



AMERICAN BENEFITS

COUNCIL

TESTIMONY OF MARIA NORMAN

ON BEHALF OF THE

AMERICAN BENEFITS COUNCIL

FOR THE

ERISA ADVISORY COUNCIL

WORKING GROUP ON PHASED RETIREMENT

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My name is Maria Norman. I am Corporate Director, Benefit Strategy and Design for Northrop Grumman Corporation. I also serve on the Executive Committee of the Board of Directors of the American Benefits Council (the "Council") on whose behalf I am testifying here today. The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

The retention of older workers is a priority for Northrop Grumman. Accordingly, I have taken on an active role with respect to phased retirement issues at the Council. And my colleague, Ian Ziskin, Northrop Grumman's Corporate Vice President and Chief Human Resources and Administrative Officer, is playing a leadership role on this issue at the HR Policy Association ("HRPA"), where he sits on the Board. As a major supplier to the United States government our employees must be U.S. citizens. Most of these employees must also possess security clearances and work in top secret environments. As such, the loss of skilled employees is extremely costly and burdensome for our company. We cannot offshore our jobs nor look to other countries for new engineering and scientific talent. Losing these employees due to the inflexibility surrounding current retirement laws is an increasing risk to the success of our company and therefore the security of the nation.

Background

Thank you for this opportunity to present the Council's views regarding retention of older workers in the American workforce. We are very encouraged that you are turning your attention to this critical area. We would urge you to focus on the role that phased (or "flexible") retirement programs can play in meeting the needs of both workers and employers, as well as in bolstering the economy and relieving burdens on government programs. Under current law, there are certain obstacles to the ability of employers to implement these "win-win" programs and, as the population ages, the disconnect between the law and the needs of the workplace will expand.

Clearly, we are in a period where attitudes toward work and retirement are evolving. As life expectancies increase, fewer Americans see early retirement as an attractive option, and not just for financial reasons. Workers also seek the intellectual challenges and social interaction associated with work. Thus, more and more workers are restructuring their work and moving gradually into retirement. Meanwhile, from the employer's perspective, older employees possess skills and institutional knowledge that are highly valued and often can help meet the companies' pressing demand for workers. Thus, employers are interested in implementing phased retirement programs—more aptly labeled "flexible retirement" programs—that enable older

employees, who might otherwise retire, to remain actively employed either on a part-time or full-time basis.

Indeed, the aging of the workforce will exacerbate a serious labor shortage in this country. An AARP survey of companies found that 74% were having difficulty finding and retaining qualified employees.¹ Meanwhile, demographic trends indicate that this labor shortage will become more acute as our population ages. Average life expectancies have increased from 66.7 and 73.2 years for men and women, respectively, in 1960 to 74.8 and 79.6 in 2005, with steady increases expected through the 21st century.² Coupled with a drop in the fertility rate from 3.61 in 1960 to 2.1 in 2005,³ there are fewer new workers to replace aging ones.

A partial solution to this problem can be found in the evolving attitudes of older workers. The 2004 Phased Retirement Survey conducted by Watson Wyatt Worldwide revealed that nearly two-thirds of surveyed workers between ages 50 and 70 would prefer to phase down from full-time work to part-time work rather than leave the workforce completely.⁴ A survey by the Pew Research Center found that almost eight in 10 Americans say they will continue to work at least part-time after retirement from their traditional full-time employment. Indeed, 60% of workers in this survey said they would continue to work even if they had enough money to live comfortably for the rest of their lives.⁵ Thus, more older Americans are leaving the labor force gradually, utilizing “bridge jobs” between full-time career employment and complete withdrawal from the labor force.⁶

The good news for these workers is that they are still wanted. For many employers facing labor and skill shortages, retention of older workers avoids the costs of recruiting and training new employees, and preserves the institutional knowledge possessed by a company’s long-service employees. Because of the broad interest within our membership, the Council has been working very closely on phased retirement issues with the HRPAs, which represents the senior human resource officers of the largest corporations in the United States.

Under a joint initiative with HRPAs, we are developing an Experienced Employee Retention Toolkit, targeted at employees who are at or near retirement eligibility, while launching pilot projects among participating companies refining these tools. We are using the learnings from a survey of recent retirees conducted earlier this year on our behalf by the Employee Benefit Research Institute (available at http://www.ebri.org/publications/ib/index.cfm?fa=ibDisp&content_id=3952), which demonstrates that the challenge is much broader than benefit plan design issues and involves issues such as job satisfaction, scheduling, job structuring, and other issues. The premise of this initiative is that there are actions employers can take within current law to try to retain these experienced employees and that, even if the law changes to give benefit plans more flexibility, these additional actions will be needed as a complement.

The Need for Further Changes in the Law

Although there are, as noted, opportunities to adopt phased retirement programs under current law, the law still contains significant impediments to the shared goal of employers and employees for the employees to work longer. These impediments include:

- The inability of active employees to access early retirement subsidies under traditional defined benefit plans that encourage employees to leave the workforce between ages 55 and 62 and that generally phase out by the plan's normal retirement age;
- The inability of active employees to take advantage of low interest rates that result in a greater lump sum payment under traditional defined benefit plans that permit lump sums; and
- The inability of employees under current law to work a reduced schedule while drawing benefits from their employer's retirement plan in order to supplement their income.

The law generally precludes qualified retirement plans from making payments to current employees, effectively causing some older employees to retire completely in order to receive an early retirement subsidy, a large lump sum, or supplemental retirement income. Alternatively, they may go to work for another company while receiving retirement plan payments from their first employer. This type of movement is generally disruptive and unwanted for both employees and employers.

In November 2004, the Treasury Department sought to address this problem with proposed phased retirement regulations. The Treasury Department is certainly to be applauded for taking a step toward facilitating flexible retirement, but unfortunately the proposed regulations are too restrictive to be widely used. Among other problems, a minimum age of 59½ is required, precluding use by a significant group of potential workers seeking flexible retirement. The rule also establishes very rigid and administratively burdensome hour reduction rules that create a strong disincentive for employers to implement a program. Moreover, these rules fail to address a form of flexible retirement where the employee continues to work full-time but with fewer responsibilities. Finally, very importantly, the rules leave unaddressed a major component of the flexible retirement area: the need to prevent valued employees from terminating employment to obtain an early retirement subsidy or a large lump sum (attributable to low interest rates).

Section 905 of the Pension Protection Act⁷ enables employers to permit active employees to begin receiving retirement benefits starting at age 62 under tax and benefits laws. A notice from the IRS indicates, however, that the IRS may well issue rules that dramatically reduce the attractiveness of this option. Moreover, as noted above, many

employees seek flexible retirement prior to age 62, so as to take advantage of early retirement subsidies starting earlier. Thus, the provision leaves much of the flexible retirement need unaddressed and would not stop the “brain drain” due to older employees leaving to take advantage of early retirement subsidies.

Meanwhile, we would underscore that flexible retirement is not just a problem under defined benefit plans. In the case of a 401(k) or 403(b) plan, if the employee wishing to phase down is under 59½, the law does not permit withdrawals of the employee’s own pre-tax contributions in the absence of a hardship (such as a medical expense, a home purchase, or college tuition). For participants in a 457(b) plan, the approach would be even less effective because the prohibition on withdrawals by current employees, other than in hardship cases, applies to all plan benefits and continues until age 70½.

We strongly encourage the Advisory Council to take a very close look at these and other obstacles to the implementation of flexible retirement programs. However, we would also urge you to be very careful in shaping policy changes so that these programs provide maximum flexibility to employers and employees and remain attractive to both interests. As we have seen from employers’ reaction to the 2004 proposed regulation, the imposition of too many restrictions and hurdles would simply reduce the likelihood of employers utilizing flexible retirement programs under the rules, so that the new rules would have little or no effect. If this issue is to be addressed effectively, it must be done in a way that allows employers such as Northrop Grumman the flexibility they need to experiment with different approaches in this evolving area. We are very eager to join you in this effort and thank you for allowing us an opportunity to express our views.

¹ “Business Executives’ Attitudes Toward the Aging Workforce: Aware But Not Prepared?,” AARP, October 2006.

² Table V.A3, 2006 OASDI Trustees Report, Social Security Administration.

³ “IDB Summary Demographic Data for United States,” U.S. Census Bureau, August 24, 2006.

⁴ “Phased Retirement: Aligning Employer Programs with Worker Preferences,” Watson Wyatt Worldwide, 2004.

⁵ “Working After Retirement: The Gap Between Expectations and Reality,” Pew Research Center, September 21, 2006.

⁶ “Are Traditional Retirements a Thing of the Past? New Evidence on Retirement Patterns and Bridge Jobs,” Kevin E. Cahill, Michael D. Giandrea, & Joseph F. Quinn, Boston College Working Papers in Economics No. 626, 2005.

⁷ Pension Protection Act of 2006, Pub. L. 109-280.