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Global Developments in Employee Benefits

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Disciplines

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Global Developments in Employee Benefits

Abstract

The last 25 years have seen defined benefit plans increasingly been replaced by defined contribution (DC) arrangements. While the pace and shape of this change varies across countries, it is evident that we are living in a DC world. Yet the DC model is itself under challenge. The assumption of engaged consumers that accompanied the birth of DC has failed, and for both retirement and health benefits, there is a lingering question whether, in a world of low growth, stagnating incomes and increasingly diverse workforces, one-size-fits-all benefits plans can meet employees financial needs. Instead employers are increasingly expressing interest in moving to a next generation of benefits, one characterized by greater flexibility and choice, to encompass a broader range of employee needs. This paper discusses the emerging trends within occupational benefits, the forces that are driving these changes, and the challenges they pose.

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The last 25 years have seen defined benefit (DB) plans around the world increasingly replaced by defined contribution (DC) arrangements. While the pace and shape of this change varies across countries, it is increasingly evident that employers are moving away from providing retirement guarantees. In the last decade, we have witnessed occupational retirement pensions shifting to DC at an even faster pace in countries such as the US and UK, while countries previously thought of as bastions of DB (such as the Netherlands) are starting to move to DC. Such a transition is now also being felt in the provision of health benefits, as more employers are looking to incorporate DC-type of arrangements for funding health benefits.

What it is clear is that, despite the shift to DC, employers' commitment to benefits has not necessarily fallen. Indeed employer costs have frequently risen due to legacy DB costs and rising health care costs. Employers are not turning away from benefits, but they are struggling in the face of rapidly increasing costs, a weak economy, constrained corporate budgets, and a more diverse workplace. Moreover, the DC model is itself under challenge. The assumption of engaged consumers that accompanied the birth of DC has been found wanting, with behavioural economics offering a number of heuristics and biases that raise concerns around employee engagement with retirement planning and savings decisions (Benartzi and Thaler 2007; Lusardi and Mitchell 2011). Given current savings levels, it is likely that many employees will reach old age with insufficient savings to be able to retire. Indeed, in some countries such as Chile, we are starting to see the first signs of discontent as retirement outcomes fail to meet employee expectations (The Guardian 2016).

There are also lingering questions whether, in a world of low growth, stagnating incomes, and increasingly diverse workforces, one-size-fits-all benefits plans can meet employee financial needs. Is it right that money should be saved into a retirement plan, when young workers at the

start of their career are faced with student loan debt? Will employees be more engaged if they have the choice to redistribute benefit funding in this way?

Faced with these issues, companies are questioning how they can get the best value for money from their benefit spend and are increasingly showing interest in moving to a new generation of benefits, one characterized by greater flexibility and increased choice. This shift would encompass a broader range of employee financial needs and aim to improve employee engagement and well-being. Indeed a greater focus on employee well-being is fast becoming a center-piece of employer benefits strategies. Today's emerging well-being programs reflect an evolution from the wellness programs that tended to focus in the past on the physical health of employees. Yesterday's wellness programs were often siloed, one-size-fits-all, and transactional, and they focused on a 'carrot and stick' approach to participation. The result has frequently been that employee engagement is abysmal and these programs have not delivered on their promises (Willis Towers Watson 2016a). By taking a broader view of well-being, including core components of physical, emotional, financial, and social health employers are designing well-being programs to meet the needs of all employees and their complex sets of challenges, and they are reshaping the well-being and benefits programs of the future.

But this process also presents challenges, especially regarding how to help employees navigate a world that is becoming more flexible and tailorable. We argue that, with personalization and DIY approaches becoming a bigger part of the employee value proposition, employers are offering their workers more comprehensive packages. To make this work, employers need to better understand how they can use plan design and technology to guide and assist employees. Providing core security will remain a foundation of their benefit offerings. But with a much wider array of benefits available today, meaningful choice will also be key. Over the last decade as employers have watched their employees struggle with excess choice and

fragmented benefits designs. They have learned that guardrails to ‘bound’ decisions and ensure the number of options are manageable are needed to help employees avoid costly financial mistakes.

New technology will be key to support decisions and provide suitable choice architecture, based on lessons from behavioural economics, to help employees overcome information overload. At the same time, employers will need to seek to ensure that individuals’ health and financial security is not harmed. Furthermore, employers increasingly recognize that a key to successfully engaging employees around their benefits is by using one of their most valuable assets – the workplace itself – where peer effects and onsite support has proven for many organizations to be key to driving positive and sustainable changes in employee behaviours.

The chapter is organized as follows. First we overview the recent trends in employee benefits highlighting the transition from DB to DC both in the pension and health care areas, as well as the influence and effect of the recent global financial crisis. Second, we analyse the main challenges and issues that have emerged along the growth of DC. Next, we present key trends that have consolidated and aligned to transform the shape of employee benefits. A final section discusses key takeaways on how employers are looking to leverage the recent changes in the benefit environment and develop their future benefits plans.

Overview of Recent Trends in Employee Benefits

From DB to DC retirement benefits. The first major development in employee benefits came with the emergence of DB pension plans. These plans granted workers a sense of retirement security, and as family-based retirement arrangements faded away, these programs provided a much-needed sense of security and fulfilled a societal goal (Hess 2013). DB plans started to grow more popular in the US around the 1950s due to the combination of wage controls and tax

incentives. In the UK, pension plans actually started as DC schemes, but the high inflation rates that followed World War II reduced their appeal, shifting workplace provision towards DB.

Similarly, in a number of Western economies, employer provision of retirement plans started to grow in the 1950s and 60s.

The cost of DB plans was initially manageable, as the prospective retiree population was small and retiree life spans were short. But as workforces matured, life expectancy improved and the size of the promises increased. Moreover, the cost of providing traditional pension plans grew sharply. In addition, governments tightened regulation and changing reporting rules, moving towards more stringent market-based accounting, which led to a heavier regulatory burden. Regulation, especially tax rules, made it increasingly hard for sponsors to reap the upside potential of overfunding, driving sponsors to become increasingly vigilant on their contributions and making overfunding of DB systems unlikely.

At the same time, trends in the labour market, such as increased mobility of workers, a changing industry landscape, and the decline of unions, reduced the demand for DB pensions. Overall, this increased regulatory burden, paired with the larger costs and affordability issues, and a lower demand for DB, raised the question of whether the effort of providing DB was actually worth it. The decline of DB had started, and with it, began the second generation of retirement plans with the emergence and growth of DC plans.

The creation of new DC plans in the US emerged in the early 1970s and was marked by the Employee Retirement Income Security Act (ERISA) in 1974 and the Revenue Act of 1978, which established 401(k) plans and changed IRA rules. In 1981, the IRS proposed regulations which made it clear that 401(k) contributions could be made from an employee's ordinary wages and salaries, ushering in the modern 401(k) plan. From this point, we have seen a gradual shift in

provision from DB to DC within corporate America that quickened pace with the turn of the millennium.

The transition to DB has varied widely across countries. In Australia, the transition to DC was led by regulation that started with the 1986 superannuation award and was followed by the mandatory superannuation guarantee in 1992. In the UK, the move to DC was a little later, with the late 1980s marketing the re-appearance of DC plans, but the change to DC was swifter. Over the decade from 2000 to 2010, the large majority of UK employers moved to offering only a DC plan to newly hired employees (Figure 1). Today, the UK's private-sector retirement landscape is almost entirely DC only for new hires (compared to around 70% of large private-sector employers in the US).

Figure 1 here

For the UK, the recent introduction of mandatory automatic enrolment fuelled a rapid rise in DC membership. In 2012, just over 40 percent of private sector employees were contributing to an employer retirement plan; by 2016, this had risen to 60 percent. The global financial crisis of 2008-9 accelerated and consolidated the trend to DC. Low interest rates and falling asset values paired with the ensuing deep economic recession. The uneven recovery and lower discount rates cut pension funding ratios and led to increased employer contributions at a time when many could least afford them (Towers Watson 2008). Additionally, lower interest rates magnify the adverse effect of increased longevity on liabilities, weakening solvency of DB plans and further eroding the economic basis for offering DB plans. Particularly, interest-rates have a 'compounding' effect over longevity improvements as increments in longevity are more heavily felt when low interest rate prevail.

It seems that the global financial crisis, the looming risks of persistently low-interest rates that followed, and the impact these have had on the cost of DB pensions have provided the final

excuse for employers to accelerate the move away from DB schemes. This DB decline is most evident in the US and the UK, where the incidence of pension freezes (ceasing future accrual for existing plan members) has risen significantly since 2008. Of the Fortune 500 companies which offered a DB plan in 1998, 21 percent of US plan sponsors froze their DB plans, and 21 percent had closed their primary DB plans to new entrants by 2009. Sponsors of US frozen plans outnumbered those with open primary plans for the first time in 2015; moreover, 39 percent sponsored frozen plans and 24 percent had closed their primary plans to new hires (Willis Towers Watson 2016b). In the UK, only 4 percent of the FTSE100 had DB schemes which were closed to future accruals (frozen) in 2009, but by 2017, almost two-fifths of FTSE 100 companies had frozen their DB plans (Willis Towers Watson 2017). Also, one in three of DB plans open to accrual in 2015 are likely to be closed by 2020 (Towers Watson 2015a).

In emerging economies, the growth in DC has taken place over a shorter timeframe, with DC emerging as a result of regulation encouraging or mandating private DC provision. For example, many Latin American countries introduced structural reforms for retirement savings and moved to funded DC plan during the 1980s and 1990s (Holzmann and Hinz 2005). The Latin American experience also influenced the reform processes in other regions such as the transition economies in Europe and Central Asia, though the process of reform developed quite differently in the two regions. Recent reform efforts in East Asia have been even more diverse, but it is noteworthy that the introduction of some type of a DC component was a key factor in countries such as China and Hong Kong (The World Bank 2016; Pai 2006). What it is clear is that, in these nations, one should probably talk more about the introduction of DC plans by governments instead of a shift to DC by employers. More recently, we have also seen moves toward DC arrangements in countries such as Germany, Japan, and the Netherlands, though all of these had traditionally been more wedded to the DB model of retirement provision.

In the Netherlands, the period 1995 to 2005 saw the majority of DB plans move from traditional final salary DB schemes to career average plans with conditional indexation where revaluation and uprating of benefits is determined by a pension plan's funding status. Such plans effectively limit the risks faced by employers, passing it to employees and retirees. In the period since the global financial crisis, we have seen plans move toward the collective DC model, where employer contributions are fixed. These plans are DC-like for employers, but they smooth investment returns and share risk among employees (especially across generations). Yet while such risk-sharing is frequently viewed as attractive by sponsors, it has not been well understood by employees. Periods in which indexation has been reduced or benefits cut to compensate for lower funding have been deeply unpopular, and there is increased disquiet as to whether younger generations are getting a fair deal from the current system.

As a result, several governments have proposed reforms that could mark a major shift in retirement provision. One option is to move to a system much closer to the individual DC account model, with employees having far greater flexibility and choice on how to use their pension contributions (Willis Towers Watson 2016c). Other countries have also evidenced some tentative moves to DC. In Germany, a recent draft law aims to expand the percentage of the workforce (particularly the lower-wage sector) covered by employer-provided retirement plans and individual retirement arrangements. The goal is to offer a combination of minor tax incentives and a new DC retirement plan option. Japan opened up the possibility of setting up corporate and individuals DC plans back in 2001. Since then, subsequent regulation has expanded eligibility to, and regulated the role of sponsors, fiduciaries, and investment rules (Willis Towers Watson 2016d). So, as Figure 2 shows, occupational retirement provision is increasingly concentrated on DC plans with DB provision increasingly rare.

Figure 2 here

Movement to DC health. The advent of DC in retirement plans is now moving to the health care area as well, particularly in the US. Traditional DC health care plans, where the employer contributed a fixed-dollar amount toward the cost of an employee's health benefit each year and the employee paid the difference between that amount and the actual cost of the coverage elected, were popular during the heyday of flexible benefits plans in the 1980s and early 1990s. But these DC approaches lost their appeal when health care costs inflation escalated in the late 1980s, which under employees' share of health plan costs outpaced pay gains. Employers are now giving DC plans a second look for several reasons: a lower trajectory of cost increases over the last decade; the emergence of private exchanges designed around a DC funding model; and the desire to make the cost of coverage more transparent, which may encourage employees to buy a lower level of coverage.

A recent survey showed that more companies now use a DC health plan strategy than ever before: 25 percent in 2016, up from 20 percent in 2015. Moreover, the number of employers going DC is expected to nearly double by 2018 (48%) based on those planning to or considering adopting the approach (Willis Towers Watson 2016e).

Whether the DC health plan approaches will spread will partly depend on the future of health care cost increases and whether private health exchanges can deliver on their value proposition. Additionally, many employers are designing these DC arrangements with guardrails and maintaining some degree of cost sharing within their programs. In fact, only 4 percent of employers have moved to a 'pure' DC strategy, with a flat dollar contribution amount that is the same for all employees regardless of plan type or tier. This is expected to increase to 16 percent by 2018 if companies follow through with their plans.

Rising costs. Despite these shifts to DC, employers' commitment to benefits has not declined. Instead, employer benefit costs have frequently risen due to legacy DB costs and rising health care costs.

In the US, the cost of employee benefits as a percentage of pay has risen from 14.8 percent in 2001, to 18.3 percent in 2015. This increase is largely driven by increments in health costs that grew from 5.7 percent to 11.5 percent of pay over the same period (Figure 3). In short, health care costs are crowding out employee short-term financial security through lower take home pay and their long-term financial security through less generous retirement programs. This trend is expected to continue, with health care costs expected to increase at a faster pace than general inflation for the foreseeable future. In nominal dollars, employers expect average employee per-year costs to rise to \$12,338 in 2016 and nearly \$13,000 in 2017 (Willis Towers Watson 2016f). In this prolonged period of relatively stagnant wage growth, employers are also becoming increasingly concerned about plan affordability. In fact, nearly 40 percent of employers are taking steps to today to achieve more affordable health insurance premiums and point of care costs, while another 15 percent plan to take action over the next few years.

Figure 3 here

The trend towards higher health care costs is also evident outside the US. In 2014, the cost of private medical insurance benefits rose more than twice than the rate of general inflation (Towers Watson 2014). Moreover, most insurers anticipate higher or significantly higher medical trends over the next several years (Figure 4). Given the design of health care provision in most developed economies, the impact of medical inflation will be felt less directly by employees, though this does not mean the costs disappear. They are likely to be felt indirectly via taxation, national premiums, or even reduced public coverage in some areas/services.

Figure 4 here

As health takes a larger share of national resources, retirement and pay are suffering. In fact, probably the biggest threat to retirement security in the US has been the rise of health care costs. In other countries, rising health care costs are increasingly weighing on government finances and squeezing other programs.

The drive towards flexibility and choice. With benefit costs rising, employers are working hard to counter their program costs and pass risk back to employees. Challenges facing employers today include the weak economy, constrained corporate budgets, and a more diverse workplace. Moreover, different generations have markedly different financial priorities, interests, and worries. For example, older workers (Baby Boomers) prioritize savings for retirement and health as they often own their homes and have little debt. For Millennials, the focus is more short term; they have lived in a decade of little pay growth and limited career opportunities, and they find it hard to get on the housing ladder and pay back student loans (Willis Towers Watson 2016g).

When employees are asked how they would allocate a hypothetical benefits spend offered by their employer, more than half of the budget tends to be devoted to non-traditional benefits including insurance and income protection products (such as life and disability insurance and financial protection), as well as lifestyle benefits (including health and well-being products and employee discounts) (Figure 5).

Figure 5 here

Clearly the benefits packages of the future must accommodate these different priorities. In fact, more and more employers, especially in the US, UK and Canada, are offering ancillary benefits. Thus exploring greater flexibility and choice through online platforms and exchanges and developing voluntary benefit programs is warranted.

Technology is also a key ingredient enabling transformation in the delivery of benefits. It has facilitated the move towards DC benefits by lowering the cost of individual account-based

plans, and the greater use of flex programs enabling greater integration of many benefit programs. Not only is technology making the administration of choice easier for employers, it is also providing the tools to streamline the choices employees face (to avoid choice overload) and to provide a more engaging and user-friendly experience.

Other drivers of change: Constraints on tax incentives and new approaches. Changes in tax incentives and policy reforms are also pushing companies to look at greater flexibility for employees. Faced with weakening government finances, many countries have sought to cap tax privileges through limits on the amount of contributions or the lifetime value of retirement savings that attract tax relief. For higher-earning employees, the caps mean that traditional retirement saving may not be tax efficient, so that greater flexibility offers an opportunity to better manage financial affairs.

It is also becoming increasingly evident that retirement savings cannot be looked at in isolation. In most countries, retirement savings have been overwhelmingly illiquid. For some especially sophisticated present-biased agents, this pre-commitment (illiquidity) is appealing (Beshears et al. 2015), but it is clearly sub-optimal for those facing high debt and simultaneously saving for retirement. There are a few cases such as the US where employees have long been able to borrow against their 401(k)s, or in Singapore where a portion of DC balances can be used to pay medical expenses, home purchases, or student loans. Yet in most countries, flexibility is extremely limited. Some countries allow for hardship withdrawals (e.g., Australia, New Zealand, and Peru) but the conditions for accessing savings and the limits on the amount that can be withdrawn are strict.

For better or worse, we are seeing signs of change, as countries begin to incorporate savings vehicles that tackle long, medium, and short term needs, shifting towards a ‘total savings’ approach. In the UK for example, the introduction of the Lifetime Individual Savings Account

(ISA) (launched in April 2017) provided fiscal incentives for savings for the under-40s that can be used to buy a first home or to build retirement savings. The Netherlands has proposed reforms to allow workers access to retirement savings before retirement for care or housing needs.

Together, these initiatives drive employers to ponder whether they should provide more flexibility in their benefits package to allow employees to better address their financial needs. From the employees' viewpoint, the possibility of using plan contributions as part of a broader wealth management strategy offers an opportunity to tackle pressing short-term financial issues (such as debt and housing). Nevertheless, the potential leakage eroding retirement savings is large.

Other drivers of change: A focus on wellbeing. Wellbeing is fast becoming a centerpiece of many employers' benefits strategies. Many organizations seek to differentiate their companies as a destination for talent. In part, employers seek to invest in their employees to offset workers' greater responsibilities in managing their benefits. New technologies that help personalize messages and advice are only a start.

Employers are taking these steps out of necessity but they also recognize that a healthy and financially secure employee can be more productive. Surveys show that employees in good health and financially secure are 70 percent more preoccupied than those with financial and health issues (Willis Towers Watson 2016g).

Today's emerging wellbeing programs reflect an evolution from the old-school wellness programs that tended to focus on employees' physical health. Yesterday's wellness programs were siloed, one-size-fits-all, transactional, and used a 'carrots and stick' approach to plan participation. The result was low employee engagement. Today, many employers have begun to take steps to correct course. A recent survey showed that, in 2016, 30 percent of employers had already incorporated financial wellbeing as part of their organization's health and productivity

strategy (Willis Towers Watson 2016a). The US had a head-start in this area with nearly half of employers incorporating personal financial wellbeing, yet other regions are also interested in broadening the spectrum of their benefits programs (Figure 6). In fact, we see growing interest in educating employees about ways to improve their financial wellbeing and to provide them with tools to help budgeting and managing debts.

Figure 6 here

Other drivers of change: the globalization of benefits. Multinational businesses are increasingly managed more consistently globally with the benefits marketplace moving in parallel. Workers are more transient, and pay and benefits are more transparent. Additionally, there is a movement towards the ‘flattening’ of designs across countries, with a more uniform and consistent set of benefits catering to an increasingly global workforce. Employers seek to avoid the administrative burden of many different benefit designs, seeking to provide a globally consistent but locally relevant total rewards package across key segments of their workforce. This is true not only in the US and the UK, but also in other territories as well. For example, Asian firms have recently moved to adopt flexible benefits in the region (Towers Watson 2015b).

Flexibility and personalization are instrumental to ensure that these globally coherent benefits packages are also locally relevant. Given enduring differences in cultures, regulations, and social insurance programs across countries, it is essential to retain adaptability, choice, and flexibility to make sure that global benefits packages cater to diverse workforce needs.

Issues Facing Flexibility and Choice

Firms are increasingly showing interest in a new generation of benefits, characterized by greater flexibility and increased choice. These will encompass a broader range of employee financial needs and improve employee engagement and wellbeing. But a lesson of the last two

decades is that the engaged consumer model has not worked well in employee benefits. Behavioural economists have documented a number of heuristics and biases that hamper individual abilities to choose wisely (Benartzi and Thaler 2007). While workers recognize that it is their responsibility to make sure they have enough resources at retirement, the vast majority fail to engage in active retirement planning (Lusardi and Mitchell 2011).

The power of defaults. To try to bypass these behavioural biases, employers have been incorporating changes to plan design and default options. For example, to avoid choice overload, employers limit the number of options they present to employees, especially in terms of asset allocation decisions and investment funds (Sethi-Iyengar et al. 2004). Strong inertia exhibited by plan participants also make automatic features appealing (Choi et al. 2006), and the use of pension automatic enrolment and auto escalation increase plan participation and contributions (Butrica and Karamcheva 2015). By 2015, some 31 percent of US Fortune 100 companies already had auto-escalation in place, either as part of the default or as a plan option (Willis Towers Watson 2016h).

These design features substantially ease employees' decision-making processes, but they can also come at a cost. Automation puts retirement, health care, and other choices on auto-pilot, making members unaware that they are choosing by not making a choice (OECD 2012). The issue with auto piloting is that it is becoming increasingly evident that the default is not the starting point for an individual to make a decision, but rather it becomes the end point, with few employees deviating from the default.

For example, we know that automatic enrolment dramatically increases the probability that employees participate in a retirement plan, but at the same time a large majority of employees will stick to the default contribution rate. Frequently, this means employees fail to

reap the maximum benefits from matching contributions, as the majority of plans set low auto-enrolment defaults (Madrian and Shea 2001; Choi et al. 2004).

Research from the UK suggests that when low contribution rates are set only around 26 percent of members contribute at the maximum. By contrast, when the maximum is the default, 77 percent of members select the maximum contribution rate. Where there is no default at all, some 64 percent select the maximum rate (Gardner 2013). The typical DC design of auto enrolling employees into the minimum contribution rate therefore helps employees who would not have participated, but it reduces the contributions of those who would have joined anyway.

How can employers better manage choice and flexibility? As companies move to provide employees with a broader range of choices, one concern is whether employees are sufficiently equipped or engaged to cope with these options. Employees typically say more choice is desirable, but when they are left to their own decision making, they often make poor choices or do not make them at all (Sethi-Iyengar et al. 2004).

It seems undeniable that more financial education is needed, especially where employers offer a wide array of benefits. Yet it is also difficult to design and implement financial education programs that work well. There is evidence linking attendance to workplace seminars with administrative data showing that seminars at the workplace do not dramatically change employee behavior with respect to enrolment, increasing contributions, or changing asset allocation (Choi et al. 2004). Today, employers seek technology to reduce the barriers to choice: to use choice architecture to streamline the choices an employee faces; to use personalization and peer effects to increase employee engagement; and to use prompts and nudges to ensure employees review their situations on an ongoing basis.

The tension between flexibility and choice and retirement adequacy. With the global move to DC and the persistent low yield environment, workers and employers are increasingly concerned

about the adequacy of retirement savings. For employees with DC plans, moderate reductions in yield have an outsized impact on replacement rates. Based on different return scenarios, savings rates needed to reach a replacement rate of 75 percent can be three times as much under the current interest rate scenario than they would be if returns tracked those of the last 40 years (Ilmanen 2017). For those with DB plans, the picture is not much better. As Blanchett et al. (2018) note, lower-income workers will need to save about 50 percent more if low rates of return persist, and higher-income workers will need to save nearly twice as much in a low return environment compared to the optimal savings using historical returns. Given current low saving rates (Byrne and Reilly 2018), people will either have much lower standards of living in retirement or will need to work much later than prior generations. More than half of UK employees and around two thirds of US employees report that retirement security has become a more salient concern, a concern also shared by employers. Both UK and US employers also foresee this becoming an even more pressing issue in the near future (Figure 7). In the US, there is emerging evidence that older Americans are exiting the workforce in a more flexible way and are willing to change employers, occupations, and work intensity late in life (Cahill and Quinn 2018).

Figure 7 here

Adequacy concerns are also prominent in the developing world. In Chile, for example, there have been massive protest against the national DC system as retirement outcomes fail to live up to expectations (The Guardian 2016). In response, the government is looking to enhance social security provision to compensate for weaknesses in the DC accounts (Comisión Asesora Sobre el Sistema de Pensiones 2015). Yet providing greater flexibility and allowing individuals to divert money previously allocated to retirement saving for other things may further jeopardize retirement security. ‘Leakages’ from retirement accounts can also lower savings if they are not

repaid (Antolin and Stewart 2009). US research shows that about 1.5 percent of assets leak out of the 401(k)/IRA system each year, and so aggregate 401(k) and IRA retirement wealth is at least 20 percent lower than it would have been without current leakage rules (Munnell and Webb 2015).¹ Others estimate that for every dollar contributed to DC accounts in the population under age 55, 40 percent flows out of the system (without counting loans or rollovers) (Argento et al. 2015).

There is also evidence that early withdrawals increased during the global financial crisis (Argento et al. 2015). Nevertheless, it is unclear whether these withdrawals were sub-optimal from consumers' financial perspective. Where these funds alleviated severe financial distress and meet pressing short-term needs, they could have been welfare enhancing. Committing funds in a long-term savings vehicle may not be optimal for many, especially for low- and moderate-income families without emergency savings or with too much debt. The possibility of withdrawals is an important determinant in the decision to join a retirement plan, and how much to contribute given participation (Munnell et al. 2001).

Against the backdrop of a decade of low pay growth around the world, employees are increasingly concerned about their short-term financial security as well as their retirement adequacy. This is reflected in how concerns around financial security have climbed to a top-of-mind issues for employees worldwide (Figure 8).

Figure 8 here

Why is this Time Different?

Many of these concepts are not new, since flexible benefits were first studied in the 1990s (Barber et al. 1992). The concept of employers moving from retirement plans to a broader concept of employee financial well-being has also been discussed frequently over the last decade.

So why is this time different? Our view is that there are several trends aligning to transform and re-shape the future of employee benefits.

Economic trends: A low growth world and the increased relevance of employee benefits.

The last decade has seen a global economy drifting into one of the longest productivity slowdowns on record. Sluggish economic growth affects both developed and emerging economies. With few exceptions, the growth of labour productivity has been steadily declining since 2000, and the slowdown worsened between 2006 and 2015. Over this period, growth in GDP per capita averaged 0.6 percent in the US and across the G7 as a whole (OECD 2017).

Slow economic growth and increased longevity also highlight the fragility of public safety nets. Governments have responded with reforms that cut the generosity and/or coverage of social security programs. Across the OECD (2016), various measures have been introduced to slow the growth in spending on retirement benefits, including raising the retirement age, tightening early retirement, and changing indexation and increments in pension payments. In the health area, real health spending has fallen and out-of-pocket spending trended upwards (OECD 2016). As a result, workers are becoming more pessimistic about the ability of social security programs to finance retirement. Over 70 percent of US and UK employees, and around 65 percent of employees globally, think that social security benefits will be much less generous when they reach retirement compared to today (Willis Towers Watson 2016g). This is not surprising considering that, in the US Social Security, replacement rates for the average earner retiring at age 65 are actually declining and expected to drop from 42 percent in 1985 to a projected 36 percent in 2030 (Cahill and Quinn 2018). As fears over safety nets have grown, so too has the relevance of private and employer benefit provision. For most employees, employer pension plans are the primary way they save for retirement. As Figure 9 shows, some four of five employees in Australia, the US, and Japan, and around three of four in the UK, Netherlands, and

Ireland, believe that their employer retirement plans are their most important source of retirement savings. Even in countries like Germany and Canada that have rather generous social security arrangements, about 60 percent of employees see private retirement arrangements as their main retirement savings vehicle.

Figure 9 here

Low interest rates and economic uncertainty have also subjected legacy DB schemes and health care benefits to greater stress. With limited productivity growth to be distributed, the small growth in worker compensation has been increasingly diverted to fund benefits rather than pay. Accordingly, employers and employees are increasingly looking to benefits to fulfill a broader range of need. With productivity growth stagnant, budgets are limited and companies are seeking to drive greater appreciation of their benefits within the same cost envelope. Here, greater choice and flexibility is a possible solution. Given meagre pay increases and economic growth, the possibility of allowing employees to use their benefit budgets to better meet their needs offers a means for employers to remain competitive and attract key talent.

Demographic trends: Changing workforce dynamics. In most Western countries, the workplace is facing two key demographic challenges. First, population aging and rising retirement ages are boosting the number of ‘old’ employees in the workforce. And second, large numbers of millennials (the ‘echo boom’) are entering the workforce for the first time. By 2017, millennials (born between 1980 and 2000) will be the majority US adult population. As a result, multiple generations with different wants and needs will coexist in the workplace. Different generations have markedly different financial priorities: Baby Boomers think savings for retirement is their main financial goal, but for millennials and Generation X, paying off debt and savings to buy a house are more pressing issues (Table 1) (Willis Towers Watson 2016g).

(Insert Table 1)

Moreover, debt issues are very different today: 80 percent of Americans hold some form of debt such as mortgages, car loans, unpaid credit card balances, medical bills, student loans, or a combination of these (PEW Charitable Trust 2015). Older Americans are also carrying more debt into retirement than in previous decades (Georgetown University 2017). Eight in 10 Baby Boomers have some form of debt, and about 47 percent are still paying off their homes. Two-thirds of all Millennials and 80 percent of college-educated Millennials have at least one source of outstanding long-term debt (Lusardi et al. 2014).

Many more workers now also pursue a mobile or portfolio career. For older workers, retirement plans and even the concept of retirement is also changing. A generation ago, most workers retired before 65, but given the economic uncertainties, more employees plan to stay at work longer than before and work flexibly as they age. And the importance of making it easy for people to stay employed by both providing incentives, trainings and reengineering job roles is becoming much more evident (Byrne and Reilly 2018). These changes are creating both opportunity and appetite for non-traditional benefits consistent with more flexible working.

Technology and consumer voice. Attempts to offer a broader range of benefit options in the past often floundered, as they proved to be too complex for both employers and employees. Employers struggled with the administrative burdens, and employees struggled with the complexity of the choices offered. Today, advances in technology are now overcoming these barriers. The cost and complexity of administering individual accounts and providing integration across different (vendor) solutions has fallen substantially and made offering choice a practical option for employers. Employees can now make choices between multiple benefits online, in real time, seamlessly with online modellers and decision support.

In the US, the private health insurance exchanges are an example of this move to online choice and flexibility. Exchanges accommodate employers' shift to the DC approach while

creating an experience that more closely reflects online shopping (an ‘Amazon’ like experience). Exchanges offer a much wider variety of benefit products and use decision support tools to help employees design their own tailored benefits package. In the process, these tools can be quite effective at pairing individuals with products that are a good fit for their personal or family situations. Employees respond strongly to the recommendations provided by those tools, and their confidence in the tools grows with repeated use. Early indications also suggest that the recommendations are not viewed as default options. Recent research shows that, when shopping for a medical plan option, 38 percent of employees bought the recommended plan while 31 percent bought a more expensive plan; just as many (31 percent) bought a less expensive plan option (Private Exchange Research Council 2016). Also, those that bought down tended to buy a much cheaper plan option (\$2,735 less than the recommended plan) than those that bought up (\$1,069 more expensive plan option). Employees are not simply accepting recommendations, but rather they are using the recommendations as a starting point to make independent decisions and shop around for plans that best meet their needs.

Decision support tools can also strongly influence which types of benefits employees buy. For many employees, the new range of income protection and voluntary products their employers offer were previously unknown to them. As shown in Figure 10, employees are three to five times more likely to buy a product when recommended to do so than when not. Again, this evidence reinforces the power of recommendations and that they can strongly influence buying patterns (Private Exchange Research Council 2016).

Figure 10 here

The movement towards online interactions in other key fields, such as retail shopping, insurance, and banking is driving employees to expect a similar experience with their benefits offering. Benefits technology has already become more versatile and personalized through apps

and tools, and it is enabling new ways of communicating with employees. Apps open up the possibility of reaching individuals just in time for key decisions and providing more interactive communication. At the same time, apps can provide useful data on employees which can be used to produce predictive analytics about the workforce and help design 'smart' defaults. These technological advances are enabling employers to offer more meaningful choices that can meet the complex and varying needs of today's workers.

Conclusion

The economic environment and changing workforce demographics are offering new flexibility and choice, both within and across benefit plans. This requires employers to see plans differently.

Core security and meaningful choice. Historically, companies have taken a piecemeal approach to employee benefits, adding programs one-by-one. Viewed in isolation, this might seem appropriate, but in aggregate this has often resulted in an incoherent benefits offering. Also, as companies become more global, employers increasingly seek to build a consistent global framework based on the company's underlying principles and strategy, leaving room for local flexibility. At the same time, employers seek a core set of benefits offering essential health, retirement, and financial security. These can then be supplemented with options to purchase more generous provision, on top of the core, as well as the option to purchase additional voluntary benefits. Employees may choose to allocate money to benefits from a fund financed by the employer, or to buy products facilitated by the employer but paid for solely by the employee.

Decision support: Segmentation and personalization. As companies add greater choice, they also add greater decision support to help their workforce make meaningful choices and using new technology to engage with employees. Employees expect the convenience of easy access to data

and instant information on their plans (via web, apps), and this is reflected in the tools employees are need to provide in their benefits plans.

Wellbeing: An integrated technology enabled approach. This broader approach to employee well-being, includes core components of physical, emotional, financial, and social health. Benefit programs are no longer viewed as supplemental: nearly 90 percent of employers globally identify their well-being programs as a core part of their benefits strategy (Willis Towers Watson 2016a).

Conventional benefit programs have tended to use outdated technologies, designed as one-size-fits-all, and the delivery is fragmented. As a result the programs fail to live up to expectations in terms of a return on investment and do not drive sustainable changes in behavior. Even in the US, where employers typically offer employees an opportunity to earn on average \$880 per year if they voluntarily participate in the company's well-being programs, most employees only ever recoup \$360 (or 40 percent) of that amount. Therefore, well-being programs of the future must leverage technology, segmentation, and personalization to be strategically aligned; focus on high-performing programs (rather than simply checking a box); personalized to life situation, culture and demographics; and leveraged to confront the social forces within the workplace to support good habits. Leading with programs has not been a successful strategy. Instead, employers are rethinking their approaches by putting their employees at the centre of their strategies.

This revitalized approach is designed to enhance well-being programs for the future. Digital developments provide opportunities to engage employees and get the most out of benefits programs, an invaluable outcome in a low return environment.

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Endnotes

¹ Policies allowing temporary or early access to private pension savings have been introduced recently, for example, in Australia, Iceland, and Spain, and are being considered in Turkey. The UK has also recently lifted the requirement to annuitize retirement savings.

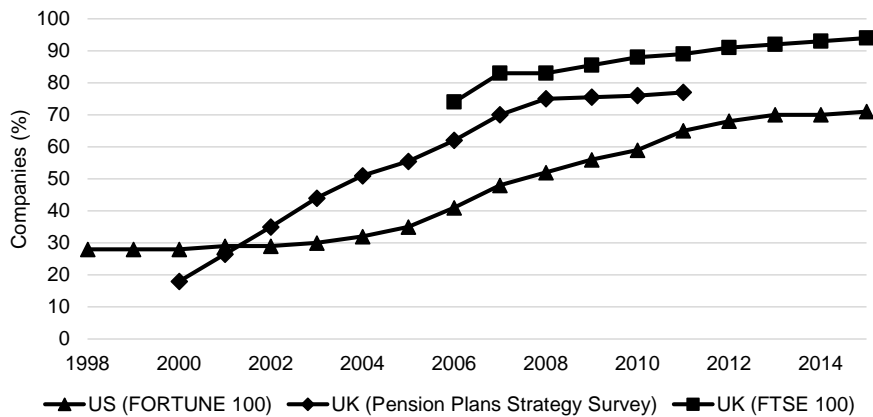
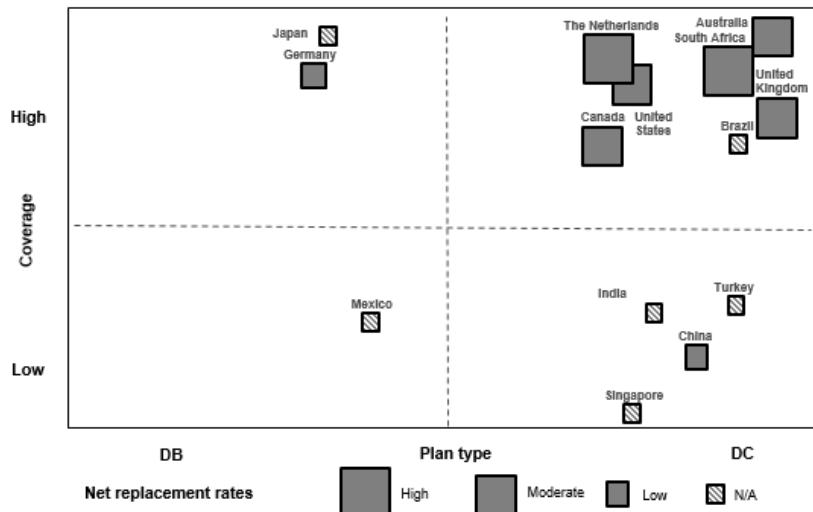


Figure 1. Prevalence of companies only offering DC plans (1998-2015).

Note: Percentage of companies offering DC plans to employees.

Source: Authors' computations using the Willis Towers Watson UK Pension Plan Design Survey, the FTSE DC Survey (Willis Towers Watson 2017) and the Fortune 100 Survey (Willis Towers Watson 2016h). The Fortune 100 is the list of the 100 largest companies in the US by gross revenue, and the FTSE 100 is an index composed of the 100 largest companies listed on the London Stock Exchange.



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Figure 2. Stages of transition towards DC in occupational pension plans.

Note: Prevalence and plan type are based on information for medium-size and large private sector companies. Prevalence refers to the percentage of employers offering occupational plans.

Source: Authors' computations using data from Willis Towers Watson, based on analysis of various proprietary and publicly available databases for the selected countries.

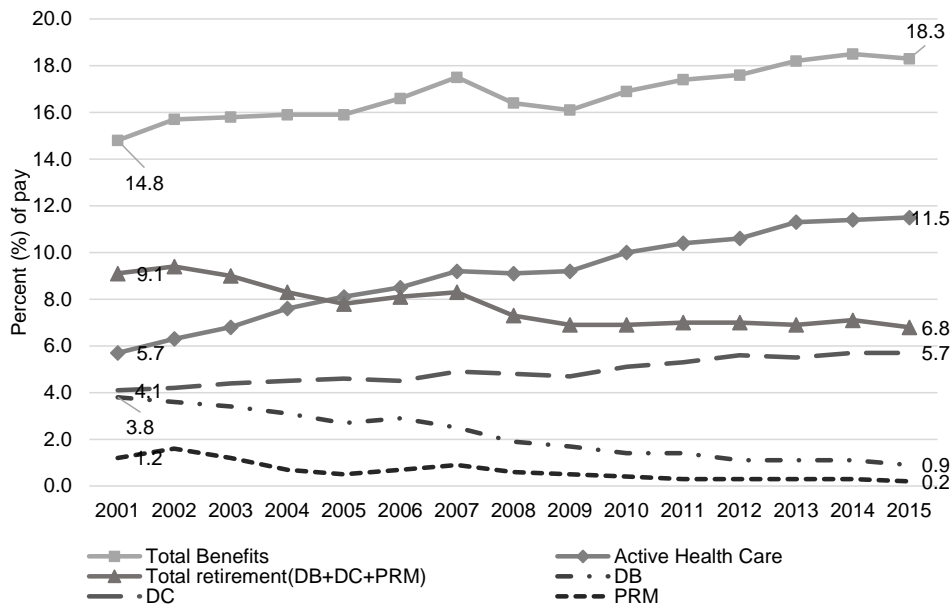


Figure 3. Total employer benefit values as a percentage of pay – US.

Note: Study focuses on employer spend as a percentage of average employee’s pay toward: DB plans (hybrid and traditional DB plans), DC plans (401(k), 403(b), profit sharing, ESPP, etc.), Active Health Care and Post-Retirement Medical (PRM). Employer value for retirement benefits is based on information from the WTW Benefits Data Services (BDS) database, a comprehensive benefits data source on provisions to employees related to retirement, health and welfare, paid time off, lifestyle and flexible benefits. For retirement data prior to 2010, legacy data from Comparison (legacy Watson Wyatt system) and EBIC (legacy Towers Perrin system) was utilized. To ensure that spend as percentage of pay are comparable from across all years 2001-2015 and legacy systems, multiplication factors were created and used to put values on a 2015 scale. Results shown for 2001-2015 use all companies in our valuation databases.

Source: Authors’ computations using data from Willis Towers Watson analysis of Fortune 500 (Willis Towers Watson 2016b)

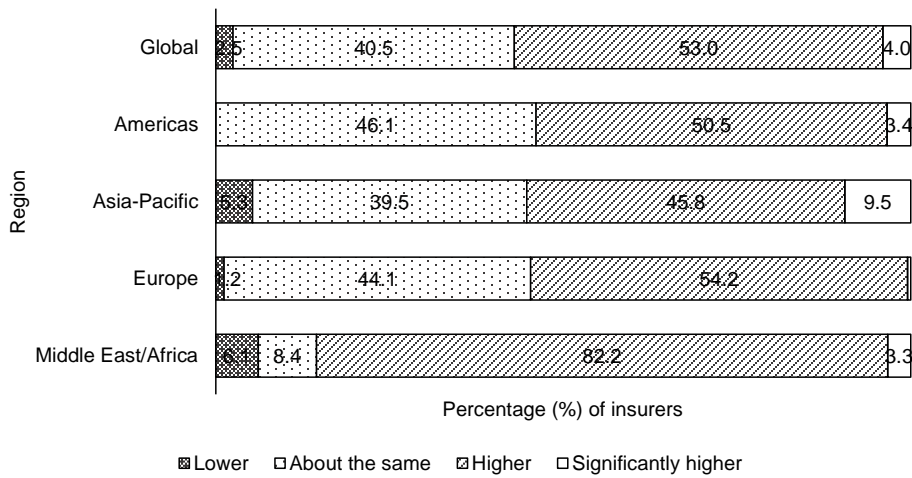


Figure 4. Expectations for future medical cost trends.

Note: Figures present percentage of insurers answering the question ‘How do you expect the medical trend in your overall book of business to change over the next three years compared to current rates?’ in the Willis Towers Watson Global Medical Trends Survey. The Willis Towers Watson Global Medical Trends Survey was conducted in October and November 2015, and reflects responses from 174 leading medical insurers operating in 55 countries. Most participants have at least a 10 percent share of the global medical insurance market in their country.

Source: Willis Towers Watson 2016 Global Medical Trends Survey

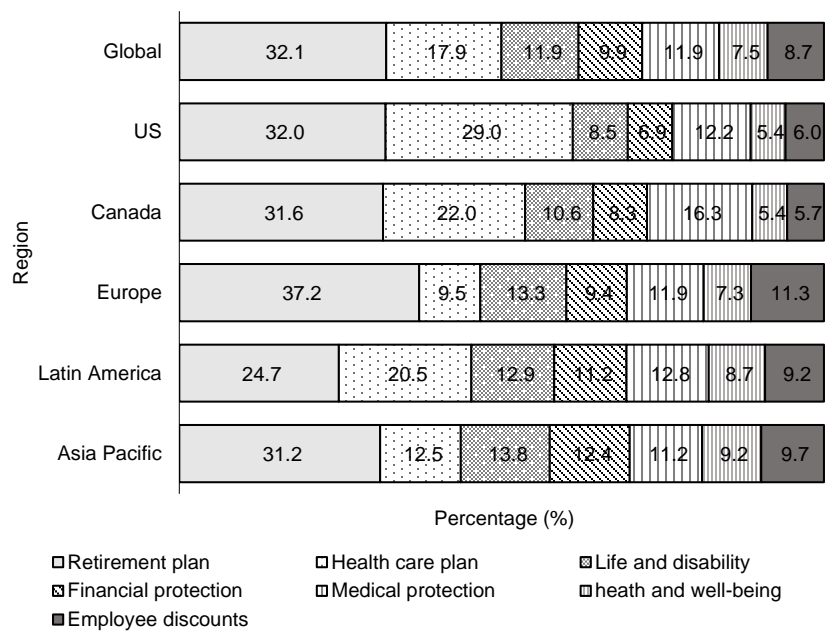


Figure 5. Employee’s preferred allocation of a benefits spend.

Note: Figures present the percentage distribution of a hypothetical benefits spend. Sample includes all employees except US and Canada where full time employees are considered.

Source: Willis Towers Watson (2016g)

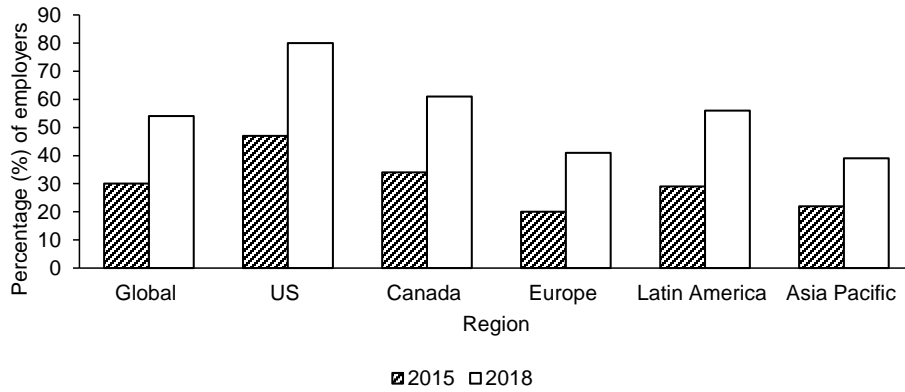


Figure 6. Adoption of a financial well-being strategy.

Note: Figures present the percentage of employees in each regions that have adopted a financial well-being strategy as part of their overall health and productivity strategy and those planning to adopt one between 2016 and 2018.

Source: Willis Towers Watson (2016i)

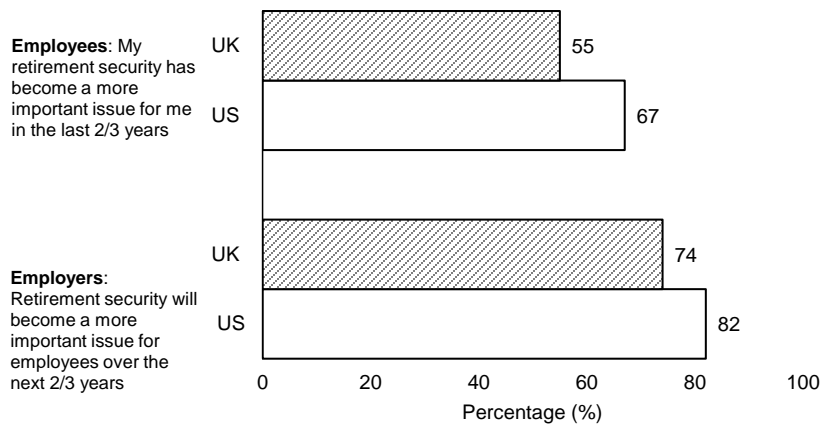


Figure 7: Expectation over importance of retirement security.

Note: Figures present the percentage of employees and employers that agree or strongly agree with the statements: ‘My retirement security has become a more important issue for me in the last two to three years’ and ‘Retirement security will become a more important issue for employees over the next two to three years’ for employees and employers respectively.

Source: Data for employees is from Willis Towers Watson 2015/2016 Global Benefits Attitudes Survey (Willis Towers Watson 2016g). Sample for the UK includes all employees while US are full-time employees only. Employer data for the US is from the 2014 DC Plan Sponsor Survey. Employer data for the UK is from the 2015 UK retirement readiness survey.

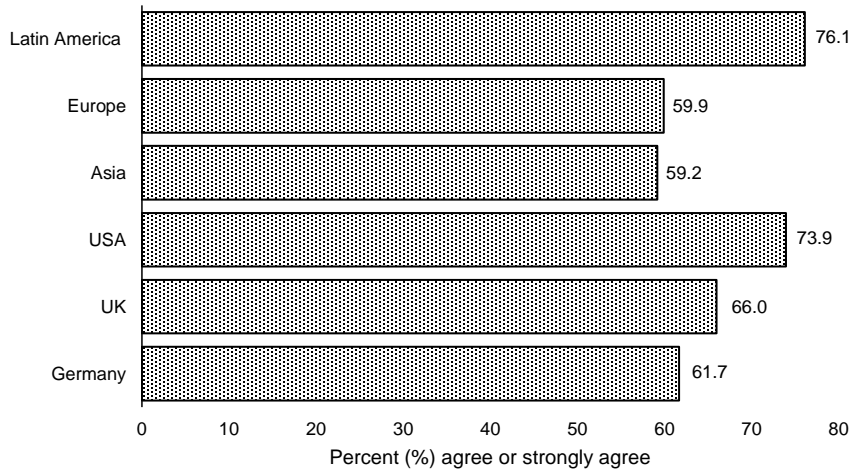


Figure 8: Financial security becoming a bigger issue over the past two or three years.

Note: Figures present the percentage of employees that agree or strongly agree with the statements: 'My financial security has become a more important issue for me in the last two to three years'

Source: Willis Towers Watson (2016g)

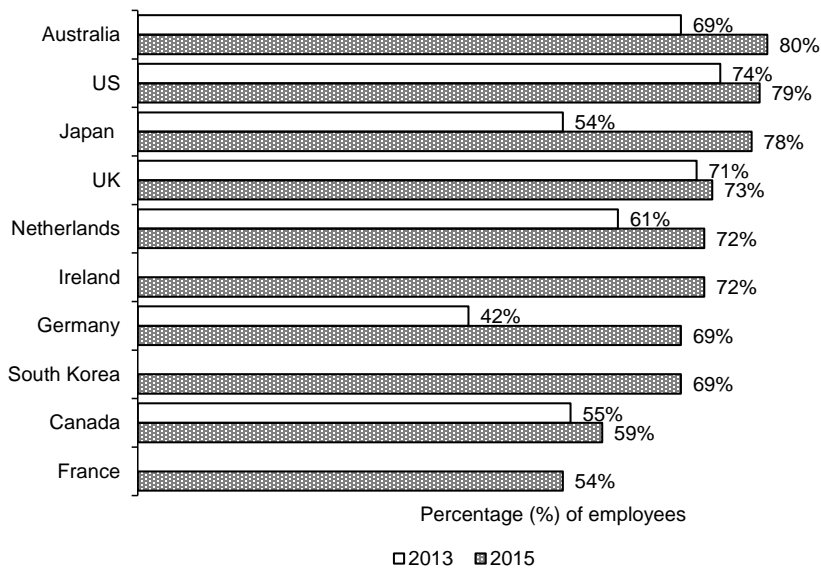


Figure 9: Relevance of employer retirement plans to finance retirement.

Note: Figures present the percentage of employees that agree or strongly agree with the statements: 'My retirement plan is the primary way I save for retirement'. Sample: All employees. Except US and Canada, full-time employees only. No trend data available for Ireland.

Source: Willis Towers Watson (2016g)

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Table 1: Financial priorities across generations

Generation	Baby Boomers	Generation X	Generation Y
Saving for retirement	72%	56%	33%
Pay off debts	42%	47%	53%
Housing	34%	46%	55%
General costs	38%	42%	51%
General saving	33%	33%	36%
Other planned saving	22%	20%	29%
Leisure	19%	18%	20%
Children's expenses	16%	23%	10%
Medical Expenses	22%	13%	8%

Notes: Figures are percentage of respondents ranking each item as their top financial priority. Sample is US employees working full-time.

Source: Willis Towers Watson (2016e)