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Workforce Management Issues Related to Retirement and Health Benefit Plans

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The U.S. Aging Challenge in International Perspective

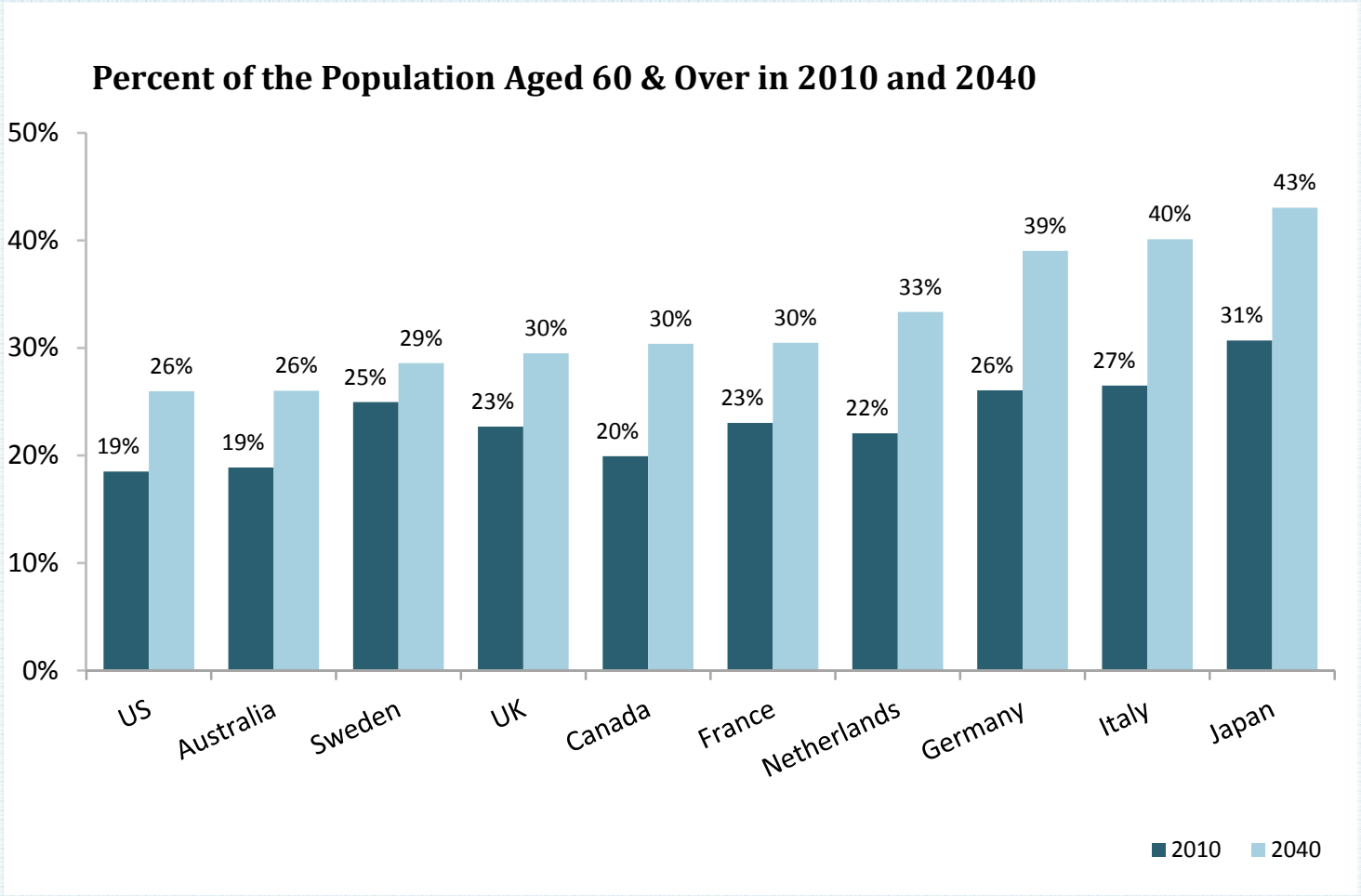
Richard Jackson
President
Global Aging Institute

Society of Actuaries
Webcast on Workforce Management Issues

November 18, 2014

Part 1
The Good News

The United States is and will remain the youngest of the major developed countries.



Source: UN Population Division (UN, 2013)

The U.S. public old-age dependency burden is not large by developed-world standards.

Total Public Benefits to the Elderly (Aged 60 & Over) as a Percent of GDP in 2010 and 2040

	Public Pensions		Health Benefits		Other Benefits		Total Benefits	
	2010	2040	2010	2040	2010	2040	2010	2040
Australia	3.7%	4.7%	3.0%	5.5%	2.3%	3.1%	9.1%	13.4%
Canada	4.0%	5.4%	4.3%	9.0%	1.0%	1.4%	9.3%	15.8%
France	12.6%	13.6%	4.7%	9.0%	1.3%	1.7%	18.6%	24.3%
Germany	10.3%	12.4%	4.7%	8.9%	1.9%	3.0%	17.0%	24.3%
Italy	13.9%	15.0%	3.9%	7.9%	2.2%	2.7%	20.0%	25.7%
Japan	9.3%	10.5%	5.2%	9.8%	0.6%	0.6%	15.1%	20.9%
Netherlands	4.6%	8.6%	3.4%	8.3%	2.2%	2.9%	10.2%	19.8%
Sweden	7.5%	8.4%	5.2%	7.3%	2.6%	3.5%	15.2%	19.3%
UK	7.5%	7.9%	4.6%	8.7%	1.9%	2.3%	13.9%	18.9%
US	4.8%	6.4%	5.1%	11.0%	1.2%	1.1%	11.1%	18.5%

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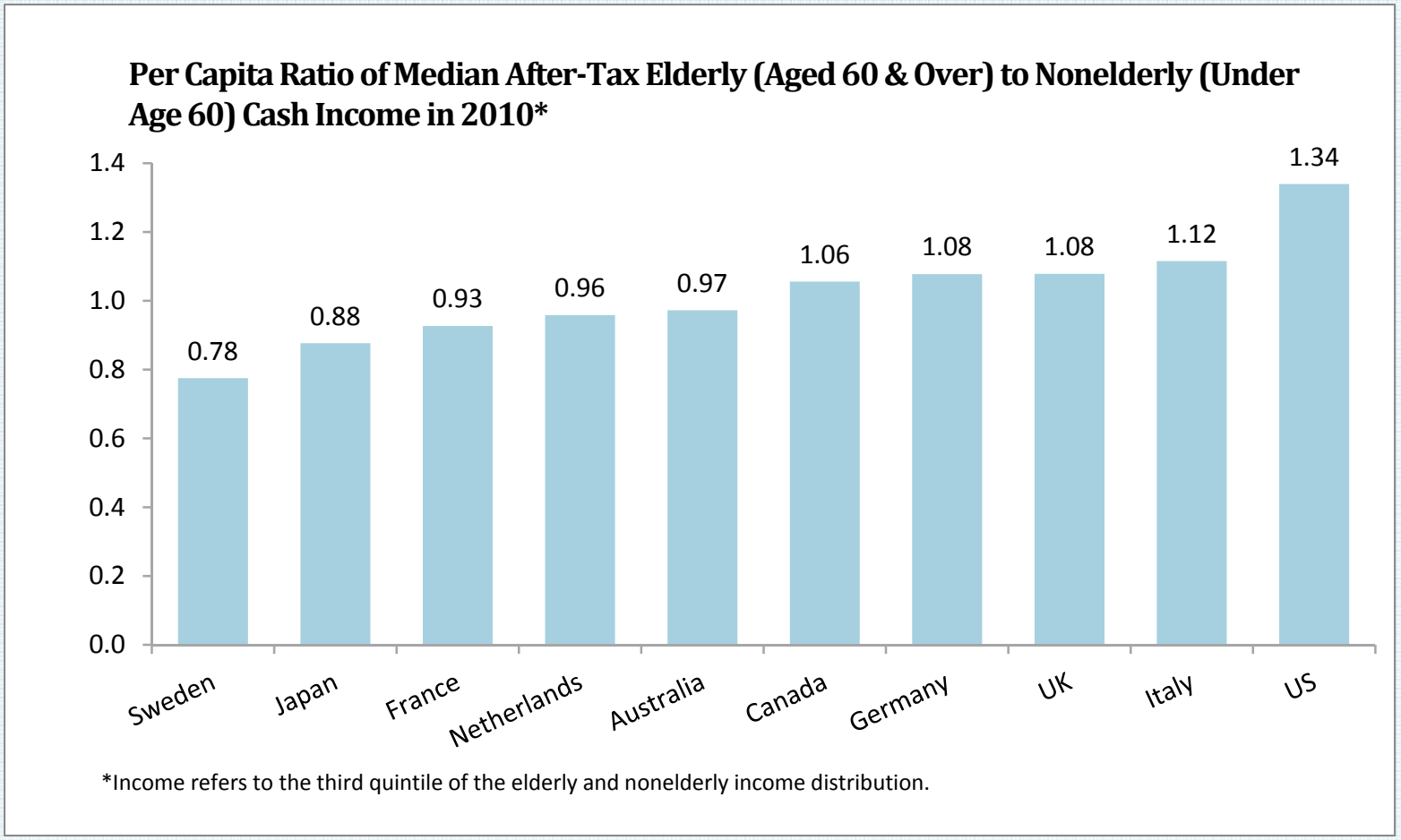
Source: GAP Index, 2nd Edition (CSIS, 2013)

Despite relatively modest government benefits, the relative living standard of the typical U.S. elder is remarkably high by developed-world standards.



Source: GAP Index, 2nd Edition (CSIS, 2013)

One Reason for High Elderly Living Standards: America's Large Funded Pension System

Funded Pension Benefits as a Percent of Median Elderly Income and GDP in 2010*

	Percent of Income	Percent of GDP
Australia	15%	4.5%
Canada	33%	5.6%
France	1%	0.3%
Germany	5%	0.8%
Italy	5%	1.1%
Japan	14%	2.6%
Netherlands	30%	4.9%
Sweden	10%	1.9%
UK	18%	3.9%
US	31%	5.9%

*Income refers to the third quintile of the elderly income distribution.

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Source: GAP Index, 2nd Edition (CSIS, 2013)

Another Reason for High Elderly Living Standards: America's High Rate of Elderly Labor-Force Participation

Elderly Labor-Force Participation Rate by Elderly Age Group, 1990-2010

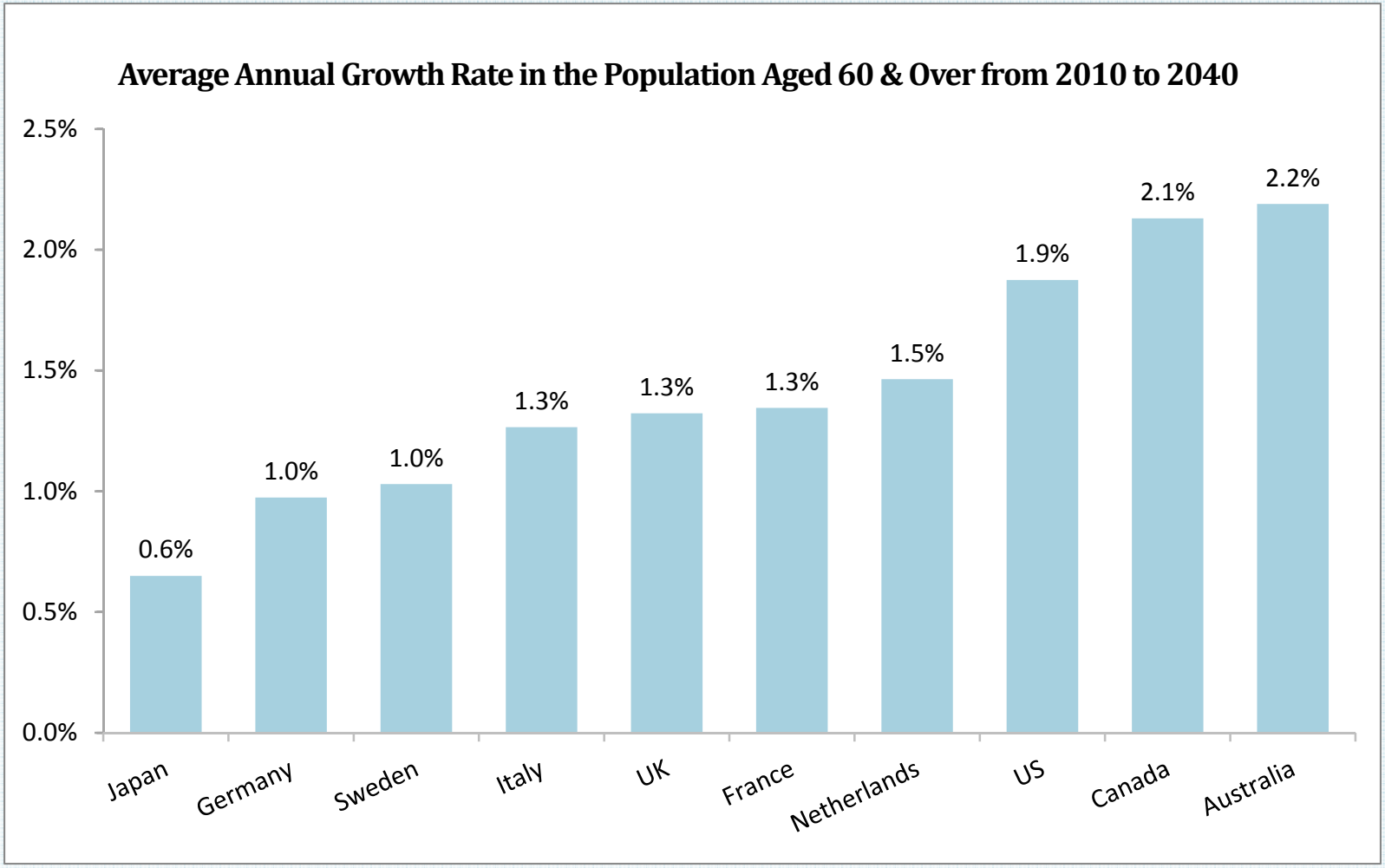
	Aged 60-64			Aged 60-74		
	1990	2000	2010	1990	2000	2010
Australia	33%	34%	52%	22%*	25%*	40%*
Canada	37%	36%	51%	20%	19%	32%
France	14%	11%	19%	8%	5%	10%
Germany	21%	22%	44%	12%	11%	18%
Italy	22%	19%	21%	12%	10%	11%
Japan	56%	56%	61%	44%	41%	44%
Netherlands	15%	19%	39%	8%	10%	23%
Sweden	58%	53%	65%	25%	26%	34%
UK	38%	38%	46%	19%	19%	27%
US	45%	47%	55%	27%	30%	39%

*Data refer to population aged 60-69.

Source: Labor Force Statistics Database (OECD, 2013)

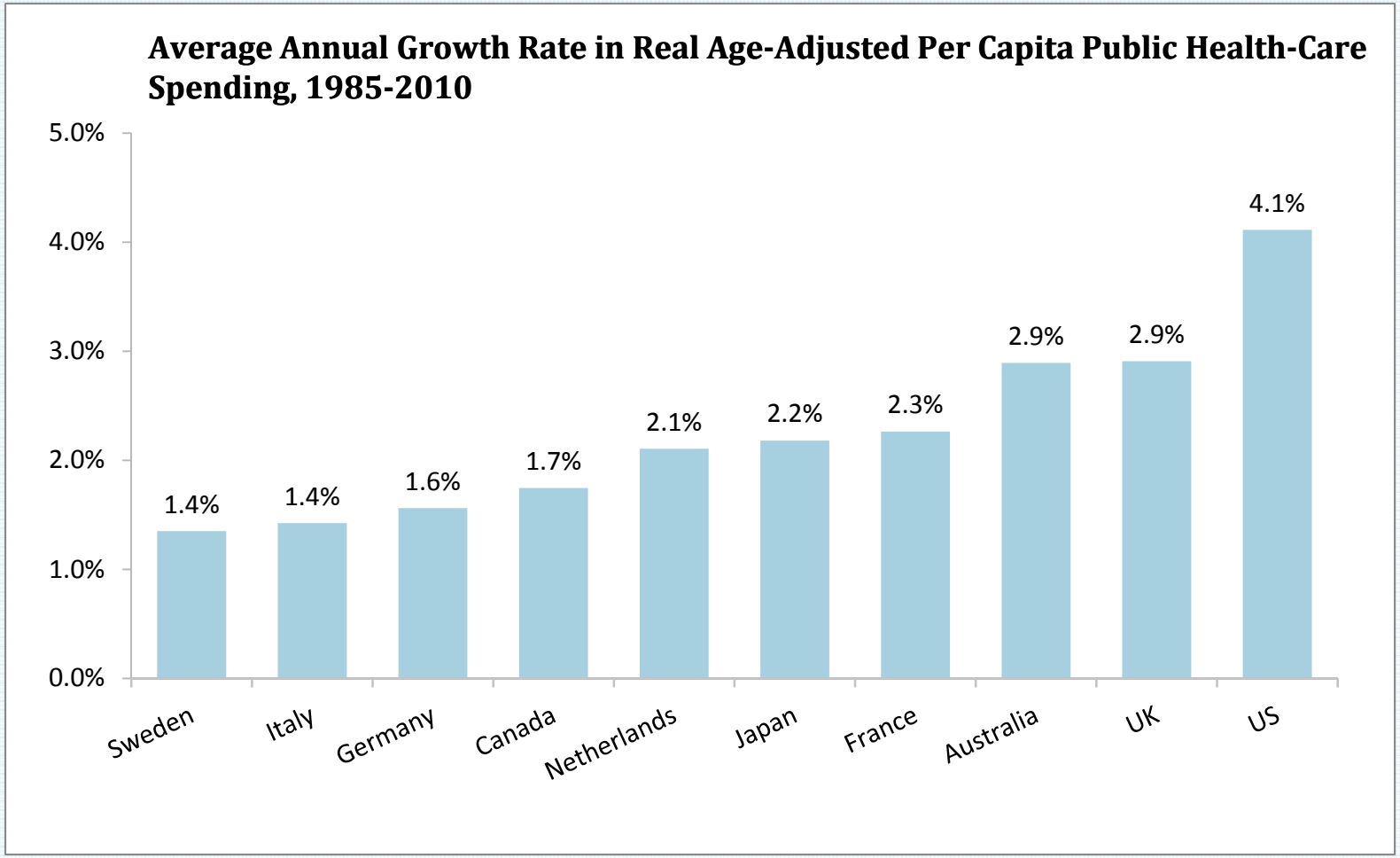
Part 2
The Bad News

Although the United States will not age as much as other developed countries, its large Baby Boom means that it will age more rapidly than most.



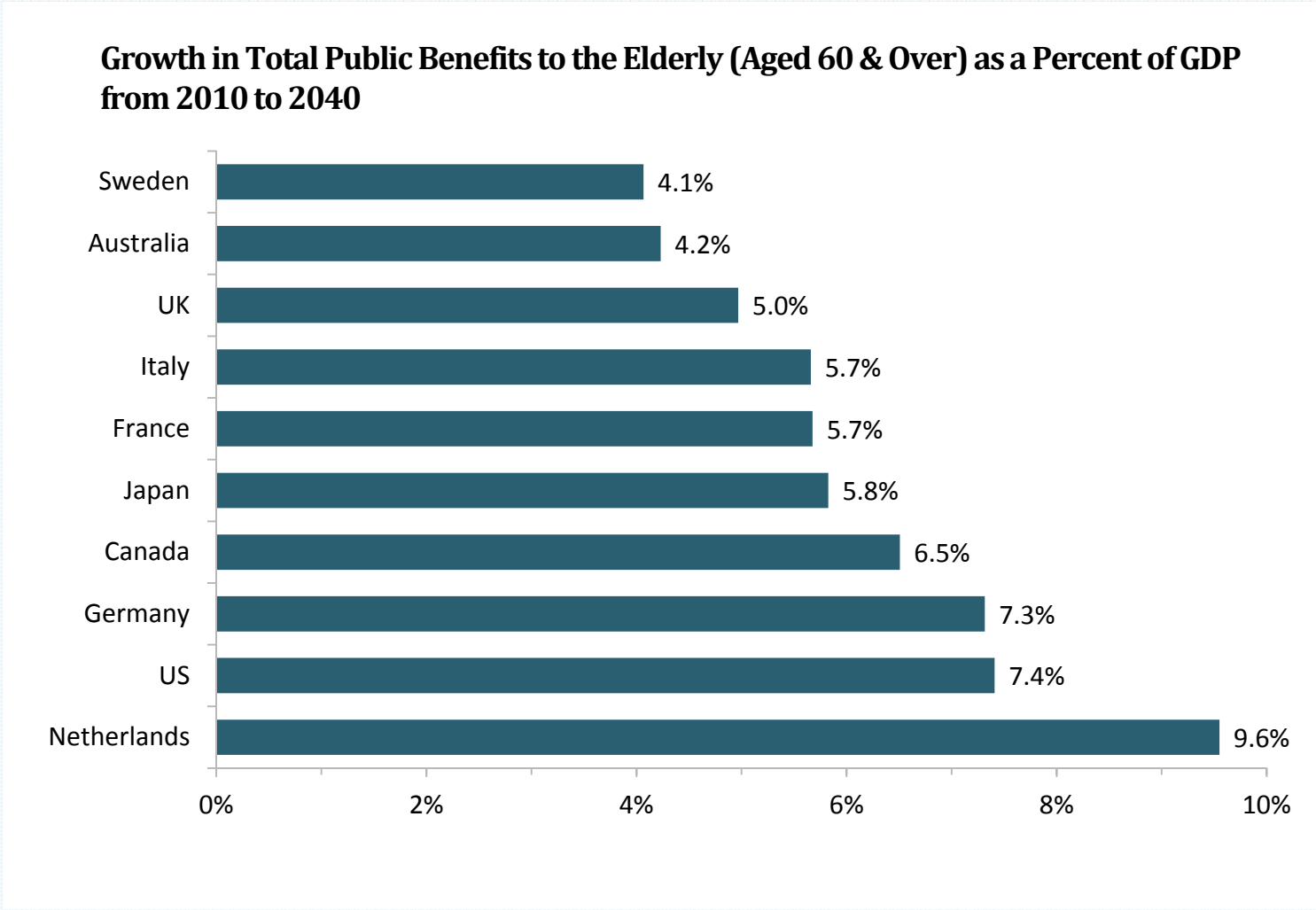
Source: UN Population Division (UN, 2013)

America's high rate of health-care cost growth will act as a multiplier on demographic aging.



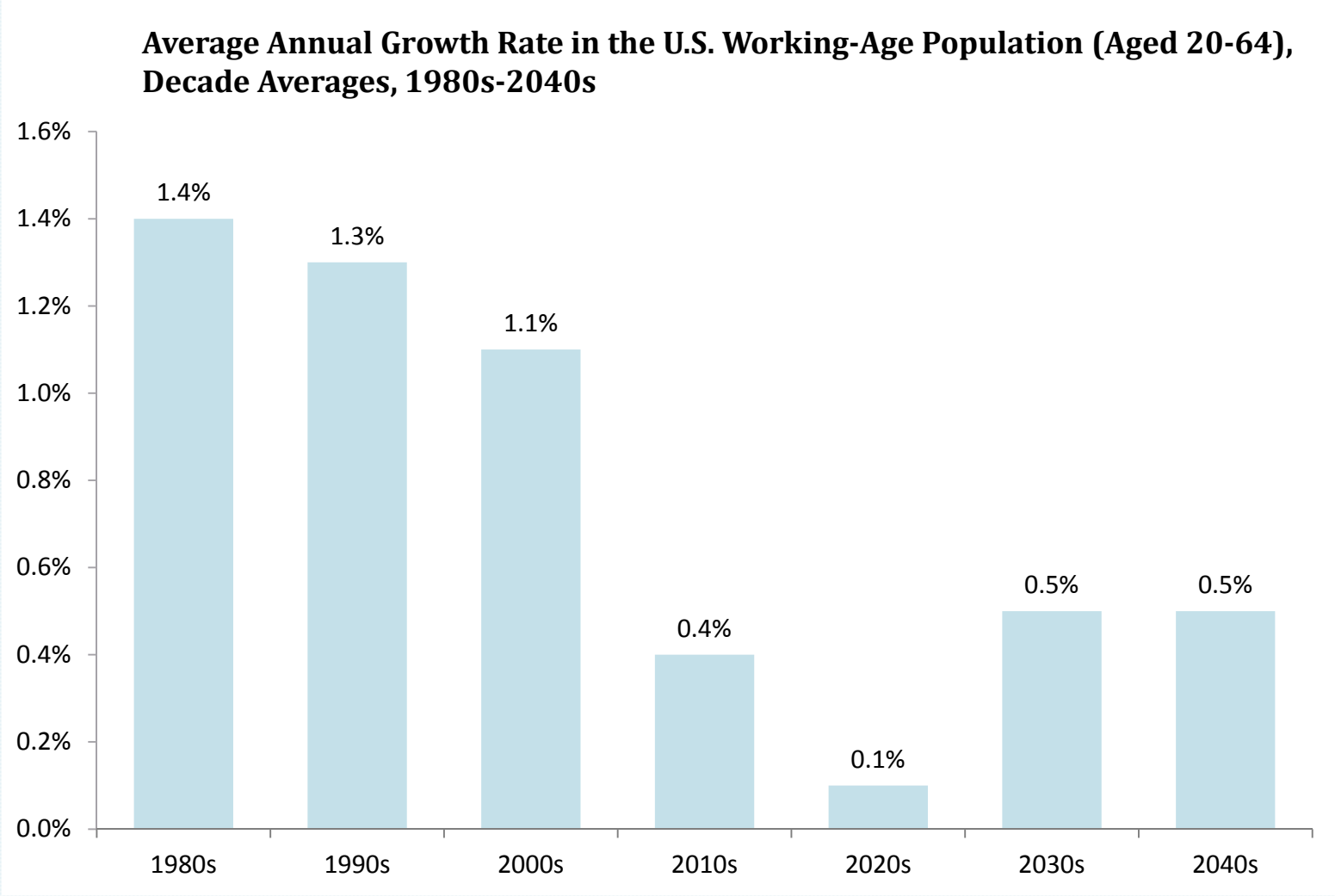
Source: OECD Health Data 2012 (OECD, 2012)

One Result: A Large Fiscal Shock



Source: GAP Index, 2nd Edition (CSIS, 2013)

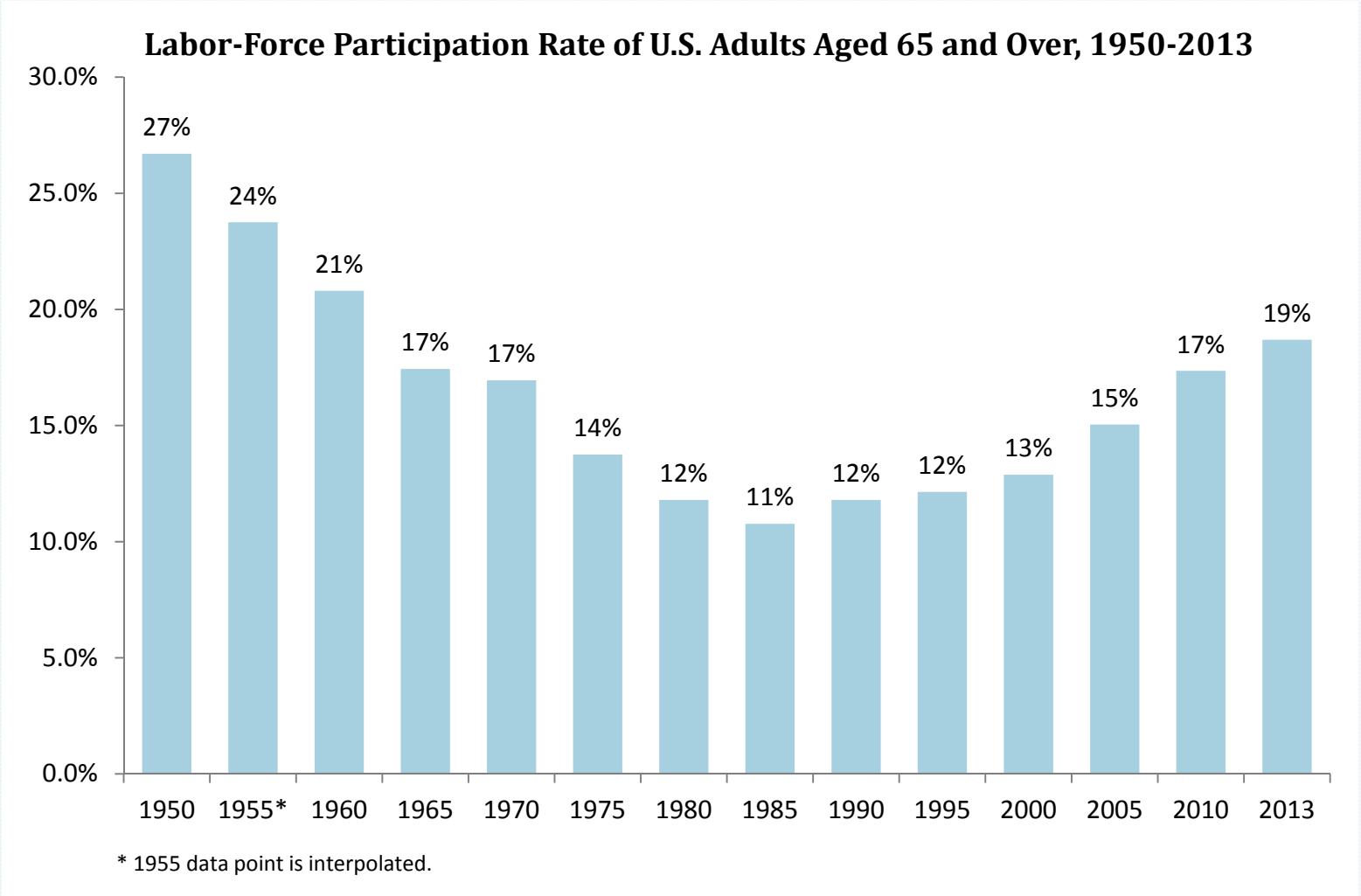
Another Result: A Large Labor-Market Shock



Source: UN Population Division (UN, 2013)

Part 3
The Workforce Management Challenge

U.S. elderly labor-force participation bottomed out in the 1980s and 1990s has been rising ever since.



Source: Monthly Labor Review (BLS, 2002)) and Labor Force Statistics Database (OECD, 2014)

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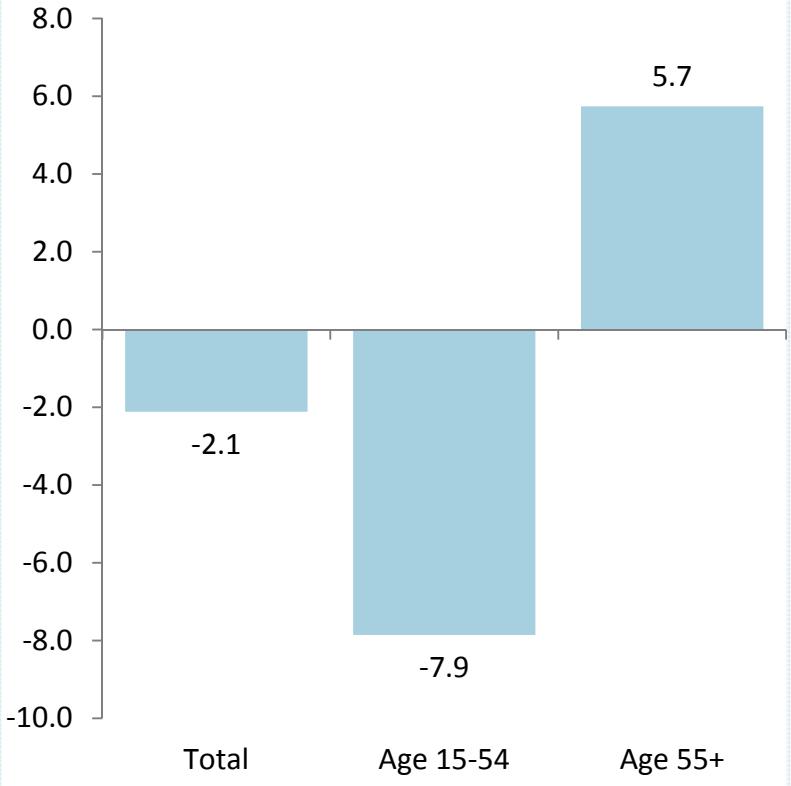
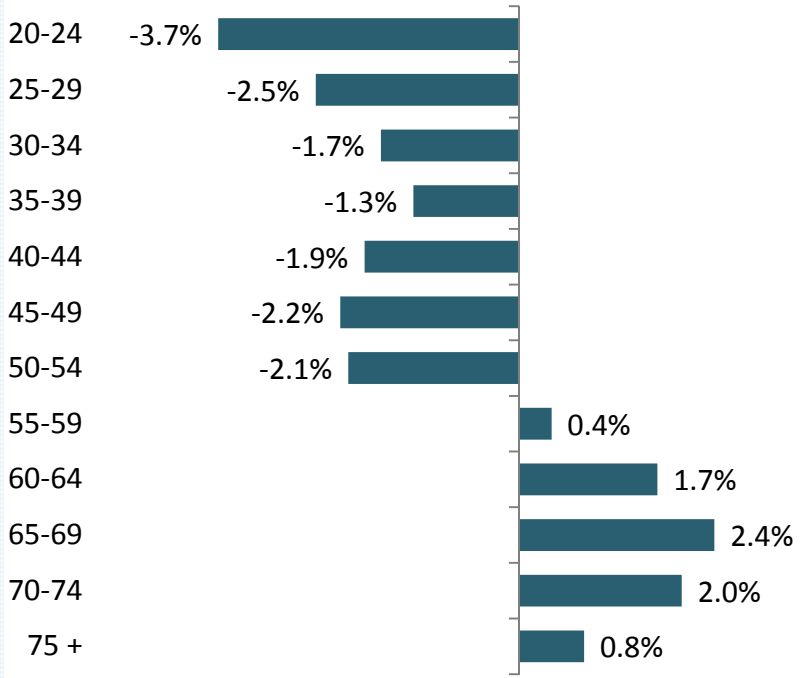
The upward trend in elderly labor-force participation accelerated during the "Great Recession."

Change in U.S. Employment in Millions, Total and by Age Group, 2007-2013



Percentage Point Change in U.S. Labor-Force Rate by Age Group, 2007-2013



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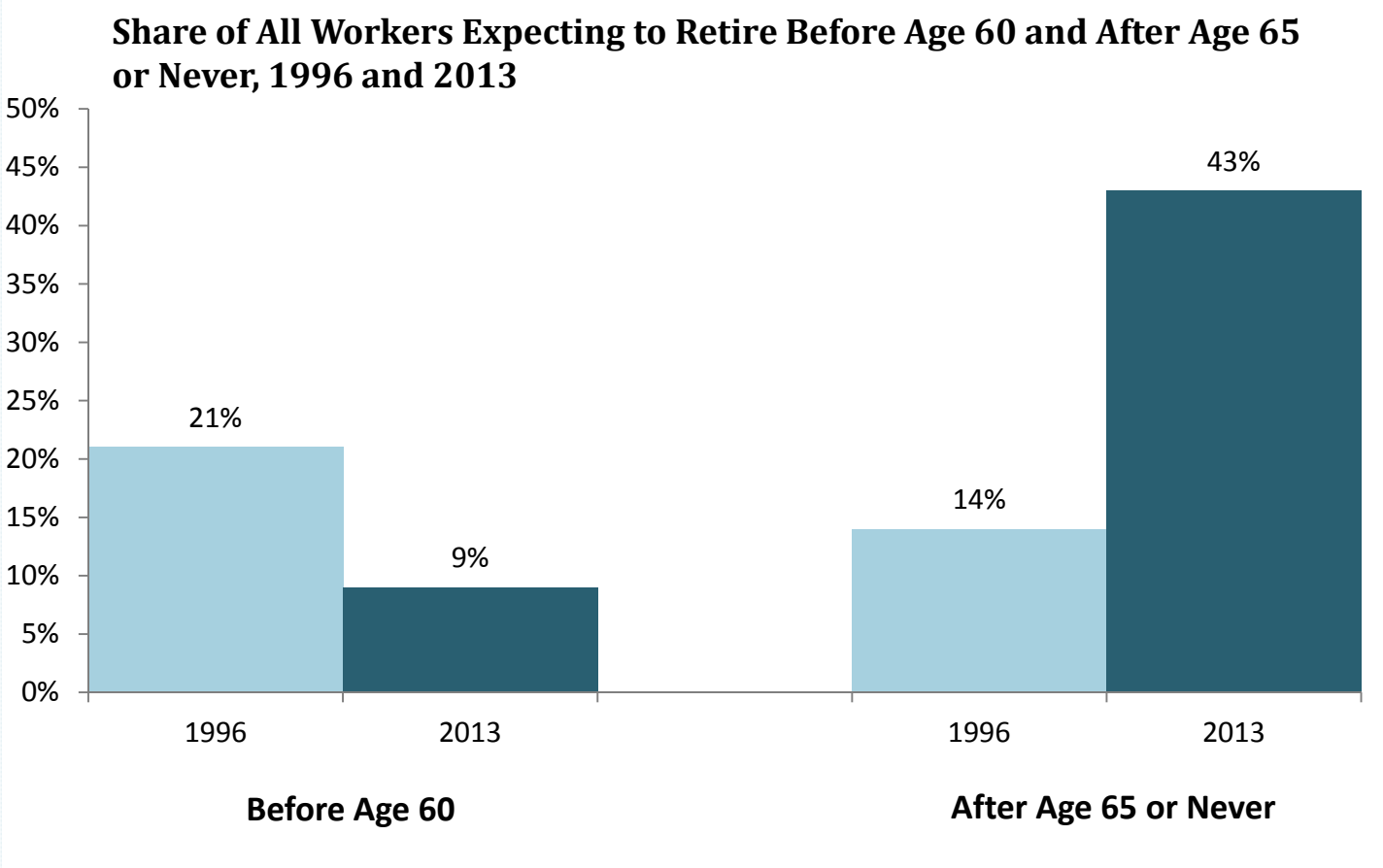
Source: Labor Force Statistics Database (OECD, 2014)

Retirement expectations surveys suggest that a large additional increase in elderly labor-force participation rates may now be in the pipeline.



Source: Retirement Confidence Survey (EBRI, 1996 and 2013)

Three Policy Conundrums

1. **Longer Work Lives.** Longer work lives are good for the federal budget, good for the economy, and, according to most gerontologists, good for the elderly themselves. At the economy-wide level, it is a fallacy that older workers compete with younger workers for scarce jobs. Yet at the firm level, this may well be the case. How do we balance the workforce management needs of firms against the broader policy needs of our aging society?

2. **The Shift from DB to DC.** From a macro perspective, the shift from DB to DC pensions is also a positive development. Yet once again, there is a conflict between the workforce management needs of firms and broader policy goals. How do we balance the need of firms to time retirement decisions with the need of society for a retirement system that encourages longer work lives, treats workers of all ages fairly, and facilitates job mobility?

3. **Older Worker Productivity.** Although rising elderly labor-force participation has important macro benefits, older workers are not perfect substitutes for younger workers. As the median age of the U.S. workforce rises, how can we ensure that it remains mobile, entrepreneurial, and globally competitive?

MERCER

TALENT • HEALTH • RETIREMENT • INVESTMENTS

ANTICIPATING THE WORKFORCE IMPACT OF RETIREMENT AND BENEFIT DESIGN DECISIONS

18 November 2014

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Senior Partner

David Rosenblum
Senior Partner

New York

MARSH & McLENNAN COMPANIES

Retirement and benefit program designs are usually viewed through the lens of Finance

- Decisions are made on the basis of:
  - Expense
  - Liability and Risk
- But it is labor productivity that drives true labor cost
- And it is workforce alignment that ultimately determines the contribution of an organization's workforce to business value
- Unfortunately, few organizations ***quantitatively*** assess the workforce impact of such retirement and benefit plan decisions
- As such, these decisions do not account for the likely effects on labor productivity or on the ability of organizations to secure the workforce they need to support business goals
  - They are unable to gauge the true costs and human capital risks associated with these decisions

Case Examples

Case Example 1: confronting the adverse impact of a loss of incentives to retire at a Global Consumer Products Company

Situation

- Large, branded company facing slow growth, almost all of which is driven by emerging markets, looks to develop a people strategy that fosters greater customer knowledge, faster, better innovation and stronger workforce diversity
- The company has traditionally built its talent from within, successfully relying on a premium rewards and employment package, to get talent to come and stay
- The company closed its DB plan in the late 1990s

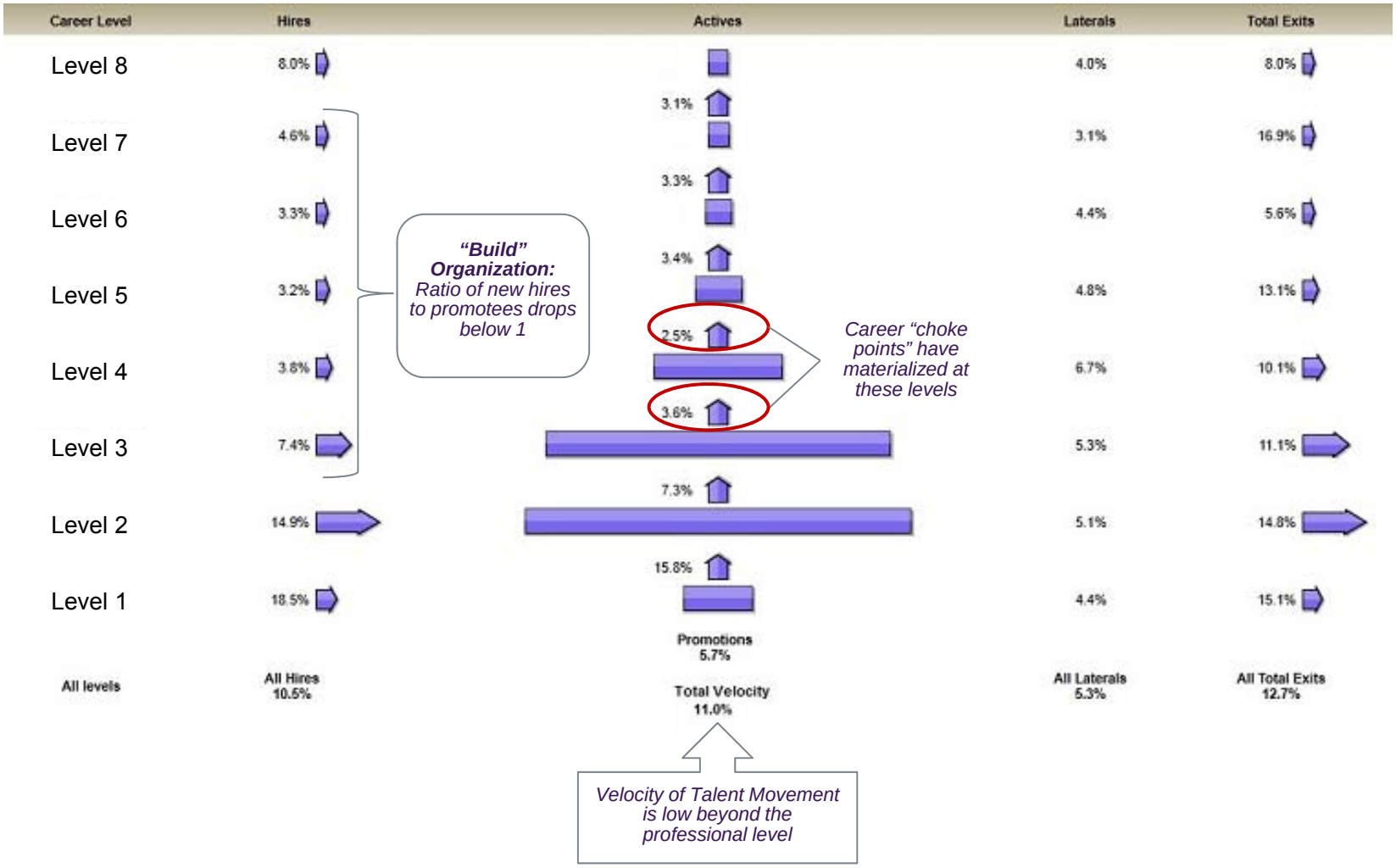
Presenting Problems

- Company experiencing significant back-up in its talent flows as more senior employees delay retirement due to erosion of wealth in retirement plans and high uncertainty about their ability to supplement retirement income from work in a weak economy.
- Absent business growth, this back-up in retirements blocks progression of more junior talent, stalling our careers and generating incentives for higher performers or the more marketable among them to leave prematurely.

Implications

- Low “velocity” of movement, created ***in part*** by the existing retirement program is antithetical to successful realization of the company’s “Build” strategy with serious negative consequences to their business
- In this instance, a retirement program that delivered incentives for retirement eligible employees to leave, would outperform one whose incentives are completely disconnected from tenure

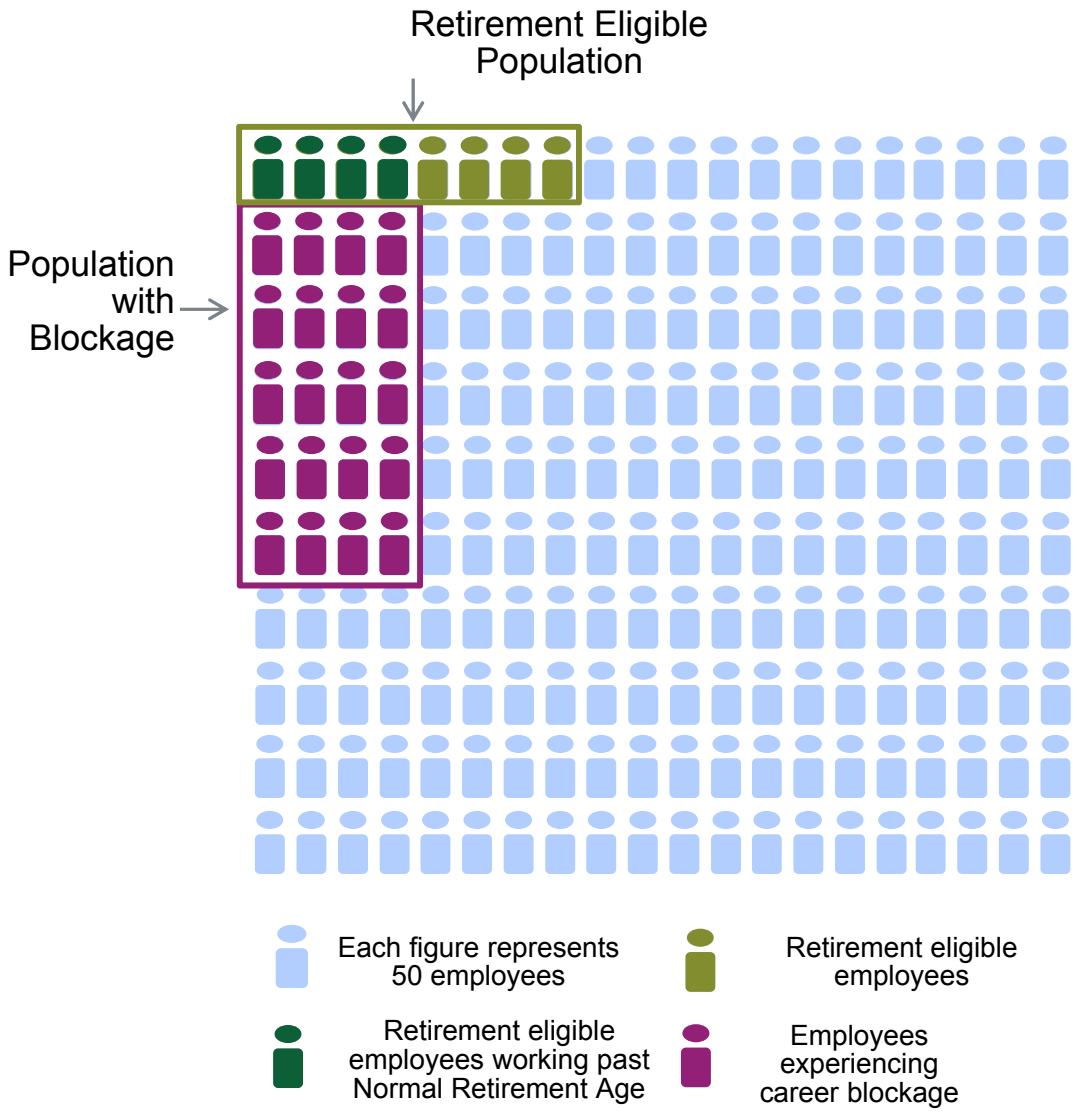
Limited incentives to retire - in the context of low growth and a “build” talent strategy - result in low internal labor market velocity, significant career choke points, and a serious drain of top talent



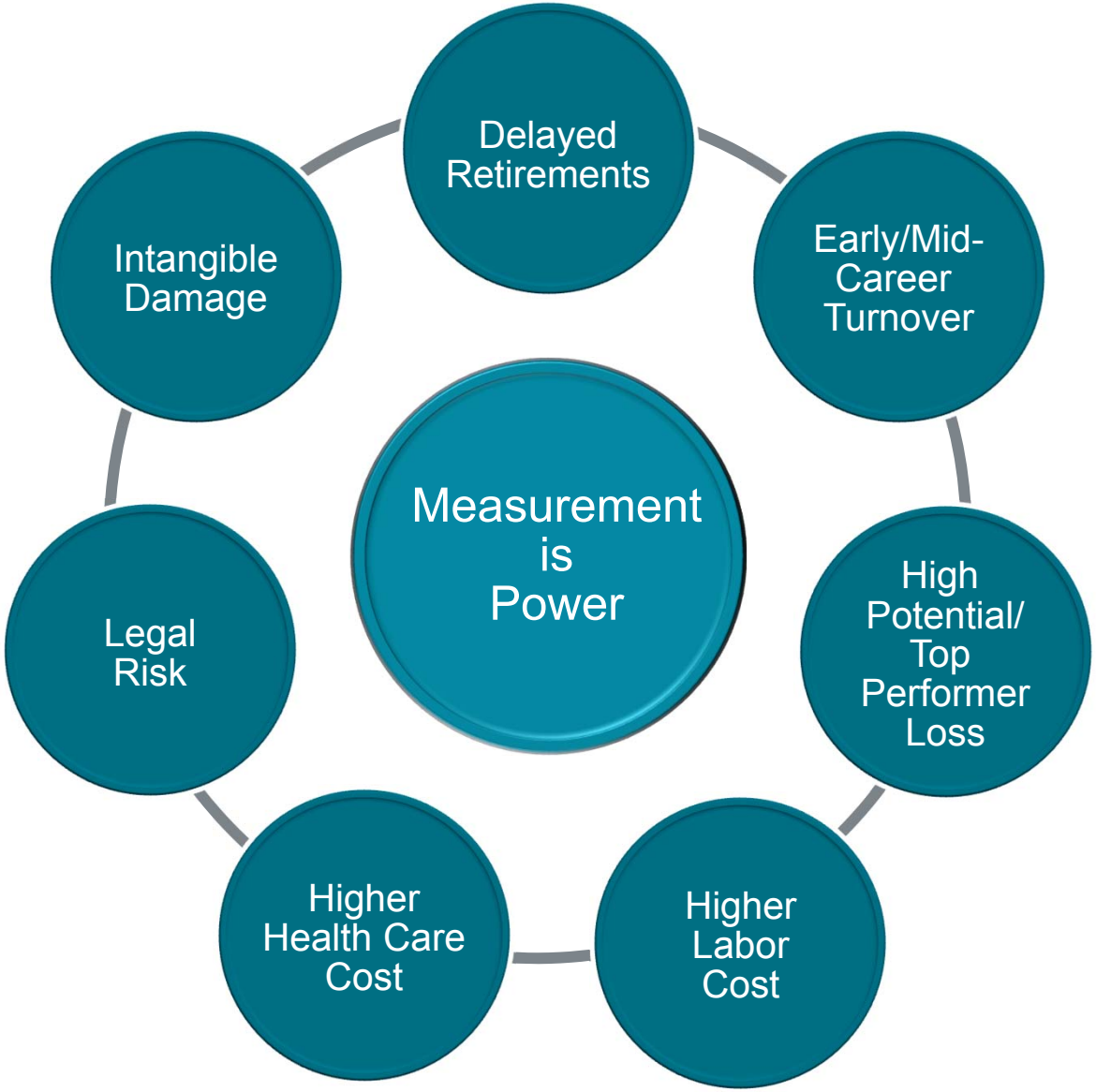
DISGUISED CASE EXAMPLE

The Unintended Consequences of an Ineffective Retirement Program

- Each delay in retirement can block 5+ jobs.
- If 4% of your population is retirement eligible and half of those people choose to delay retirement, 10% of your employee population would experience promotion blockage.
- This means 1000 employees would experience promotion delays in a 10,000 employee firm.



The Unintended Consequences of Retirement Program Changes



Case Example 2: confronting the adverse impact of an erosion of employees' return to tenure in a Global Professional Services Company

Situation

- Company, under financial pressure with growth stalled and stock price imploded, is focused on developing an effective talent strategy to strengthen business performance
- With a business strategy that emphasizes highly differentiated service offerings and customer focus, the company orients to a "build" (rather than buy) talent strategy

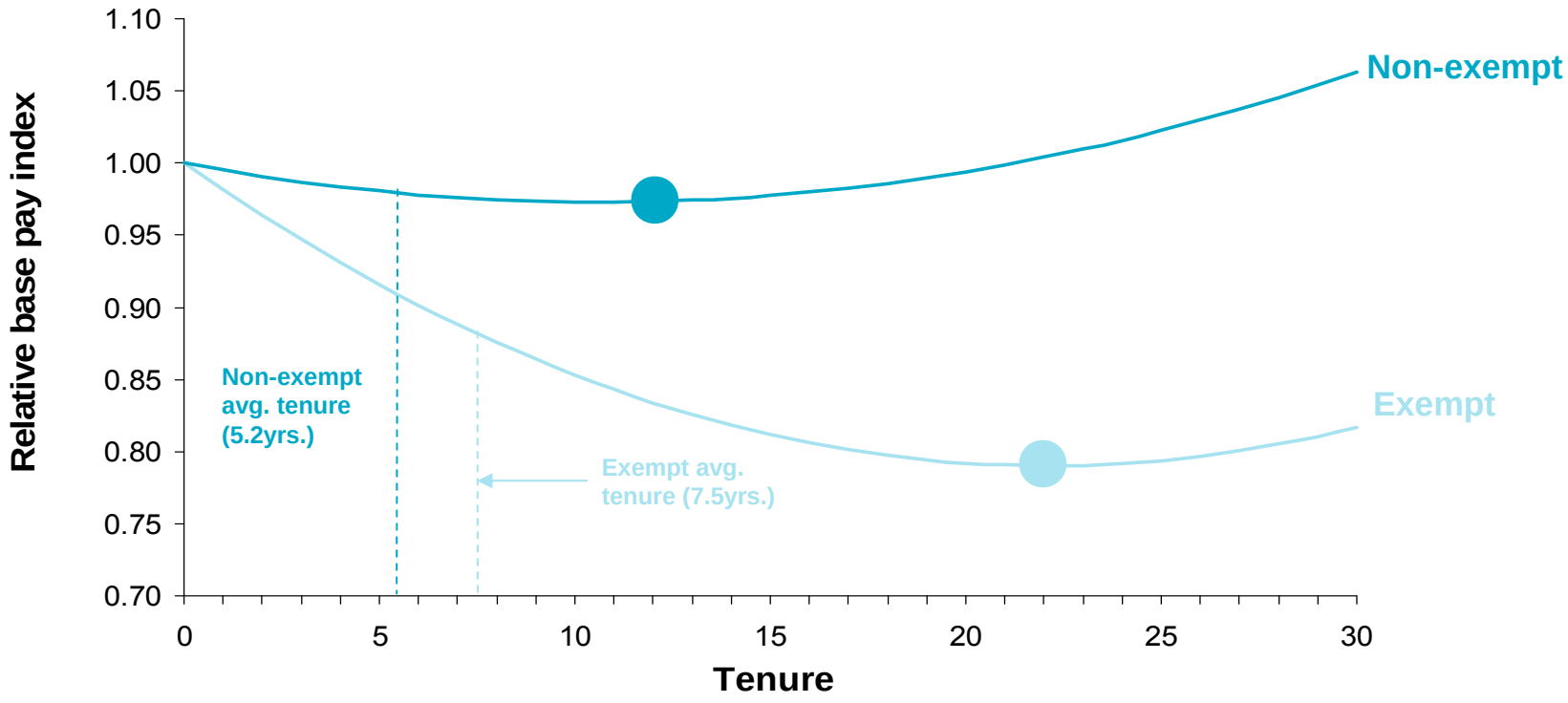
Workforce Analysis Findings

- Years of pay containment and freezes, combined with significant pay premia for new hires, has produced a steeply negative "return to tenure" for incumbent employees – each year of service significant reduces ***relative*** pay
- This is compounded by a significant deterioration of value of employee 401k plans and virtual obliteration of option values for company executives
- Turnover patterns show short and long terms incentives have no retention value; overall sensitivity of turnover to labor market conditions is high and rising – suggesting an eroding value proposition

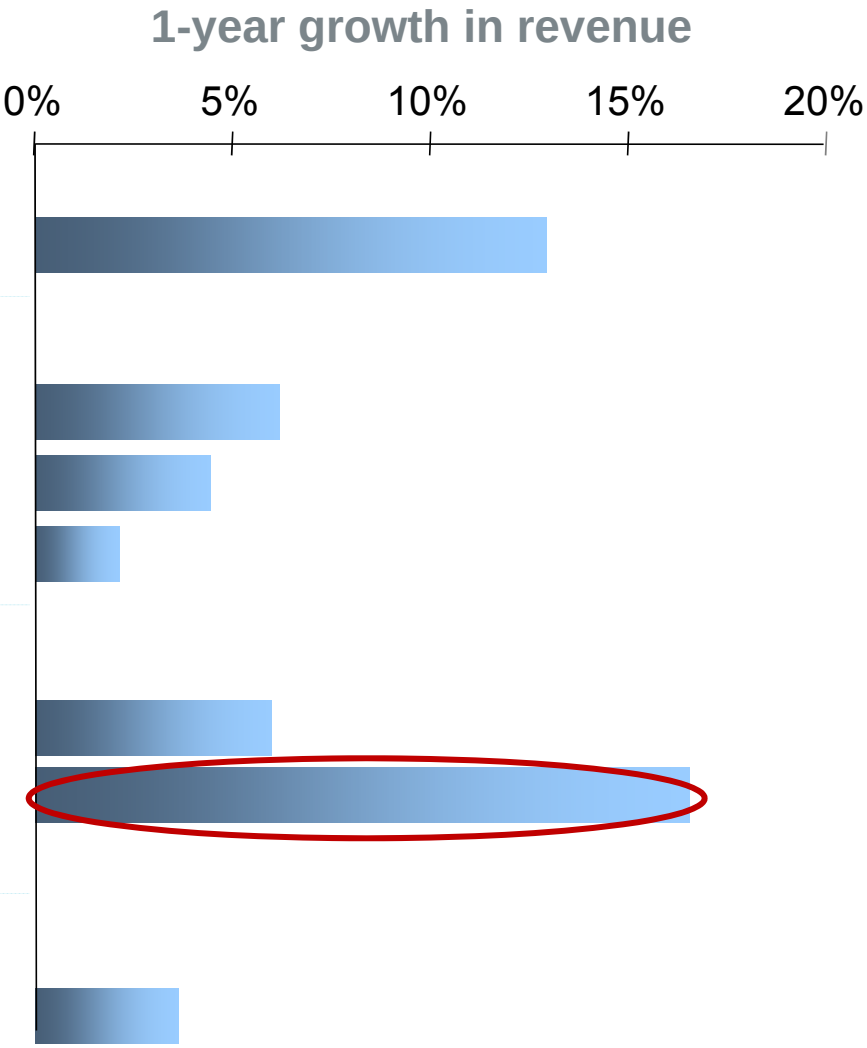
Implication

- In this context, financially driven consideration of opportunities to further pare back combined DB and DC plans appear ill-advised
- Could this company really afford to weaken or eliminate the **only** component of their reward system that attributes value to tenure and which differentiates their employment package?
- What adjustments to retirement programs/plan design better support the company's Build talent strategy?

In this firm, the return to tenure for employees had actually turned negative, despite Leadership's assertion of a "build" strategy. . .



. . . And despite hard evidence that having more seasoned employees in customer facing roles was the single largest predictor of revenue growth



Breadth of relationship

Delivering one additional service to customers

Stability of relationships

Increase in dedicated staff serving customers

Reduction in the turnover of seasoned people

Reduction in voluntary turnover

Key personal attributes

Increase average performance rating

Increase in the tenure of customer service employees

Diversity

Increase in the percentage of non-whites

Case Example 3: Looking beyond cost control to value creation when confronting declining margins

Situation

- Regional hospital system with multiple facilities varying from large hospitals to local clinics with different mix of services and patients
- Facing margin pressures from increased competition and reduced Medicare and health insurance reimbursements

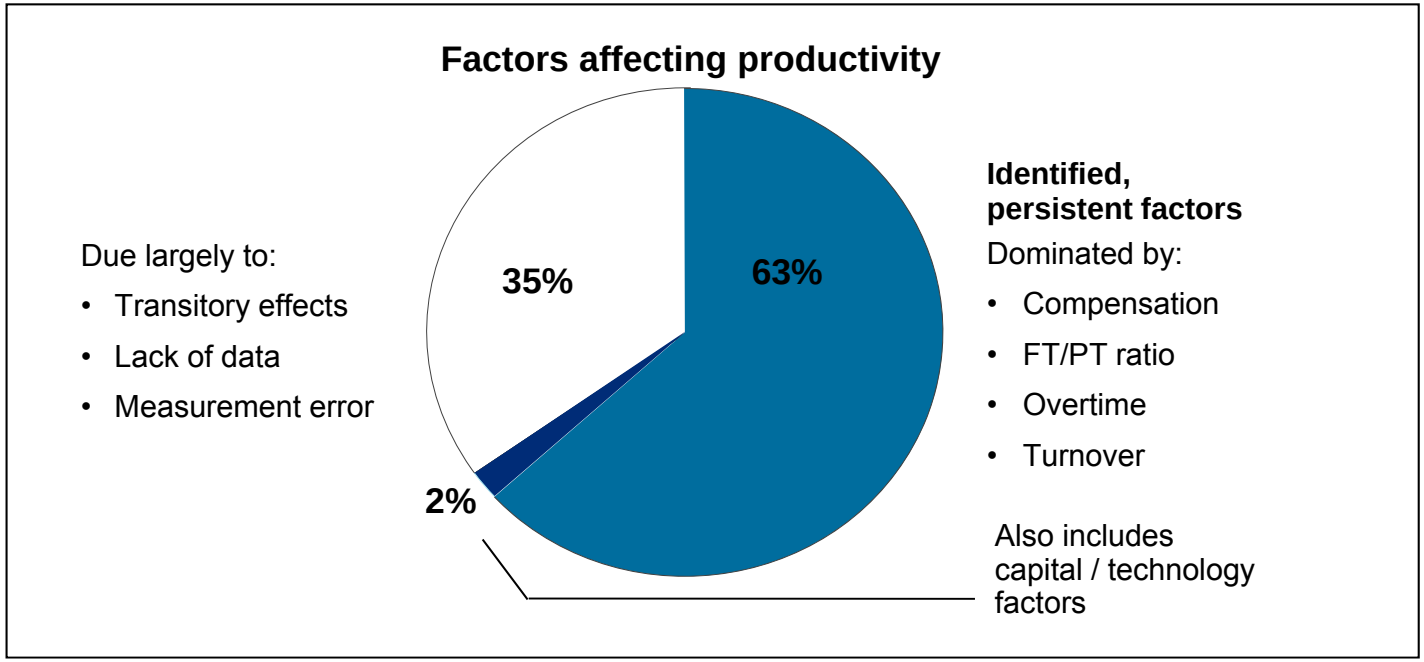
Presenting Problems

- Organization focused on findings ways to reduce labor cost – decides to cut pay and benefits costs
- Intensive benchmarking and re-engineering finds major cost saving opportunities, including such actions as:
  - Greater utilization of “lower-cost” part time employees
  - Reducing middle management
  - Clamping down on overtime

Implications

- While part-timers “cost” less than full-timers, the negative effects on workforce productivity of heavy part-time utilization drive up true labor cost. New staffing mix actually destroys economic value
- Expense reduction doesn’t always lead to cost reduction: failure to assess workforce impact leads to sub-optimal decisions that undermine business performance

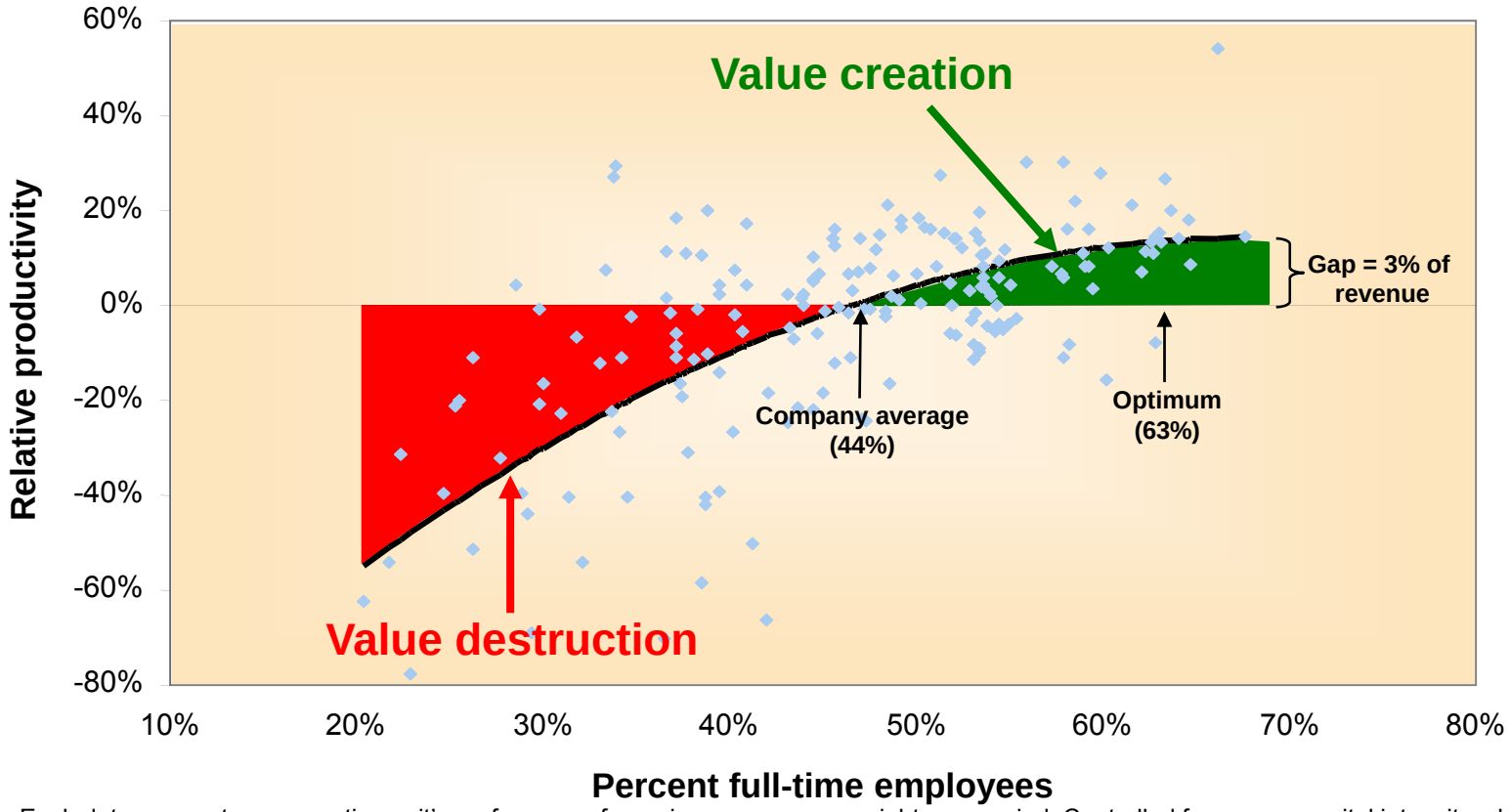
Human capital factors play a key role in driving workforce productivity and other performance outcomes - as in this healthcare organization



Implications of these persistent effects are profound:

- The effects are much more sizable, stable, and enduring than ever realized
- They are dominated by human capital issues
- A powerful human capital strategy provides a sustainable competitive advantage – unlike the effects of capital and technology which *appear* to be much more easily competed away

Over-utilization of part-timers was associated with productivity losses worth about 3% of its annual revenues

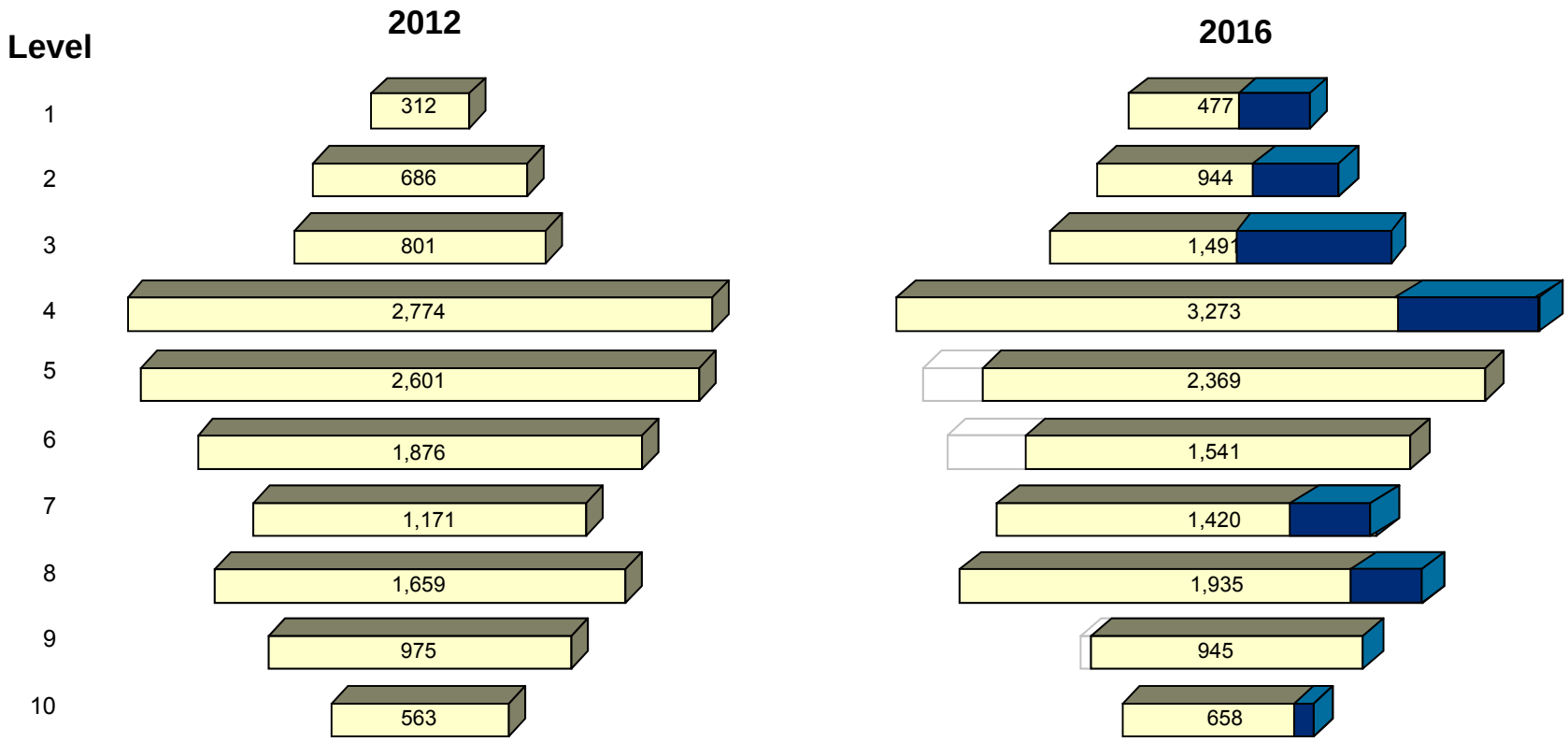


Each dot represents an operating unit's performance for a given year over an eight year period. Controlled for wages, capital intensity, share of overtime hours, turnover, and product mix.

This example provides a cautionary tale for companies thinking of moving employees to part-time status in face of the Affordable Care Act

Costing the problem: the expense view

By forecasting the evolving profile of its internal labor market, this company could gain insights on where its workforce was heading and the implications for compensation and benefits cost



The number of employees on the ILM Map at the right are the “expected numbers” given the current workforce and existing hiring, promotion, retention and transfer practices.

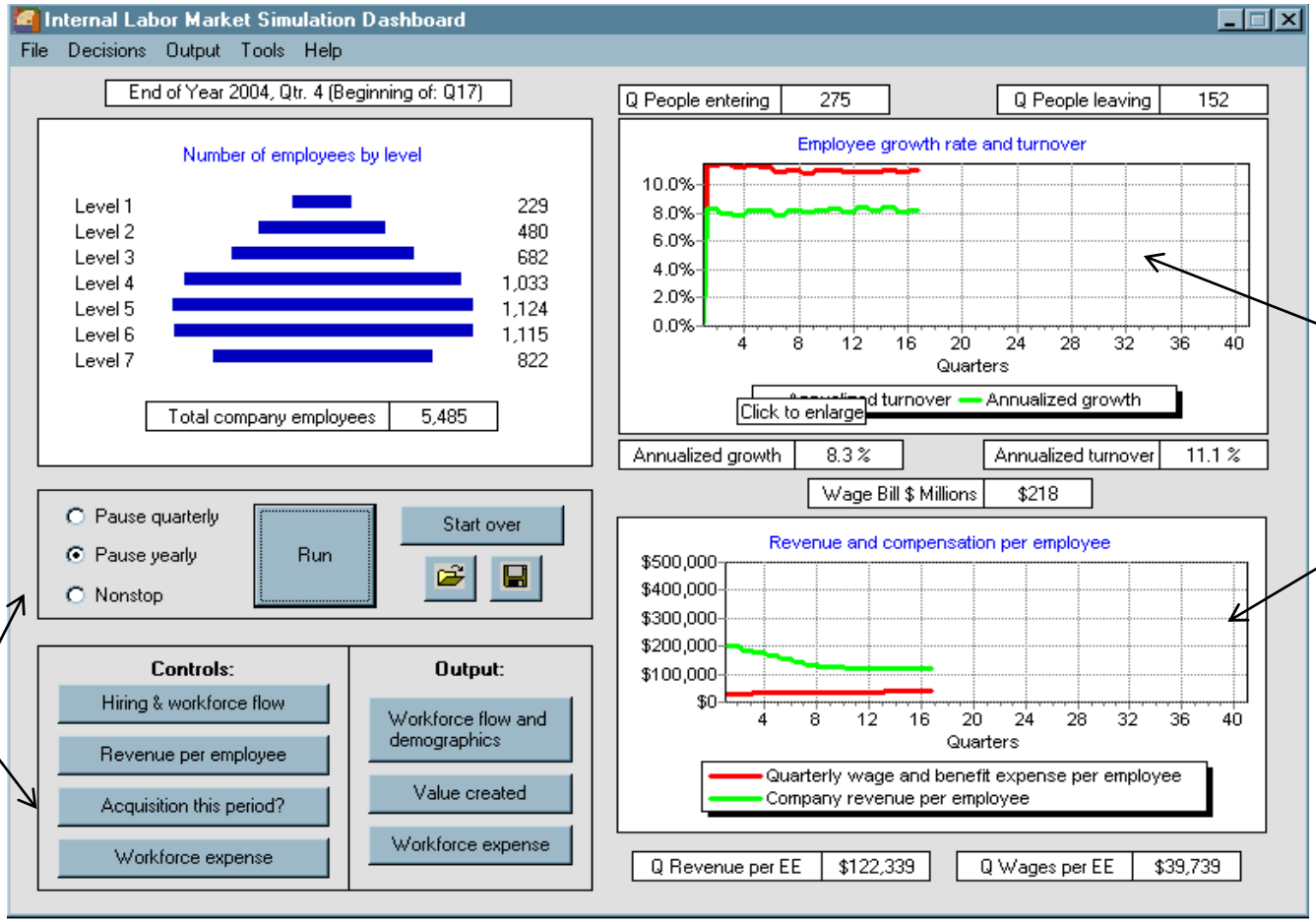
losses gains

The information from an ILM can be used to develop a “simulator” to play out future workforce scenarios and what they mean for labor cost

The changing internal labor market dynamics are shown here

The user controls these inputs for each simulation period

Results are shown here



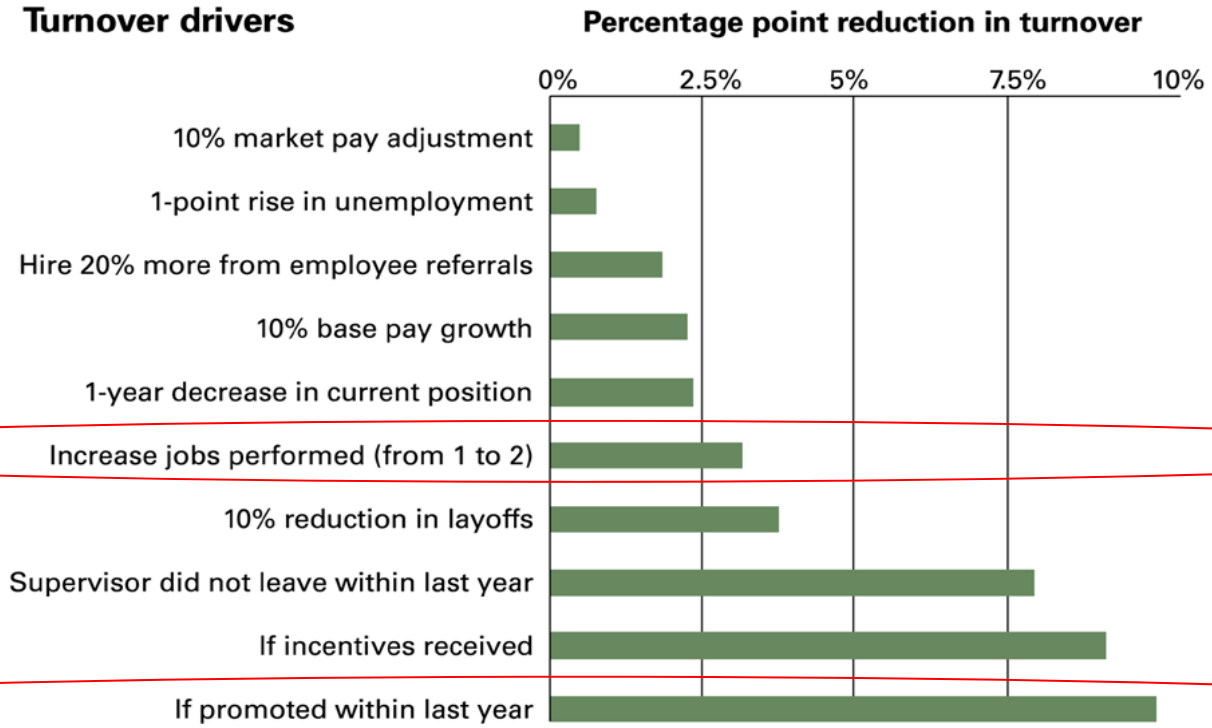
Disguised case example

Costing the problem:
the behavioral impact and productivity view

Measure and understand the impact of low velocity and choke points on employee turnover

In this organization career velocity – promotion and lateral moves – is the single biggest driver of retention

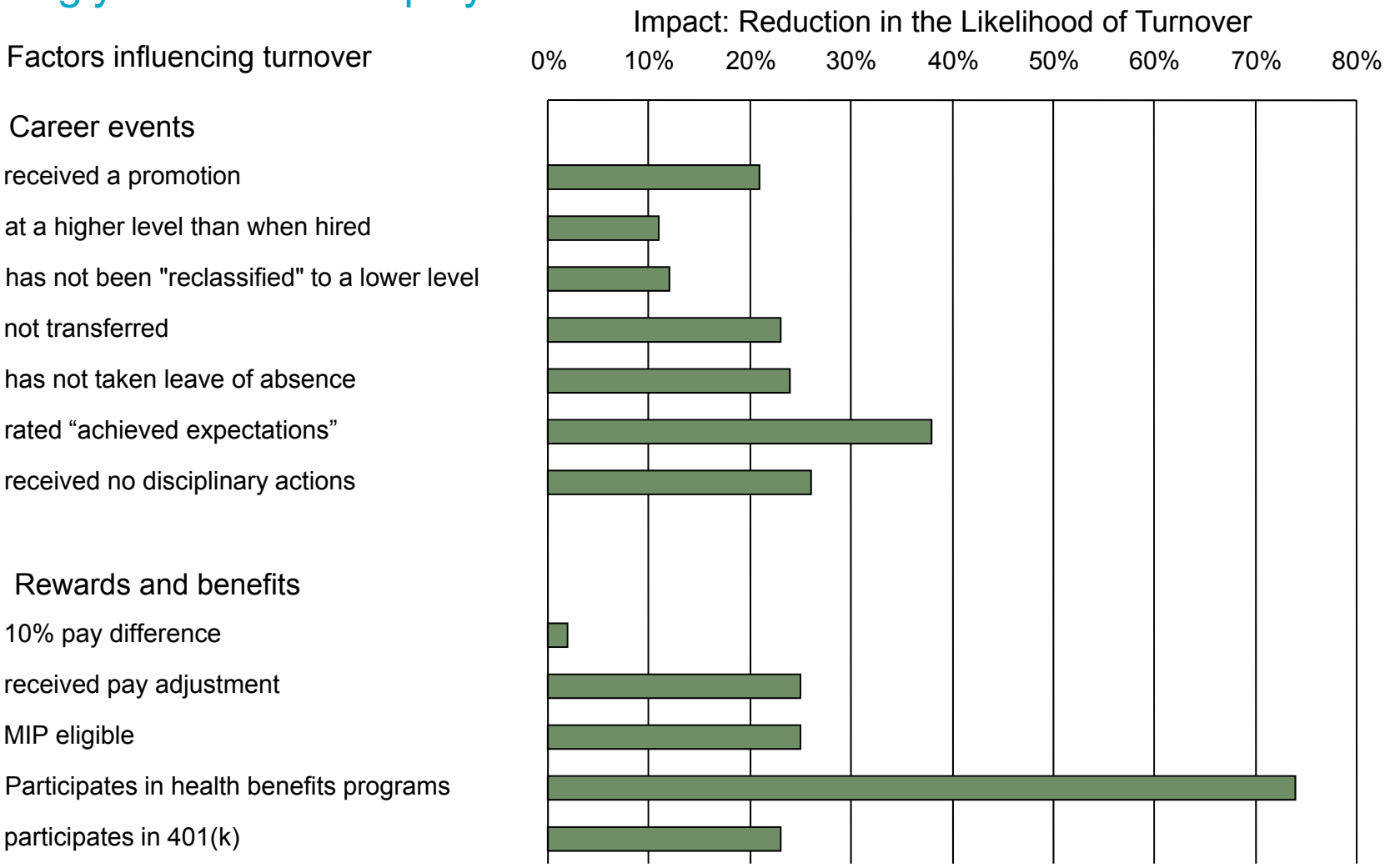
Analysis of actual turnover behavior



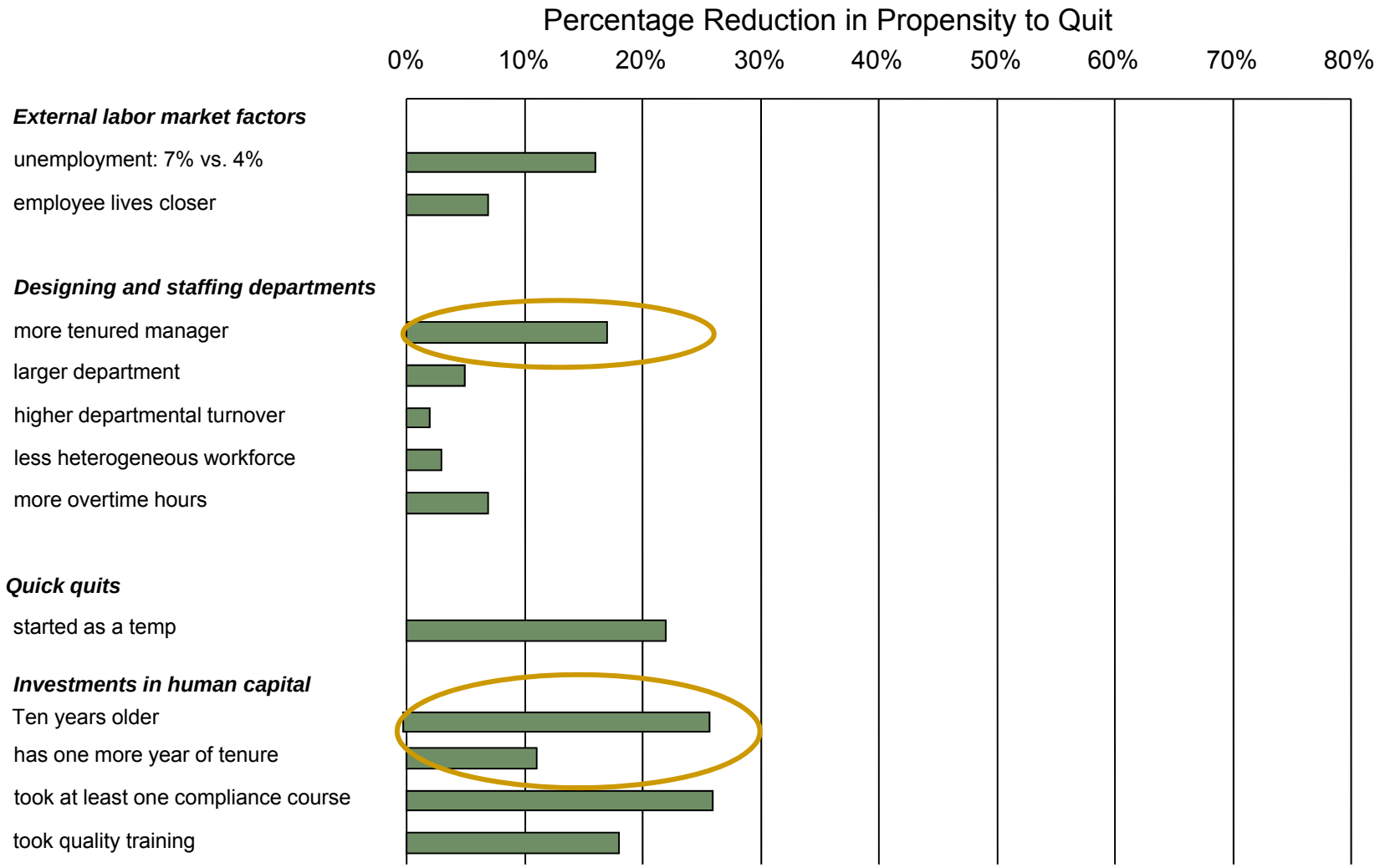
Such quantitative estimates enable the organization to determine how reduced promotion opportunities affect voluntary turnover

Measure, where possible, the direct impact of benefits programs

In this organization learned that participation in health benefits programs strongly influenced employee retention

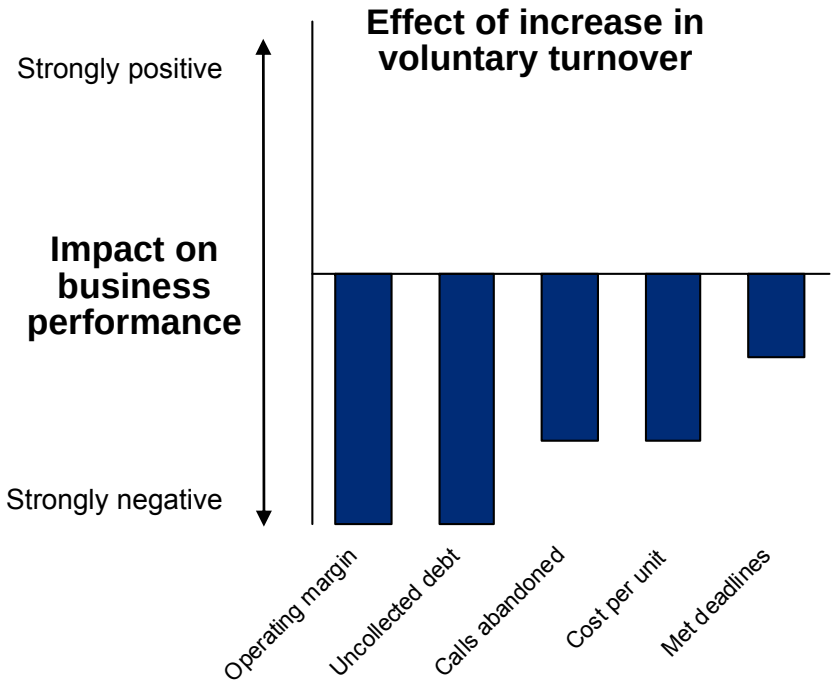


In this health services organization, older and more tenured employees are far less likely to quit as are those who report to more seasoned managers



DISGUISED CASE EXAMPLE

This matters a great deal from an organizational productivity perspective, because the cost of turnover is extremely high, *across all job families*



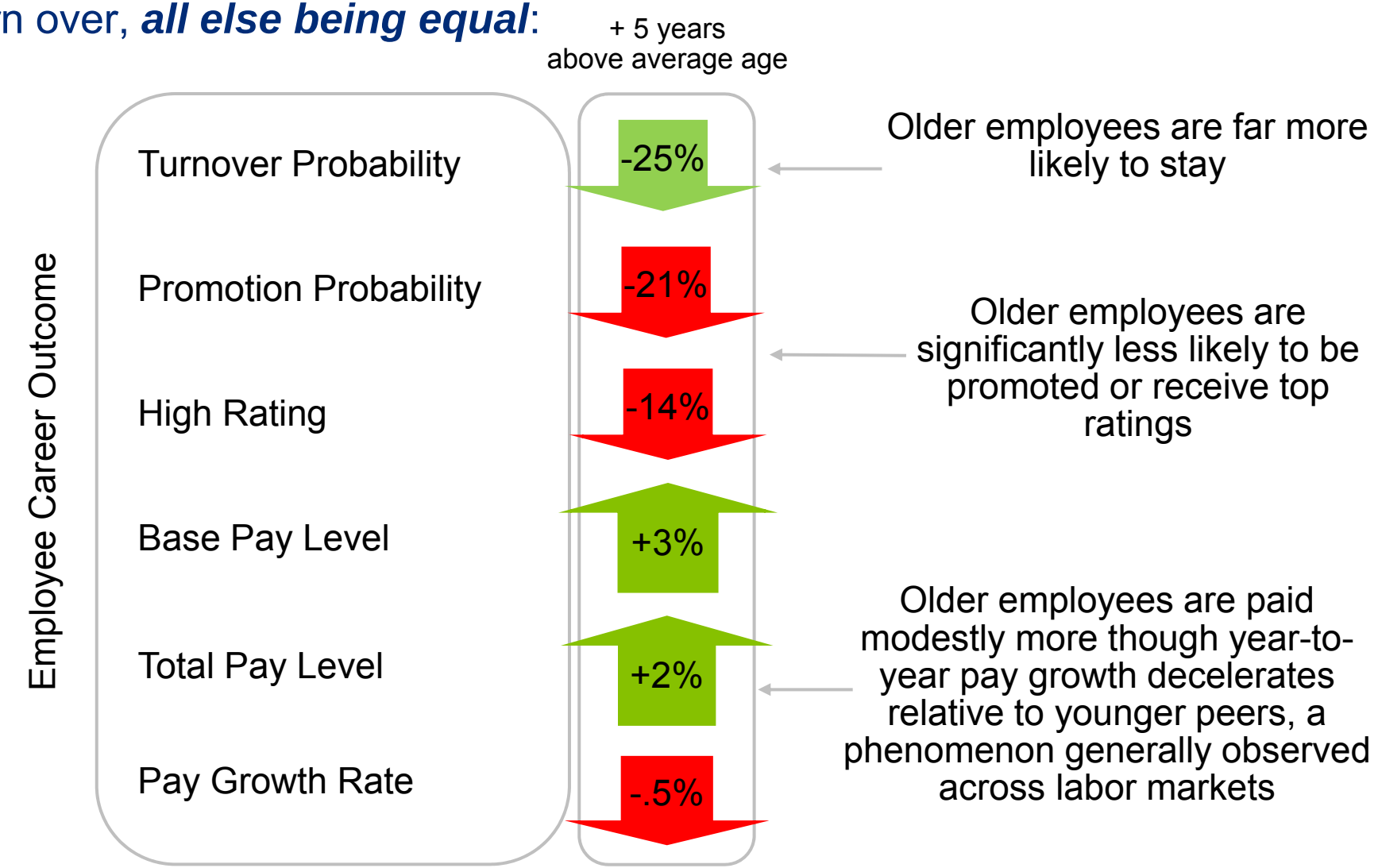
Annual impact of 5, 10, and 15-percentage point reductions in turnover

	5	10	15
Improved operating margin	$31mm	$63mm	$94mm
Decreased cost per unit	$66mm	$132mm	$198mm
Increased deadlines met	5%	11%	17%

DISGUISED CASE EXAMPLE

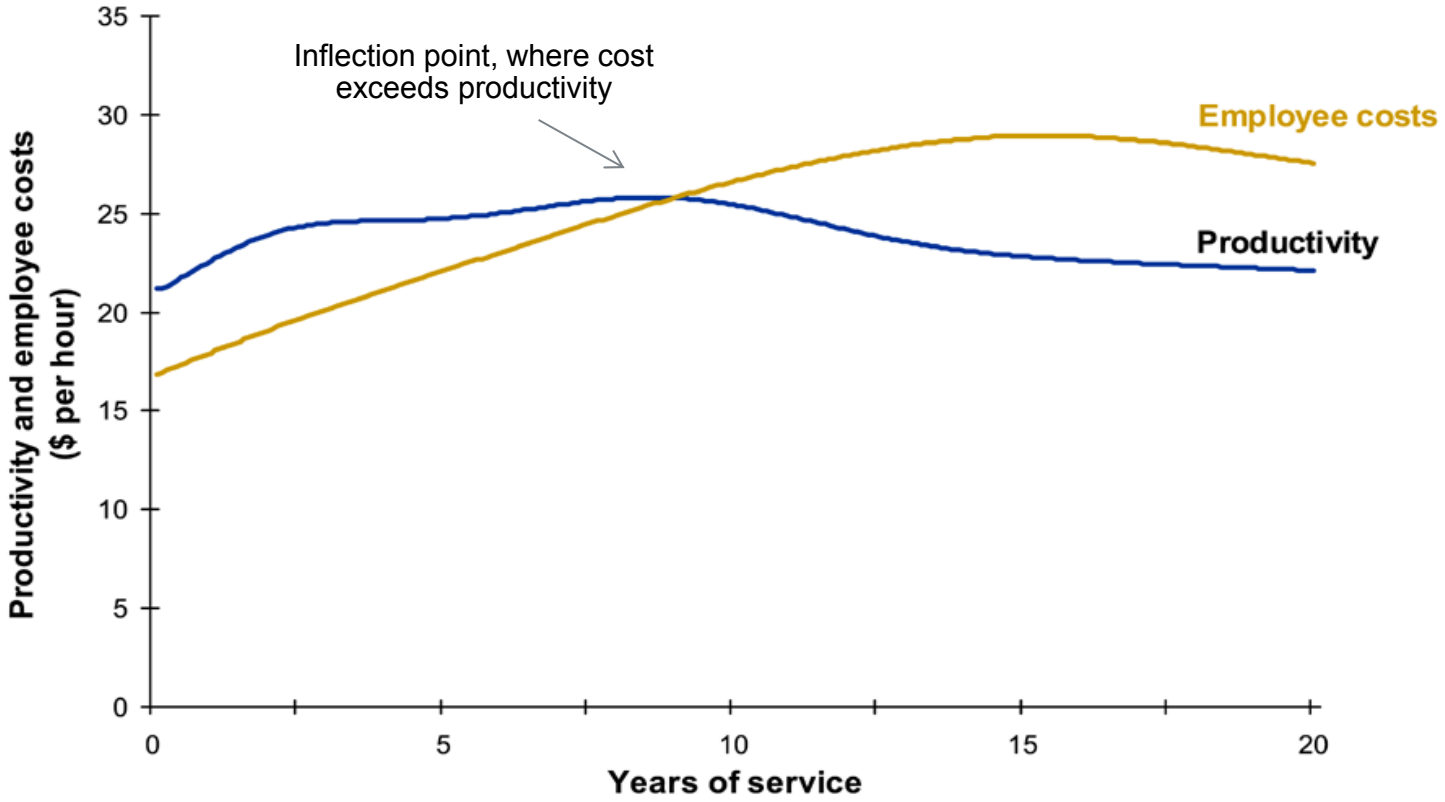
DISGUISED CASE EXAMPLE

At this large consumer products company, older workers face a significant fall-off in career advancement and ratings, even as they are far less likely to turn over, ***all else being equal***:



Identify and measure the crossover point between employee productivity and employee costs to determine optimal time to exit or change roles

The productive value of tenure at this distribution company is exceeded by employee costs after about10 years of service



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Developing solutions: an “option-value” approach to designing retirement incentives

Option value models provide a framework for measuring incentives to retire, informing pension plan design

- **Option value models are formal ways of representing the utility (value) to an individual of continuing to work versus retiring**
- **A firm's pension plan provisions are important elements in such a model**
  - Other elements include, at a minimum, current employment earnings, age, and life expectancy
  - Further, option value models can include such things as expectations of future earnings through work, net worth, discount rates, health, and other factors potentially relevant to retirement decisions
- **Option value models can be applied to assess whether an employer's pension plan is creating values for working v. retiring that are consistent with tenure – performance relationship**
  - So, for example, some pension plans may encourage excessive tenure while others may not encourage enough tenure … relative to the value of tenure to the enterprise

Two approaches to identifying the factors that influence retirement decisions at your organization – one relying on what employees ***SAY***, the other relying on what they ***DO***

Conjoint Analysis of Importance

The focus is on stated importance: Employees' judgments about factors influencing the choice to retire

Analytic approach: Maximum difference conjoint analysis in a survey-response format

Strengths: Easy to administer, leverage points for designing a retirement offer

Statistical Modeling of Behavior

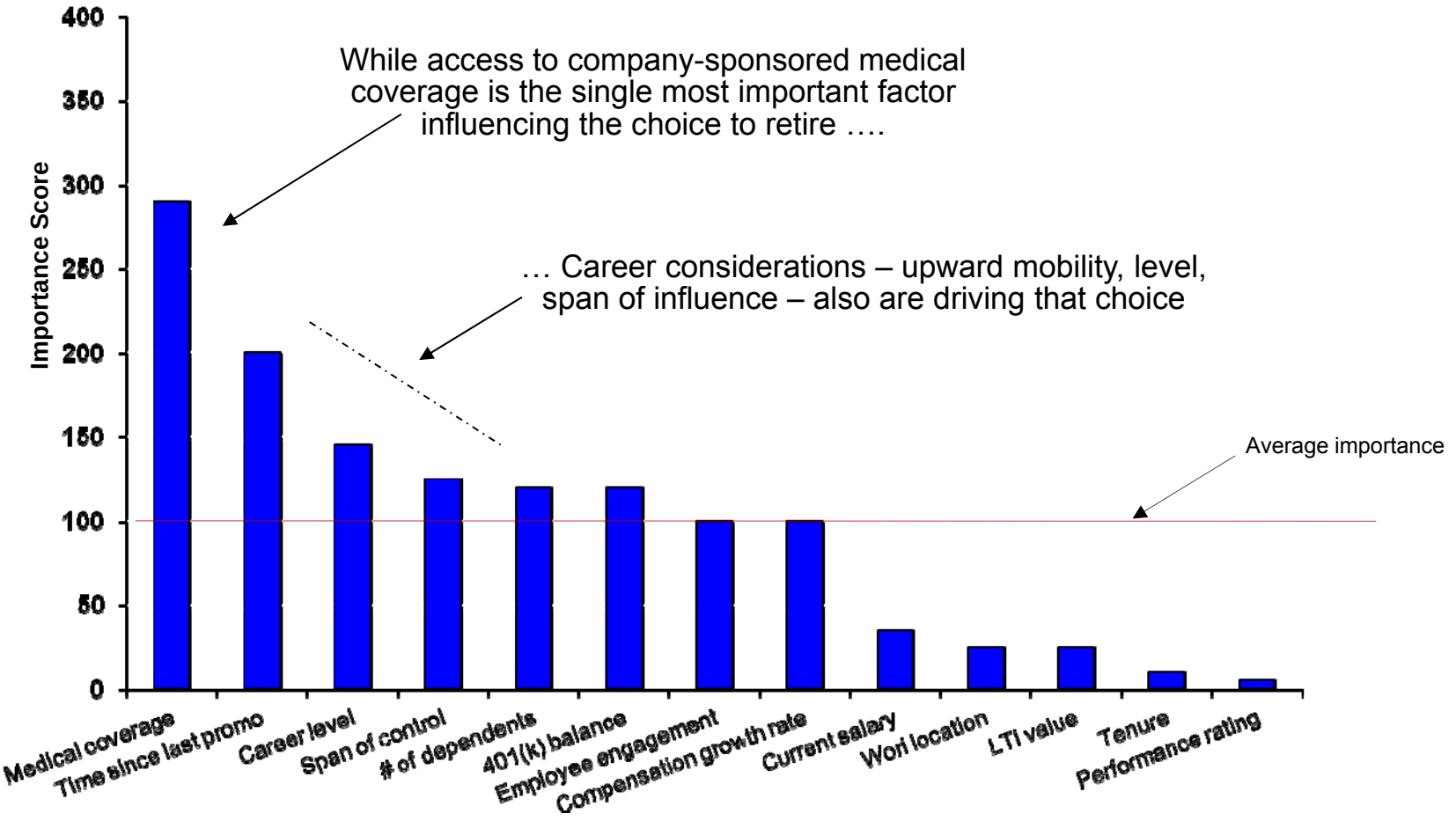
The focus is on behavior: Retiring or not at the point of eligibility

Analytic approach: Statistical modeling of the factors influencing actual choices made by employees

Strengths: Company-specific models, leverage points for designing a retirement offer, predicting acceptance

Many factors can influence the choice to retire – hypothetical ***SAY*** example

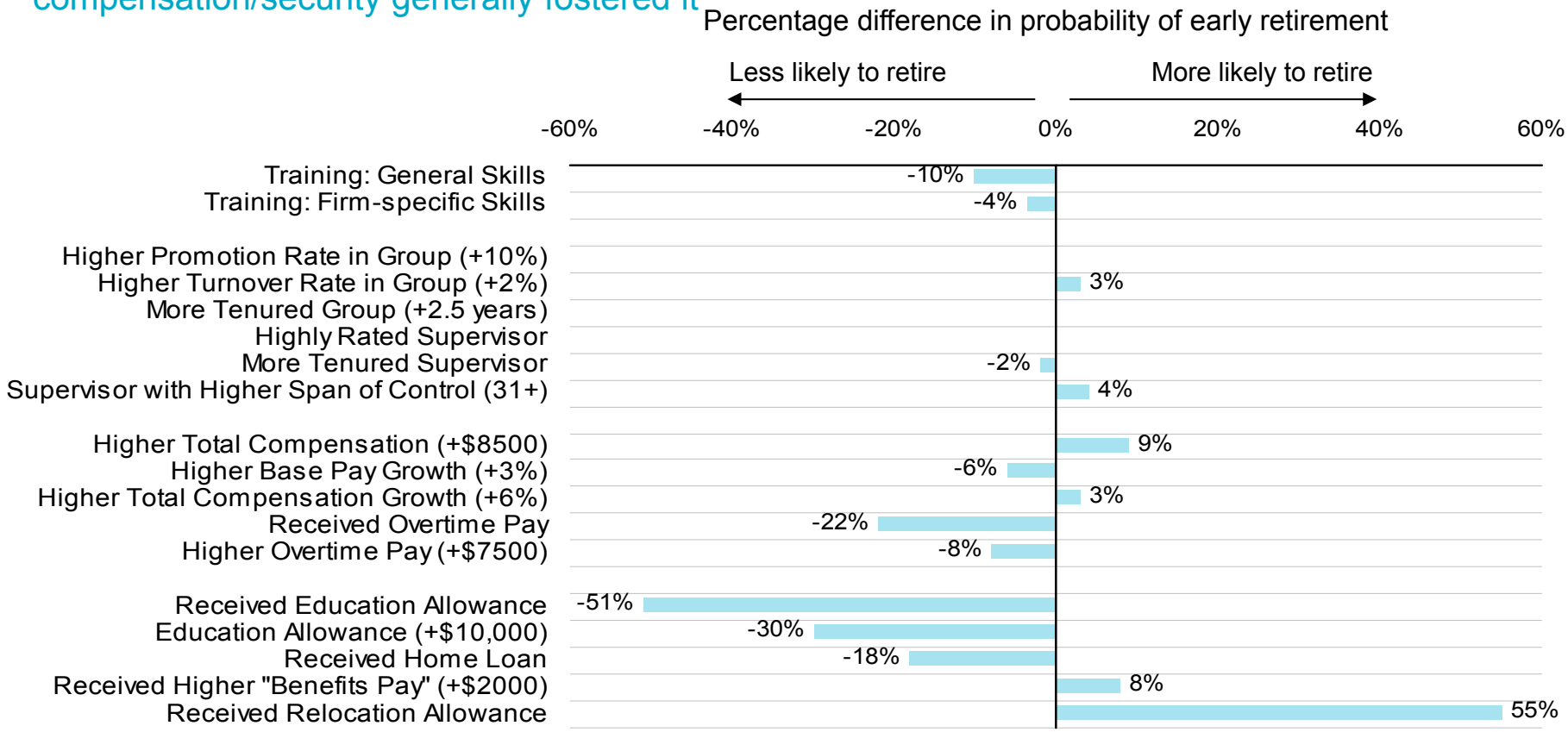
Identifying the factors that actually influence retirement decisions is essential to designing the right solutions for "on time" retirement



Importance scores are scaled so that the average score is 100.

This global company statistically estimated the drivers of actual decisions to retire early – an actual DO example

Education, training, pay growth and overtime helped delay retirement whereas higher compensation/security generally fostered it



The models on which these results are based control for individual attributes and organizational factors. All effects are significant at the 5% level unless otherwise noted.

Finding the optimal design for inducements to retire “on time”

- Many other factors can influence the choice to retire, such as:
  - The age at which one’s peers are retiring
  - Employee health status
  - Health status of dependents
  - Retirement status of spouse / partner
  - Economic conditions
  - Type of dependents / caregiving responsibilities
    - For example, children versus adults

- “Option value models” can be applied to assess whether the inducements to retire – including pension plans 401(k)s – are, in the your organization context, encouraging the right amount of tenure
  - That is, are they encouraging “on time” retirements, neither too early nor too late for the business

KEY CONCLUSIONS

Finding the optimal design for on-time retirements

Answer three key questions:

1. What is the true cost of delayed retirement for the organization?
2. What is the value of tenure to the business(es)?
3. Is the value of tenure to employees properly aligned with its value to the business(es)?

And use that information coupled with data on actual retirement choices to resolve the third question:

4. What is the optimal design of inducements for “on-time” exits from the workforce?

With strong workforce analytics, you can bring innovative approaches to solution design and implementation, to best serve your organization’ s business interests

Retirement Program Effectiveness

Characteristics of an Effective Program

- Efficiently enables employees to be financially able to retire
- Encourages employees to exit the company when they and/or the company are ready for exit
- Promotes a healthy workforce cycle with desirable promotion and exit rates

Importance to the Company

- Effectiveness is less relevant to companies that have few employees reach retirement
- If a significant number of employees retire from the Company, effectiveness can have a significant positive or negative impact on business results
- To gauge the workforce impact, look at the percentage of employees with 5 years of service staying until retirement

Potential Ways To Improve Effectiveness

Education

- Targeted communication to DC plan participants

Accumulation

- DC design changes:
  - Auto-enrollment/escalation
  - Target-date funds
  - Age or service-weighted contributions
- Low-risk DB benefits:
  - Variable pre-retirement annuity
  - Long bond investment strategy

Spend-down

- DC income menu
- DC to DB rollovers

In the age of big data, there is no longer an excuse for ignoring how retirement and benefit plan changes will affect the workforce

- Growing availability of digital data on your workforce and business performance and the emergence of the new discipline of “workforce sciences” makes possible direct measurement and modeling of likely impact
- Predictive modeling tools and methods help connect human capital management to business performance
- Reliance on qualitative methods alone - what people SAY – can be misleading; you need to examine what employees and employers actually DO
- Understanding the dynamics of your “internal labor market” and how specific programs and policies affect them is key to anticipating impact and avoiding unintended consequences

Applying this new discipline will improve the decision process around retirement and benefit plan design

About the presenter

Haig R. Nalbantian is a *Senior Partner* and at Co-founder/Co-leader of Mercer's Workforce Sciences Institute. A labor/organizational economist, he has been instrumental in developing Mercer's unique capability to measure the economic impact of human capital practices. Those capabilities have been applied in numerous project he has directed globally and across a board range of industries in the U.S., Europe and the Middle East, including: pharmaceuticals, high technology, manufacturing, financial services, media and information services, energy, telecommunications and professional services.

Haig came to Mercer from National Economic Research Associates, Inc.; before that he was on the faculty of economics at New York University and was a research scientist at its *C.V. Starr Center for Applied Economics*. He is an internationally recognized expert in incentives, human capital measurement and management and their links to workforce productivity and organizational performance.

Nalbantian is widely published in major economic, business and human resources journals. He co-authored the prize-winning book on human capital measurement and management "***Play to Your Strengths***" (McGraw Hill, 2004). He is also editor of and chief contributor to the book "*Incentives, Cooperation and Risk Sharing"* and is a frequent speaker before industry groups, professional associations and academic audiences. His article (with Rick Guzzo), "***Making Mobility Matter***," published in the March 2009 issue of the **Harvard Business Review,** won the *Academy of Management's 2010 Award for "Outstanding Practitioner-Oriented Publication".* Most recently, he co-authored a study sponsored by the World Economic Forum and Mercer, entitled, *Talent Mobility Good Practices: Collaboration at the Heart of Economic Growth (2012).*

Haig earned his BA in English and Economics at New York University and his graduate degrees in economics from Columbia University. He is a member of the American Economic Association.

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About the Presenter

David Rosenblum is the Northeast Retirement Market Business Leader. David joined Mercer in 1989.

David has experience in retirement plan design, workforce planning, financial strategy, funding, accounting, retiree medical plans and pension risk management. He is the actuary to several Fortune 500 companies, as well as several mid-size companies.

David holds a BA in economics and biology from Colgate University. He is a Fellow of the Society of Actuaries, a member of the American Academy of Actuaries, and an Enrolled Actuary under ERISA.

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