

# Retirement, Risk & Finance Perspective

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## Phased retirement and older workers: Keeping talent on board

*By Pierce Noble and Erica Harper*

Baby boomers are starting to leave the workforce. The oldest of the nation's 78 million baby boomers turned 60 in 2006. However, as some begin their transition into retirement, others will remain in the workforce. With the current financial and banking crisis rocking the nation as well as the world, full retirement for some baby boomers is simply not an option. Faced with the realities of increased life expectancy, rising health care costs and less savings for retirement, many boomers have chosen to phase into a retired lifestyle through a flexible work arrangement known as "phased retirement." While this generation is challenging the traditional retirement paradigm, there is a silver lining, for both employers, who were facing the loss of skilled workers in an era of fierce competition for talent, and for baby boomers, who will benefit from staying active, feeling valued and achieving the comfort and security they desire.

While analysts disagree about the extent of the future labor shortage resulting from the retirement of baby boomers, it is clear that this group represents a significant portion of the workforce, and their exodus from the workforce, especially in industries such as aerospace, energy and health care, will surely be felt by employers. In this *Perspective*, we look at the combination of challenges and opportunities faced by employers as they try to retain these veteran workers and meet their business goals. Changes to the workforce profile are inevitable, and the question is *how will you respond?*

### This issue

- 2 *What challenges do employers face as they try to retain older workers?*
- 3 *How employers can adapt to the changing workforce?*
- 5 *What steps can employers take to implement a phased retirement program?*



*“Not only will companies be losing key workers, but they may find that similarly skilled replacement workers are also retiring.”*

## High-growth industries with a large percentage of older workers

Industry	Workers age 45 and older
Aerospace	55%
Energy	52%
Transportation	47%
Advanced manufacturing	43%
Health care	43%
Automotive	39%
Financial services	38%
Construction	34%
Retail	34%
Information technology	33%
Hospitality	21%

Source: Report of the Taskforce on the Aging of the American Workforce, February 2008.

## Challenges of an aging workforce

The workforce of the not-too-distant future will look a lot different from the workforce of the past. In the US it grew at a rate of 30 percent in the 1970s and at 12 percent in the 1990s through the present. But workforce growth is expected to slow to about 3 percent and level off by 2010.

By 2010, the number of 35 – 44-year-olds, those normally expected to move into senior management ranks, will actually decline by 10 percent. Also by 2010, the number of US workers between the ages of 45 and 54 will grow by more than 20 percent, while the number of 55 – 64-year-olds will expand by more than 50 percent.<sup>1</sup> Some research predicts a potential labor shortage of up to 35 million workers by 2030.

As the baby boomers retire, the pool of skilled, knowledgeable and experienced workers will shrink. Not only will companies be losing key workers, but they may find that similarly skilled replacement workers are also retiring. Labor shortages have already begun to be felt in a number of industries including health care, energy and aerospace. The shortage will become more acute as more workers in these industries retire in the next five to 10 years.

<sup>1</sup> Managing the Mature Workforce, Report #1369, The Conference Board

## Phasing in new opportunities for work

“As we are living longer and staying healthy and active to higher ages, many Americans are seeking new kinds of opportunities and new ways to work. Work is increasingly part of retirement. For many Americans, the most logical place to work as they are moving gradually into retirement is in the same firm where they worked before beginning to scale down. Yet benefit plans and pension laws that were designed to offer a secure and happy retirement and to protect Americans’ interests as they retire create barriers to restructured work and partial pension benefits. It is tragic that the systems designed to help Americans have a better retirement are a major factor in closing off good retirement options.

About half of Americans are phasing into retirement in some way. Many of them have no possibility of doing this within their long-term employers. I hope that more options will be open to them in the future, and that more employers will offer their own employees and retirees new work options.”

**Anna M. Rappaport, FSA, MAAA**

Anna is an internationally recognized expert on the impact of change on retirement systems and workforce issues and a retiree of Mercer. Read more on her phased retirement at <http://www.annarappaport.com/>.

## Employer’s perspective: Rethinking value

Traditionally, employers have felt that the value gained by retaining older workers wasn’t necessarily worth the cost and instead have hired new, younger employees. That thinking is being challenged as employers recognize that older employees tend to be more loyal and reliable than their younger colleagues, and often are more motivated.

In addition, although younger people have more career longevity ahead of them, they tend to change jobs more frequently, while older employees are more likely to finish their careers with their current employer. So, often the rewards reaped by investing in younger employees won’t likely be realized by the company making the investment.

If you invest in a 23-year-old, you are likely training them for their next job. The average 20 to 30-year-old worker changes jobs every three years. The average 40-plus worker changes jobs about every 15 years. So, you will usually get more years back by retraining and investing in a 45-year-old than a 25-year-old.

***“...employers recognize that older employees tend to be more loyal and reliable than their younger colleagues, and often are more motivated.”***

*“...‘phased retirement’ refers to a spectrum of opportunities that allow older workers to phase into full retirement by reducing their work hours (either in their current job or another area) with or without the ability to draw on their retirement income – along with opportunities for employers to hire retirees in a part-time capacity. ”*

## Employee’s perspective: Rethinking needs

People are living longer. In fact, post-retirement life expectancy has increased more than 25 percent in the past 35 years.<sup>2</sup> As a result, retirees may find that they have not saved enough money to maintain an acceptable standard of living for their lifetime. This is especially true for employees whose benefit “promises” have been taken away in recent years, as pension plans have been frozen and retiree medical benefits have been reduced or eliminated. In addition, as medical costs continue to soar, many retirees on fixed retirement incomes will not be able to afford post-retirement health care coverage without working part time or working past their normal retirement age.

From a social perspective, employees may not be ready to abandon the workforce overnight after working full time for 30 to 40 years. Phasing into this new lifestyle allows them to continue to interact with co-workers and engage in intellectual stimulation. And it’s been shown that working is just plain good for your health. The University of California Los Angeles (UCLA) Center on Aging Events found that the key components of successful aging include the ability to stay physically active and mentally engaged. Staying connected to the workforce is an effective way to accomplish both.

Over the past several years, the American Association of Retired People (AARP) and other organizations have surveyed employees about what they think they will do as they reach retirement age. The surveys find:

- A significant percentage of respondents said they do not want to retire when they reach what had been considered traditional retirement ages (typically age 62 or 65). These employees want to continue to work and gradually reduce the number of hours they work.
- The most common reason people gave for continuing to work is the need for money, including the need for medical benefits. But the desire to stay active and engaged is also important.



### Phased retirement – what is it?

Basically, “phased retirement” refers to a spectrum of opportunities that allow older workers to phase into full retirement by reducing their work hours (either in their current job or another area) with or without the ability to draw on their retirement income – along with opportunities for employers to hire retirees in a part-time capacity.

<sup>2</sup> National Vital Statistics Report, Vol. 53, No. 6 (Employment Policy Foundation, March 31, 2005)

Phased retirement programs can be formal or informal and can include various elements such as:

- Employees continue to work but on a reduced hours basis, such as part-time or seasonal
- Employment in the same job with reduced responsibilities or in a different area altogether
- Employees can be rehired in a consulting arrangement or through a third-party organization

While many businesses have begun to recognize the importance of human capital strategies and talent management in long-term success – and some industries such as health care, retail and banks have traditionally made use of a variety of work schedules – most companies have yet to take the steps necessary to stem the substantial loss of talent they will suffer as baby boomers retire. This “labor drain” threatens to hurt an organization’s economic prospects and competitiveness. While some companies have adopted creative approaches to deal with the issues, many other organizations have either not yet recognized the situation or are taking a “wait-and-see” approach.

In order for employers to have a successful phased retirement program, it must be aligned with the overall benefits program so that retirement benefits are not negatively impacted and employees are not penalized for working past normal retirement age. Although the current legal and policy environments present barriers to implementing such a coordinated program, alternatives do exist to accommodate a contingent workforce. These alternatives involve other aspects of human resources – programs and benefits besides just the retirement plans – and are dependent on the demographics of the workforce and the organization’s specific needs.

### **What might phased retirement look like?**

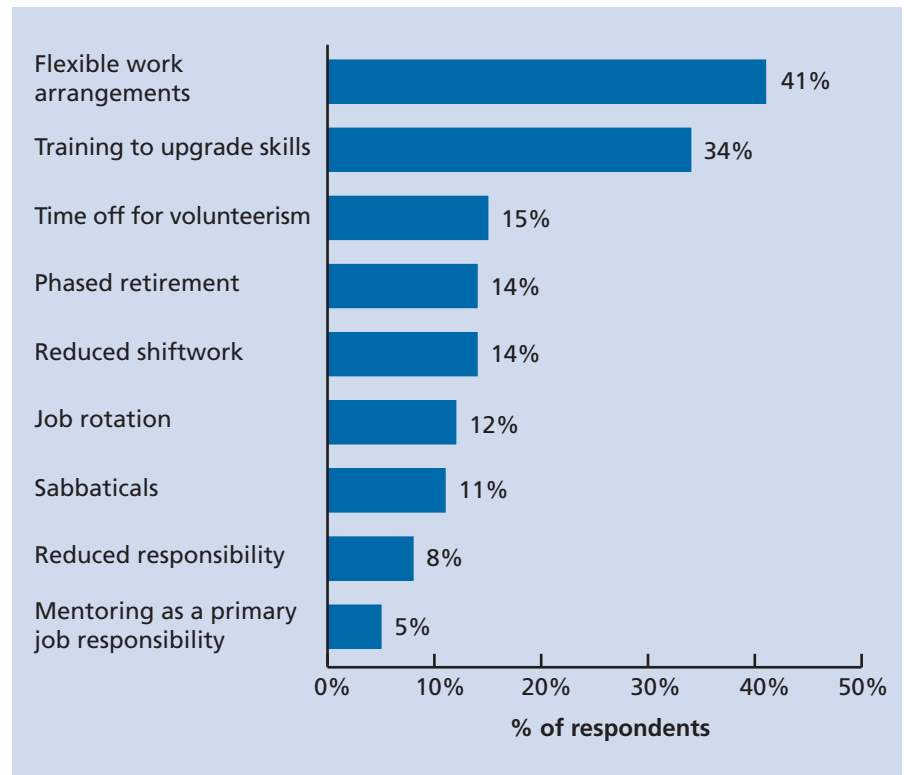
Before delving into the details of what to do, an employer will need to make a few basic decisions.

- Will it be a formal or informal program?
- Will there be an established narrow set of guidelines/rules that each interested employee must follow?
- Will the program be available to anyone who is interested? Will certain features of the program, such as flexible schedules, be available to all employees regardless of age or restricted to older employees?
- How much flexibility will be allowed, and what types of flexibility will be available? Will the program be limited to adjustable work schedules, or will it include job design and work location?
- How will pay and benefits be adjusted?
- How will the impact of phased retirement be communicated?

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*“While there are no barriers per se to adopting policies to encourage phased retirement, there are some obstacles to coordinating such a program with a company’s existing benefit programs.”*

A survey by The Conference Board identified various initiatives employers had undertaken to retain mature workers.



The most prevalent initiative was flexible work arrangements, offered by more than 40 percent of the employers. While a third of the respondents provided training to upgrade skills, the training was typically the same as that offered to all employees. Only 5 percent of the employers provided specialized training applicable to the needs of older employees.

### **What are the barriers to adopting a program?**

While there are no barriers per se to adopting policies to encourage phased retirement, there are some obstacles to coordinating such a program with a company’s existing benefit programs.

#### **Commencement age for pension benefits**

Prior to enactment of the Pension Protection Act of 2006 (PPA), a pension plan could not begin to pay benefits to an active employee prior to normal retirement age regardless of how few hours an employee worked. Normal retirement age is typically age 65. However, a plan that provided unreduced retirement benefits upon retirement at an earlier age, such as 60 or 62, could define normal retirement as such earlier age. Thus, even under prior law, such plans could commence benefits at this earlier age while an individual was still employed, although the IRS has recently placed new restrictions on plans with normal retirement ages under 62.

PPA did add a provision that allows pension plans to begin benefit payments to individuals who are still working at any time after age 62. A pension plan would need to be amended to add such a provision and would need to specify under what conditions payments would be made. The provision would also need to apply to all employees who meet the criteria, not just those handpicked by the employer. Since many employees interested in this option generally want to begin part-time work before age 62, this new option is not particularly helpful to many employers.

While this provision of PPA became effective on January 1, 2007, most employers have been hesitant to implement it without specific IRS guidance. The IRS has indicated that it is considering whether it should impose restrictions on the treatment of early retirement subsidies when benefits commence while an employee is still working. Presumably, the IRS will specify how the plan should calculate the pension benefit when the employee ultimately retires.

### **Proposed regulations issued in 2004**

In late 2004, the IRS issued proposed regulations on phased retirement programs. Key provisions of the proposal are summarized below. Some of these provisions might be included in the IRS regulations under PPA.

- Employees must be at least age 59½ to participate.
- Employees must reduce their hours by at least 20 percent.
- The phased retirement benefit cannot exceed an employee's accrued benefit, reduced in the same proportion as the hours have been reduced.
- Phased retirement benefits may not be paid in a lump sum or any other form that qualifies as an eligible rollover distribution.
- Employees must continue to participate in the pension plan in the same manner as if they were working full time, with adjustments made to reflect part-time status: pay must be annualized and credited service must be reduced.
- The hours worked during phased retirement must be monitored and the benefit must be adjusted if the actual hours worked differ from anticipated hours worked.

***“PPA did add a provision that allows pension plans to begin benefit payments to individuals who are still working at any time after age 62.”***

*“...to prevent a double reduction in benefits resulting from lower earnings and reduced hours/service, both pay and service could be annualized, thereby eliminating the negative impact of part-time employment on pension benefits.”*

## Benefit reductions

Sometimes employees who go to a part-time schedule could receive lower expected pension benefits when they ultimately retire than they would have received had they continued full time. This result can obviously reduce the attractiveness of phased retirement to employees.

According to a 2005 AARP survey of individuals over age 50 concerning their reactions to the concept of phased retirement:

- Almost 90 percent of the respondents thought it was important to be able to continue to accrue pension benefits while participating in phased retirement.
- About two-thirds indicated that a phased retirement program would be less attractive to them if it could lead to lower final pension benefits than what they would receive if they continued to work full time.

The causes of this potential reduction in benefits for those who move to part-time status and phase into retirement can be linked to how the plan calculates final average earnings and credited service. Many pension plans determine final average earnings by adding the compensation paid to an employee over a five-consecutive-year period (often the last five years or the highest consecutive five over a 10-year period) and dividing the total by five, regardless of whether the employee works full or part time. For employees finishing their career as a part-timer, this can result in a decrease in final average earnings causing the pension benefit to plateau (since once the benefit has been earned it cannot decrease), even as the employee continues to work.

Similarly, credited service can be impacted when an employee reduces his or her work schedule. For plans that use the elapsed time method of counting service, working reduced hours does not reduce the amount of service credit the employee receives. However, hour-counting plans typically determine service credit based on the percentage of a full-time schedule an employee works during a year. So an employee who works 75 percent of a full-time schedule would receive 75 percent of a year's service credit.

In order to prevent a double reduction in benefits resulting from lower earnings and reduced hours/service, both pay and service could be annualized, thereby eliminating the negative impact of part-time employment on pension benefits.



## DC plan withdrawals

Defined contribution (DC) plans such as 401(k) plans offer more flexibility than pension plans with respect to distributions while an employee is still working (called in-service withdrawals). In-service withdrawals can be made after age 59½, regardless of the source of the funds. Before age 59½, distributions can only be made from a DC plan under the following circumstances:

- Pretax and Roth contributions to 401(k) plans can be withdrawn in the event of financial hardship.
- After-tax contributions can be made available at any time.
- Vested employer account balances attributable to non-safe harbor matching contributions or non-safe harbor nonelective employer contributions to profit sharing plans can be withdrawn for any reason after a specified number of years.

Employees who take in-service withdrawals from a DC plan before age 59½ are subject to a 10 percent excise tax in addition to ordinary income taxes. However, distributions payable upon termination of employment after age 55 are not subject to the excise tax.

So employers who allow older employees to work reduced hours and begin receiving distributions from their DC plan to supplement their reduced income have some flexibility. However, as more employers adopt safe harbor matching contribution formulas, there will likely be fewer funds available for in-service withdrawals.

Besides the technical withdrawal issues, there are more tactical issues that DC plans present to employees as they near retirement. Specifically, the economic and investment uncertainty inherent in a DC plan may affect the retirement decisions of older workers and give them pause before tapping into a DC account, even as a part-timer. A phased retirement program that provides access to a guaranteed income stream, available predominantly through a pension plan, can offer the security needed to transition from full-time employment to ultimate retirement.

## Where to begin?

In the past 10 years many employers have seen a lot of their employees retire between ages 55 and 60. In fact, many employers with generous early retirement subsidies may experience an average retirement age of 60 or lower. Oftentimes there is no business need for these early retirements; instead, they drain the business of important intellectual capital, experience and customer relations. Meanwhile, most of these employees are fully capable of continuing to work and making valuable contributions to the business.

Employers who have compelling business needs to get older employees to work beyond traditional retirement ages might consider some changes in their benefit plans to encourage employees to stay. These changes could be in the form of a “carrot” (you get more benefits if you choose to retire later) or a “stick” (your benefits are reduced if you elect to retire early).

*“Besides the technical withdrawal issues, there are more tactical issues that DC plans present to employees as they near retirement.”*

*“Some employers have already taken significant actions to retain and recruit older employees.”*

As an example, let’s consider some changes an employer could implement if it wanted to provide incentives to employees to work past age 62:

1. Reduce the early retirement subsidy on future pension accruals for employees who retire before age 62 and increase the subsidy for those who retire at age 62 or later. This could be designed to be cost-neutral, but it would help to retain older employees. Employees view the early retirement reduction as a penalty and significant penalties do impact retirement patterns.
2. The same thing could be done with retiree medical benefits. The premium paid by retirees could vary based on the age of the employee at retirement. Again, this could be a cost-neutral design, where the premiums are increased for employees who retire before age 62 and are decreased for those who retire after age 62.
3. Increase the value (or perceived value) of the pension benefit to employees who retire after age 62 by
  - A. Providing a free (that is, subsidized) joint and survivor distribution option for those who retire after age 62
  - B. Adding a lump sum distribution option for those who retire after age 62
4. Assuming the pension plan currently suspends retirement payments to employees who retire and are subsequently rehired, amend the plan to remove the suspension and continue payments upon rehire.
5. Continue to provide active medical benefits with little, if any, increase in the premiums charged to the employee, since medical benefits are often a key reason to continue in employment.

### **What’s being done now?**

Some employers have already taken significant actions to retain and recruit older employees. Many of these initiatives go beyond mere changes to benefits programs and address real human capital needs by creating long-term workforce planning strategies. Described below are two real-life approaches:

#### **Borders Group**

In common with most employers in the retail sector, Borders Group, the parent company of Borders and Waldenbooks, has traditionally had a younger workforce profile. However, following publication of US census data in 2000, which underscored the anticipated growth of the 50+ working population alongside an expected reduction in the working population aged under 30 in a 10 to 20-year horizon, the company saw an opportunity. Employee job satisfaction surveys were demonstrating very high satisfaction levels among Borders’ older workers (a minority at that time). Taken together, Borders realized that older workers could potentially be a great fit for its business.

By promoting the benefits of a diversified workforce with hiring managers and offering attractive benefits, Borders has been able to increase the proportion of its workforce aged 50+ from 6 percent in the late 1990s to 18 percent today.

As well as flexibility in scheduling working hours from as little as four hours per week, the company makes available health and dental care plans to all staff, including part-timers. Importantly, the work environment provides intellectual stimulation and community connection.

The company values the stability that the older employees bring to the workplace, along with their life knowledge and experience. Stability has further value in lower turnover and consequent savings in training costs. Presently, turnover among Borders' over-50s workforce is six times lower than in its under-30s workforce.

As half its book sales are to customers aged over 45, the correlation between its staff profile and its customer base has provided further benefits: Customers like to buy from people like themselves. Those stores where the staff profile was more similar to that of the customer base have been financially more successful.

Reflecting on the obvious success of this policy, Dan Smith, senior vice president of HR for Borders Group, described his greatest challenge: "We don't have to persuade older workers or those in partial retirement to come to work, for these individuals are motivated and engaged. Rather, the challenge is in constantly reminding existing younger staff of the very significant and proven benefits that these older workers bring to the business."

Extracted from the Mercer Retirement Perspective "Gullible's Travels, Part III: Capturing the aging workforce to stay competitive" (<http://www.mercer.com/referencecontent.htm?idContent=1305010>)

### **Bon Secours Richmond Health Systems**

Bon Secours has effectively used a combination of phased retirement and other flexible arrangements and benefits to retain workers over age 50. The health system employs more than 6,000 people who provide care at four hospitals and numerous outpatient facilities statewide. Nearly one-third of its employees are nurses, 40 percent of whom will be age 50+ by 2010.

In addition to a variety of flexible work arrangements (like part-time, on-call, and compressed workweeks), common in the health care industry, Bon Secours has been offering three ways to phase into retirement since 2000.

- Employees who retire at age 65 or older may continue working part time (up to 24 hours per week) while collecting a full pension.
- Employees who work past age 70½ begin receiving a pension check in April of the following year.
- Employees who retire may later return to work and continue to receive their pension benefits, regardless of how many hours they work.

*"...turnover among Borders' over-50s workforce is six times lower than in its under-30s workforce."*

*“Employers that think outside the box and implement human resource strategies and policies that meet the phased retirement desires of employees will have a strategic advantage over other employers.”*

Under each option, employees continue to earn pension credit if they work more than 1,000 hours in a year. Their benefit is then recalculated when they stop working. In addition, employees receive full benefits if they work at least 16 hours a week. Or they can opt out of benefits for higher pay.

Read more on the Bon Secours' website at <http://www.bonsecours.com/>.



### **Thinking outside the box: Leveraging in-house talent**

Data show that in the years ahead there will likely not be enough workers in the US to fill the available jobs. This will present a problem for all employers as they look for qualified individuals. Employers in industries with an aging workforce face additional challenges. They could see a loss of institutional knowledge as they experience mass retirements of the baby boomers in the years ahead.

A significant percentage of the baby boomers are not interested in traditional retirement. Many prefer to continue working under alternative work schedules – part-time, temporary, seasonal and such. Employers that think outside the box and implement human resource strategies and policies that meet the phased retirement desires of employees will have a strategic advantage over other employers.

Employers are not alone in addressing this challenge. The impact of the aging workforce is significant enough to draw national, and even international, attention. In the US, many organizations and agencies independently address the needs of older workers. However, it has become apparent that a more collaborative effort may be required. In May 2006, the *Taskforce on the Aging of the American Workforce*, an interagency group comprising nine federal agencies including the Social Security Administration and the Department of Labor, among others, was formed.

Although employers have been hesitant to react quickly to these predictions, the imminent demographic shifts of the workforce cannot be ignored if businesses are to remain productive and competitive.

## Taskforce on the Aging of the American Workforce

The Taskforce on the Aging of the American Workforce is an interagency effort that was launched in 2006 to focus on the aging of the American workforce and the impact of this demographic change. It is composed of senior representatives from nine federal agencies: the Departments of Commerce, Education, Health and Human Services, Labor, Transportation, and Treasury; the Equal Employment Opportunity Commission; the Small Business Administration; and the Social Security Administration. The taskforce is chaired by Assistant Secretary of Labor for Employment and Training Emily Stover DeRocco and was charged with two primary goals:

1. Identifying strategies to enhance the ability of older Americans to remain in or re-enter the labor market and pursue self-employment opportunities; and
2. Identifying strategies to enable businesses to take full advantage of this skilled labor pool.

The taskforce released a report in February 2008 focusing on employers' response to the aging workforce, employment opportunities for older workers and the legal issues surrounding "phased retirement." The report demonstrates that this issue reaches from the individual contemplating retirement to the employer addressing productivity to the legislation supporting the changes. You can access information about the taskforce and download the full report at <http://aging.senate.gov/record.cfm?id=296837>.



*"...the imminent demographic shifts of the workforce cannot be ignored if businesses are to remain productive and competitive."*

## Additional resources

- **Gullible's Travels, Part III: Capturing the aging workforce to stay competitive**  
This article examines the effects of an aging workforce and explores how businesses can achieve competitive advantage by keeping older employees in the workforce longer and leveraging their skills.
  - May 2008 Mercer Retirement Perspective (<http://www.mercer.com/referencecontent.jhtml?idContent=1305010>)
- **AARP Best Employers for Workers Over 50**  
US companies and organizations are recognized annually for their best practices and policies for valuing the mature worker.
  - Published annually by AARP (<http://www.aarp.org/money/careers/employerresourcecenter/bestemployers/winners/2007.html>)
- **EBRI 2008 Recent Retiree Survey: Report of Findings**  
The 2008 Recent Retirees Survey was undertaken to better understand the tools and practices that might encourage workers to postpone their retirement and remain longer with their employer.
  - July 2008 Issue Brief 319 ([http://www.ebri.org/publications/ib/index.cfm?fa=ibDisp&content\\_id=3952](http://www.ebri.org/publications/ib/index.cfm?fa=ibDisp&content_id=3952))
  - July 22, 2008, podcast on Mercer HRadio (<http://www.mercerselect.com/cc/hg/podcast20080722ext/>)
- **Report of the Taskforce on the Aging of the American Workforce**  
The Taskforce on the Aging of the American Workforce was created as part of an effort to expand opportunities for older Americans choosing to remain in the workforce, and to develop proposals to address the challenges and opportunities of an aging workforce.
  - February 2008 report (<http://aging.senate.gov/record.cfm?id=296837>)
- **Gray Skies, Silver Linings: How Companies are Forecasting, Managing and Recruiting a Mature Workforce**  
The specter of baby boomer retirements raises unprecedented challenges for many companies, and important questions for others. To identify and respond to corporate concerns about recognizing potential workforce shortages and recruiting and managing mature workers, The Conference Board report presents 12 case studies, plus companies' bottom-line strategies and their own big-picture insights.
  - December 2007 Conference Board report authored by Mary Young with Diane Pikatialis and Anna Rappaport (<http://www.conference-board.org/>)
- **Phased Retirement After the Pension Protection Act**  
More companies will be able to use phased retirement to retain valuable skills and knowledge while providing mature workers with an alternative to the all-or-nothing approach to retirement, according to a report released by The Conference Board.
  - May 2007 Conference Board report authored by Anna Rappaport and Mary Young ([http://www.conference-board.org/utilities/pressDetail.cfm?press\\_ID=3099](http://www.conference-board.org/utilities/pressDetail.cfm?press_ID=3099))

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## Editorial policy

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