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The Faculty Retirement Decision: Financial and Other Considerations

Introduction

Decisions about retirement encompass numerous factors, both financial and nonfinancial, and require careful consideration of the employee's unique personal needs as well as all of his/her available options. For college and university faculty, nonfinancial issues – particularly in regard to intellectual and social engagement – may weigh just as heavily into the decision as the monthly payout from the pension plan. As healthcare costs continue to accelerate, the question of who will pay the insurance premiums throughout retirement looms large, and may play a big role in influencing one's retirement date. Whether phased retirement is available and attractive also becomes an important consideration for faculty members wanting to ease into retirement.

Financial advisors and relationship managers can provide enormous assistance to faculty members as they wrestle with both certainties and uncertainties surrounding retirement decisions. Helping them assess their full financial picture – both before and after retirement – is a critical component of the advisory process. Understanding their nonfinancial requirements is another essential component of the advisory relationship.

This paper will attempt to provide insights into the myriad factors that enter into an individual's decision-making process. With a better understanding of these factors, advisors and relationship managers can provide more valuable counsel to their clients.

Financial Considerations

A number of studies have indicated that people who plan for retirement tend to have greater wealth in retirement, and the sooner the planning begins, the better off they'll be. Higher levels of education are generally associated with increased planning, contributing to the fact that college and university faculty members tend to be better prepared financially for retirement than the general public. Nevertheless, a sizable percentage of working faculty have not engaged in a detailed analysis of their current income and expense components, let alone an examination of how these variables may change in retirement. Getting a handle on the individual's overall financial situation – including assets and liabilities in addition to income and expense items – is thus an essential step in considering the economic feasibility of retirement.

Many workers have a preconceived retirement date in mind that is not based on economic reality, which can result in negative surprises in retirement. Others may assume that they'll need a certain percentage of preretirement income – 75-80 percent, for example – simply because they've heard of generalities that may or may not apply to their own circumstances. Other income – such as Social Security and earnings from other investment accounts – needs to be considered, along with all expenses. Will income increase in line with inflation? Are the children finished with college and will they need help buying their first home? Are there elderly parents who will need financial assistance?

Medical Coverage in Retirement

One of the biggest retirement considerations is that of healthcare coverage. In fact, more than one study has indicated that the availability or lack of health benefits is the single most important variable in faculty retirement decisions.[1] Does the institution provide a group medical plan? If so, does the employer or the employee pay the premiums, or do they share the costs? Are there service or age requirements for eligibility? In a recent study by Watson Wyatt, 12 out of 46 private school respondents, or 26 percent, indicated that they do not provide a retiree medical insurance plan.[2] On the other hand, nearly all of the public institution respondents – 21 out of 22 – indicated that they do provide a health insurance plan for retirees.

Offering a retiree medical plan, however, does not necessarily mean that the institution picks up the tab: some institutions may cover all of the costs, while others pay part or none. Some institutions do not contribute to medical coverage for persons retiring before Medicare becomes available at age 65. Employees at such institutions may not be able to afford early retirement if they have to cover their own medical insurance costs. Other institutions may stop coverage when Medicare benefits begin. Institutions also may vary widely in eligibility requirements that are based on employees' years of service; the requirements typically are more stringent at private institutions than at public institutions. For example, about 90 percent of private academic employers in the recent Watson Wyatt survey have implemented service requirements of at least 10 years for retiring faculty to qualify for retiree health benefits, compared to about 60 percent of public academic employers. Conversely, about 40 percent of public employers provide retiree healthcare coverage to employees with five years or less of service, compared to only about 10 percent of private employers.

Age, Health, Gender

A recent survey of faculty at the University of Minnesota and the University of North Carolina indicated that a large majority of college and university faculty members plan to retire at age 66.[3] Other studies have corroborated an average faculty retirement age of 65-66. The end of mandatory retirement ages has added approximately one year, on average, to the working career of faculty. Interestingly, it appears as if there is a bimodal distribution of retirement ages in which a small percentage of faculty intends to work significantly beyond the average retirement age. In general, good health is associated with later retirement and poor health is associated with earlier retirement.

Regarding differences in retirement patterns between the genders, survey data suggest that women are far more affected than men by their family situations – including household income and spouse's employment – when making retirement decisions.

Spousal Influence

Considerable research has been conducted on the tendency of spouses to retire near the same time. One particular study, conducted of a broad segment of retiring workers, revealed that between 22 percent and 40 percent of husbands and wives retire within two years

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[1] Jerry Berberet et al. "Planning for the Generational Turnover of the Faculty: Faculty Perceptions and Institutional Practices." To be published in a collection of papers by the TIAA-CREF Institute in 2005.

[2] Sylvester S. Schieber, "The Future of Retiree Health Benefits in Higher Education in the United States." Paper presented at the TIAA-CREF Instittue "Three Rs" conference, New York, NY, on April 1-2, 2004.

[3] Berberet et al. "Planning for the Generational Turnover of the Faculty: Faculty Perceptions and Institutional Practices."

of each other, presumably in order to spend their leisure time together.[4] The likelihood of both spouses retiring at about the same time is higher when the retirement decision is voluntary for both of them as opposed to when one retires involuntarily. However, if one spouse retires involuntarily – perhaps due to health reasons or job termination – there's an increased probability that the other spouse will need to work longer for financial reasons. This is particularly true if the non-working spouse is too young to qualify for Social Security (SS) retirement benefits and does not qualify for SS disability benefits.

Anchor Effect

Employees thinking about their retirement age also can be influenced by what is called the "anchor effect," meaning that people develop expectations for themselves based on what they perceive their peers to be doing. If an individual's peers tend to retire at age 62, he/she will be reluctant to deviate much from that because of the anchor effect. The anchor effect can cause employees to retire sooner than is economically feasible because working longer than the anchor may be considered a failure. This type of influence appears much more frequently in jobs that provide little satisfaction, and much less so in positions such as teaching where working longer does not carry a stigma.

Type of Retirement Plan

The type of retirement plan can influence one's chosen retirement date, particularly with defined benefit (DB) plans in which retirement payouts are generally a function of one's years of service and salary level. A DB plan may provide a significantly larger pension payout after 30 years of service, for example, compared to 27 years. As a result, retirement dates for employees with DB plans tend to cluster around the ages (or years of service) for early and normal retirement, similar to the clustering that occurs at early and normal retirement ages for Social Security.

In contrast to DB plans, the value of a defined contribution (DC) account is not based on years of service per se, but rather on the behavior of the financial markets in which it is invested. (The amounts of employer and employee contributions, obviously, also are important factors to the value of the retirement account.) Employees with DC plans tend to work approximately one year longer than those with DB plans. However, a very strong financial market may influence an employee to retire and lock in an annuity at a favorable rate; conversely, years of poor market performance may influence an employee to work longer and attempt to build up the nest egg before retiring. Advisors and clients may want to consider locking in a fixed annuity with a portion of the retirement fund, in order to cover basic needs, and keep some of the remainder invested in equities to allow for future growth.

Intellectual and Social Aspects of Working

An extremely important aspect of the retirement decision relates to the nonfinancial benefits that faculty derive from working. Among them, intellectual stimulation and satisfaction from the life of academia are paramount. Senior faculty members who have worked 55-60 hours a week for many years have much of their identity associated with their colleagues, students, research, and institution. A number of studies of faculty motivation and satisfaction rank intellectual inquiry at the top of the list, followed by membership in a meaningful academic community, the desire to have institutional impact, and the desire to be recognized for one's work.[5] In general,

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[4] Richard W. Johnson and Melissa M. Favreault, "Retiring Together or Working Alone: The Impact of Spousal Employment and Disability on Retirement Decisions." Center for Retirement Research at Boston College, March 2001.

[5] Berberet et al. "Planning for the Generational Turnover of the Faculty: Faculty Perceptions and Institutional Practices."

employees with particularly high and low motivation are more likely to keep working than those with a moderate level of motivation. Those with high motivation keep working because they enjoy it; those with low motivation (found more likely outside of academia) often need to keep working for financial reasons.

In short, faculty members are more inclined to work longer than the general population because they enjoy it more. A related factor may be that academic work is less physically demanding than many other types of work, despite the fact that faculty members tend to work long hours. However, certain faculty members may burn out from years of teaching and administrative responsibilities, and want to consider a lighter workload or a different type of pursuit altogether. Relationship managers need to be attuned to each client's particular level of work satisfaction (or lack thereof) and help him or her factor that aspect into retirement-related decisions.

Hobbies and Other Interests

The decision to retire may be strongly influenced by the employee's desire to have more time for hobbies, grandchildren, and volunteer work, among other things. If this desire is strong, the preference for more discretionary time may outweigh the financial and other benefits of continuing to work. This concept is referred to as "time preference," and those with a strong time preference may be willing to give up substantial monetary benefits in order to gain more discretionary time. Advisors can help clients assess the full ramifications of the tradeoffs and perhaps suggest other alternatives such as part-time work or phased retirement. In other instances, faculty may be considering retirement from their institution in order to take on more lucrative employment outside of academia. This scenario is more likely during strong economic periods when the unemployment rate is low.

Changing Circumstances

Unexpected developments can cause employees to consider retiring either earlier or later than originally planned. The onset of poor health may cause an employee to choose early retirement; on the other hand, poor health and early retirement of one spouse may require the other spouse to delay retirement. A change in marital status can sometimes alter one's retirement plans, either earlier or later.

Retirement Incentives

As institutions of higher education grapple with severe budgetary challenges and aging faculty, particularly since the end of mandatory age-based retirement, some offer retirement or "separation" incentives as cost-saving measures. In some instances the incentives are available only for a limited time whereas in others they are ongoing. Often, the incentives are linked to variables such as the employee's salary level, age, and years of service. The incentives may be paid in cash as a lump sum or take the form of pension credits. Studies have shown that employees often are not well informed about incentives and other benefits; relationship managers can fill in many of the knowledge gaps and help employees make better-informed decisions.

A faculty member considering a separation incentive will want to consider not only the monetary aspects – including cash payments, pension credits, medical insurance – but also whether nonfinancial benefits would continue after accepting the separation agreement. For example, assuming the faculty member wants to maintain a connection to the institution and to scholarly endeavors, would office or lab space still be available? What about the ability to apply for research grants?

Phased Retirement

Offering phased retirement is another tool institutions may use to help achieve staffing objectives. Perhaps an institution needs to reduce the number of older full-time faculty in order to have funds for attracting younger faculty. Or perhaps the institution wants to increase intergenerational continuity by making continued employment of older faculty an attractive option for those who no longer want to work long hours. For older employees, phased retirement may offer an ideal arrangement for easing into retirement. It allows them to maintain their relationships at their institution while offering more time to pursue other activities.

A survey conducted in 2000 by the American Association of University Professors, with the financial support of the TIAA-CREF Institute, found that 27 percent of the responding institutions had a phased retirement program in place. Most commonly, the programs require participants to have reached a certain age, such as 55 to be eligible, along with a service requirement such as 10 years or more.[6]

A phased retirement program is generally not a good fit with DB plans since DB payouts are linked to final average salary, which would be greatly reduced under phased retirement. For these and other pension-related reasons, institutions with DB plans are far less likely to offer phased retirement than are those with DC plans. Partly because private institutions tend to offer only DC plans, phased retirement programs are more commonly used at private institutions – and particularly at private research and doctoral institutions – than at public institutions.

As alluded to earlier, employees with DC plans face considerable uncertainty about their pension income because the value of their pension hinges on investment performance. Faculty members who are concerned about a possible decline in their pension value may be attracted to a phased retirement program that permits them to annuitize their retirement account while still earning approximately half-pay and possibly other benefits. The phased retirement option allows the employee greater flexibility in deciding the timing of work reduction and the commencement of pension payout.

The most common form of phased retirement is half-pay for half the workload. Typically, the teaching load is cut in half and administrative responsibilities are reduced by more than half. In most plans, the phased retirement option lasts for either three or five years, after which tenure is relinquished. More often than not, healthcare, disability, and life insurance are covered at least partially by the employer during the period of phased retirement, and the employee's pension income is commenced. Careful investigation of the terms is required since the various components of phased retirement programs vary from school to school.

A survey in 2003 of the phased retirement program at the University of North Carolina (UNC) revealed that faculty in the program come fairly close to maintaining their previous level of income. For the average respondent, the combined income from pensions, Social Security, and phased retirement equaled 90 percent of university earnings before entering phased retirement. Nearly half of respondents indicated that they had replaced 100 percent or more of their income.[7]

Faculty members considering phased retirement will want to consider nonfinancial factors too, such as the availability of a private office, access to parking, ability to teach summer school, ability to choose between half-time loads across both academic semesters

Notes

[6] Steven G. Allen, "The Value of Phased Retirement." Paper presented at the TIAA-CREF Instittue "Three Rs" conference, New York, NY, on April 1-2, 2004.

[7] Ibid.

versus a full-time load for one semester and the other semester free. They should be aware that some participants in phased retirement programs have expressed sentiments of feeling marginalized by other colleagues who know they're in the process of retiring.

Perhaps surprisingly, a recent study has shown that a significant number of faculty are not even aware that phased retirement is offered at their institution.[8] Once again, relationship managers can provide valuable services to clients by informing them of various options and benefits.

The Need to Know

A number of studies about employee response rates to various benefits and incentives show that employees are responsive to their perceived understanding of the benefits and options available to them. This occurs whether their perception of the benefits is accurate or not. The gap between their perceptions and actuality present opportunities for financial advisors and relationship managers to provide significant value to faculty who need to understand and fully weigh their retirement-related options.

Summary: How Advisors Can Help

Decisions about retirement can be very stressful to faculty. Much of their identity may be associated with their academic life, and they may have difficulty sorting out the financial and nonfinancial considerations that need to be factored into their decision-making process. Advisors can play a tremendously valuable role in providing information about their financial situation in retirement, including information about the benefits that are available through their institution, Social Security, and their own personal resources. Among the issues advisors will want to discuss and analyze with their clients are:

- Will the client have sufficient income in retirement to cover all expenses and maintain emergency reserves? This will require a full analysis of all sources of income and expenses in retirement. Will the income increase to cover inflation?
- What is the status of the client's health and job satisfaction? If both are positive, he/she may decide to delay retirement for a number of years. What about the health of the client's spouse? If it is poor and financial resources are tight, retirement may need to be delayed.
- How will healthcare insurance be covered in retirement? Will the client continue to have access to the employer's group plan? How much of the premiums will the employer pay? Is there a cap on employer contributions? What about coverage for one's spouse and benefits available from the spouse's employer? How much will the new Medicare drug law help the client?
- What about nonfinancial considerations such as social and intellectual aspects of working? Will the client feel a great sense of loss and emptiness in retirement, or does he/she have other meaningful activities and hobbies?
- How does the type of retirement plan enter into the decision-making process? If the client has a DB plan, has he/she met the years-of-service requirement that will maximize the annuity payout? With a DC plan, are the assets sufficient and are they positioned appropriately so that they can provide sustainable lifetime income?
- Are there any incentives from the institution, such as buyouts, that the client would be eligible for? Is phased retirement an option that would ease the transition into retirement?

In summary, well-informed advisors can offer tremendous value in helping their clients make better-informed decisions about retirement. References for additional reading on these topics are provided below.

Notes

[8] Berberet et al. "Planning for the Generational Turnover of the Faculty: Faculty Perceptions and Institutional Practices."

References

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