The Effect of Pension Plans on Job Attraction and Employee Retention

Attraction

The empirical evidence that pension plan characteristics attract new employees, particularly younger ones, is limited. As a standalone factor, pensions do not seem to influence a person's job choice, although the importance increases with age (Gough and Hick, 2009). As consulting firm Towers Watson noted, "In general, retirement plans do a much better job of retaining workers than attracting workers." and "Older employees are significantly more likely than younger employees to have been attracted to their firm by the retirement plan."(Towers Watson, 2005). In 2005, Alaska replaced their traditional pension with a defined contribution (DC) plan and a 2008 Alaska DOA report showed that vacancy rates in AK state government actually decreased the year following the adoption of the new plan. In Maryland, there was legislative debate in 2006 that the state's pension plan, with the lowest average replacement rate in the nation, was hampering teacher recruitment relative to neighboring PA. Data showed that there was no significant difference in certified staffing levels between MD and PA, implying that Maryland's relatively inferior pension system was not causing a migration of teacher recruits (Podgursky, 2006).

Retention

There is stronger evidence supporting a relationship between retirement plan characteristics and employee retention. Regression analysis on U.S. Census Survey of Income and Program Participation data showed that a reduction in average tenure for U.S. employees was related to the shift from DB plans to DC plans, implying that the portability of DC plans increases worker turnover (Munnell et al., 2006). "30-and-out" rules, such as the one in place in PA in the 1990's and studied by Fergeson et al. (2005), increase the incentive for retirement. Thus, retirement benefits can be effective at retaining employees up to a certain age or service and then encouraging them to leave after that point.

Under a DB plan, the incentive to retire is tied to the present value (PV) of accrued benefits. In the aforementioned PA study, an increase in the PV of pension benefits of $1,000 increased the probability of retirement among female teachers by .02 to .08 percentage points (Ferguson et al., 2005). In an accrual model based upon the current TSERS plan (see attachment), a person who enters service at age 20 will have a strong incentive to stay with the State between ages 40 and 50, where the value of pension benefits being earned is equal to 20% to 90% of salary. Once he can retire, the value of benefits earned can turn negative, even reaching as much as -60% of salary, providing a strong incentive to leave. TSERS also provides greater value to older workers than younger workers. The value of benefits earned for someone who starts at age 50 can be 15% to 35% of salary in the first 15 years, while the value in the first 15 years for someone hired at age 20 is less than 6% of salary. Note that this incentive pattern may be exactly the one we want to create. Also, note that we could design a DB plan with a very different incentive pattern.

Phased Retirement

In a phased retirement, an employee transitions from full-time work to retirement by continuing to work on a limited basis (part-time or seasonal) and receiving some amount of his or her pension benefit. With respect to employers, phased retirement can be beneficial in that it may 1) help retain trained personnel, 2) reduce training costs, and 3) reduce salary and benefit costs as employees shift to part-time status. For employees, phased retirement can be beneficial in that it allows for 1) flexible work arrangements, 2) a gradual transition into retirement rather than a sudden shift, and 3) the opportunity to supplement retirement income or increase future retirement benefits by deferring current retirement income.

There are potential problems that may inhibit phased retirement implementation. It may increase actuarial costs and reduce spousal benefits. There are also legal and regulatory obstacles that may impede implementation. For example, phased retirement in DB plans prior to age 62 is restricted by IRS codes, which do not allow benefits distribution until the employee reaches retirement age or terminates employment. There are also concerns that phased retirements may violate age discrimination laws.

References and Summary of Literature

Furgeson, J., Strauss, R.P., and W.B. Vogt. 2005. The Effects of Defined Benefit Pension Incentives and Working Conditions on Teacher Retirement Decisions. *Education Finance and Policy* 1(3): 316-348.

- A $1,000 increase in real present value of pension benefits is estimated to increase the probability of retirement for female teachers in Pennsylvania by .02 to .08 percentage points
- Present value of real pension benefits strongly and significantly related to the retirement decision
- "30-and-out" rule increased retirement incentives in Pennsylvania

Gough, O., and R. Hick. Employee Evaluations of Occupational Pensions. 2009. *Employee Relations* 31(2): 158-167.

- Few respondents expressed the view that a pension was an important standalone factor in influencing their choice of employer
- Findings suggest that the retention function of pension is stronger than its recruitment function
- Pensions are more important to employees as they advance in age

Munnell, A.H., Triest, R.K., and Jivan, N.A. 2004. How do Pensions Affect Expected and Actual Retirement Ages? Chestnut Hill, MA: Center for Retirement Research at Boston College.

- On average, people with any type of pension plan will retire earlier than those without
- On average, people with DB plans retire earlier than those without DC plans
- Implication: Shift from DB to DC will eliminate much of the incentive to retire early

Munnell, A.H., Haverstick, K., and G. Sanzenbacher. 2006. Job Tenure and the Spread of 401(k)s. Chestnut Hill, MA: Center for Retirement Research at Boston College.

- Workers with DB plans who change jobs receive significantly lower benefits than workers with continuous coverage under a singe plan
- There was very little change in job mobility in the 1970's and 1980's
- During 1990's, median tenure for men of older ages started to decline
- Male workers in their 50's appeared to be shifting jobs more in a 401(k) world than they did when covered by DB plans
- Retention rates were also significantly lower in 1996-2000 than in 1983-1987
- Regression analysis: Coverage under DB plan raises tenure by 4 yrs., on average, compared to no pension coverage; under combined DB\DC by 5.8 yrs.; and under DC alone by 2.7 yrs.
- Implication: Shift from DB to DC implies a reduction in average tenure of 1.3 to 3.1 yrs, suggesting that the reduction in tenure between 1998 and 2003 and the shift from DB to DC are related

National Association of State Retirement Administrators, 2002, Phased Retirement Overview: Summary of Research and Practices, http://www.nasra.org/resources/Phased%20Retirement%20Overview.pdf

Podgursky, M. 2006. Is It Time to Rethink Teacher Pensions in Maryland? Baltimore: The Abell Foundation.

- MD pension system lowest in nation with respect to replacement rates
- There was argument in MD legislature that teachers were going to PA because it had a superior pension plan
- The report found no statistically significant differences in certified staffing rates between MD and PA, implying that teacher recruitment in MD was not hampered by the state's relatively inferior pension system

Towers Watson, 2005, How Do Retirement Plans Affect Employee Behavior, *Watson Wyatt Insider April 2005*. http://www.watsonwyatt.com/us/pubs/insider/showarticle.asp?ArticleID=14596

- Pensions are more effective at retaining workers than attracting new ones.
- Pensions, particularly defined benefit pensions, have greater appeal at older ages.
- Pensions attract workers who are more likely to stay with the employer.

Figure 1: Value Earned as % of Pay Under Current TSERS Plan

Enrollment Starting at Age 20

0% Annual Salary Increase and 7.25% Interest Rate

Figure 2: Value Earned as % of Pay Under Current TSERS Plan

Enrollment Starting at Age 20

5% Annual Salary Increase and 7.25% Interest Rate

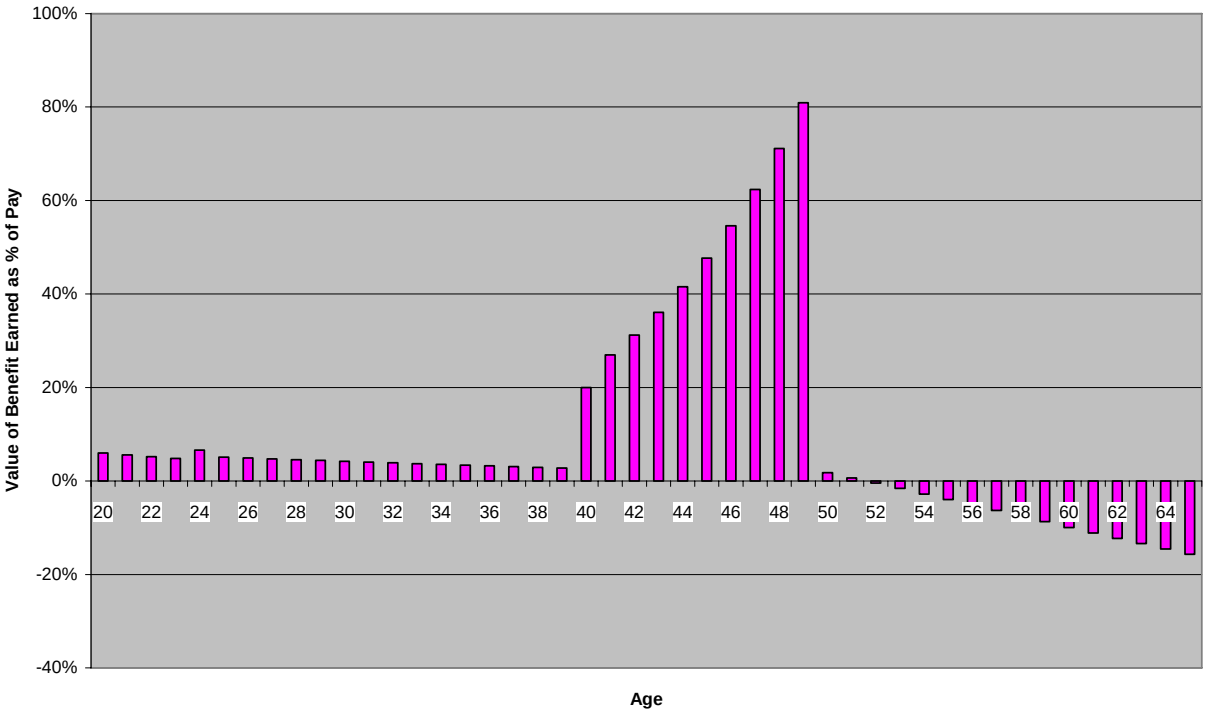

Figure 3: Value Earned as % of Pay Under Current TSERS Plan

Enrollment Starting at Age 35

5% Annual Salary Increase and 7.25% Interest Rate

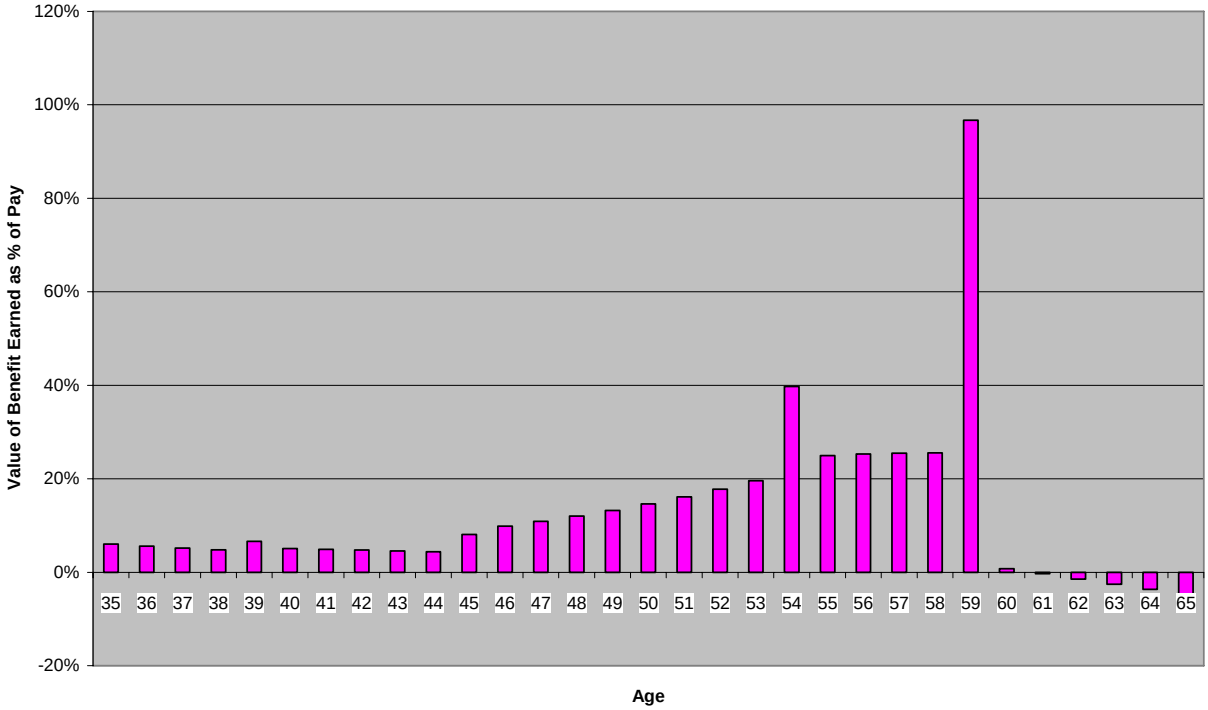

Figure 4: Value Earned as % of Pay Under Current TSERS Plan

Enrollment Starting at Age 50

5% Annual Salary Increase and 7.25% Interest Rate