PENSION RIGHTS CENTER

PHASED RETIREMENT

What is phased retirement?

The term phased retirement refers to programs in which workers can reduce their working hours in lieu of immediate retirement. An employee would draw a reduced salary, which she would supplement with distributions from her employer's retirement plan. Such plans can in some circumstances be positive for both the employee and the employer.

Are phased retirement program currently permitted to pay retirement benefits to employees who reduce their hours?

This depends. A profit-sharing plan can pay benefits to still-employed individuals. A pension plan historically could not pay benefits until an employee had separated from service, but the Pension Protection Act now permits such plans to pay benefits to active employees after they turn 62. A 401(k) plan can make payments to an employee once he attains age 59.5, even if he is still employed.

What are some of the concerns with phased retirement?

- Some employees who would have continued working full time will elect phased retirement and thus accumulate less retirement savings than they would have otherwise.
- In some final-pay plans, a participant's full retirement benefit is reduced because the participant's benefit reflects the employee's part-time pay in the last years of employment.[1]
- Some phased-retirement supporters advocate allowing individuals to begin phased retirement at ages as young as 50, and have also argued for changes in the law that would allow individuals to access their retirement benefits even if they continue to work full time.
- Some employers might use phased retirement programs as a strategy for pushing older workers out of the full-time workforce.
- Small firms might use phased retirement programs to favor firm owners over rank-and-file employees.
- Employees might lose access to employer-provided health care if they reduce their hours.

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[1] For example, assume a pension plan that provides 1% of final pay, multiplied by years of service. Further assume a 60-year-old employee who earns $50,000 per year, and thus has an accrued benefit of $10,000. The employee reduces her hours and is paid $25,000 for five years and then retires. Her benefit under the plan is now 25% of $25,000, or $7,500--$2,500 less than it was five years earlier. It should be said that there are some arguments under current law that such a reduction is illegal.