

2007 Aging U.S. Workforce Survey:

Challenges and Responses –
An Ongoing Review

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Ernst & Young LLP Tax Practice

October 2007

How Far Ahead of the Graying Curve Are You?

The first members of the Baby Boomer generation have entered their sixth decade—the eldest in a generation that comprises the most significant portion of the U.S. labor force today. Can retirement in record numbers be far behind? The U.S. Bureau of Labor Statistics predicts that 43 percent of the workforce operating between the years 2004 and 2012 will be eligible to retire in the next ten years.¹ Are employers prepared for, or even aware of, the potential impact of this undeniable trend on their businesses?

Human Resources (HR) executives are accustomed to handling the “employee life cycle,” whether that begins with the initial hiring of a new entrant into the workforce or recruiting experienced hires, and lasts through each departure. Yet, over the past few years, new challenges have emerged, as HR executives also have to factor into their jobs a working understanding of the compliance, accounting, and governance requirements that impact their benefits and compensation programs. Now, they need to add in the increased complexity of dealing with the demographic issues surrounding an aging workforce.

With limited resources, escalating responsibilities, and increased regulatory demands, HR executives are doing a great job of dealing with the immediate issues that are arising due to the aging of their workforce. However, what is different about this employment phenomenon is the wave of changes it will bring with a tsunami-like force. Therefore, to avoid serious strategic and financial issues in the future, HR executives need to take a more proactive stance when analyzing, developing, and implementing their benefits and compensation programs.

Along with that is the potential for corporate America to effect a shift from the centuries-long history of productivity to reductivity—the phenomenon brought on by the systemic reduction of business wisdom that extends learning curves, slows otherwise smooth processes, and causes duplication of efforts. If properly engaged, the accumulated business wisdom of mature workers could provide significant solutions and cost savings at a time when global competition makes it more important than ever before to increase productivity ratios.

What HR executives may be underestimating is the significance of the strategic issues that can arise with an aging workforce. This wisdom withdrawal should not be considered just an HR risk, but rather a much larger business risk, as it will directly impact financial statements, as well as create strategic, compliance, and operational issues for businesses. This situation must be seen as a shared responsibility across all corporate departments. By acting as a cohesive unit, businesses can more effectively identify and obtain the resources necessary to resolve the risks ahead.

Against the backdrop of such countermanding influences as the Pension Protection Act of 2006 (PPA), the foreseeable “brain drain” health care concerns, the potential strain on Social Security and Medicare, and “60 as the new 40,” the questions are how and when will business feel the impact of this segment of society that has shifted marketing, sociological, and economic models virtually since that first Boomer’s cry? Because the bulk of responsibility for dealing with that impact falls squarely on the shoulders of HR executives, is the C-suite structure supporting their efforts? What can be done to assist HR executives in getting in front of the challenges that may accompany this graying group of employees, rather than reacting to them out of necessity?

Ernst & Young LLP set out to gain some perspective on these and other questions in its 2007 report, *Ernst & Young LLP’s 2007 Aging U.S. Workforce Survey: Challenges and Responses – An Ongoing Review*, as a follow-on study to our 2006 report.

¹ U.S. Bureau of Labor Statistics, 2007.

Survey Participants' Profile

This 2007 report is a compilation of the responses of HR executives at *Fortune* 1000 global organizations, representing more than a dozen industries and ranging in size from fewer than 1,000 employees to more than 100,000 employees. Greenwald and Associates conducted the survey electronically and via telephone interviews from May 14 to June 25, 2007.²

This report establishes a profile of how these organizations view the aging workforce relative to these key areas:

- Succession Planning
- Pension Plans
- Executive Compensation
- Health Care Benefits
- Compliance and HR Risk

It also looks at how these representative companies have prioritized the issue of their graying population, what plans they've already implemented, and what they anticipate doing in the near future as more than two-thirds of those surveyed will see employees, from virtually every occupational level, leave the active workforce.

Ernst & Young's Aging Workforce survey is considered the leading comprehensive survey on this topic, identifying not only the immediate business risks associated with the aging workforce, but also the long-term strategic and financial issues that will impact businesses going forward.

Today, the aging workforce is emerging as a critical and complex issue that will impact all aspects of business in the near future. Because Ernst & Young is known for assisting clients with serious business issues impacting both productivity and profitability, we took an in-depth look at the challenges of an aging workforce that lie ahead and how prepared Corporate America is to handle them.

The results, while not altogether surprising, do acknowledge the progression of pain that is occurring for companies encountering head-on the next phase in the Boomer's life. With this generation living healthier and likely to live longer than its predecessors, projected extensions of life span, and the potential for two or more active decades beyond traditional retirement age, retirement itself will likely be redefined by these trendsetters. All that said, however, the hippie generation is getting hip replacements, and aging *will* have its impact on corporate America.

² Mathew Greenwald & Associates, Inc. is a premier public opinion and market research company that specializes in serving the needs of the financial services industry. Mathew Greenwald & Associates, Inc. has conducted customized research for more than 200 organizations and is a member of the Council of American Survey Research Organizations (CASRO), an invitation-only industry governing body that comprises the 400 leading survey research practitioners in the United States.

More than 3,300 representatives from *Fortune* 1000 companies and other large employers were contacted by e-mail in May 2007. The e-mail contained a direct link to the survey. Respondents were given two weeks to complete the survey and were also sent a follow-up e-mail. Respondents who did not respond to the Internet survey were also contacted by phone. A total of 151 responses were collected.

The Difference a Year Makes

With aging as the predicate, it stands to reason that company profiles on that subject will evolve from one year to the next. As the workforce ages, the accompanying issues will become more obvious and employers will become more aware and thus more active in their approach to dealing with the issues. Using the two Ernst & Young surveys on the aging workforce as benchmarks, what has changed over the past two years?

In 2006	In 2007
<ul style="list-style-type: none"> · Thirty-eight percent of respondents said retaining key employees and maintaining intellectual capital were the human capital issues of most concern. 	<ul style="list-style-type: none"> · Sixty-eight percent of respondents say retaining key employees and maintaining intellectual capital were the human capital issues of most concern.
<ul style="list-style-type: none"> · Sixty-two percent of respondents said retirements would cause a talent gap or brain drain. 	<ul style="list-style-type: none"> · Sixty-two percent of respondents say retirements would cause a talent gap or brain drain.
<ul style="list-style-type: none"> · Forty-eight percent of respondents said middle and senior management would be the levels most affected by the brain drain. 	<ul style="list-style-type: none"> · Seventy percent of respondents say middle and senior management would be the levels most affected by the brain drain.

As the Baby Boomer generation further ages, the impact of the changes that manifest themselves are much more likely to be exponential, not incremental—especially if employers’ modus operandi remains reactive. In short, things may get worse.

Key Findings and Common Themes

How far ahead of the graying curve are HR leaders, C-suite executives, and corporate boards of directors? As we look through the eyes of the HR professionals who responded to the survey, there are some overarching trends and common themes that span both company size and industry. On the whole, HR executives are currently dealing with the more immediate problems that arise, which are primarily operational or HR risk-related. Continuing in this mode in the long run may result in significant issues surfacing that will impact productivity, profitability, and global competitiveness.

Therefore, a more proactive and strategic approach is required to avoid significant problems in the long term, from both strategic and financial perspectives.

On the positive side, there is an increase in the overall awareness of the issue of the aging workforce. In 2006, 38 percent of surveyed HR executives said retaining key employees to maintain intellectual capital was the human capital issue of most concern. In 2007 that number grew to 68 percent, which tells us that more HR executives are paying attention to this issue and understand its importance.

However, with HR executives already having a full plate, and with the absence of a goal-driven strategy, the tendency is to fall back on immediate stop-gap tactics. This state of “operational being” impacts business behavior relative to everything from benefits and compensation to resource allocation.

- **Retaining key management talent and intellectual capital is the biggest concern for C-suite executives and boards of directors, according to the HR executives who participated in our survey.** However, while 41 percent of the respondents say middle management is the area most likely to be affected by the brain drain and skill shortage, 75 percent say they're focusing on succession-planning programs at the senior management level. The impact? Unexpected turnovers, additional costs, and exaggerated learning curves. Beyond the brain drain is the *wisdom withdrawal*—business value that is uniquely derived from experience, making it an asset that can't be replaced simply with technical knowledge or know-how. This is arguably one of the most significant risks with the most profound impact if these valued Boomers leave without transferring their knowledge to future generations.
- **The absence of an aging workforce strategy or perspective is showing up in increased recruiting costs, continual hiring from outside, and more significant training and development investments.** Thirty-five percent of companies are seeing an increase in recruiting costs—more than other costs that might be associated with the aging workforce. This is likely another indication that stopgap measures are in play. Retirements are the most visible outcome of an aging workforce—as they literally deplete the employee count, and HR reaches out to bring in replacements and fill the immediate needs. One-quarter of respondents say they are trying to adjust benefits in order to keep a specific group of employees they don't want to retire right away. Given the potential risk of age discrimination constraints implied by favorable treatment of one group over another, this approach demands a **strategic perspective**. A thorough understanding of the demographics of its workplace and the issues of the graying group might enable an employer to develop and operationalize a **replacement strategy** *ahead* of the actual loss of talent. That, in turn, could drive more effective utilization of in-house resources, thus flattening the learning curve, saving time and money, and demonstrating a commitment to internal promotion.
- **Phased retirement is an available, albeit underused, option for retaining talent and managing the brain drain from both cost and resource perspectives.** More than 80 percent of the organizations surveyed don't permit their employees to start receiving pension benefits while they're still employed with the company. Given that 25 percent of respondents are looking for ways to retain certain key employees and nearly 70 percent are concerned about retaining both human and intellectual capital, this begs the question as to why phased retirement isn't being leveraged. While there are likely several different reasons, anecdotal evidence and field experience suggest that confusion over how to define and administer such a program may be a significant factor in its limited use, especially if employers are looking for a quick fix or immediate bandage. The PPA's phased retirement provisions and their clarification through rules issued by the Treasury Department and the Internal Revenue Service (IRS) in May 2007 may give employers what they need: the IRS now allows in-service distribution to an employee who has reached the "normal retirement age" (NRA) of 62 and continues to work. The same type of distribution methods may be available to employees between 55 and 62 if the employer can provide facts and circumstances demonstrating that the determined age is in keeping with its specific industry's standard for NRA. Although in-service distributions are not required to be in the plan design, there are requirements as to NRA. In the absence of a hard-and-fast definition, phased retirement has meant different things to different parties and does not come with black-letter instructions regarding what is or is not allowed from a tax and regulatory standpoint. Here again, however, the absence of a strategic perspective may be hampering employers' best efforts and creative retention plans.

Corporations must provide HR executives more direction regarding their roles and responsibilities so they can strategically manage the issue of the aging workforce. The survey responses tell us there must be better coordination between HR executives, the C-suite executives, and boards of directors on both regulatory and accounting technical issues as they pertain to this demographic.

- Eighty-one percent say they are responsible for identifying changes that need to be made in their benefits and compensation programs.
- Similarly, 77 percent say they are responsible for identifying financial risks, yet only 37 percent are changing or considering making changes to their benefits and compensation programs.
- Respondents from 51 percent of the companies with more than 25,000 employees say that such legislative issues as the PPA or accounting issues such as Statement of Financial Accounting Standards No. 158 (FAS 158) are not of concern to their C-suite executives or boards. Yet as many as 21 percent of companies say they don't know if it is important to them.
- Forty percent of respondents say that the PPA has not forced them to re-examine their pension programs, and 15 percent don't know. Half of those responding say the requirements of FAS 158 relative to balance sheet reporting will not change the way they think about their pension and/or postretirement medical plans, and 30 percent say they don't know (Footnote 4).
- Seventy-seven percent say that regulatory changes have not forced them to make strategic modifications to their benefits and compensation programs relative to the aging workforce.

Seventy-seven percent responded that HR is responsible for identifying financial risks associated with the company's aging workforce, while 81 percent say they are also responsible for identifying changes to benefits and compensation programs. Separately, 79 percent of respondents say that C-suite executives are responsible for determining the strategic direction of compensation and benefits programs, and 65 percent say C-suite executives are responsible for approving budgets. While the survey does not enable an exploration of the reasons driving any of the answers regarding FAS 158 and the PPA, such responses do raise concerns. In today's complex and demanding regulatory environment, these numbers indicate that some communication gaps do exist between HR and C-suite executives, making it difficult for HR to understand the more technical issues.

In today's complex and demanding regulatory environment, it is critical that any gaps in communication which may exist between HR and C-suite executives be closed quickly. One way to accomplish this task is by making sure HR executives are included in corporate discussions surrounding major legislative and accounting issues that have the potential to impact the treatment of retirees.

The issues surrounding the aging workforce are bigger and more complex than can be solved individually. More strategic and financially beneficial solutions can be achieved if all parties work together.

What You Don't Know Can Hurt You

One arguable limitation of surveys is the inability to delve into the nuances of participants' responses and the reasons behind them, particularly when the survey is administered largely online. Even factoring in that missing link, however, the number of answers indicating "don't know/refused" was enough to raise some concern for us, particularly since HR is responsible for identifying financial risks associated with the aging workforce (77 percent), as well as changes that need to be made in the benefits and compensation programs (81 percent).

- Sixty-four percent of the largest companies (25,000 employees or more) don't know what percent of their current workforce will be eligible to retire over the next five years.

- Thirty-two percent of the largest companies (25,000 employees or more) don't know whether financial risks associated with the aging workforce will effect changes in their benefits and compensation plans.
- Fifteen percent of the overall respondents don't know whether the PPA has forced a re-examination of their pension programs, and 25 percent don't know whether it will change their distribution requirements.
- For the 53 percent who say they have looked into whether the PPA will force them to change their distribution requirements, 36–44 percent don't know what those changes will entail.
- Thirty percent don't know whether FAS 158 will change the way they think about their pension and postretirement medical plans.

Even factoring in the proviso that the survey doesn't tell *why*, this is still a list that adds up to some missing links between employers and the smooth transition of a significant number of their employees. While some of these issues may seem like minor information gaps today, they could cause serious problems in five or ten years as the actual number of retirees multiplies. While many employers may be looking at implementing formal retention programs, the 2007 survey results suggest they may be underestimating what will be involved—especially if action is put off until it's too late to step back and develop a strategy. At that point, with employers operating in triage mode, wisdom will be lost, learning curves will be extended, costs for recruitment and training will escalate, productivity might suffer, and profitability might decline—and that is just the beginning.

However . . .

Though the window of opportunity is gradually closing, there is still time to take some proactive steps—with first stepping *back*. Now is the time to gain a strategic perspective on the aging workforce and to develop a plan for addressing its challenges methodically and efficiently. Fifty-eight percent of respondents either haven't or don't know whether they have performed an analysis of their benefits plans or conducted a review to gauge whether employees are receiving accurate benefit amounts. Gaining not only the answers to those questions but also a strategic view of the challenges will result in the development of solutions that are socially responsible and cost-effective—solutions that enable the efficient transfer of knowledge and wisdom to other generations of workers, while they help manage the costs in real dollars, time, and resources that would otherwise be spent on “emergency” recruitment, training, and assimilation.

What to Do Next—Blueprint and a Better Plan

Because there is no fountain of youth, the aging workforce is a reality that will not be going away. Dealing with the issues and impact, however, can be much simpler with a blueprint for action—one that will enable companies to comprehend the potential financial impact of their aging workforce. Equally important, though less tangible, are the implications of wisdom withdrawal—what it takes to make sure this subtle attribute is transferred from one generation to the next, and what it means to the enterprise if that doesn't take place. Now more than ever, HR executives need to be able to make informed choices and form clear objectives around retention/retirement/replacement relative to this group of employees, then build and execute a plan that can meet those objectives.

These are some steps that can help:

1. **Perform a diagnostic study** of the company's current demographics and how the aging trend will impact its workforce. This includes identifying and tracking the number of people expected to retire in a given time period and where they are in the organization. That number will be the basis for determining the medical, health, and welfare costs that will be incurred pre- and postretirement, along with the impact that retiring or retaining older workers will have on pension, 401(k), and other benefit costs. Equally important, the study will provide a more realistic sense of the wisdom withdrawal the company may experience in terms of the value that may walk out the door. For example, survey results show that 41 percent are concerned that middle management will be their Achilles heel for a brain drain, yet 75 percent are focusing their succession management programs on senior management. Clearly, a diagnostic study would uncover these areas of missed opportunities.
2. **Evaluate and analyze the results** to uncover future implications as well as to understand the financial implications of the aging workforce based upon its utilization of health care and other corporate HR programs. This may include the identification of benefit plans that have built-in biases for unknowingly forcing premature retirement for some employees or unknowingly favoring others. If a thorough analysis is done of health care claims information, it may be possible to identify the specific areas that are leading to increases in plan costs. An analysis also pulls together a realistic picture of what parts of the business might take the biggest hits in terms of the loss of experience and how much it would cost to replace or retain that expertise. The aging workforce brings both corporate and business unit consequences.
3. **Define an aging workforce strategy aligned with the organization's strategic plan** that addresses the needs and demands of the aging workforce, and provides a foundation for the future workforce. This includes making recommendations on succession planning, compensation, and benefits programs (especially health care), and determining how to leverage retention programs. It also is the pivot point from which HR can support the company's overall goals and business objectives.
4. **Execute components of the aging workforce strategic plan**—specifically the design and redesign of compensation, benefits, and retention programs, making sure that any changes are considered in the broader context of governance, cost, and risk for active employees, retirees, and the company at large. Succession planning and implementation are other key components of the strategic plan, as they drive the effective transfer of knowledge from one generation of employees to the next.
5. **Provide employee financial education and counseling**, both as a preretirement planning tool and a general benefit to help retain older workers. This is one largely overlooked area that may make a significant difference, especially with respect to plan neutrality, social responsibility, and guided retention.

As two more generations grow in the workforce, it is the Baby Boomers who will have reshaped the fundamental structure of retirement. Lessons learned—with and from this huge generation—are lessons that can remain viable and valuable for generations to come.

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Succession Planning—A Strategic Approach to Brain Drain and Financial Pain

By definition, *succession planning* implies that some form of strategy is at work to ensure seamless continuity in both human and intellectual resources. The Ernst & Young 2007 survey on the aging workforce,¹ second in a series, seeks to determine, among other things, whether employers really are responding to this graying generation of employees. If so, are they following a well-developed succession plan aligned to the company's strategic goals, or are executives finding themselves unprepared for the wide-scope transition from rock and roller to retiree?

Survey respondents comprise primarily top HR executives from *Fortune* 1000 companies that vary in industry (more than a dozen are represented) and size (from fewer than 1,000 to more than 100,000 employees).² Of all the questions, there is one that stands out as the quintessential reason for succession planning:

Question: *Which human capital and benefits issues concern your C-suite executives and board of directors most?*

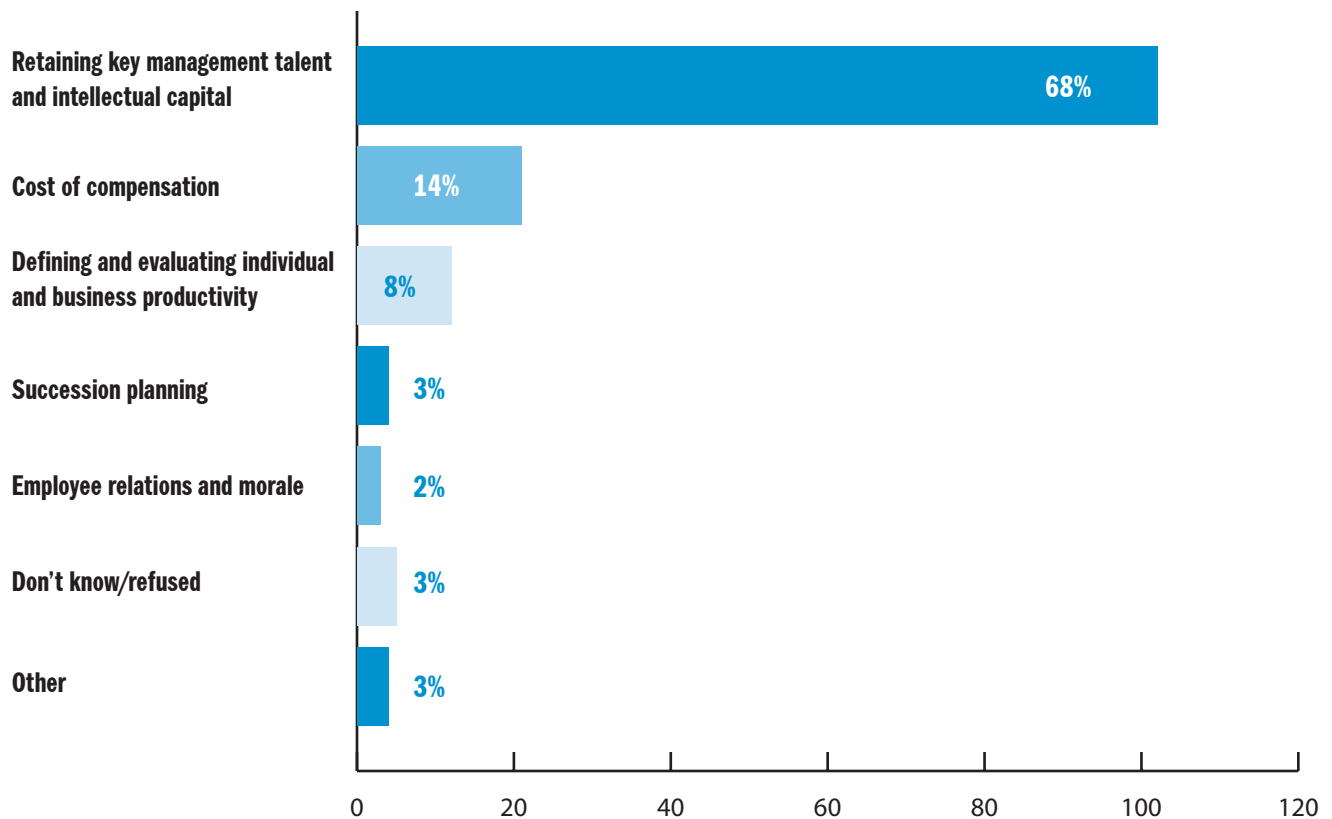
Overwhelming response of 68 percent: *Retaining key management talent and intellectual capital.*

(See chart next page)

¹ Ernst & Young LLP began a series of surveys in 2006 to gauge the impact of the aging workforce at large and on the needs of American businesses. The 2007 survey details and questions can be found in the overall report, *Ernst & Young LLP's 2007 Aging U.S. Workforce Survey: Challenges and Responses – An Ongoing Review*.

² Survey questions and complete response details can be found in the appendix of the overall survey white paper, *Ernst & Young LLP's 2007 Aging U.S. Workforce Survey: Challenges and Responses – An Ongoing Review*.

Which human capital and benefits issues concern your C-suite executives and board of directors most?



Everything about succession planning stems from this fundamental driver—whether analytical observation and theoretical discussion or real-world efforts. What appears to be at issue is how well-aligned or integrated succession planning is with a company’s overall strategic planning. The overarching answer is, “not very.” In fact, as with other elements of the aging workforce dilemma, stopgap measures rather than strategies seem to be driving many of the decisions.

Survey Says . . .

Along with as much or more *awareness* around the issues relative to succession planning between the first and second surveys, there is appreciably more (pro)*activity*.

Here’s a comparison of the “awareness profile” relative to succession planning from one survey to the next. While some questions may be phrased a bit differently, the parallels are valid.

In 2006	In 2007
<ul style="list-style-type: none"> Retaining key employees and maintaining intellectual capital was a concern for just over 38 percent. 	<ul style="list-style-type: none"> Retaining key talent and intellectual capital is the issue of most concern for 68 percent.
<ul style="list-style-type: none"> Sixty-two percent expected retirements to cause a talent gap or brain drain. Forty-eight percent cited middle management and senior management as the levels that would be most affected. 	<ul style="list-style-type: none"> Sixty-two percent expected retirements to cause a talent gap or brain drain. Seventy percent cited middle management (41 percent) and senior management (29 percent) as the levels that would be most affected. They were significantly higher than hourly (12 percent), C-level management (9 percent) and supervisory (3 percent).
<ul style="list-style-type: none"> Of the 66 percent of organizations with a formal plan for “wisdom continuity,” 22 percent had a leadership succession plan. 	<ul style="list-style-type: none"> Of the 77 percent of respondents with a formal succession-planning program in place, 75 percent monitor senior management and 25 percent monitor the entire workforce.

The conclusion? There has been encouraging progress, but there is still a long way to go before businesses get far enough ahead of the aging curve to implement **strategies** for softening, mitigating, or significantly reducing its impact.

What Happens in the Middle Doesn’t Stay in the Middle

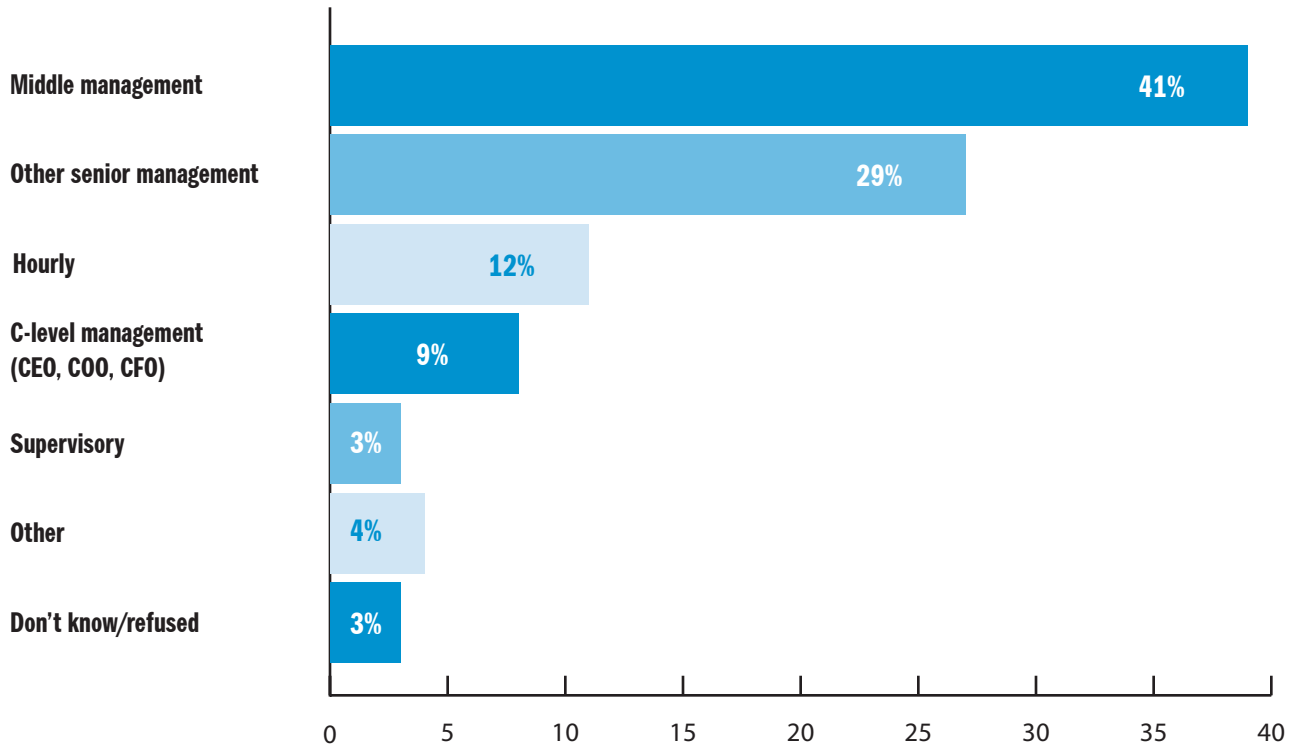
Beyond answering the 35 questions posed, the responses from these HR executives revealed five key challenges that have yet to be adequately addressed in discussion or in reality—challenges that are fundamental to effective succession planning:

- Being strategic rather than reactive
- Understanding the demographics of the aging workforce
- Making middle management the fulcrum for organizationwide succession planning
- Understanding the issues that drive retention and facilitate transition
- Encouraging effective, comprehensive governance with clear accountability and measurement

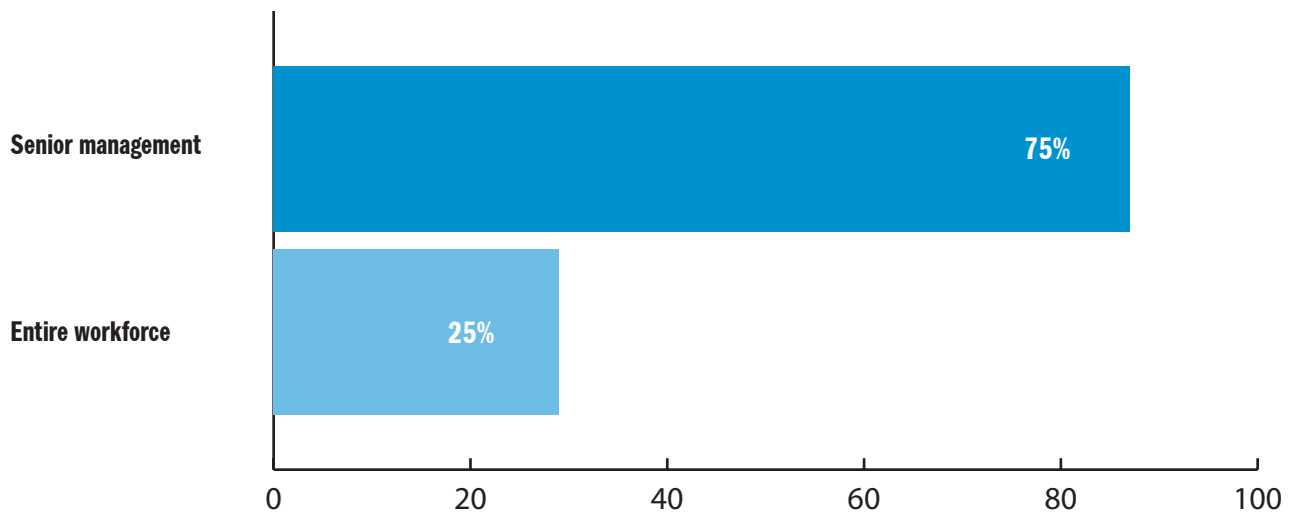
Addressing any or all of these issues really happens on a reciprocal course, as dealing with one may underpin the plan for another.

At the center of the process, both literally and figuratively, is the need to shift the focus of effective succession planning from senior and executive management to middle management. Survey responses confirm that attention is out of sync with the issue—41 percent of companies say that *middle* management will be the level most affected by the talent gap, yet 75 percent are focused on monitoring succession at the *senior* management level. For the purposes of the survey, we defined “Senior Management” as the group of employees that the respondents would define within their own organization as senior management and above, including C-suite executives.

Which levels will be most affected? (Answered only by those who responded “Yes” that a brain drain is likely.)



What group is monitored in your succession-planning program? (Answered only by those who have a formal succession-planning program.)



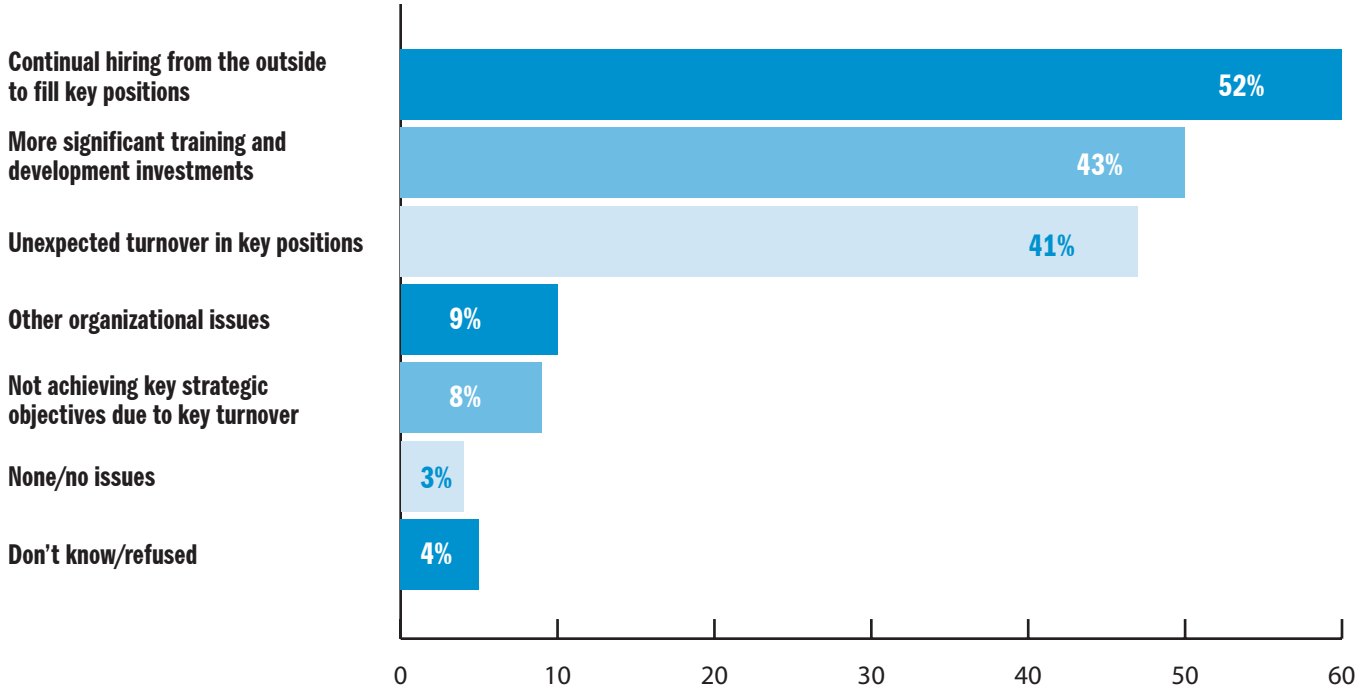
What may not be obvious is that a healthy pipeline at the middle-management level will facilitate succession as an intentional and ongoing process, not a one-off reaction to fill the immediate gap left by a retiree. Best practice treats middle management as both the proving ground for succeeding the first wave of retiring Boomers at the senior management and C-suite levels and a mid-point goal for aspiring employees from late-date Boomers and Generations X and Y. This simple shift in focus can effect significant strategic growth with respect to succession planning, developing and maintaining a well-trained and ready pipeline.

Cause and Effect

This concept of the essential pipeline gets further validation in the form of the issues HR executives say their companies are experiencing:

- Fifty-two percent say they are continually hiring from the outside to fill key positions.
- Forty-three percent acknowledge more significant training and development investments.
- Forty-one percent or more are dealing with unexpected turnover in key positions.

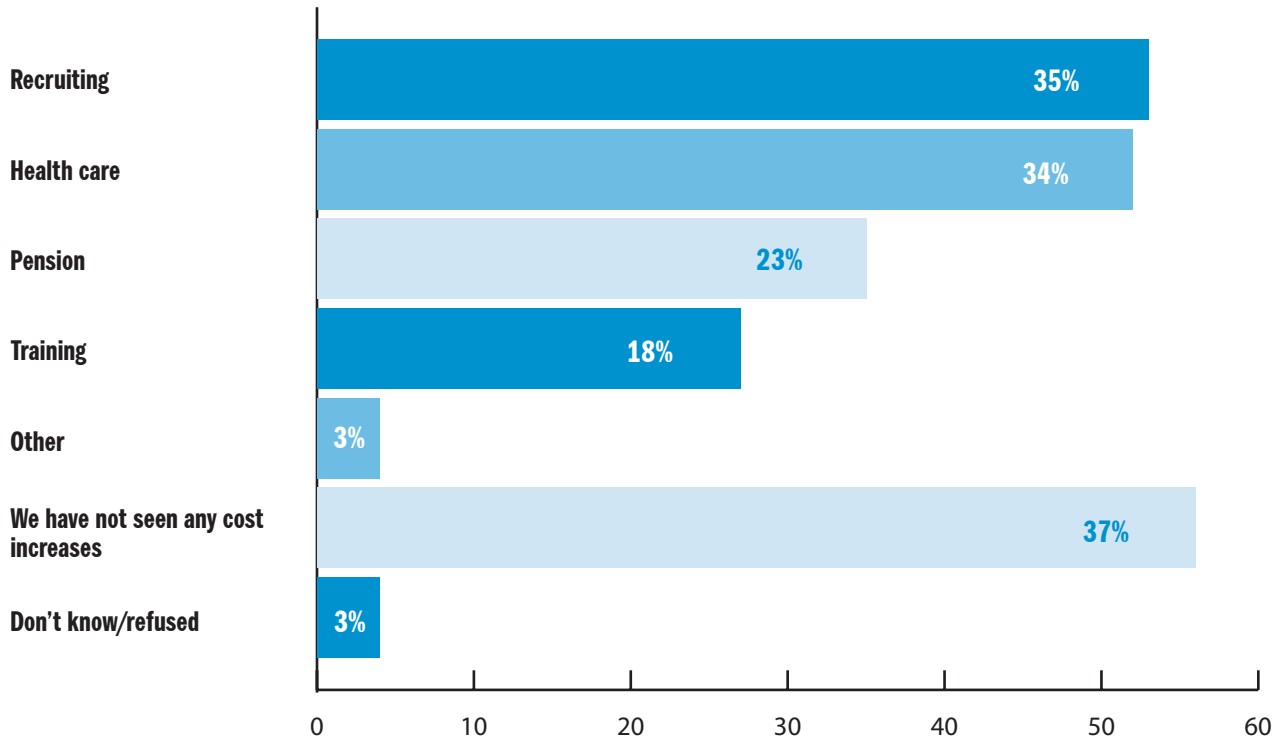
Have you experienced any of the following issues? (Multiple responses accepted.)



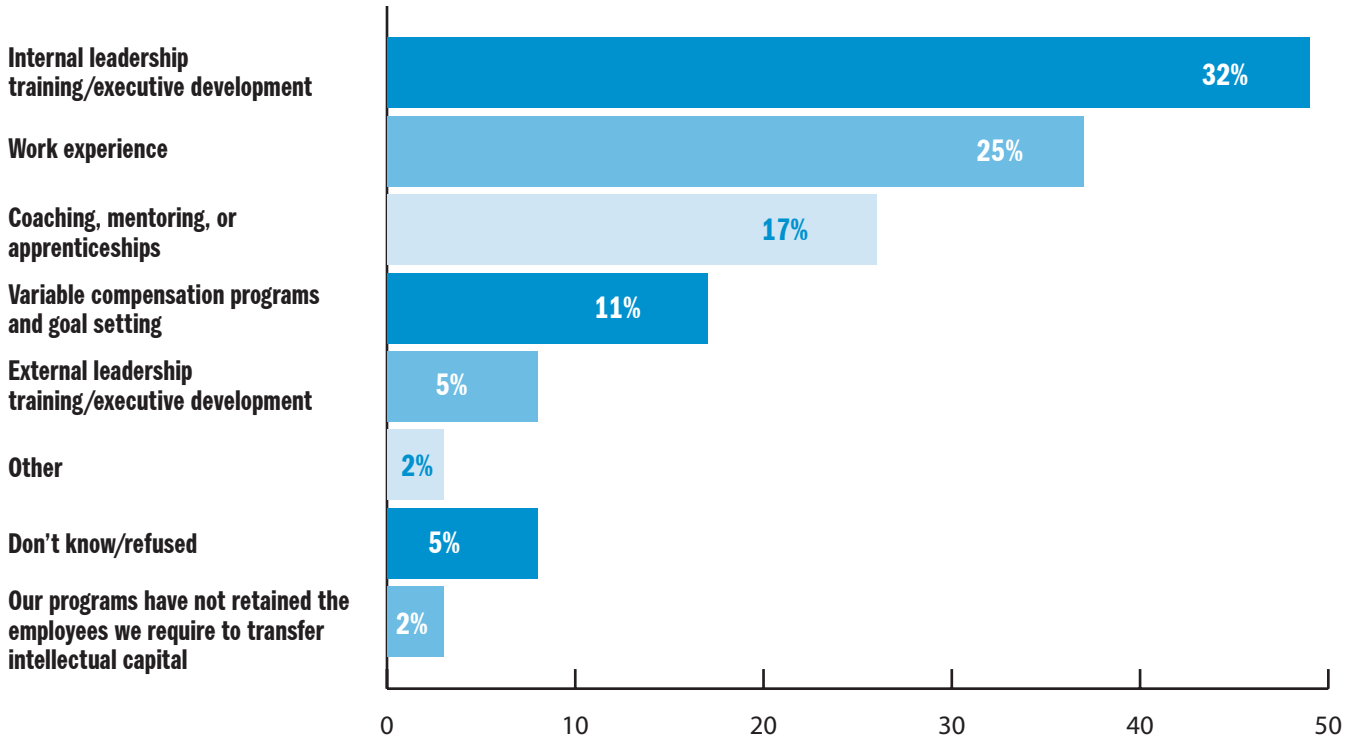
Issues such as these don't just exacerbate the challenges of the HR function from an operational standpoint; they can also have a trickle-down effect on productivity and the learning curve, pension plans, and more.

An external hire at the middle manager to senior executive level typically costs the organization more than an internal candidate—higher total compensation costs to attract a certain talent, recruiting costs to bring the individual in, training costs and learning curve requirements, and pension and medical costs, especially for someone hired in mid-career. Many survey respondents have experienced this firsthand: 35 percent of companies overall have seen an increase in recruiting costs as their senior managers near retirement age, and 67 percent of smaller companies (fewer than 5,000 employees) say their training costs have risen.

Have you seen an increase in the following costs as your senior managers near retirement age? (Multiple responses accepted.)



What program has been the most effective in terms of seamless transition of management, development of key individuals, and retaining and transferring intellectual capital?



All of these generate pain that can be avoided at best and reduced to a minimum with the revamped treatment of middle management and a commitment to grooming talent from within.

What Works

With or without an overarching strategy in place, a number of companies have projects and processes in place that can contribute to the seamless transition of management, development of key individuals, and retention or transfer of intellectual capital. The three most critical to succession planning are:

- Internal leadership training and executive development
- Work experience
- Coaching, mentoring, or apprenticeships

While these share some success, they don't work the same for all companies across the board.

- Thirty-two percent of all companies responding say internal leadership training and executive development is most effective. That takes into account a low of 13 percent for the smallest companies and a high of 41 percent for large companies of 25,000 to 99,999 employees.
- Work experience is effective for 25 percent overall, particularly for mid-size companies.
- Seventeen percent overall say coaching, mentoring, or apprenticeships are the most effective, with the highest success at smaller companies (52 percent of companies under 5,000 employees).

Figures seem to indicate that the larger companies can afford to spend more money on training and development, while smaller companies are more likely to rely on grass-roots efforts at a more personal level. Again, there is no evidence that these reflect an overall strategy and are more likely to be approaches that happen to have worked.

In 2006, when we asked what formal processes companies have in place to capture and transmit “business wisdom”:

- Twenty-two percent used leadership succession planning
- Nineteen percent had older workers mentoring younger workers
- Eighteen percent had informal knowledge networks
- Sixteen percent had Web-based knowledge management and transmission tools
- Nine percent had training programs conducted by older workers
- Nine percent conducted interviews with retiring employees
- Seven percent had knowledge transmission goals in older worker performance reviews

However, close to 50 percent responded that mentoring programs had the highest impact.

What's Next?

It doesn't take a survey to make the point that companies today operate in an environment of increased scrutiny, whether they are bound by the Sarbanes-Oxley Act or other regulations or are just taking measures to ensure they're “doing what's right”—legislated or not. A natural by-product of this environment may be an overemphasis on who's in charge, bordering on “runaway responsibility.” This issue goes beyond just HR risk—it is a much larger business risk. Therefore, the responsibility for addressing the issue rests with the entire organization. As such, can you answer the following questions?

- What percentage of your workforce is approaching retirement?
- What are the demographics of your workforce and how do/will they impact your business strategies?
- What percentage of your key positions have an internal candidate(s) ready for succession and with what lead time?

If you can't answer these questions, can you identify someone in your organization who can? Succession planning is a topic that can be discussed and debated ad infinitum and one whose resolution is likely to be a dynamic and iterative process. However, it is also one that particularly begs leadership for understanding while it affords the opportunity to analyze the company population across all demographics and come away with a clear picture of where to spend money and effort to get the desired result. The result will be different for each company, but success can be found in three simple words: strategy, strategy, strategy.

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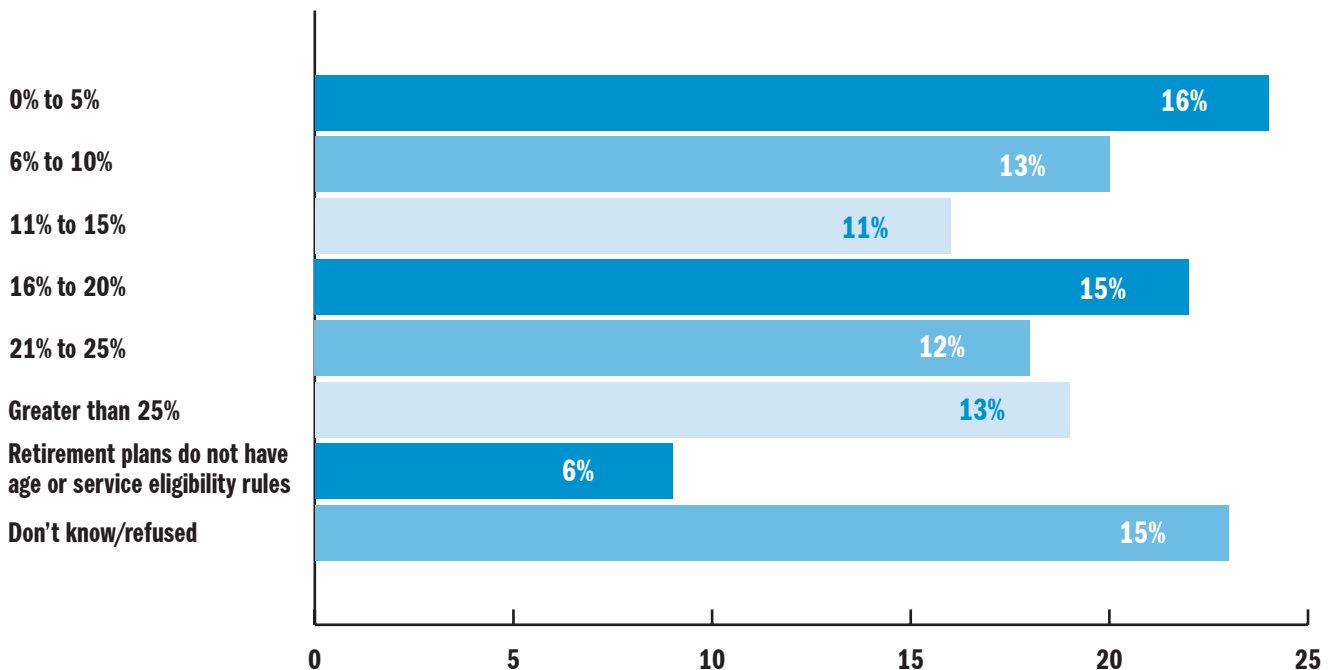
Retiring Boomer Style—Pension and Gold Watch or Paycheck and Updated Resume

There is an old Chinese proverb that says one generation plants the trees under which the next takes its ease. The Baby Boomer generation, one of the most formative of all time, is rapidly approaching the time at which it can begin to “take its ease.” But is even the first wave—that is to say its oldest members—ready to do that? What trees will they find when they are ready, and what trees will they leave for those who come after?

Let’s start with this premise: over time, one’s desire, need, and drive to remain a part of the workforce may diminish. Although many factors can contribute to this waning interest in being a part of the workforce, it is hard to pinpoint one reason behind it all. Some may choose to abandon their careers altogether, seeking out an increased quality of life or change of environment. Others may wish to stay involved, however at a much slower pace than was originally kept. But these types of changes don’t typically happen all at once, not for every person and particularly not with respect to an entire workforce. So what is being done by employers and by or for employees to plan for progress toward that eventuality rather than crash into it? Therein lies the pension plan.

With the first wave of Baby Boomers having turned 60 in 2005, historical demographic patterns indicate that the majority of Boomers will be retired by the end of 2030. Accordingly, half of the *Fortune* 1000 organizations that participated in Ernst & Young’s second survey on the Aging Workforce said at least 11 percent of their populations would be eligible to retire over the next five years. Interestingly, 15 percent of the companies surveyed said they don’t know or refused to answer. That number alone begs the question: How prepared are companies to deal with the loss of a significant number of employees?

What percentage of your current workforce will be eligible to retire over the next 5 years?



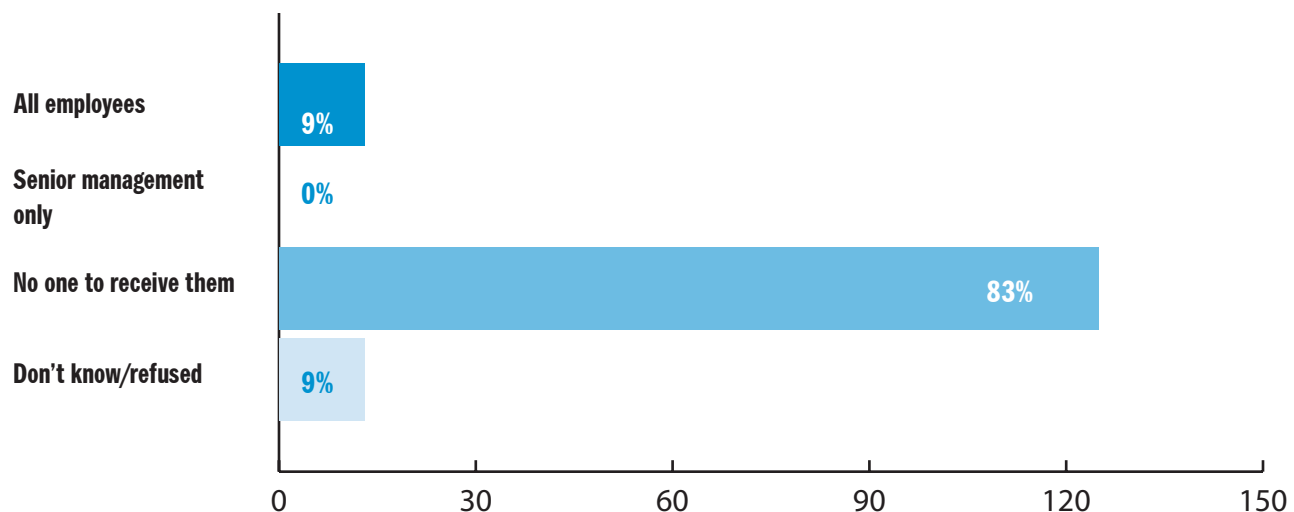
Should I Stay or Should I Go?

For those retirees in the generation before, retirement was an event occurring on a particular day, providing a clear line of demarcation between one phase of every person’s life and the next. Depending upon length of service—in those days typically significant—the retiree was given a going-away party and officewide send-off, with roasts, toasts, perhaps a gold watch for the past, and fishing rod or golf clubs for the future.

Over the years, this approach to retirement has been changing, as has the Baby Boomers’ take on retirement. Whether because “60 is the new 40” or “health care handcuffs” keep people working longer, many eligible Boomers now retire from one job, collect retirement benefits, and go on to work at another job. This may be a “retire/rehire” process or an overall “recareering.” Retirement is no longer the main event, it is a process—and one that requires a stable bridge to cross from one side to the other. It provides Boomers with the opportunity to give themselves a raise, reduce their hours, and perhaps finally achieve the work-life balance they’ve always wanted.

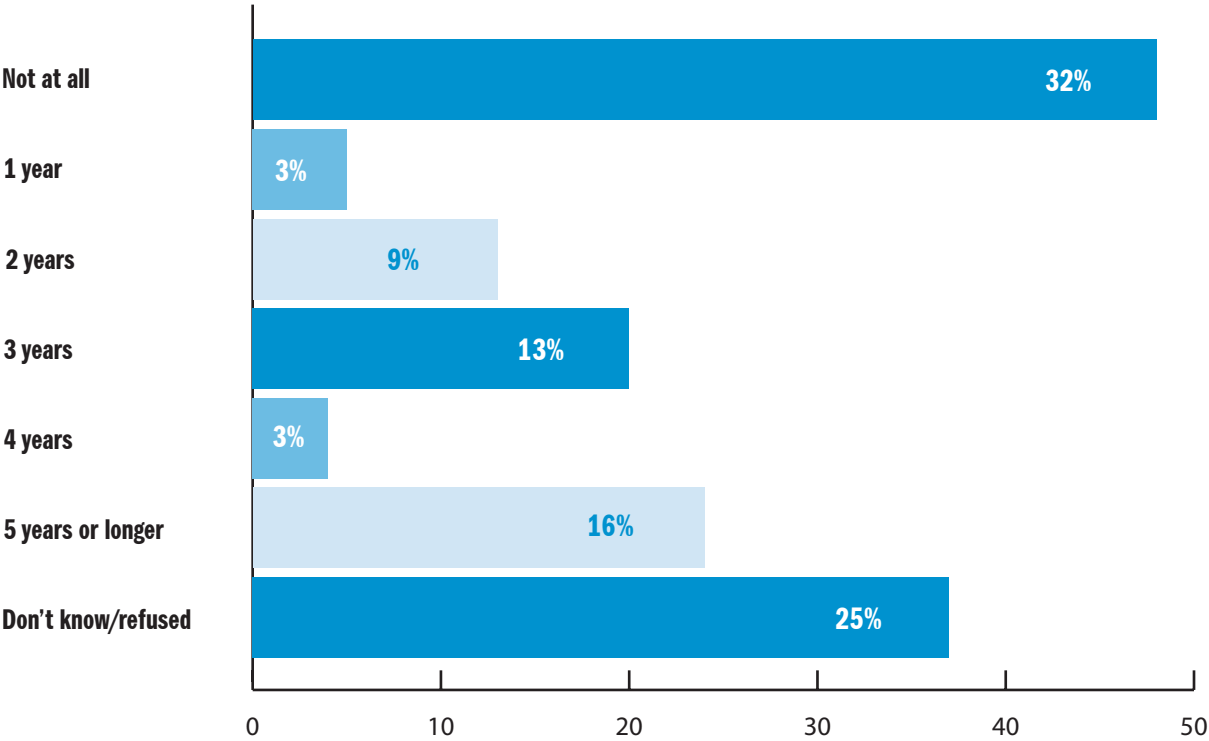
Depending upon the plan, these quasi-retirees and those not quite at retirement age may also be able to continue at the same place of employment instead of taking their skills and services elsewhere, thus helping companies better manage the brain drain. The concept of *phased retirement*, albeit a seemingly viable win-win alternative, is both hard to define and difficult to administer. Without a hard-and-fast definition, it means different things to different parties, particularly relative to retirement age. Nor does it come with black-letter instructions regarding what is and is not allowed from a tax and regulatory perspective. More than 80 percent of the organizations surveyed don’t permit their employees to start receiving pension benefits while they’re still employed with the company. The 9 percent of respondents who say they do allow phased retirement will be the primary source for leading practices and knowledge transfer on how they’ve managed such a plan and what success rate they’ve achieved.

Does your company policy allow for employees to start receiving pension benefits while they are still employed with the organization?



Absent an available “phased” approach, what about keeping key employees longer? This survey posed the question regarding senior management and, based upon anticipated enterprise needs and individual contributions, how much longer it would be beneficial for them to stay past their normal retirement age. Interestingly enough, nearly a third (32 percent) said not at all. Only about half that number (16 percent) said they would keep senior managers an additional five years or longer. Optimistically speaking, these responses could indicate that companies are prepared with succession planning and knowledge transfer for the individuals at that level, so their leaving would effect a negligible brain drain or knowledge gap. Certainly the response suggests that whatever benefit programs are in place are keeping senior management for an appropriate amount of time.

Ideally, based upon anticipated enterprise needs and expected individual contributions, on average, how much longer would it be desirable for your senior management to stay behind their normal retirement age?

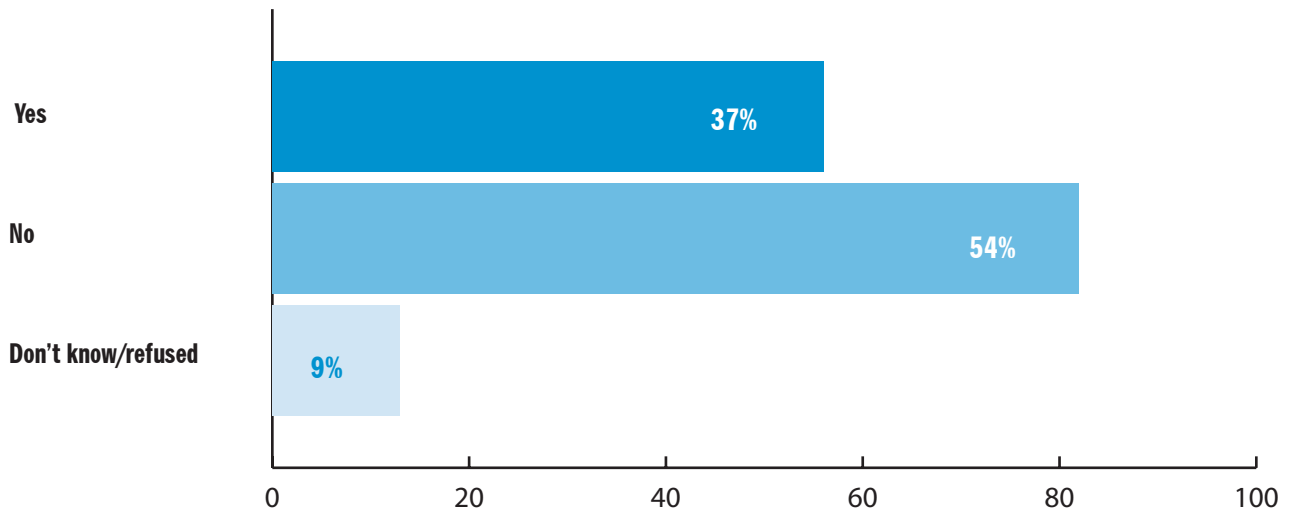


As with several other questions, there was a significant number of respondents who didn't know how to answer or refused to respond—25 percent, in this case. Although the survey questions weren't designed to surface the reasons behind the responses, this percentage may indicate that the issue of brain drain in the C-suite is believed to be too far into the future or the organization hasn't gotten deep enough into analyzing its aging workforce to assess the specific impact. In short, this response may be due to timing and may well change in future years.

Changes to Plans and Plans to Change

While there may be varying degrees of preparedness and strategic planning driving new decisions about retirement and the aging workforce, approximately 37 percent of all the companies surveyed say they're considering or have already made at least some changes in their benefits/compensation programs due to financial risks. Fifty-four percent of survey participants say they're changing nothing.

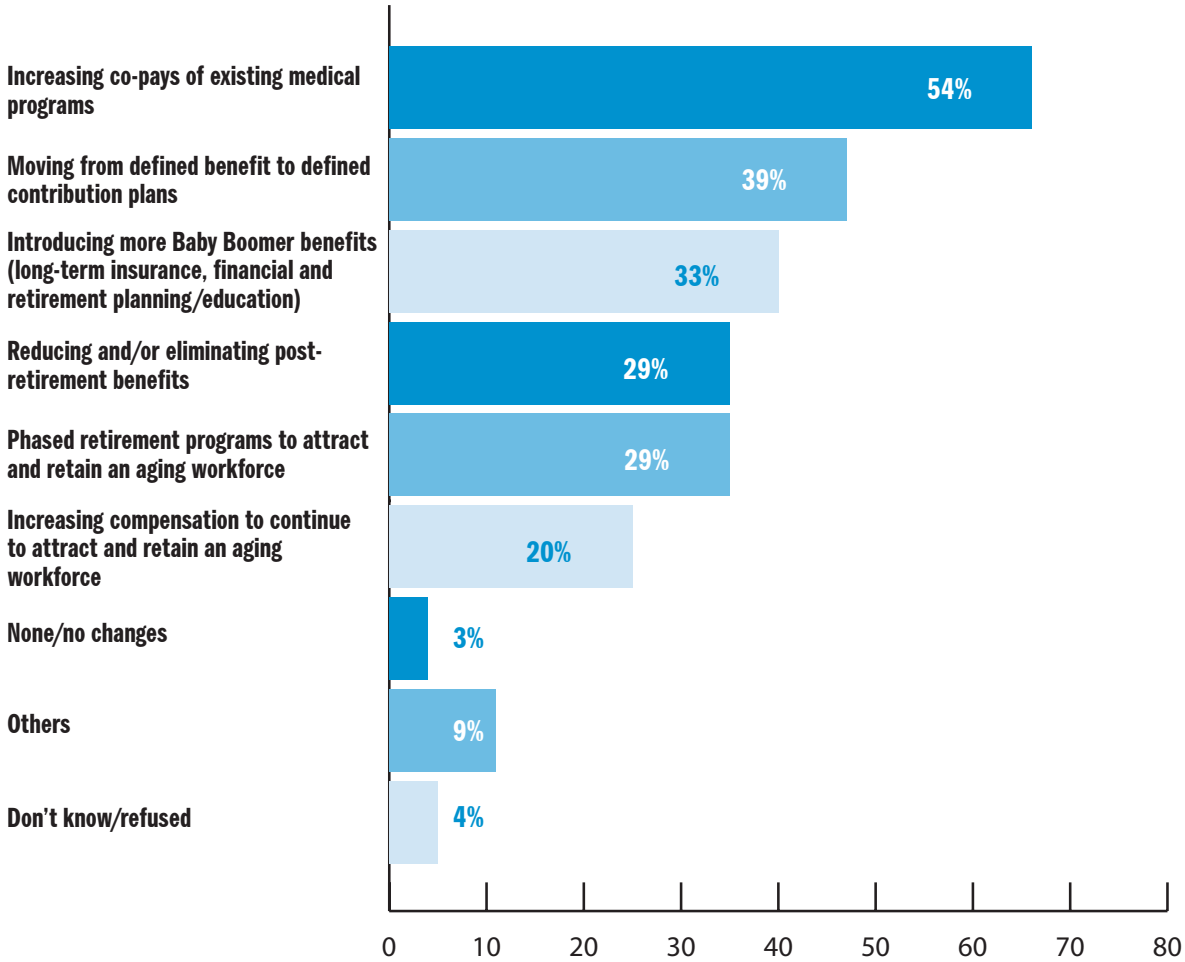
Has your company changed or is it considering changes to its benefits and compensation programs due to financial risks associated with your aging workforce?



It came as no surprise that a change for the majority of respondents involves increasing the co-pays to their existing medical programs. Rather, it was more surprising that only 54 percent of companies were considering such action.

Although some companies may feel a stronger tie to the defined benefit system for one reason or another, 39 percent of those surveyed are considering shifting from these programs to defined contribution plans, if they haven't already done so. Again, this is not really a surprise. The interesting part of this response is that it appears that such a shift is more of a consideration for the largest organizations (71 percent) than the smallest ones (17 percent).

What changes have you made or are considering for your benefits/compensation program? (Multiple responses accepted.)



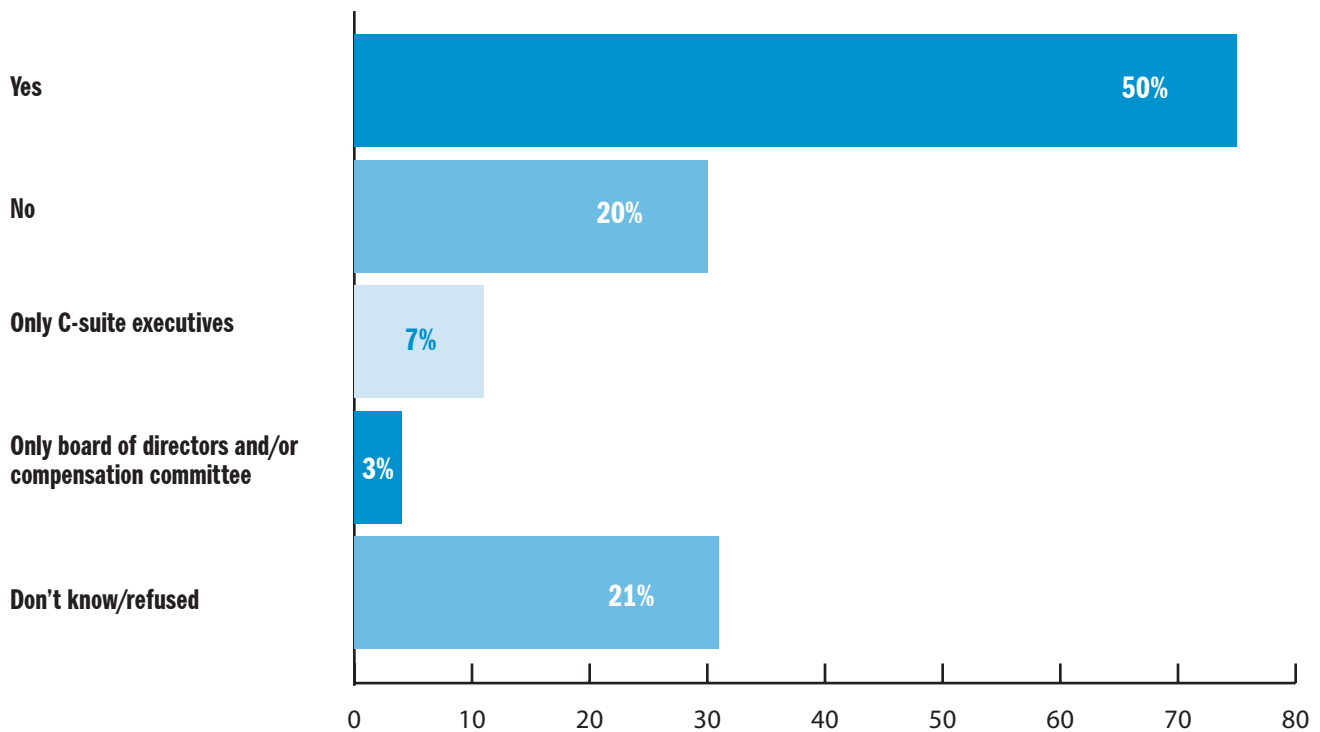
Even as Boomers get closer to customary if not mandatory retirement age, they are retaining viability in the workforce. More than a quarter of the companies surveyed (29 percent) are considering some form of phased retirement, while 20 percent are considering increasing compensation to attract and retain an aging workforce. Because multiple responses were permitted, it's difficult to know how many organizations were exploring both options. Absent a significant overlap of these responses, the numbers suggest that organizations see the need to consider graying workers as a resource worth utilizing.

Not quite one-quarter (23 percent) of companies say they've seen an increase in their pension costs as their senior managers near retirement age, the third most cited cost increase after recruiting (35 percent) and health care (34 percent).

Legislation and Pain as Cause and Effect

One of the things this second survey seeks to surface is those “pockets of pain” that companies are beginning to feel—where they are and what part legislation and regulatory mandates play in the cause. Sixty percent of surveyed organizations said that legislative and accounting issues like the PPA or FAS 158 were of concern to their C-suite executives and their board of directors, while 20 percent said they were not concerned. Legislation such as the PPA affects the manner in which an organization can provide benefits inside a qualified retirement plan. FAS 158 impacts the accounting for all defined benefit plans, whether they are qualified or not. That means these rules will have an impact on retirement plans from both a financial and a design perspective. This response may indicate that there is less emphasis being placed on compensation and benefits packages with respect to defined benefit retirement plans. Rather, organizations are compensating their employees through other means.

Are legislative issues like the Pension Protection Act or accounting issues like FAS 158 of concern to your C-suite executives or board of directors?



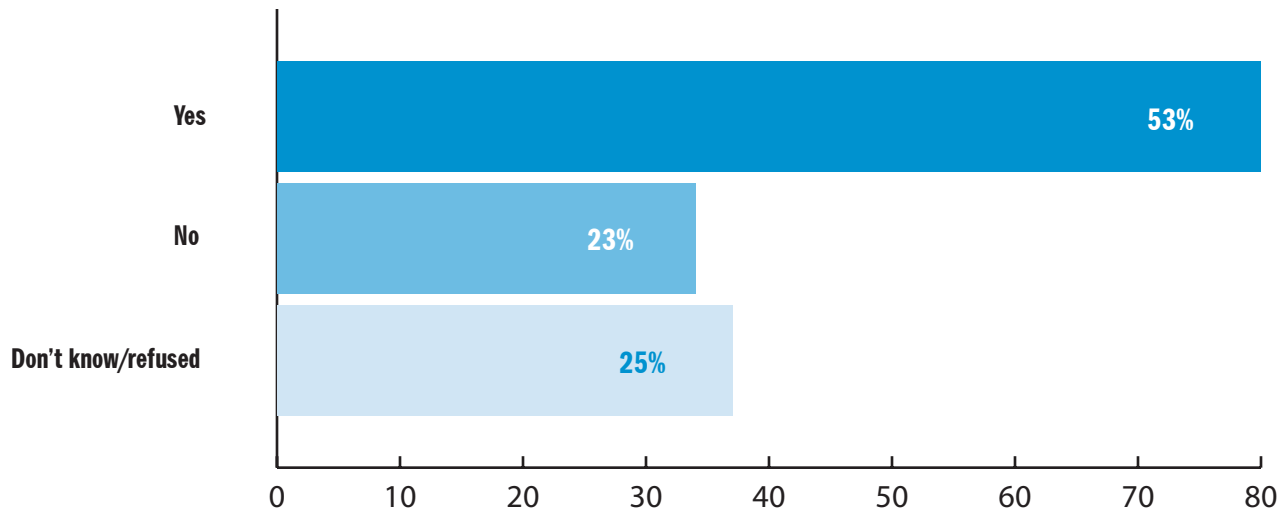
Forty percent of all respondents indicated that the PPA had not forced them to re-examine their pension programs, with the most “no’s” coming from companies that have either under 1,000 or more than 25,000 employees. In other words, the PPA appears to have a lesser impact on plans sponsored by smaller or larger companies. Slightly more (46 percent) responded that the PPA did force them to re-examine their programs.

The impact of the PPA was much greater on pension plans than it was on defined contribution plans. For pension plans, the PPA rewrote the requirements for minimum funding, increased the administrative requirements, and introduced rules that can interrupt a plan’s operation based on the percentage of the plan’s liabilities that are covered by its assets. The PPA changed the rules for cash balance plans, removing many of the accrued benefit concerns that affect such plans and those that use a hypothetical balance as their main form of determining benefit accruals, and provided support for organizations that want to convert their plans to cash balance arrangements. Forty percent of respondents indicate that these changes did not cause them to re-examine their retirement program, which may be a sign that those respondents are trending or have trended away from pension plans.

The PPA also changed the assumptions used to convert annuity payment streams into lump-sum payments, providing specific interest assumptions convert the maximum permissible annuity to a present value, and introduced a new section to the Internal Revenue Code titled *Distributions During Working Retirement* (Section 905). This section permits plans for the first time to commence benefits to active participants after age 62, even if the participant is under the plan’s normal retirement age. It also leaves open the possibility for providing such benefits to employees between the ages of 55 and 62 who are still in service, as long as the lower normal retirement age corresponds to similar determinations in the same industry. Pension plans subject to these final IRS regulations include defined benefit 401(a) plans or defined contribution 401(a) plans that aren’t 401(k) or profit-sharing plans.

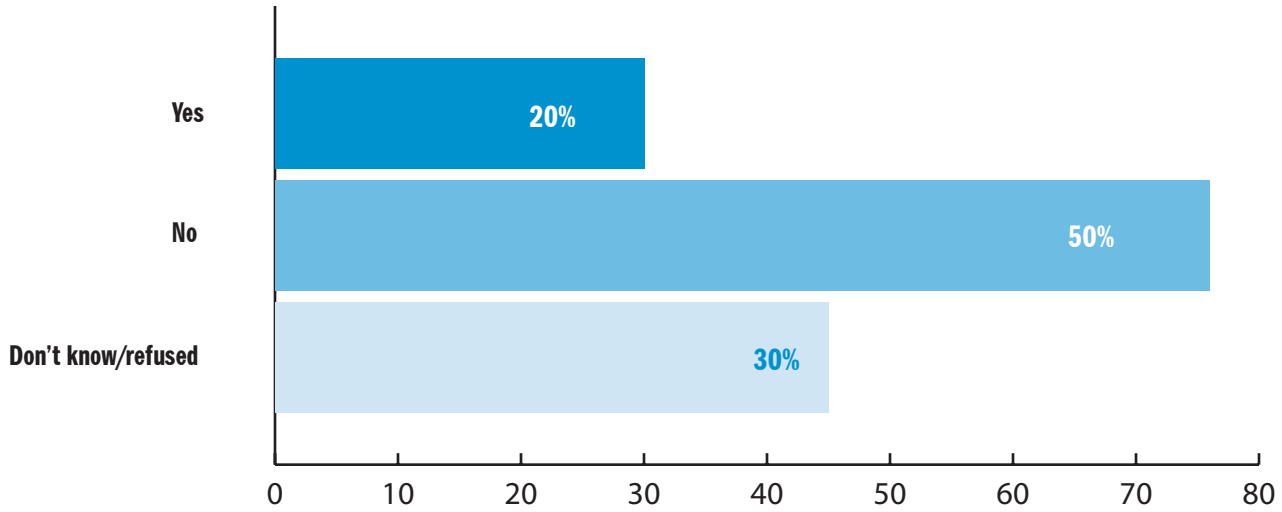
More than 50 percent of respondents say that they have looked into their plan’s distribution requirements based on changes included in the PPA; only 23 percent say they haven’t looked into these changes. Of those who are looking into the distribution, the majority seems to be focused on the single-sum options provided by their plans and how the PPA will change the amounts payable to their participants. Of those who have looked into changing distribution requirements, barely 15 percent are either permitting in-service distributions or lowering the age for receiving them. While that may be one alternative to help employees bridge into full retirement, it doesn’t appear to be getting serious consideration by the majority of companies.

Have you looked into how the Pension Protection Act (PPA) will change your distribution requirements?



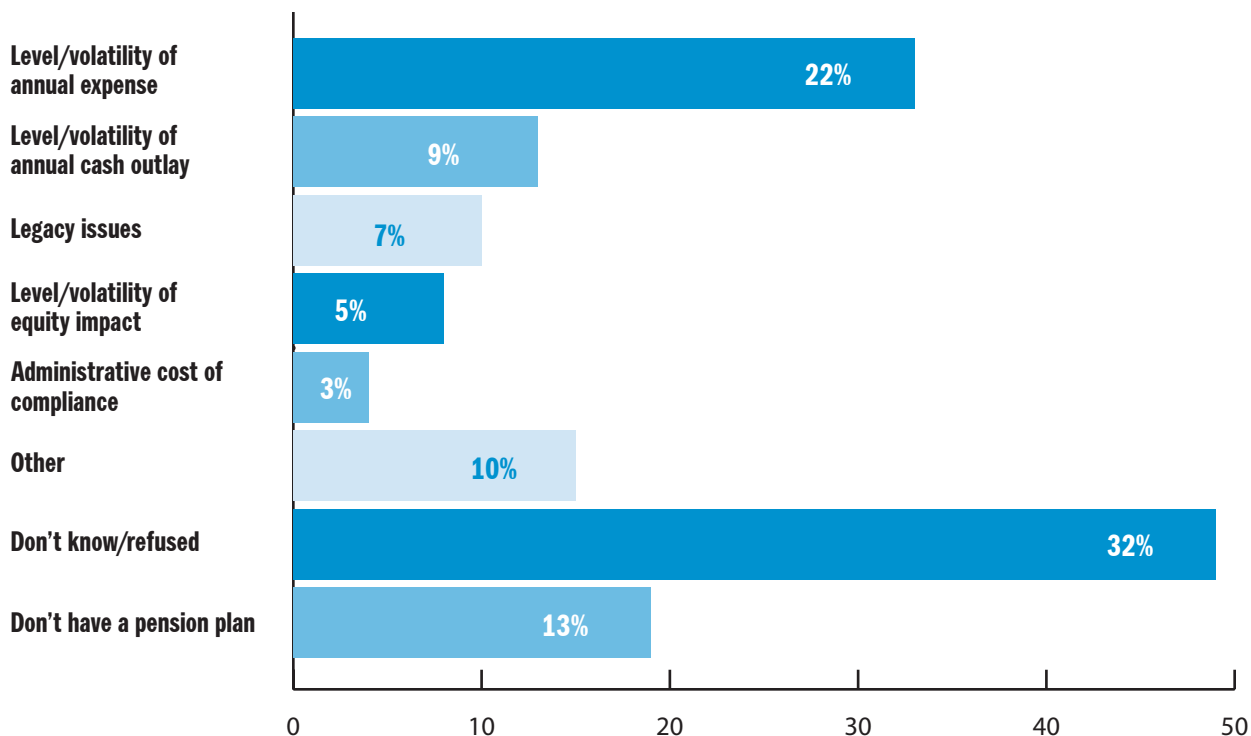
Only 20 percent of all respondents say that FAS 158 changed the manner in which they think about their pension or postretirement medical plans, and 30 percent either didn't know or refused to answer. Conversely, 56 percent of companies with more than 100,000 employees responded that FAS 158 did cause them to change the manner in which they think about these plans. Under FAS 158, changes in a plan's assets and obligations will have a dollar-for-dollar impact on a company's equity. Pension and other postretirement plans will directly affect debt/equity ratios and possibly the organization's loan covenants. Phase two of FAS 158, which may take another three to five years to complete, will involve a comprehensive re-examination of all aspects of employers' accounting for their pension and other postretirement benefit plans.

FAS 158 now requires companies to put underfunded liabilities and overfunded assets on their balance sheet. Will this change the manner in which you think about your pension and/or postretirement medical plans?



Only 22 percent of all respondents identified that level or volatility of annual expense would cause them to change their mind and terminate or freeze their pension plans, compared to 44 percent of companies with more than 100,000 employees. What isn't clear from the responses is whether these large organizations are facing a different set of issues or have a different perception of the issues that all companies are facing.

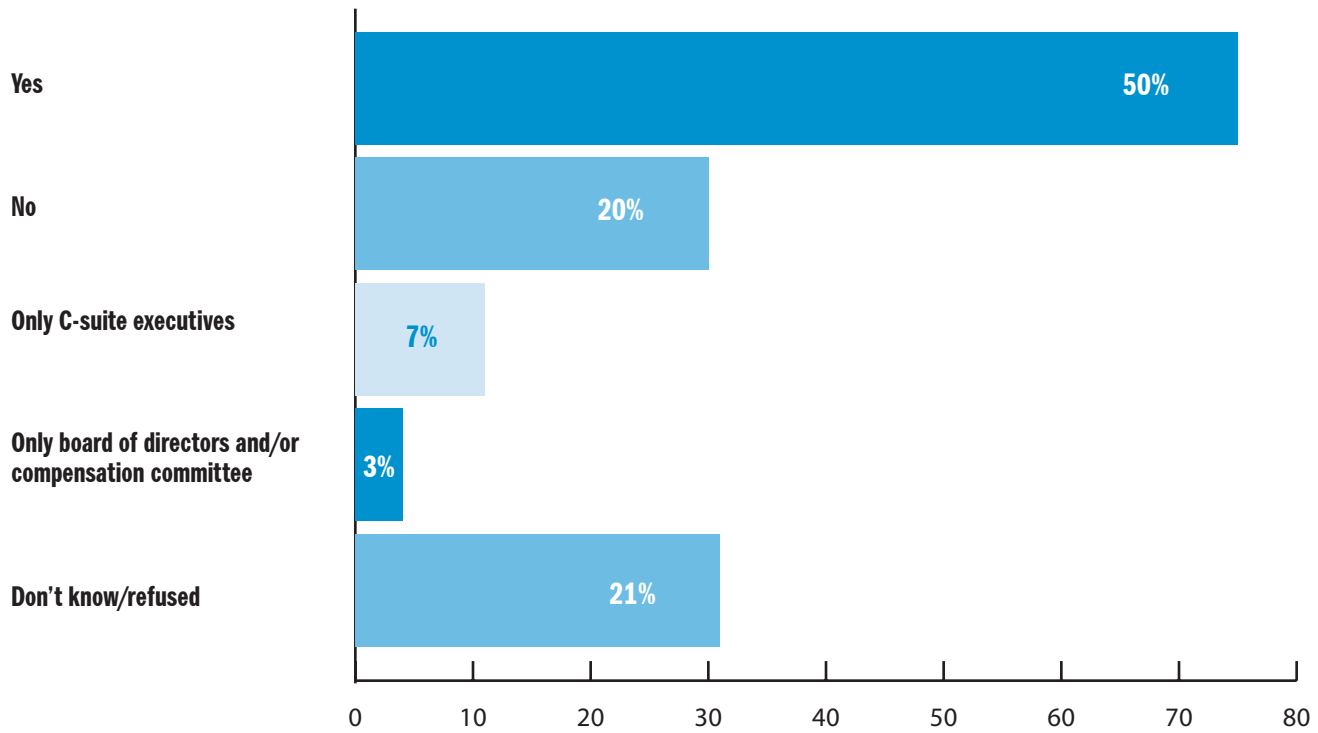
What would be the biggest factor to cause you to change your mind to terminate or freeze your pension plan?



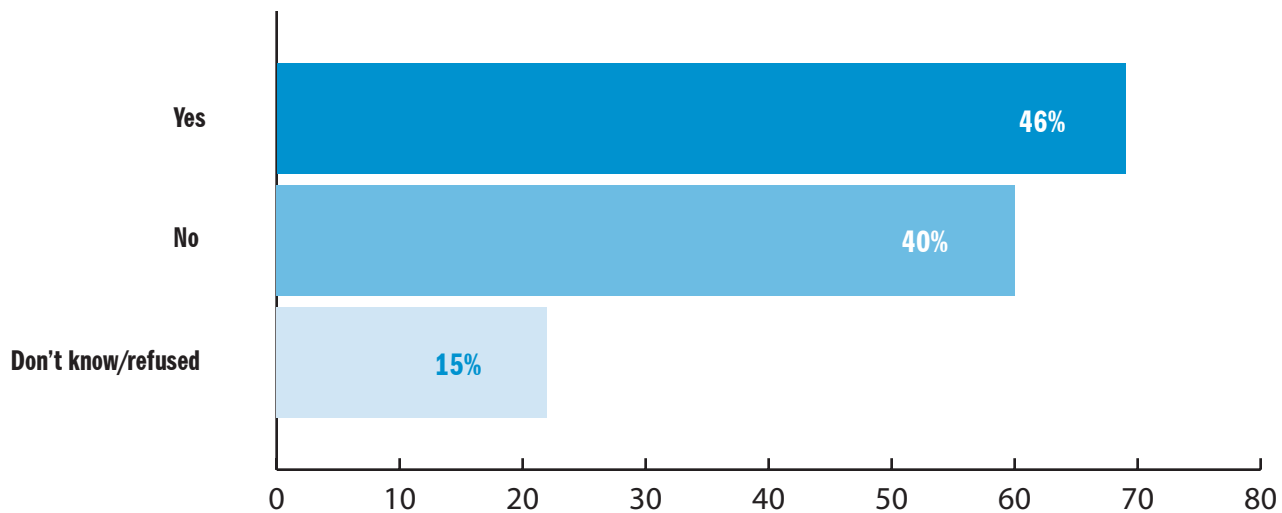
Ignorance Is Not Bliss

The responses to the questions relating to the impact of major regulatory and accounting issues are two examples of a surprising thread throughout the survey in the realm of “don’t know/refused.” About 20 percent don’t think their boards and C-suite executives are concerned about the PPA or FAS 158. Some 15 percent or more don’t know whether the PPA means they should re-examine their pension plans or change their distribution requirements.

Are legislative issues like the Pension Protection Act or accounting issues like FAS 158 of concern to your C-suite executives or board of directors?



Has the Pension Protection Act of 2006 forced you to re-examine your pension programs?



It is impossible from these responses alone to pinpoint the exact reasons behind them. However, a significant number of “don’t know/refuse” responses on such risk-bearing issues raises concerns. One needs to question whether respondents considered their aging workforce when re-examining their pension programs. They may have been focused on being technically compliant when assessing the impact of FAS 158 or the PPA, but may not have factored in the demographic shift of their aging workforce.

The dilemma for employers is determining who makes up their workforce and what it will look like five and even ten years down the road. Only then will they be able to identify who they need to retain.

Phased retirement is an option, but while there are rules and legislation surrounding this concept, it still means very different things to different organizations. This makes it difficult to determine how to best implement programs to support these efforts. When the focus was on retaining senior management, it was easier to implement specific retention programs. Yet, as evidenced by the survey results, management needs to focus on retaining middle management. This strategy switch makes retention efforts more complex because businesses are managing broader-based programs.

Knowledge is power. Therefore, the key to reducing future strategic and financial risks is knowing what your workforce will look like and what it requires to help the organization to succeed.

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Executive Compensation and Benefits—Is it Really in the Money?

In spite of the varying degrees to which companies are responding to the imminent challenges of the aging workforce, 62 percent of the companies surveyed in Ernst & Young's 2007 study on the subject agree that a brain drain is one likely outcome of the loss of key talent. Sixty-eight percent say that retaining key management talent and intellectual capital is the most significant human capital and benefits issue that concerns the C-suite and board of directors. Along with that concern goes a well-established guiding principle of many key employee and executive pay programs that makes retaining top talent an important consideration in program design, especially for senior executives of many companies who often have a significant portion of their pay package linked to long-term incentives, most of which have some sort of vesting schedule or feature designed to encourage retention.

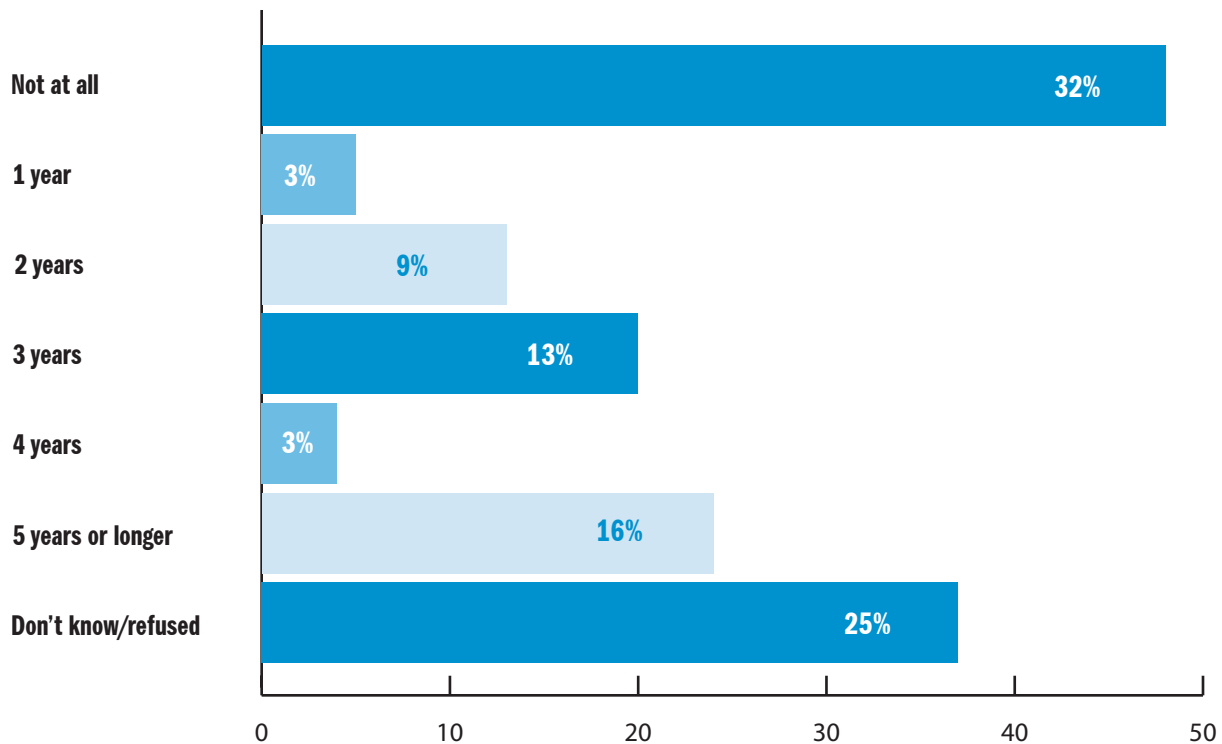
So with the meaningful majority of survey respondents indicating that forecasted retirements will cause a talent gap or brain drain in some functions of the organization, does this mean that the retention features of the pay programs are ineffective? Or does it simply mean that there are more compelling points that drive key employees to leave, forfeited compensation notwithstanding?

While the projected talent gap by some organizations is not strictly limited to senior management and executives, it is clear that this classification of employees is among the categories of concern. More than 40 percent of the companies that responded indicated that it would be desirable for senior management to stay from one year to five years or longer beyond their normal retirement age. It would seem that companies that have gotten to this degree of detail, in terms of specific senior management positions and the specific postnormal retirement age service periods desired, could surgically construct a more robust and customized retention incentive plan for this grouping of individuals. But will this type of approach be successful?

Indicators or Anomalies?

- Key employee retention is a big concern.
- Although retention features are a common aspect of compensation programs, a significant majority of survey respondents indicate that forecasted retirements still will lead to a talent gap or brain drain.
- Even though only a small percentage (11 percent) of respondents believe that variable compensation will be a key component in the ultimate retention solution, 20 percent plan to increase compensation as a means of addressing these concerns.

Ideally, based upon anticipated enterprise needs and expected individual contributions, on average, how much longer would it be desirable for your senior management to stay behind their normal retirement age?



When asked what program was the most effective in terms of transition of management and retaining intellectual capital, only 11 percent of the respondents cited variable compensation programs. That said, however, 20 percent of the respondents indicated that they plan on increasing compensation as one of the mechanisms to address the concern of brain drain.

Who’s in Charge—The Expansion of the HR Role

Survey respondents clearly indicated that the aging workforce issue, in general, falls in the lap of the HR function of an organization. In recent years, HR functions in many organizations have continued to grow in terms of their strategic importance and in the scope of responsibilities and the number of important initiatives they manage. In fact, in many companies, the HR function finds itself operating at maximum capacity almost year-round. Layer on top of ordinary responsibilities the occasional transaction, acquisition, or other such special initiatives, and the HR function can be especially challenged in terms of its own resources.

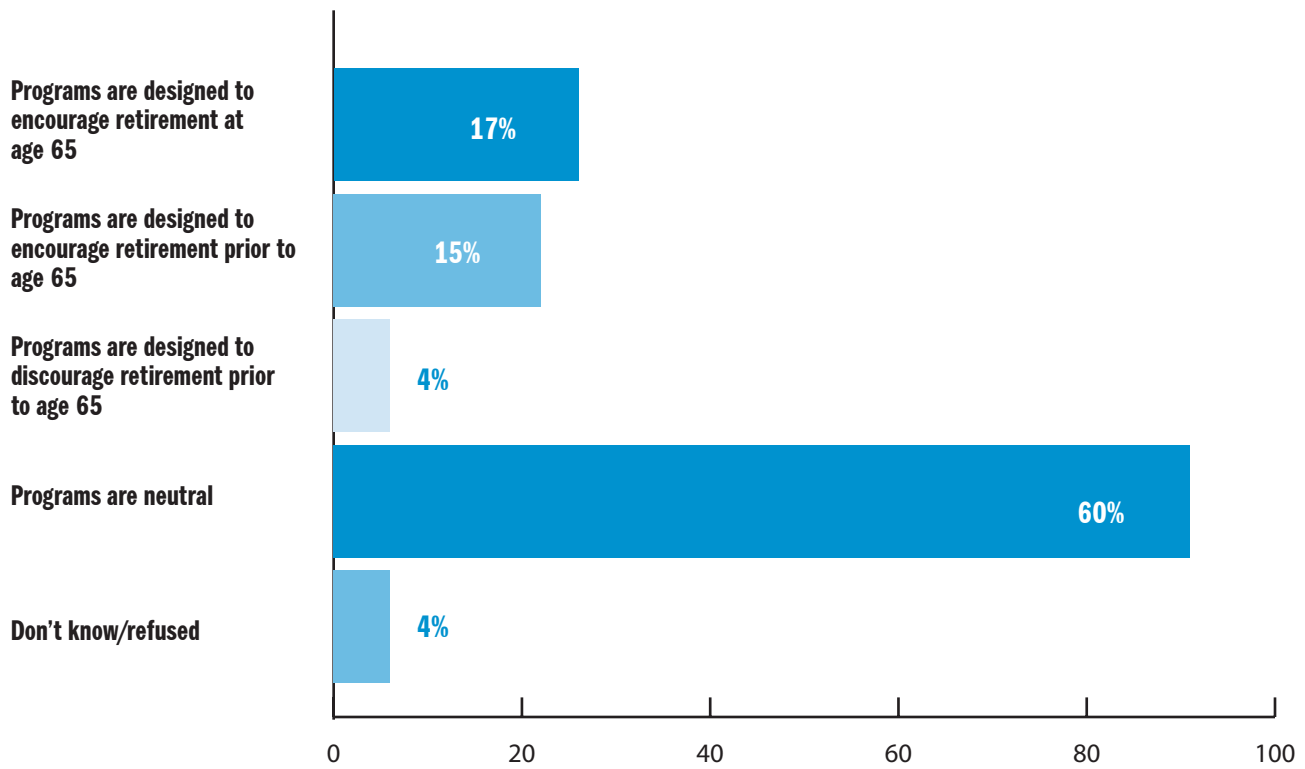
With 79 percent of survey respondents saying their C-suite executives have a role in determining the strategic direction of the compensation and benefits programs for their companies, resource constraints can't keep HR executives from participating at a higher, more strategic level. Now is their time to come to the table—the executive conference table—as well as the board room, and bring with them a knowledge of the demographics of their workforce and an understanding of the impact the aging element is likely to have. They also have the reciprocal responsibility to become knowledgeable about the business and technical issues that may drive some program design decisions.

Compensation and Benefits Programs—Are the Parts Greater Than the Whole?

Against this backdrop and in light of the somewhat curious array of survey perspectives noted above, perhaps it's no wonder that some HR executives have embarked upon an analytical exercise to assess the effectiveness of certain features in their compensation programs and their linkage to specific concerns about the aging workforce, the talent loss, and the brain drain. For example, 60 percent of survey respondents indicated that their programs are “neutral” in terms of encouraging or discouraging retirement at normal retirement age. It seems that if a company has both neutral programs and an active concern about losing talent, it also has the opportunity to make changes that would render its programs positive rather than neutral.

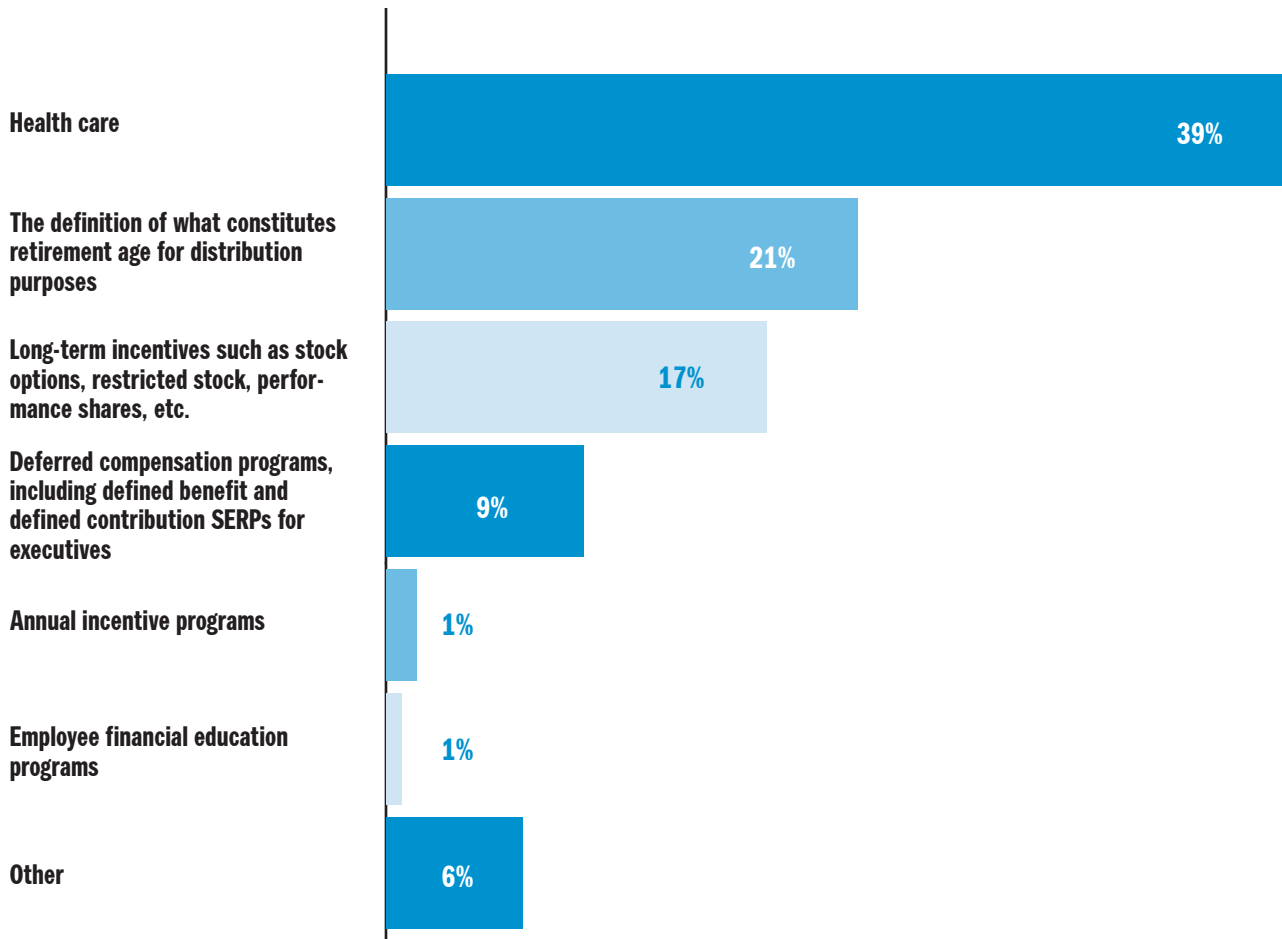
There also appears to be a disconnect between the employer's view of the company's retirement program and the reality for the employee. One particular topic where perceptions diverge is the notion of plan neutrality. When asked what best describes the objective of employers' benefits and compensation programs, 60 percent of respondents said they viewed their programs as neutral. By definition, a plan is neutral if it neither encourages nor discourages retirement—a 401(k) plan controlled by the employee is neutral. On paper, that is a logical assumption, but there is a hidden disconnect between theory and reality. In reality, 401(k) contributions, for example, may be limited by the individual's income, lifestyle, family obligations, or any number of other factors. And even if the employee is financially able to contribute the maximum allowed, that maximum may be diluted by poor investment returns or plan loans for nonretirement purposes. Employees may then need additional vehicles to supplement their retirement savings. In either situation, knowing how to make that money work after retirement to reasonably maintain an accustomed lifestyle may be missing. The result is the 401(k) plan may be “deneutralized” by a lack of financial understanding on the employee's part. What responsibility an employer chooses to assume for providing employee financial education, counseling, and advice is a question of social responsibility and perhaps litigation exposure. What should not be in question, however, is awareness, particularly when the well-being of an ever-growing number of people is at stake.

Which best describes the objective of your benefits and compensation program?



Having said that, the survey respondents also indicated that they do not consider such long-term incentive plans as stock options, restricted stock, and performance shares and deferred compensation programs such as supplemental executive retirement programs (SERPs) to have the most impact on an employee's decision to retire (17 percent). That consequently begs the question as to why, especially for executive programs (such as SERPs, stock options, restricted stock, etc.), one stated objective of these programs is employee retention. Again, does this mean that the program features themselves are not working? In that case, are the features of the program efficient for the organization in terms of the cost to shareholders vs. the effectiveness of the program in terms of performance and retention incentives?

What is the top compensation and benefits program/feature that you think impacts an employee's decision to retire?

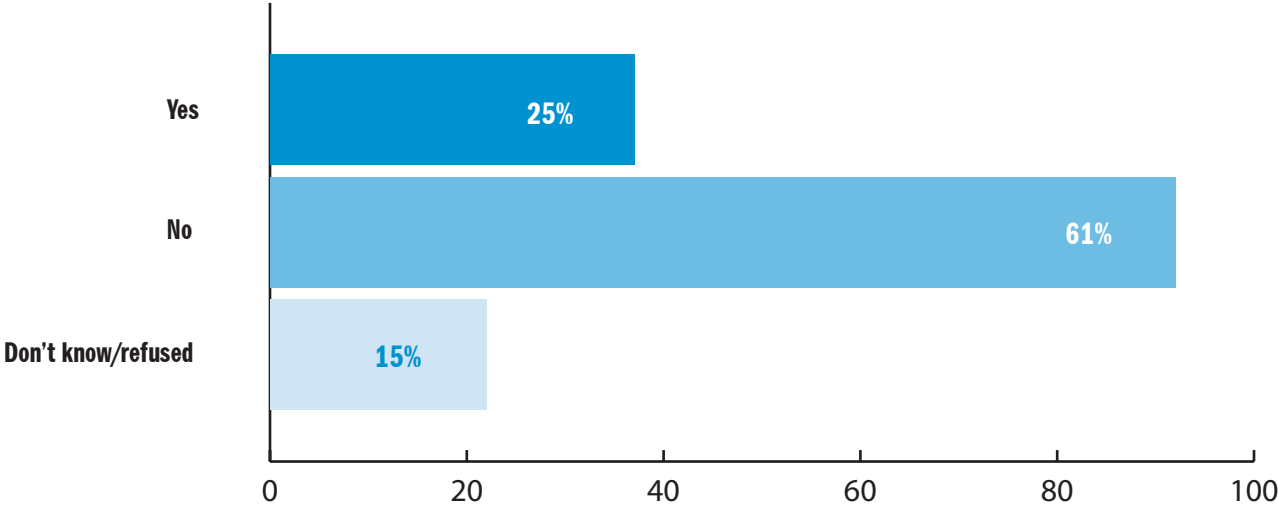


We have observed over the years that while many companies have retention features as important objectives in their senior management pay programs, some of these same companies have features that in effect “reward” key employees who stay with the organization after having met some pre-established retirement age or years of service milestone. In many cases this arbitrary retirement age was set long before such a need arose for retaining key management. A simple example of this might be a feature in a stock option program that cuts short the option exercise period if someone terminates employment but allows the full exercise period if someone terminates employment after having met a pre-established retirement age or years of service milestone. Such features were often designed to reward long-term employees who devoted the bulk of their careers to the organization. This might also be an example of a program feature that is counterproductive to retaining key senior management talent after their normal retirement age in light of the aging workforce brain drain concern. This is but one simple example out of many features in pay programs that might need to be re-evaluated in light of the broader strategic issues and concerns.

The objectives of individual features aside, it is generally more desirable for an organization to consider alterations to its compensation programs as part of an overarching strategic and philosophical framework rather than as one-off changes. Given that variable pay and incentive plans and supplemental retirement plans are often significant components of the compensation programs for key employees and often contribute significantly to their wealth accumulation, there is cause for revisiting the features of these programs to provide better balance between the issues of talent loss and brain drain and a compelling and competitive pay program. The survey showed that one-quarter of all respondents are trying to determine how to adjust benefits for a specific group of employees that they do not want to retire right away. Perhaps given the sensitivity about pay programs, an organization might consider that this is not the most desirable area for trying to help address the issue of the aging workforce and the associated talent loss. However, when companies consider modifications to broad-based retirement and welfare plans, it may not be as effective to pinpoint certain subsets of the employee population to deal with specific issues of forecasted talent loss. Thus, when it comes to senior management employees and senior executives, consideration of adjustments to program features and the compensation strategy may be an especially effective avenue to consider.

While it is generally recognized that compensation programs alone are probably not sufficient to retain and motivate key talent, program design can be a highly effective aspect of a broader strategic solution to the loss of key talent that comes with the aging workforce.

Are you trying to determine how to adjust benefits for a specific group of employees that you do not want to retire right away?



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Health Care and the Aging Workforce—Triage or Strategic Planning?

Twenty years ago, the Washington Business Group on Health and the AARP released a report on “. . . how U.S. businesses will be affected by the demographic changes of an aging society.” In addition to encouraging employers to “develop new strategies to address current and future change,” the report made this highly prescient observation:

As employers plan for the coming years, two trends will become increasingly related: the aging of the American population and the rising costs of health care for workers and retirees.

Today, the U.S. health care market represents 16 percent of the gross national product.¹ Employers are already spending billions of dollars on health care for their employees, with no ready means of assessing its quality or cost-effectiveness. Against the background of a system that itself clearly is challenged, the people it must serve are aging—concurrent trends that by definition are upping the likelihood of increasing health care costs. So while technology has reduced the physical demands of many jobs and Baby Boomers are living longer and healthier lives than their ancestors, they will be managing more chronic conditions and, therefore, utilizing more health care services.² In short, health care and its accompanying costs are immutable factors in the impact of a graying population on American business.

Twenty years from now, according to the American Hospital Association and FCG:³

- The over-65 population will nearly double.
- More than six of every ten Boomers will be managing more than one chronic condition.
- One of every four Boomers will be living with diabetes.
- Nearly one of every two will be living with arthritis.

While meeting the somatic challenges in the Boomers’ future rests largely in the laps and labs of the health care and biotechnology industries, the impact will certainly be contagious—it will be virtually impossible for business at large to be immune.

So how prepared are companies today for conditions that, arguably, are only beginning to show the effects of aging? Have preventive measures been put in place or has the prospect of pain not reached a threshold that demands action? One way to gauge this kind of preparedness is to take a look at how companies are prioritizing their benefits plans relative to health care.

Survey Says ...

Ernst & Young asked *Fortune* 1000 companies from a range of industries and sizes varying from fewer than 1,000 to more than 100,000 employees a number of questions concerning their benefits and compensation programs to see, among other things, how the issue of health care was factoring in relative to their broader treatment of the issues of the aging workforce.⁴ The survey was directed

¹ *Facts on the Cost of Health Care*, prepared by The National Coalition on Health Care, 2007.

² *When I’m 64: How Boomers Will Change Healthcare*, prepared by American Hospital Association and First Consulting Group, May 2007.

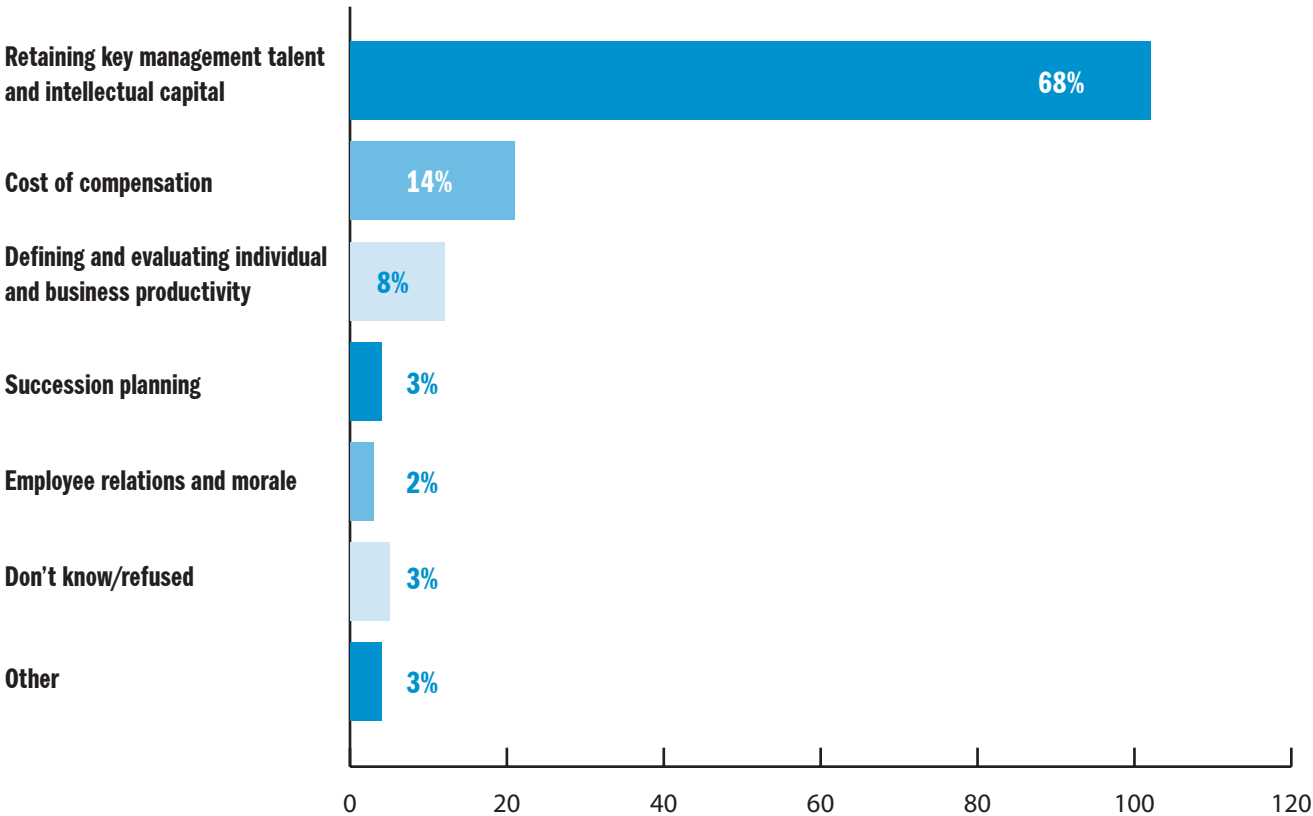
³ *Ibid.*

⁴ Survey questions and complete response details can be found in the appendix of the overall survey report, *Ernst & Young LLP’s 2007 Aging U.S. Workforce Survey: Challenges and Responses – An Ongoing Review*.

primarily to top HR executives. The answers not only apply to the specific questions, but also provide insight into the HR perspective overall and its relative sphere of influence and knowledge.

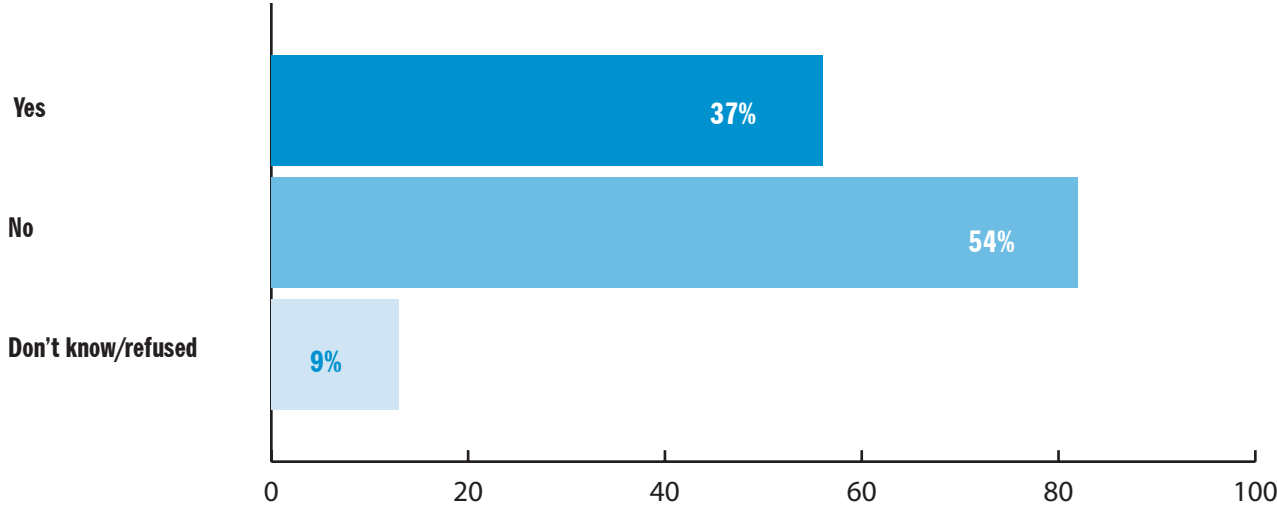
One of the level-setting questions asked which human capital and benefits issues are of most concern to the companies' C-suite executives and boards of directors. While *cost of compensation and benefits programs* received the second highest response, this was the top concern of only 14 percent of the total companies participating. The response was somewhat higher for small to mid-size companies (5,000 to 9,999 employees) and very large companies (more than 100,000 employees), at 30 percent and 33 percent, respectively. The issue cited by far as the biggest concern was *retaining key management talent and intellectual capital*—so said 68 percent of all respondents.

Which human capital and benefits issues concern your C-suite executives and board of directors most?

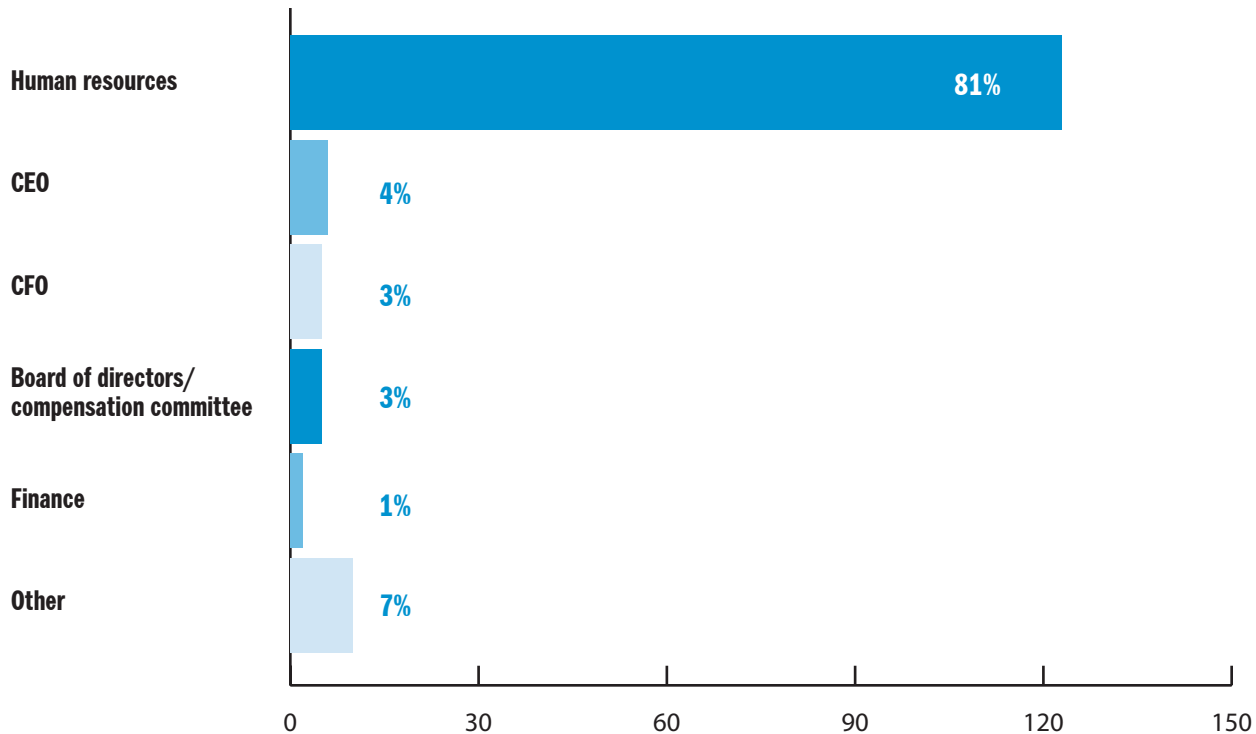


More than 80 percent say that HR is responsible for identifying the changes that need to be made to a company's benefits and compensation programs, one of the most unequivocal responses in the survey. What, how, and whether changes are actually made vary. For some companies, the concern over the cost of their benefits programs has been a catalyst—37 percent say that they've changed or will change these programs due to financial risks associated with their aging workforce. While that still leaves a majority that are neither making nor contemplating such changes, the response is still encouraging—field experience and client conversations suggest that number would've been much higher just a year or two ago. Thus, the health care component is gaining board and C-suite attention and will likely continue to do so as the workforce continues to age and more Boomers reach retirement.

Has your company changed or is it considering changes to its benefits and compensation programs due to financial risks associated with your aging workforce?



Who is responsible for identifying the changes that need to be made or have already been made to your benefits and compensation programs?

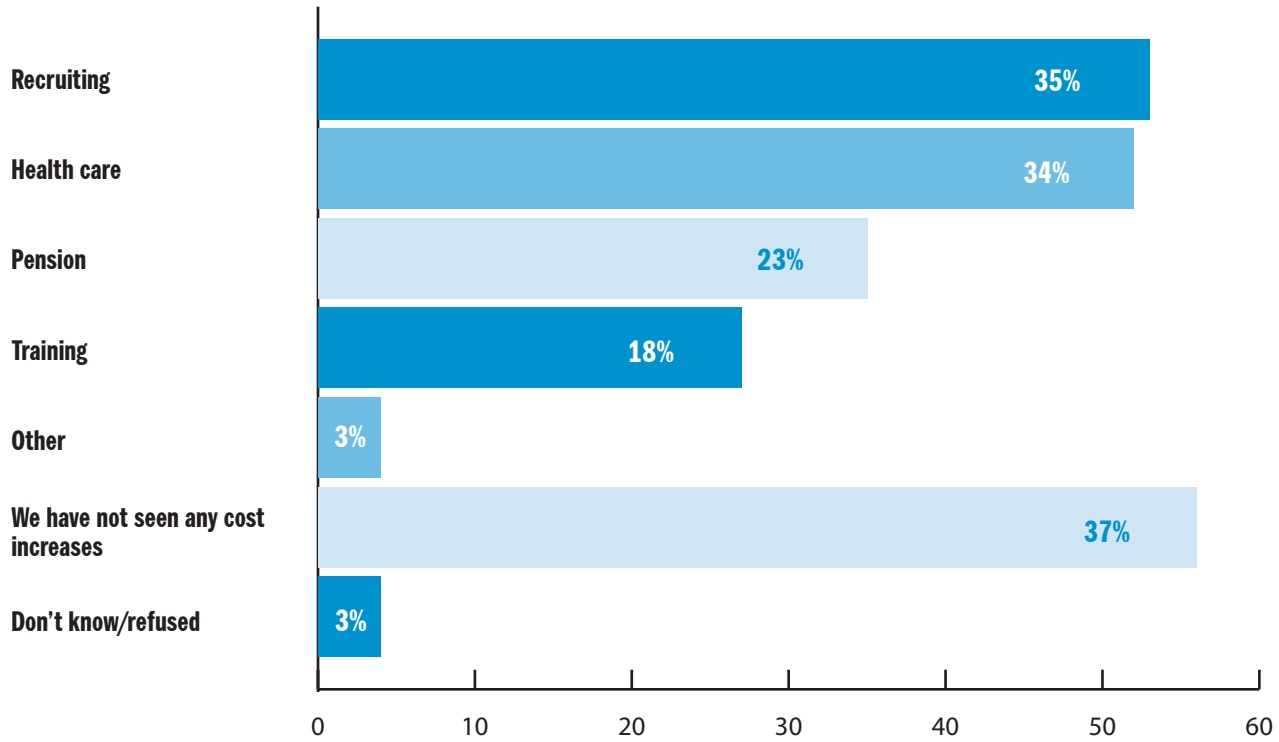


Health care is certainly a critical component from the employee’s perspective. Thirty-nine percent of the companies surveyed say that health care is the top feature in the compensation/benefits program that influences an employee’s decision to retire—arguably the “health care handcuffs” that keep them working. Any other factors cited are far behind. By extension, health care can’t fall too far down on the list of corporate priorities, and executives, whether HR or C-suite, can’t afford not to pay attention.

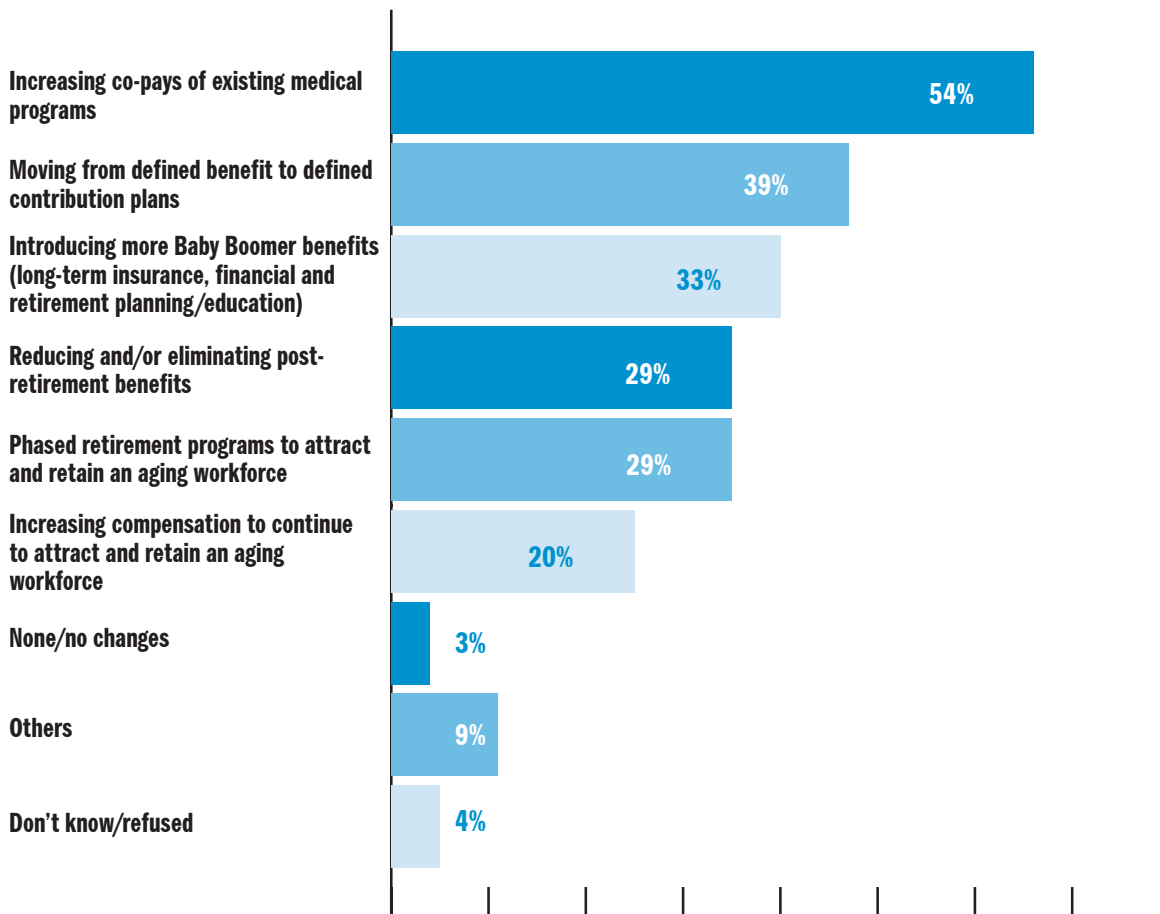
Health Care Mathematics—The Addition and Subtraction of Benefits

Thirty-four percent of all companies surveyed say they have seen an increase in health care costs as their senior management nears retirement age—a number that is somewhat surprisingly low. That said, 54 percent are increasing the co-pays of their existing medical programs. Nearly 30 percent are reducing and/or eliminating postretirement benefits—the number increases to 50 percent for companies with 5,000 to 9,999 employees and 43 percent for the largest companies (100,000+ employees).

Have you seen an increase in the following costs as your senior managers near retirement age? (Multiple responses accepted.)



What changes have you made or are considering for your benefits/compensation program? (Multiple responses accepted.)



Reactions such as these seem to be more about quick-fix responses to help manage costs than elements in a long-range strategic plan, although an interesting by product may have the effect of keeping employees in the workforce longer.

On the other hand, 33 percent of companies (mostly those in the mid-size range) are introducing more Baby Boomer benefits, such as long-term care insurance, financial and retirement planning, and the education to support it. It should be noted, however, that these benefits are largely voluntary. Employers are offering long-term care insurance, for example, with the inherent economy of a group rate and handling the administration of the programs, but the premium is paid by the participants. While this may or may not indicate that a strategic plan is in effect, it does suggest a growing awareness of the fact that the needs of an aging workforce are different and employers are considering what it means to address their graying population.

What may also be missing when it comes to making relevant changes in health care benefits is a real understanding of the health care constituency and what drives their claims. It's safe to say that employers across the board are experiencing an increase in health care costs of 7 percent or more, but why they're experiencing it is different in each case.⁵ For example, in 2002, a Dartmouth Medical School (DMS) and Dartmouth-Hitchcock Medical Center (DHMC) study showed that lumbar fusion was performed on 4.6 of 1,000 patients in Idaho Falls, Idaho, while an average 1.0 patients underwent the procedure in cities such as Bangor, Maine. That disparity probably isn't because people in Idaho just don't know how to lift things, but reasons for geographic variations are not fully understood.⁶

As the survey indicates, employers are passing along the increases in health care costs to the participants rather than looking to understand their root causes. Although some proactive employers may begin examining such claims, they may not be focusing on the actual cost impact of the aging work force vis-à-vis the changing types of procedures and treatments and their corresponding costs—i.e., acute conditions become less frequent and chronic conditions become more prevalent. Stepping back and taking a look at what's behind employee claims can provide a company with real insight into the specific issues of its workforce and the pattern of demographic differences to enable stakeholders to design an appropriate strategy that can demonstrate both social and fiscal responsibility, rather than simply passing along the increasing cost through annual increases in deductibles, co-pays, and employee contributions.

What's Next?


What raises some concern for observers is the extent to which strategy is playing a part in employers' responses to the aging workforce or whether triage is the common approach, with health care-related decisions more likely to be made in a reactive mode. One quarter of the companies say they are trying to determine how to adjust their benefits for a specific group of employees they don't want to retire right away. Presumably that group comes from middle and senior management, since more than 70 percent of respondents say that's where they are likely to feel the pain of the "brain drain."

When it comes to responsibility, 77 percent of the respondents say that HR is responsible for identifying financial risks associated with the aging workforce, while 81 percent say HR is also responsible for identifying changes to benefits and compensation programs. Additionally, 68 percent of respondents say their board of directors and compensation and benefits committee are responsible for determining the strategic direction of their compensation and benefits programs (however, 79 percent of respondents say their C-suite executives play that role). Our concern continues to be the communication gap that exists between these two groups. If this gap is not closed, it may result in lost opportunities to connect all the dots and therefore negatively impact a company's ability to develop benefit programs meeting their employees' needs without downloading costs onto them. Because retaining key talent and knowledge is their foremost concern, benefit packages and their attractive features remain a key tool in the retention strategy.

If the plan includes adding more voluntary benefits, as the survey indicates, the positive effect will likely be limited to only those who can afford them—again, mid- to senior management. Clearly, there is a larger picture that bears considering and could encompass everything from social responsibility to productivity and profitability.

⁵ *Facts on the Cost of Health Care*, prepared by The National Coalition on Health Care, 2007.

⁶ *2002 Dartmouth Medical School and Dartmouth-Hitchcock Medical Center study on National Spinal Fusion Rates*. Lead Author James N. Weinstein, DO, MS, a surgeon and Chair of the Department of Orthopedics at DHMC and Professor of Orthopedics at DMS, member of the Center for the Evaluative Clinical Sciences (CECS) and Director of the Institute for Informed Patient Choice.



Even a year ago, there was very little “overt” thought about or focus on the aging workforce among corporations. Only 7 percent of 2006 survey respondents cited the cost of compensation and benefits as a concern—half as many as in 2007. Bringing a murky issue into specific relief was one of the catalysts of the 2006 Ernst & Young survey. Responses to this second survey and anecdotal experience indicate that there has been a lot of growth in the interest in and attention paid to the topic since then. As long as the economy goes well, that will probably continue to be the case. If the economy slows, however, organizations are more likely to concentrate on how to trim costs and headcount than on how to keep people. Such tendencies notwithstanding, the workforce isn’t getting any younger. The age spots aren’t fading, and neither should the focus.

A Call to Action

Although employers are beginning to increase their focus on the impact of an aging workforce, there is very little being done to evaluate future workforce requirements and proactively manage the costs and risks associated with these eventual changes. Employers need to begin to develop a strategy and understand how the strategy will impact them financially as well as from a productivity management perspective.

Here are two fairly simple scenarios that can provide a framework by which employers can more deeply analyze their own situations. In the first scenario the economy is strong—both in general and within the employer’s industry. The labor force is tight, and the influx of new, young talent needed to support the business goals does not match that of the aging Baby Boomers currently employed.

The organization has decided that it needs to retain this older workforce for a number of years, at least until it can better train the staff and middle management and prepare them to assume the roles and responsibilities currently held by the Baby Boomers. Keeping an older workforce could mean altering the programs that these workers value, such as retirement programs (pension plans, health care, retiree medical, long-term care, financial planning, etc.). Employers facing this scenario should be assessing what programs and offerings will help retain these valued employees longer and what the associated costs would be. They also need to assess their current training initiatives to ensure that the proper knowledge will be transferred during the time they still employ the aging portion of the workforce.

In the second scenario the economy is weak, and the employer needs a headcount reduction to maintain financial viability. Baby Boomer employees want to stay onboard to accumulate income before retirement, and younger workers could be lost if they can’t see a clear upward path, whether because of the Boomers who stay or the weakening of the organization due to the economy. These employers will want to assess the training needs of the younger group to determine if they are ready to assume the roles vacated by the Boomer generation. The organization also needs to assess the financial impact that would result if it offered early retirement packages to those near retirement as a way of managing headcount and cost.

Whether a company falls squarely into one of these scenarios or somewhere in between, the time for strategic response and preparation is now. And the questions to answer are these: what are my company’s workforce requirements now and in the future? What do I need to prepare replacements, and are we prepared with adequate and timely training and development? What do we need to do to make sure our compensation and benefits programs are aligned with the company’s overall business goals, and how can we support achieving them? While the scenarios may shift, the responsibility for strategic planning and action will not.

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Retirement in the Regulatory Era—Plan or Perish?

The 78 million Americans who comprise the Baby Boom generation are rapidly and unavoidably graying. According to the AARP, this generation comprises 40 percent of the U.S. labor force.¹ And despite improved health, longevity, or a need to continue working for as long as possible, retirement is just as inevitable.

Employers may think they have enough on their plates when it comes to dealing with the inevitable aging and imminent retirement of a significant portion of their workforce over the next five years—the number forecasted by the *Fortune* 1000 companies surveyed in Ernst & Young’s second report on the aging workforce and its impact on business and compliance.² However, there is no question that the talent gap and the brain drain are real-world issues that are moving further up toward top-of-mind for company leaders, boards of directors, and HR executives. Although each situation ascends the ladder of importance with varying speed and intensity, practical, social, and financial considerations are part of the process as the Baby Boom generation retires. In today’s highly scrutinized and increasingly transparent business environment, meeting these challenges may not be enough. The brain drain age is taking place in the regulatory era, where scrutiny, transparency, and compliance add exponentially to the complexity of doing business no matter what the age of employees.

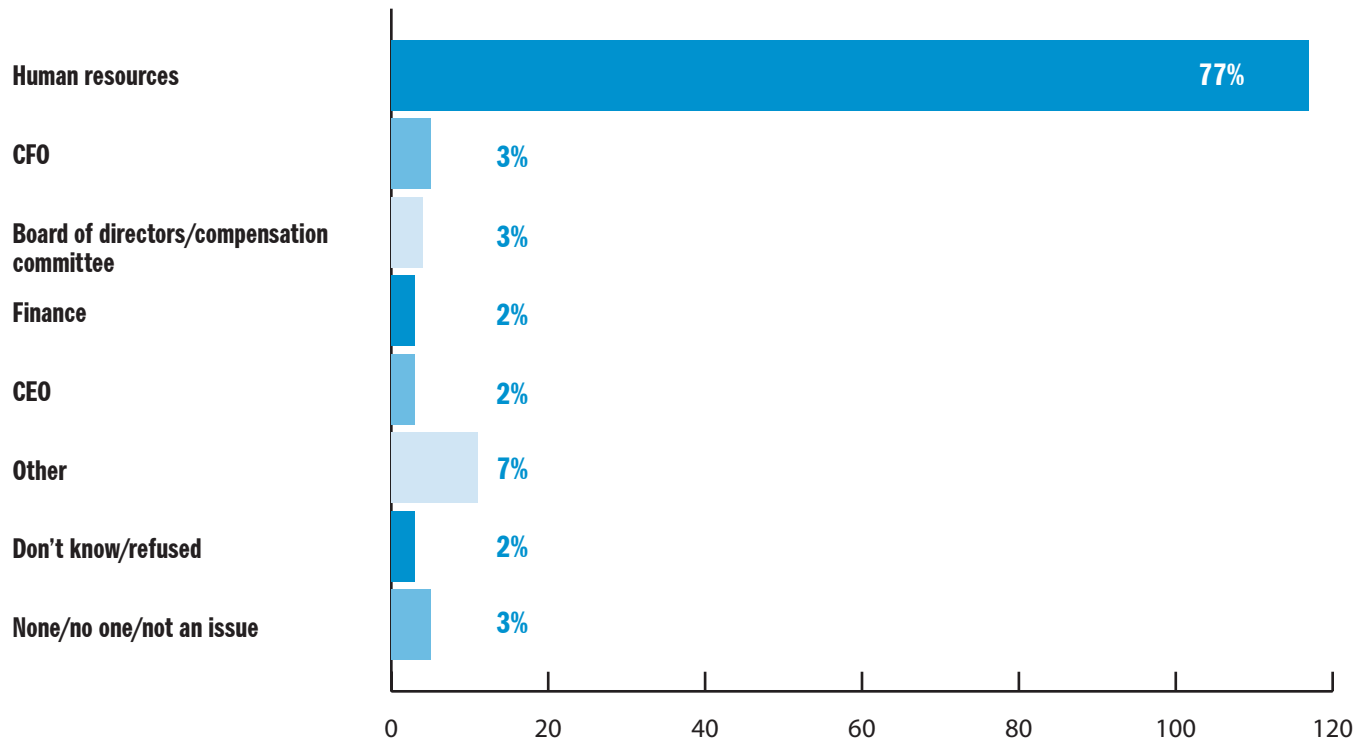
Who’s Minding the Plans?

In the overwhelming majority (77 percent) of companies surveyed, HR is responsible for identifying the financial risks associated with the aging workforce. Likewise, most companies assign HR the responsibility for identifying changes that need to be made to the benefits/compensation programs. In this case, it’s at least 80 percent in all companies, with the exception of a sharp decline for the smallest companies (25 percent of those with fewer than 1,000 employees) and a somewhat more moderate decline to 56 percent for the largest companies.

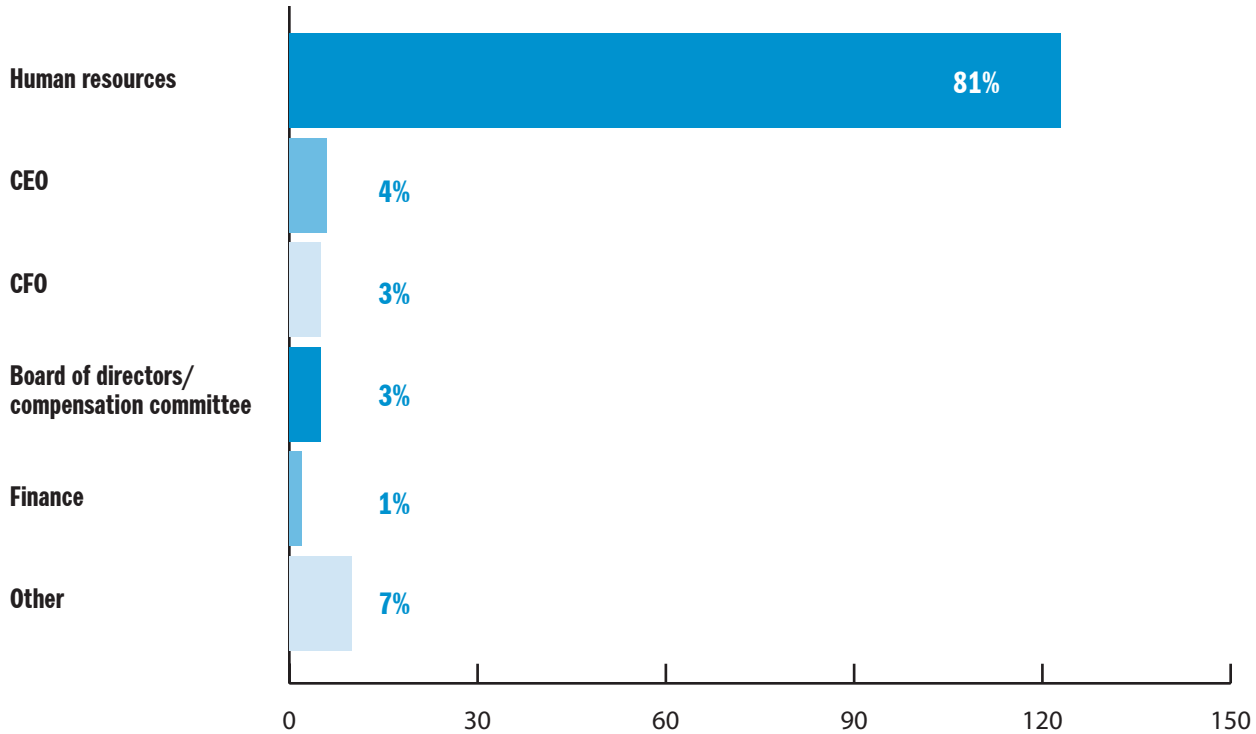
¹ *Workers 50+ – Business Executives’ Attitudes Toward the Aging Workforce: Aware But Not Prepared?* Survey conducted by *BusinessWeek* Research Services for AARP, October 2006, Revised Edition.

² *Ernst & Young LLP’s 2007 Aging U.S. Workforce Survey: Challenges and Responses – An Ongoing Review.*

Who is responsible for identifying the financial risks associated with your company's aging workforce?



Who is responsible for identifying the changes that need to be made or have already been made to your benefits and compensation programs?



Because HR executives at the vice-president level or above were the primary respondents to this survey, they had the opportunity to answer for themselves whether their companies had made any changes because of the Boomers and the potential financial risks that may have accompanied them. More than half (54 percent) of all those surveyed said “no,” they were neither making nor considering changes to their benefits and compensation programs due to financial risks associated with the aging workforce. Although some observers may be heartened by the fact that 37 percent said “yes,” the results of current regulatory and IRS efforts, such as the Employee Plans Team Audit (EPTA), may dampen that optimism.

An Ounce of Prevention

One of the common themes surfacing in each perspective on this study³ is not just the brain drain or the talent gap; it’s the *strategy gap*. Responses are not indicating any clear and consistent evidence that companies are stepping back to get a strategic view of where they are now relative to the needs of the soon-to-be retirees or the relative demands of compliance, and what needs to be done to shore up operational efficiency as well as compliance. While 42 percent say they have analyzed their benefits plans and conducted a compliance review to gauge whether employees are receiving the accurate benefit amounts, 58 percent either haven’t done so or don’t know.

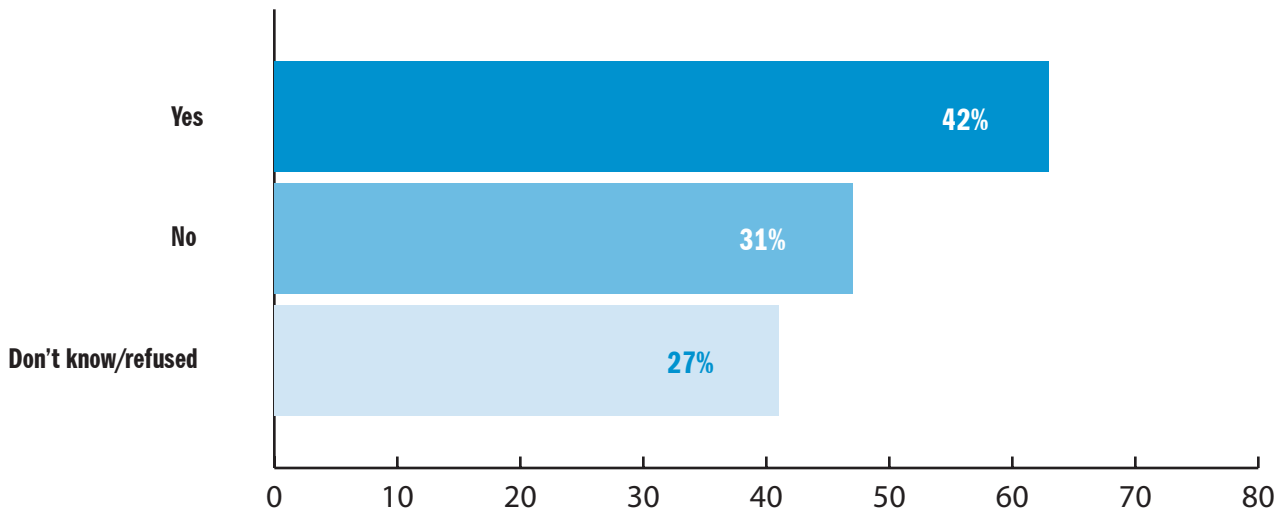
³ Ernst & Young LLP’s 2007 Aging U.S. Workforce Survey: Challenges and Responses – An Ongoing Review examines the aging workforce from the perspective of pension plan compliance, compensation and benefits, succession planning, pensions, and health care.

Making the assumption that programs that were once compliant may always remain compliant is not entirely accurate. There are many variables (including demographics), such as systems, calculations, and regulations that are constantly changing and impacting existing programs. The IRS EPTA is one example of how many organizations that believed they were fully compliant were found to be noncompliant.

There are 4,500 single-employer qualified plans in the United States that meet the 2,500 participant threshold and are subject to an IRS EPTA examination. This is from 6,900 single-employer qualified plans in the United States. Those 4,500 “large” plans, however, cover 60 percent of all plan participants and hold 70 percent of the trillions of dollars invested in those plans. The initial IRS pilot audit program showed such a high degree of noncompliance that the IRS made the program permanent. Further, the IRS has stated that for companies that meet the number of participants threshold: “It is not a question of whether a company will be audited, it’s a question of when.” To date, the IRS has completed more than 100 of these examinations and identified between \$2 billion and \$3 billion in corrections and adjustments. That level of exposure, coupled with the program becoming permanent, has many large employers very concerned about their qualified plans’ operational compliance. That may increase considerably the burden of responsibility that HR executives feel when contemplating design changes to address the aging U.S. workforce and the imminent increase in the number of retirements.

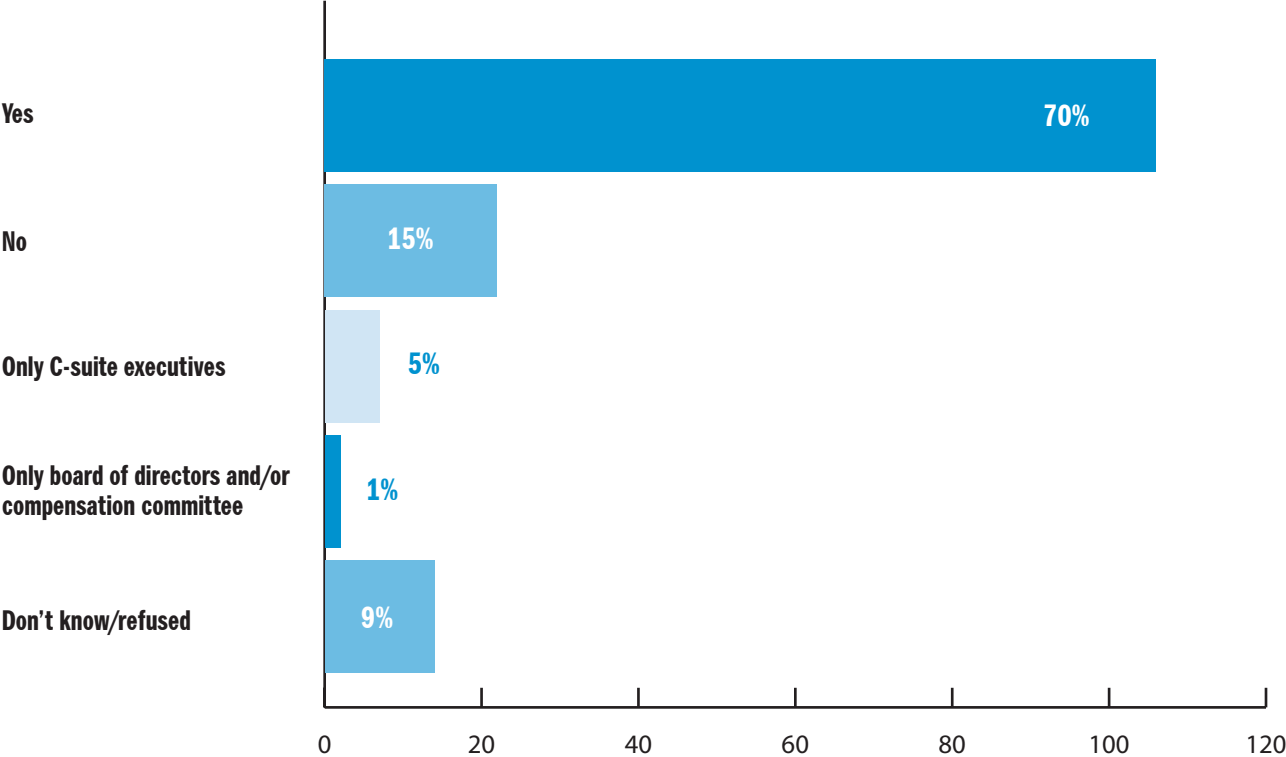
As EPTAs and other audits progress, the IRS is gaining a better understanding of what issues should be examined more closely—a lesson that could be good news or bad news, depending upon each company’s retirement plan profile. Either way, the climate is changing, and it’s reasonable to assume that once the IRS completes the audits of the large plans, even the smaller ones may not be immune.

With Babyboomers getting ready to retire en masse, have you performed an analysis of your benefits plans and conducted a compliance review to gauge if employees are receiving accurate benefit amounts?



On the other hand, 70 percent of respondents say that their C-suite executives and boards of directors are concerned about compliance issues. This gap could indicate a significant disconnect between what management and stakeholders want and what is actually being done to address plan compliance. Because the regulatory environment shows no signs of relaxing, HR executives may want to read this as a signal to make sure their priorities are aligned with leadership's.

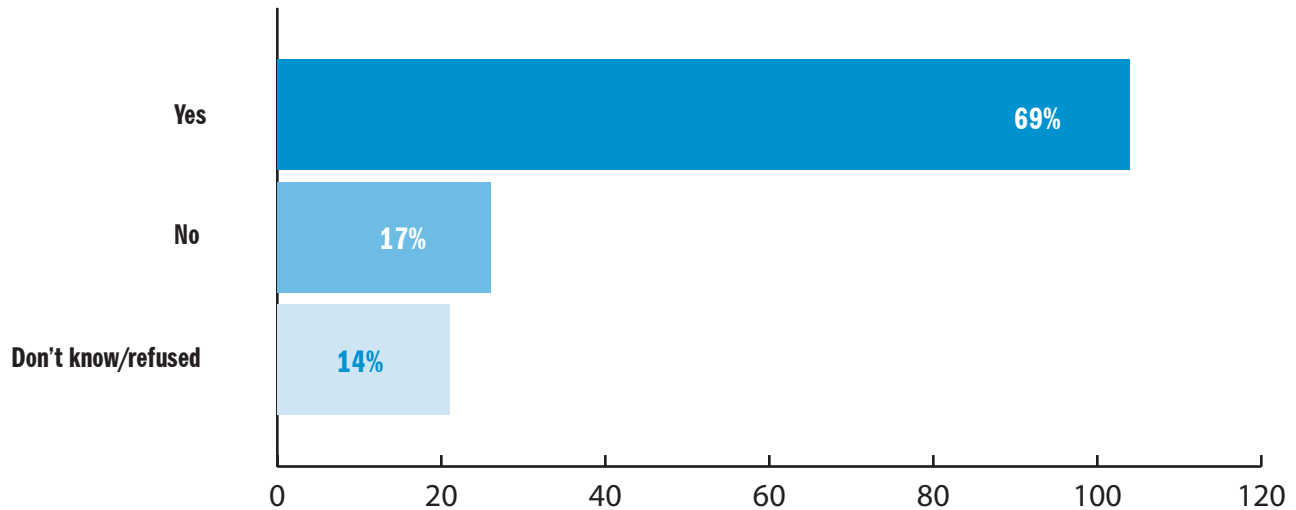
Are compliance issues of concern to your C-suite executives or board of directors?



Now for the Good News

The picture is somewhat better when it comes to analysis and understanding compliance with all labor and discrimination laws. Sixty-nine percent of all respondents say they have performed such an analysis; only 17 percent say they haven't, and 14 percent say they don't know.

Have you performed an analysis to determine whether you're in compliance with all labor and discrimination laws as they pertain to your aging workforce?



At the same time, 25 percent of all respondents say they're trying to adjust benefits for a specific group of employees that they don't want to retire right away—a seemingly strategic move with an intended positive result that may instead backfire. Adjusting benefits for a discrete group of the employee population carries the potential for nondiscrimination and coverage issues that need to be addressed vis-à-vis the overall population. If the aging workforce concerns are principally around the executive and middle management levels, as survey responses indicate, this group would likely meet the definition of “highly compensated employees (HCEs)”—and these qualified plans cannot be designed or operated to favor HCEs and still maintain the tax benefits of the plan provided to the company and employees.

The IRS and Congress have attempted to at least partially address these issues by creating rules allowing for phased retirement alternatives for workers. Under these complex rules, workers who have reached a certain age can reduce the number of hours they work and get small distributions from their pension plans to make up the shortfall in their earnings due to reduced hours. This facilitates the involvement of older workers in the business while they phase into retirement and helps the organization address important knowledge transfer issues that are imperative for the development of younger workers. Unfortunately though, these rules have administrative requirements that are so complex that most HR executives who are in charge of plan administration don't view them as a viable option—only 9 percent of respondents say that their employees are allowed to receive pension benefits while they are still with the organization. Yet 25 percent of respondents are looking for ways to retain certain key employees, and nearly 70 percent are concerned about retaining both human and intellectual capital. While authorities have issued some clarifications, there is still a way to go to make phased retirement a manageable alternative from the perspective of the HR professional.

Bottom Lines

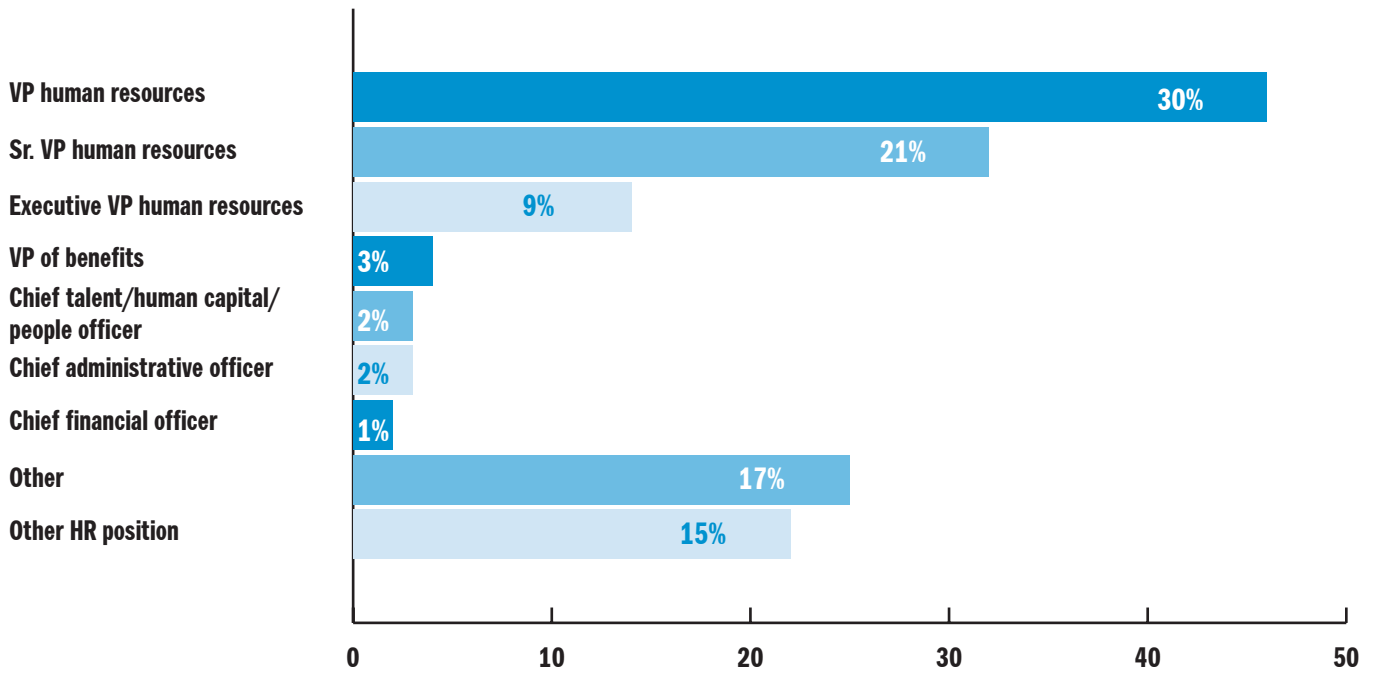
So are there as many lines on a preemptive evaluation or IRS audit as there are on the unadorned faces of this graying workforce? Probably that many and then some. But beyond identifying compliance issues, an operational review can also help companies identify opportunities to improve plan administration and benefits without increasing costs. The intrinsic value of such an exercise is that it can contribute to employee morale and reduce the rate of turnover for reasons other than retirement—like eliminating lines without surgery.

Authored by Christopher Lipski, Principal, HR Risk Service Line Leader, Performance & Reward Practice. He can be reached at chris.lipski@ey.com.

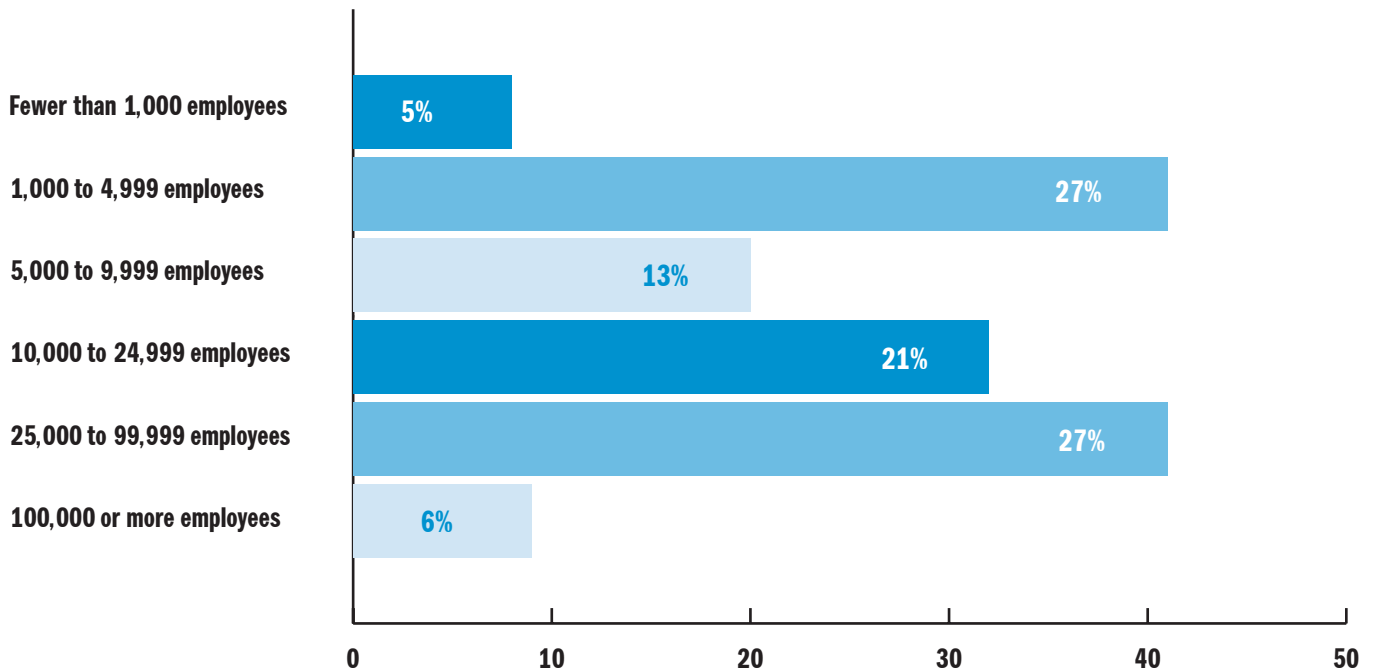


Appendix

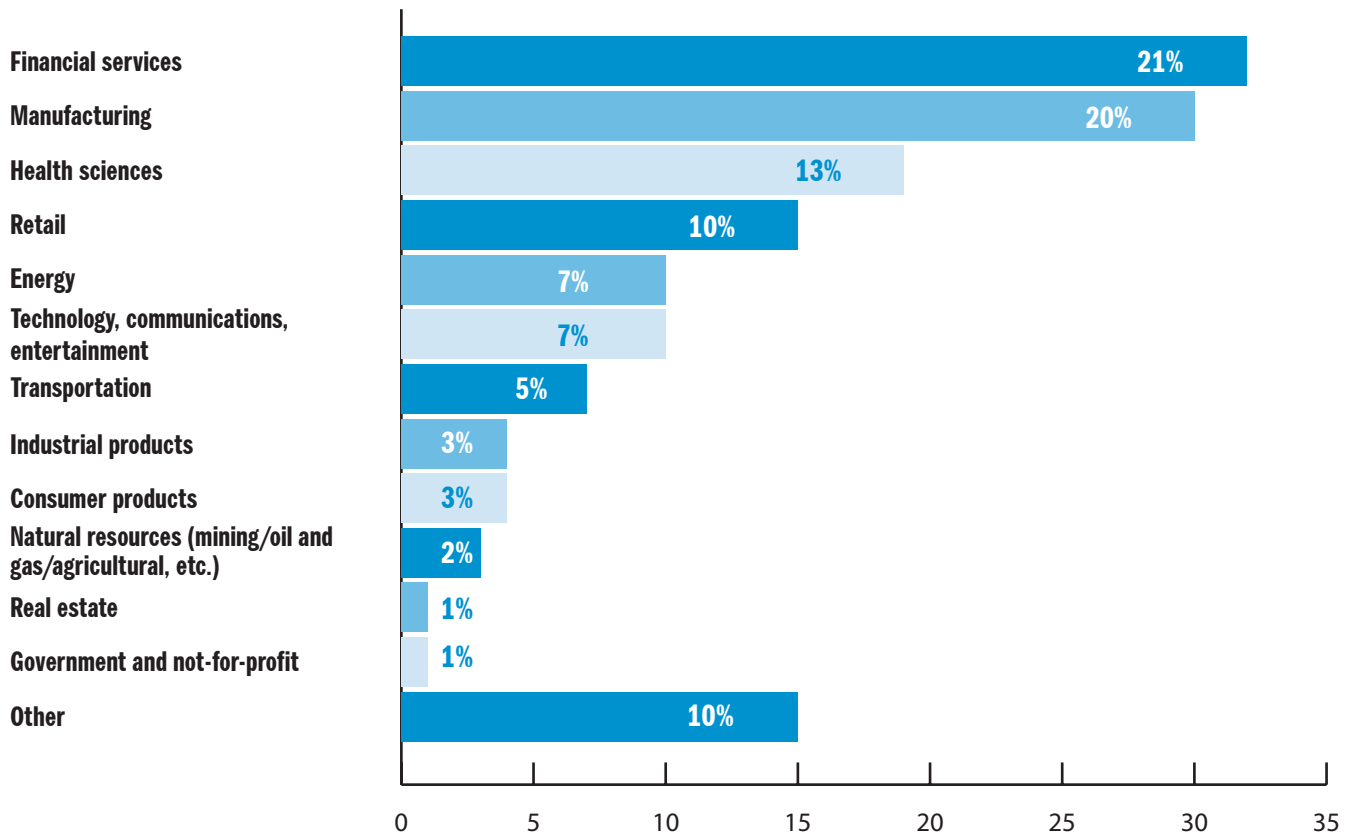
Q1 – What is your title?



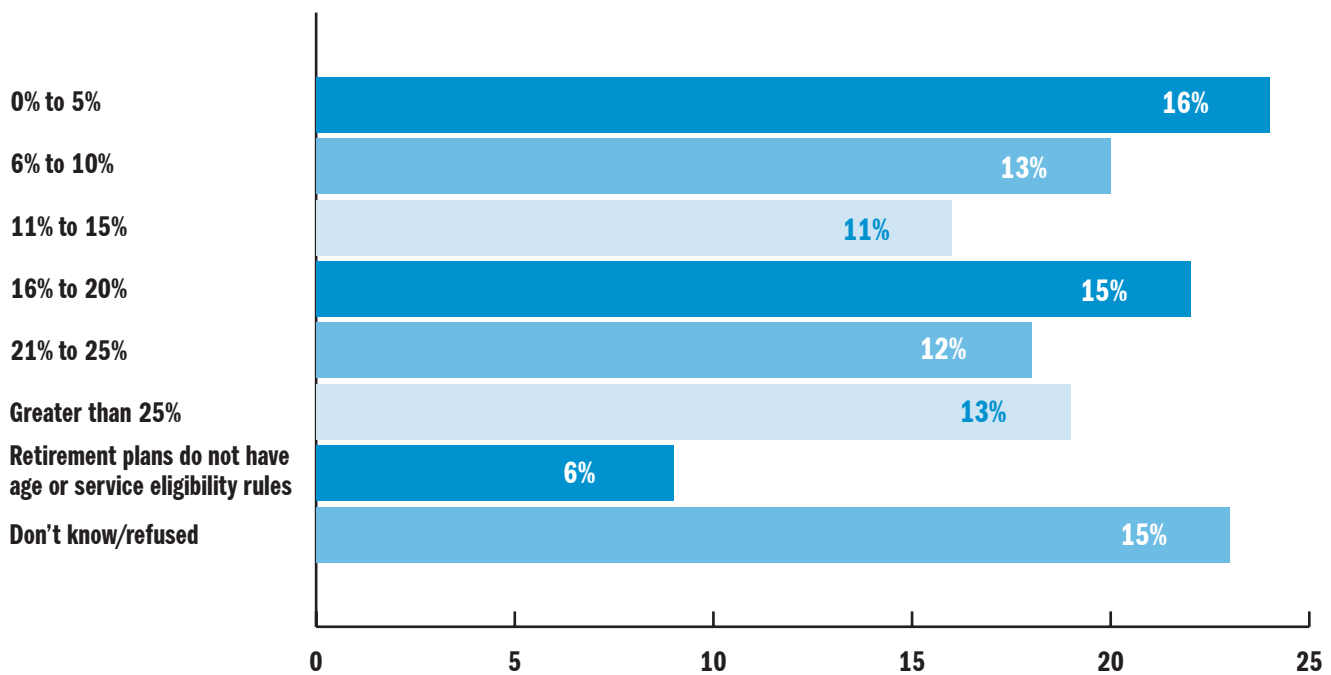
Q2 – What is the size of your organization?



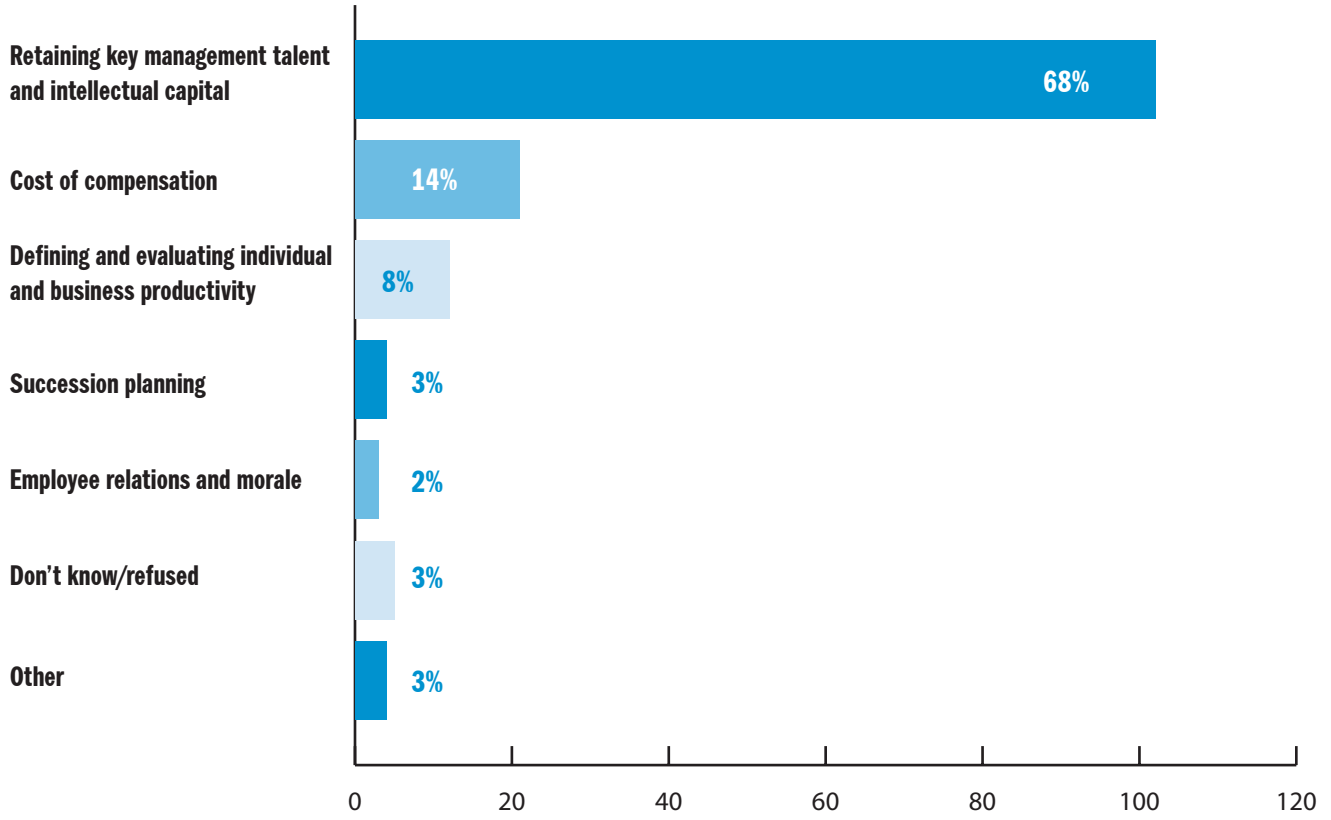
Q3 – The major industry your organization is in:



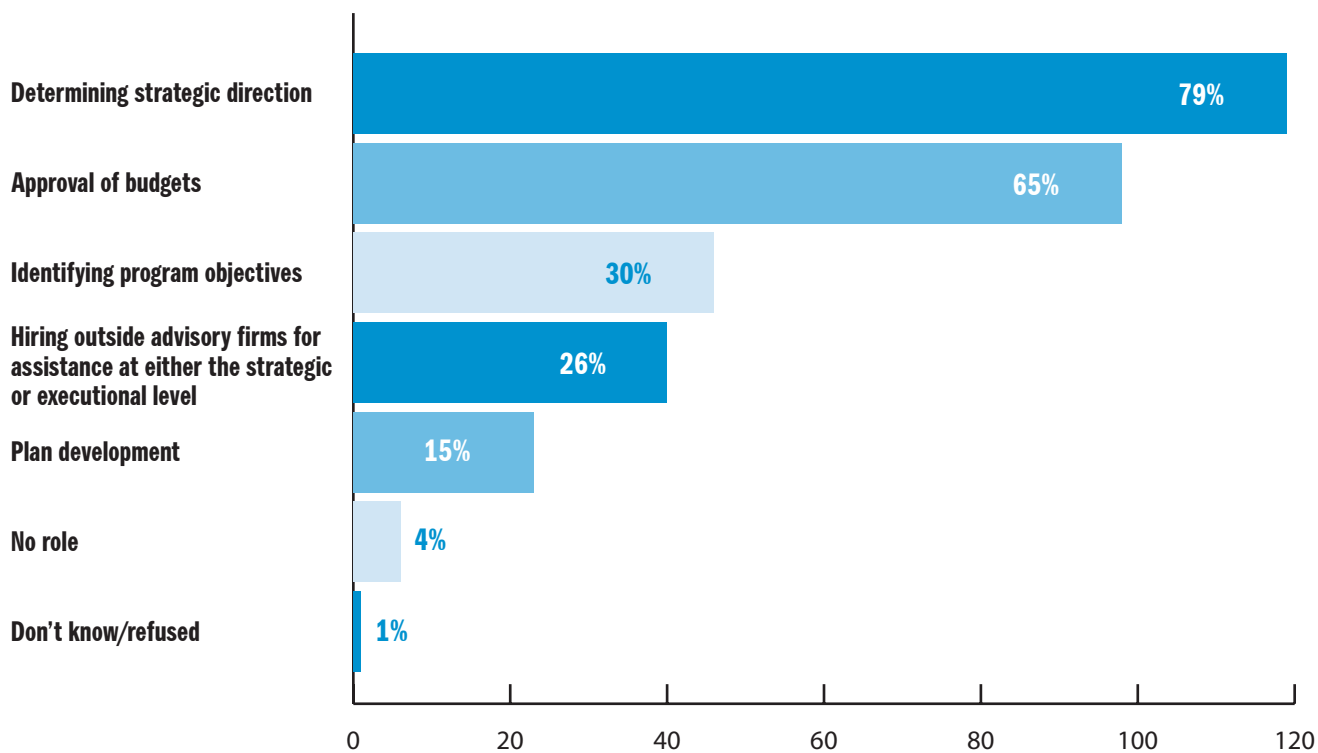
Q4 – What percentage of your current workforce will be eligible to retire over the next five years?



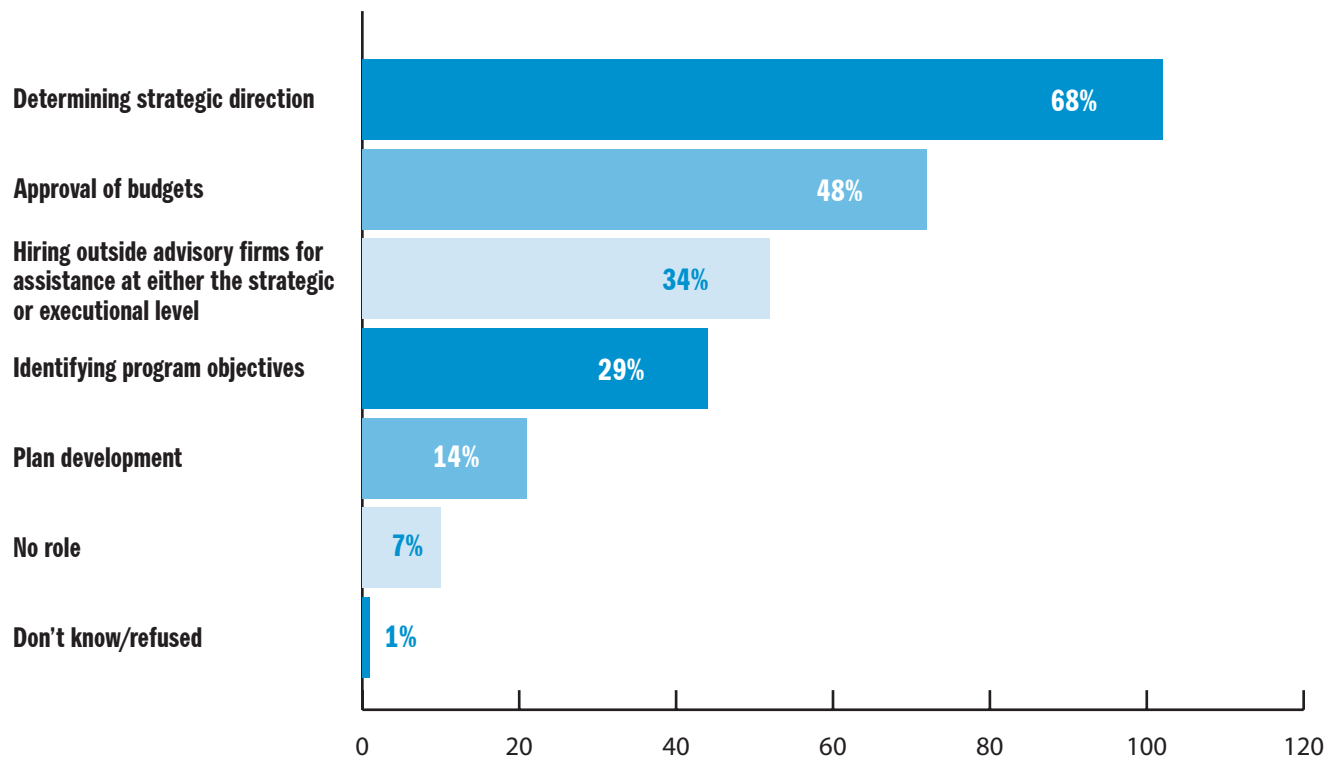
Q5 – Which human capital and benefits issues concern your C-suite executives and board of directors most?



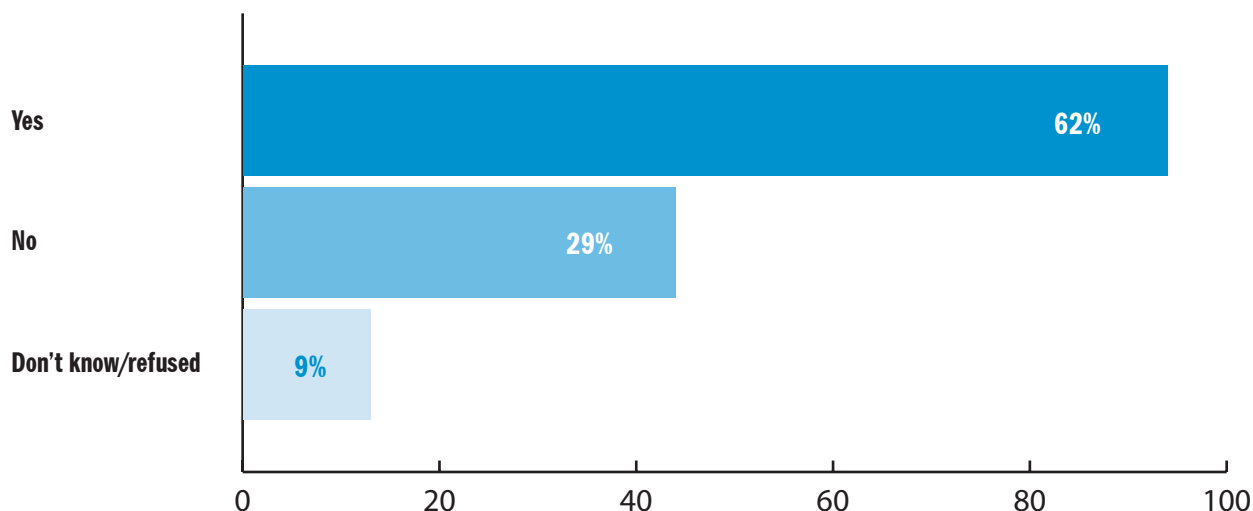
**Q6 – What roles do your C-suite executives have in your compensation and benefits programs?
(Multiple responses accepted.)**



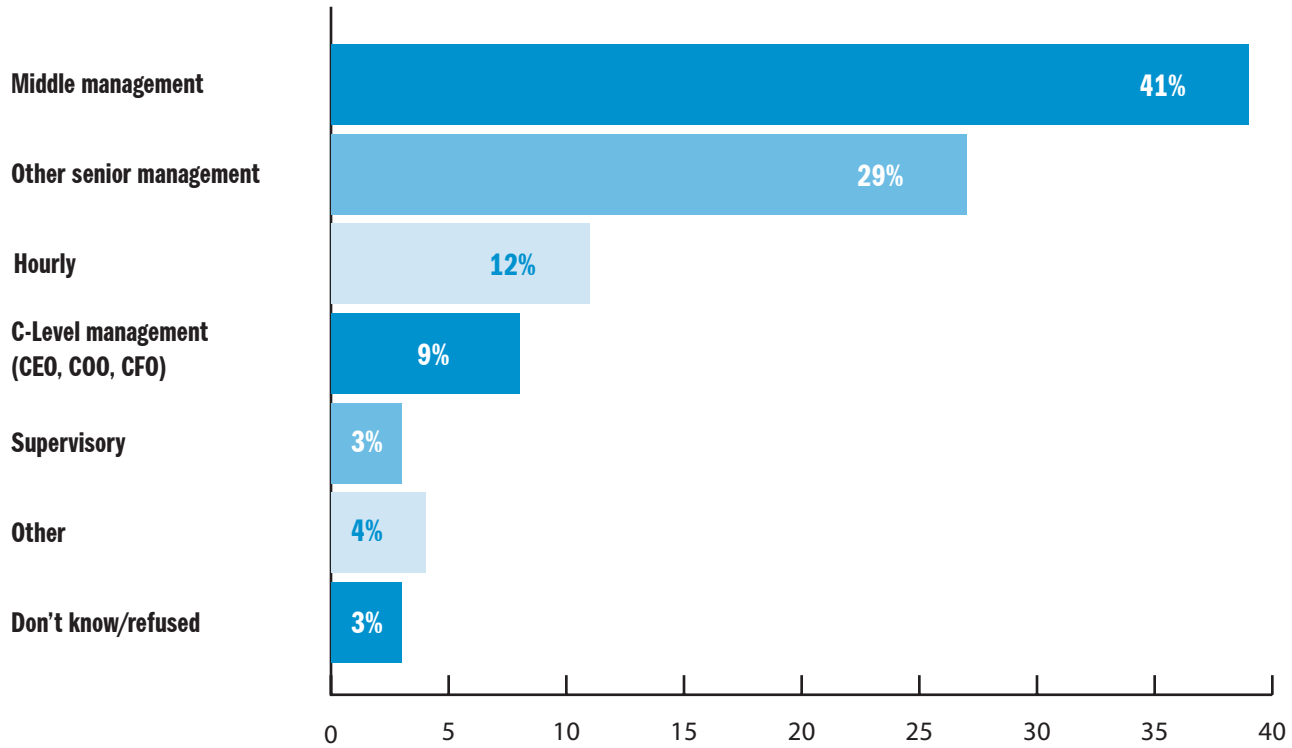
Q7 – What roles do your board of directors and/or your compensation and benefits committee have in your compensation and benefits programs? (Multiple responses accepted.)



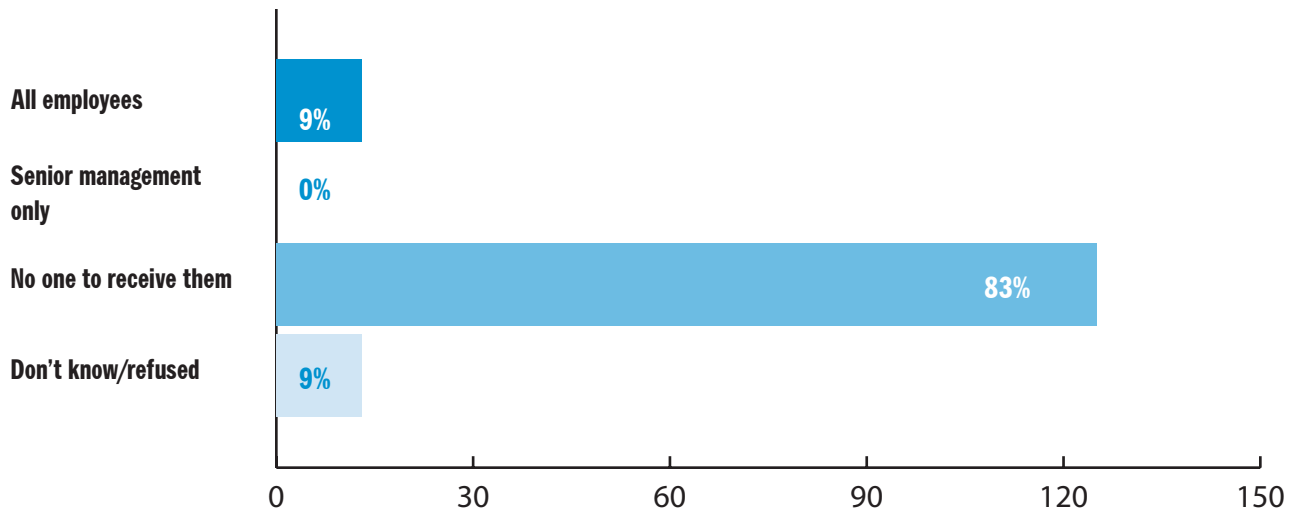
Q8 – Based on your estimates, will forecasted retirements cause a talent gap or brain drain in some functions of your organization due to likely labor and skill shortages?



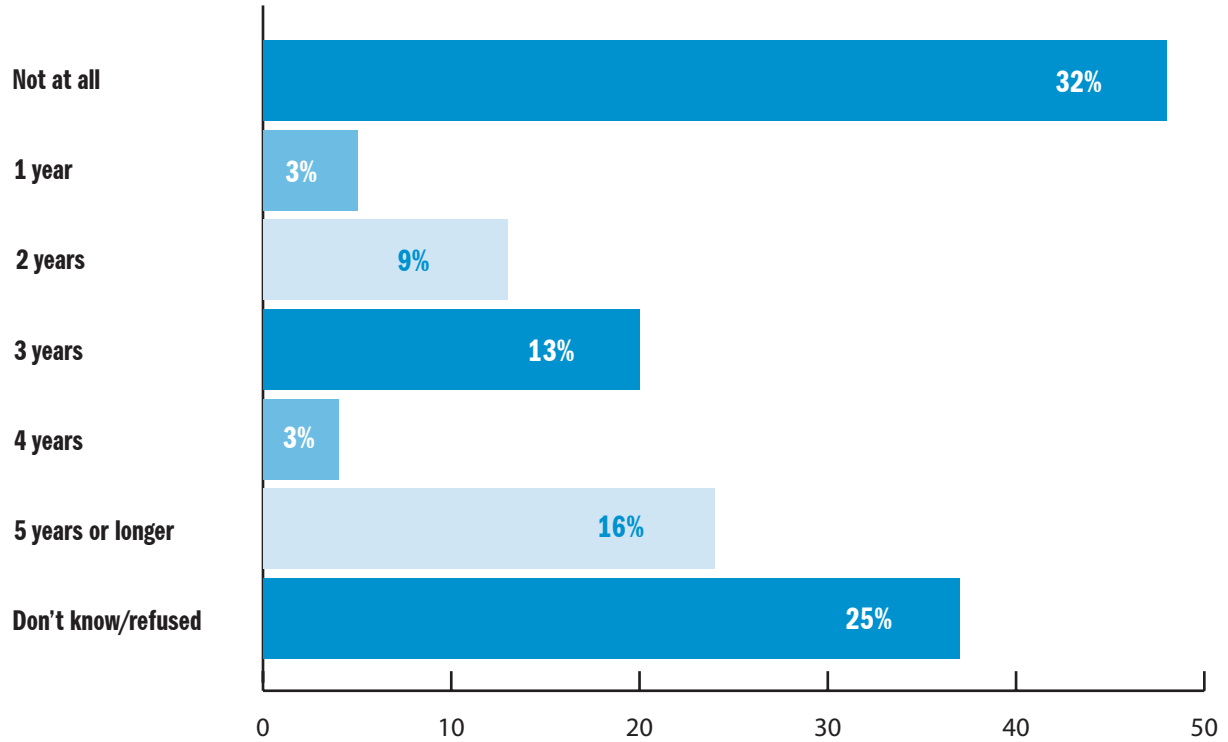
Q9 – Which levels will be most affected? (Answered only by those who responded “Yes” that a brain drain is likely.)



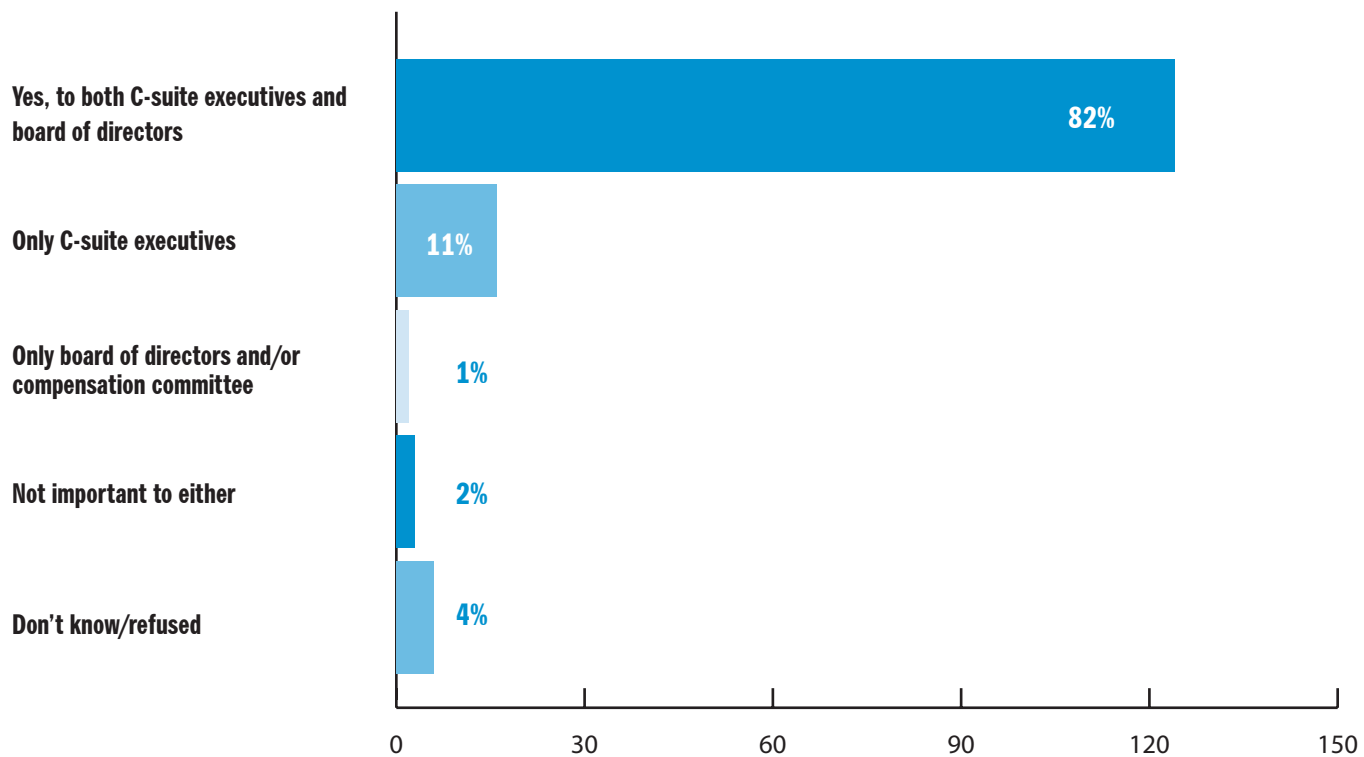
Q10 – Does your company policy allow for employees to start receiving pension benefits while they are still employed with the organization?



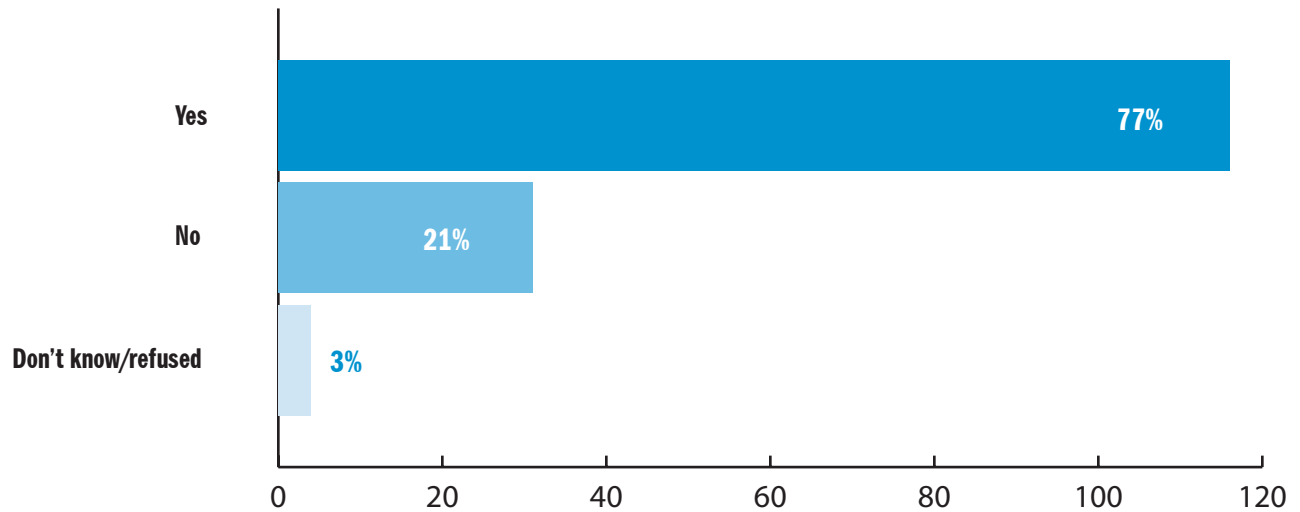
Q11 – Ideally, based upon anticipated enterprise needs and expected individual contributions, on average, how much longer would it be desirable for your senior management to stay behind their normal retirement age?



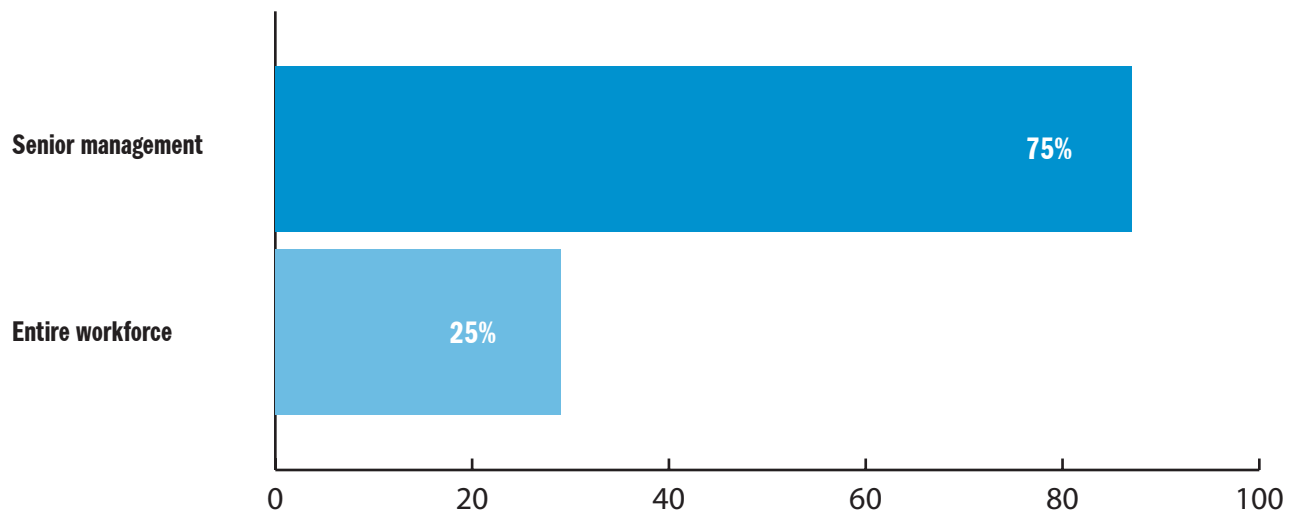
**Q12 – Is succession planning an issue of importance to your C-suite executives and board of directors/
compensation committee?**



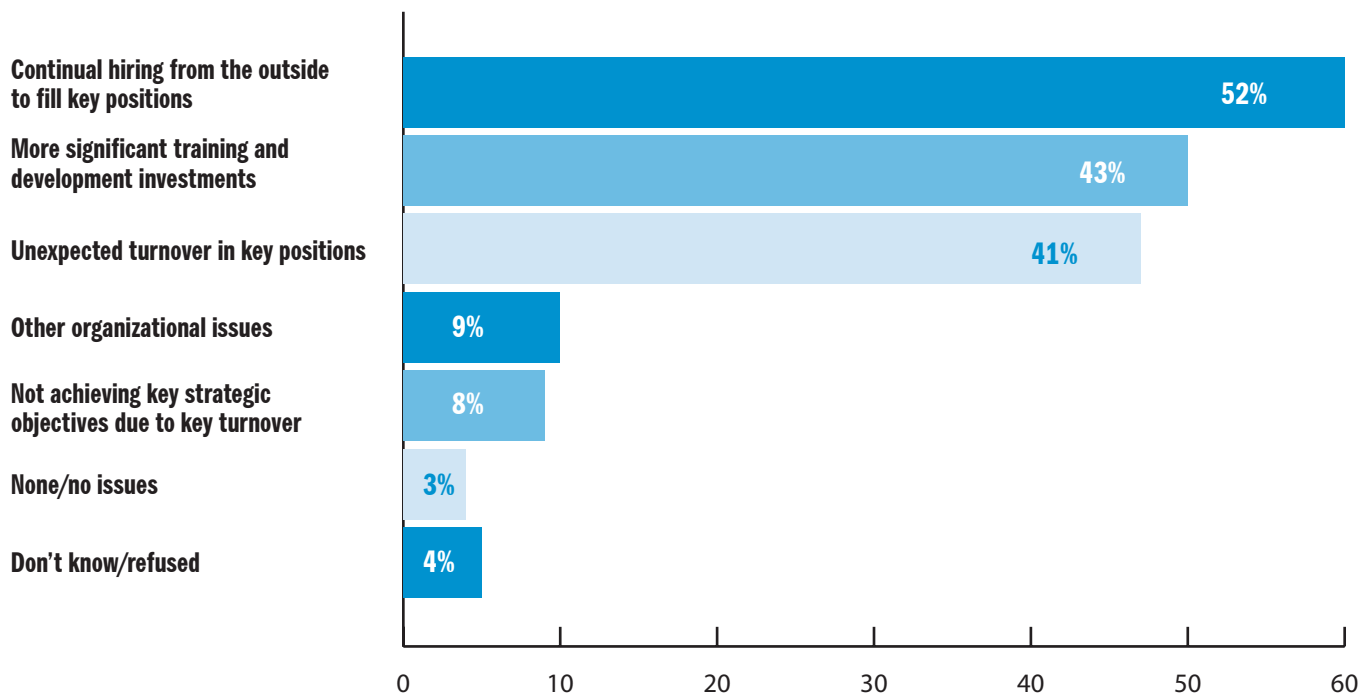
Q13 – Is there a formal succession-planning program in place?



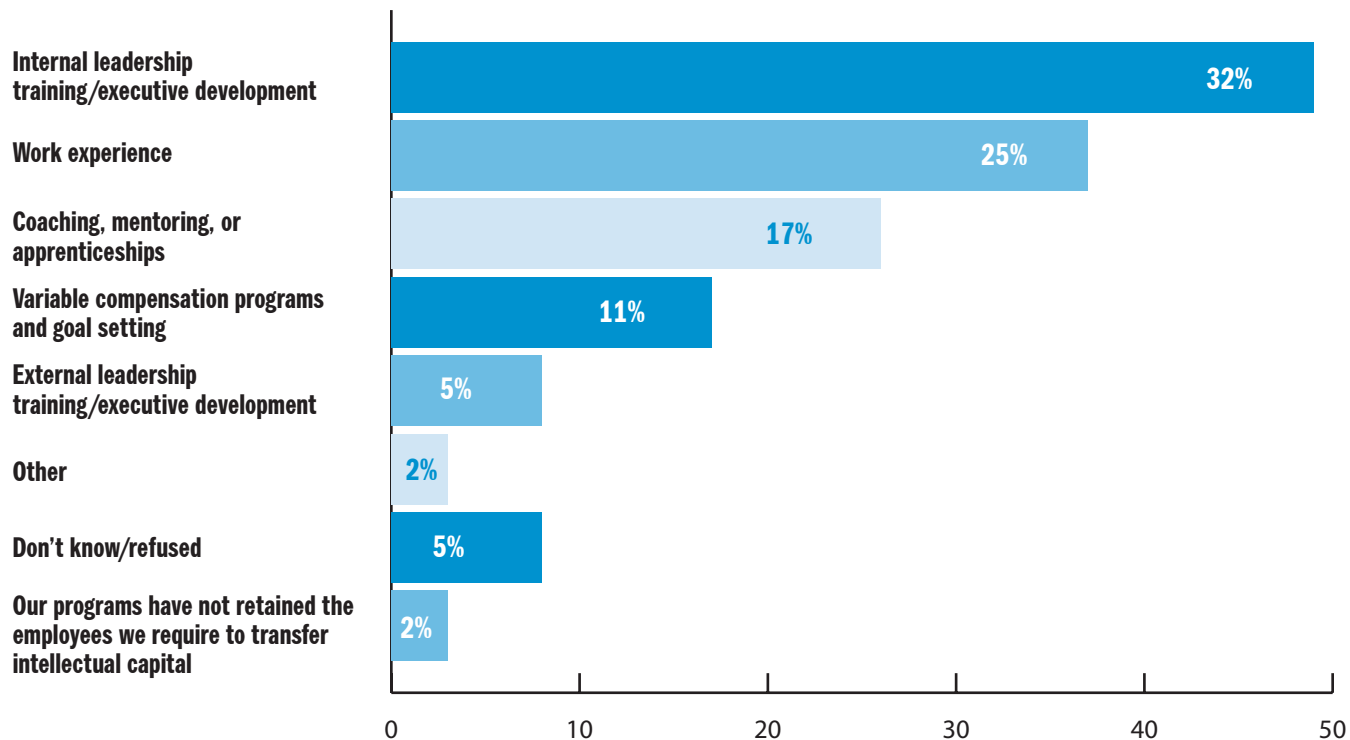
Q14 – What group is monitored in your succession-planning program? (Answered only by those who have a formal succession-planning program.)



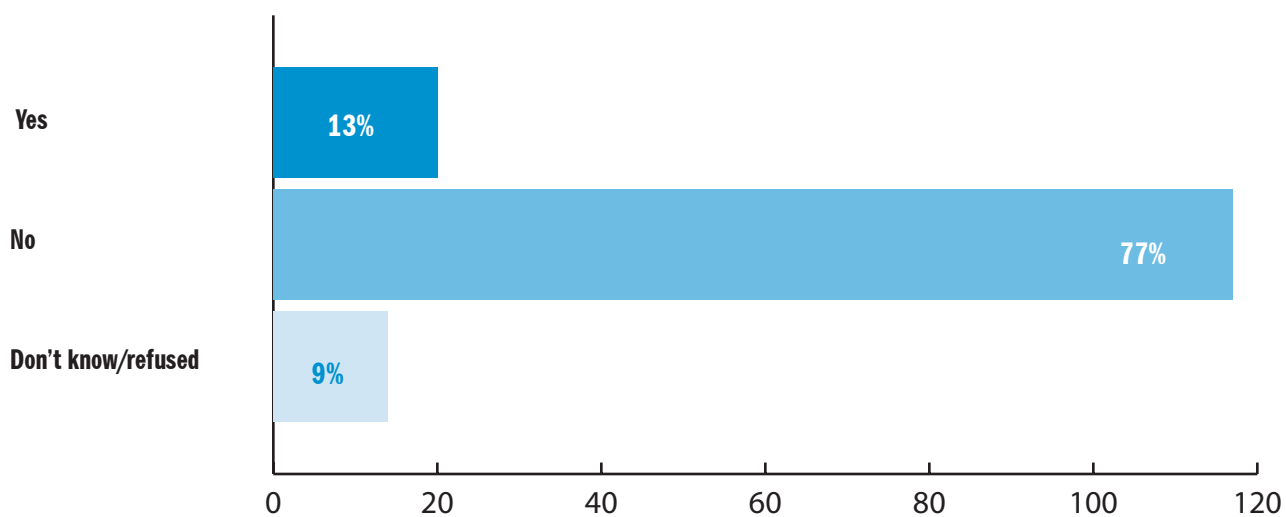
Q15 – Have you experienced any of the following issues? (Multiple responses accepted.)



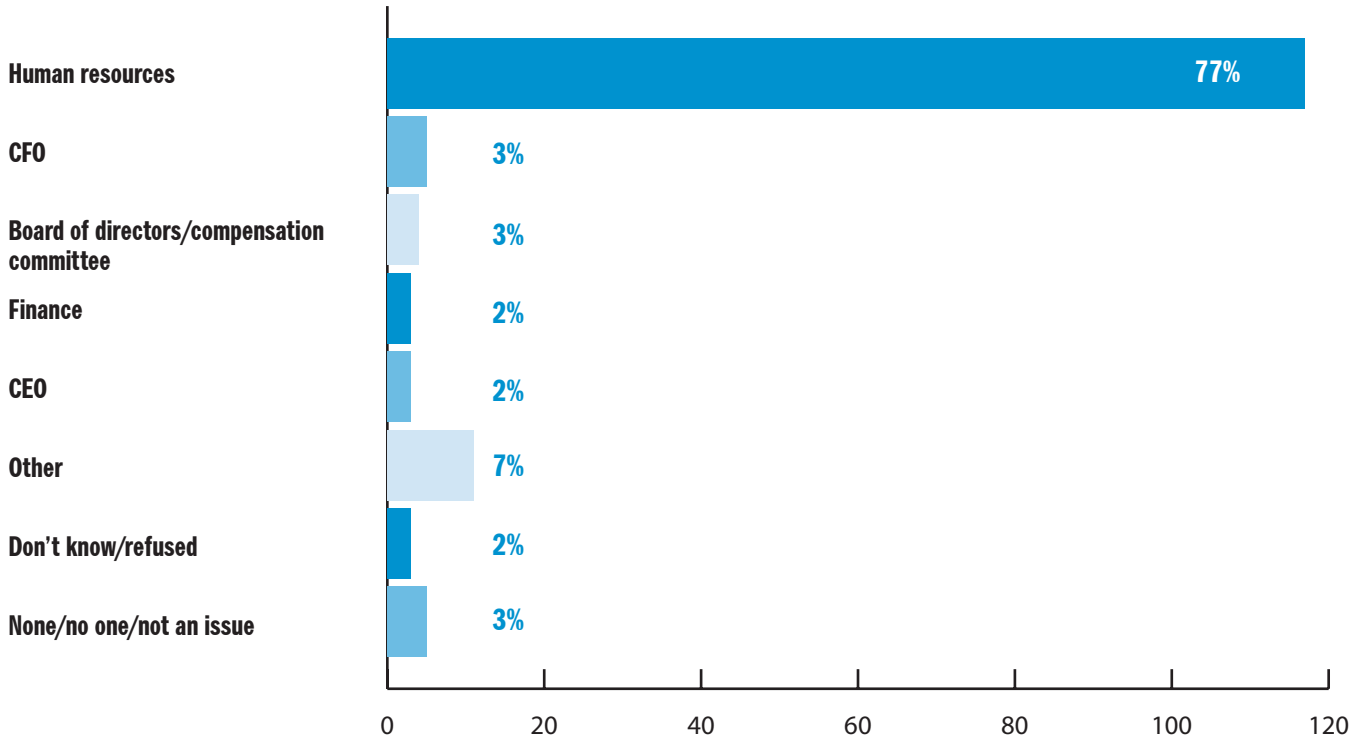
Q16 – What program has been the most effective in terms of seamless transition of management, development of key individuals, and retaining and transferring intellectual capital?



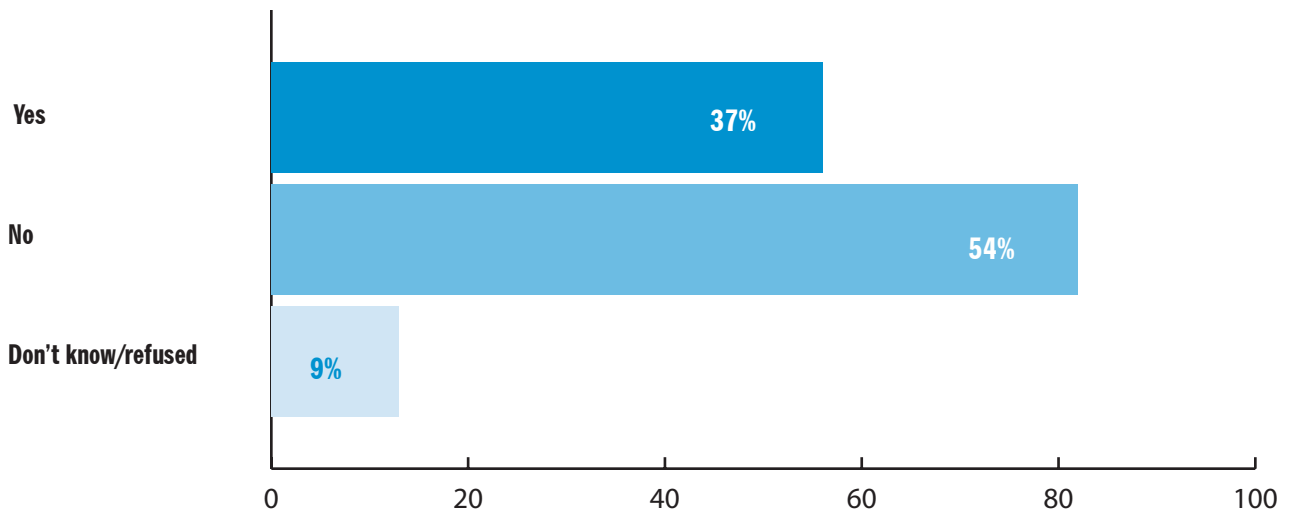
Q17 – Did you use an advisory firm to set up your succession plan and executive development to review its effectiveness and/or to report back to the board on governance issues?



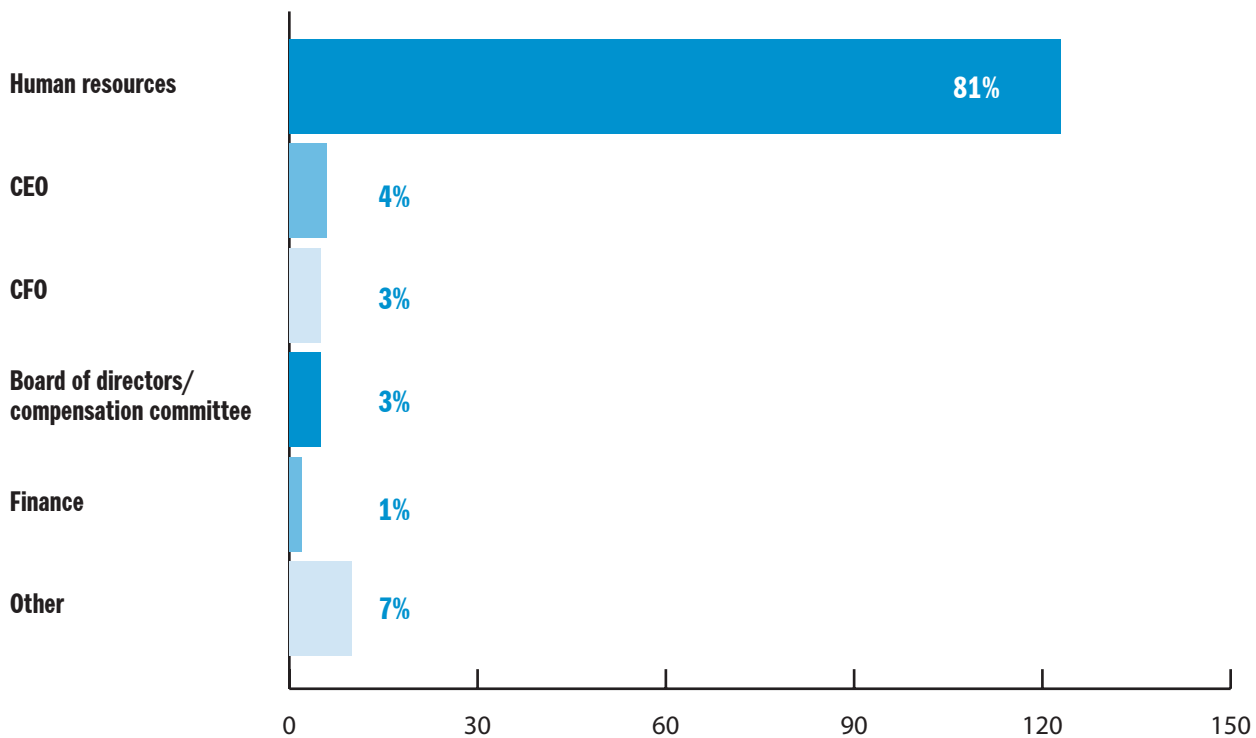
Q18 – Who is responsible for identifying the financial risks associated with your company's aging workforce?



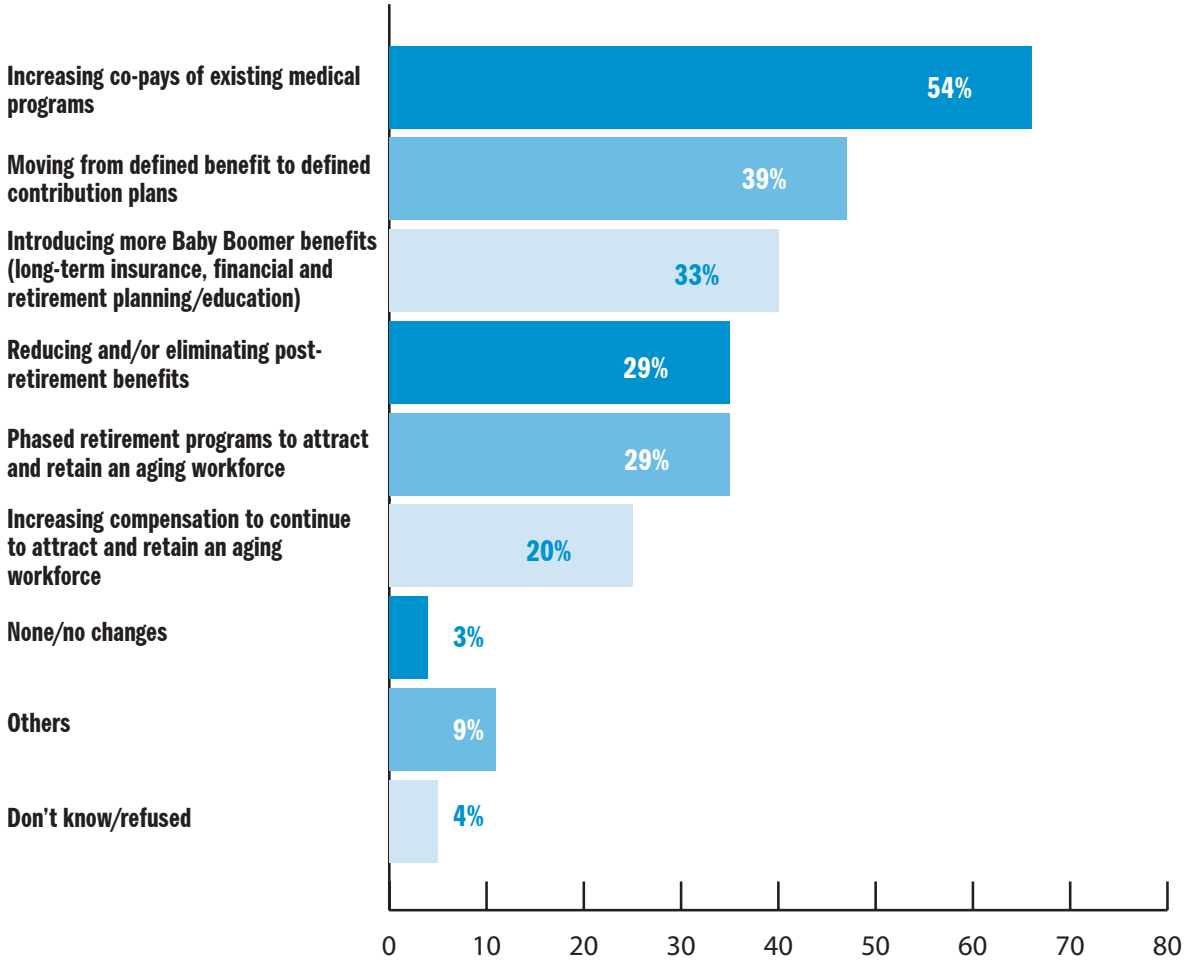
Q19 – Has your company changed or is it considering changes to its benefits and compensation programs due to financial risks associated with your aging workforce?



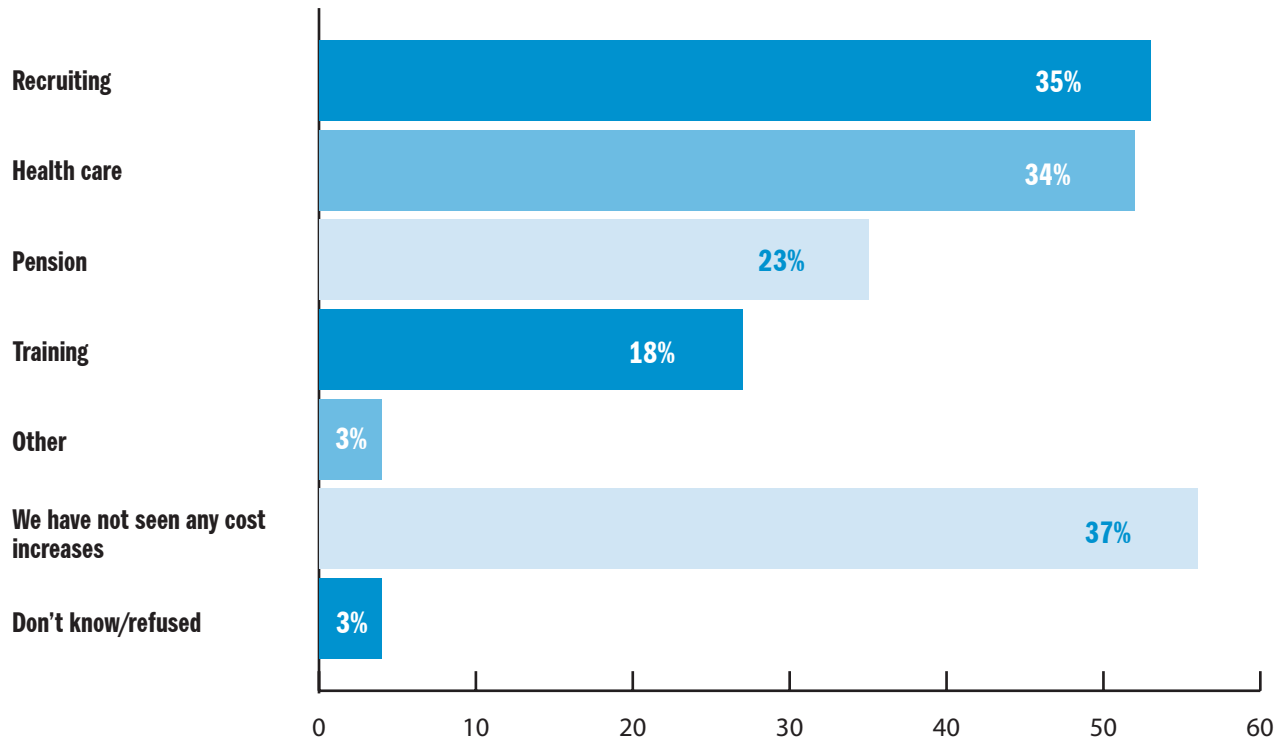
Q20 – Who is responsible for identifying the changes that need to be made or have already been made to your benefits and compensation programs?



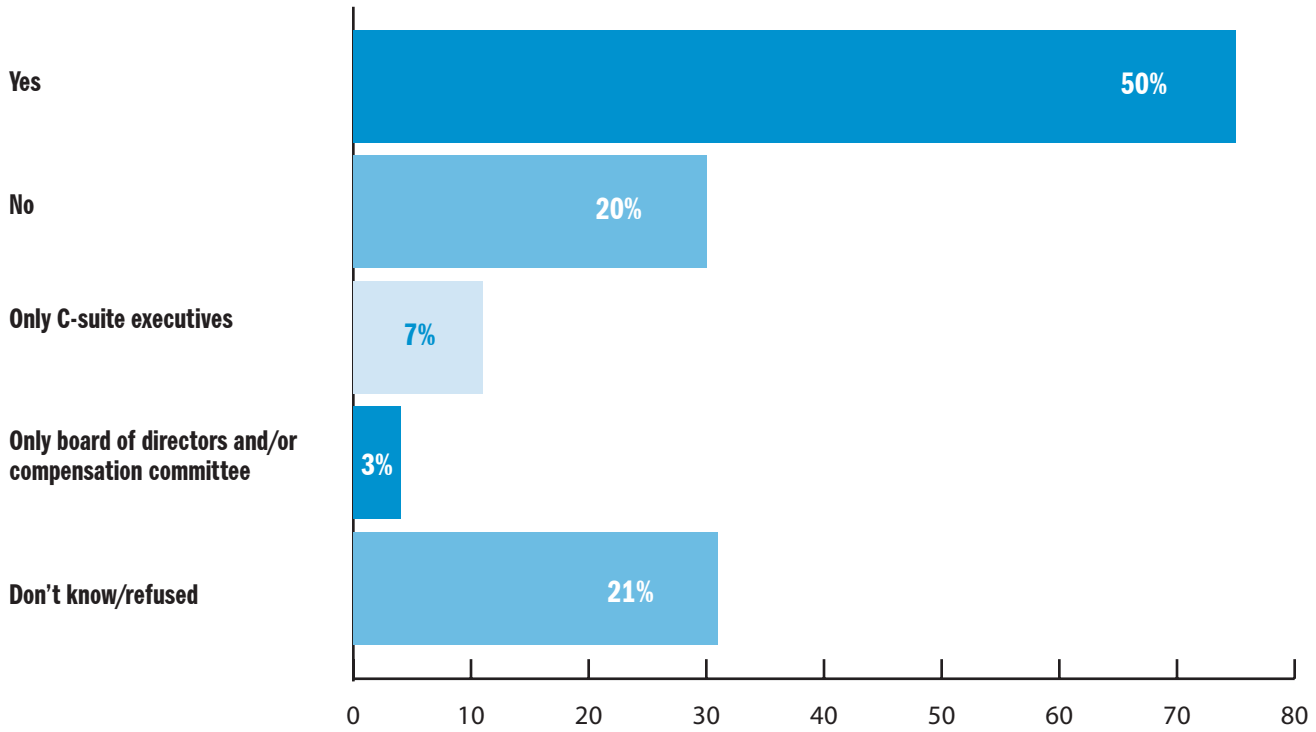
**Q21 – What changes have you made or are considering for your benefits/compensation program?
(Multiple responses accepted.)**



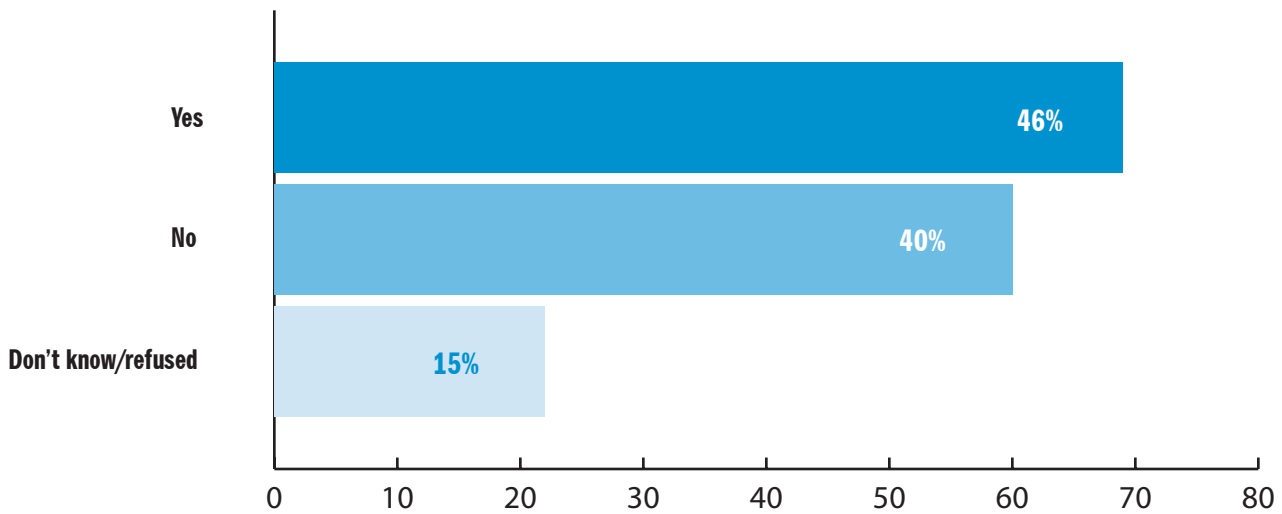
**Q22 – Have you seen an increase in the following costs as your senior managers near retirement age?
(Multiple responses accepted.)**



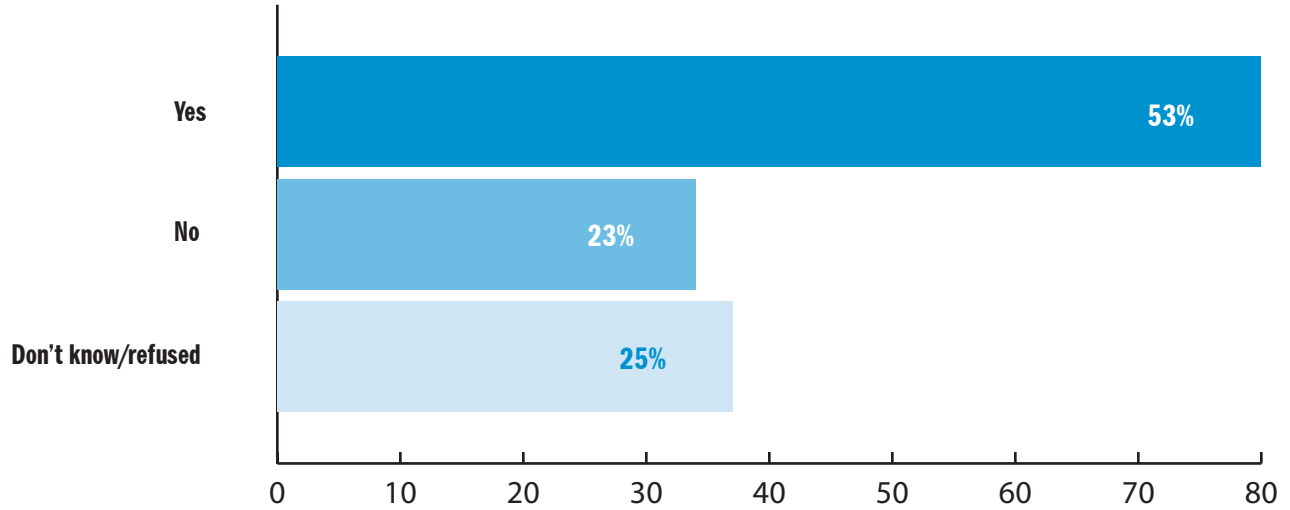
Q23 – Are legislative issues like the Pension Protection Act or accounting issues like FAS 158 of concern to your C-suite executives or board of directors?



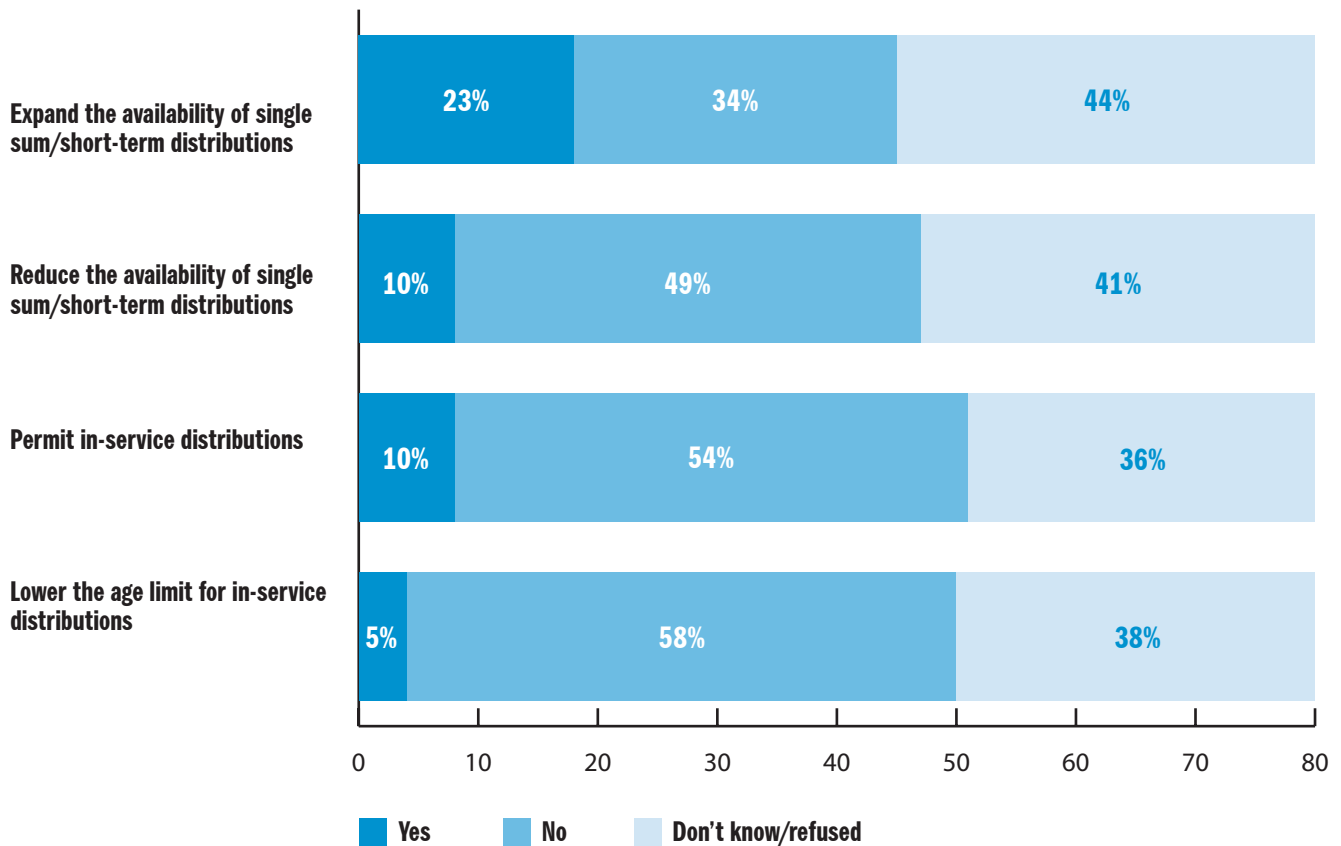
Q24 – Has the Pension Protection Act of 2006 forced you to re-examine your pension programs?



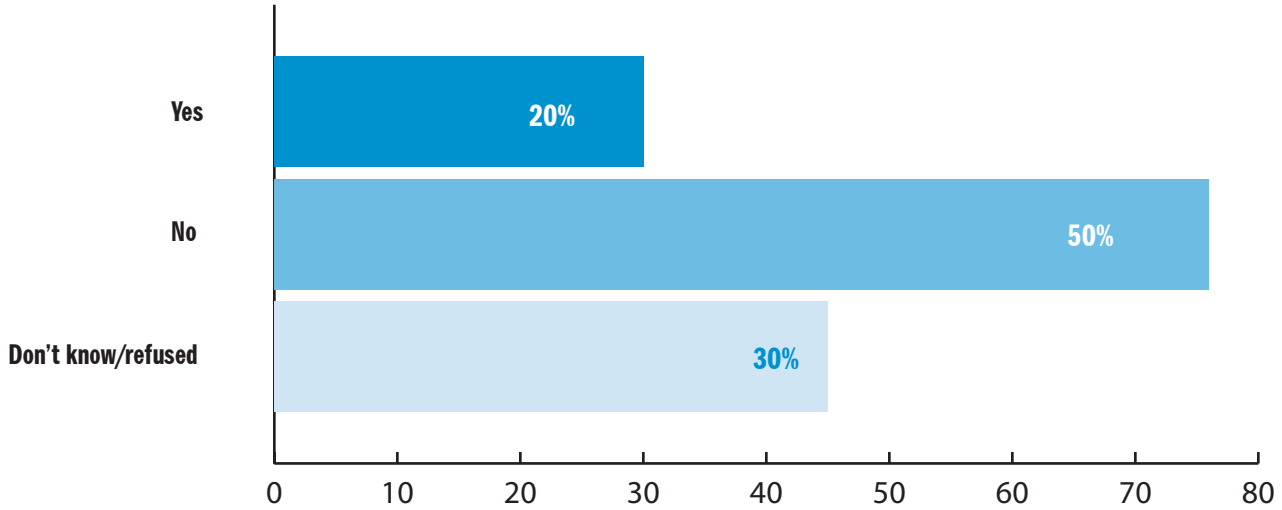
Q25 – Have you looked into how the Pension Protection Act will change your distribution requirements?



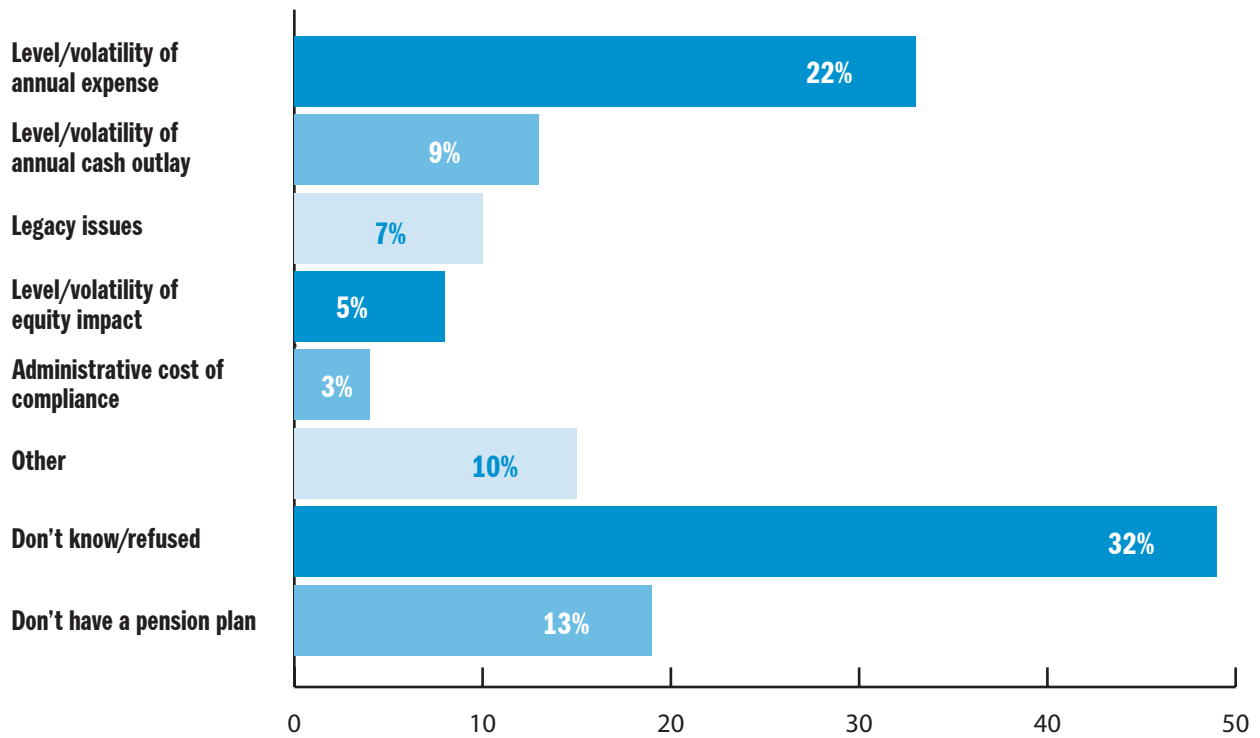
Q26 – How did the Pension Protection Act change your distribution requirements? (Answered only by those who have looked into how the Pension Protection Act would change their distribution requirements.)



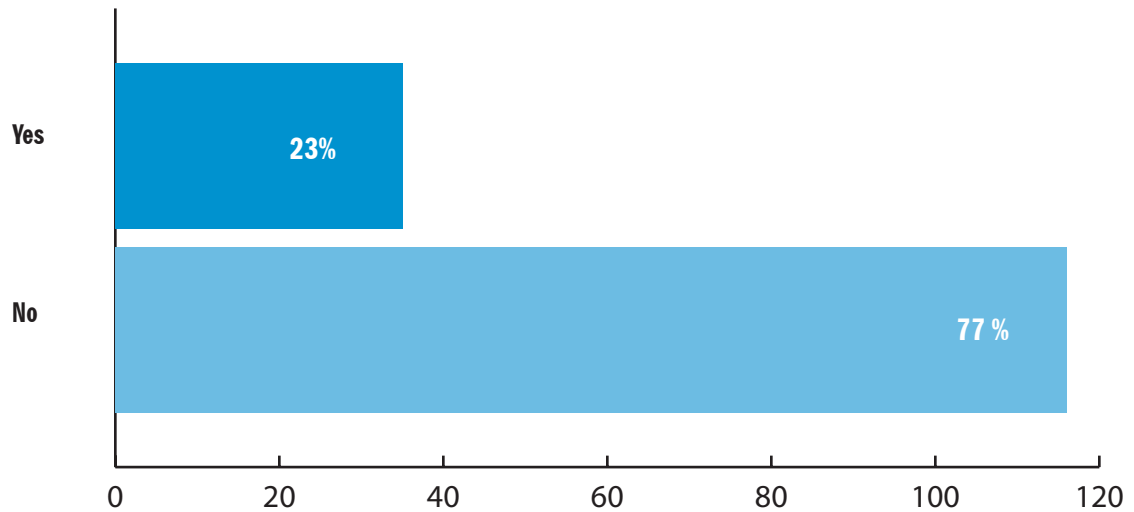
Q27 – FAS 158 now requires companies to put underfunded liabilities and overfunded assets on their balance sheet. Will this change the manner in which you think about your pension and/or post-retirement medical plans?



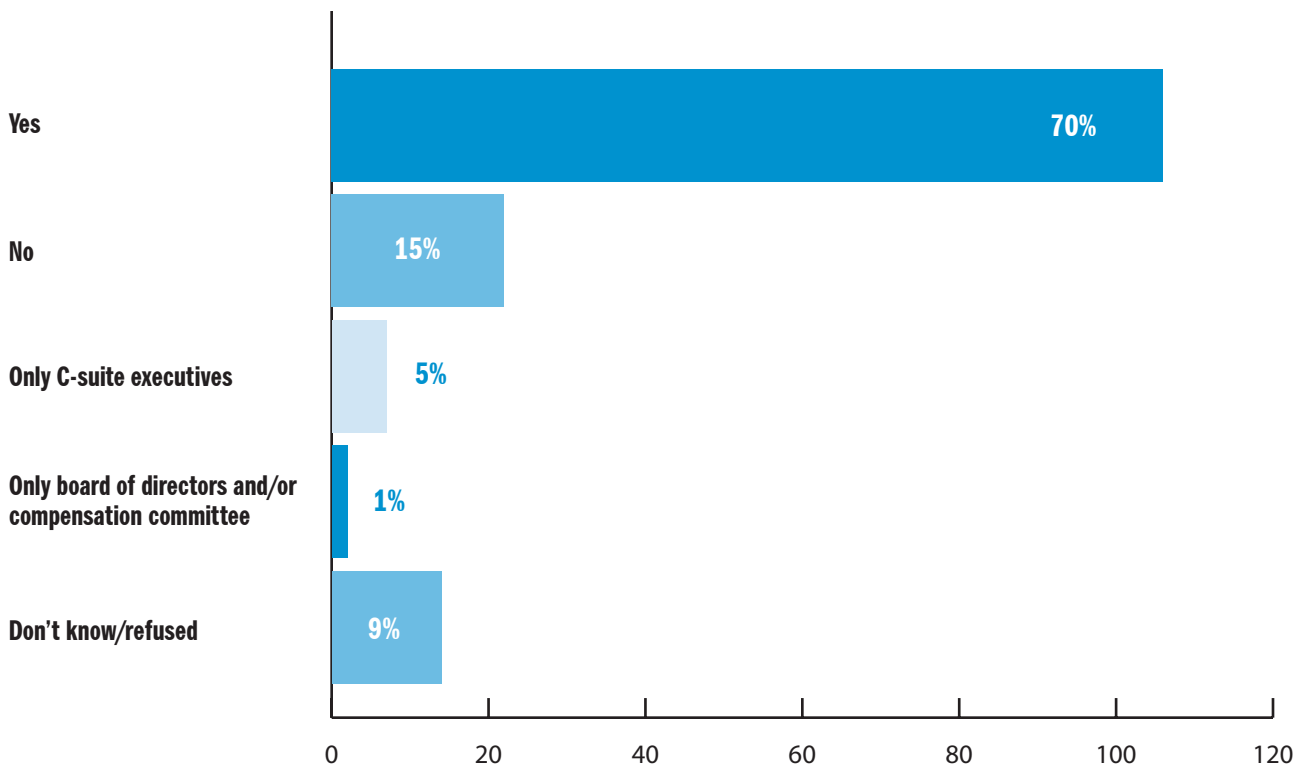
Q28 – What would be the biggest factor to cause you to change your mind to terminate or freeze your pension plan?



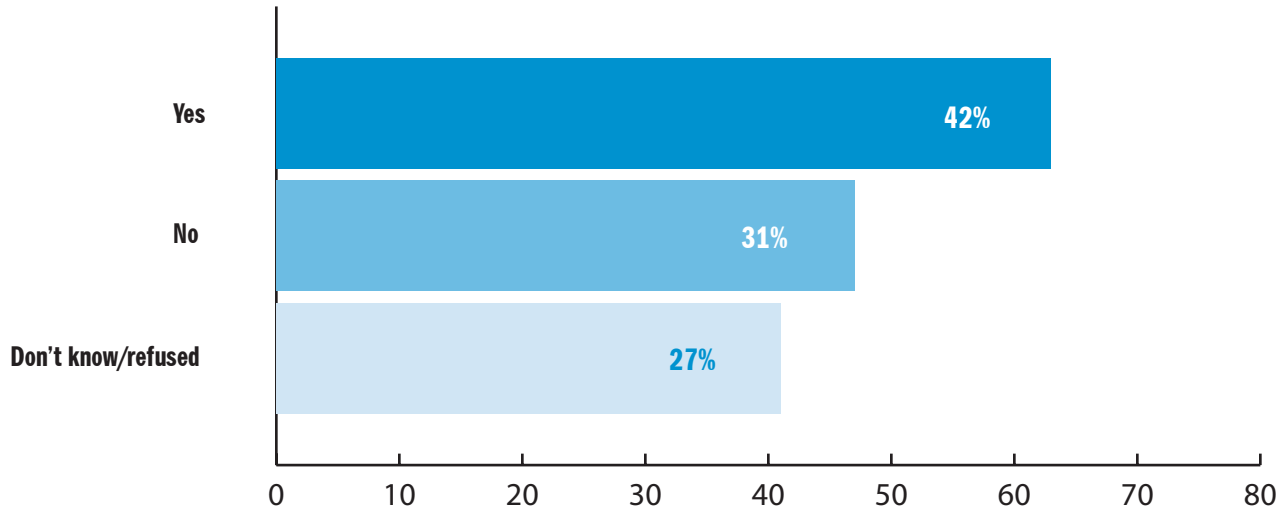
Q29 – Have regulatory changes forced you to make strategic changes to your benefits and compensation programs in order to address aging workforce issues?



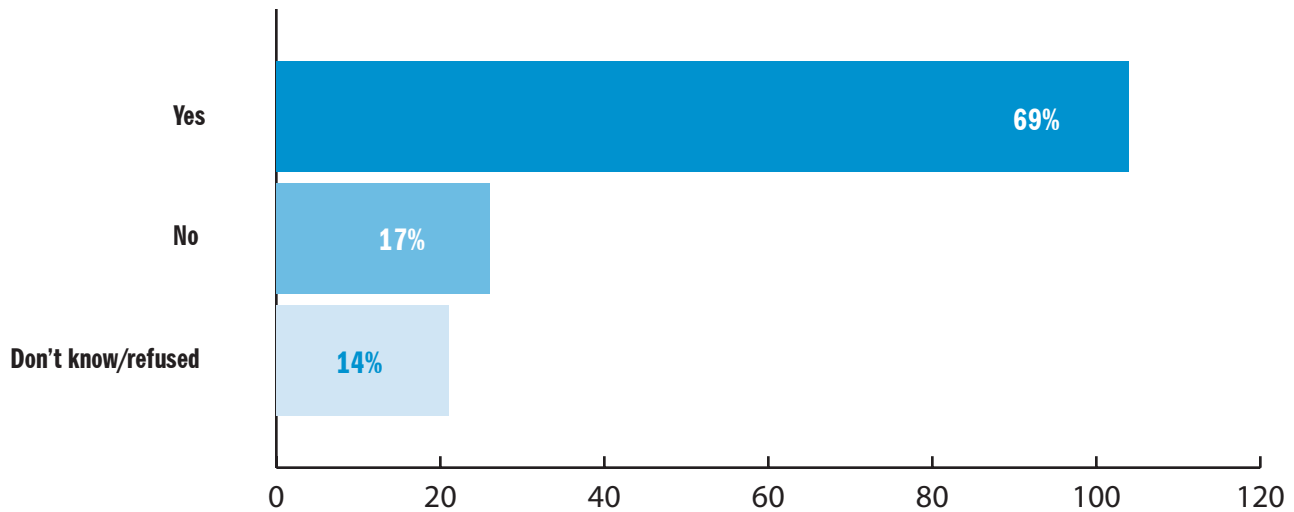
Q30 – Are compliance issues of concern to your C-suite executives or board of directors?



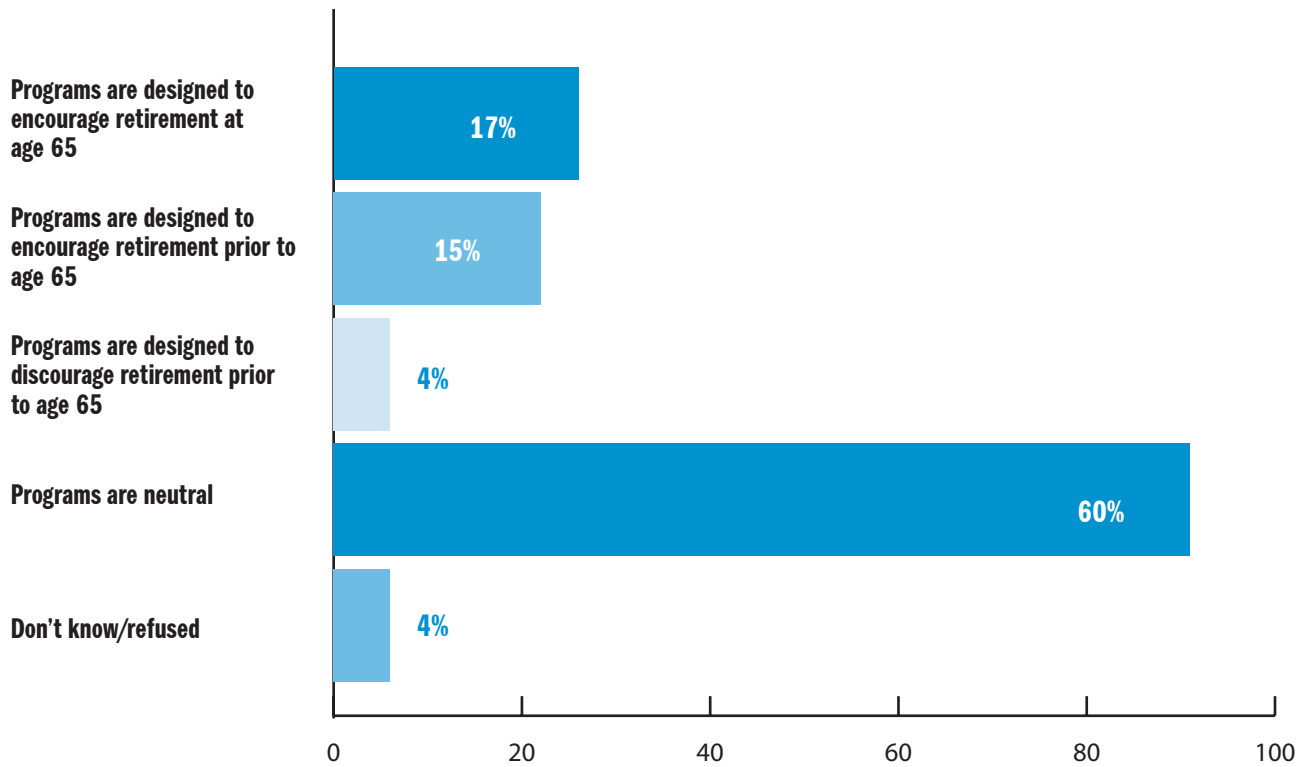
Q31 – With Baby Boomers getting ready to retire en masse, have you performed an analysis of your benefits plans and conducted a compliance review to gauge if employees are receiving accurate benefit amounts?



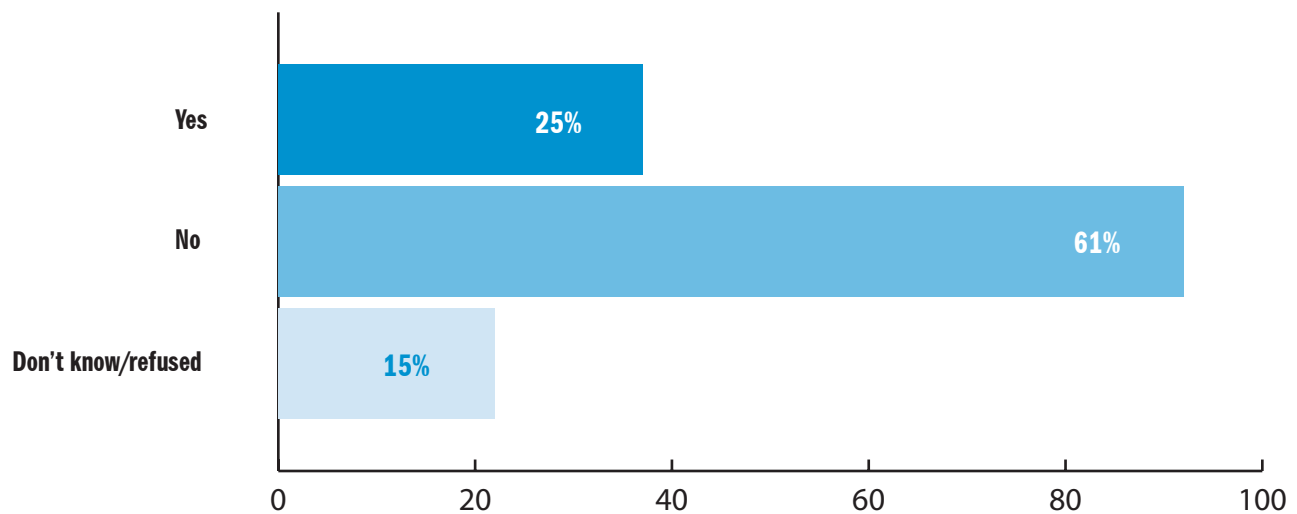
Q32 – Have you performed an analysis to determine whether you're in compliance with all labor and discrimination laws as they pertain to your aging workforce?



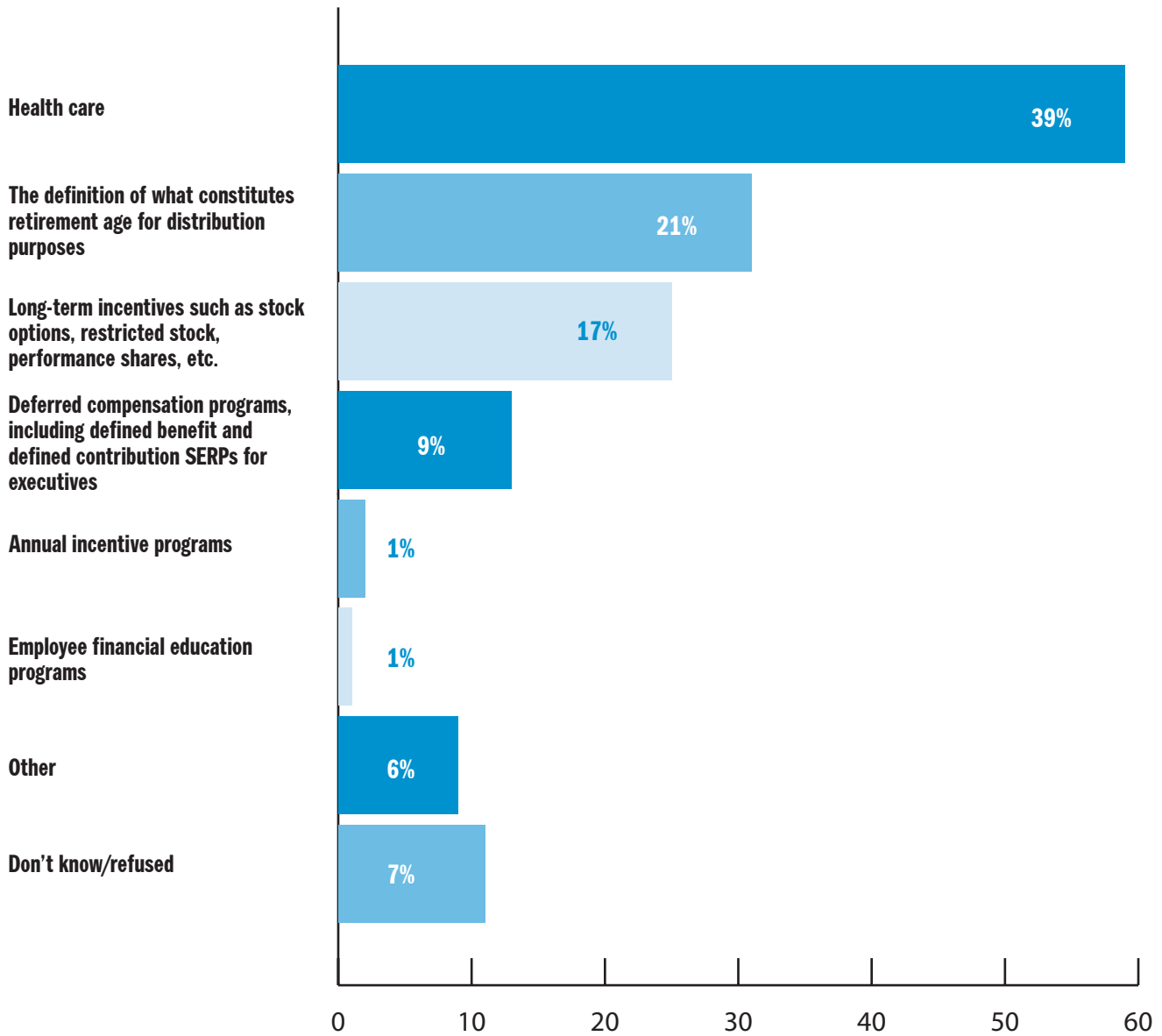
Q33 – Which best describes the objective of your benefits and compensation program?



Q34 – Are you trying to determine how to adjust benefits for a specific group of employees that you do not want to retire right away?



Q35 – What is the top compensation and benefits program/feature that you think impacts an employee's decision to retire?



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