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Global Developments in Employee Benefits

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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The last 25 years have seen defined benefit plans increasingly been replaced by defined contribution (DC) arrangements.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.

Disciplines

Economics

Comments

The published version of this Working Paper may be found in the 2018 publication: *How Persistent Low Returns Will Shape Saving and Retirement*.

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How Persistent Low Returns Will Shape Saving and Retirement

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Chapter 12

Global Developments in Employee Benefits

Natalia Garabato, Jonathan Gardner, and Steve Nyce

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 United States and United Kingdom, 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 arrangements for funding health benefits.

It is clear that, despite the shift to DC, employers' commitment to benefits has not necessarily fallen. Indeed, employer costs have frequently grown due to legacy DB costs and rising healthcare 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 behavioral 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?

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, 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 centerpiece 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 behavioral 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 behaviors.

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 healthcare areas, as well as the influence and effect of the recent global financial crisis. Second, we analyze 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 United States 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 toward 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 toward 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 labor 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.

New DC plans in the United States emerged in the early 1970s, encouraged by the Employee Retirement Income Security Act (ERISA) in 1974 and the Revenue Act of 1978, which established 401(k) plans and changed

Individual Retirement Account (IRA) rules. In 1981, the Internal Revenue Service (IRS) proposed regulations that 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 reappearance 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 12.1). Today, the UK's private-sector retirement landscape is almost entirely DC only for new hires (compared to around 70 percent of large private-sector employers in the United States).

For the UK, the recent introduction of mandatory automatic enrollment 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 2008–2009 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

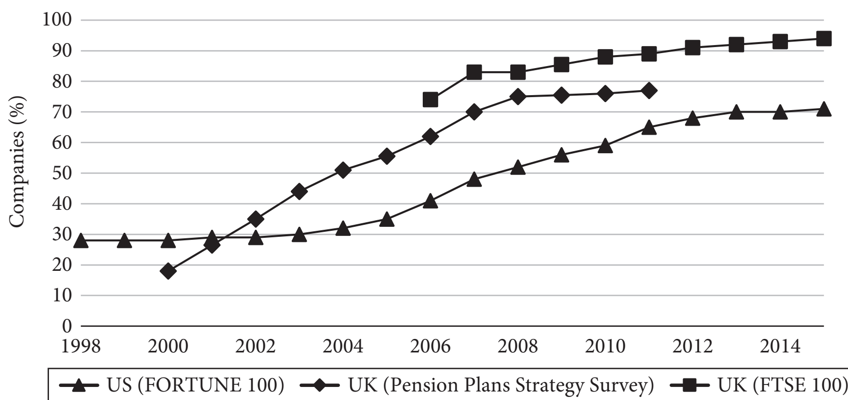

Figure 12.1. Percentage of companies offering only DC plans (1998–2015)

Source: Authors' computations using data from Willis Towers Watson.

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 rates 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 United States and United Kingdom, where the incidence of pension freezes (ceasing future accrual for existing plan members) has risen significantly since 2008. Among the Fortune 500 companies that 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 FTSE 100 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). One in three of DB plans still open to accrual in 2015 is likely to be closed by 2020 (Towers Watson 2015a).

In emerging economies, the growth in DC has taken place over a shorter time frame, 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 plans 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 DC component was a key factor in countries such as China and Hong Kong (Pai 2006; The World Bank 2016). What 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 them 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 establishing corporate and individuals DC plans back in 2001. Since then, subsequent regulation has expanded eligibility criteria, and regulated the role of sponsors, fiduciaries, and investment rules (Willis Towers Watson 2016d). So, as Figure 12.2 shows, occupational retirement provision is increasingly concentrated on DC plans with DB provision increasingly rare.

Movement to DC health. The advent of DC in retirement plans is now moving to the healthcare area as well, particularly in the United States. Traditional DC healthcare 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 healthcare costs escalated in the late 1980s and employees' share of health plan costs consequently 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

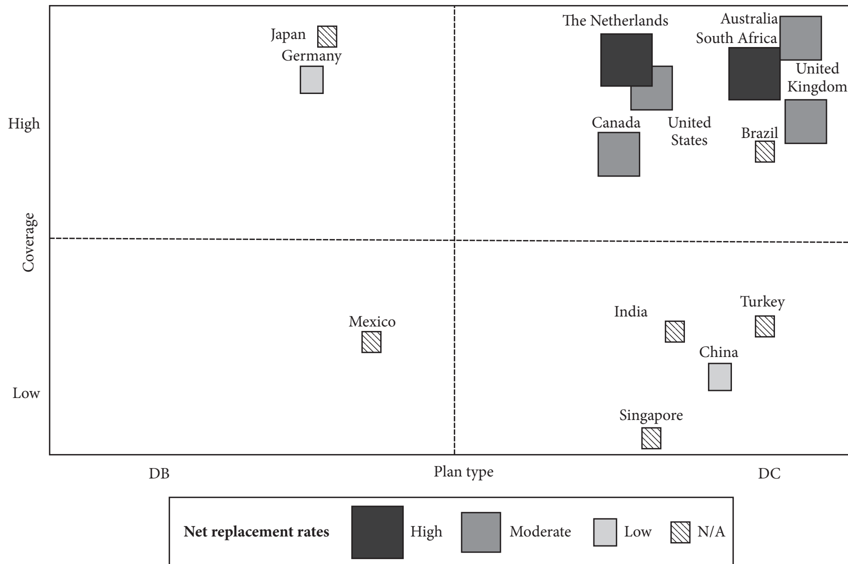

Figure 12.2. Stages of transition toward DC in occupational pension plans

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

Source: Authors' computations using data from Willis Towers Watson.

by 2018 (to 48 percent) 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 healthcare 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 healthcare costs.

In the United States, 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 12.3). In short, healthcare

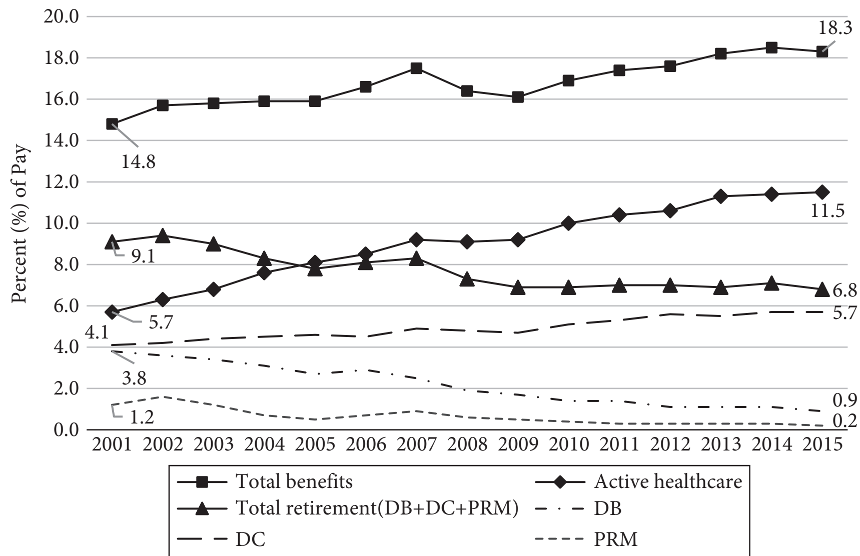

Figure 12.3. Total employer benefit values as a percentage of pay – United States

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) were utilized. To ensure that spend as percentage of pay is comparable 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.

costs are crowding out employee short-term 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 healthcare costs expected to increase at a faster pace than general inflation for the foreseeable future. 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 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.

The trend towards higher healthcare costs is also evident outside the United States. In 2014, the global cost of private medical insurance benefits rose more than twice the rate of general inflation (Towers Watson 2014). Moreover, most insurers anticipate higher or significantly higher medical

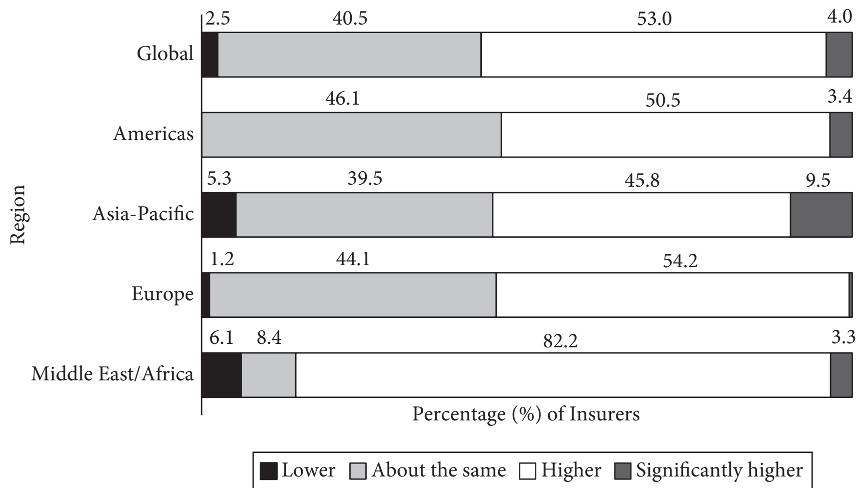

Figure 12.4. Expectations for future medical cost trends

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 group medical insurance market in their country.

Source: Willis Towers Watson (2016e).

trends over the next several years (Figure 12.4). Given the design of healthcare 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 or services.

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 United States has been the rise of healthcare costs. In other countries, rising healthcare 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 12.5).

Clearly the benefits packages of the future must accommodate these different priorities. In fact, more and more employers, especially in the United States, United Kingdom, 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 toward DC benefits by lowering the cost of individual account-based plans and increasing the use of flex programs,

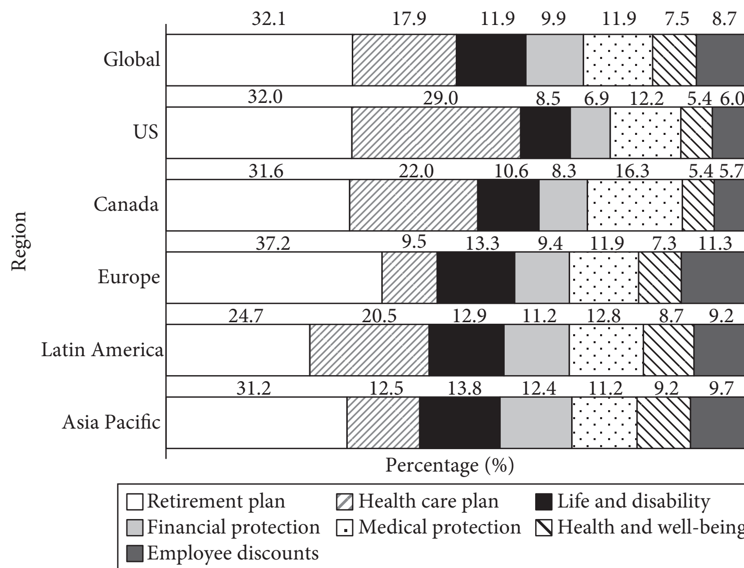

Figure 12.5. Employees' preferred allocation of benefits spend

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

Source: Willis Towers Watson (2016g).

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 United States, where employees have long been able to borrow against their 401(k)s, or 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 toward 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 well-being. Well-being 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 productive than those with financial and health issues (Willis Towers Watson 2016g).

Today's emerging well-being programs reflect an evolution from the old-school wellness programs that tended to focus on employees' physical health. A recent survey showed that, in 2016, 30 percent of employers had already incorporated financial well-being as part of their organization's health and productivity strategy (Willis Towers Watson 2016a). The United States had a head start in this area with nearly half of employers incorporating personal financial well-being, yet other regions are also interested in broadening the spectrum of their benefits programs (Figure 12.6). In fact, we see growing interest in educating employees about ways to improve their financial well-being and to provide them with tools to help with budgeting and managing debts.

Other drivers of change: the globalization of benefits. Multinational businesses are increasingly managed more 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

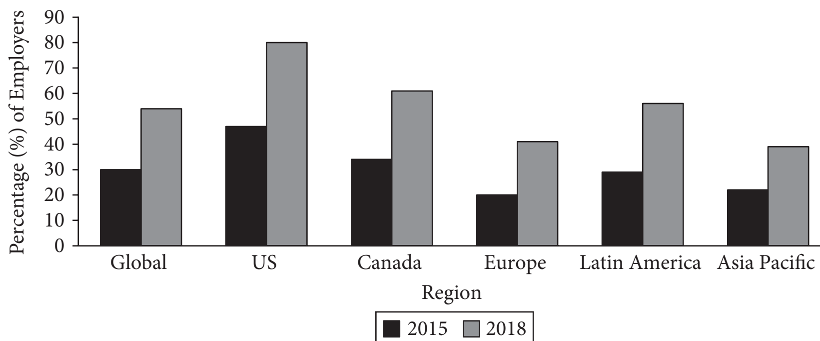

Figure 12.6. Adoption of a financial well-being strategy

Note: Figures present the percentage of employees in each region that had adopted a financial well-being strategy as part of their overall health and productivity strategy by 2015 and those planning to adopt one between 2016 and 2018.

Source: Willis Towers Watson (2016i).

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 United States and the United Kingdom, but 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 well-being. But a lesson of the last two decades is that the engaged consumer model has not worked well in employee benefits. Behavioral 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 behavioral 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 makes automatic features appealing (Choi et al. 2006), and the use of pension automatic enrollment 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, healthcare, 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 enrollment 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-enrollment 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 at workplace seminars with administrative data showing that seminars at the workplace do not dramatically change employee behavior with respect to enrollment, 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 that are needed to reach a replacement rate of 75 percent can be three times as much under current interest rates than they would be if returns tracked those of the last 40 years (see Ilmanen and

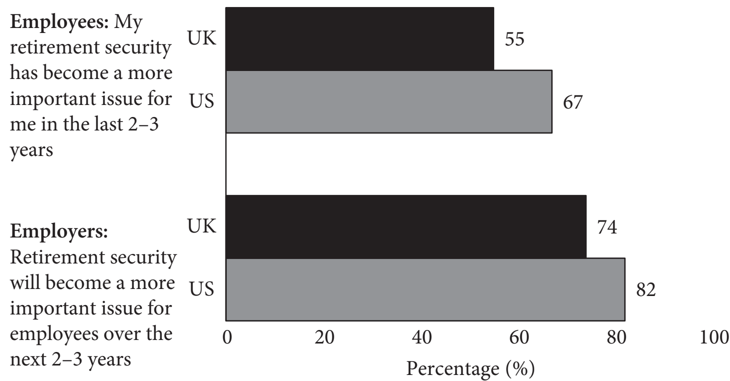

Figure 12.7. Expectation over importance of retirement security

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: Authors' calculations using Willis Towers Watson.

Rauseo's chapter in this volume). For those with DB plans, the picture is not much better. As Blanchett et al. note in their chapter, 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 (see Reilly and Byrne, this volume), 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 foresee this becoming an even more pressing issue in the near future (Figure 12.7). In the United States, 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 (see Quinn and Cahill's chapter in this volume).

Adequacy concerns are also prominent in the developing world. In Chile, for example, there have been massive protests 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 met 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 issue for employees worldwide (Figure 12.8).

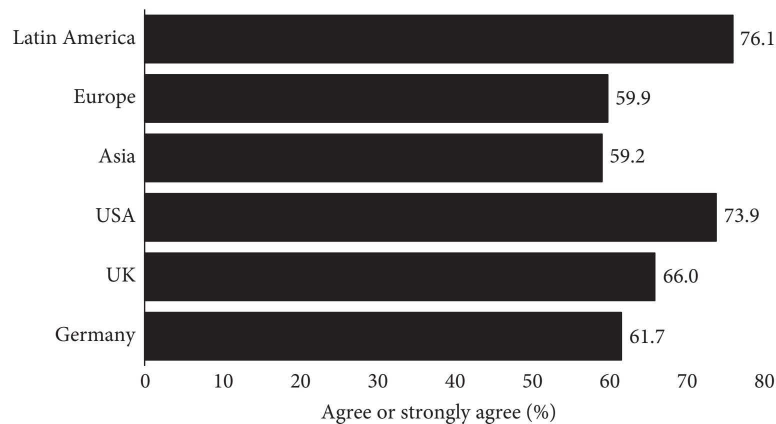

Figure 12.8. Financial security becoming a bigger issue over 2015–2016

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).

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 reshape 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 labor 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 United States 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 (see Quinn and Cahill, this volume). 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 12.9 shows, some four out of five employees in Australia, the United States, and Japan, and around three out 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 such as 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.

Low interest rates and economic uncertainty have also subjected legacy DB schemes and healthcare benefits to greater stress. With limited

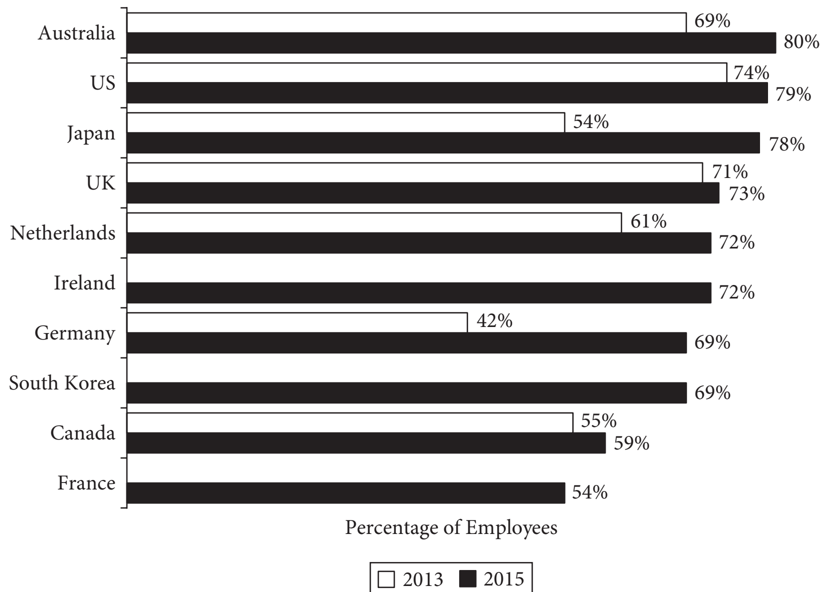

Figure 12.9. Relevance of employer retirement plans to finance retirement

Note: Figures present the percentage of employees that agree or strongly agree with the statement: 'My retirement plan is the primary way I save for retirement.' Sample: All employees, except US and Canada, where full-time employees only are included. No trend data available for Ireland, South Korea, or France.

Source: Willis Towers Watson (2016g).

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. Since 2017, Millennials (born between 1980 and 2000) have become the majority US

TABLE 12.1 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%

Note: 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).

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 saving for retirement is their main financial goal, but for Generation X and Millennials (Generation Y), paying off debt and saving to buy a house are more pressing issues (see Table 12.1) (Willis Towers Watson 2016g).

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 ten 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 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 providing incentives and training and reengineering job roles is becoming much more evident (see Reilly and Byrne, this volume). 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 have 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 United States, 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 strongly influence which types of benefits employees buy. For many employees, the new income protection and voluntary products their employers offer were previously unknown to them. As shown in Figure 12.10, 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 shows that they can strongly influence buying patterns (Private Exchange Research Council 2016).

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

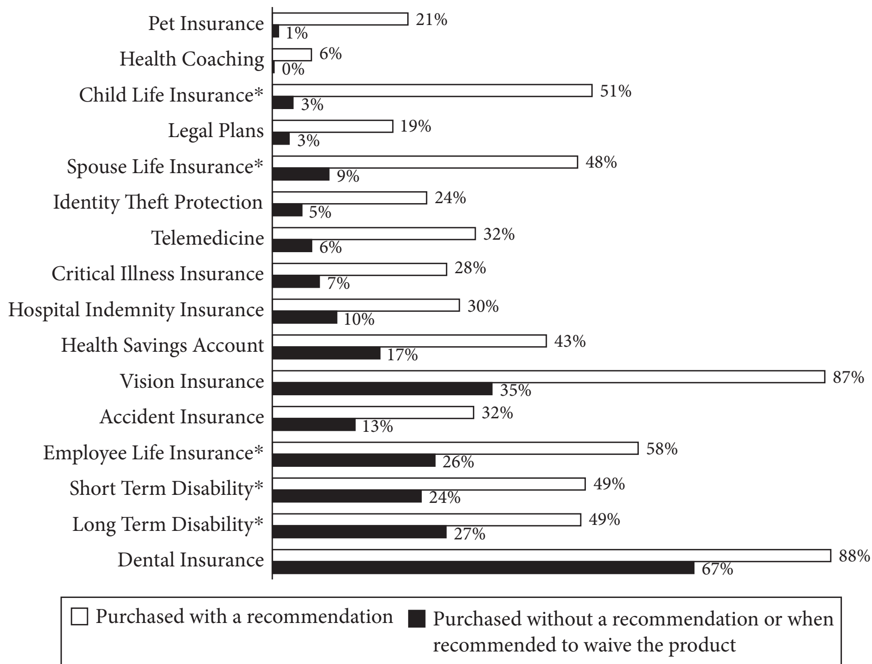

Figure 12.10. Impact of recommendation on buying decisions

Note: Figures are the percentage of employees buying each product with and without a recommendation through Liazon private exchanges. Sample: Data representative of all employees in the study sample who bought a Medical plan. 'Purchased without a recommendation' includes those choosing to get 'Advice' rather than getting a full recommendation (AKA those using the 'Advice Path'). *Net employer-paid products.

Source: Private Exchange Research Council (2016).

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 use new technology to engage with employees. Employees expect the convenience of easy access to data and instant information on their plans (via the web or apps), and this is reflected in the tools employers provide in their benefits plans.

Well-being: 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 United States, 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 center 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.

Note

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.

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