Common Risks Associated with Early Retirement Incentives

GFOA recommends state and local governments (governments) not offer Early Retirement Incentives (ERIs).\(^1\) Governments that have offered ERIs have commonly found that what may have seemed like a reasonable option in fact created significant unintended consequences once implemented. ERIs have material short-term and long-term risks inherent to their offering that can be difficult to quantify and are often overlooked. The risks can be considerable and consequential and should be addressed in advance by decision-makers.

The risks are detailed across four key areas below: (1) goal setting, (2) cost/benefit analysis, (3) budget, and (4) implementation. While not an exhaustive list, the risks demonstrate the degree to which ERIs present challenges. Even when these risks are taken into consideration, there is potential for ERIs to underperform versus expectations.

1. **Risks Associated with Goal-Setting**
   a. Lack of clarity about the goal of the ERI and its intended objective.
   b. Risk that short-term nature of ERI conflicts with other long-term retirement plan goals as specified by applicable law or policy.
   c. Potential for actual or perceived conflicts of interest among decision-makers who both design the ERI and could benefit from it.
   d. Lack of pre-determined quantitative or qualitative metrics to assess the effectiveness of the ERI. For instance, if the financial goal is obtaining long-term cost savings, how will that be measured and what is the desired timeframe?

2. **Risks Uncovered Through Cost/Benefit Analysis**
   a. The potential costs and benefits of the ERI proposal are not adequately quantified and/or properly assessed including the following:
      i. Costs of external resources that may be needed, such as an outside consultant, to study, set up, or implement the ERI offering.
      ii. Issues and considerations identified by the affected retirement system.
      iii. Experiences, outcomes, and lessons learned of peer governments who have offered ERIs.
      iv. Actuarial analysis of the long-term and short-term impacts to the government’s unfunded liability and required contributions caused by earlier and extended retirements and new members to replace current workers. If part of a larger pension system, the impacts to the system and other employers, and if applicable, any supplemental contributions required because of the ERI.
      v. Analysis of the impact on the government for providing retiree health care and additional contractor costs.
      vi. Costs of replacement personnel including direct cost such as recruitment, training, interim coverage and indirect costs such as updates or changes to reports and accounts and loss of institutional knowledge.
      vii. Impact to the budget associated with lower salaries for new employees, different retirement benefits (if applicable due to different structure for new employees), reduced staffing levels (if applicable), and/or operational efficiencies through reorganization.

\(^1\) GFOA Advisory, “The Use of Early Retirement Incentives”
b. The cost/benefit analysis is not linked to the goal of the ERI and does not recoup the cost over an appropriate period such as three to five years.

c. Lack of consideration of the direct and indirect impacts, including morale, productivity, customer and/or public service, institutional knowledge loss, and organizational efficiency, among others.

d. Failure to consider the long-term benefits and costs of ERI against the default scenario of a hiring freeze or other available options.

e. Insufficient analysis of the potential salary growth rate of new staff hired post-ERI implementation or other market conditions that may require higher than expected starting salaries.

f. Lack of understanding of how ERIs have been used historically within the entity, the frequency with which they have been used, and resulting associated outcomes.

g. Failure to seek legal review of the ERI offering.

3. Risks Uncovered By Quantifying Budgetary Impact
   a. Failure to consider or misinterpret the incremental costs of the ERI over the following: an extended period (i.e. 3-5 years), in contrast with the status quo without the ERI, and in concert with other budgetary influences such as anticipated increases in pension contributions or service demand.

b. Lack of sufficient comprehensive analysis, in that it does not include the following:
   i. Direct and indirect impacts, such as the effect of the ERI on the government for providing retiree health care and additional contractor, recruitment, and training costs.
   ii. Multiple scenarios and rates of ERI adoption, including varying levels of employee participation and market conditions for hiring replacements.
   iii. Consideration of strategic plan goals, service demands and expectations, and impact on public and customer service.
   iv. Lack of understanding as to the outcomes of current or prior ERI initiatives sponsored by neighboring or adjacent governments that may impact the hiring market or employee expectations.

c. The ERI offering window is not calibrated to the workload of retirement staff so that retirement applications are processed timely.

d. The provisions of any pre-existing return-to-work policy are not sufficiently considered.

4. Risks Associated with Implementation
   a. The communications plan is not adequately developed or implemented, including the following:
      i. Identifying a point person or persons within the organization who are authorized to comment to employees, stakeholders, and the media on the ERI.
      ii. Outlining parameters for what topics the point person can and cannot comment on by audience and associated key messages.
      iii. Providing adequate legal training to the point person or persons on matters such as providing guidance versus advice related to an employee’s ERI decision and the associated liability to the organization.
      iv. Supporting public awareness and understanding of the ERI particularly for those critical of public pensions.

b. The awareness and education plan is not adequately developed or implemented to help employees understand and make decisions about the ERI in the context of their overall retirement planning.

c. The ERI offering is implemented without gaining input from collective bargaining units and pension system administrators (if applicable) in advance.
d. Failure to develop a framework from which to proactively monitor and make timely adjustments to staffing levels based on service delivery workloads after employees retire, particularly in essential services that must be maintained.