

**CFO**

# Delayed Departure

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In early 2014, Hugh O’Toole of retirement plan provider MassMutual felt discouraged—“haunted,” he says—by finance chiefs’ lack of engagement in their companies’ 401(k) plans.

When he met with the rare companies that still offered defined-benefit (DB) pension plans, the CFO was typically the most engaged person in the room, he says, because the employer was responsible for 100% of the funding and investment liability.

But when it came to defined-contribution (DC) plans like the 401(k), the attitude was typically, “It’s a nice HR story, but why should I care about employees’ retirement readiness?” O’Toole says. After all, workers themselves provided a majority of the plan’s funding and assumed all of the investment risk. Not even a trove of academic research pointing to a negative association between employees delaying retirement and a company’s financial results got CFOs’ hearts pumping.

O’Toole actually quit his job as senior vice president of sales and client management to take a hard look at the problem. “They [CFOs] wanted to see it in their own data,” he says of what he found out during a lengthy series of discussions with finance chiefs over the few months following his departure from MassMutual. “They wouldn’t make decisions based on academic studies.”

What O'Toole did next landed him at the forefront of a surge in the use of data models to help companies understand more about retirement readiness: he founded a firm, Viability Advisory Group, dedicated to quantifying the relationship between the level of workers' retirement readiness and company financial performance. The promise inherent in such information is that the more companies know about the problem, the more proactively they can take measures to mitigate it.

### **Looking at Outcomes**

Retirement readiness is often a problem despite the ambivalence of many CFOs about retirement outcomes. Only 26% of Americans think they are saving enough for retirement, according to research by the Transamerica Center for Retirement Studies. In addition, only about 4% of U.S. private sector workers are enrolled in a traditional pension plan.

Methodologies to measure a workforce's retirement readiness, using data such as an employee's age, gender, 401(k) account balance, and contribution level, have been around for years. They've grown progressively more sophisticated, and companies that are interested in knowing how many of their older employees are likely to stick around past, say, age 65 can get good directional data on that.

But Viability Advisory Group's econometric model looks at the problem from the company's perspective: it calculates the cost to companies of workers who retire late. The model primarily uses wages, health-care costs, and workers compensation.

For employers that have used Viability's solution, the average annual cost for salary, health benefits, and workers comp totals about \$98,000 for a 60-year-old employee and \$102,000 for a 70-year-old employee—a difference of 3.7%. Opinions may differ on

whether that gap is meaningful or negligible, but it doesn't come close to portraying the true cost of an employee delaying retirement. A retiring worker is, on average, replaced by a much younger, less expensive one. Salary and benefits costs for 40-year-olds, for example, average just \$61,000, according to the Viability model. (See table.)

**The Costs of Aging**  
As workers get older, employers' average annual salary and benefits costs per employee increase.

AGE	WORKERS' COMP	HEALTH CARE	SALARY
30	\$2,250	\$4,073	\$47,601
40	\$2,613	\$4,478	\$60,813
50	\$3,384	\$6,155	\$74,235
60	\$5,298	\$9,709	\$83,197
70	\$6,121	\$11,219	\$84,480

Source: MassMutual Viability

That means even a brief retirement delay by an employee can prove costly. Someone who retires at 66 instead of 65, for example, costs his or her company an average of more than \$34,000, according to Viability. If retirement is postponed

to age 70, the cumulative incremental tab rises to \$172,000. And if 100 people at a company fit that profile, it creates a hit of more than \$17 million.

Perhaps even more important, though, is that the hard costs associated with delayed retirement are only a fraction of the entire cost pie. "There are softer costs [to workers delaying retirement] that are much more significant to employers, even though they are harder to measure," says Dean Aloise, global consulting leader at Conduent HR Services.

That's a reference largely to the downstream impact on the next generation of employees. "Midlevel people who are ready for promotions or leadership positions get very frustrated if the levels above them are clogged up," Aloise says. "They tend to be disgruntled, which affects their engagement and causes retention issues."

While such impacts are difficult to measure precisely, there are ways to dig into available data to estimate them. Look at turnover data for people who have been trained and are eligible to move up,

Aloise suggests. If a CFO can correlate that to pockets in the company where people are hanging on past the expected retirement date, the company knows it has a problem, he says.

And the effects cascade right down through the organization, even impeding the hiring of entry-level people. “You can’t just keep adding head count, because your margins will deteriorate,” Aloise adds. If a company usually hires 100 people from universities in the summer but now is hiring only 50, that too is an indication there’s a problem.

Somewhat more controversially, Aloise also suggests that studying business metrics may reveal, depending on the industry, suboptimal productivity or a stagnation of innovation and ideas correlated with retirement unreadiness.

On the other hand, companies may not want every worker in his or her 60s to retire. It’s important to distinguish between healthy delays in retirement and unhealthy ones, notes Shane Bartling, a senior retirement adviser for Willis Towers Watson. Older employees who are highly experienced in value creation and remain engaged and motivated likely will offer more value than the hard-dollar savings their retirement would generate.

## **Moving the Needle**

To the degree a company does want to proactively mitigate the ill effects of unhealthy retirement delays, though, what courses of action are available?

When the future cost of older workers delaying retirement is forecast to be significant enough, a company might want to incur the present expense of increasing its 401(k) matching contributions, resulting in a net savings. Greater awareness of the savings opportunities for companies also may encourage more

employers to implement automatic enrollment in a 401(k) for new employees and automatic escalation of employee contributions tied to salary increases.

“CFOs have often stopped the auto features from being implemented, not wanting to disrupt the employee population for what they saw as something not very beneficial to the company,” O’Toole notes.

Matching contributions and auto-enrollment and auto-escalation features are well-entrenched tactics. Placing significant restrictions on participants taking out loans from their DC plan is another. Phil Webb, a senior adviser at Retirement Plan Advisors, goes as far as suggesting that employers should consider disallowing loans altogether.

The biggest improvement in retirement readiness, of course, comes from workers electing to save a larger chunk of their paycheck. Convincing employees to raise their contribution rate by a couple of percentage points “is where the real magic happens,” Webb notes. But HR officials have been trying to convince participants to do that through educational and promotional campaigns since the dawn of 401(k) programs, with fairly modest success. “It takes a lot of nudging and hands-on actions,” says Webb.

Still, there are some untapped opportunities. According to Bartling of Willis Towers Watson, not enough companies offer health savings accounts, which allow participants to sock away cash they can use, tax-free, to pay medical bills in retirement.

For many plan sponsors, especially midsize and smaller ones, an even bigger missed opportunity is offering DC plan participants the ability to invest in investment vehicles that have low fees.

Webb says he finds most CFOs are quite aware of retirement funds’ investment fees. But they’re much less aware of the other costs of

running a 401(k) plan. Those include brokerage fees, as well as fees for recordkeeping and preparing the required annual Form 5500 report on plan returns and management. There are also fees for performing required discrimination testing to ensure that highly compensated employees don't receive an unlawfully high share of plan benefits.

Often those services are performed by the same financial institution that provides the plan's menu of investment options. "Unfortunately, in a lot of plans those costs are baked into the fund expense, and [CFOs] don't know enough about stripping them out or who's getting paid, and how much, from the funds," says Webb.

Service providers to 401(k) plans are actually required under federal law to disclose their fees to plan sponsors, which in turn are obligated to report them to participants. But in many cases plan sponsors don't pay much attention to the fee disclosures, let alone benchmark them against other plans' fees, according to Tom Zgainer, CEO of America's Best 401k, which offers plans loaded with low-cost index funds.

"Smaller companies and even midsize ones generally believe that the 401(k) plan must be working fine if nothing seems to be [overtly] breaking," Zgainer says. Participants, working for companies of any size, typically don't look at the fee disclosures either, he notes. "People don't read anymore. Even if they do, they don't get past the second page."

That behavior can be devastating to a participant's retirement readiness and future financial health. "If Joe and Bill both put in the same amount of money over 30 years, but Joe pays 1% in fees and Bill pays 2%, with negative compounding Bill may run out of money in retirement 10 or 12 years earlier," says Zgainer.

Large companies typically have investment committees that perform due diligence to ensure they have good-quality 401(k) plans. But at companies with about 300 or fewer employees, it's rare to find a full-blown, engaged investment committee, according to Zgainer. "It's just a laissez-faire approach to plan governance," he says.

Fee issues aside, a majority of companies still don't offer passive investment options like index-based funds, even though such options have grown increasingly popular with investors over the past decade. That's problematic, as actively managed funds, Zgainer observes, tend to have periods of brilliant performance interspersed with lengthier periods of poor performance. Passively managed index funds, by comparison, are a "steady-as-you-go strategy for the long term," he says.

### **Blast from the Past**

If a company is looking for a truly out-of-the-box solution for getting workers ready to retire, here's one recommended by Conduent's Aloise: start a defined-benefit pension plan. Never mind that a majority of companies that once offered DB plans have terminated or frozen them, and that the employer landscape is devoid of new ones.

Traditionally, Aloise notes, pension plans were far more effective at managing retirement readiness than 401(k) plans are today. Not only did they offer guaranteed retirement income, they could be designed to offer financial incentives to retire early. According to the National Institute on Retirement Security, administering the average DB plan costs 46% less than a typical 401(k) plan to provide the same benefit level in retirement. That's due to higher 401(k) fees, lower investment returns, and the ability of DB plans to pool risk.

“This, I think, is what CFOs should be thinking about for the future,” Aloise says. “We’ve learned so much by now about how to manage volatility and manage assets and liabilities. Actuaries, investment consultants, and other service providers are sophisticated enough today to avoid the pitfalls of the past.”

Pension plans went into stagnation because they got into financial trouble, which happened for many reasons. For one, many were designed in an era of high interest rates. As rates dropped, plan sponsors found the promises they made to employees were more expensive than expected.

Also, in the 1980s plan sponsors were required to use yields on high-quality corporate bonds to discount pension liabilities, as part of a move to mark-to-market accounting. They also were forced to recognize the cost of future pension liabilities on their balance sheets. “Sponsors no longer had the luxury of ignoring those obligations—or their size,” says Aloise.

Another factor was that people were living longer than they did when most DB plans were designed.

But employers today are newly open to some strategies that, if used in connection with a DB plan, could significantly lessen the financial risks, according to Aloise. Those strategies include:

- Increasing interest-rate hedging ratios—a measure that compares rate-stimulated changes in assets to rate-stimulated changes in liabilities—to limit volatility. A ratio of 100% would mean that a change in interest rates would not affect a plan sponsor’s balance sheet. There are a number of ways to increase the ratio: fund up the plan; increase the percentage of assets allocated to fixed income; lengthen bonds in the plan’s investment portfolio; and utilize synthetic strategies like interest-rate swaps.

- Offering windows during which plan participants could opt for a lump-sum distribution of their pension accounts. That transfers the risk from the plan sponsor to participants.
- Purchasing annuities on behalf of certain groups of plan participants, thereby transferring the risk associated with those populations to an insurance company.

“The pendulum swung to having only defined contribution plans,” says Aloise. “It’s time for it to swing back a little bit.”

Would starting a pension plan be an extreme reaction to the problems posed by workers unable to retire? Perhaps. But for some company, somewhere, it might be the wisest choice. To solve a problem that corporate America hasn’t yet fully dealt with, CFOs will have to assess whether their companies are being affected and keep an open mind to unique solutions.

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## **Lay the Groundwork for Savings**

### **Financial wellness programs help workers overcome common but serious challenges to building wealth.**

Employees aren’t likely to save for their golden years when they’re under immediate financial stress. They may first need to get themselves out of debt or get their spending under control.

“Financial wellness” is a hot benefits concept, but it’s not just the participants who benefit from programs to help put them on sounder financial footing. Not only do the programs ultimately impact retirement readiness, but studies have drawn a link between financial stress and lost productivity.

Such wellness programs are part of a trend toward a more holistic approach to retirement readiness that takes an employee’s full life

situation into account, notes Greg Marsh, managing director of retirement plans for Bridgehaven Fiduciary Partners.

Most large employers offer some type of financial wellness education. Midsize companies may look to firms like Bridgehaven, which provides programs of its own and also partners with outsourced providers. Here are some of the firms companies hire:

- **Financial Finesse** provides clients with financial wellness assessment tools and an aggregated report on all assessment results in its database, broken down by age, income, gender, and location. The firm also offers a financial helpline and one-on-one consultations with employees.
- **Smart Dollar** teaches a step-by-step approach to handling money. Lessons for getting out of debt and on a budget are delivered through video presentations and interactive tools. The approach is designed to be easy to understand and implement.
- **HelloWallet** offers programs for controlling spending and creating emergency savings. It also provides a web portal that offers participants convenient access to their investment account balances.
- **Student Loan Genius** provides technology that allows employees to evaluate their loan-repayment options and pay off loans via payroll deductions. It also offers companies a mechanism to make matching contributions when employees make student-loan repayments. —D.M.