Despite a growing gap in retirement income adequacy, much of employers’ focus has been based on internal and external benchmarks and “throwing money” at the problem. The current economic environment offers employers a unique opportunity to better meet employer and employee objectives by becoming an “enabler” rather than a “provider” of retirement benefits. By changing roles from providers to enablers, employers can increase productivity by optimally aligning the design and cost of total rewards with organizational objectives and employee values. In addition, employers acting as an enabler can reconfigure benefit programs to maintain flexibility in managing through future downturns and provide greater financial wellness value to employees at lower cost than employers that fail to redefine their role.

Recent trends in employer-provided benefits indicate a migration toward greater employee responsibility. The reasons vary by organization, but it appears that employers’ decisions are driven by the cost and sustainability of their benefit programs and generally anchored on two data points:

- Internal benchmarks: What retirement benefits their employees have today
- External benchmarks: What types of retirement programs and level of benefits their competitors are offering.

This article evaluates how employers can redefine their role in providing retirement benefits by breaking free of these two anchors. It begins with a working presumption that—as a starting point—companies should target no more than what workers will need for adequate retirement. In doing so, employers have an opportunity to reallocate retirement dollars more efficiently in a manner that:

- Substantially lowers the cost of retirement programs
- Improves business results by optimizing total rewards spend
- Better prepares employees for retirement.

POSITIONING FOR ECONOMIC RECOVERY

A panel of senior human resource (HR) professionals at Aon Consulting’s second annual Client Symposium discussed the business outlook for their organizations. They offered the following observations about their own organizations as well as the broader marketplace:

- Companies are expecting modest to meaningful growth in 2010 in some, but not all, of their business segments.
- Senior management is making sure that growth
Focusing on health and financial wellness to provide greater value to employees at a significantly lower employer cost.

In the current economy and with new trends in retirement programs, what does this mean for employers in terms of retirement benefits? How can they redefine their role in helping employees achieve financial wellness at significantly lower cost?

EMPLOYER’S ROLE IN RETIREMENT

Historically, the employer has taken a paternalistic role in providing employees’ health and retirement benefits. Health care now accounts for employers’ most significant employee expense after payroll, with plan sponsors experiencing an 80% increase in health insurance premiums since 2002. Likewise, traditional pension plans were looked upon favorably (or largely ignored, at least) by most plan sponsors during the 1990s; investment returns during the bull market of that era more than paid for pension costs and contributed handsomely to the bottom line. However, downturns in financial markets during the 2000s and recent changes in funding and accounting rules have underscored the true economic costs of sponsoring defined benefit plans. In the United States, defined contribution plans have grown in popularity dramatically since the early 1980s and are becoming a primary vehicle of retirement security for workers. Meanwhile, defined benefit plans have seen a steady...
make poor investment choices and “sell low and buy high” in knee-jerk reactions to market fluctuations. They also are exposed to other risks outside their control such as rapidly deteriorating health, high health care cost inflation and longevity risks.

Figure 1 illustrates the potential impact of three key postretirement risks—inflation, longevity and health care costs—on retirement adequacy needs on an individual basis. After considering these risks, the replacement ratio increases significantly from 78% to 101%.

Despite this growing gap in retirement adequacy, much of the focus has been on financing such risks on an individual basis. In fact, employers have paid little attention to what they can do to potentially pool such risks at lower costs for their employees. This is a very inefficient model for both the employees and their employers. The typical plan sponsors’ position has always been based on internal and external benchmarks and “throwing money” at the problem. Most U.S. employers spend anywhere from 3% to 6% (or higher) of their payroll on retirement benefits for employees, with higher levels provided by those that decline over the same period. With the viability of U.S. Social Security benefits in question, the proverbial three-legged retirement stool (statutory benefits, employee savings and employer contributions) may be going through a paradigm shift.

According to the 2008 Replacement Ratio Study™ by Aon Consulting and Georgia State University, workers with preretirement income of less than $90,000 who elect to start receiving Social Security pensions at the age of 65 will need to replace anywhere from 90% to 80% of that income (based on current U.S. tax laws and the increase in the baseline cost of health benefits after retirement).² In its current form, Social Security benefits replace a sizable portion of retiree income.

However, employees can replace an additional 34% of their preretirement income by saving 6% of pay starting at the age of 30 in their 401(k) plans, using reasonably conservative assumptions for investment returns. So those who earn less than $90,000 per year when they retire can have adequate savings in their 401(k) plans before any employer contributions.

In reality, however, these assumptions may not actually be realized due to

- **Behavioral risks:** Most workers often begin saving at a later age, do not save enough and generally make poor choices in terms of investment options.
- **Investment risks:** Market volatility and high expense ratios of investment funds can create a significant drag in funding the nest egg.
- **Postretirement risks:** When separated from their employers, individuals often struggle to manage their finances during the spend-down phase in retirement. They may spend too much too soon.

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sponsor defined benefit plans or that did so before moving to defined contribution plans.

REDEFINING THE EMPLOYER’S ROLE

If most workers can meet their retirement objectives by making prudent savings and investment decisions, one can argue that organizations

• May be spending substantially more than necessary on retirement benefits
• Should increase their efforts to help employees understand their retirement needs and related risks and make informed and prudent choices on savings and investments.

Given this premise, we can redefine the employer’s role as an “enabler” rather than a “provider” of retirement benefits as illustrated in Figure 2.

CALL TO ACTION

Based on this new perspective, what can employers do to promote retirement savings? Here are direct ways that they can help.

• Leverage scale to provide access to savings and risk-management vehicles at a lower cost:
  — Help employees understand postretirement needs and develop a fund lineup to cover basic sustenance; postretirement risks such as health care costs, inflation and longevity; and postretirement leisure
  — Offer diversified investment options that tie to employee behaviors, ranging from target-date funds to brokerage accounts
  — Leverage scale to provide high-quality, low-expense funds
  — Evaluate cost efficiencies for pooling postretirement risks on behalf of participants
  — Ensure enhanced service delivery, targeted communications and low administrative expenses through vendor negotiations and ongoing vendor management.

• Create comprehensive policies to establish non-economic incentives to drive savings behavior:
  — Architect choices that are financially literate
  — Launch a comprehensive multimedia communications and education strategy (Web 2.0 and social media) to enhance awareness, engagement, promote savings behavior, and avoid poor choices such as loans and in-service withdrawals.
  — Develop a change management and communication strategy to provide rationale for the change, demonstrate the employer’s commitment to providing information, and highlight any reallocation of savings to other total reward/workforce programs.

Finally, when it comes to economic incentives to promote savings, consider providing some matching contributions to encourage employee savings if there is evidence that employees place higher value on employer contributions to the retirement plan compared to other total reward programs.

A NEW PERSPECTIVE

Employers have the opportunity to reallocate the savings realized by taking a new perspective on the financial wellness of their employees. To a certain level, these themes have matured when it comes to employee health and wellness to reduce the costs of health care. The same arguments can be applied to retirement.

Further, retirement programs may in fact be blunt instruments to attract and retain talent. Effectively reallocating these funds to targeted reward policies may ultimately improve an organization’s competitive edge.

Endnotes