



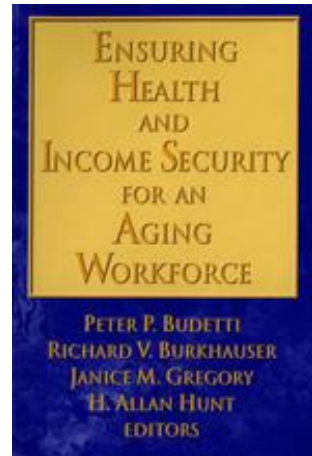
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## Employer Perspective on Retirement Trends and Policies to Encourage Work among Older Americans

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# **Employer Perspective on Retirement Trends and Policies to Encourage Work among Older Americans**

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As a response to the chapter by Gary Burtless and Joseph F. Quinn, I here consider the environment for employers and how they are responding to the challenges of an aging society.

## **EMPLOYERS, POLICY, AND OLDER-WORKER ISSUES**

The Burtless and Quinn paper focuses on older workers. When employers focus on human resource issues, they generally do not focus on a particular demographic subset of employees, but rather on the business and on the people needed to get the work done. However, when worker shortages occur, employers seek out any method they can to fill in the gaps.

Burtless and Quinn focus on the impact of Social Security and Medicare benefits, as well as that of pensions and retiree health, on workers' decisions to retire. They also note that employment discrimination is banned, but they do not explore the many requirements of age discrimination legislation. They then provide a list of ideas for policy changes that might encourage later retirement. They approach these ideas from a policy and individual perspective, rather than an employer perspective.

I contend that employers need to be careful if they provide special programs or focus on particular demographic groups. The United States protects older workers through age discrimination legislation. (Other groups are protected as well by different legislation, but the requirements differ.) Age discrimination requirements are complex

and apply to many aspects of employment. These requirements must be considered in structuring human resource programs, whether the programs target older workers or not. Employers, in considering new programs, must first focus on business need, but in addition they should focus both on compliance and on avoiding litigation. Involuntary terminations of employment and real or perceived unequal treatment can lead to costly litigation, whether the employer's action was justified or not. That is why employers should exercise care throughout the entire employment process. Whether these requirements deter employers from implementing otherwise desirable programs is unknown. It would be helpful to have research on the implications of this legislation to better understand how it impacts human resource programs and policies and whether it has served as a deterrent to innovation.

Some benefit plan requirements definitely serve as a deterrent to programs that would facilitate older worker employment and phased retirement. It would be desirable to offer programs that allow for partial payment of pensions and continued work. However, such programs are not feasible under current U.S. law. Programs may not allow payment of pensions during periods of continued work prior to normal retirement age, usually age 65. Plans may provide for payment of pensions during periods of continued work after normal retirement age, but this practice is rare. The author located anecdotal information about a retailer and a financial institution who allow continued payments to part-time workers after retirement. The number of retirees electing to work is substantial. There is no provision for plans to make partial payments during periods of reduced work. A desirable next step would be a review of pension legislation to seek out changes needed to accommodate phased retirement. Congress has given a strong signal that it supports the notion of phased retirement in its unanimous vote to repeal the Social Security earnings test. It needs to support that decision with appropriate changes in private pension regulation.

## **DEFINITION OF RETIREMENT**

Burtless and Quinn define retirement based on exit from the labor force. They define the average age at retirement as the point when half

of men have left the labor force. This definition works well from a social perspective, but not from an employer perspective.

From an employer's perspective, the common definition of a retiree is one who has retired from that organization, and what is important is whether benefits are being paid, not whether the individual has found other work. Other work, in the form of bridge jobs, is common. Retirement often takes place in steps, with multiple retirements before a person leaves the labor force. This phenomenon is not new. Traditionally, it was common in the military and certain types of public service (such as police and fire) to retire early, get a benefit, and then go on to further employment, maybe several times.

Today, most gradual or phased retirement uses one or more bridge jobs at an organization other than that of the long-term employer. A key question is whether more employers will develop programs to encourage long-term employees to phase down within their own organizations rather than accepting a bridge job elsewhere.

We need to give further consideration to the definition of retirement. It has been suggested that we should seek a new set of terms to describe different life stages. I do not seek new terms, but rather a different idea. If phasing down through a series of bridge jobs is commonplace, then the idea of retirement as a one-time event does not work any more. We might think of retirement in terms of a financial situation: focus on a period of building assets and a period of using assets to replace or supplement current earnings. The point of retirement is the crossover point. Of course, labor force participation rates would not help us measure retirement on that basis.

## **COST/BENEFIT OF USING OLDER WORKERS**

Equity markets demand better performance from companies, and employers, in turn, put greater demands on employees. This raises the question, are there advantages in having a workforce with one set of demographics versus another?

I am not aware of any definitive research on this topic. The value and cost of using older workers likely offers both advantages and disadvantages. Older workers have more experience, which can lead to

better judgment. This experience is extremely valuable for some types of jobs, particularly those with a long learning curve and a lot of need for human capital, particularly firm-specific human capital. Customers also value long-term relationships and generally do not like to see the people they are doing business with change frequently. In many cases, employers lose valuable history when a long-term employee leaves an assignment. On the other hand, with changes in organizations and technology, current education and training gain importance. If skills are not maintained, the value of long-term experience is largely lost. In addition, some experienced people focus on the past and resist change. The ideal is to have to a balance of experience, current training, and willingness to embrace change.

In recent interviews, top managers at a major financial institution made these comments:

- Some jobs have high firm-specific human capital, whereas others have low firm-specific human capital but a lot of technical knowledge. Employees in the latter jobs move between jobs easily, and long service does not add much value. An example of the first group is the account manager for a major account, and a foreign securities trader is an example of the second.
- Burnout can be a factor, particularly for high-stress jobs. At the point of burnout, it is important for both the employer and employee that the employee make a change and move on, either within the organization or outside of it.
- Customers and the organization both value continuity of service; however, that does not mean people will stay until traditional retirement age.
- Technology will replace many jobs, particularly in the back office. Some of these employees can be retrained and placed in other jobs, but it will not work out for others.

The bottom line is that human resources policies should support long service but not lock people into jobs that they no longer want. I also encountered parallel issues in a specialized manufacturing environment. The engineering and technical staff, as well as the account representatives, have a lot of knowledge that is important to the firm.

Yet for many jobs, the training period is short, and experience adds little value after an initial period, whether that is one day, one month, or one year.

Also, significant cost issues must be reviewed for both pay and benefits. In traditional seniority-based pay systems, longer-term employees got paid more, and older employees with longer service were likely to be among the higher paid. Where the value contributed by a longer-service person is not commensurate with the higher pay, the organization can save money by replacing higher-paid, longer-service employees with lower-paid, shorter-service employees. Employers today address this issue by using different types of compensation programs that are much less linked to seniority.

Employee benefits in the United States may comprise 30–40 percent of cash compensation. Older workers may have higher benefit costs depending on the structure of the programs. Some general comments on benefit costs follow.

- Traditional defined-benefit plans (based on final average pay) cost more for both longer-service and older employees. For large employers in the private sector, the average value of a traditional pension plan is 3–5 percent of pay. Pension benefits and costs in public employment tend to be much higher.
- Defined-contribution plans, unless they have formulas linked to age or service, have the same cost regardless of age or service. Employer contributions to defined-contribution plans range from no contribution to 15 percent of pay.
- Medical care for individuals generally costs more with increasing age (except for maternity benefits, which have a high cost for younger employees). Per employee costs are also influenced by number of covered dependents. The average number of dependent children is likely to increase by age and then decline. How the cost of a health benefit plan varies by employee age depends on the structure of the plan, the numbers of covered dependents, and the plan's cost-sharing provisions. Employer spending per active employee averaged \$4,097 in 1999 according to the 1999 Mercer Foster Higgins National Survey of Employer Sponsored Health Plans. Spending per active employee includes the cost of coverage for the employee and covered dependents.

- Vacation time often increases with length of service, so it costs more for longer-service employees.
- Life insurance and disability benefits become more expensive with increasing age.
- Many factors affect absences, and no generalization can be made about patterns of absence and age.

The bottom line is that experienced employees bring greater value to some jobs and that older employees do cost more in many benefit programs. Whether the net impact of these factors is an advantage or disadvantage in employing more longer-service employees depends on the situation.

Companies who offer continued health care to retirees have an added cost for this benefit. As indicated by Burtless and Quinn, the availability of retiree health benefits is an important factor in individual retirement decisions; a lack of retiree health benefits prior to Medicare eligibility is a barrier to retirement. Benefit costs can be a major factor in competition. For example, in the auto industry, the major traditional car companies had mature workforces and provided substantial benefits to retirees. They were competing against start-ups who were either foreign companies manufacturing in the United States or joint ventures and overseas companies. The companies with mature workforces had a substantial cost disadvantage, partly due to benefit costs. These companies had to downsize and ultimately restructure to remain competitive.

## **ENVIRONMENT FOR EMPLOYER RETIREMENT PROGRAMS**

In the year 2000, the environment provides a backdrop for the employer response to employee benefit issues. Some of the key factors that affect private businesses are as follows.

- Employers are facing shortages of skilled workers for certain jobs. The recruitment and retention of employees has become a high-priority issue for many businesses. This issue creates a good situation for focusing on creating better opportunities for older

workers. However, Burtless and Quinn indicate that economic conditions are not a major factor in determining older worker labor force participation rates.

- Business is becoming more global. Many global businesses are working to create common cultures.
- Mergers and acquisitions have become commonplace. Some of the deals are large, and they often cut across countries. Often, the aftermath of the deal is to sell lines of businesses that do not fit the large organization, which results in one large organization and several smaller ones. Many mergers result in the dislocation of a substantial number of employees. Nearly all require revisiting the appropriate retirement programs in the new organization. To integrate organizations, it is usually necessary to provide a common pension program for future periods. In some of these situations, employers offer new benefit packages after the merger. It is common to use early retirement window programs to help implement postmerger changes and workforce adjustments.
- The common trend is to have employees assume more responsibility for their own retirements, including stressing the importance of employee saving, and employers are offering more opportunities for employees to save. However, Americans save relatively little; this strategy is therefore likely to disappoint many people.
- U.S. equity markets have performed with uneven results. While some organizations have seen huge increases in the value of their stocks, others have not. Markets demand strong performance, which drives the fine-tuning of organizational structure. Key employees commonly receive stock options, and many employees get stock purchase opportunities. In many organizations, company stock is an important source of employee wealth that will facilitate retirement.
- The compensation systems of emerging e-commerce businesses have focused much more attention on stock options and ownership opportunities. These businesses, particularly start-ups, can have a large part of their compensation package based on stock.



Traditional businesses as well as new start-ups are feeling the impact of this competition.

- Technology and electronic business are changing the way business is being done. Employees are faced with constant and, at times, overwhelming change. Only some workers adapt well to change. Dealing with employees who do not adapt well can be awkward.
- Employers use a variety of employment systems. These systems include full-time, part-time, contract work, use of temporary employees, and increased use of individuals working as consultants and doing projects on a consulting basis. Some of the most attractive opportunities for using older workers may be outside of full-time employment.
- There is a widespread belief that employment patterns are changing and that employees will change jobs more frequently in the future. Trend data on length of service with current employer by age group show a long-term trend of modest reductions in male length of service and increases in female length of service. The biggest reductions are for males at and just before early retirement age. Male and female tenure patterns are becoming more similar. The data show modest change and do not match the perceptions of radical change.
- Companies are taking employee performance more seriously and working diligently to measure it. In addition, there is much less tolerance to retain a marginal performer. The demands of the competitive environment and equity markets push companies to improve productivity.
- Regulatory and legislative requirements have increased greatly over the last 25 years, and employment-related litigation can be costly. Employers need legal advice when developing virtually all employment policies and practices.

## PRIORITIES FOR HUMAN RESOURCES MANAGEMENT

During 1999, William M. Mercer, Incorporated, surveyed large employers in the United States, the United Kingdom, and continental Europe to better understand their priorities and the factors driving retirement strategies. Table 1 shows the priorities of the multinational respondents to this survey.

Controlling cost levels and attracting new talent were the most important workforce issues faced by respondents, with more than 9 in 10 rating each as critical or major. The biggest difference between U.S.-headquartered companies and companies headquartered in the United Kingdom or continental Europe was that 28 percent of U.S. respondents cited retaining employees longer as a critical issue, compared with only 5 percent of U.K./Europe respondents.

**Table 1 Major Workforce Issues of Multinational Employers in 1999 (%)**

Workforce issue	Critical issue	Major issue	Minor issue	Not an issue
Attracting new talent	46	46	8	0
Controlling the level of costs	45	48	7	0
Controlling the variability of costs	24	54	21	1
Retaining employees longer	19	41	32	8
Aligning benefit programs with corporate goals	18	54	25	3
Achieving/maintaining competitive benefit levels	17	65	17	1
Having consistent benefits across the organization	9	48	34	9
Having employees invest in company stock	5	18	32	45
Giving employees benefit choices	4	38	49	9
Reducing average years of service	0	7	37	56

The Mercer results include responses from 230 organizations with international operations; 63 percent are headquartered in the United States, 12 percent in the United Kingdom, 23 percent in continental Europe, and 2 percent in Australasia. The respondents' international operations range from one location outside the headquarters country to almost 200, averaging 23. U.K./Europe-based companies averaged 30 countries of operation, compared with 17 for U.S.-based respondents. Forty-four percent of respondents have at least 10,000 employees worldwide. These results point to employers trying to retain workers longer, but doing it in a way that controls costs. I view the use of alternative employment arrangements as particularly promising in that regard.

## **RETIREMENT PLAN STRUCTURES AND TRENDS**

In the United States, we can define differences in retirement plan trends by size and type of employer. Larger private-sector employers, those with at least 1000 employees, often include in their retirement packages a combination of a base plan (which is paid for totally by the employer) and a savings plan (usually a 401(k) plan). The savings plan generally provides for employee contributions and often an employer match, typically 50 percent of the amount paid by the employee up to 6 percent of pay. The base plan may be a traditional final average pay plan, a hybrid plan (like a cash balance plan), or a defined-contribution plan. Traditional plans are still most common, but hybrids are growing in popularity. Many employers also offer employees and dependents continued health care on a cost-shared basis. Nearly all provide a combination of tax-qualified plans and supplemental plans; the supplemental plans are used to make up amounts that cannot be paid in a tax-qualified plan.

In addition, these employers may offer other programs that help the employee build assets for retirement and help the employee own company stock. Medium-sized employers are more likely to use a single plan, most often a defined-contribution (DC) plan, which includes an opportunity for employees to save. Such plans are usually managed through a single outsourced vendor such as a major mutual fund com-

pany. Medium-sized employers are unlikely to offer retiree health benefits. Most small employers, those with under 50 employees, do not offer any retirement benefits. Those that do offer retirement benefits are most likely to offer only a defined-contribution plan.

The use of defined-contribution plans has grown in the United States, with these plans part of a combined program in larger organizations and the sole program in medium and smaller organizations. Many countries experience parallel trends. A recent study “Defined Contribution Retirement Plans around the World: A Guide for Employers”, published by William M. Mercer, Incorporated, shows the growth in popularity of defined contribution plans and the truly global nature of this trend. Table 2 shows the percentage of companies having plans today and projected to have them in 2003 for selected countries.

## WHAT CAN EMPLOYERS DO?

Many employers are concerned about retention, but relatively few have focused on delaying retirement beyond normal retirement age as a

**Table 2 Employers Sponsoring Defined-Contribution Retirement Plans, Selected Countries (%)**

Country	1998	2003 (projected)
Australia	80	90
Hong Kong	75	85
Indonesia	30	45
Japan	0	10
Belgium	45	60
France	40	50
Germany	10	12
United Kingdom	25	35
Canada	80	80
United States	60	70
Mexico	4	25

method of increasing retention. However, many of those employers who had large “cliffs” in their retirement plans have focused on this issue. A *cliff* is a liberal early retirement benefit, so an employee who qualifies for this benefit gets a subsidized benefit. For example, the benefit might be available at age 55 with 30 years of service. Such benefits encourage people to stay until the point of the cliff and then do little to encourage staying after that point. They artificially bunch retirements. Many of the employers who had cliffs have redesigned plans to eliminate them for future employees. A variety of transition plans are used to phase-out such provisions. Benefits already earned are protected by law, but benefits to be earned in the future are not. Plans generally reserve the right to the plan sponsor to change benefits to be earned in the future. When plans are changed, most larger organizations offer transition benefits greater than what is legally required to protect employees near retirement, because they often will have made plans based on expected benefits. Eliminating cliffs smooths out retirements by removing or reducing incentives to retire at a particular point in time.

For those employers who want to encourage longer work, a variety of strategies is available. The most important strategy is creative work options. Some older workers would prefer to continue working, but with a different schedule and pace than full-time workers. This option particularly applies to professional and technical people, who have faced increasing demands and schedules for a number of years. Innovative work options are an important first step. Pension design needs to be considered together with innovative work options ensure benefits make sense in light of the work options. As indicated by Burtless and Quinn, defined-contribution plans are age neutral with regard to encouraging retirement. The same is true for cash balance plans. However, neither type of plan automatically goes to the next step and supports phased retirement. Optimal support of phased retirement requires legal changes.

Some of the work options used today involve temporary and consulting work. Under such arrangements, generally no provision is made for benefits and no implication of continued employment beyond the immediate project or assignment. The individual can, however, be hired for further assignments. Many organizations prefer such arrangements, which involve no long-term commitment and less legal risk,

although they may require higher out-of-pocket spending for the specific assignment. Some organizations use retiree pools as a method of enabling their retirees to secure temporary work in the company. Another important issue is to establish a culture that values experience as well as provides training to maintain skills and stay up to date.

To be successful with a program to encourage older workers to stay longer, an organization needs to have a strong performance management system fairly applied to all employees. This system is necessary so poor performance can be dealt with fairly. When an organization fails to manage performance effectively, it can sometimes look to retirement as a substitute for managing performance.

Medical benefits are also important. Many people seeking bridge jobs need medical coverage. Offering some medical coverage to part-timers would be a way to attract this group. Cafeteria benefits are also a good idea as employees can tailor their benefits to personal needs.

## **NEXT STEPS**

The ideas for further work and exploration include the following:

- Research the impact of age discrimination legislation on programs to encourage later work.
- Identify policy changes needed to accommodate phased retirement programs that would permit partial payment of benefits together with continued work.
- Investigate alternative definitions of retirement and the implications of using them.

Burtless and Quinn have also suggested several ideas for further policy incentives. It would be helpful to expose these ideas to various stakeholders to get their reactions.