfortunately, the legislation in both Quebec and Alberta proved to be largely unworkable, as the Canada Income Tax Act (ITA) would not permit a plan member to receive a pension and continue to accrue pension credits under the plan at the same time. As a result, phased retirement benefits in both Quebec and Alberta had to be provided in the form of an annual lump sum payment. This is likely why, until recently, only these two provinces had enacted phased retirement legislation.

The legislative changes in Quebec and Alberta were designed to give plan members the flexibility to ease into retirement. Because of their cost neutrality and the awkward lump sum workaround to stay within the boundaries of the ITA rules, the take-up rate for phased retirement has not been significant.

Federal Government – In March 2007, the federal government acknowledged the need for organizations to retain skilled workers in the workforce by introducing legislation that effectively removed the receive-and-accrue restrictions that stood in the way of phased retirement. The legislation now allows organizations to create incentives for older employees within the plan.

Originally designed for federal public service employees, the federal strategy was modified and eventually adopted in late 2007 to allow all pension plans to offer phased retirement to employees who are age 55 and eligible for an unreduced pension or who are age 60 and older.

If an employee meets these criteria, then the organization is allowed to offer the continued accrual of pension benefits while the employee is working, plus up to 60% of the accrued lifetime pension and/or any bridge benefits payable under the plan. There is no requirement to reduce the lifetime pension to account for the amount of income provided under the phased retirement program prior to full retirement. In addition, the employee is not required to reduce the number of hours worked as a condition of participating in the program.

Clearly, a phased retirement program can have a significant cost impact on the plan, depending on how it is structured. If an organization wanted to make this possible, an employee could “double dip” by receiving phased retirement benefits, as well as compensation and pension credits, while working for the organization.

Next Steps

The new federal legislation paves the way for the implementation of phased retirement in defined benefit (DB) pension plans. However, before organizations can begin using this new tool to try to hold on to skilled workers who are eligible to retire, the provinces must amend their pension acts to allow phased retirement to occur. Half of the provinces either have moved toward adopting phased retirement provisions or have expressed a desire to do so.

But what about phased retirement in defined contribution (DC) plans? So far, only Quebec has explicitly responded to this issue, making phased retirement available to anyone between the ages of 55 and 65 under a DC pension plan. The amount of money that can be withdrawn in a year is up to 60% of the maximum life income that could be generated by the account balance if it was a life income fund. Contributions made for work during phased retirement continue to be credited. In addition to phased retirement legislation, Quebec offers a reduction in work hours and a cash payment option.
Costly Propositions?
Costs may be kept under control by offering phased retirement benefits that are less than the ITA maximums or by trading off benefits such as cost-of-living adjustments for phased retirement. There are also other effective cost-control plan design features to consider, such as the following.

**Target only specific individuals** – The ITA does not require you to offer phased retirement to all eligible employees. However, the provincial regulators will ultimately decide how the selection of employees plays out. Quebec, British Columbia and the federal *Pension Benefits Standards Act* (PBSA) all require that the organization and the eligible employee enter into an agreement. It is unclear if this selective approach would work with Ontario’s traditional class-based eligibility system. It’s also unknown how employment standards and labour law will respond to perceived “cherry-picking.” The other issue that is still unclear is the extent to which disclosure to the general plan membership will be required.

**Implement employee cost-sharing** – It is not clear at this time if provincial pension acts will permit cost-sharing for employees who agree to receive phased retirement benefits, or if there will be any restriction on the scope of the agreement between the employee and the organization. If the cost of phased retirement could be shared with targeted employees, it would increase the effectiveness and flexibility of the program. However, we will have to wait and see what the provincial phased retirement legislation will look like in order to determine the most appropriate plan design solutions.

Provincial Legislation
Currently, phased retirement legislation is at various stages across Canada.

**Alberta** – In July 2008, the Alberta Superintendent of Pensions took the position that the provisions of the *Alberta Pension Act* are broad enough to accommodate the new ITA provisions without the need for amendment.

**British Columbia** – B.C. has introduced phased retirement legislation, which received royal assent in May 2008. The legislation has not been proclaimed yet.

**Manitoba** – Manitoba implemented lump sum phased retirement provisions in 2005 under its Bill 10. However, this legislation has not been proclaimed yet.

**Quebec** – Quebec introduced legislation in 2008 to revise current provisions (both DB and DC) in line with the ITA. This legislation is now in force.
Ontario – The Financial Services Commission of Ontario has indicated that it is committed to establishing standards for phased retirement. No action is expected until the Expert Commission on Pensions reports later this year. However, phased retirement is currently not permitted in Ontario.

Federal – The PBSA was amended in late 2007 to include phased retirement legislation, but the legislation has not been proclaimed yet.

At this point, the remaining provinces have not yet taken steps to draft proposed phased retirement legislation.

The Future of Retirement Planning

With the abolition of mandatory retirement and the growing need for skilled workers in many sectors of the workforce, organizations are facing the often conflicting challenges of enticing some employees to retire early, while encouraging others to retire later. A properly structured phased retirement program will need to accommodate both objectives.

For employees who are reluctant to retire because they want to remain productive and stay physically and mentally active, or for those who need the income, a good phased retirement program can provide an opportunity to adjust their work hours and responsibilities to balance their needs.

While phased retirement helps organizations benefit from the retention of valued employees and the transfer of knowledge and skills to younger workers, reliance on the pension plan alone will not completely solve the retention challenges facing HR managers. The best solutions for retaining baby boomers may continue to exist outside and independent of the pension plan.

Age 65 is no longer the magic number for retiring employees, nor can it be if organizations are to be successful in retaining knowledgeable employees in the future. Organizations need a strategic approach to retirement and workforce transition planning, including these steps.

1) Survey the talent and job positions among employees age 50 and older within the organization to assess what skills are at risk of being lost without a proper transition plan and to find out what, if any, retirement strategies these employees have in place. For many small- to medium-size companies, this may simply be a matter of interviewing the employees in this age group.

2) Conduct demographic projections to assess when to expect talent shortages.

3) Implement special mentoring programs designed to effectively pass on the knowledge and experience of older workers to younger employees.

4) Implement retirement financial and lifestyle planning programs to help older employees make the transition to retirement.

The organizations that will be successful in retaining more than their fair share of the first cohort of baby boomers will be those who embrace the concept of phased retirement as a corporate objective. A significant part of the strategic plan will be the management and communication of the programs, benefits and processes so that organizations can become a part of the employee’s retirement planning to facilitate a smooth and comfortable retirement for this critical cohort. BC

Kevin Sorhaitz is a principal and consulting actuary, Charlene Moriarty is a consulting actuary and David Blundell is a consultant in the research and compliance practice of Buck Consultants, an ACS company. kevin.sorhaitz@buckconsultants.com; charlene.moriarty@buckconsultants.com; david.blundell@buckconsultants.com