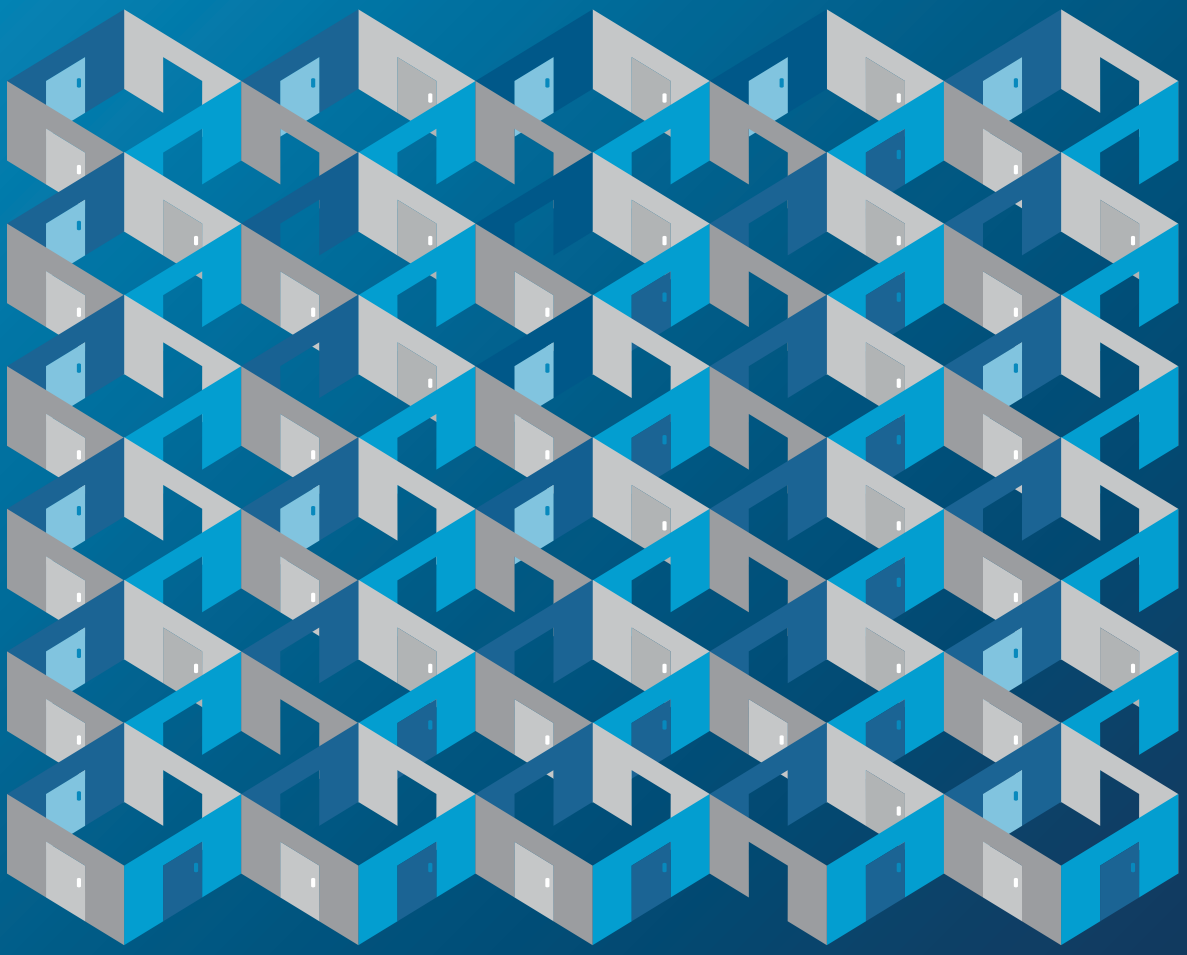

Why Employers Should Care About the Cost of Delayed Retirements

Prudential

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Executive Summary

Having employees able to retire "on time" is a win/win scenario for both employees and employers. In a perfect world, all employees would be able to begin enjoying their retirement years when they wish, and employers would, therefore, be better able to manage workforce resources and costs. However, in today's society, many employees are expected to delay their retirements beyond their desired retirement ages due to financial concerns, such as having inadequate savings to sustain them throughout their retirement. To quantify the impact of delayed retirements on employers' costs, Prudential conducted research[1] using workforce composition and cost assumptions based on national averages for private sector workers. The research indicates that a one-year increase in average retirement age results in:

- An incremental cost of over $50,000 for an individual whose retirement is delayed.[2] This represents the cost differential between the retiring employee and a newly hired employee.
- Incremental annual workforce costs of about 1.0%–1.5% for an **entire workforce**.[3] For an employer with 3,000 employees and workforce costs of $200 million, a one-year delay in retirement age may cost about $2-3 million.

To put this in perspective, we compared the cost of delayed retirement to other types of workforce costs,[4] and found that, on an aggregate national basis, a delay in retirement may cost employers about as much as:

A Delay in Retirement of…	May Cost Employers About as Much as…
1 year	• Paid sick and personal leave combined, or • Two times life and disability insurance combined
2 years	• DC retirement plans, or • DB retirement plans, or • Paid holiday leave
3 years	• Paid vacation leave, or • More than one-third of health insurance

We also compared the cost of delayed retirement to rising healthcare costs. In the early 2000s, rising healthcare costs were a front-and-center concern for benefits and finance executives, as healthcare inflation costs exceeded inflation rates for other workforce costs. From 2004 to 2015, healthcare costs as a percentage of total workforce costs increased from 6.6% to 7.6%, or an incremental 1.0% of workforce costs. This 1.0% increase is similar to the expected incremental cost of a one-year delay in retirement (1.0%–1.5%).

The true cost of delayed retirement is likely understated in this analysis, because qualitative costs of delayed retirements, such as the impact on productivity and on promotion and advancement opportunities in the workforce, are not considered. Moreover, while this analysis focuses on national averages, both qualitative and quantitative costs may vary significantly from employer to employer due to several factors. Data analytics can be used to customize the cost of delayed retirement for a specific employer.

Employees Expected to Increasingly Delay Retirement

Having employees able to retire "on time" is a win/win scenario for both employees and employers. In a perfect world, all employees would be able to begin enjoying their retirement years when they wish, and employers would, therefore, be better able to manage workforce resources and costs. However, in today's society, many employees are expected to delay their retirements beyond their desired retirement ages due to financial concerns, such as having inadequate savings to sustain them throughout their retirement. Other employees may delay their retirements in response to the increase to age 67 for the Social Security Full Retirement Age, and the decline in employer-sponsored retiree healthcare insurance availability, which may lead employees to wait until they are covered by Medicare.

There are many trends that impact an employee's ability to retire. Most notably, the shift from defined benefit (DB) to defined contribution (DC) plans places more responsibility on individuals to save adequately for retirement, invest their savings appropriately, and generate a stream of retirement income from those savings.[5] Employees whose primary retirement plan is a DC plan tend to retire one to two years later, on average, than employees covered by a DB plan.[6]

There is evidence that individuals have not saved enough to fund their own retirements. More than one in five Baby Boomers (22%) reports having no savings for retirement, and among those Boomers who have retirement savings, 40% have balances less than $100,000.[7] These retirement savings must stretch further than before, because increased longevity means individuals must plan for longer retirements. Moreover, purchasing power has been eroding faster for Americans age 62 or older, who experienced an inflation rate 5.5% higher than other consumers from 1985 to 2015, primarily due to their higher spend on healthcare.[8]

In light of these statistics, the trend to delay retirement is not surprising. Americans' average self-reported age of retirement is 62 as of 2014, up from 60 in 2012.[9] Fifty-nine percent of surveyed Boomers plan to retire at age 65 or older, and 26% plan to retire at age 70 or later.[10] Surveyed finance executives anticipate that their companies will have to manage an increasingly aging workforce. Fifty-seven percent believe that a significant portion of their employees will have to delay retirement due to inadequate retirement savings.[11]

The impact of the delayed retirement trend and the aging of the U.S. population are expected to result in a larger concentration of older people in the workforce. By 2020, 7% of the workforce will be over 65, up from 4% in 2010. Twenty-five percent will be over 55, up from 18% in 2010.[12]

57% of surveyed finance executives believe that a significant portion of their employees will have to **delay retirement** due to inadequate retirement savings.

Implications of Delayed Retirements for Employers

Employers may look at the implications of delayed retirements through several lenses.

1. **Paternalism.** A long-standing relationship between employers and employees can motivate employers to want to help employees to be more prepared for retirement, so employees can retire when they want.

2. **Productivity and Workforce Management.** From the employers' perspective, there are many positive implications of employees delaying their retirements. Employees nearing retirement age may have more experience, a historical perspective, institutional knowledge, and the ability to serve as mentors. Some employers actively seek to retain experienced employees with unique skill sets.

   On the other hand, employees who are not able to retire when they wish may experience financial stress, a lack of engagement, and lower productivity. Delayed retirements may also reduce employers' ability to hire new employees, reducing the inflow of new ideas and talent, and resulting in higher turnover amongst younger employees due to the lack of advancement opportunities.

3. **Employers' Economics.** While the relationship between the age of a workforce and its cost is complex, with qualitative factors such as productivity also playing a role, delayed retirements typically result in higher costs for employers. These costs manifest as increased compensation, DB and DC retirement plan costs, and group benefits costs. For example, annual healthcare costs for a 65-year-old or older worker are twice those of a worker between the ages of 45 and 54.[13]

This paper focuses on the third lens—employers' economics. It quantifies the cost of delayed retirements, provides context to gauge the magnitude of the resulting costs, and offers best practices for employers to help their employees retire on time.

Quantifying Employer Costs of Delayed Retirements

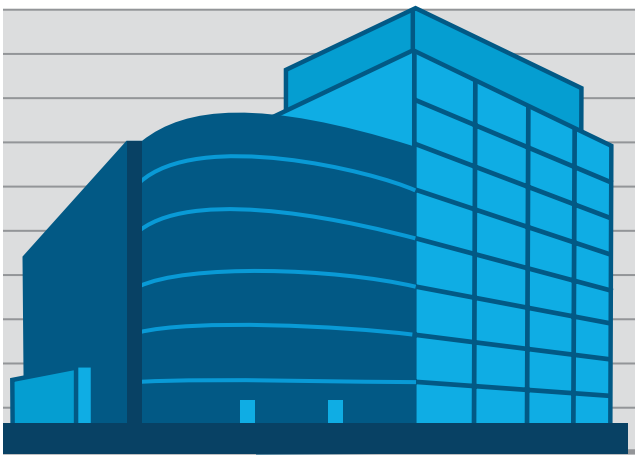
Prudential sponsored the University of Connecticut's Goldenson Center for Actuarial Research to build a model that quantifies the impact of delayed retirements on employers' costs.

For a given employee population, the model reflects a set of variables, such as the current retirement age, age distribution, income distribution, and benefit cost assumptions. The model simulates employment behaviors and costs over a five-year period based on assumptions such as turnover, mortality, and average retirement age. The costs of increasing the average retirement by one year represents the incremental total workforce costs using an average retirement age of, for example, 63 versus using a retirement age of 62.

The model does not include qualitative factors that may vary somewhat by age, such as productivity, morale, skill sets (e.g., for new technologies), work capacity (e.g., cognitive and physical changes), and frequency and duration of disability leaves. It also does not include other qualitative factors, such as the reduced flexibility for management to control the composition of their workforce, and higher turnover of younger workers that cannot be promoted. Therefore, the true cost of delayed retirement is likely even higher than stated in this analysis, because these qualitative costs are not reflected.

Using this model, a "National Case" has been developed based on national averages for a hypothetical private sector workforce of 3,000 employees with workforce costs of $194 million, as shown in the table.[14] The cost of delayed retirement for this National Case has been measured using two methods, yielding significant findings.

Hypothetical Company – Workforce Components *($ million)*



Wages and salaries	$ 135.1
Government payroll related	$ 15.4
Health insurance	$ 14.8
Paid vacation leave	$ 6.9
Supplemental pay	$ 7.1
DC retirement plans	$ 4.3
Paid holiday leave	$ 4.1
DB retirement plans	$ 3.2
Paid sick and personal leave	$ 2.4
Life and disability insurance	$ 0.9
Total workforce costs	$ 194.2

- For an individual employee, **the cost of a one-year delay in retirement is over $50,000.**[15] This result compares the average workforce costs (i.e., salary and benefits) of a retiring employee vs. a newly hired employee. It is assumed that when an employee retires, an advancement opportunity is created such that all employees progress through the workforce (i.e., "move up a notch"), and an entry-level employee is hired. This is a simple measure that focuses on retiring employees only, which represents a small segment of the workforce.
- For an entire workforce, **a one-year increase in the average retirement age results in an average annual incremental run rate of about 1.0%–1.5% of workforce costs.**[16] In the hypothetical case study of an employer with 3,000 employees and workforce costs of about $200 million, a one-year increase in the average retirement age may result in an incremental $2-3 million of workforce costs annually.

Importantly, the results for the entire workforce are diluted compared to the results of the individual employee because only a small portion of the employee population retires each year. In other words, the results for the entire workforce blend the impact of the minority of the employees that are retiring with the majority that are not retiring. While the blended impact may seem small, it is significant when compared to other components of workforce costs, as will be demonstrated later in this paper.

The impact for this National Case would undoubtedly vary from one employer to another. Several factors influence the cost of delayed retirement, such as an employer's geographic location, industry workforce characteristics, mix of internal versus external new hires, and benefit plan design. Data analytics can be used to more precisely quantify the cost of delayed retirement for a specific employer, and establish the probability that various employee segments will retire at a certain age. Customizing the true cost of delayed retirement may yield more accurate results for a specific employer than the National Case.

Why Employers Should Care About the Cost of Delayed Retirements

While many employers are aware that delayed retirements will likely increase their workforce costs, some simply consider this trend to be unavoidable, and others may not know whether the incremental costs are significant. However, when considered in appropriate context, the numbers may motivate employers to take action to help employees retire when the employees wish. In order to put the magnitude of the cost of delayed retirements in perspective, we compared this cost to other workforce costs and to rising healthcare costs.

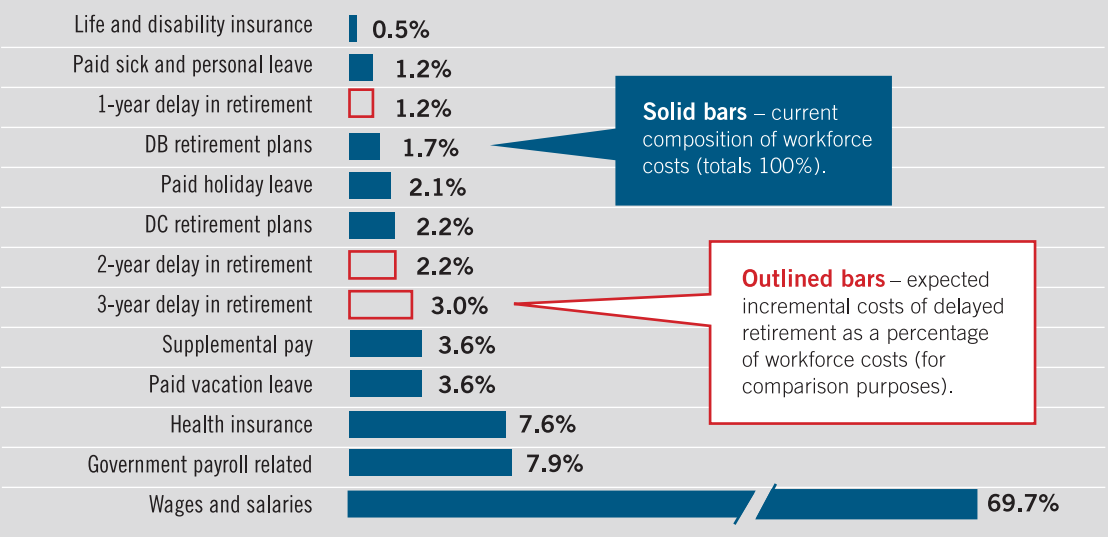
Comparison to Other Workforce Costs

Most employers closely manage the various components of their workforce costs, but many may not consider the cost of delayed retirement relative to these workforce costs.

The blue bars in the table below display the components of employers' aggregate workforce costs (i.e., salary and benefits) for all private sector workers as compiled by the Bureau of Labor Statistics,[17] and total 100%. For comparison purposes, the red bars represent the expected incremental costs, as a percentage of total workforce costs, of a one-, two-, and three-year delay in retirement.

Chart View | Table View

Composition of Workforce Costs: Private Sector, 2016



Notes:
1. DB retirement plans include premiums, administration fees, and dollar amounts placed by employers into pension funds.
2. Supplemental pay includes overtime, shift differentials, and nonproduction bonuses.
3. Government payroll related includes Social Security, Medicare, Federal and State Unemployment Insurance and Worker's Comp.

Source: Bureau of Labor Statistics, *Employer Costs for Employee Compensation – March 2016*, Table 5, June 2016. Prudential Financial analysis with supporting research by Goldenson Center at University of Connecticut.

This comparison demonstrates that the cost of delayed retirement is significant relative to national expenditures incurred for other workforce costs.[18] On a national basis, a delay in retirement of:

- **One year** may cost as much as paid sick and personal leave, or more than twice as much as life and disability insurance.
- **Two years** may cost as much as either DC retirement plans, DB retirement plans, or paid holiday leave.
- **Three years** may cost almost as much as paid vacation leave, or over one-third as much as health insurance.

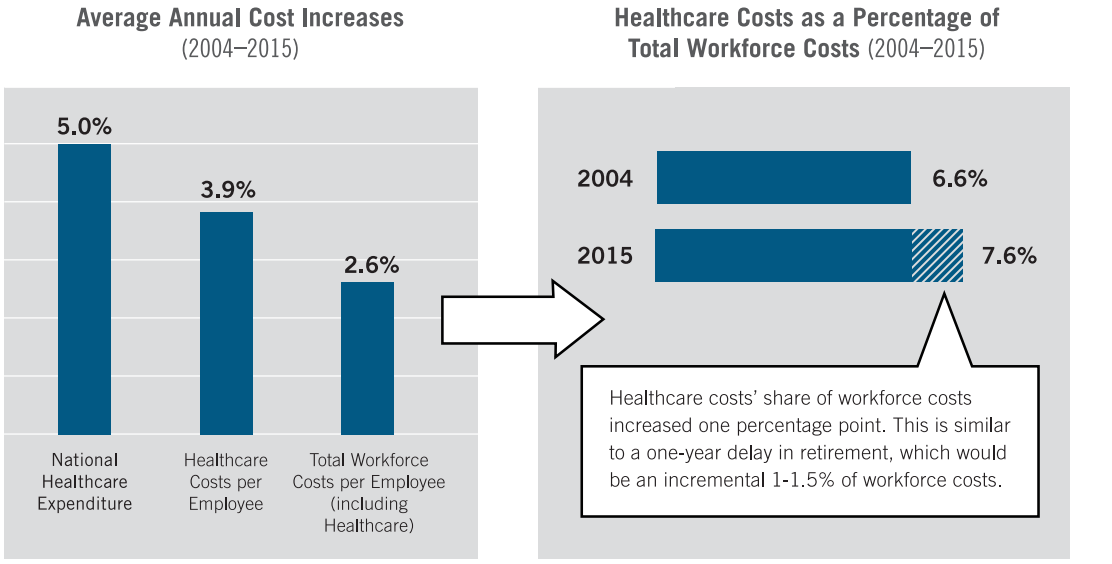
This comparison is based on *national aggregate workforce costs,* which are spread out over all private sector employees, even though not all employees have access to every benefit. Because not all employees have access to, or participate in, every plan, the costs per person would be higher if they were averaged only by employees that have access to each plan. This is especially the case for DB plans, because access is relatively low for these plans. As a result, employers may find it beneficial to conduct an analysis based on their own specific workforce demographics and benefit offerings.

Comparison to Rising Healthcare Costs

Another way to put the cost of delayed retirement in perspective is to compare it to rising healthcare costs, which are a front-and-center concern for benefits and finance executives. As shown below, from 2004 to 2015, national health expenditures increased at a rapid 5.0% average annual growth rate. During this period, employers' healthcare costs per employee increased at a slightly lower average rate of 3.9% annually.[19]

However, during this same 2004 to 2015 period, the average annual growth rate of employers' healthcare costs per employee still exceeded the average annual growth rate of total workforce costs per employee, at 2.6% annually. The net effect was that in 2015, healthcare costs represented 7.6% of workforce costs—or an incremental 1.0% of workforce costs. **This 1.0% increase realized is similar to the expected incremental cost of a one-year delay in retirement for the National Case discussed earlier in this paper (1.0%–1.5%).** Even more remarkable is that the cost of a two-year delay (2.7%) or three-year delay (3.4%) is more than two and three times, respectively, the healthcare increase.

Chart View | Table View



Sources:
Bureau of Labor Statistics, *Employer Costs for Employee Compensation Historical Listing, March 2004–December 2015.*
Centers for Medicare & Medicaid Services, *National Health Expenditure Amounts by Type of Expenditure and Source of Funds: 1960–2024.*

This comparison demonstrates that the cost of delayed retirement is even significant relative to dramatically rising healthcare costs, which many view as having a significant impact on workforce costs.

Best Practices for Employers

Employers are in a position to help their employees be financially secure so they may retire on time. The following are best practices that can benefit employers and employees alike.

1. **Consider adopting retirement programs with features that help employees retire on time.**
    - Design DC plans to encourage employees to save for retirement while optimizing employer contribution dollars. This includes adopting matching contribution formulas, automatic enrollment features, and automatic escalation features that encourage employees to start saving earlier in their careers and at higher rates.
    - Make available guaranteed lifetime income products to help reduce the level of DC savings that employees need to generate their desired level of retirement income. Prudential's research estimates that incorporating guaranteed lifetime income products into a DC plan reduces the level of assets required for a typical participant to retire at age 65 by 36%.[20] Fifty-three percent of surveyed finance executives believe DC plan participants will make better behavioral decisions (e.g., not getting out of investments at the wrong time) if they are invested in an option that includes a guaranteed income feature.[21]
    - Provide Qualified Default Investment Alternatives, such as target-date funds. Fifty-three percent of surveyed finance executives say that participants are apt to make better investment decisions when presented with pre-packaged diversified investments like target-date funds.[22]

2. **Provide education to help employees proactively make informed financial decisions.**
    - Provide saving and investment education, including ways to fund college, so as to avoid compromising future retirement security.
    - Help employees optimize the retirement programs listed above. For example, employees should contribute to DC plans at a rate at least enough to take full advantage of an employer's matching contribution. One in four employees does not save enough to receive their full employer match, leaving $24 billion on the table each year.[23]
    - Provide education on how much income will be needed in retirement to cover expenses and identify potential sources of income (e.g., Social Security, savings, retirement plans, and annuities). Planning tools may help employees set and gauge progress against retirement income planning objectives. Prudential has found that the average contribution rate for participants who used its Retirement Income Calculator was 7.2%, versus 5.8% for those who did not.[24]
    - Help employees understand their exposure to key financial risks during their working years. Employees should understand that having adequate protection during the working years may help them stay on track for a secure retirement. When faced with an illness or injury, employees who do not have adequate protection may withdraw savings from their DC plans.

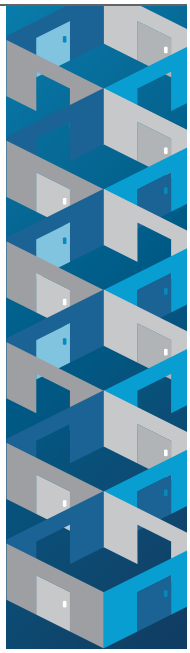
3. **Adopt a holistic approach to improving employees' financial wellness.**

   - Offer workplace financial wellness programs that include budgeting, expense management, and debt repayment tools.
   - Measure employees' protection adequacy, and target those that need the most help. Leverage employer-based tools to gauge aspects of financial wellness of an employee population, and compare the measures to relevant national, regional, or industry benchmark scores. This may be used as a basis to target employee segments that have large coverage gaps.
   - Provide student loan repayment programs. Easing employees' debt may help them start to save for retirement earlier. A study found that, while 49.2% of households without student debt were at risk of not being able to maintain their standard of living in retirement, the risk was much higher, at 60.1%, for households with student loan debt.[25]
   - Facilitate savings by offering payroll deduction savings vehicles, such as 529 plans for college funding, for various financial goals and offering planning tools.
   - Offer voluntary benefits as a way to provide robust offerings that help employees address risks that have shifted to them.
   - Encourage participation in health wellness programs. This may reduce the probability of health issues and related absences and out-of-pocket expenses that may take a toll on retirement savings.

4. **Consider using data analytics to customize the cost of delayed retirement analysis for your organization.**

   - Several factors influence the cost of delayed retirement, such as an employer's geographical location, industry workforce characteristics, mix of internal versus external new hires, and benefit plan design. Data analytics can be used to customize the cost of delayed retirement for a specific employer, and establish the probability that various employee segments will retire at a certain age. Armed with these insights, employers can work with their advisors to understand how their DC plan design features can be configured to encourage the right employee behaviors to drive successful retirement outcomes. This evaluation should enable employers to help employees retire when they wish while making the most efficient use of their benefits budget.

Conclusion



While having employees able to retire "on time" is a desirable outcome, employees, on average, are expected to delay their retirements beyond their desired retirement ages due to financial concerns. As the average retirement age increases, employers face workforce management and economic challenges.

Prudential's research indicates that a one-year delay in retirement age may add an incremental 1.0%–1.5% of annual workforce costs to employers' costs. We conclude that the cost of delayed retirements is significant as compared to other workforce costs and compared to the increase in healthcare costs during years of rapid growth. Delayed retirements of two or three years—which may not be unrealistic—would be, of course, even more significant. Employers may want to consider best practices to help their employees retire on time.

Endnotes

1 With supporting research and analysis from the University of Connecticut's Goldenson Center for Actuarial Research.

2 Represents the difference between the workforce costs of a retiree vs. an entry-level employee. It is assumed that when an employee retires, an advancement opportunity is created such that all employees progress through the workforce (i.e., "move up a notch"), and an entry-level employee is hired.

3 Represents the incremental annual cost of a one-year delay in retirement averaged over a five-year period.

4 Based on *national aggregate workforce costs,* which are spread out over all private sector employees, even though not all employees have access to every benefit.

5 The extent of the shift in responsibility to employees is dependent upon many factors, such as plan design (e.g., whether the DB plans are based on final pay or cash balance formulas) and industry practices.

6 Society of Actuaries, *The Effect of Changes in Retirement Plans on Employee Savings and Retirement Age and the Financial Impact on Employers of Delayed Retirement,* December 2012, page 14.

7 Insured Retirement Institute (IRI), *IRI Fact Book 2014.*

8 JP Morgan Asset Management, *Guide to Retirement, 2016 Edition*, 2016.

9 Gallup, *Average U.S. Retirement Age Rises to 62*, 2014.

10 Insured Retirement Institute (IRI), *Boomer Expectations for Retirement 2016,* April 2016.

11 CFO Research/Prudential Survey, *Helping Employees Achieve Secure—and Timely—Retirements,* 2015.

12 Stanford Center on Longevity, *Adapting to an Aging Workforce, Conference Proceedings,* April 2013, page 33.

13 Employee Benefit Research Institute, *The 2014 Retirement Confidence Survey: Confidence Rebounds—for Those With Retirement Plans,* March 2014.

14 The National Case uses the national distribution of employees by age and income. Benefit cost assumptions were made to reflect income- and age-related variations.

15 Cost of salary and benefits of a retiree versus a new hire, using national averages of salaries and benefit costs by age.

16 Represents the incremental annual cost of a one-year delay in retirement averaged over a five-year period.

17 Represents average of all private sector workers, excluding the self-employed and farm and private household workers. Bureau of Labor Statistics, *Employer Costs for Employee Compensation – March 2016,* Table 5, June 2016.

18 Based on *national aggregate workforce costs,* which are spread out over all private sector employees, even though not all employees have access to every benefit.

19 Bureau of Labor Statistics, *Employer Costs for Employee Compensation Historical Listing, March 2004–December 2015.*

20 Prudential Financial, *What Employers Lose in the Shift from Defined Benefit to Defined Contribution Plans ... and How to Get it Back,* 2015, page 9. Calculations of 2,000 Monte Carlo simulations using a guaranteed minimum withdrawal benefit.

21 CFO Research/Prudential Survey, *Helping Employees Achieve Secure—and Timely—Retirements,* 2015.

22 Ibid.

23 Financial Engines, *American Employees: Are You Leaving Money on the Table?,* May 12, 2015.

24 As of March 31, 2016. Prudential Financial.

25 Center for Retirement Research study sponsored by Prudential, *Planning for Retirement: The Growing Impact of Student Loan Debt on Retirement Security,* 2016.

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