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RETIREMENT STRATEGY
DOES YOUR COMPANY HAVE ONE, DOES IT NEED ONE?

2022

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FOREWORD

This report should act as an aid and a prompt to any company that seeks to develop a more broad-based approach to the challenges faced by an ageing working population. It provides critical insight into the many issues that confront society at all levels.

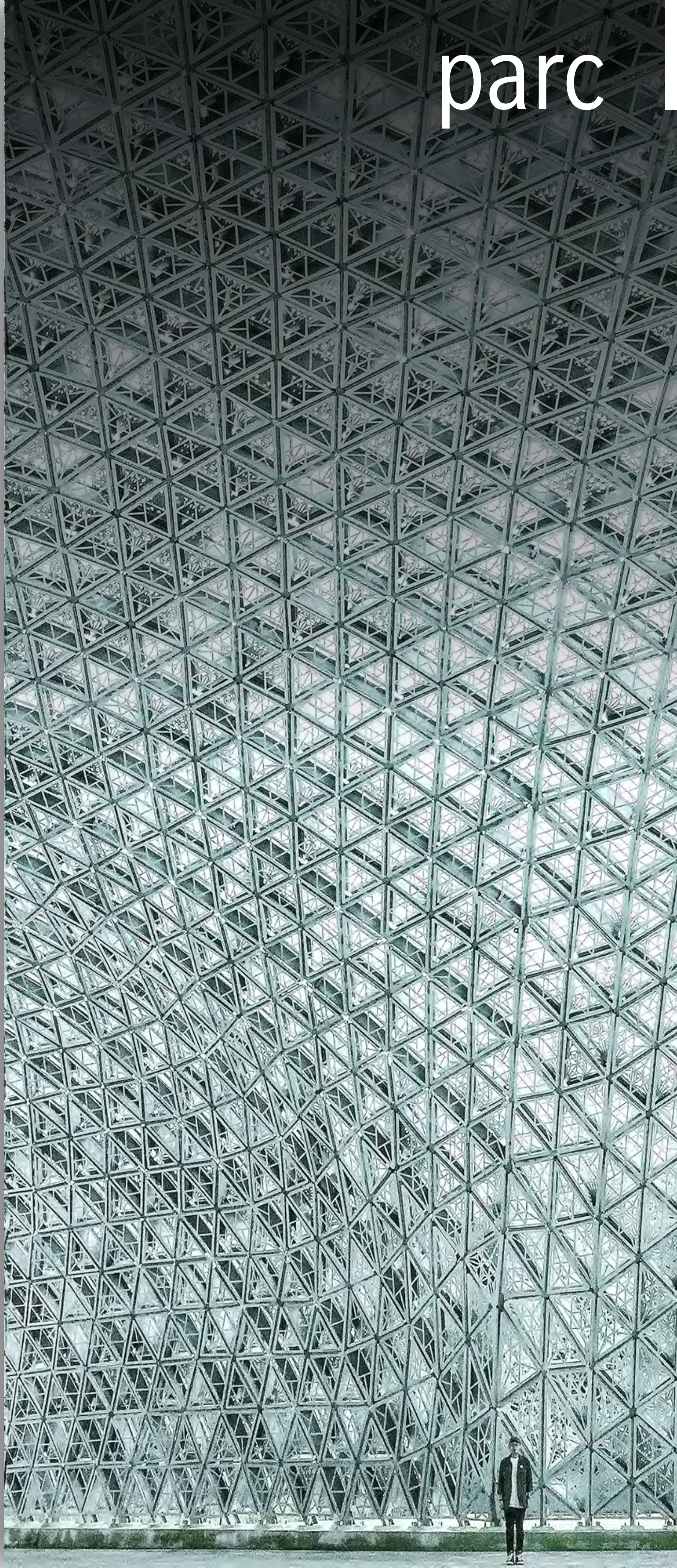
The financial decisions that employees need to take are increasingly complex – and not just as they approach retirement. The Freedom and Choice legislation which came into force in the UK during 2015 provides considerable flexibility – but it puts control squarely in the hands of the individual. Those who have a good grasp of their financial affairs, at all stages up to and beyond the point of retirement, may well be winners from this new-found flexibility. Unfortunately, many find this whole area very confusing and are destined to make mistakes, some of which may be critical. We have already seen a constant flow of data on pension scams and individuals paying more tax than they need to as they simply don't understand what options they have and how they work.

The earlier an individual begins to understand this complexity, which includes managing the range of pension pots they may have from previous employers, the more likely they are to make better decisions. But this knowledge must be built up over a period of time. It cannot be acquired in haste and applied as a rushed decision as retirement approaches. Income needs will vary over what may be 25 years or so in retirement. Cognitive decline, which becomes more likely as people get older, may also hamper the ability to make such decisions later in life.

Just as fundamental is the impact of ageing on the pattern of their employment, which itself has critical implications for the way in which employers manage an ageing workforce. As this report notes, skills shortages may become a recurring feature of the 2020s and employment policies to address the needs of older workers will assume a new importance. It is in the interests of employers (as well as for employees and governments) to develop strategies to support older workers to continue working, to acquire new skills and to plan effectively for their retirement. Clearly this includes providing Financial Wellbeing programmes where multiple strands of an individual's finances can be drawn together.

We have known about the challenges posed by an ageing population for years, if not decades. The significant economic headwinds most countries will face during the 2020s will only add to the scale of the task. Employers will play a key role in meeting these challenges. This is no longer a question for the future. We need to start planning for it now.

Jonathan Watts-Lay, Director, WEALTH at work



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1.0
INTRODUCTION

The question of retirement – when people expect to retire, how they fund their retirement, and how companies manage the process – is a subject that has been discussed by executives, commentators, and policy makers for many years. 'The demographic timebomb', 'the retirement income crisis', 'the longevity problem' and 'global greying' are some of the terms used when discussing the numerous challenges brought about by the ageing of populations across the world. As countries' demographic profiles have changed, so has the conversation about what it means to retire, when people should do so, and what counts as an 'older worker'. For much of this time, the imperative to answer these questions has seemed some way ahead. No longer. **The 2020s is the decade during which the challenge of an ageing population shifts from tomorrow's problem to today's.**

Governments, employers, and employees are facing a potential 'perfect storm'.

- For **employees,** low investment returns, the likelihood of less government financial support arising from a worsening fiscal position, and the withdrawal of many employers from meaningful pension provision, combine to threaten leaving an ever-increasing number of people with inadequate funds for their income in later life. Increasingly, both the investment risk *(whether investments generate an adequate return)* and the longevity risk *(whether people live longer than they budgeted for)* are now borne by the employee.
- For **employers,** there is the threat of skills shortages as working-age populations decline and the post-war population bulges retire, taking their skills with them. There is a perception that a workforce skewed towards the upper age range may find it more difficult to acquire new skills or change jobs, thereby hampering the ability to respond rapidly to shifting market conditions. *(We will touch on this later in the report).* Yet, with the likelihood of labour shortages across the globe, employers will need to learn to manage older workers more flexibly and effectively.
- **Governments** face the combination of economic stagnation, increased pressure on pensions and healthcare spending, massive public investment to reach Carbon Net Zero and increased debt resulting from the Covid pandemic. A cohort of underfunded retirees – requiring more support and yielding less tax revenue – presents a significant fiscal challenge on top of those already faced. The next decade's fiscal forecasts look challenging for most countries, and parlous for some.

PARC last looked at this broad topic in 2016. We noted the OECD's warning that a dramatic global shift towards private 'retirement-saving' plans had transferred significant risks from the state and employers to individuals. We concluded that governments, employers, and employees may be *"sleepwalking into a crisis"*.

Re-visiting the question in 2022, we find many similar themes – but which have now become more acute. Beyond the factors we identified in 2016, a number of developments have increased the urgency and magnitude of the problems we highlighted as follows.

- **Climate change and the shift to Carbon Net Zero** require nothing less than the complete redesign of economies. The potential economic disruption and threat to assets is unquantifiable, but likely to be on an unprecedented scale.
- **Spending during the Covid pandemic** has increased the fiscal pressures and has limited the scope for governments to address the gap between life expectancy and 'healthy' life expectancy.
- **The fear of the next wave of the Covid pandemic** is likely to heighten economic uncertainty.
- **Low GDP growth** now appears to be set in for the medium term, whereas in 2016 it was still believed to be a temporary hangover from the 2008 crash. A global 'synchronised stagnation' is reflected in poor economic forecasts for much of the 2020s.
- **The ageing of working populations** is now more advanced, with many in actual decline, including those of emerging economies.

If the factors intensifying the retirement income crisis have become more acute over the past six years, what of the other side of the equation? Have governments and employers taken heed of the warnings in 2016 and put measures in pace to mitigate their impact? We have found very little evidence to suggest that this is the case. While individual firms may have taken action, there has been no widespread movement from employers to mitigate a crisis which will affect many aspects of their business – and most of their employees. Likewise, from governments, there has been very little initiative taken to head off the effects of what will inevitably become a systemic problem over the coming decade.

In this report, we aim to help redress the balance.

- We will re-examine and re-assess the extent of the retirement income problem in the context of the critical social, economic, and political factors that will impact upon it.
- We will consider the potential role of the employer in ensuring that their employees are better equipped to plan their own finances for later life – and provide insights to help companies develop support strategies to mitigate the looming crisis.

Section 2 examines **the economic and demographic background** to the retirement income crisis. What macro-economic forces have combined to bring society to this point and how might they develop over the next decade?

In **Section 3** we look at **the (micro-level) social, employment-related, financial, and political challenges** that are contributing to the pressures on individual retirement incomes, and how they might be further exacerbated by the developments of the 2020s. Retirees running out of money is a potential social catastrophe. Its causes need to be addressed at the micro-level and understood in terms of how they impact the individual employee.

Section 4 focuses on the necessary level of **financial awareness** in the population. This is one of the major barriers to effective retirement planning. Without the required level of financial education, there is no context for the provision of financial advice. We look at what governments and employers might do to improve employees' financial knowledge and increase their confidence to take investment decisions, including a better understanding of risk.

Section 5 looks at **the changing work environment.** This has become a critical area of focus and research for Mercer, one of our partners in this report. This section was written by Yvonne Sonsino, Mercer's Global Co-Lead on the work related implications of longevity and equality. Skills shortages and a tighter labour market may mean that employment policies to address the needs of older workers will assume a new importance. It is likely to be in the interest of companies to encourage older workers to stay in employment. Research by Mercer found a high level of concern among CEOs about high performers taking early retirement, and about the lack of movement in senior roles. How a company supports its employees in later life may become a source of strategic competitive advantage for those companies that do, and a reputational risk for those that don't.

In **Section 6** we summarise the various types of **remedial action** that employers might wish to take to address some of these issues. These include: whether and how to plug the education gap; to re-design employment policies; to provide employees with the confidence that they will be supported; and to maximise the contribution and effectiveness of their older workers.

Finally, the **Conclusion** draws the themes of the paper together, and highlights the risks of inaction.

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2.0 THE CHANGING (MACRO-ECONOMIC) CONTEXT – THE MOUNTING CHALLENGES OF THE 2020S

Let's first examine the **economic and demographic background** to the retirement income crisis. What are the macro-economic forces that have combined to bring society to this point, and how might they develop over the next decade?

The unexpected global pandemic has inevitably left its scars. But of equal, if not greater concern are the social, environmental and economic headwinds that look set to make the next decade very different from those which immediately preceded it. We examined these factors and their likely impact on employment in some depth in our ***Building a Future Fit Workforce*** report published in September 2021. However, many of these challenges will equally set the context for retirement strategy and retirement income planning over the next decade. *At the time of writing, the economic and investment impacts of the war in Ukraine are still unclear but they will only add to the already significant challenges of the 2020s.*

2.1
THE DEMOGRAPHIC CHALLENGE

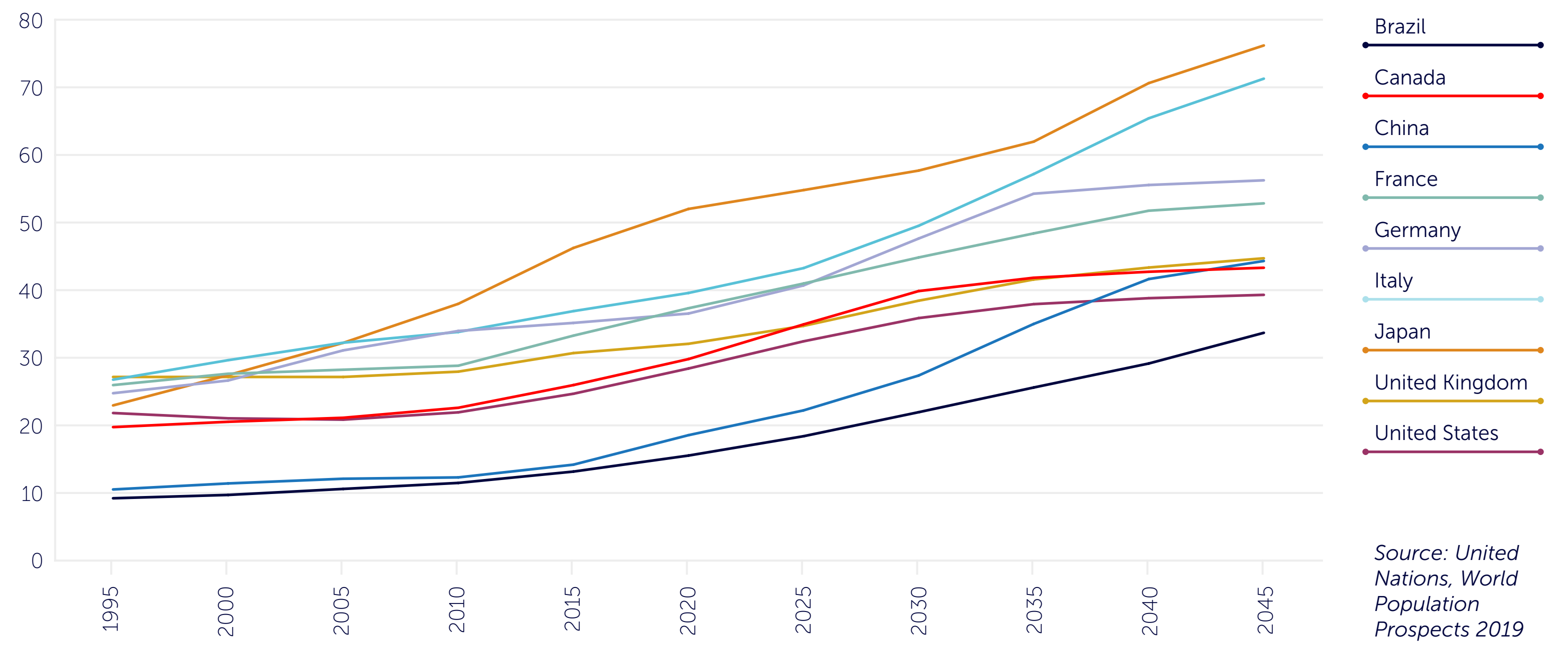
The 2020s will be the decade during which the demographic changes we have known about for many years start to have a significant impact in many countries. Since the Second World War, two of the key indicators by which international bodies such as the United Nations and the World Health Organisation have judged social progress are 'rising life expectancy' and 'falling birth rates'. Both have been objectives of social policy across the world for many decades, and public health systems have worked hard to increase the health of the population and to encourage people to have smaller families. Their efforts have been largely successful. In many countries, the combination of economic progress and health policy in recent decades has reduced birth rates and enabled people to live for longer. But this comes with a social cost. Inevitably, the average age of populations in these countries has increased.

While ageing populations are often cited as a feature of the more 'advanced' economies, this is simply because the process in these countries is further along the line. However, the average age in some countries which currently have a relatively young age profile is projected to overtake that of some of these 'advanced' economies by the middle of this century. According to UN forecasts, rapidly rising life expectancy and falling birth rates will see countries such as South Korea, Iran, Thailand and Brazil move to a higher median age than the USA and UK by 2050.

The result of this fall in the size of working-age populations is an increase in what economists call the ***dependency ratio*** – indicating the proportion dependent on the 'productive' part of the population. Most advanced economies will see their dependency ratio increase over the next decade. Germany, Japan and France are already seeing falling absolute numbers of 16 to 64-year-olds. *(In the UK, this is expected from 2028).* According to OECD projections, China's 15-64 population will fall by 34 million between 2020 and 2030. The chart below shows the change in the old-age to working-age ratio over the 25 years to 2020 and the projected change over the next 25 for the G7 economies and for China and Brazil. The speed of change is particularly notable in Japan and Italy and, more recently, in China and Brazil.

Old-age to Working-age Ratio

Number of people older than 65 years per 100 people of working age (20 to 64 years)



Source: United Nations, World Population Prospects 2019

This, then, is the demographic arithmetic behind the pension crisis. **An ever-expanding number of retirees supported by a declining number of workers.** The coupling of this demographic challenge with a sustained period of low economic growth adds a further dilemma for governments struggling with increased spending pressures, and for individuals needing to save.

2.2
THE ECONOMIC CHALLENGE

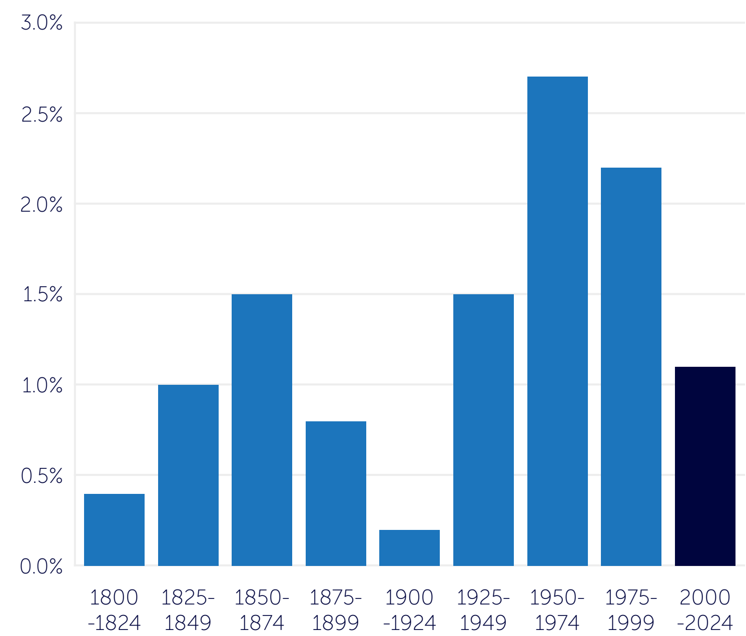
Although global economic growth recovered after the 2008 financial crisis, it never again reached the levels seen in the previous decade. Low productivity growth worldwide led to what Chris Giles of the *Financial Times* dubbed 'synchronised stagnation'. 2019 was the worst year for growth since the 2008 crash.

There is little consensus among economists about the reasons for this – hence the term 'productivity puzzle' – but it is likely that the dependency ratio is a factor in the slowing of economic growth. Periods of high economic growth have tended to be associated with the 'demographic sweet spot' when the largest proportion of the population is in the workforce and the dependency ratio is at its lowest. This was the case for the advanced economies in the second half of the twentieth century and for the emerging economies in the 2000s, when productivity increased and per capita GDP growth reached historic highs.

The advanced economies and many of the emerging economies are now experiencing the opposite – falling working populations and falling productivity. There is evidence that employers are more reluctant to invest in the training of older workers, which adds to the challenge of skills and labour re-allocation. As the median age of those still in the workforce rises, the economy therefore starts to lose what economists call its allocative efficiency. Its ability to respond to change is reduced.

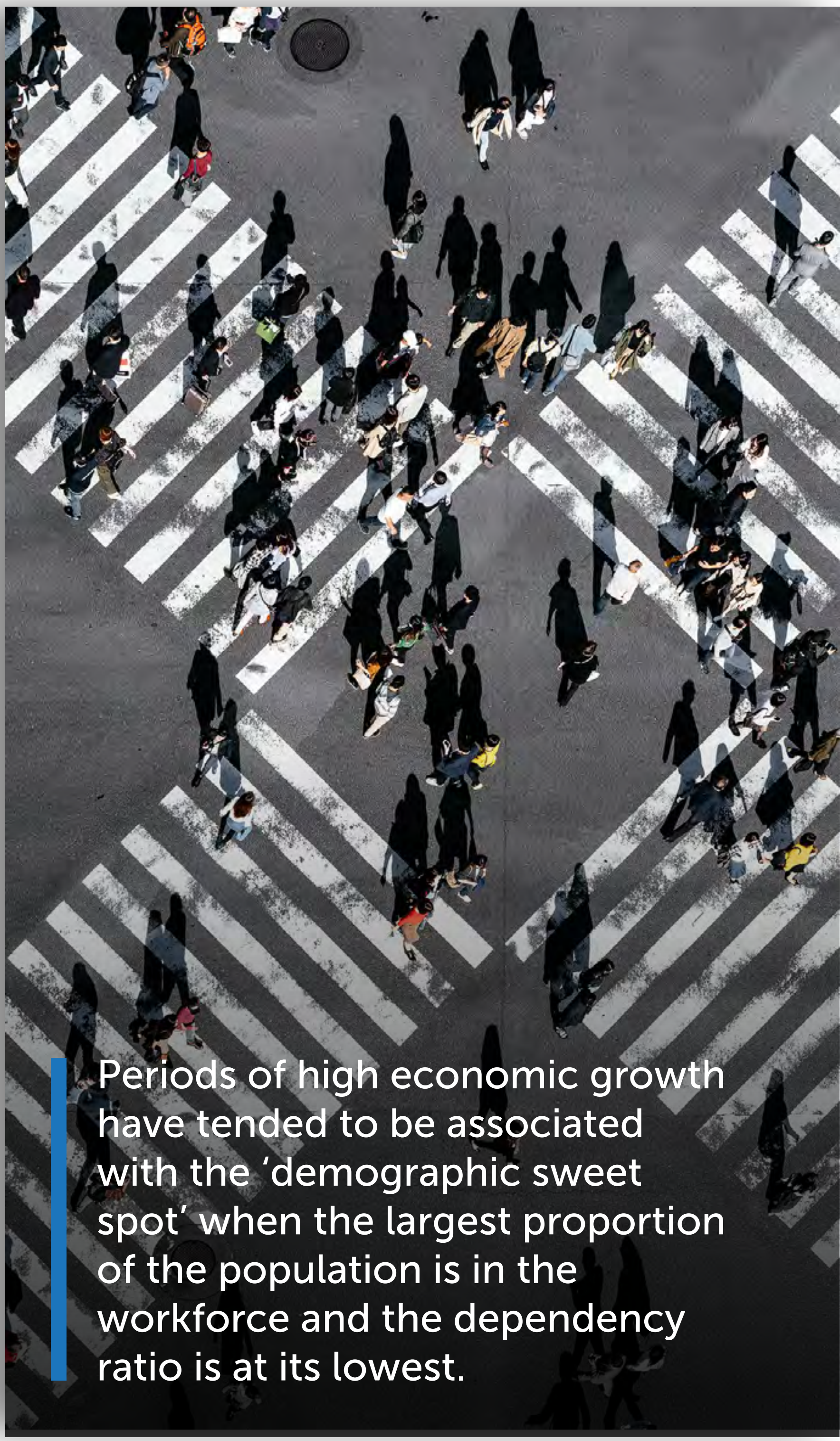
Once the post-pandemic bounce-back has worked itself out, economic forecasts for the advanced economies suggest a return to the relatively low levels of growth seen in the 2010s. The synchronised stagnation identified in the period before the pandemic looks set to become a feature of the 2020s economy. For the UK economy, the Office for Budget Responsibility forecasts a return to per capita GDP growth similar to that of the 2010s. The effect of this can be seen when comparing the first quarter of the 21st Century with previous 25-year periods. The growth of the early-to-mid 2000s was wiped out by the 2008 crash and productivity never recovered. Consequently, the GDP growth so far this century looks very different to that of the post-war decades. (The pandemic made little difference to these figures as the OBR expects most of the contraction to be recouped in the post-pandemic bounce-back.)

Average Real UK GDP Per Capita Growth



Source: Bank of England (historic data) and OBR (forecasts)

This is important because many of our assumptions about work, living standards, government spending and, crucially, investment growth, retirement incomes and the age we stop working, were largely shaped during a period when per capita GDP growth was significantly higher than it is now. For much of the 2010s, governments seemed to be working on the assumption that growth would eventually return to its pre-2008 levels. It now appears that synchronised stagnation may be with us for some time. For governments, this will present a significant challenge, which we discuss in more detail below.



Periods of high economic growth have tended to be associated with the 'demographic sweet spot' when the largest proportion of the population is in the workforce and the dependency ratio is at its lowest.

2.3
THE ENVIRONMENTAL CHALLENGE

Low economic growth isn't the only global phenomenon that will render our existing assumptions obsolete. During the 2020s we also start to face the ramifications of climate change and the shift to Carbon Net Zero. While this has been under discussion for many years, the impact is now imminent. The climate events of recent years have focused minds. Governments have begun to realise that the cost of doing nothing is likely to be catastrophic, both economically and in terms of loss of life. The governments of most major economies have therefore either enshrined Carbon Net Zero targets into law or are planning to do so in the next few years. To achieve these targets, much of the work and the associated investment and cost burden will need to take place during the 2020s.

The technological innovations of the past enabled people to produce more, travel faster and build bigger. What is being dubbed as the Green Industrial Revolution will simply enable us to do the same things – but with less environmental impact.

Over time, these investments may start to pay off. Projections for energy costs show break even points during the mid 2030s. But the implications of this are colossal, including the question of stranded capital. In 2020, the oil industry alone wrote off $145bn in assets in recognition of the resources that can never be used.

This will inevitably affect pension funds, as the World Energy Council explained:

> *"Although stranding will occur primarily in the energy sector, other sectors such as mining, utilities, transport, agriculture, real estate will be affected. Stakeholders like financial institutions and investors (e.g. banks, pension funds, insurance companies), governments and workers who all have shares in stranded assets will suffer."*

Climate change and the response to it will therefore impose significant costs on companies and investors, many of which will not be recouped until the next decade. This, in turn, is likely to make the fiscal challenge for governments that much more difficult.

2.4
THE HEALTHCARE CHALLENGE

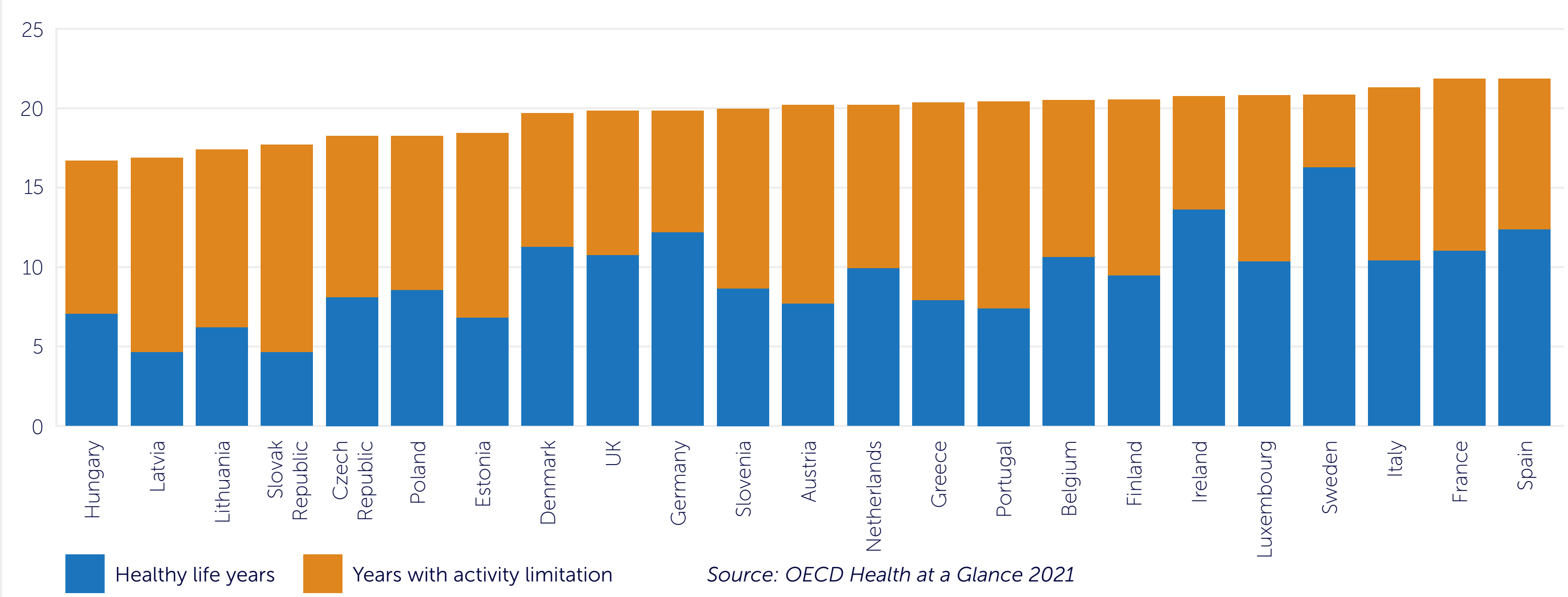
The combined effects of ageing populations and low economic growth will see healthcare costs increase at a faster rate than GDP growth over the coming decades. According to IMF projections, health spending will outstrip GDP growth in all the advanced economies over the next decade by an average of an extra 2.6 percent of GDP.

This increase in healthcare costs will have to be borne by higher taxation and/or government debt, and/or by increased spending by those needing care. None of these options looks politically attractive. For now, the UK government has opted to raise taxes on those in work to pay for increased pressure on the health service, but this measure is likely to prove unpopular with working-age voters as the costs continue to rise. The alternative, though, is that these costs will have to be met from the diminishing resources of pensioners in future years.

A crucial variable affecting the impact of healthcare costs is the difference between life expectancy and 'healthy' life expectancy. The greater the difference between the two, the greater the need for care provision. In Europe, for example, Scandinavians tend to die earlier than southern Europeans but they stay healthier for longer. On average, people in Sweden are likely to die a year earlier than people in Spain but they are only likely to be sick for the last five years of life, compared to the last ten years for those in Spain.

In this context, government admonishments to live healthier lives take on a new urgency. Critics may dismiss this as the 'nanny state' but governments are more worried about becoming the 'geriatric nurse state' in the next decade.

Average Years of Life Expectancy at Age 65



Source: OECD Health at a Glance 2021

2.5
THE STATE PENSION CHALLENGE

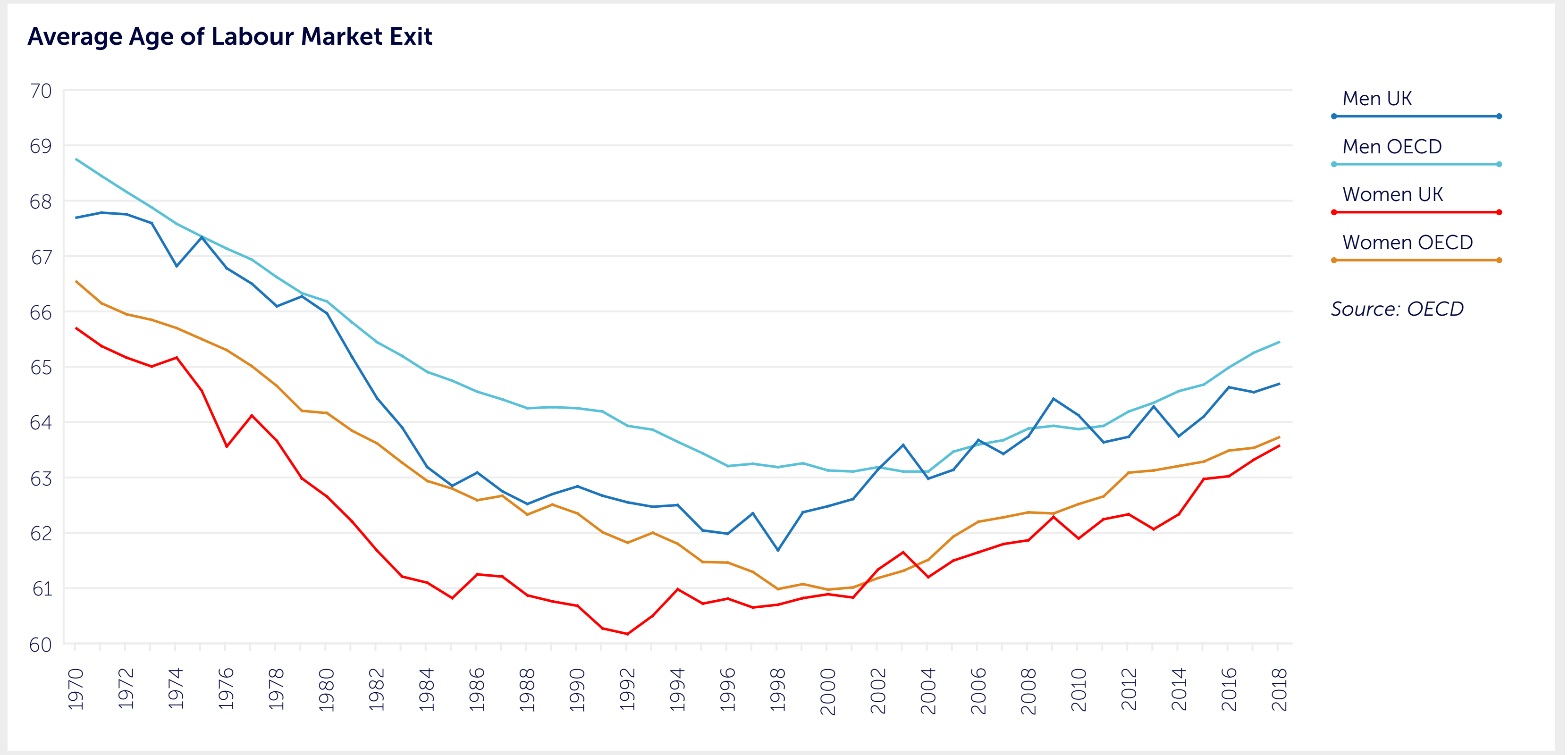
Most of the advanced economies were already carrying relatively high debt-to-GDP ratios as a result of the 2008 crash. On top of this, the pandemic caused a massive spike in government borrowing. This leaves governments with little room to manoeuvre. The cost of pensions as a proportion of GDP will inevitably rise because ageing populations affect both sides of that equation. As with healthcare costs, state pension expenditure will outstrip economic growth, taking an extra 1 percent of GDP in advanced economies and 2 percent in emerging economies over the next decade.

One measure that might ease the financial burden on both state and private pension schemes is to encourage people to work longer. Put simply, people keep paying in rather than starting to draw out. Furthermore, such a measure might help to alleviate the projected labour shortages over the coming decade.

With this in mind, many OECD countries are planning to raise or abolish mandatory retirement ages, and most have gradually pushed their state pension ages into the late 60s. Under current plans, today's 22-year-olds will have to wait to retire until 69 in the Netherlands, 71 in Italy and Estonia and 74 in Denmark. At present, the UK government has no (overt) plans to extend the retirement age beyond 67. We can expect to see more countries increasing their retirement ages as time goes on and fiscal pressures start to bite.

Raising the retirement age redefines the working population and thus the dependency ratio. It is a blunt instrument though. While it is reasonable to assume that some workers can continue in employment, is it reasonable to expect those in physically demanding jobs to continue working into their late sixties or early seventies?

The raising of retirement ages appears to have increased workforce participation among older people. Institute for Fiscal Studies (IFS) research published in January 2022 found that the employment rate among 65-year-olds in the UK increased by around 8 percent when the state pension age rose to age 66. That said, the average age of labour market exit had been rising across the developed world since the early 2000s. Patterns of retirement show a broadly similar profile across the OECD. The end of the last millennium could be said to be the heyday of the early retiree, with average retirement ages falling until the late 1990s and rising thereafter.



However, the Covid pandemic may have halted this trend. Some countries are now reporting a fall in the number of older workers. Recent data from the UK's Department for Work and Pensions showed the average age of retirement and the employment rate of older workers falling since the pandemic. The UK has 1 million fewer workers than it did in 2019. One third of that fall is accounted for by early and ill health retirement. Similar patterns have been reported in the US and Australia. While there is much talk of a 'Great Retirement', it is too soon to detect a long-term trend of people being prepared to trade income for leisure. But there may be a danger that early retirement becomes attractive again just at the point when fiscal pressures and labour markets are pointing in the opposite direction.

A potential problem here is that people may have made their retirement calculations on the basis of inadequate financial knowledge. As we will see in Section 4, levels of financial education are poor in most countries. People may feel financially comfortable enough to retire in their early sixties, but there is a danger that people may run out of money before they run out of life. Or, worse still, run out of healthy life with inadequate resources to cover the care provision they need. **It is to this and the potential social disruption it may cause that we turn in the next section.**

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The pensions story of the last two decades has been the almost complete disappearance of private sector DB pensions.

3.0 THE RETIREMENT INCOME GAP AND ITS SOCIAL IMPACT

We now turn to the (micro-level) social, employment-related, financial, and political challenges that are contributing to the pressures on individual retirement incomes, and how they might be further exacerbated by the developments of the 2020s. Retirees running out of money is a potential social catastrophe. Its causes need to be addressed at the micro-level and understood in terms of how they impact the individual employee.

3.1 THE CONTINUING DECLINE OF DEFINED BENEFIT (DB) PLANS

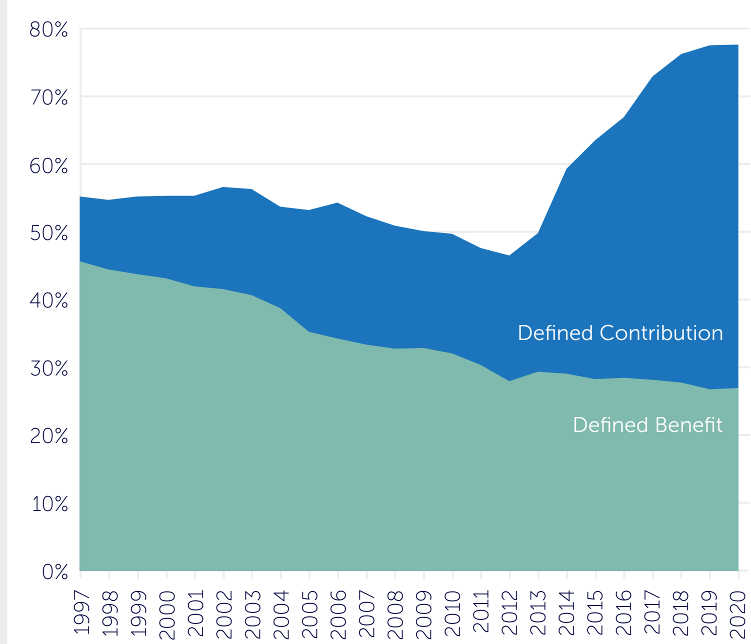
The 'dramatic shift' away from private sector pension plans with pre-defined benefits expressed as a percentage of final salary has continued. In the UK, the proportion of employees in DB plans declined from 46% in 1997 to 27% in 2020.

Around 87% of those currently in DB plans are in the public sector. According to the Pension Protection Fund, in 2021 the number of active members of private sector DB plans fell below 1 million for the first time. With 90% of private sector plans now closed to new members, this figure will continue to fall. The pensions story of the last two decades has been the almost complete disappearance of private sector DB pensions.

On the other hand, the overall pension coverage has increased. The introduction of auto-enrolment in April 2012 has meant that three quarters of employees are now in some form of workplace pension arrangement. These, though, are all Defined Contribution plans. As IFS Director Paul Johnson remarked, this is good news but it is not going to solve the retirement income gap:

> *"We should celebrate the success of auto-enrolment in getting millions more private-sector workers building up savings accounts. We should not kid ourselves into believing that auto-enrolment is achieving what it was originally designed to achieve, which was a huge extension of pension provision."*

Proportion of Employees with Workplace Pensions



Source: Office for National Statistics, Employee Workplace Pensions in the UK, 10 May 2021

3.2
DEFINED CONTRIBUTION (DC) PLANS ARE LESS GENEROUS

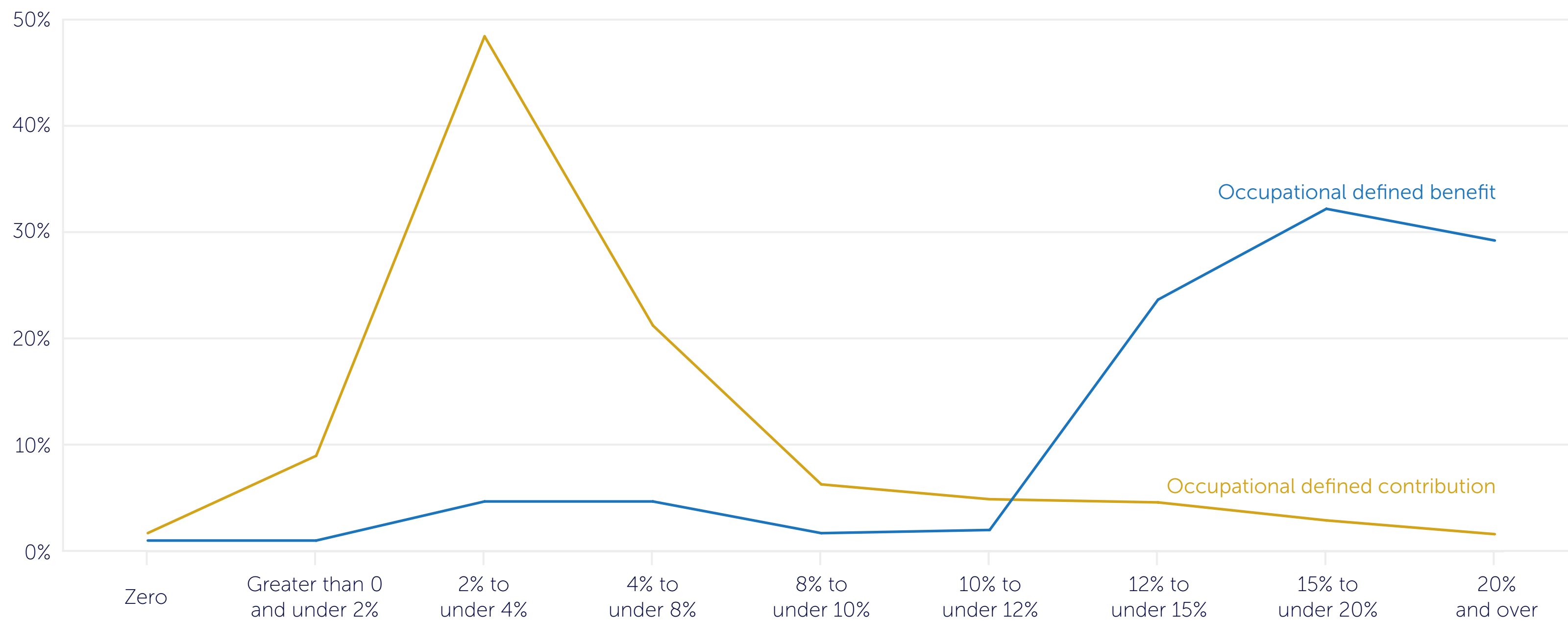
The whole point of the flight from DB pensions was to reduce the size and volatility of employers' long-term liabilities. Employers typically contribute less to DC plans than they do (or did) to DB plans. Research by the Resolution Foundation in 2017 came to the interesting conclusion that the increase in employer pension contributions since 2000 was largely accounted for by companies trying to plug their DB plan deficits, rather than by more generous payments into workplace DC plans.

The majority of employees in DC plans received contributions equivalent to less than 4% of salary, whereas most employees with DB pensions received contributions of 10% or more.

This difference between market value and accrued rights gets to the root of the difference between DB and DC schemes. A legal right to an income is very different from the possession of a fluctuating investment. The removal of this right represents a significant transfer of risk from employer to employee.

However, the introduction of auto enrolment has improved the overall picture for pension savings. The Pensions Policy Institute (PPI) notes that aggregate assets in DC plans in the UK grew between 2015 and 2020 from £324 billion to £471 billion. Even so, the level of savings and the rate of return on investments has not been enough to prevent a savings gap opening up for the retirees of the future.

Proportion of Employees by Banded Rate of Employer Contribution to Workplace Pension April 2019



Source: Office for National Statistics, Annual Survey of Hours and Earnings: Summary of Pension Results, Revised 2019 estimates

3.3
PENSION RISKS

The Pensions Policy Institute defines four key pension risks:

1. *Inflation risk:* retirement income doesn't rise in line with inflation, reducing the pensioner's standard of living over time;
2. *Investment risk:* investments don't generate the expected level of return, reducing income in retirement;
3. *Longevity risk:* people live longer than they budgeted for and run out of income;
4. *Insolvency risk:* the pension provider becomes insolvent.

As the PPI notes, the shift from DB to DC pensions has the effect of transferring risks 1, 2 and 3 from the employer to the individual. This concern was echoed by the OECD in its most recent report, pointing out that the shift to DC pension plans shifts both the investment risk and the longevity risk to the individual employee. Not only do employees now have to make investment judgements to determine what their pensions will be worth, they also have to work out how long they might need them for. Under DB plans, all of that was taken care of by the employer. Company pension plans used to provide an income for the duration of an employee's life, and frequently, beyond that, at a reduced rate for the life of their partner. Now, employees must invest their own savings and assets and work out how long they think they (and their partner) might live. It is no great shock that the OECD has noted that many people will get this calculation wrong.

In July 2021 the PPI published a report warning that most of those currently over 50 do not have adequate funds to achieve a 'comfortable' retirement as defined by the Pensions and Lifetime Savings Association (PLSA), and a quarter will not meet the minimum requirements as defined by the Joseph Rowntree Foundation (JRF).

These pressures are likely to increase as a result of changing social and economic factors since the 2008 financial crisis. As the PPI notes:

> *"A number of social and policy changes are increasing the demands made on assets originally saved to provide a retirement income. These include:*
>
> - *A widening gap for some between leaving work and receiving the State Pension*
> - *Paying for rent in retirement as fewer expect to retire as owner-occupiers*
> - *Paying off debts carried into retirement, and*
> - *Supporting other family members with regular financial payments, housing deposits and loans."*

Other reports have produced similar findings at international level. A report by Mercer and The World Economic Forum, for example, found that a combination of inadequate savings, low returns and an inadequate understanding of investment was behind a growing pension gap across eight of the world's largest economies.

It has even been suggested that the pensions industry in the UK may be contributing to the lowering of UK stock market returns. As DB plans have closed to new members, they have been shifting their investments into cash-bearing assets and have therefore become major sellers of UK equities. A *Financial Times* article in March 2022 reported that the shift from DB to DC pensions has been a key factor leading to lower valuations. The level of UK equities held within DB schemes has fallen from about half of total assets in the early 2000s to less than 5 percent today.

3.4
THE PENSIONS 'FREEDOMS'

The introduction of so-called Pension Freedoms by the UK government in 2015 has added a further layer of complexity to the picture. Before April 2015, those with DC savings of a certain level were required to purchase an annuity, providing a secure retirement income, in order to access their DC savings.

Annuities are insurance products that convert the savings in a DC pension pot into an annual pension. This gives the pensioner a guaranteed income for life. There are a number of different types of annuities. Some pay a simple flat rate; others are inflation linked. As with any insurance product, the amount of income depends on several factors, such as health, inflation proofing options, and the amount of money in the pension pot.

The variety of different options can be baffling for customers. As the financial investment website Investopedia warns:

> *"Annuities come in many varieties, and that fact alone is enough to create a lot of confusion among consumers. There's also a whole new vocabulary you'll need to learn. This complexity can lead to people buying annuities without fully understanding the terms. They may end up purchasing – or being sold – a product that is not the right fit for their needs."*

Pension Freedom gave owners of DC pensions a way to access their savings without using an annuity. It allowed people to draw down some or all of their pension pots. This can be done through drawdown products or by simply taking the money out.

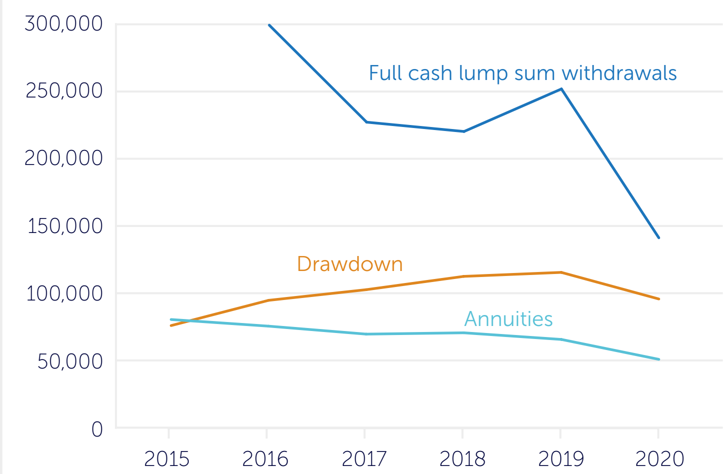
As the PPI reports, this led to a rush of withdrawals when the scheme was initially announced. Though the number of cash withdrawals has fallen since, they still exceed the number of people using drawdown products or buying annuities.

As a consequence, the number of annuity sales declined. The annual figure fell below 50,000 in 2020.

One (perhaps) unforeseen consequence of Pension Freedoms is that people have transferred their DB entitlements into DC schemes so that they can then withdraw the cash. The PPI notes that the number doing so is increasing:

> *"Between October 2018 and March 2020, around 52,400 DB pension savers who had sought advice transferred their DB pension. Some of those who were advised not to transfer chose to still transfer as 'insistent clients'."*

Numbers of Drawdown and Annuity Purchases and Full Cash Lump Sum Withdrawals by Year, ABI Members



Source: PPI

While Pension Freedom might be beneficial for some pension holders, it is likely that those who have gained are those who were the most well-informed. For the majority, it simply added another series of bewildering options to those that already existed.

As we have discussed, the shift to DC pensions transferred more responsibility onto individuals, many of whom lacked the financial awareness to be able to manage them. If that was difficult enough, Pension Freedoms and the consequences of drawdown have added a complexity to the calculations. It is likely that many people are unaware of the longer-term consequences of drawdown, and the financial demands that it places on the individual. The Financial Conduct Authority has expressed concern about the quality of advice being given and believes that drawdown and transfer from DB plans may not be appropriate for many of those being advised to do so.

3.5
THE WIDER SOCIETAL IMPLICATIONS OF INADEQUATE PENSION PROVISION

Inadequate pension provision is not just a problem for the underfunded pensioners. The societal consequences could be significant. The UK economy has become used to a cohort of pensioners whose incomes are, on average, similar to those of the working population. The median pensioner disposable income is, after housing costs, slightly higher than that of the median working-age income. The consequence of this is that the economies of some geographical areas have become dependent on spending by retirees.

In its 2019 report on the localised impact of ageing in the UK, the Resolution Foundation noted that local variations in productivity were not reflected in household incomes. Some of this is due to redistribution due to the tax and benefit system, but it is also due to the redistributive effect of occupational pensions. **A large proportion of retirees in an area reduces its per capita productivity but strong pensioner income growth maintains the area's overall spending power.**

What we see here is the last phase of de-industrialisation still playing out.

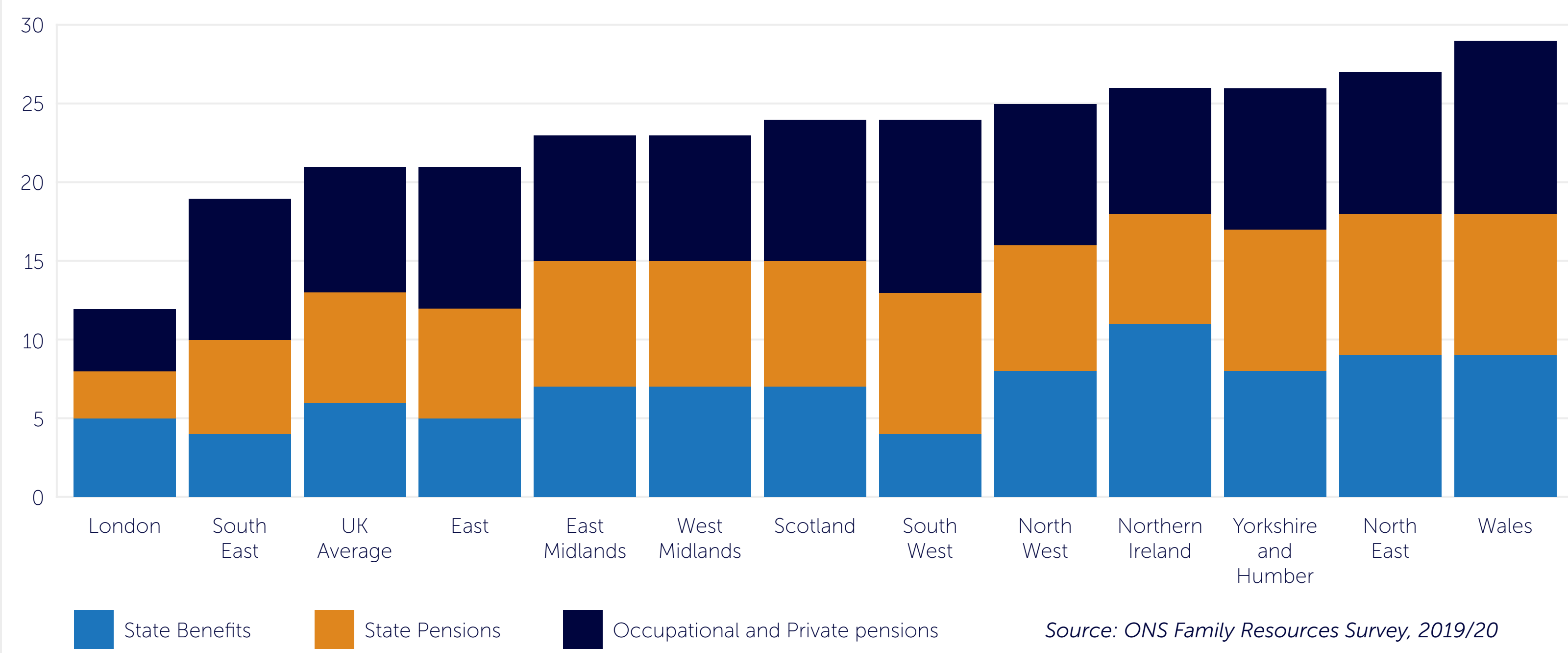
> *"Pensioners' spending power creates demand for the goods and services that the older population is increasingly spending money on, like eating out and going to the cinema. Ghosts of the old industries are still present in small towns and rural areas in the form of their Defined Benefit pension schemes."*

Employment and business opportunities are created in service industries by the spending power of older residents. The mine, steelworks or factory may be long gone but its pensions are still paying out and, for as long as they do, work will be created in that area.

The percentage of household income accounted for by benefits and occupational pensions varies considerably across the UK, from 12 percent in London to 29 percent in Wales. In some areas, such as Blackpool, Blackburn and Port Talbot, the proportion is over 30 percent.

But what happens to these areas when the current generation of retirees, with its generous DB plans, is replaced by the next cohort of retirees, with less generous pension provision?

Percentage of Household Income from Benefits and Pensions



Source: ONS Family Resources Survey, 2019/20

As IFS Director Paul Johnson pointed out, it is unlikely that future generations will have the same spending power:

> *"It is an astonishing fact that most pensioners today are financially better off than they were during much of their working life. Once you take account of housing costs and the costs of bringing up children, they have a higher disposable income in their late sixties than they had when they were in their forties. Today's 40-year-olds should not look at their parents' generation and expect anything remotely similar."*

As we saw in Section 3.4, the outlook for the 50-somethings doesn't look all that much better. As financial commentator Frances Coppola remarked:

> *"Younger boomers – those now aged 50-64 – have reason to be angry, as indeed do their 40-something brothers and sisters. Their wages have been stagnant for a decade, their occupational pensions are stuffed and their state pensions are receding into the distance."*

The economic impact of Covid-19 has knocked retirement planning sideways as investment markets recoiled, interest rates stayed low for so long and corporations pulled back on the dividend payments upon which pensions rely. As we saw during the 2008 financial crisis, one in ten organisations paused matching pension contributions during Covid and we know from the financial crisis that individuals' finances never fully recovered subsequently. Employees who have endured both crises will have been severely impacted.

Professor Colin Talbot of Cambridge and Manchester universities summed up the problem succinctly:

> *"If we have an increasingly large segment of the population dependent on pension incomes and that income is steadily eroded, what is the economic impact? I assume it will act like a giant sheet anchor on the economy, slowing trend growth as a large, poor group spends less and less."*

The impact of this will be felt across the country, but it will be particularly acute in some areas. Given that the UK will have a larger proportion of retired voters and its political geography gives additional electoral weight to the areas where they are concentrated, it is unlikely that this scenario will play out without 'political' fallout.

3.6
INTERGENERATIONAL TENSIONS

The receding likelihood of even an adequate pension for Millennials and Gen Z is one of the factors that has fuelled intergenerational tension. Younger generations – already with lower levels of savings and home ownership than the generation currently approaching retirement – are now realising they face working longer due to lower levels of employer or state retirement income. The Great British Retirement Survey (N = 10,000) published by Interactive Investor in September 2021, remarked:

> *"Our finding that a large proportion of young workers don't think the state pension will be there for them when they retire should ring alarm bells – it suggests the intergenerational contract is as good as broken."*

A widening gap in wealth between generations is reflected in political polarisation, with **age now being a stronger indicator of voting behaviour than social class** – in many Western democracies as well as the UK. At the same time, an increasing geographic age polarisation has been noted as younger people leave the old industrial areas and become increasingly concentrated in the major cities.

The narrative of 'entitled Boomers' versus 'impoverished Gen Y and Gen Z' is gaining traction. As Lucy Kellaway remarked in a recent *Financial Times* piece on age discrimination:

> *"The ageism against my generation — I am 62 — feels personal. We aren't allowed to feel discriminated against because we've had it so good. I mentioned this article to a 25-year-old friend at the school where I teach. She rolled her eyes. "I'm sorry," she said. "I just can't feel bad for you Boomers. You guys have got the pensions. You've destroyed the climate. I live in a rented flat with illegal cladding — you live in a huge house. All the power structures in society benefit you. How many top people in companies or politicians are under 30?""*

The Covid pandemic has fuelled this narrative, as younger people felt the economic and social brunt more acutely. Young people's employment and pay were disproportionately hit while property wealth, more concentrated among the elderly, increased. As Sky News economist Ed Conway quipped:

> *"In the past year, the average house has earned more than the average youngster."*

But deteriorating relationships and increased stereotyping between generations does not bode well for the multi-generational workplaces that will be essential if the multiple challenges of demographic change are to be met. Employers will need to stress the benefits to all employees of supporting older workers to continue working and of encouraging younger workers to prepare for their own retirement a lot sooner.

Inadequate preparation for retirement, then, is more than just a problem for the retired. It has the potential to cause a ripple effect that could impact on societies and economies in a number of different ways. Not least, it is likely to cause political pressure for increased state aid. Companies that thought they had offloaded the responsibility of looking after older workers may yet find themselves paying for them through increased taxation.

The problem of underfunded pensions, then, can be seen as an economic feedback loop. Partly created by economic circumstances and likely to be exacerbated by the headwinds of the 2020s, it will play back into the economic problems facing governments towards the end of this decade.

The DC pension, with its transfer of risk to employees, and its assumption that they will have the knowledge and resources to make informed decisions, is now the norm in the UK.

4.0
FINANCIAL EDUCATION

As we have seen, the pensions landscape has changed radically in recent decades. The DC pension, with its transfer of risk to employees, and its assumption that they will have the knowledge and resources to make informed decisions, is now the norm in the UK. The widening pensions gap threatens to create misery for pensioners but will also have knock-on effects for the economy and society in what is certain to be a more challenging decade. If we are to have any hope of mitigating this risk, we need to provide people with the wherewithal to manage more effectively their pension investments and risks.

4.1
FINANCIAL ADVICE OR FINANCIAL EDUCATION?

When it comes to pensions and investments, there is certainly no shortage of advice on offer in the UK. Developments such as the shift to DC pensions and 'pension freedom' have fuelled the growth of a financial advice industry. Many employers encourage employees to seek financial advice and some even pay for employees to consult independent financial advisors.

In doing so, though, they may be in danger of putting the cart before the horse. To take full advantage of financial advice requires an employee to already have a certain level of knowledge. It is important to have a broad understanding to be able to ask a financial advisor the right questions and to understand the answers. Indeed, even the decision to consult a financial advisor in the first place requires a degree of awareness.

A report by HM Treasury remarked on this as early as 2007:

> *"Regulation may protect consumers from making some bad decisions, but it cannot empower them to make good ones. Transparency and disclosure may protect providers from future mis-selling claims, but they may not necessarily help the consumer to make good decisions unless they have the background knowledge to take disclosure on board and the motivation to do so.*
>
> *Financial capability is a broad concept, encompassing people's knowledge and skills to understand their own financial circumstances, along with the motivation to take action. Financially capable consumers plan ahead, find and use information, know when to seek advice and can understand and act on this advice, leading to greater participation in the financial services market."*

A prerequisite for financial advice, then, is the building of financial capability. Financial awareness is built through education. Many companies appear not to make the important distinction between financial advice and financial education. Financial advice can just be about introducing employees to one or more of the institutions that sell these products and services. Financial education is about building employees' understanding and making them more informed and sophisticated consumers of financial products. Without financial education, financial advice can do more harm than good.

parc

4.2
LOW LEVEL OF FINANCIAL EDUCATION

In the 15 years since the Treasury proclaimed the need for greater financial capability, there is little evidence that much has been done to advance it. The level of financial capability has not kept pace with the complexity of financial products and the speed with which they have developed. In a recent report, the European Banking Authority cited low levels of financial education as a systemic risk to economies:

> *"As the world digitises, financial education is likely to play a central role in fostering effective consumer protection frameworks by raising awareness among specific groups, as well as dealing with specific risks and behavioural biases. However, behavioural sciences find that being informed does not necessarily mean making informed choices. In order to be fully protected against the risks connected to the use of digital services, not only should consumers possess the knowledge and expertise to comprehend complex information, but they should also feel confident enough to deal with all kinds of financial service providers.*
>
> *Financial illiteracy and unfamiliarity with digital technologies could lead to widespread financial vulnerability. By raising consumers' awareness of digital financial services, financial education policies may be of great help in addressing such challenges."*

The OECD has raised similar concerns, noting that overall levels of financial literacy are relatively low across its member countries. Even with this low bar, its survey of financial literacy found that the UK ranked below the OECD average and well below other major European economies.

This is consistent with a number of reports that have raised similar concerns about the lack of financial capability in the UK. A study by the Bank Workers' Charity was scathing in its assessment of UK financial literacy:

> *"A damning consequence of the lack of financial literacy is that in some people's efforts to remain solvent, they make financial choices that inflict further punishment. The rise in uptake of payday loans, the credit of last resort, means that many of the people who can least afford to do so, become further indebted and end up paying more than ever. Hardly surprising when only 3% of respondents in one study were able to correctly estimate the cost of a payday loan."*

The Financial Capability Survey carried out by the government's Money Advisory Service described a 'spend today rather than save for tomorrow' mentality and found that 40% of adults were not in control of their finances. A YouGov study found that one third of middle-class families would need to borrow to pay an unexpected bill of £500.

If, as these studies suggest, managing day-to-day finances is something of a challenge for most people in the UK, the chances of them being able to understand the intricacies of DC pension plans, pension freedoms and annuities are slim.

4.3
IMPACT OF LOW FINANCIAL LITERACY

Low financial literacy shows up in a number of areas. Recent research by the Institute for Fiscal Studies (IFS) has shown that people tend to have a poor grasp of both their investment and longevity risks. A 2021 paper by two IFS economists cites 'survival pessimism' as a factor in the low take-up of annuities. People simply don't think they will live long enough to justify the cost of paying for an annuity. They tend to underestimate the length of time they are likely to live which then leaves them with inadequate resources for their final years. As the study's authors remark:

> *"Overall, pessimism dominates, and most respondents would perceive an annuity that is priced fairly from an actuarial point of view as one which is unfairly priced."*

It appears to be a similar story when it comes to understanding investment risks and decisions on when and how to draw down pension savings. An IFS paper in January 2022 raised concerns:

> *"The literature in finance and consumer decision-making tends to look at empirical evidence on financial decisions with respect to individual portfolio and insurance choices and documents low levels of financial literacy, imperfect information, behavioural biases, poor numeracy and choice inconsistencies. Such results do not bode well for future cohorts of retirees who will need to make increasingly high stakes and complex financial choices at older ages, and are perhaps at the heart of concerns about the financial security of retirees within policymaking communities."*

Even where people have built up significant pension investments, they often neglect them, assuming that they will be managed effectively. A study by the IFS in February 2022 found that many pensions to which people no longer contribute, but which they will still rely on for income in the future, are providing declining value for money over time. Many older DC plans have high fees and portfolio allocations that are no longer appropriate. Over 20 percent of those between 45 and 60 have at least one such deferred pension.

As the IFS points out, greater engagement could mitigate these problems:

> *"Many of these issues could be solved with greater individual engagement with pensions – for example, if people understood the charges they were paying on their pensions and the performance of their funds, and shopped around for better deals – potentially involving consolidating their pensions. This is clearly hard to achieve."*

So hard that, after commentators sounding warnings for well over a decade, the message still doesn't seem to have cut through. This lack of interest seems to illustrate a wider problem. The UK public's level of disengagement from pensions reflects a set of attitudes that goes beyond just a lack of education. Not only do people not know, they appear not to want to know. It is as though we still have DB assumptions even though we are now in a DC world. We pay into DC pensions but assume that someone somewhere will look after them and that somehow they will give us the income we need when we retire. This 'DB nostalgia' featured in the Great British Retirement Survey:

> *"Several respondents highlighted the complexity of managing pensions. They compared the relative simplicity of the final salary pension schemes of the past with the pension options available today and the challenges of managing pensions in drawdown."*

DB pensions guaranteed people a certain level of income and the investment and longevity risks were managed by someone else. Many of us are behaving as though we think that is still the case.

The level of anxiety about pensions, far from inspiring people to act, seems to have scared many people into doing nothing. As the authors of the Great British Retirement Survey remarked:

> *"There was evidence in the survey that more people are taking the view that YOLO ('You Only Live Once'), so they are going to enjoy themselves and worry about retirement later – partly because it is just too much to think about. The last thing we need is a decline in retirement saving, following a loss of faith in the pensions system and an attitudinal shift towards living for today and a move towards accepting a lifetime of debt through later life borrowing."*

That is, indeed, the last thing we need. Combine this lack of education and engagement with the dynamics we discussed in Sections 2 and 3 and there is a likelihood of trouble ahead. As the IFS warned:

> *"Financial decision-making in later life, and the issue of managing retirement resources and incomes, is going to be increasingly important for future cohorts of retirees. This is most true in the Anglophone countries where Defined Contribution pension wealth is already a large and increasing component of retirement wealth. But it is also likely to be true in other countries given the direction of travel of many social security systems. And in all countries there will be inevitable changes to health insurance and healthcare, long term care insurance and housing markets that will arise as a result of the broader economic pressures of population ageing and which will change the nature of retirement wealth and incomes needed."*

What we appear to be seeing here is not simply a lack of financial education but a set of attitudes and cultural assumptions that militates against people engaging with the subject of pensions and financial planning. For people to engage with financial education they need to understand the imperative for doing so. A cultural and attitudinal shift is needed and, despite government campaigns in recent years, the public seems reluctant to see planning for their retirement as a priority. Consequently, as a YouGov survey found in 2021, only 7 percent of the adult population had taken professional financial advice in the previous two years. And, as we noted in Section 3.5, even among those who take advice, some 'insistent clients' then act against it anyway.

As Martin Wolf remarked in the *Financial Times,* recent decades have seen the shift of 'unmanageable and uninsurable risks' from corporations to ordinary people. We have transferred a set of complex liabilities onto a population that is, for the most part, completely unprepared and unequipped to deal with them.

4.4
ACTION BY EMPLOYERS

As we noted in our report and event on Health and Financial Wellbeing Programmes in 2018, there has been a lot of public discussion of the subject and a lot of interest from companies and the HR profession, but this interest has not translated into action.

Our survey found that, while 53% of organisations said that financial wellbeing policies are important for attracting and retaining the right talent, only around 30% were actually doing anything about it and only 18% planned to increase their spending on it. And the UK government's Financial Advice Working Group concluded that neither employers nor employees were keen to talk about personal finances at work:

> *"Discussing finances in the workplace is not encouraged. Employees feel as though there is an invisible line that should not be crossed: they avoid discussing salaries and pay rises and would feel a sense of 'weakness' if they admitted to employers that they were in financial difficulty. Employers, particularly smaller companies, believe finances are a personal matter."*

This is perhaps not surprising, given the cultural aversion to financial planning that we discussed above. Yet, at the same time, employers are expressing concerns about the impact of financial anxiety on workplace performance. A report produced by the government's Financial Advice Working Group in 2017 noted:

> *"A growing body of evidence shows that anxiety about finances leads to poorer mental, physical and social wellbeing, which can affect attendance and performance at work.*
>
> *Recent research now draws a strong link between peoples' financial circumstances and their overall wellbeing. Most employees come to work with an underlying concern about their finances. Left unchecked, these financial worries can affect attendance and performance at work – indeed, 90 percent of employers agreed that financial concerns have an impact on employees' workplace performance".*

Our review of the literature in this area found that:

- The Centre for Economics and Business Research, in partnership with Aegon, finds that poor financial wellbeing costs UK employers £1.56 billion annually through absenteeism and presenteeism. Further, more than 500,000 private-sector workers have taken time off in the last year due to their financial wellbeing, taking an average of 8.1 days each. 73% of those taking time off earned less than £25,000 annually (pre-tax), and the average cost to employers of a day lost to financial distress is estimated to be £150.
- Research by Close Brothers in partnership with Professor Cary Cooper, University of Manchester, finds that 22% of employers attribute reduced productivity to poor employee financial wellbeing. 48% say that fewer people are retiring from their organisation than they would like (with financial reasons a major factor), and the same percentage say that the rate of retirement in their organisation is increasing their people costs. 45% say it is negatively impacting their succession plans.
- Mercer's 2020 Global Talent Trends Study finds that, regardless of age group, 68% of employees say they want financial wellness advice and assessments, and 61% say it's important to know if they are on track to have sufficient funds in retirement. Yet organisations have been slow to catch on: only 23% currently provide financial education for employees.

Reflecting on the findings from PARC's 2020 research, we noted:

> *"Many HR Directors simply do not think the juice is worth the squeeze. They do not see Financial Education as a today problem – for the simple reason that it isn't. But it is going to be a giant problem for tomorrow!"*

The changing patterns of employment are likely to mean that providing financial education support to our employees is a must-have rather than a nice-to-have. The next section discusses these shifts in employment in greater detail.

5.0 CHANGING WORK ENVIRONMENT

As we have learned so far in this report, the demographic transformation of economies, declining healthy life expectancy trends, financial gaps and rising state pension ages are forcing the evolution of new models and behaviours relating to work and retirement. How a company chooses to support its employees to understand and confront these issues will become a source of strategic advantage in an increasingly competitive labour market.

Employees that can't afford to retire, or do so in ill health because of burnout, will not leave behind them a picture of a purposeful and socially responsible employer. Given the increasing scrutiny companies are facing to demonstrate the strength of their ESG position, particularly to new hires and customers, employers need to ensure these employment and retirement stories have a happy ending.

Today, we live ten years longer than our parents' generation and twenty years more than our grandparents' generation. How societies and individuals prepare for retirement was not designed with this trajectory of demographics in mind. For many people, their savings will expire long before they do. On average, individuals will outlive their money by between eight and 20 years. And women are at the sharp end of this scale, because of their longer lives (on average women outlive men by six years or more) and their low pension savings (which are around 40% lower than men's).

One key objective for redesigning retirement is securing financial resilience for this new period of longevity – making long life worth living.

It is likely that even more people will need to keep working beyond retirement age to make up shortfalls. Pre-Covid-19, 72% of Baby Boomers *(those born between 1946-1964 – and thus retired or soon to retire)* said they intended to work past retirement age. Early indications from Mercer's Global Talent Trends 2022 study show this figure is now 84% of all employees, not just the Boomer generation.

The pressure on companies will mount. Seven in ten executives are worried about the cost of financial overheads – like health and retirement contributions – for employees who stay on. Without action to strengthen financial wellness, employees will be left chasing the rainbow of retirement – and organisations risk paying for longevity. For all the uncertainties of the coronavirus' legacy, one thing is sure: financial resilience is an imperative for all generations, not just those nearing retirement. The impact of the virus on longevity, however, is not yet known, but we do know that it affects people very differently. It appears that the general trend in longevity is still increasing (over the long term0 overall.

Yet companies appear to be doing very little to address these pressures: Mercer's Global Talent Trends study 2020 showed that 97% of C-suite are concerned about high performers in their organisations taking early retirement but only 33% of employers have an active programme in place to manage retirement.

And what is to be done about the Great Retirement? Up to two-thirds of the folks leaving jobs in the US last year weren't actually 'quitting.' They were retiring, and only a million of those were 'normal' retirements at the expected state retirement age. An additional 1.5 million opted for early retirement – some say because they have had enough of the pressures of work and don't want to face the risk of poor health ruining their chance of freedom from it. Whatever the reason, this behaviour is adding to the skills and labour shortages that countries and companies are already facing.

5.1
OUR HEALTH AND OUR CAREERS ARE PART OF FINANCIAL RESILIENCE

Companies' attitudes towards financial resilience will need to mirror the mindset shift that we have seen in health and wellbeing *(i.e. away from treating illnesses towards preventative actions).* Safeguarding financial wellness over the course of a longer life will require taking an all-encompassing view of a person. This means their tangible assets (including savings and assets such as property), but also less tangible assets such as their health, their skills and career readiness to work longer. Working longer may also not be in the traditional 9-5 way that we have been used to. For example, working in later life might involve running a small self-owned business alongside a part-time job, or even maintaining three or four flexible, contract style jobs to bring in extra cash.

Building a later-life strategy will become the norm – i.e. personalised goals against which companies can help individuals assess whether they are on track and how to close the gap if not. New apps such as Halixia are being developed to help people understand the small steps they can take toward living a better, longer life. Indeed, 71% of employees say they want a midlife check-up to help them explore their own health, wealth and career expectations and limitations.

Workshops Mercer has run with the World Economic Forum during 2020 and 2021, used design thinking to develop exactly this type of holistic long-term life plan. Taking into account the personal circumstances of different worker groups – including their life expectancy, aspirations, health and skills status, and their finances – the workshops explored ways to: design new ways to work and earn; invest in skills to raise people's potential; increase access to health support; and unlock creative additional sources of income.

There will be innovations in the ways we redesign work to turn life plans into reality, but some early ideas include:

DESIGNING FLEXIBLE WORK ARRANGEMENTS.

- New employment models (such as phased-retirement; re-employment and portfolio careers; and multi-employer consortium talent pools) will be essential to redesigning work for the 100-year life. The Covid-19 crisis has even spurred innovation through Temporary Talent Sharing (where companies temporarily transfer underutilised workers to the sectors seeing the highest demand).
- We are also seeing experiments with different work patterns for older workers, including allowing experienced workers to undertake project-based contracts with added social protection employee benefits which Mercer are calling 'contractor+' working. The '+' reflects the fact that the deal includes employee benefits, which a standard contractor would not get. This type of employment model, with benefits such as basic pension contributions, life and health insurance, and access to training via an education budget, none of which are usually provided in a standard contractor deal, makes for a novel approach to an engaged and rewarding later life and are becoming increasingly popular. Unilever's U-Work model is one of the pioneers of this approach, and is enjoyed by workers of all ages.

INCREASING ACCESS TO REMOTE HEALTHCARE.

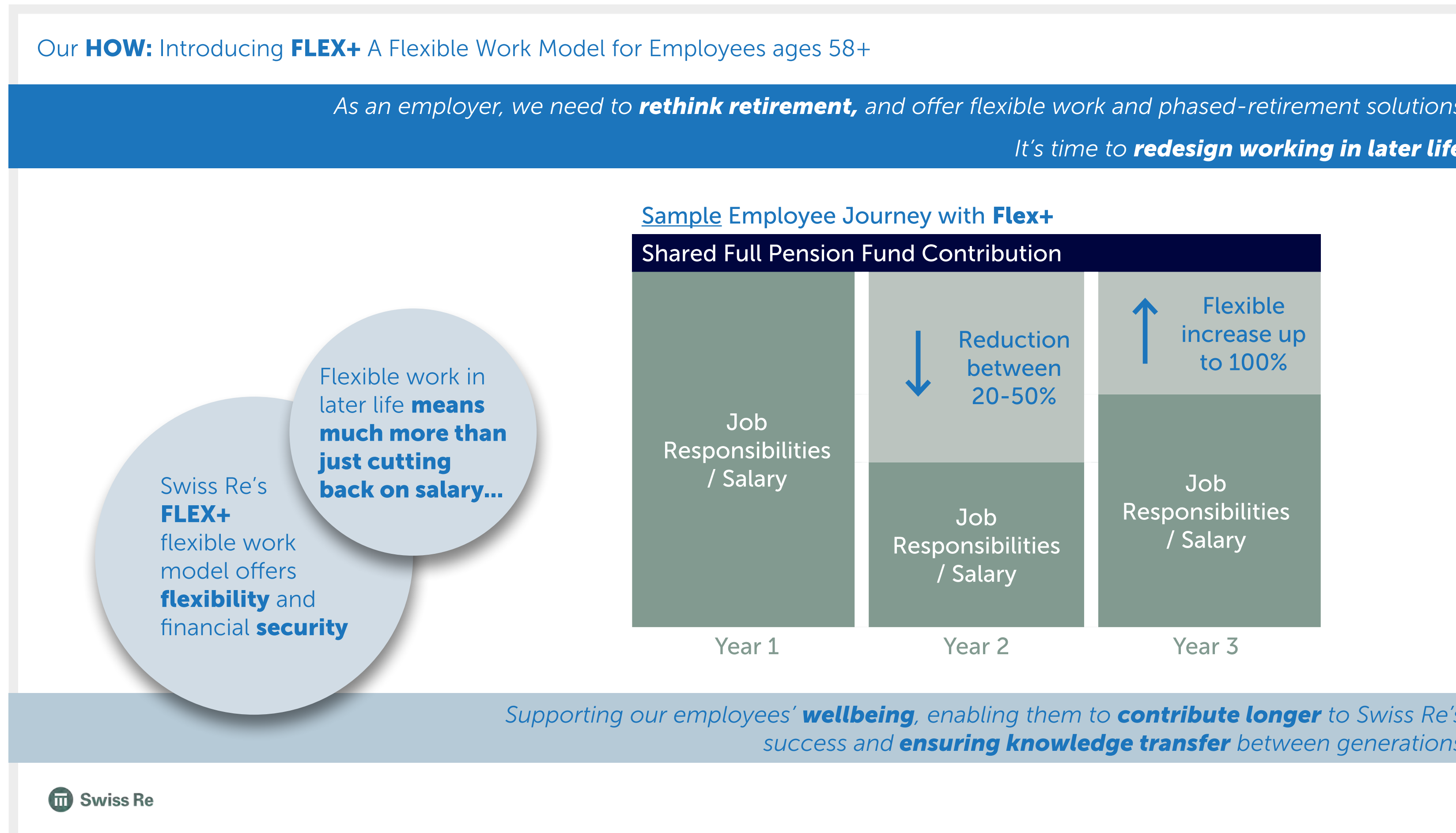
- One positive outcome of the pandemic has been the growing prevalence of telehealth. With social distancing measures in place, access to digital doctors and/or virtual specialists is becoming commonplace. Digital health tools broaden access to vital health interventions, particularly among low-wage workers. Data show only 43% of organisations deploy remote healthcare or telemedicine today, but the good news is that 68% of employers are likely to invest in digital health in the next five years.

THINKING CREATIVELY ABOUT WEALTH MANAGEMENT.

- Let's be honest: 'tweaking' pensions is wholly insufficient to secure people's financial wellness based on the extent of the pensions gap, today's financial products, and demographic realities.
- Only 45% of companies make personal financial management tools (like wealth calculators) available today, although more plan to invest for the future. Offering employees access to robo-advisory services, and a personal financial health check every five years after age 40 are some ideas that can help.
- But we must go significantly further and reimagine retirement altogether. Can we support individuals to think intergenerationally across the family and pool assets (funds or property) for higher return potential, for instance? What income-smoothing products might the self-employed require to manage income volatility? What about permanent life insurance or longer-term mortgages? How can we make phased access to pension assets easier? Governments and companies will have to work together to make outdated financial products and solutions more age- and longevity-appropriate.

REIMAGINING WORK AND RETIREMENT MODELS.

- Let's take a look at a case study. When one of the world's largest reinsurers, Swiss Re, learned it was at risk of losing a third of its employees to retirement – and in many cases, early retirement – over the next 10 years, it decided to take action. The organisation looked quickly and creatively to construct a more attractive phased-retirement programme to extend the career longevity of its people – and protect the extensive knowledge and experience they hold.
- Through work with clients and in collaboration with the World Economic Forum (WEF), Mercer developed a 10-factor framework to help employers redesign retirement. Offering solutions such as flexible work and phased-retirement enhances the transfer of knowledge between generations of employees, while supporting the wellbeing of those on the retirement path. As one of the companies involved in the WEF collaboration, Swiss Re brought the issue to the fore.



- In an expedited 12-week pilot, Mercer worked together to successfully develop, test and prove seven hypotheses around flexible retirement and working in later life. The results? A new phased-retirement plan called 'Flex+' was developed as an extension to all the current flexible working conditions available for all employees, thus providing a multigenerational and multi-life-stage solution. Flex+ allows employees over age 58 to reduce their working hours by up to 50%, and salary is pro-rated. Pension contributions remain based on 100% salary however, offering an incentive to stay in work for longer while pension still accrues at the best rate.

The new programme began to roll out in February 2021 and is getting good participation and reviews from managers and employees. Other countries outside of the Swiss HQ are now being considered.

Here's what employees are saying:

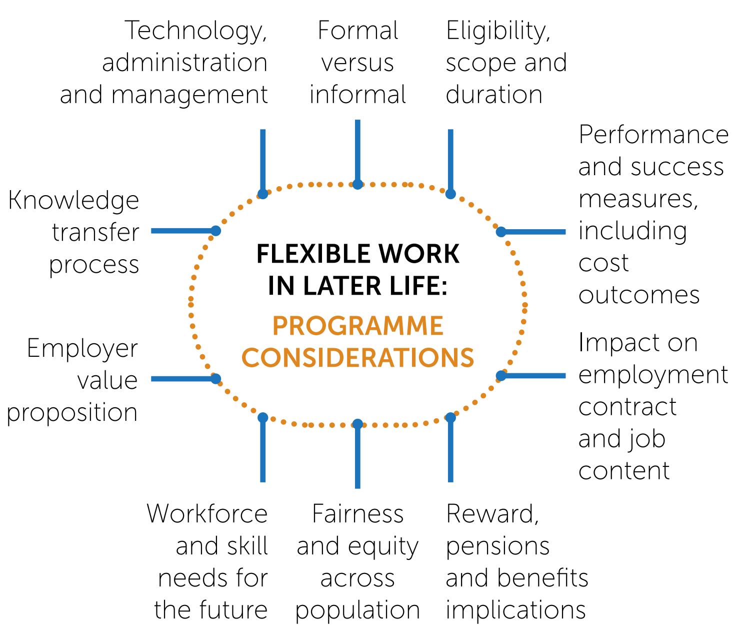
> *"I did expect that Flex+ would have a positive impact on my life – but I'm completely blown away to find out just how much of a difference it makes! With my new 80% employment, it turns out that it isn't just the one day: it actually rebalances the whole week and I find it to be hugely motivating and invigorating."*
> Swiss Re employee, Baby Boomer, Flex+, part-time worker

The 10-factor framework is an effective framework for development of such programmes – its methodology yielded rich insights that enabled better decision-making. The model is shared below.

REACHING THE END OF THE RAINBOW.

Redesigning retirement means redesigning work too. In our experience, this will mean a deeper blurring of the lines between employment and self-employment, and between retirement and semi-retirement. People will need the freedom to design their own glide path out of paid work, with good access to the tools that will enable them to navigate it well and understand the financial implications.

Our WHAT: Mercer's Ten-Factor Design Framework applied to Swiss Re



- Set and tested hypotheses
- Focus groups, interviews and surveys
- Strawman design
- Pilot
- Iteration

Swiss Re © Mercer, 2020

5.2
WHAT ARE FIRMS DOING TO CAPTURE THE 'LONGEVITY DIVIDEND' BY RETAINING OLDER WORKERS?

Some companies are using analytics and business impact modelling to examine their own organisational data to discover what drives business performance. In fact, our research found that age diverse teams outperform:

- Experienced workers lower costs because they are less likely to leave and, interestingly, so are the people they supervise. Turnover and on-boarding can cost businesses between 25% and 300% of annual pay per person. A 5% reduction in turnover saved one of our clients \$66m in cost per unit and \$31m improvement in operating margin
- Experienced workers increase productivity – one study with a US bank showed that specific branch performance had increased revenue of \$40m per year for each year of extra service / age of its sales team

And yet 20% of job leavers in the UK aged 50-64 are being made redundant. That makes no sense – employers need to analyse their own data to isolate performance drivers and optimise them. Optimisation could be through constructing and maintaining age diverse teams, so redundancy for this potentially outperforming segment of the population could be counter-productive.

By prohibiting phased-retirement and congruent flexible working, pension plan design can put handcuffs on employers and employees. There should be mandatory enabling mechanisms to allow employees to transition from work to non-work over a longer period of time to suit changing physical and financial needs. The decision is binary in many countries – you either work or retire, there is no middle ground. In recent focus groups with the over-50s in the UK, Mercer found that four out of five employees wanted to 'work differently' in future. Half wanted more flexibility, and fewer working hours. The other half were hungry for a new challenge.

Not only do organisations need to enable phased-retirement and flexible working, employers need to make sure the workplace is a great place to be for older workers. Addressing ageist practices is key to this, and by undertaking pay, promotion, bonus award, performance grade and hiring equity checks, employers can get to see the full extent of potential ageist outcomes. According to our research, fewer than 3 in 10 companies do any of these checks; of those that do, more than two-thirds find these checks to be an effective way to become more 'age friendly'. Even more shocking is that fewer than 1 in 10 companies have examined the age distribution of training spend – if they do, they will find it is heavily skewed towards younger workers. It's simply unacceptable to discriminate on grounds of age – it's illegal and immoral.

Finally, companies are starting to realise the importance of taking a lifelong learning approach. People have an appetite for learning – in the US, as many as 57% of workers in some states have 'skills anxiety' and believe they need more training to stay relevant for jobs of the future. In focus groups Mercer recently ran in Europe, as many as 62% of the over-50s prioritised lifelong learning opportunities as part of their future development plans, and 55% had undertaken new skills training in the last three years.

6.0
POSSIBLE ACTIONS FOR EMPLOYERS?

The coming decade will present a variety of challenges to employees, employers, and governments. For employers, attracting and retaining older workers will become more central to the task of maintaining a skilled and motivated workforce. This requires a two-pronged strategy in making it easier to stay in or return to work and in supporting older workers to plan 'later life' careers, including any required upskilling. Many companies are talking about retirement as a phase rather than a single event. This requires the blending of these two elements so that people are supported for as long as they want to be in work, but also given the wealth-building opportunity and the confidence to move into retirement as and when they deem it appropriate.

6.1
FINANCIAL EDUCATION AND PLANNING

As we saw in Section 4, encouraging people to engage with the idea of planning their retirement income is more than just an education challenge. It requires a shift in assumptions. Employers need to start by helping people to scope the potential size of the problem, and then by enabling them to understand the different ways of dealing with it. When people understand the extent of their potential income needs in retirement, they will be better placed to grasp the size of any shortfall, and they can then start to engage with possible ways of plugging the gap.

This awareness must precede any financial education, which must in turn precede any financial advice. Those companies who facilitate potential sources of financial advice before building this understanding may simply be scattering seeds on stony ground. And all of this precedes any sense of 'financial wellbeing' which may act as the bedrock for individual performance.

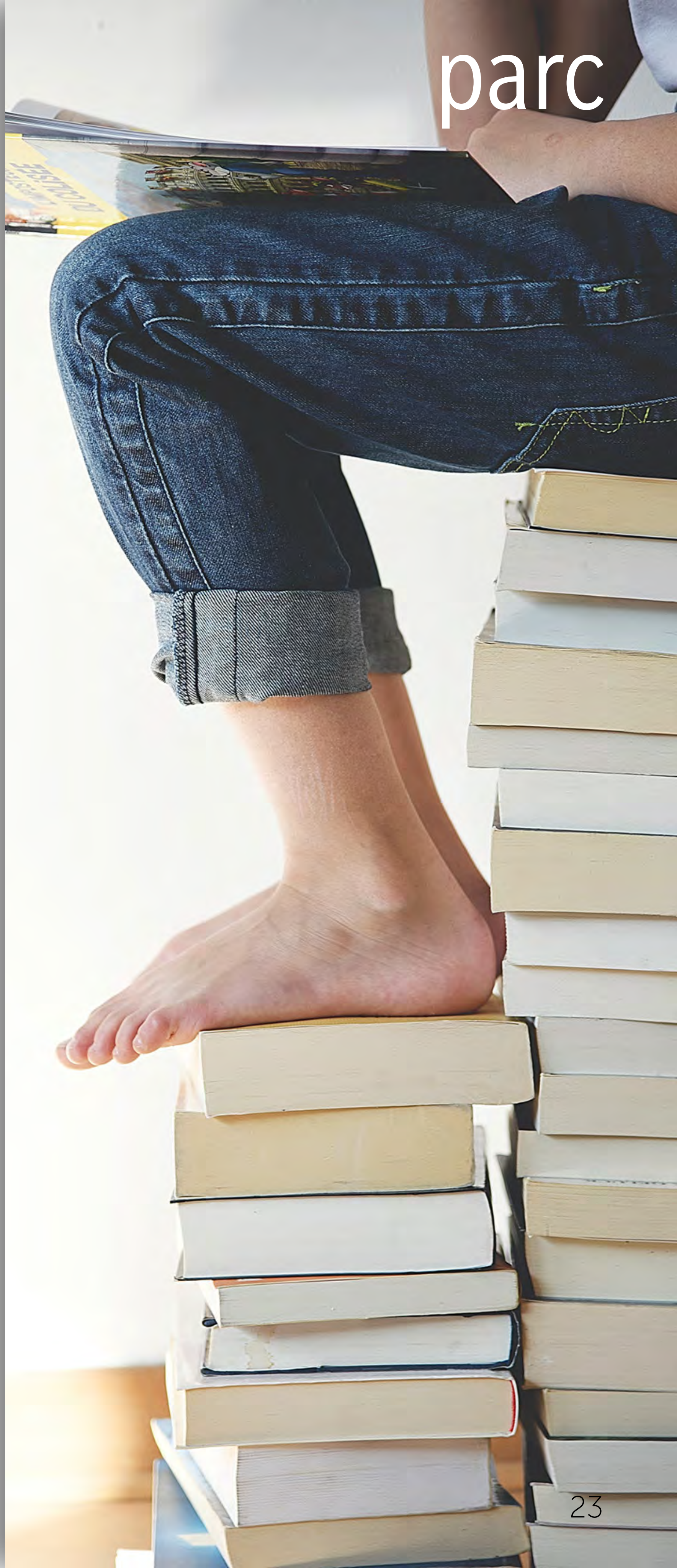
Given the reluctance to discuss financial issues, some employers have used online tools and education to help people gain this awareness and make decisions at their own pace and in private. The key is to raise awareness and 'nudge', if necessary, the need for action.

Tools outlined in Sections 4 and 5 include:

- Online awareness tools
- Online learning tools
- Online pensions modelling tools
- Financial awareness and education seminars
- Personalised financial assessments

In the UK, the Government's Money and Pensions Service (MPS) offers advice and support both to employers and employees. This is particularly useful for smaller companies that may not have the resources to design their own programmes. However, it may also be of use to larger companies where employees are reluctant to discuss their financial affairs in a work environment. As we have seen, getting over the reticence to engage with retirement planning is a major obstacle. Referring people to the MPS may give them the confidence to engage further with employer initiatives. The hardest and most important task for employers is getting people to engage with the process.

Monitoring the effect of these initiatives is also critical. For example, monitoring the extent of any increases in contributions to DC pension plans after running any such initiatives.



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6.2
FACILITATING LATER LIFE EMPLOYMENT AND CAREER PLANNING

Countering the Great Retirement may be an equally significant challenge. As Resolution Foundation Chief Executive Torsten Bell remarked, recent decades of increasing employment among older workers may have made us complacent and the longer people stay out of the workforce the less likely they are to return. As we discussed in Section 5, there are an increasing number of initiatives that employers are taking to make it easier to stay in work – and make the work itself more attractive and satisfying to older workers. Such programmes have included:

- Enabling phased-retirement – such as the SwissRe programme discussed in Section 5
- Encouraging former employees to return on a part-time, flexible or contract basis.
- Providing more learning and development opportunities – especially important given the 'skills anxiety' and low level of investment in older workers in recent years
- Monitoring the age distribution of training spend
- Monitoring the extent to which working practices policies on recruitment, pay, and performance may be perceived as 'ageist'.

Much of this needs to be underpinned by a shift in basic assumptions about the organisation of work. The Covid pandemic has acted as a catalyst for a reassessment of how workplaces might be organised. This has now provided an initial impetus to framing them in a way that assumes a much broader age range and a much larger number of employees who might take a phased approach to leaving the workforce.

Time was when re-training someone at 60 would have been considered a waste of time. When the state pension does not cut in until age 67, it is quite possible to create a culture where skills can be acquired to age 70 and beyond.

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CONCLUSION

Even in our 2016 report, we remarked that: "Employers now have a golden opportunity to differentiate themselves in terms of how they help employees approach retirement." This is now destined to become a very real source of strategic competitive advantage in a tight labour market.

The challenges of an ageing population have been talked about for years, if not decades. Much of that has appeared an academic discussion about something on the horizon. The 2020s will be the decade when this changes. The ageing population is here. The Resolution Foundation has even referred to the 2030s as THE decade of ageing, saying that it is: "projected to be the fastest pace of ageing in any decade from the 1960s to the 2060s, as higher longevity combines with the powerful effect of the large Baby Boomer cohort moving into retirement."

Working-age populations around the world are starting to shrink, the average age of those in work is rising, and the proportion of the population that plans to leave the workforce is rising. This all presents:

- a fiscal, healthcare and welfare headache for governments,
- a retirement funding problem for employees, and
- a skills shortage and management challenge for employers.

Against this background, the prospect of the late Boomer and early Gen X generations moving into an underfunded and impoverished retirement is not just a problem for them. It's a problem for everybody. The economic impact, especially in those areas dependent on pensioner spending, is likely to be severe. As IFS director Paul Johnson remarked:

> *"The past really is not a good guide to the future. The era of many retiring in their early sixties on a decent pension will soon be over, and is already over for increasing numbers."*

When taken together with the other economic headwinds the world will face during this decade – climate change, low growth and the shift to Carbon Net Zero being chief among them – words like 'crisis' or 'potential catastrophe' don't seem too overblown. It is not difficult to imagine combinations of these factors creating a series of 'perfect storms' for countries and companies as the decade rolls forward.

Clearly much of the planning for these developments will need to take place at government policy level. Nevertheless, companies too must prepare for a world in which there are a lot more older people than there used to be. This will be a pre-requisite of attracting and retaining high calibre skills. Workplaces, management practices and employment policies are evolving, and will continue to do so.

In this report, we have examined in detail the economic and social context and trends, and clearly identified why there is a looming problem for governments, employers and employees. We have also explained why we believe employers must start to plan for these developments and suggested some of the actions they may wish to take.

We are hoping that our members, if they have not done so already, will consider this report as a call-to-arms. Having looked at the forces shaping economies and societies in the current decade, we strongly believe that the way companies support and develop their employees throughout their working lives will not only become a competitive advantage, but will also become a reputational risk for those companies that fail to take the necessary action.

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