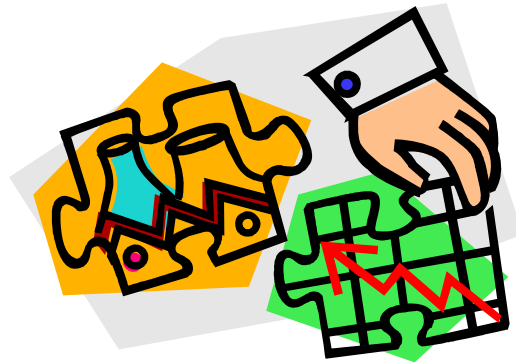




# The Challenge of “Phased Retirement”



**CUPE Discussion Paper**

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## The Challenge of “Phased Retirement”

With little fanfare, the March 2007 federal budget outlined a plan to formally introduce a fairly dramatic new version of an idea that has been around for some time – so-called “phased retirement”. While this concept has existed in several Canadian jurisdictions since 1997<sup>1</sup>, its implementation had previously been complicated, and the take-up was minimal.

With a package of amendments to the federal *Income Tax Act* (ITA) and the federal *Pension Benefits Standards Act* on December 14, 2007 the earlier budget proposals were passed into law through Bill C-28. They open the door to a fundamentally different and potentially troubling version of “phased retirement” that merits significant debate and discussion throughout CUPE and across the labour movement. While the older form of phased retirement had required complicated systems to “work around” the tax rule prohibiting simultaneous work and receipt of pension income, the new changes have eliminated that prohibition. Phased retirement – version 2008 – will for the first time ever allow (certain) workers with defined benefit pension plans to begin to draw pension benefits while simultaneously continuing to work.<sup>2</sup>

The idea certainly sounds appealing. Phased retirement would permit eligible individuals to continue to work into their late 50s and 60s, possibly working substantially fewer hours, and receive substantial pension income that supplements their less-than-full-time earned wages. What’s not to like?

There are some immediately noticeable concerns. Who will be eligible for such phased retirements? Would employers be able to hand-pick the employees they want to grant “Cadillac” phased retirement benefits? What would prevent employers from using phased retirement to lure those willing (and able) to continue working and effectively subsidize their payroll from the workers’ pension fund? What if employers want to pay for this by cutting back on the current early retirement provisions or even delay the normal age of retirement past age 65? A serious debate is clearly needed.

This paper aims to accomplish four things. First, it will briefly set out the difficult labour relations context into which Phased Retirement has been introduced. Second, it will outline the basic framework of Phased Retirement that the newly amended tax rules permits. Third, it will consider a number of “pros and cons” of the concept, focusing in particular on the situations of unionized and public sector/public services work that CUPE members perform.

Finally, as a “Discussion Paper”, the paper will set out a number of questions that we should be asking and discussing within our membership. Whether or not phased retirement becomes a topic for future formal policy development, the issues raised in what follows deserve to be widely aired and fully debated if CUPE is to continue its strong leadership in defence of our members, our working conditions, and our retirement security.

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<sup>1</sup> See Grant Buckler, “Making a gradual exit,” *Globe and Mail*, November 12, 2003. For a more detailed overview, please see *Mercer Pension Manual*, Vol. I. [DETAILED CITATION NEEDED]

<sup>2</sup> While phased retirement can also be implemented under “defined contribution” or money purchase type pension plans, such plans will not be considered in this discussion paper.

## The Present Context

It is now commonplace to hear that employers are either already facing or are about to face a serious labour shortage. The further ageing of the “baby boom” generation into the range of early retirements and close to the age of normal retirement (65) has led many employers to complain about the “threat” of a mass exodus from the labour market. In certain cases, particularly within health care and skilled trades groups, there is also a concern of a shortage of younger workers with the skills or training to replace these workers. To some extent, this demographic reality forms a key part of the context for the introduction of phased retirement programs that will keep older workers working.

The debate about age and demographics has been particularly advanced in Québec. In part, this is an understandable product of a distinct demographic context in which the widespread “ageing” of the workforce is particularly acute, and is exacerbated by an exceptionally low birth rates. This explains the early introduction of “phased retirement” options in Québec.<sup>3</sup>

Nonetheless, the workplace realities that CUPE members face across the country are much more challenging than just an ageing workforce. **Our pension plans are under significant attack.** Many employers are proposing to convert secure defined benefit plans to individualized RRSPs or defined contribution to plans that offer no security. Proposals to introduce new, second-tier “defined contribution” plans for new hires only are beginning to hit bargaining tables. While most groups have successfully fought off such attacks, the pressures and the threats are growing.

Broader government policies are also affecting the “age of retirement” picture. In recent years, consideration has been given to **raising the age of retirement for CPP.** Similar proposals in the US and Germany have already been approved, resulting in gradual increases of the “normal retirement age” to 67 (in the US and Germany) and 68 (in Britain).<sup>4</sup> These policy changes have been driven by governments aiming first, to reduce social expenditures (and the taxes needed to finance them) and second, to extend working lives to a later age such that longer pay-in periods will finance shorter periods of retirement. To the extent that this is successful, these changes will also relieve many employers of pension costs as workplace pension plan liabilities are proportionately reduced by delayed retirements.

Severe pressures at the workplace and the bargaining table are also taking their toll. **Continuing threats to contract out or privatize services** shape CUPE’s bargaining climate. In many sectors, the incidence of part-time, temporary, casual, and other “precarious” work categories are on the rise – all of which have the effect of reducing the percentage of workers that have access to key benefits, including decent pension coverage.

Finally, what should be good news for workers – we are living longer lives – is fuelling another pressure. Under existing age of retirement rules, our longer lives produce longer retirements. In turn, this has led to increased pension plan liabilities – and has therefore been yet another factor in rising pension plan costs. Employers are reacting in the ways listed above: proposals to either dump the pension plan altogether or to cut various kinds of benefits, particularly beneficial rules allowing early retirement (at various ages between 55 and 64).

This is the difficult context into which the federal government has introduced “Phased Retirement”.

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<sup>3</sup> For a detailed discussion of the demographic picture in Québec, see Finances Québec, “Promoting Phased Retirement,” Budget 2007-2008, February 2007.

<sup>4</sup> See for example, Uwe Hessler, “Controversy over rising retirement age heats up in Germany,” *Deutsche Welle*, February 12, 2006. Also, “Britain to raise retirement age,” *CBCNews.ca*, May 25, 2006.

## The New Framework for Phased Retirement

The new framework for phased retirement is markedly different than what had been in place. Looking back, the Alberta and Québec governments had introduced variants of the concept that involved those eligible (minimum age 55) receiving annual lump-sum payments from their pension plan to make up for reduced work time. The caps on those lump sums and the reductions in work time required were variable, and the cost of the lump sum pay-outs were, essentially, borne by the individual plan member. The **New Brunswick Nurses Union** also negotiated a type of phased retirement program, and it involved a “deeming” of full-time work during a “phased” period of reduced work time that saw top-up payments from the pension plan.<sup>5</sup> However, as in Alberta and Québec, the temporary payments are essentially deducted from the pension that otherwise would have been payable to the member.

The new framework under the Income Tax Act and federal pension law permits plans to establish new and greatly expanded “phased retirement” provisions. To be eligible for the provisions, plan members must be either:

- 1) age 55 and eligible for an unreduced early retirement;
- 2) age 60.

The phased retirement benefit allowed to provide plan members with:

- a benefit worth up to 60% of their already earned lifetime pension; and/or
- the amount of the plan member’s early retirement bridge benefit (if any)<sup>6</sup>

While it is often assumed that phased retirement will involve a reduction in either hours or days worked, **the new form of phased retirement benefit can be legally provided even to those workers that continue working full-time.** In practice, this makes the term “phased retirement benefit” inaccurate – it would more accurately be characterized as a **wage supplement**. Whether the recipient is continuing to work full time, or reducing their hours substantially, they are not retired but working, and the wages that they will continue to earn will be additionally supplemented by the phased retirement benefit.

The new tax legislation does not specify who will be responsible to pay the costs of phased retirement programs. This question may be determined by expected changes to provincial pension legislation or, it will ultimately be determined at the level of each individual pension plan. One significant point is that the rules permit plans to allocate all of the new costs associated with a phased retirement program to the employer (or in some cases the fixed-cost payers that may include plan members).

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<sup>5</sup> See Conrad Ferguson, “Phased Retirement (Enablers and Barriers) and Other Programs for the Retention of Older Health Care Workers,” Workforce Management study, Morneau Sobeco, March 31, 2004, p. 16.

[http://www.cna-aic.ca/CNA/documents/pdf/publications/Retention\\_Older\\_Health\\_Care\\_Workers\\_e.pdf](http://www.cna-aic.ca/CNA/documents/pdf/publications/Retention_Older_Health_Care_Workers_e.pdf) This study explains that in all three examples, the existing ITA restrictions were avoided by having the phased retirement benefits structured as partial terminations.

<sup>6</sup> ACS/Buck Consultants, “Extra! – Department of Finance releases draft amendments to enable “phased retirement” pension benefits,” December 2007. We note that while this document suggests that the Phased Retirement benefit can constitute both the 60% pension and the bridge benefit together, other commentary is not as clear on this point.

It is also possible to allocate the costs in the way that Québec's pension law originally required: the value of any "phased retirement" benefits drawn while still working would be deducted from the ultimate full-retirement entitlement of the individual.<sup>7</sup> In other words, in Québec, plans would reduce their final pension at retirement to reflect the amounts that were already paid out to the individual under the phased retirement program.

None of the provinces have yet amended their pension regulations to reflect these new possibilities so it remains to be seen whether the original Québec model will be followed, or whether such decisions will be left to plans, employers, and unions to work out.

### **Phased Retirement: Pros and Cons**

CUPE's National Advisory Committee on Pensions has been concerned about the emergence of Phased Retirement for several years. Clearly, the idea is appealing to those of us who think we will benefit from it. But how does phased retirement connect to the larger context of today – our fight to defend pensions and early retirement, the move to privatize and shift jobs to part-time, and the attack on unions? What are the "pros and cons" of this idea?

It is still early in the evolution of the new model for phased retirement to come to definitive answers to some of these questions. However, enough is known for us to be able to identify a number of clear "pros" and "cons" (depending in part on the model for phased retirement eventually implemented).

#### Pros

- Creates a new option for workers, particularly those in physically demanding jobs, who are inclined to reduce work-time without facing penalties on their eventual pension;
- For those in low-wage jobs, an opportunity to continue working and building pension entitlement while slowing down the pace of work;
- Allows "work-and-pension-payment" combination at same job, rather than having to fully retire and find work elsewhere;
- Advantageous for those intending to continue working beyond "normal" retirement age.

#### Cons

- Phased retirement pension benefits could become a wage supplement that indirectly subsidizes employer wage payroll, particularly if recipients of phased retirement benefits continue working full-time;
- Particularly if full-timers begin to receive phased retirement benefits, it could introduce a new relatively privileged group of phased retirement recipients who no longer count on union to collectively bargain fair wage increases;
- Adds to pressure to reduce or eliminate decent early retirement provisions;
- Could contribute to pressures to increase normal age of retirement (for CPP and OAS, currently age 65 for most workers);
- Without clear rules, could be applied selectively by employers only to favoured individuals, management, or other categories;
- May contribute to increasing move from full-time to part-time jobs;

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<sup>7</sup> However, the Government of Québec has just passed Bill XYZ, which appears to accommodate the new ITA rules in much the same way as the federal Pension Benefits Standards Act.

- May only or primarily benefit long-service workers (often disproportionately male) who are more likely to reach unreduced early retirement thresholds;
- May leave some “phased retirees” who continue to work without group insurance (extended health) benefits, particularly for groups where eligibility for LTD and other benefits ends at age 65.

One of the “cons” listed above deserves particularly strong comment. Perhaps the most shocking aspect of the phased retirement provisions now permitted in the federal jurisdiction is the lack of any rule protecting workers from arbitrary and unilateral employer discretion regarding which employees will be eligible for phased retirement benefits. At worst, this would seem to permit the possibility of an especially generous provision for phased retirement that the employer would be entitled to “give out” to employees of their choice.

Not surprisingly, Ian Markham - one of Canada’s most conservative actuaries - has already embraced the handpicking option in one of his recent commentaries:

Ideally, **an organization needs to be able to pick and choose** which individuals are most critical and to develop tailor-made phased retirement packages that meet the needs of the almost-retired employee and the organization itself.<sup>8</sup>

By all appearances, such “picking and choosing” is now possible in the federal jurisdiction and Québec, since the December 2007 changes to the federal pension law (the *Pension Benefits Standards Act*) and the April 2008 changes to Québec pension law appear to permit it.<sup>9</sup>

Clearly, trade unionists have much to be concerned about with the advent of a new form of phased retirement. We turn next to the kinds of strategies that we can use in response.

### Strategic union responses to phased retirement

As the new framework for phased retirement is so recent, very few trade unions have yet established policies or positions on the subject. Even in the absence of a formal policy, there are several things that we know CUPE members and locals will want to do in response to phased retirement. The following is an initial list of “defence strategies” that might be considered when confronting employer proposals for (or negotiating) phased retirement programs.

- i) Defending and improving existing pension plans – Care must be taken to avoid any “trading off” of early retirement provisions or other pension benefits for phased retirement, particularly where phased retirement is likely to benefit fewer members.
- ii) Ensuring fairness – Like any other pension or benefit program, phased retirement must not become a special benefit that the employer is permitted to provide selectively on an individual basis (i.e. handpicking). Note: this fairness requirement should be made a minimum standard on each provincial pension law, and pressure should be applied to ensure that this happens.
- iii) Defend and improve public pension plans – Trade unionists can press even harder to defend the long-standing age 65 normal retirement and to improve the inadequate benefits paid by both Canada Pension Plan and Old Age Security;

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<sup>8</sup> Ian Markham, “Are pension plans part of the solution to labour shortages?” *Benefits Canada*, June 7, 2007. [http://www.benefitscanada.com/pension/db/article.jsp?content=20070607\\_092253\\_5248](http://www.benefitscanada.com/pension/db/article.jsp?content=20070607_092253_5248) Emphasis added.

<sup>9</sup> See AON Consulting, “Bill 68 – Québec Government takes a Stand on Phased Retirement,” *InfoFlash Canada*, April 8, 2008.

- iv) Protect existing plans, funds, and surpluses. Any costs associated with new phased retirement provisions must be distinguished from the existing plan, and allocated fairly – preferably to the employer. Employers should not be permitted to raid our surpluses to pay for phased retirement that will primarily benefit them.
- v) Defend full-time jobs. The introduction of a phased retirement program must not be an excuse to permanently change full-time jobs to part-time, or to leverage public sector work into contracted-out or privatized work.

### Some “Open Questions” for Debate and Discussion

Having outlined the concerns above, there remain a number of open questions that merit significant debate in the coming months. Provincial governments across the country are now in the process of reviewing their options for adding phased retirement provisions to their pension laws. This makes it quite urgent that a strong union perspective, policy and strategy be developed in response.

With an eye to provoking a discussion that will help feed the development of such policies and strategies, we close this paper with the following questions.

1. Should CUPE National develop a policy, or a strategy, in response to the new phased retirement framework?
2. Given the potential for super-generous “Cadillac” phased retirement, should unions advocate certain limits on the wide-open range of options left available by the new Income Tax Act provisions? Such limits might include:
  - a. a cap on the combined (wage plus pension) income permitted at, for example, 100% of regular wages (or less);
  - b. a requirement that “phased retirement” requires a minimum level of reduced work time, such as 25%<sup>10</sup>
  - c. a cap on the percentage of lifetime pension payable to phased retirees (i.e. something below the 60% level permitted by the ITA);
  - d. a firm rule requiring the employer to fund all costs associated with phased retirement;
  - e. a rule requiring that any new costs associated with phased retirement will be paid by the employer and that no fund surpluses should be used to fund phased retirement costs;
3. Is phased retirement a union priority at all? What percentage of the existing membership would benefit from a phased retirement program?
4. What kinds of tools should members, bargaining teams, and staff have at their disposal when confronting phased retirement?

### Conclusion

This Discussion Paper will be circulated widely throughout CUPE, and the intention is to generate sufficient debate in order to begin formulating policies and strategic responses to these developments. If your membership or local has views on the subject, or direct experience with phased retirement, please share them with your provincial representative on the National Advisory Committee on Pensions and with our research specialists on pensions at the National Office.

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<sup>10</sup> The original model for phased retirement in Québec followed this logic, but it appears that the Bill 68 proposals to adopt more liberal phased retirement provisions may have discontinued that legislative framework.

Further information and tools relating to phased retirement will be posted to the CUPE website and distributed in print form as they become available. Stay tuned, this debate is only beginning.

**To share experiences with or views on phased retirement, please contact:**

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