Still River
Retirement Planning Software, Inc

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Retirement Income Planning, Part 11*: Early Retirement Offers as a Special Case and a Special Opportunity

Many employees receive an early retirement offer at some point in their careers. Each time this happens, it creates a crisis for the employee, and an opportunity for the financial community. We could be doing a better job of both easing the crises and making the most of the opportunities. Employers could also do a better job of designing special offers for select employees. This paper explains the problems and points to the beginnings of a solution.

A serious gap

The prevalence of early retirement offers fluctuates with the economy and with adjustments in strategy within the employee benefits profession. But the overall effectiveness of early-out offers is well established, and they are here to stay.

According to a study by Charles Brown at the University of Michigan's Institute for Social Research, during the 1990s nearly 30% of employees born in 1940 (and therefore in their 50s during that entire decade) received at least one early retirement offer.** Though this experience may be somewhat higher than the norm, the study does not include what later happened to these workers in their 60s. Looking at an entire career, therefore, it seems likely that about one out of three employees typically receives such an offer at some point.

* Part 1 of this series discussed in general form the urgent and wide-ranging planning needs of people facing retirement. In Part 2 we further explored the follow-up question: can a comprehensive financial planning approach really work for retirees and, if so, how? Part 3 examined investment risks and strategies, and argued that most retirees should be investing conservatively rather than for asset growth. Part 4 identified serious problems with the use of Monte Carlo models in retirement income planning, and suggested an alternative approach. Part 5 discussed the optimal time to annuitize. Part 6 dealt with the question of what retirees need from the planning process, suggesting inadequacies in current approaches. Part 7 outlined what "holistic" planning should mean for retirees. Part 8 set as its goal to define what Income Planning will look like in 2010. Part 9 discussed new product developments in this area, and weighed their importance and their limitations. Part 10 explored the different ways in which calculators could deal with risk.

** Charles Brown, "Early Retirement Windows," presented in May, 2002 at the 4th Annual Research Consortium, Washington, DC. Brown is also an economist at the National Bureau of Economic Research.

This means a lot of crises for people. At the very least, receiving an early retirement offer is a psychological jolt: it suggests that the company thinks it might be better off without you, and that it's time to start reevaluating your career. There is also a difficult immediate decision to make. The implications of accepting or rejecting an offer can be enormous, but the situation is hard to evaluate.

The difficulty is intentional. From the employer's standpoint, retirement offers are intended to produce a certain rate of acceptance, often about one-third to one-half, or even more. Making an offer "sweet" enough to entice that many employees to accept it, and not just reject it out of hand, means deliberately creating a dilemma for people.

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Unfortunately, many employees are just baffled by the financial side of the decision and, feeling inadequate, will make a choice based on uninformed assumptions or on purely non-financial grounds. Some employers help by making counseling available, or employees may find their own advisors. But unless these advisors have the right financial tools – and, as of now, they don't – the value of such advice is seriously limited.

For advisors with products or services to sell, this is a missed opportunity. Brown's study shows that employees receiving offers are much more likely to have pension plans, including defined contribution plans. This means that employees accepting such offers often have funds that could be immediately rolled over, annuitized, or withdrawn.

In addition, about 70% of people accepting early retirement offers actually do retire, instead of finding another job. When people retire, all kinds of financial decisions get made. Houses are sold, assets are re-allocated. Even for strictly middle-class families, hundreds of thousands of dollars are often in play. And Brown's study indicates that people receiving early retirement offers are not strictly middle class: they tend to have higher than average education and income. So a financial advisor who can provide comprehensive analytical services to people receiving early retirement offers has an extraordinary opportunity to expand his or her business, as well as to provide an extraordinary, useful service in the community.

Perhaps best of all, as a business opportunity, early retirement offers come in waves. When they happen, it is easy to find people who are receiving them. Since these people tend to be overwhelmed and confused by the decision they confront, they are eager clients for advisory services. The biggest problem, even for the well-prepared advisor, may be how to handle all the new business that becomes available. Without the right analytical tools, this kind of business can be seen as more trouble than it's worth.

But it doesn't have to be that way.

Qualitative vs. Quantitative analysis

Advisors in this market do have a difficult task. In fact, they have two difficult tasks. The first one is qualitative analysis: what is happening in ABC Company, and how does it affect employee X? Is the company restructuring in a way that will strengthen it, and that will ultimately provide more opportunity for employees who stay? Or is this just the next revolution in a long downward spiral? What are employee X's personal work skills and prospects, and what is their likely value inside and outside of ABC Company? Is the employee (and his/her family) really ready for a change in jobs, for relocation, or for retirement?

There can be no general answers to the qualitative questions. An advisor's ability to assist with them depends on his or her knowledge of the community, the company, and the employee.

But there is also a quantitative problem to be solved, and while it, too, is complex, general approaches and tools *can* be designed for it.

For most employees, there are really three choices: (1) reject the offer, (2) accept the offer and retire, or (3) accept the offer and get another job. Any one of these might be the obvious choice for any given person, but for most employees, it is not obvious at all. Only by showing the financial implications of each option can you make the decision manageable.

This is easier said than done. A truly robust analysis of the employee's situation is essential to determine whether immediate retirement is a feasible option, or how lucrative or long-lasting a new job would have to be to permit retirement a bit later down the road. Such an analysis has to go well beyond the specific terms of an early retirement offer and its effects on salary, severance pay, pension benefits, and health benefits. The family's income from other sources, its assets and debts, its expenses, its other benefits and insurance coverages, and its other financial goals and needs, all have to be taken into account. The advisor who can provide this kind of analysis is in a position to quell the crisis the employee faces, to gain permanent new clients, and to get easy referrals to other new clients. The advisor who cannot offer this kind of analysis can do only part of the job, and may end up not satisfying anyone.

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Opportunities for employers

Early retirement offers are, of course, intended primarily to benefit employers. The same kind of analysis that helps employees and advisors figure out whether to accept or reject an offer can also be used by employers to design retirement offers.

This is particularly true in cases where individual rather than group offers are being made. Employers often want to move an existing employee out of the organization, but don't want to fire him/her – or can't, because of union or other constraints. In many cases, therefore, the best solution is to offer the employee a package that will entice him or her to leave. Since we are now talking about an individual decision rather than a group one, rules of thumb may no longer hold. Designing an appropriate early-out offer has to be, to some extent, a cooperative arrangement between employer and employee.

If we had a good tool for helping recipients of general offers, that same tool could also help employers design special offers for specific employees. An offer would not just be tempting, it would be persuasive, because the employee could see that it would produce a good personal financial outcome. And if the analysis is persuasive, the employer saves money. The offer doesn't have to be overloaded for it to be accepted.

How close are we?

If you have looked for good software to help with these problems, you probably feel stymied. That's because early retirement is really a special case of "retirement income planning," and that software market is itself still in its infancy.

Here at Still River, we have been contending for some time now that planning for retirees and near-retirees should center on cash flow analysis, not investment analysis. This applies even more strongly to early retirement offers. They are rarely about investment expectations. They are about pension and health benefits, severance pay, new job opportunities, and the potential adequacy of all of these. Our approach also has the merit of existing today. As of this summer, our model (called RetirementWorks® II) has been enhanced to deal specifically with early retirement – though we see this as the beginning, not the end, of the solution in this market.

If, as some economists believe, we are now near (or even already somewhat past) the peak of the current business cycle, this issue could become much more urgent in the next few years. We don't claim to have all the answers, though, and if you are interested in sharing ideas, we will be happy to discuss what we have done, and happier still to hear what you have to say.

Still River Retirement Planning Software, Inc., provides both web-based and desktop software offering specialized calculations related to retirement plans and retirement planning.

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