Global Developments in Employee Benefits

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Abstract

The last 25 years have seen defined benefit plans increasingly been replaced by defined contribution (DC) arrangements.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

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

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

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

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

Faced by these issues, companies are questioning how they can get the best value for money from their benefit spend and are increasingly showing interest in moving to a new generation of benefits, one characterized by greater flexibility and increased choice. This shift would encompass a broader range of employee financial needs and aim to improve employee engagement and well-being.

Indeed a greater focus on employee well-being is fast becoming a center-piece of employer benefits strategies. Today's emerging well-being programs reflect an evolution from the wellness programs that tended to focus in the past on the physical health of employees. Yesterday's wellness programs were often siloed, one-size-fits-all, and transactional, and they focused on a 'carrot and stick' approach to participation. The result has frequently been that employee engagement is abysmal and these programs have not delivered on their promises (Willis Towers Watson, 2016). 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 re-shaping 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 package.

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 employers have learned as they watch their employees struggle with excess choice and fragmented benefits designs, that guardrails to "bound" decisions and ensure the number of options are manageable can 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 behaviours.

The chapter is organized as follows. Section 2 provides and overview of the recent trends in employee benefits highlighting the transition from DB to DC both in the pension and health care areas, as well as the influence and effect of the recent global financial crisis. Section 3 analyses the main challenges and issues that have emerged along the growth of DC. Section 4 presents key trends that have consolidated and aligned to transform the shape of employee benefits. Finally, Section 5 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 breakthrough in employee benefits came with the emergence of defined benefit (DB) pension plans. These plans granted workers a sense of retirement security, and as family-based retirement arrangements faded away, these programs provided a much-needed sense of security and fulfilled a societal goal (Hess, 2013). DB

plans started to grow more popular in the US around the 1950s due to the combination of wage controls and tax incentives. In the UK, pension plans actually started as DC schemes, but the high inflation rates that followed World War II reduced the appeal of DC plans, shifting workplace provision towards DB. Similarly, in a number of Western economies, we see employer provision of retirement plans start to grow in the 1950s and 60s.

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

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

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

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

The transition to DB has varied widely across countries. In Australia, the transition to DC was led by regulation that started with the 1986 superannuation award and was followed by the mandatory superannuation guarantee in 1992. In the U.K., the move to DC was a little later, with the late 1980s marketing the re-appearance of DC plans, but the change to DC was swifter. Over the decade from 2000 to 2010, the large majority of U.K. employers moved to offering only a DC plan to newly hired employees (Figure 2.1). Today, the U.K.'s private-sector retirement landscape is almost entirely DC only for new hires (compared to around 70% of large private-sector employers in the U.S.).

(Insert Figure 1)

For the U.K., the recent introduction of mandatory automatic enrolment fueled a rapid rise in DC membership. In 2012, just over 40% of private sector employees were contributing to an employer retirement plan; by 2016, this had risen to 60%.

The global financial crisis of 2008-9 accelerated and consolidated the trend to DC; Low interest rates and falling asset values paired up with a deep economic recession and an uneven recovery lowered pension funding ratios and led to increased employer contributions at a time when many can least afford them (Willis Towers Watson, 2008). Many plan sponsors are looking to more carefully manage financial risks, particularly their DB liabilities and this has accelerated the move away from DB schemes.

This is most evident in the U.S. where the incidence of pension freezes (ceasing future accrual for existing plan members) has risen significantly since 2008. By 2009, according to Willis Towers Watson data, of those Fortune 500 companies who offered a DB plan in 1998, 21% of plan sponsors had frozen pensions, and 21% had closed their primary plan to new

entrants. By 2014, sponsors of frozen plans outnumbered those with an open primary plans for the first time in 2015, 39% sponsored frozen plans and 24% had closed their primary plans to new hires (Willis Towers Watson, 2016).

In the UK, back in 2009 only 4% of the FTSE100 had DB schemes which were closed to future accrual (frozen), but by 2017, almost two-fifths of FTSE 100 companies had frozen their DB plans (Willis Towers Watson, 2017). Also 1-in-3 of DB plans open to accrual in 2015 are expected to be closed by 2020 (Willis Towers Watson, 2015).

In emerging economies, the growth in DC is occurring over a shorter timeframe. Unlike developed countries, where DC retirement plans are gradually replacing DB plans, in many emerging countries DC has emerged as a result of regulation that encourages or mandates private provision of funded DC schemes. For example, many Latin American countries introduced structural reforms for retirement savings and moved to funded DC plan during the 1980s and 1990s (Holzmann & 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 also noteworthy that the introduction of some-type of a DC component was a key factor in countries such as China and Hong Kong (The World Bank, 2016; Pai, 2006). What it is clear is that in these nations one should probably talk more about the introduction of DC plans by governments instead of than a shift to DC by employers.

More recently, we have seen moves toward DC arrangements in countries such as Germany, Japan, and the Netherlands, which 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 the pension plan funding status. Such plans effectively limited the risks faced by employers and passed risk onto employees and retirees. In the period since the global financial crisis, we have seen plans move to become collective defined contribution plans where the employer's contributions are fixed. These plans are DC-like for employers, but smooth investment returns and share risk amongst employees (especially across generations). Yet while such risk-sharing is frequently viewed as attractive, 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 on whether younger generations are getting a fair deal from the current system.

As a result, the governments have proposed reforms that could mark a major shift in retirement provision: moving to a system much closer to the individual account model of DC traditionally with employees having far greater flexibility and choice on how to use their pension contributions (Willis Towers Watson, 2016).

Other countries have shown the first tentative moves to DC. In Germany, a newly announced draft law aims to expand the percentage of the workforce (particularly lower-wage workers) covered by employer-provided retirement plans, and individual retirement arrangements. The goal is to offer a combination of minor tax incentives and a new DC retirement plan option. Japan opened up the possibility of setting up corporate and individuals DC plans back in 2001. Since then, subsequent regulation has expanded the eligibility to participate and regulated the role of sponsors, fiduciaries and investment rules (Willis Towers Watson, 2016). So, as Figure 2.2 shows, occupational retirement provision is increasingly concentrated on defined contribution plans with DB provision increasingly rare.

(Insert Figure 2)

Movement to DC health. The shift to DC in retirement is also migrating to the health care area, particularly in the US. In part, this trend is a continuation of a long-standing challenge to rein in the cost of health care increases which have annually outpaced inflation for the last three decades. Yet in many ways, this trend is not new. Traditional DC plans in health care, where the employer contributes a fixed-dollar amount toward the cost of an employee's health benefit each year and the employee pays the difference between that amount and the actual cost of the coverage elected, were most popular during the heyday of flexible benefits plans in the 80s and early 90s. But these DC approaches lost their appeal when inflation in health care costs escalated in the late 1980s, which under these designs led the employees' share of health plan costs to outpace 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.

Willis Towers Watson's 2016 Best Practices in Health Care Survey shows that more companies use a DC strategy than ever before: 25% in 2016, up from 20% in 2015. But looking forward, the number of employers going DC is expected to nearly double by 2018 (48%) based on those planning to or considering adopting the approach (Willis Towers Watson, 2016).

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

Rising costs. Despite the shift to DC, employers' commitment to benefits has not declined. Indeed, employer costs have frequently risen due to legacy DB costs and rising health care costs. Employers are not turning away from benefits, but they are struggling in the face of rapidly increasing costs.

In the U.S. the cost of employee benefits as a percentage of pay has risen from 14.8% in 2001 to 18.3% in 2015. This increase is largely driven by increments in health costs that grew from 5.7% to 11.5% of pay in the same period (Figure 3). In short, health care costs are consuming an increasing share of employee productivity, crowding out employee short-term term financial security through lower take home pay and their long-term financial security through less generous retirement programs.

(Insert Figure 3)

This trend is expected to continue, with health care costs expected to increase at a faster pace than general inflation for the foreseeable future. In absolute dollars, employers expect average employee per-year costs to rise to $12,338 in 2016 and nearly $13,000 in 2017 (Willis Towers Watson, 2016). As in recent years, employers continue to make changes to their plan designs to hold the line on costs. But in this prolonged period of relatively stagnant wage growth, employers are also increasingly concerned about affordability. In fact, nearly 40% of employers are taking steps to today to achieve more affordable premiums, point of care costs, and another 15% plan to take action over the next few years.

The trend towards higher health care costs is also evident outside the U.S. In 2014, the cost of private medical insurance benefits rose more than twice than the rate of general inflation (Willis Towers Watson, 2014). Moreover, most insurers anticipate higher or significantly higher medical trends over the next three years (Figure 4). Given the design of health care provision, in most developed economies the impact of medical inflation will be felt less directly by employees,

though this does not mean the costs disappear. They are likely to be felt indirectly via taxation, national premiums, or even reduced public coverage in some areas/services.

(Insert Figure 4)

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 U.S. has been the rise of health care costs. In other countries, rising health care costs are increasingly weighing on government finances and squeezing other programs.

The drive towards flexibility and choice. With benefit costs rising, employers are managing their program costs and passing risk back onto employees. Employers recognize this and are seeking to maximize the value from their benefit spend. The challenge facing employers today is, with a weak economy, constrained corporate budgets, and a more diverse workplace, how can companies deliver the best value for money to their employees?

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, 2016).

Globally, when employees are asked how they would allocate a hypothetical benefits spend offered by their employer, more than half of the budget has been 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).

(Insert Figure 5)

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

Technology is also a key ingredient enabling transformation in the delivery of benefits. It has facilitated the move towards DC benefits, by lowering the cost of individual account based plans, and the greater use of flex programs enabling greater integration of different 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 provide a more engaging and user friendly experience.

Other drivers of change: Constraints on tax incentives and new approaches. Changes to 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 and greater flexibility offers an opportunity to better manage their financial affairs.

In addition, 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). However, it is clearly sub-optimal for those faced with high debt interest to simultaneously be saving for retirement. With the exception of a few examples such as the U.S. where employees have long been able to borrow against their 401(k)s, or in Singapore where a portion of DC balances can be used to pay medical expenses, home purchases

or student loans, in most countries, flexibility is extremely limited. Some countries allow for hardship withdrawals (e.g., Australia, New Zealand, 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 regulation begins to incorporate savings vehicles that tackle long, medium, and short term needs, shifting towards a total savings approach. In the U.K. for example, the introduction of the Lifetime 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 access to retirement savings before retirement for care or housing needs.

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

Other drivers of change: A focus on Wellbeing. Well-being is fast becoming a center-piece of many employer benefits strategies. Many organizations also aspire to make it an integral part of the employee value proposition they are building, to differentiate their companies as a destination for talent.

In part, employers are investing in their employees to offset the greater responsibilities they now face around their benefits. Employers know that employees are struggling to navigate through the complex set of decisions they now own. The use of new technologies as a way to personalize messages and to help support employees in those decisions is only a start.

Employers are not taking these steps only out of necessity; rather they recognize that a healthy and financially secure employee is ultimately more productive. Results from the Willis Towers Watson's Global Benefits Attitudes Survey shows that employees in good health and financially secure are 70% more engaged than those with financial and health issues (Willis Towers Watson, 2016).

Today's emerging well-being programs reflect an evolution from the old-school wellness programs that tended to focus on the physical health of employees. Today employers have come to recognize through trial and error that there are many limitations in their wellness programs. Yesterday's wellness programs are siloed, one-size-fits-all, transactional and focused on a carrots and stick approach to participation. The result: employee engagement is abysmal and these programs, for all of the investments, are not delivering on their promises.

Many employers have begun to take steps to correct course and have started to incorporate a more holistic view of their employee. Our Staying@Work 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, 2016). Though the US has somewhat of a head-start in this area with nearly half of employers incorporating personal financial well-being, there is no doubt that other regions are interested in broadening the spectrum of their benefits programs (Figure 6). In fact, we see increasing interest in educating employees about ways to improve their financial well-being and in providing tools to help them budget spending and manage debts.

(Insert Figure 6)

Other drivers of change: the Globalization of benefits. Multinational businesses are increasingly managed more consistently globally and the benefits marketplace is not alien to this trend. Workers are more transient, and pay and benefits more transparent. We are seeing a movement towards a flattening of designs across countries with a more uniform and consistent set of benefits that cater to an increasingly global workforce.

Employers are looking to alleviate the administrative burden of a multitude of benefit design and ultimately provide a globally consistent but locally relevant total rewards package that differentiates their employee value proposition across key segments of their workforce. This is helping to lead the key trends we observe in the more mature markets of the U.S. and the U.K. The moves to DC and provision of greater flexibility and choice are quickly taking hold in other territories as well: for example, the 2014/2015 Asia Pacific Benefit Trends Survey (Willis Towers Watson, 2015), revealed a significant increase in flexible benefits in the region.

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

The Issues Facing Flexibility and Choice?

Companies today are questioning how they can get the best value for money from their benefit spend and are increasingly showing interest in moving to a new generation of benefits, one characterized by greater flexibility and increased choice. These encompass a broader range of employee financial needs and aim to improve employee engagement and well-being. But one of the lessons of the last 20 years is that the engaged consumer model has not worked in employee benefits. The field of behavioral economics has documented a number of heuristics and biases that show that hamper individual abilities to choose wisely (Benartzi & Thaler, 2007). While

workers recognize that it is their responsibility to make sure they have enough resources at retirement, the vast majority do not engage in active retirement planning (Lusardi & Mitchell , 2011).

The power of defaults. Employers have been incorporating changes to plan design and default options, to try to bypass these behavioral biases. For example, to avoid choice overload options (Sethi-Iyengar, et al., 2004), employers limit the number of choices they present to employees, especially in terms of asset allocation decisions and investment funds options. The strong inertia exhibited by plan participants make automatic features appealing (Choi, et al., 2006), and the use of automatic enrollment and auto escalation in employer-sponsored retirement plans has been shown to increase plan participation and contributions in numerous studies (Butrica & Karamcheva, 2015). In 2015, some 31% of Fortune 100 companies already had auto-escalation in place, either as part of the default or as a plan option (Willis Towers Watson , 2016).

These design features substantially ease the employee decision-making process, but at a cost. Automation puts retirement, health care, and other choices on auto-pilot, making members unaware that they are choosing by not making choices (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 the end point, with few employees deviating from the default. For example, we know that automatic enrolment dramatically increases the probability that employees participate in a retirement plan, but at the same time the large majority of employees will stick to the default contribution rate. Frequently, this means employees do not reap the maximum benefits from matching contributions, as the majority of plans set auto-enrolment defaults at the minimum (Madrian & Shea, 2001; Choi, et al., 2004).

Research from the UK suggests that when the contribution rates of the default option are set at the minimum, only around 26% of members contribute at the maximum. By contrast, when

the maximum is the default, 77% of members selected the maximum contribution rate. Where there was no default at all, some 64% selected the maximum rate (Gardner, 2013). The typical DC design of auto enrolling employees into the minimum contribution rate then helps those employees who would not have participated, but at the cost of reducing 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, a particular concern is whether employees are equipped or engaged enough 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 are offering a wider array of benefits. Yet it is also hard to design and implement financial education programs that really work. There is evidence linking attendance to workplace seminars with administrative data showing that seminars at the workplace do not dramatically change employee behavior with respect to enrolment, increasing contributions or changing asset allocation (Choi, et al., 2004). Employers are instead looking to 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 increases employee engagement; to use prompts and nudges to ensure employees review their situation on an ongoing basis.

The tension between flexibility and choice and retirement adequacy. It is becoming evident that, with the move to DC, workers and employers are increasingly concerned about the adequacy of retirement savings. Given current savings rates many younger and middle-age workers around the world, will either have much lower standards of living in retirement or have to work much later than prior generations did. Today, more than half of U.K. employees and about 2 of 3 U.S.

employees believe that their retirement security has become a bigger concern for them. This concern is also shared by employers. Both U.K. and U.S. employers not only agree that retirement inadequacy has become a bigger deal, but also foresee it becoming even more pressing in the near future (see Figure 7).

(Insert Figure 7)

Adequacy concerns are not only evident in the developed nations. In Chile, for example, there have been massive protest against the national DC system as retirement outcomes fail to live up to expectations (The Guardian, 2016). In response, the Government is looking to enhance social security provision to compensate for weaknesses in the DC accounts (Comisión Asesora Sobre el Sistema de Pensiones, 2015).

In such circumstances, providing greater flexibility and allowing individuals to divert money previously allocated to retirement saving to be used for other things may further jeopardize retirement security. "Leakages" from retirement accounts can significantly lower savings if they are not repaid (Antolin & Stewart , 2009). Research for the US shows that about 1.5 percent of assets leak out of the 401(k)/IRA system each year and that means that aggregate 401(k) and IRA retirement wealth is at least 20 percent lower than it would have been without current leakage rules (Munnell & Webb, 2015)[1]. Others estimate that for every dollar contributed to DC accounts in the population under age 55, .40% 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). Yet while detrimental to retirement saving, it is not clear these withdrawals are sub-optimal from the consumer's financial perspective. Where these funds

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

alleviate severe financial distress and meet pressing short-term needs, they can be 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.

Against the backdrop of a decade of low pay growth in the developed economies, 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 and become one of the top of mind issues for employees worldwide (See Figure 8).

(Insert Figure 8)

While greater flexibility for those in economic hardship is clearly beneficial, it may also create less beneficial consequences. For example, one could conceive of cases where money directed from retirement plans to house purchase simply sustains higher house prices and rewards home owners (baby boomers), rather than home buyers (millennials). Alternatively, greater flexibility in how employees can access their retirement savings may make them more willing to save. Research shows that 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).

The challenge for employers is whether they can provide flexibility and choice that better meet short term financial needs, without reducing financial security in the long-term. The more holistic view that employers take with regard to financial matters suggests they are heading this way. In a recent survey we have shown that more employers are taking a comprehensive look at the financial wellbeing of their employees, and they seek to provide tools to help them budget their spending, debts, and long term savings (Willis Towers Watson, 2016).

Why is this Time Different?

Many of these concepts are not new. Flexible benefits have been studied back to 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. In the last 20 years, there have been a number of periods of excitement around employers providing the flexibility for employees to meet their own individual needs and for employers to better cater for a diverse workforce. So why is this time different? Our view is that there are several trends that align to transform and re-shape the future of employee benefits.

Economic trends: A low growth world and the increased relevance of employee benefits. Over the last decade, the global economy has drifted 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% in the U.S. and across the G7 as a whole (OECD, 2017) .

Slow economic growth and increased longevity also highlights 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 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 (OECD, 2016). In the health area, OECD data also show how real health spending fell over the period 2010-2015 and how out of pocket spending concomitantly trended upwards (OECD, 2016).

These changes are being felt by workers, as they become more pessimistic about the ability of social security programs to finance retirement. Over 70% of employees in the US and in the UK, and around 65% of employees globally, think that social security benefits will be much

less generous when they reach retirement than they are today (Willis Towers Watson, 2016). As fears over the safety net provided by governments has grown, so too has the relevance of private and employer benefit provision despite the retreat from DB. For the vast majority of employees, employer pension plans are the primary way they save for retirement. As Figure 9 shows, some 4 of 5 employees in Australia, the US, and Japan and around 3 in 4 in the UK, Netherlands, and Ireland, believe that their employer retirement plans are the most important source of retirement savings. Even in countries like Germany and Canada that have rather generous social security arrangements, about 3 of 5 employees see private retirement arrangements as their main retirement savings vehicle. Our data also suggest that the perception that employees have of the importance of employer plans has grown of late.

(Insert Figure 9)

Moreover, low interest rates and economic uncertainty have placed major pressures on legacy DB schemes and the cost of health care benefits. With limited productivity growth to be distributed, the small growth in worker compensation has been increasingly diverted to fund benefits rather than pay.

Accordingly, both 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 many Western countries today's workplace is facing two key demographic changes. Population aging and rising retirement ages are increasing numbers of 'old' employees in the workforce. At the same time, large numbers of

millennials (the ‘echo boom’) are entering the workforce for the first time. By 2017, millennials (born between1980 and 2000) will be the majority adult population in the U.S. These demographic shifts are changing the workplace, as multiple generations with multiple wants and needs coexist in the workplace. Different generations have markedly different financial priorities: Baby Boomers think savings for retirement is their main financial goal, but for millennials and Generation X, paying off debts and savings to buy a house are more pressing issues (Table 1) (Willis Towers Watson, 2016).

(Insert Table 1)

Are current benefits programs catering to the different needs of these different groups? How can employers meet the needs of workers in their 20s, as well as workers in their 70s, while reflecting the different economic experience their generations have faced? After a decade of low-growth and frequently low pay increases, younger works are struggling with housing and debts, and they had greater flexibility to use benefits in different directions. In fact, 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 (The PEW Charitable Trust, 2015). Older Americans are carrying more debt into retirement than in previous decades (Georgetown University, 2017). Eight in 10 Baby Boomers have some form of debt, and about 47 percent are still paying off their homes. Two-thirds of all Millennials and 80 percent of college-educated Millennials have at least one source of outstanding long-term debt (Lusardi, et al., 2014).

Many more workers now also pursue a mobile or portfolio career. For older workers, retirement plans and even the concept of retirement is also changing. A generation ago, most workers retired before 65, but given their uncertainties about their retirement future, more employees plan to stay at work longer than ever before and work flexibly as they get older. These

changes are creating both opportunity and appetite for non-traditional benefits consistent with more flexible working.

Technology and consumer voice. Back in the late 1980s and early 1990s, there were concerted attempts to offer a broader range of benefit options. Nevertheless, these attempts floundered as they were found to be overwhelming to both employers and employees. Employers struggled with the administrative burdens, and employees struggled with the complexity of the choices offered.

Today, advances in technology are now overcoming these barriers. The cost and complexity of administering individual accounts and providing integration across different (vendor) solutions has fallen substantially and made offering choice a practical option for employers. Employees can now seamlessly make choices between multiple benefits online, in real time, with online modelers and decision support.

In the U.S., the private health insurance exchanges are an example of this move to online choice and flexibility. Exchanges accommodate an employer's shift to a more certain funding approach, such as defined contribution, 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.

New evidence from some of the private exchanges in the US suggest that decision support tools can be quite effective at pairing individuals with products that are a good fit for their personal or family situation. Employees are responding strongly to the recommendations provided by those tools and their confidence in those tools grows with repeated use. Early indications also suggest that the recommendations are not viewed as a default option. Recent research from the (Private Exchange Research Council 2016) shows that when shopping for a

medical plan option, 38% of employees bought the recommended plan while 31% bought a more expensive plan, and just as many (31%) bought a less expensive plan option. 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 taking the recommendation as is. Rather, they are clearly using the recommendation as a starting point and making independent decisions and shopping around for plans that best meet their needs.

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

(Insert Figure 10)

Such tools offer employees the consumer-grade experience they want and expect. The movement towards online interactions in a number of 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 migrated to be more versatile and personalized through apps and tools, and is enabling new ways of communicating with employees. Apps open up the possibility of reaching individuals just in time for key decisions and providing more interactive communication. At the same time, apps can provide useful data on employees which can be used to produce predictive analytics about the workforce and help design ‘smart’ defaults.

These technological advances are enabling employers to offer more meaningful choices that can meet the complex and varying needs of today’s workers.

The Road Forward

The economic environment and changing workforce demographics are a movement to offering flexibility and choice within and across benefits plans. How are employers looking to develop such benefit plans?

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 is likely to result in an incoherent benefits offering. And when programs are analyzed on a global scale, the inefficiencies and complexities add up. As companies becomes more and more global, the focus among employers is increasingly to build a consistent global framework based on the company's underlying principles and strategy, leaving room for local flexibility.

As employers are moving to provide a wider array of benefits, employers still seek to maintain a core level of security. That is, employers design structures where there are a core set of benefits offering employee essential health, retirement, and financial security. These are 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 are adding greater choice, they are also added greater decision support to help their workforce make meaningful choices and using new technology to engage with employees.

Technological advances and new administrative platforms are giving companies the ability to elevate the benefits selection process to a consumer-grade experience. We are seeing this in the U.S. in the exchange platforms, where many employers are now applying some of the

same tactics used by consumer brands to their benefits experience. Today people differ in the way they consume (they expect real time information and access, the ability to personalize choices, share opinions, etc.), and this new modern consumerism is being translated to employee benefits as well. Employees expect the convenience of easy access to data and instant information on their plans (via web, apps), and this is reflected in the tools employers are looking to provide in their benefits plans.

Employers today seek to provide more assistance to employees in making decisions to help employees navigate hundreds of plan options. Such tools seek to use the same approaches employed in marketing science to move beyond segmenting employees by their simple demographic characteristics, to understand more about their attitudes, preferences, and family circumstances. The technology then seeks to streamline the choices the employee faces, give customized projections of possible outcomes, and suggest where adjustments can take place. Research shows that employees respond to advice, education, and guidance from such decision support tools (Private Exchange Research Council, 2016). The role of technology is also becoming more and more relevant to understand how employees make decisions, to get a better sense of their preferences and to gather important information to inform choice architecture and make choices more relevant for employees.

The power of defaults is clear and employers will need to look to use data analytics to ensure that these are appropriate for their workforce and aligned with the organization's business strategy. Communication messaging and media will need to address the whole people: who they are at work and in their lives (and use the information embedded in the decision support process). Whole-person marketing can drive behavior change and help employees drive employee appreciation of their benefits. Finding new ways to use technology, apps and intelligent assistants to make benefit management smarter and easier for employees is key to effective delivery. We

expect to see benefit-related communication diversify, as employers convey targeted messages to employees via a variety of channels.

Wellbeing: An integrated technology enabled approach. Employers worldwide are starting to take a more holistic approach to employee well-being, including core components of physical, emotional, financial, and social health. These programs are no longer viewed as supplemental: nearly 90% of employers globally identify their well-being programs as a core part of their benefits strategy (Staying at Work). After several decades of shifting greater responsibilities to workers for their health and financial security, firms now recognize that employees can't do this on their own.

There is also growing recognition among employers that the current state of these programs is not working as intended. A pattern seen around the world is that these programs tend to use outdated technologies. That is, they are one-size-fits-all and the delivery is fragmented – all of which results in very poor engagement and the programs fail to live up to expectations around behavior change. Even in the US, where employers typically offer employees an opportunity to earn on average $880 per year, most employees only ever recoup $360 or 40% of that amount. Employers recognize there must be a better way and the stakes are high for getting it right.

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 meet the needs of all employees and their complex challenges to enhance well-being programs for the future. Digital developments creates an entirely new experience critical to engaging employees and getting the most out of benefits programs.

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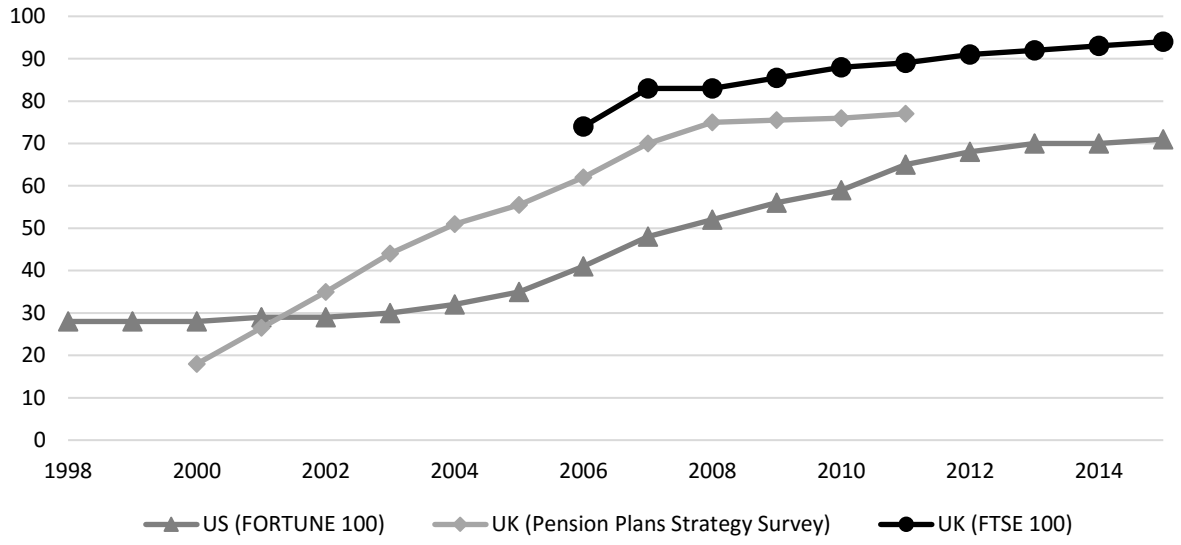

Figure 1: Prevalence of companies only offering DC plans (1998-2015)

Note: Percentage of companies offering DC plans to employees.

Source: Multiple years of the Willis Towers Watson U.K. Pension Plan Design Survey, the FTSE DC Survey and the Fortune 100 Survey. The Fortune 100 is the list of the 100 largest companies in the U.S. by gross revenue, and the FTSE 100 is an index composed of the 100 largest companies listed on the London Stock Exchange.

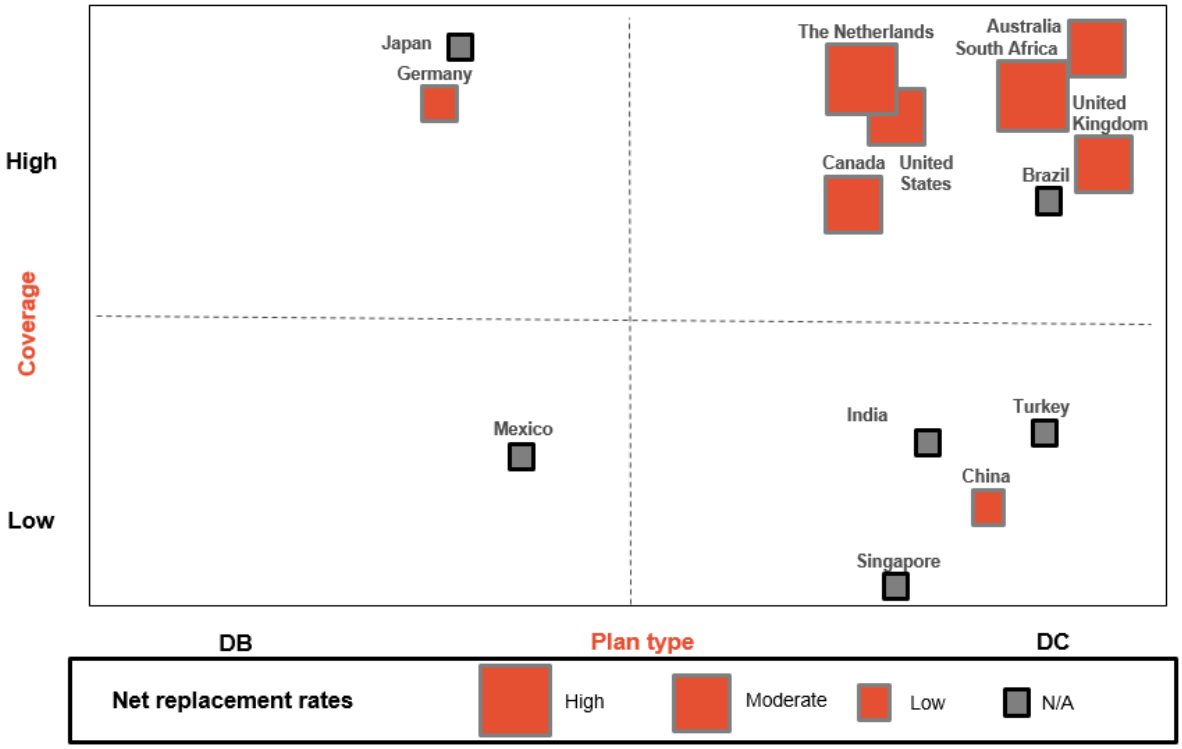

Figure 2: Stages of transition towards DC in occupational pension plans

Source: Developed by Willis Towers Watson, based on analysis of various proprietary and publicly available databases for the selected countries.

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

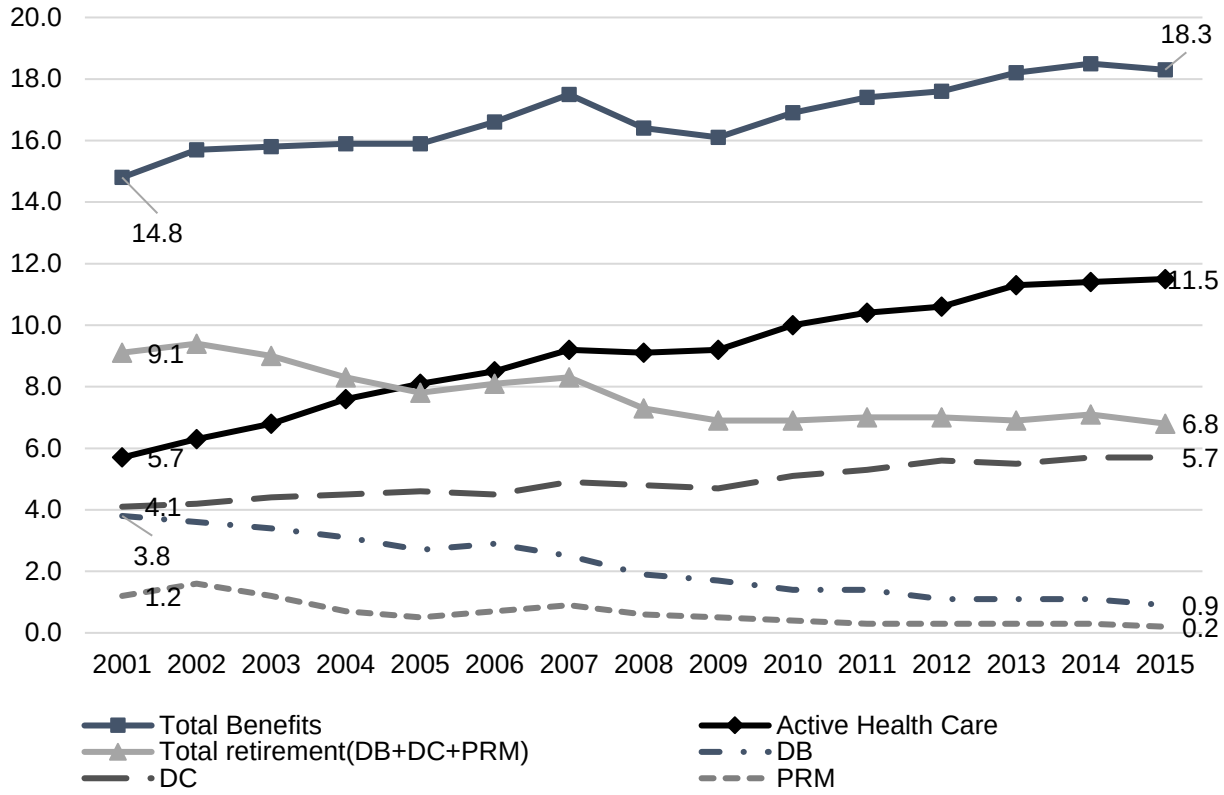

Figure 3: Total Employer Benefit Values as a Percentage of Pay – U.S.

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

Source: Willis Towers Watson analysis of Fortune 500

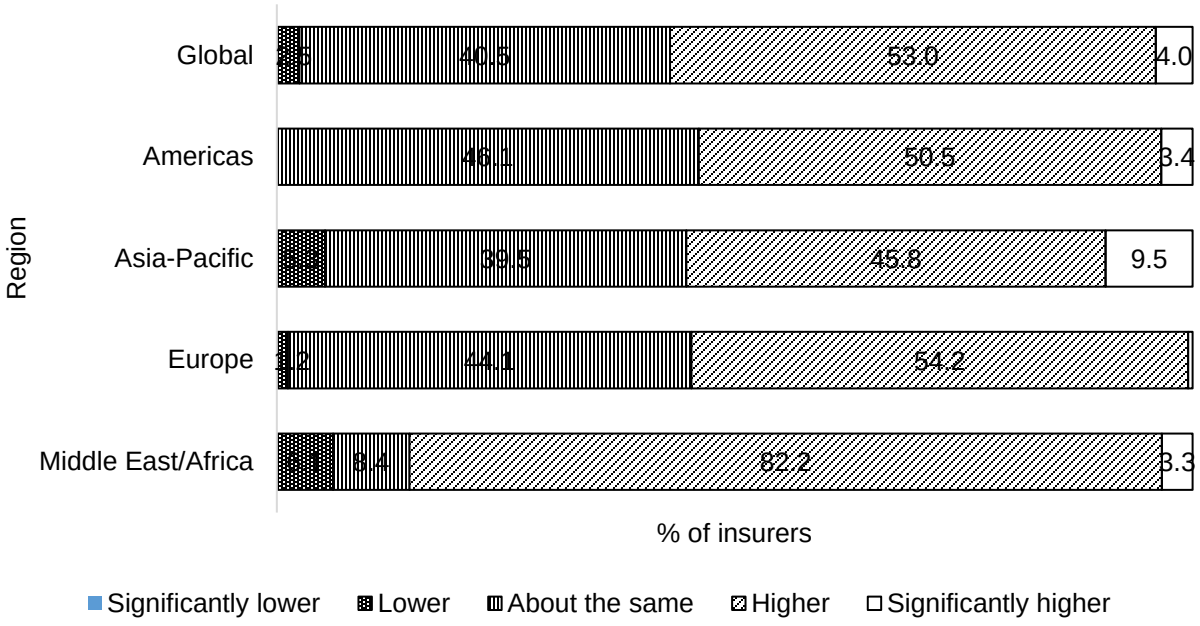

Figure 4: Expectations for future medical cost trends

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

Source: Willis Towers Watson 2016 Global Medical Trends Survey

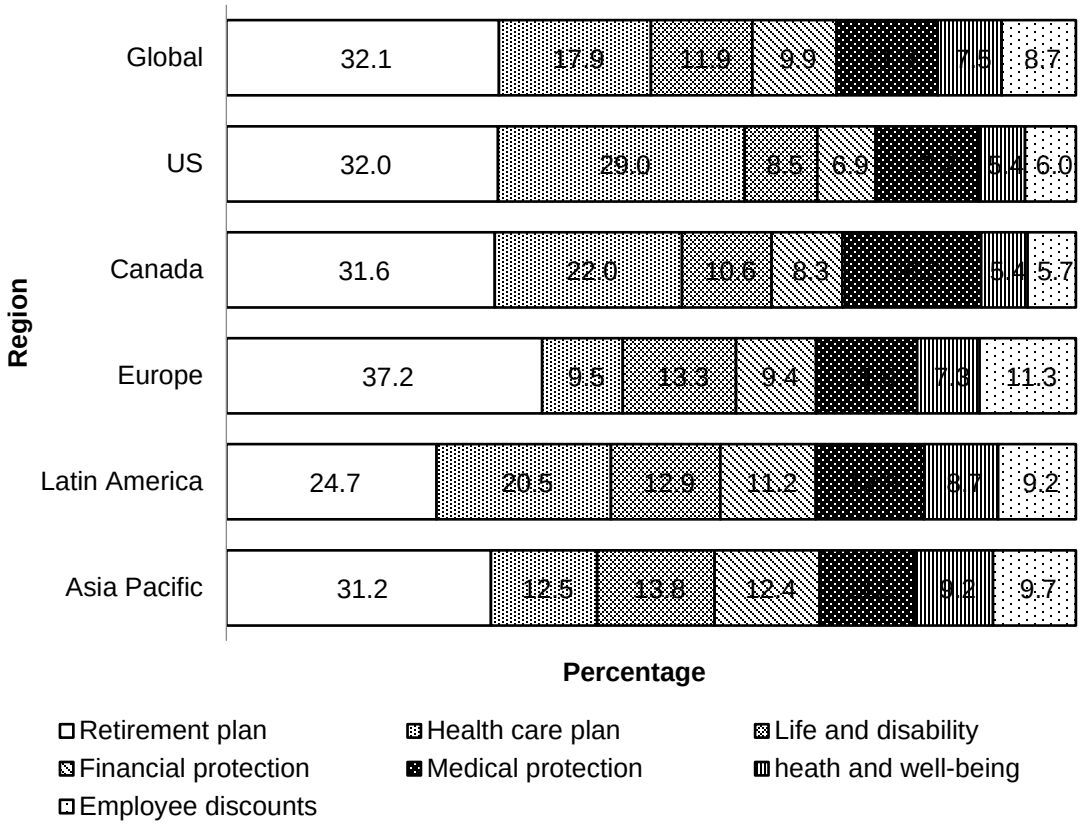

Figure 5: Employee's preferred allocation of a benefits spend

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

Source: Willis Towers Watson 2015/2016 Global Benefits Attitudes Survey.

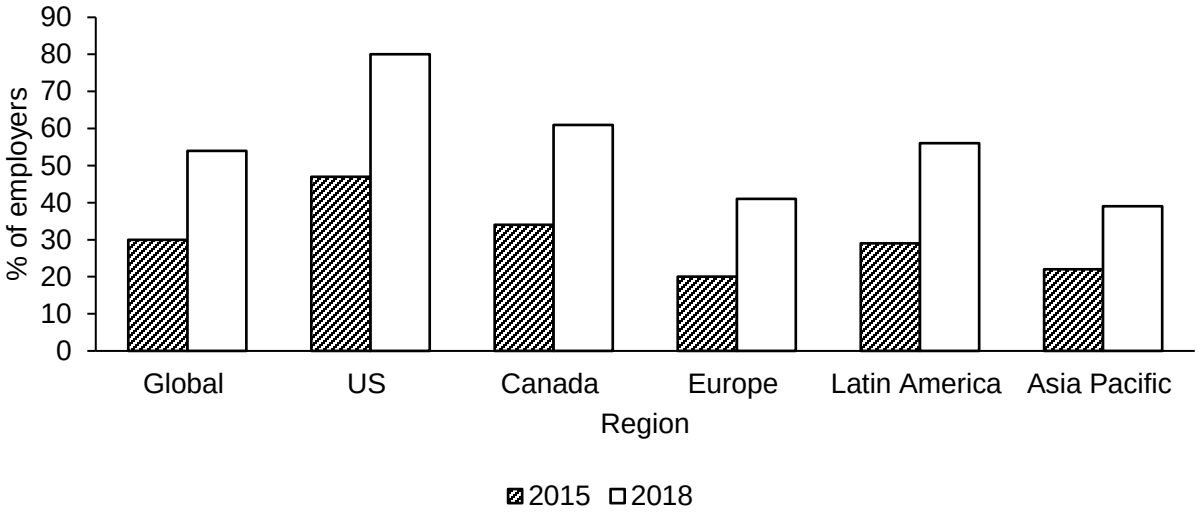

Figure 6: Adoption of a financial well-being strategy

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

Source: Willis Towers Watson 2015/2016 Staying@Work Survey.

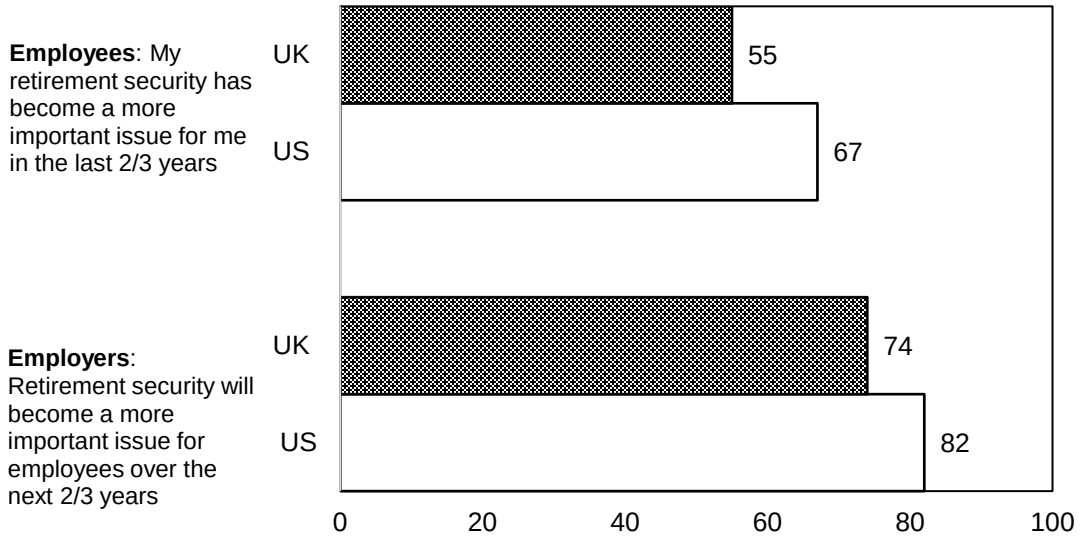

Figure 7: Retirement Security

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

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

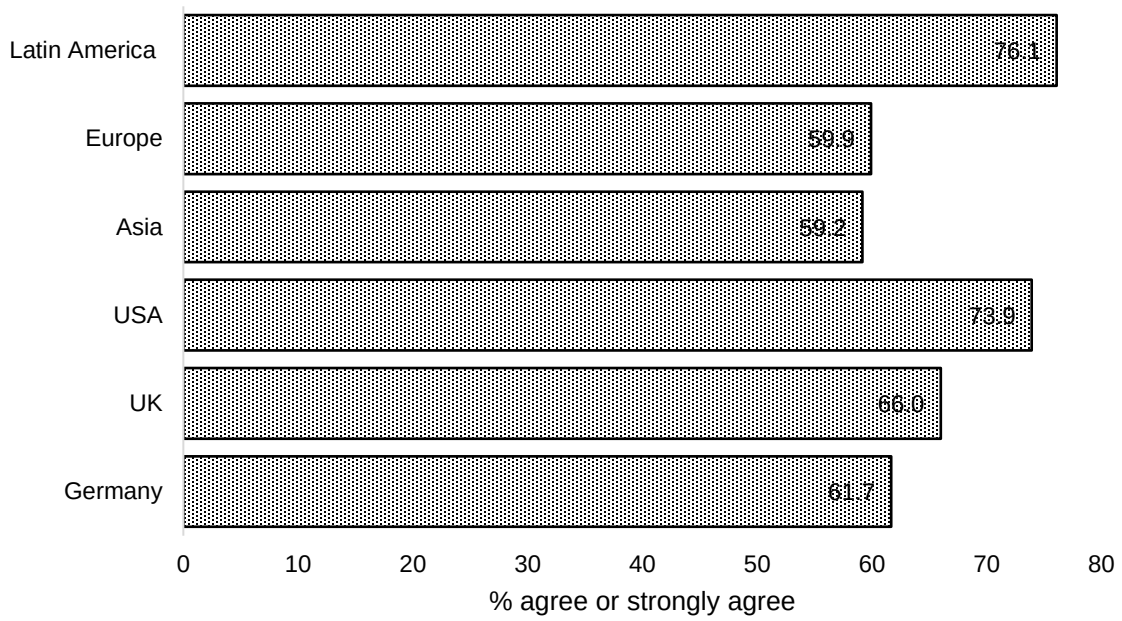

Figure 8: Financial security becoming a bigger issue over the past two or three years

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

Source: Willis Towers Watson 2015/2016 Global Benefits Attitudes Survey

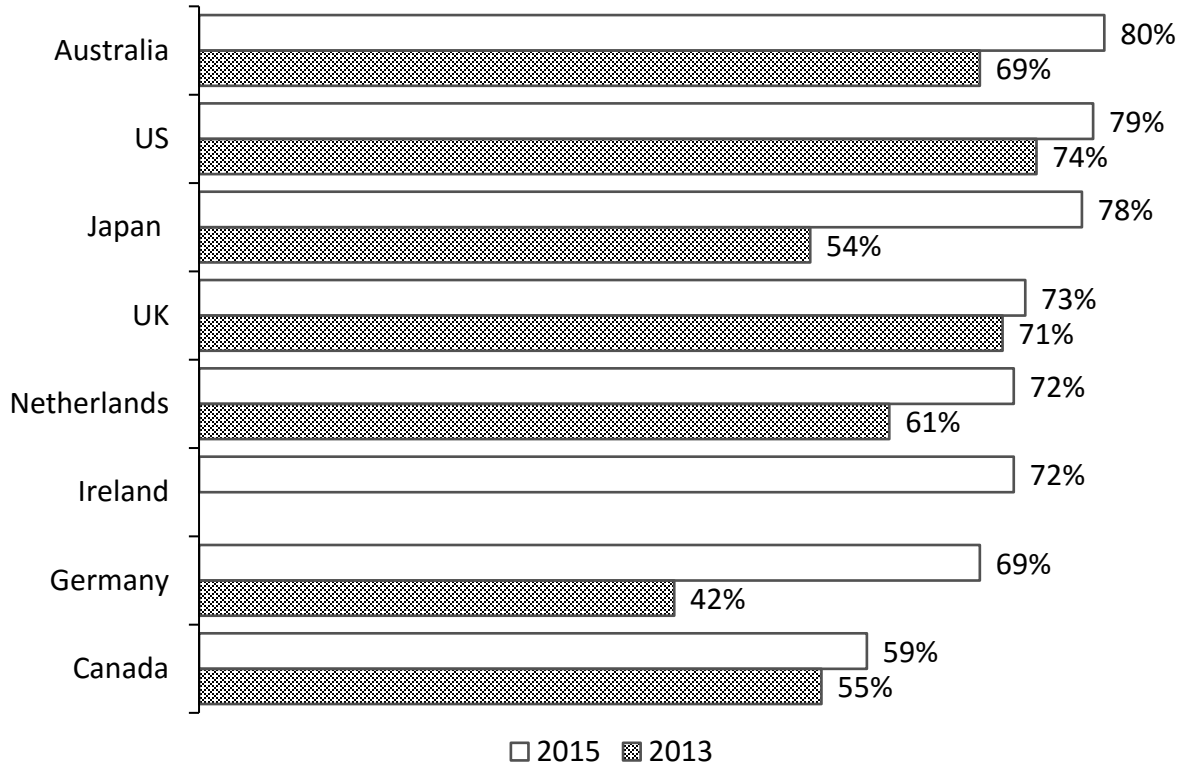

Figure 9: Relevance of employer retirement plans to finance retirement

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

Source: Willis Towers Watson 2015/2016 Global Benefits Attitudes Survey

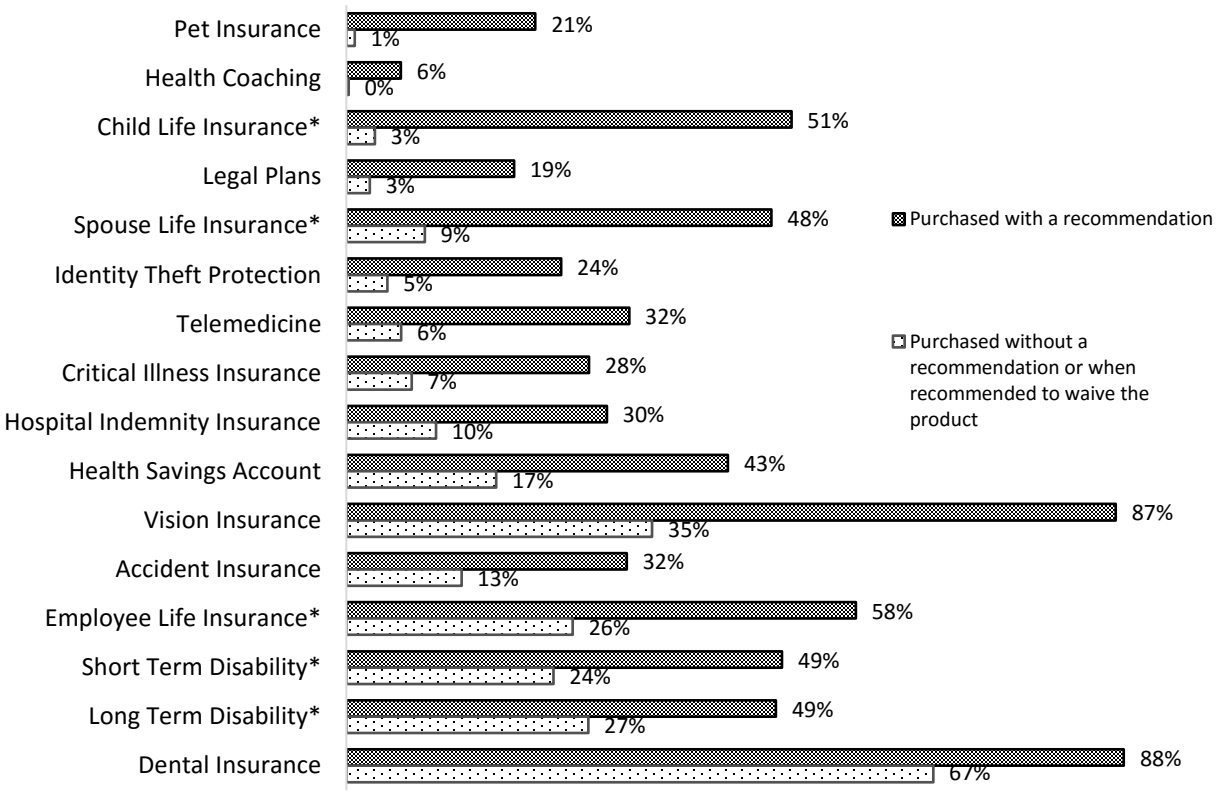

Figure 10: Impact of recommendation on buying decisions

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)

Table 4.1: Financial priorities

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

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

Source: Willis Towers Watson's Global Benefits Attitudes Survey.