As part of their terms and conditions, most pension plans offer a normal retirement age and an early retirement age. The normal retirement age is the age at which an employee retires under "normal" circumstances, which usually means a certain number of years of service with the company. However, the early retirement age can mean two things:

* the age at which an employee can retire with a normal unreduced benefit if certain standards are met. This usually means the achievement of a set number of years of service while covered by the plan;

or

* the age at which an employee can retire regardless of the number of years of service completed but with a reduced benefit.

For example, under normal circumstances, an employee who participates in the ABC Pension Plan for 20 years can retire at age 60 and receive a normal unreduced benefit of $2,500 per month. If this same employee chooses to retire early, at age 55, with 20 years of service under the plan, he or she can receive a reduced benefit of $1,750 per month. However, some plans' guidelines include provisions for early retirement with full, unreduced benefits. Normally, there is a minimum requisite number of years of service in order for an employee to qualify for such benefit. Some examples include a "30 and out" meaning an employee with 30 years of service can retire at any age with a full, unreduced benefit and a "rule of 80" meaning an employee whose years of service and age equal 80 can retire at any age with a full, unreduced benefit. Many plans have variations of these examples.

In a divorce, the retirement age - normal or early - can have a profound effect on the bottom line of the present value of the pension. In a divorce, these differences can make dividing a pension problematic. Because of the time value of money, the closer an individual is to retirement, the greater the bottom line present value of the benefits. Therefore, if age 55 is chosen as the retirement age for the analysis as opposed to age 65, the present value of the benefits will be greater.

In some states, the attorney and client have the discretion to choose any age of retirement for valuation purposes. However, some states have decided which age is the most appropriate for use in this type of analysis.

Various case law illustrates a practical example of the effect of the age of retirement in present value analysis.

In Pennsylvania (DeMasi v. DeMasi, 530 A 2d. 871 (1987 Super)), for example, the participant's retirement age for a present value analysis is that age at which an employee can retire with a full, unreduced benefit based on the years of service rendered as of the date of separation. Therefore, if the employee has worked for ABC, Inc. for 20 years as of the date of separation, the appropriate age to be used in the analysis is 60. The employee has not met the service requirements as of the date of separation to retire at age 55. He may want to continue to work for ABC, Inc., and he may complete the 30-year service requirement for retirement at age 55. However, as of the date of separation this benchmark has not been met, and, therefore, the assumption that the employee will be eligible to retire early is considered inappropriate. The Pennsylvania courts have decided that use of any early retirement age and a reduced retirement benefit is inappropriate. In compliance with case law, this analysis would be performed using the benefit earned for the 20 years of service rendered as of the date of separation payable at age 60.

However, in other states the courts have concluded that the appropriate retirement age to be used in a present value analysis is the earliest retirement age established under the plan that still permits a normal unreduced benefit. Therefore, in this case, the appropriate age to be used would be 55. Some courts have concluded that it is appropriate to assume that the employee will eventually complete the required years of service in order to be eligible to retire early. In compliance with the law in these states, this analysis should be performed using the benefit accrued for the 20 years of service completed as of the date the marriage ended but payable at age 55. It should be noted, however, that appraisals completed under these guidelines have spawned many arguments regarding the employee's likelihood of completing the requisite number of years of service forcing the courts to apply reductions to the present value figures to account for the possibility that the employee may not complete the requisite number of years of service to qualify for a full, unreduced benefit at an earlier age. These reductions are often subjective in nature with no basis in the actuarial sciences.

In order to demonstrate the effect these assumptions have on the bottom line present value, let's examine the following illustration:

John Doe has worked for XYZ, Inc. for 12 years as of the date his marriage ended (July 15, 2002). Under the XYZ, Inc. pension plan, the normal retirement age is 65, but employees who have 30 years of service can retire with an unreduced benefit at 55. Any vested employee under the plan may retire at age 60 with a reduced benefit. (The reduction in benefits is equal to 2% for each month prior to age 65). John Doe has accrued a benefit of $1,100 per month for the 12 years he has worked for XYZ, Inc. as of July 15, 2002.

Following are the present value analyses for John Doe using the three retirement ages:

At the retirement ages of, respectively, 65, 55, and 60, the monthly benefit is, respectively, $1,100, $1,100, and $916.66, with a present value of, respectively, $24,090, $57,044, and $31,676. ($916.66 is the result of $1,100 reduced by 2% for each month prior to age 65 (60 months), and the interest rate used for each of these analyses is 5.51 percent).

As the above illustration makes clear, the selection of the appropriate benefit and retirement age can drastically affect the bottom line present value. The division of these pensions would produce very different results.

Use of a reduced retirement benefit payable at an early date is irregular for these types of analyses. However, this does not mean that this is not the norm in any particular jurisdiction. As stated earlier, these variables are often subject to the discretion of the attorney and client requesting the valuation.

Any practitioner in doubt of the appropriate age or benefit to be used should not hesitate to contact one of our analysts for assistance. We are always happy to give assistance and discuss options.