A PUBLICATION OF THE NEW JERSEY DIVISION OF PENSIONS AND BENEFITS

Retirement Incentive Programs

All Funds

UNAUTHORIZED RETIREMENT INCENTIVE PROGRAMS ARE PROHIBITED

State law does not allow public employers that participate in State-administered retirement programs to establish unauthorized retirement incentive programs. Unauthorized retirement incentive programs are retirement incentive programs not expressly authorized by law. They are programs in which an employer offers employees, who are otherwise qualified to retire, some form of financial inducement to retire sooner than they would under normal circumstances.

This prohibition has been tested several times in the State Appellate Courts and in the Supreme Court and has been upheld in every instance. The law was clearly set forth in Fair Lawn Ed. Assn. v. Fair Lawn Bd. of Education, 79 N.J. 574 (1979). In this decision, the Supreme Court of New Jersey held invalid a retirement incentive plan negotiated between the parties because it posed a substantial potential for financial harm to the State- administered retirement system and was not specifically authorized by State law. The court also held that the retirement incentive plan violated the principle, stated in the State v. State Supervising Employees Ass'n, 78 N.J. 54(1978), that the area of retirement benefits may not be the subject of negotiation in the public sector.

The prohibition against employer-sponsored retirement incentive programs is in place primarily to protect the financial integrity of the retirement systems. If employers were able to offer employees incentives to retire, it would seriously degrade the ability of the pension system to establish reasonably accurate experience assumptions, on which funding is based. A second reason for the prohibition is to prevent employers from shifting the costs of their retirement incentive programs to other employers through the pension funding mechanisms.

Matters pertaining to the terms and conditions of employment, salaries, and time and mode of payment are responsibilities vested with local employers. However, the Division of Pensions and Benefits, as the agency which administers the rules to safeguard the funds in the public retirement systems, must request information from the employer when notified that the employer may be offering an incentive outside of the provisions of specific laws authorizing retirement incentive programs.

Sick leave buy-outs, while not increasing a member's retirement benefit, may sometimes be considered as retirement incentives as they induce employees to retire earlier than they otherwise would.

AUTHORIZED RETIREMENT INCENTIVE PROGRAMS

Several times over the past decade, State laws have been enacted that have permitted either general or very restrictive retirement incentive programs. These include the general retirement incentives of 1991/92 and 1993/94 and a specific retirement incentive targeted for institutions being closed in the Department of Human Services in 1997. These laws specifically identified the costs of retirement incentives and included provisions for employers to bear those costs. They were also constrained to a limited window or timeframe and have since expired.

Currently, there are two laws in force that authorize local governmental employers to offer retirement incentive programs. These laws are Chapter 59, P.L. 1999 and Chapter 126, P.L. 2000. There are no laws currently in effect that authorize any retirement incentive programs for State employees or employees of State colleges and universities.

Chapter 59, P.L. 1999

Chapter 59 was enacted to facilitate consolidation of services and downsizing, thereby reducing the cost of government for local taxpayers. The law authorizes counties, municipalities, and other local units of government, that enter into interlocal agreements to provide governmental services on a joint or consolidated basis, to offer incentive programs for retirement or termination of employment of employees affected by the interlocal agreement. The allowable retirement incentives include the following options:

- Cash payments or the purchase of annuities;
- Employer contributions to an approved employee deferred compensation program;
- Employer-paid continuation of health benefits coverage after retirement for up to five years or attainment of eligibility for Medicare, whichever comes first;
- Employer-paid continuation of health benefits coverage after retirement under the provisions of the State Health Benefits Program Act (N.J.S.A. 52:14-17.25 et seq.) or under group insurance contracts pursuant to N.J.S.A. 40A:10-23 for employees who fail to meet the service requirements for employer-paid coverage by no more than five years, but who are otherwise eligible for employer payment for health benefits coverage after retirement; or
- Up to five years of additional service (pension) credit for members of the PERS, PFRS, or certain municipal and county retirement systems for employees who will have at least 20 years of service in the retirement system on the last day for retirement under the incentive plan.

Chapter 126, P.L. 2000

Chapter 126 supplements Chapter 59. It allows a county governing body to offer a retirement incentive program without having to enter into an interlocal service agreement. The county would still have to comply with all the other provisions of Chapter 59 including the showing of cost savings as a result of the retirement incentive program and the reduction in the number of authorized employees.

APPLYING TO CONDUCT AN AUTHORIZED RETIREMENT INCENTIVE PROGRAM

The Director of the Division of Local Government Services in the Department of Community Affairs (DCA) must approve any retirement incentive program offered under the provisions of Chapter 59 or Chapter 126. Approval requires a sufficient demonstration that the incentive program would result in a reduction in the number of employees and employment costs to provide governmental services. Local units that implement incentive programs approved by the DCA will be required to pay the costs for the incentives. They will also be prohibited from increasing the number of employees, above the number stipulated in the incentive program for five years, without the approval of the DCA. Employers may obtain more information concerning these programs by contacting the Department of Community Affairs, Division of Local Government Services at (609) 984-7764.

COSTS OF A RETIREMENT INCENTIVE PROGRAM

The cost to an employer for providing a retirement incentive program can be significant. The exact cost must be determined by way of an actuarial analysis of the program and is dependent upon the nature of the incentive provided and the profile of the employees eligible for the program. Any employer adopting a retirement incentive program will be directly billed for the pension costs resulting from the program.

The cost of the retirement incentive program will include two components:

- The cost of the incentive itself (e.g., cash payment, post retirement medical premiums, additional pension credit, etc.), and
- The pension cost of inducing an employee to retire sooner than actuarially anticipated. Each retirement system operates under a set of assumptions, based on experience, as to when members will retire. If an employer offers its employees an incentive to retire, members retire earlier than would otherwise be the case, thereby increasing costs to the retirement system.

Historically, retirement incentive programs that provided five additional years of pension service credit generated a present value cost to the employer that ranged from two to three times an employee's annual salary. Even without an increased pension service credit incentive, the premature retirement costs can approximate one year of salary for each employee.

The Division of Pensions and Benefits will calculate the cost of a retirement incentive program authorized under Chapters 59 and 126 at the request of the DCA. When an employer submits an application for a retirement incentive program under the provisions of Chapter 59 or 126, the DCA will forward the proposal to the Division of Pensions and Benefits for the cost analysis. The Division will submit its report on pension costs directly to the DCA.

SUMMARY

Employers are not permitted to offer their employees incentives to retire unless specifically authorized by law. Currently, the only two laws in force that authorize retirement incentive programs are Chapter 59, P.L. 1999 and Chapter 126, P.L. 2000. These laws are applicable only to local government units. Any retirement incentive program offered under the provisions of these laws must be approved by the Department of Community Affairs, Division of Local Government Services and must contain cost savings through a permanent reduction in staff.

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