The Real Deal

2018 Retirement Income Adequacy Study

>>

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Introduction

Introduction

Only 1 in 3 workers will have saved enough to retire comfortably by age 67. Do you know where your employees stack up?

The Real Deal is designed to help you find out. *The Real Deal* study provides powerful insights into retirement savings behavior and investment experience at U.S. private-sector plan sponsors.

The data for this study—which comes from Aon's Benefit Index® and Benefit SpecSelect™, Alight Solutions, and the Bureau of Labor Statistics (BLS)—was used to project retirement resources and needs for this population. The results shed light on the most critical questions employers ask as they help prepare their employees for a financially secure retirement:

- How much money do workers need to retire and maintain their standard of living?
- Are today's workers prepared to meet their needs at retirement?
- How much do employees need to save on top of what employers are providing in retirement income?
- How do factors such as investment experience, longevity, and retirement age influence an individual's retirement readiness?

11.1 The multiple of final pay that the average employee needs to save for an adequate retirement at age 67. Keep in mind that every employee's need is different.

70 The age at which the median employee is expected to be financially ready to retire.

16% The proportion of annual pay that needs to be deferred by a typical employee, including employer contribution, beginning at age 25, to accumulate 11.1x pay at age 67.

4–7% The proportion of annual pay that people tend to save, which is often influenced by the amount required to receive a full employer match.

20% The amount the average retiree would need to cut their preretirement standard of living to overcome their shortfall if they retired at age 67.

Introduction (cont'd.)

Overall, *The Real Deal* paints a portrait of a workforce that is generally not on track to maintain their standard of living in retirement. Only 1 out of 3 workers who participate in their employer's benefit plans over a full career ("full-career contributors") are expected to be able to retire with reasonably adequate retirement income.

It is important to note broad averages don't tell the full story. Retirement readiness is ultimately about each individual's goals and resources, and every person's retirement resources and needs calculations are unique. That means that to improve the financial wellbeing of the workforce collectively, individual needs must be addressed one person at a time. We reflect that individuality in this study by projecting resources and needs separately for each person in the study's population.

The Real Deal explores the key factors in retirement adequacy, sharing insights into each one as well as guidance on how employers can use these insights to potentially improve their retirement offering:

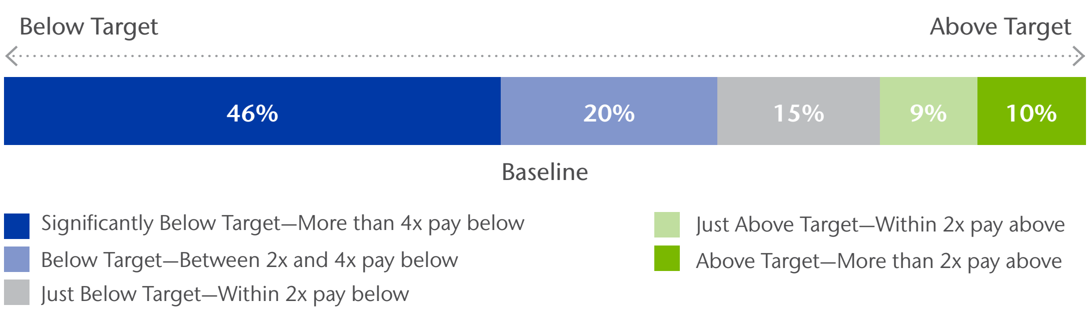
- Savings Rates
- Income
- Generations
- Gender
- Industries

Here's How the Results Break Down:

- Only 19 percent of full-career contributors are projected to accumulate more assets than needed.
- Another 15 percent will fall close enough, within 2x pay, to their target needs to allow them reasonably adequate retirement income if they adjust their postretirement spending or supplement their retirement savings with assets outside their employer's plans.
- That leaves 2 out of 3 full-career contributing employees who are not expected to have saved enough to retire at age 67, being further than 2x pay away from their target retirement needs. Even with adjustments in spending, these employees will likely need to increase their savings or delay their retirement.

Distribution of Retirement Income Surplus/(Shortfall)

Retirement Age 67



What's New in *The Real Deal*?

The 2018 study offers insight into the overall retirement readiness of U.S. workers and a benchmark for employers as they measure the effectiveness and sufficiency of their programs. This year's study includes industry-specific results, which means it is now possible to compare retirement readiness across 28 different industries.

The previous study was performed in 2015. The 2018 study incorporated adjustments to a few key assumptions, including:

- Changing the baseline retirement age from age 65 to age 67 to represent a more realistic retirement age for many people and to tie to Social Security's normal retirement age; and
- Lowering employees' expected rates of return by 0.5 percentage points—to 6 percent preretirement and 5 percent postretirement—to reflect the lower long-term expectations in the market at large.

See *The Real Deal* research paper for a detailed discussion of the study's assumptions and methodology.

Retirement Readiness—The Averages

Retirement Readiness—The Averages

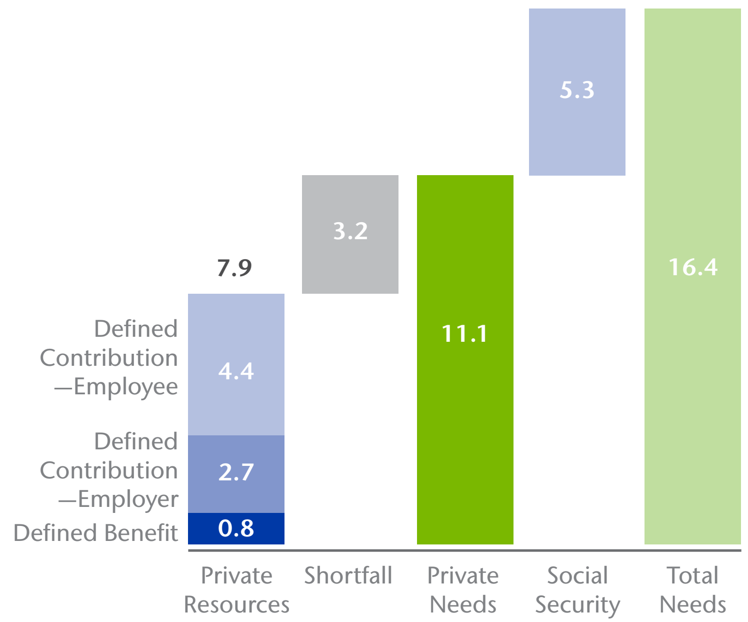
Workplace benefits and employee savings are not sufficient to meet retirement needs for the average participant. By age 67, the average full-career contributing employee is projected to have saved 7.9 times pay at retirement, split between their own savings (4.4 times pay), employer-provided defined contribution assets (2.7 times pay), and defined benefit pension plan value (0.8 times pay).

While 7.9 times final pay in private resources seems like a lot, it falls significantly short when it is compared to the amount needed of 16.4 times pay.

The total amount needed to maintain the average employee's standard of living through an average retirement period (about 21 years for males and 23 years for females, for employees retiring at age 67) is 16.4 times pay. This reflects the fact that saving for retirement is no longer needed and taxes are lower in retirement, but also reflects the fact that medical costs will be much more substantial in retirement than during the employment years.

Private resources are only one component to meet needs; the other is Social Security. The value the average full-career contributor can expect from Social Security is the equivalent of 5.3 times pay at retirement. If you offset this from total needs (16.4 times pay less 5.3 times pay), you end up with a need for "private" retirement income sources of 11.1 times pay.

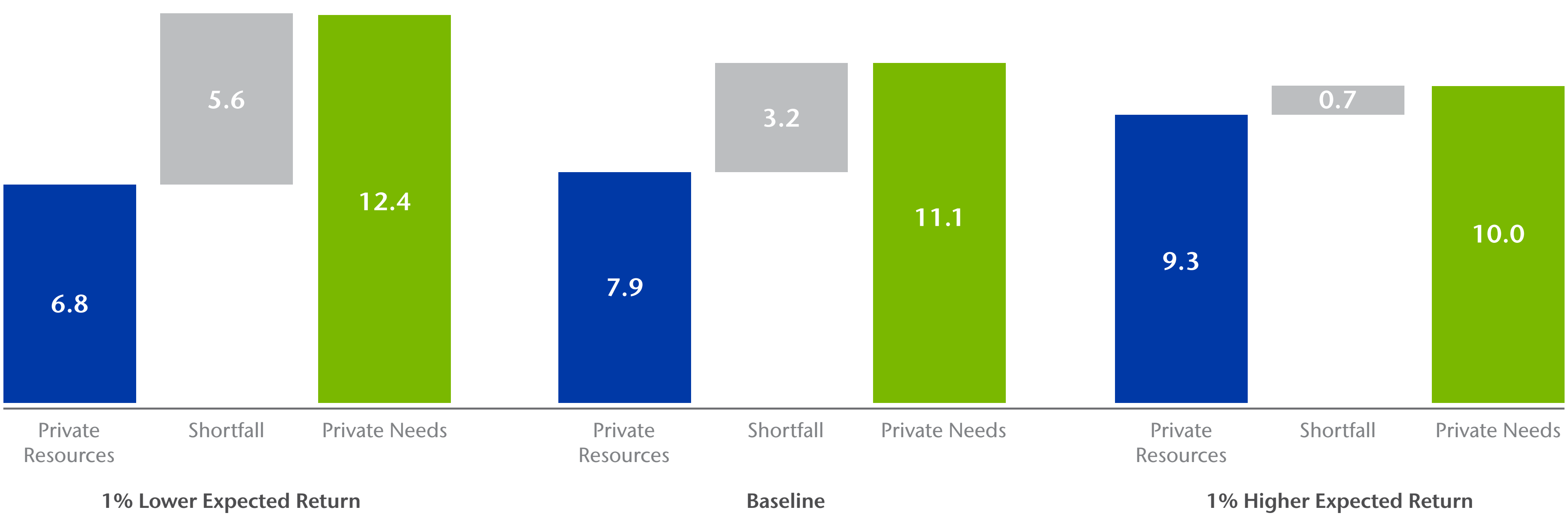
The difference between the 11.1 times pay needed from private resources and the 7.9 times pay in projected private resources is a shortfall of 3.2 times pay. This shortfall would need to be made up through lowering the standard of living in retirement, covering the shortfall with assets outside the employer retirement system, working longer, or some combination of these actions.



Retirement Readiness—The Averages (cont'd.)

The Real Deal's baseline results are based on a set of assumptions and our best estimates given the facts we have today. Changes to any assumption result in a change in outcomes. If the employee's investments outperform expectations, the shortfall will decrease. On the other hand, if inflation is higher than expected, needs will increase. Longevity, medical costs, or potential future legislative changes can all affect the amount needed.

Investment Returns Have Significant Impact on Retirement Adequacy



Savings Rates

Savings Rates

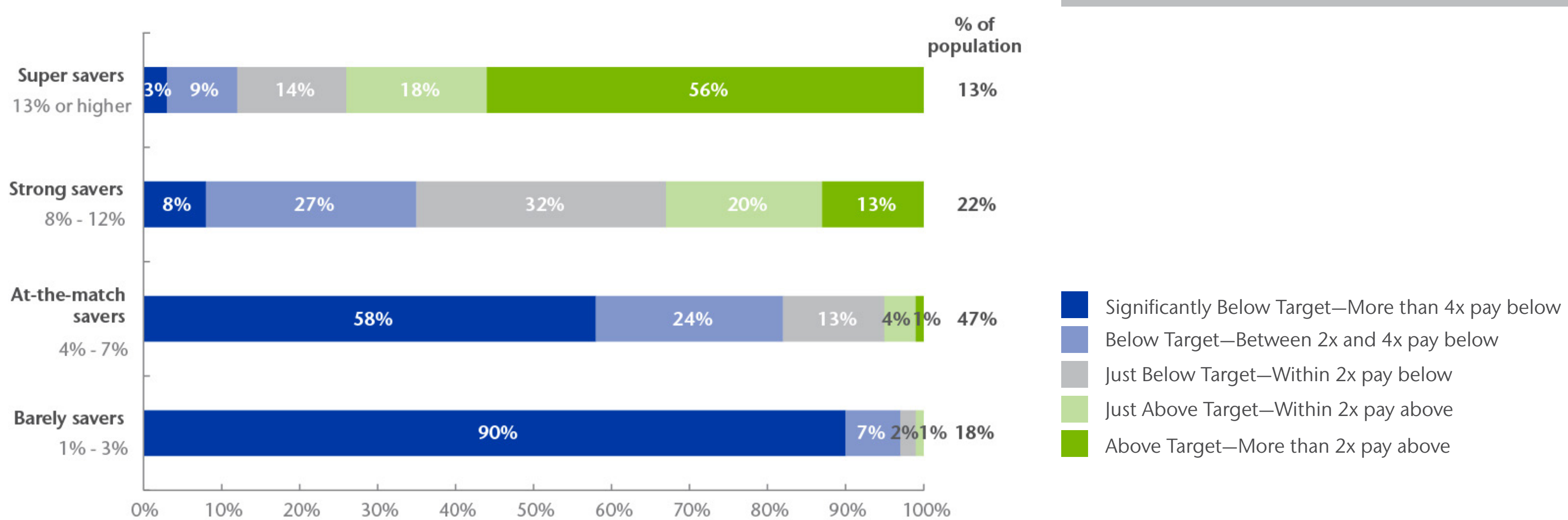
An employee's savings rate is the greatest predictor of whether the employee will be on track for retirement.

Key Takeaways:

- The most important thing employees can do to increase their retirement readiness is to save more, starting sooner.
- Many contributing employees only save enough of their pay in employer-sponsored retirement plans to receive all available matching contributions.
- Workers enrolled in an automatic contribution escalation program in their employer's retirement plan save considerably more by retirement than those who are not.

Distribution of Retirement Income Surplus/(Shortfall) by Savings Rate Bands

A vast majority of Super Savers (those saving at least 13 percent of pay a year) are projected to have more than enough to maintain their standard of living in retirement. Closely behind are the two-thirds of Strong Savers (those saving 8 to 12 percent of pay a year) who are on track. The biggest group, the At-the-Match Savers (saving 4 to 7 percent of pay a year, a rate most likely targeting their employer's match), generally does not accumulate the amount needed for a financially secure retirement. The Barely Savers (saving 1 to 3 percent of pay per year) tend to be early in their career and/or have been automatically enrolled at a low savings rate.

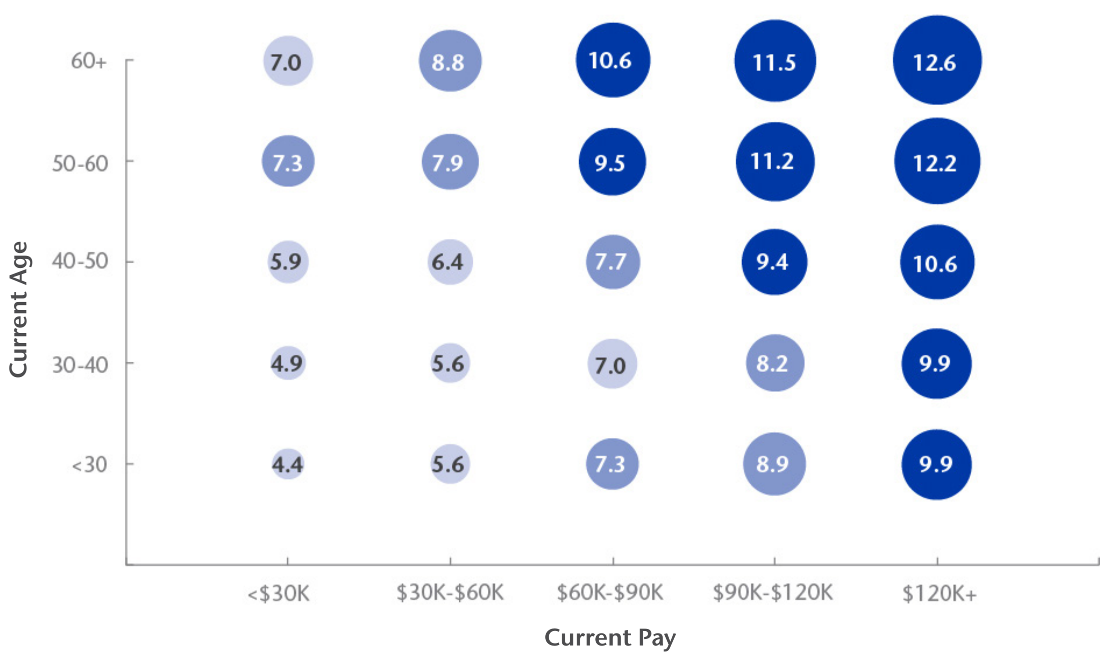


Savings Rates (cont'd.)

On average, contributing employees are saving about 8 percent of their pay. The good news is that as employees advance in their careers, they typically start saving more. They may have more discretionary income, have potentially paid off student loans, and may have gotten past certain major expenses (like child care and buying a home). Also, once retirement is looming, people tend to realize they need to be saving more.

To really change the adequacy picture for the average employee, a more fundamental understanding of and changes in the amount the average employee is saving is required.

Savings Rates by Age and Pay



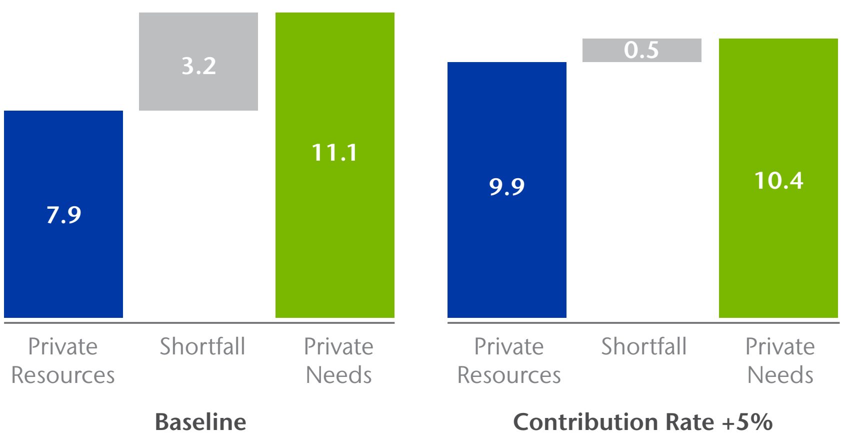
Savings Rates (cont'd.)

Even small changes in savings rates can make a difference in retirement readiness. To really change the adequacy picture for the average employee, a more fundamental understanding of and changes in the amount the average employee is saving is required. For example, if every worker boosted their savings rate by 5 percentage points tomorrow, the average employee would be close to an adequate retirement at age 67.

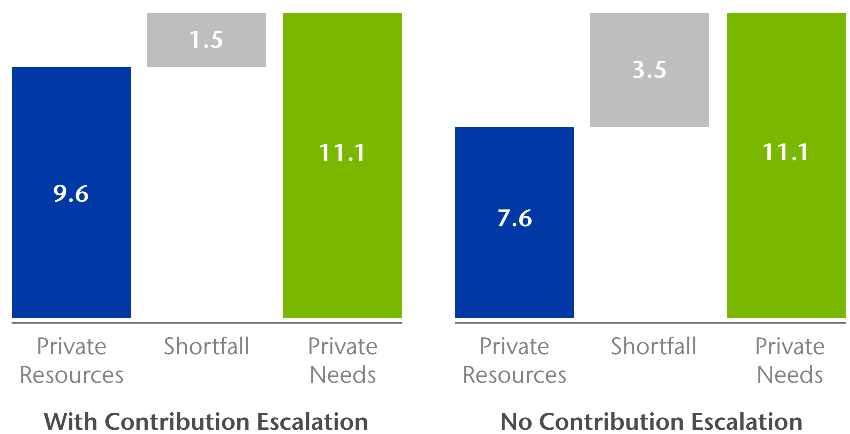
Automatic escalation features can nudge workers to save more than they may otherwise. In *The Real Deal*, employees who are enrolled in contribution escalation are projected to be much better off in terms of retirement adequacy.

For each additional 1 percent of pay saved per year, workers could reduce their shortfall by 0.5 times pay

Savings Rate Increases Can Reduce the Retirement Income Shortfalls



Participants Enrolled in Contribution Escalation Projected to Accumulate Significantly More Resources



Savings Rates (cont'd.)

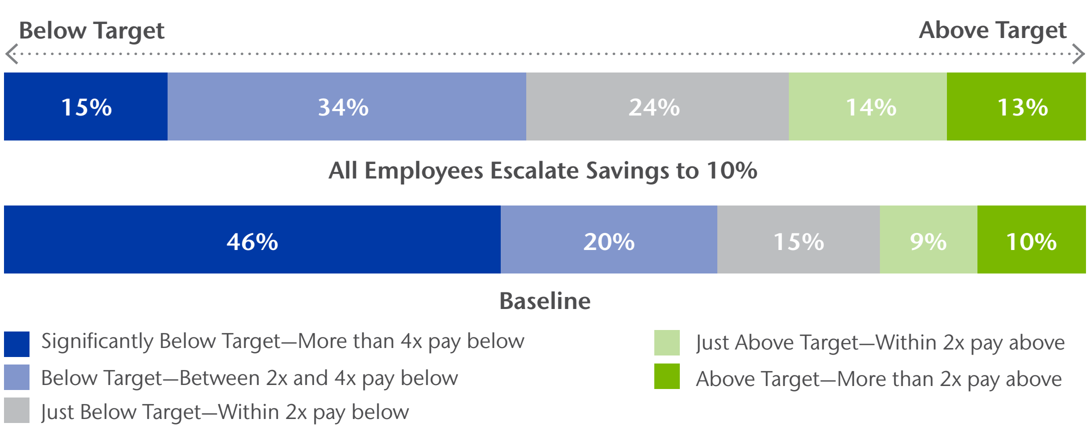
The targets employers set for matching contributions and automatic escalation profoundly affect how much workers will save in retirement plans. Since many retirement plan participants contribute only enough to receive all matching contributions offered, employers' targets for those matches will drive savings rates. The same holds true for automatic escalation targets. If an employer sets an escalation target at 10 percent, that may send a signal to employees that they should be contributing only up to 10 percent of their pay to the plan.

Employers have the opportunity to substantially influence how much employees save and to improve retirement readiness throughout their workforce through actions such as:

- Educating workers on how small changes in savings rates can lead to big gains in retirement readiness;
- Creating or expanding an automatic contribution escalation program in a 401(k); or
- Setting higher savings targets for matching contributions and contribution escalation.

How Automatic Escalation Affects Retirement Adequacy

Retirement Age 67



Seventeen percent more employees would save close to or beyond what they need in retirement if automatically escalated to 10 percent. But half of workers would still be behind their retirement targets.

Income

Income

Retirement adequacy in *The Real Deal* is based on maintaining a worker's preretirement standard of living. Many things factor into an individual's standard of living, but health care costs and taxes are two items that change significantly upon retirement and are major drivers of retirement needs.

Private Needs by Current Age and Pay

Retirement Age 67

While 11.1 times pay is a useful overall benchmark, current income and current age affect retirement needs. Income affects private needs primarily because of the amount of income Social Security replaces, taxation differences, and medical costs, which are typically a much larger proportion of spending for lower-income individuals. Needs vary by age because health care costs are growing faster than salaries are expected to increase and life expectancies are rising.

Key Takeaways:

- The amount workers need to save for an adequate retirement varies significantly by income.
- Health care costs can drive up retirement needs, especially for low-income workers.
- Social Security benefits somewhat offset the adverse effects that health care costs have on retirement needs for low-income workers.
- Tax brackets before and after retirement vary based on income, but can also vary greatly by individual. The differential between the tax rates will influence any tax adjustment for retirement needs.

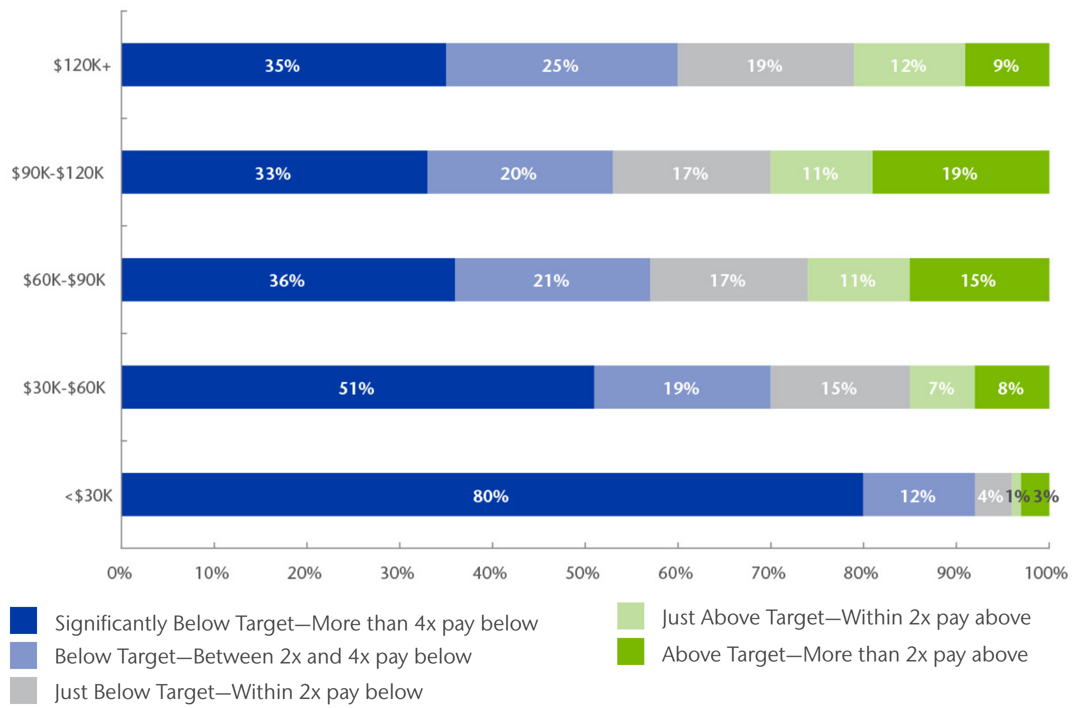
Income (cont'd.)

Generally, the higher a worker's income, the more they save. However, resources of higher-income workers are often limited to tax-qualified plans, which restricts the amount that can be saved in tax-preferred retirement vehicles. For these workers, outside assets, such as home equity and other investments, can supplement retirement-specific savings and offer more flexibility in terms of maintaining one's standard of living.

Comparing resources and needs, we do see a progressive improvement of results until we get to the higher income levels. However, these higher income levels are where more retirement income likely resides outside of the employer retirement system and, thus, is not reflected in this analysis.

Distribution of Retirement Income Surplus/(Shortfall) by Income

Retirement Age 67



Given how widely retirement readiness varies for employees based on income, here's what employers could do to help meet that challenge:

- Understand how the company's employee population differs from overall retirement guidelines.
- Deliver segmented messages to different employee populations, communicating appropriate targets for each group.
- Consider noncontributory employer contributions, to provide some retirement income for low-income participants who cannot afford to save enough to receive the full 401(k) match.

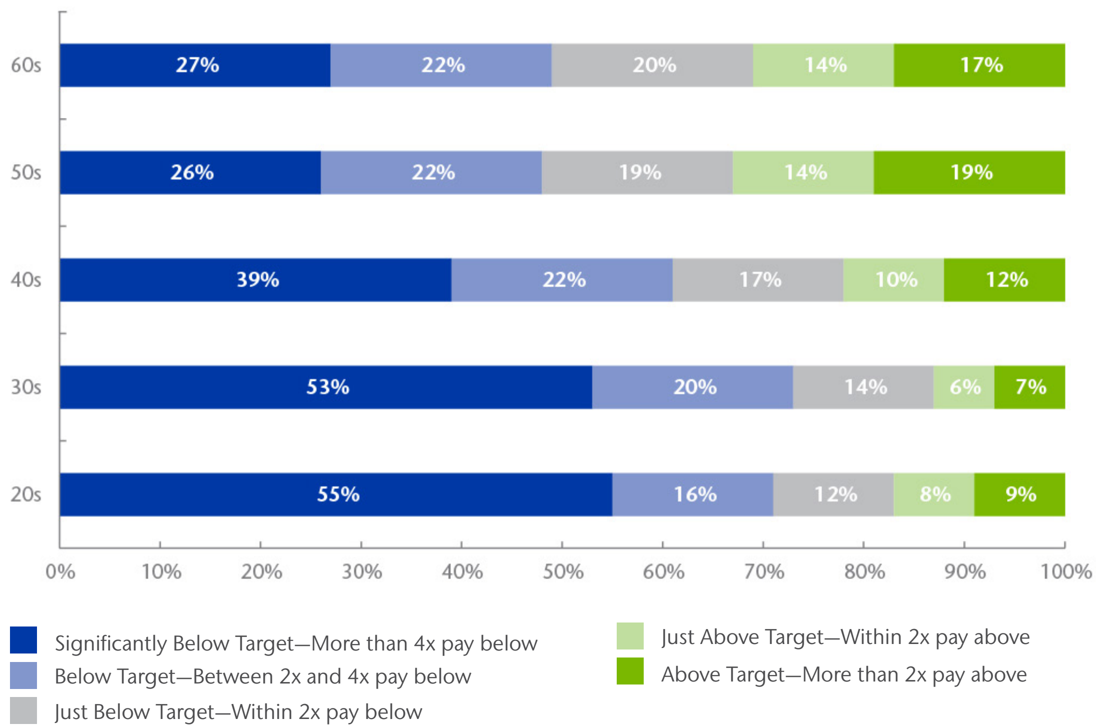
Generations

Generations

The retirement adequacy outlook for younger workers is more challenging than for workers later in their careers.

Distribution of Retirement Income Surplus/(Shortfall) by Age

Retirement Age 67



Key Takeaways:

- Retirement benefits have decreased over time, so older workers have received more help from employers than younger workers will have.
- Younger workers will need to save more for retirement because medical inflation is expected to outstrip wage growth.
- The younger an employee is, the later their retirement age will likely have to be because of rising life expectancy.
- Employees in different life stages are focused on different financial matters.

Generations (cont'd.)

Needs will be higher for younger workers than for workers of previous generations for a variety of reasons. Medical inflation is expected to grow faster than salary over time. That means health care costs are going to be a bigger concern in retirement for today's 30-year-old workers than for the 60-year-olds headed into retirement soon. As a result, younger workers will need to save more to cover those higher costs.

Trends in retirement benefit plans have also put more pressure to save on younger workers, as traditional pensions have declined in availability. Overall, employer contributions have also declined over the past few decades. The chart below shows the percentage of needs met by employer benefits versus the employee's responsibility by generation.

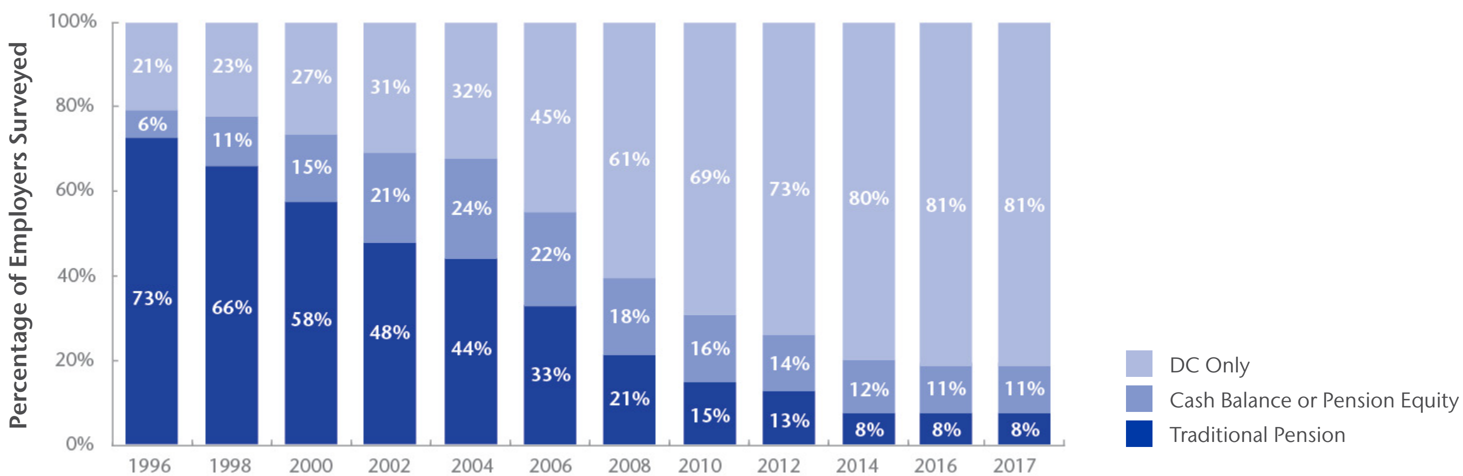
Retirement Benefit Value as a Percentage of Pay

Source: Benefit Index valuations of Fortune 500 companies over time

Traditional Pension Prevalence Declining for Salaried New Hires

General Industry—Salaried New Hire Benefits

Source: Benefic SpecSelect™



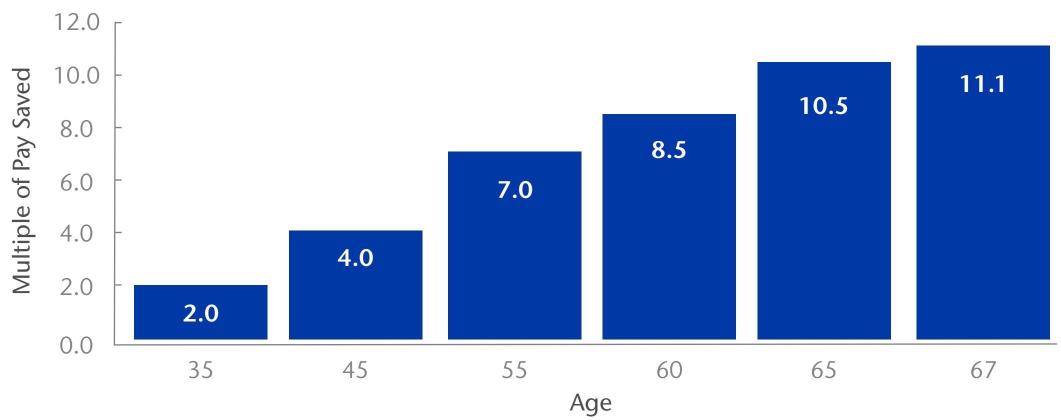
Generations (cont'd.)

Since younger employees need to take more responsibility for their own retirement, additional education and tools may be really helpful for them. In particular, providing information about how much one should save to reach their retirement goal, and about balance milestones along the way, can be a concrete way to set up employees for financial success in retirement.

When talking about retirement savings, it is important to remember the broader financial wellbeing picture, and there may be legitimate reasons why employees at certain ages aren't saving "enough." Retirement planning is only one aspect of a worker's financial life. Generally, younger workers will be concerned about student loans and home buying, middle-aged workers will be likely to focus on saving for their children's college education, and older workers will want to increase their retirement readiness.

Get on Track!

The average employee needs to accumulate 11.1 times pay by age 67 to maintain their preretirement standard of living throughout retirement (after Social Security). It is helpful to show employees savings milestones throughout their career.



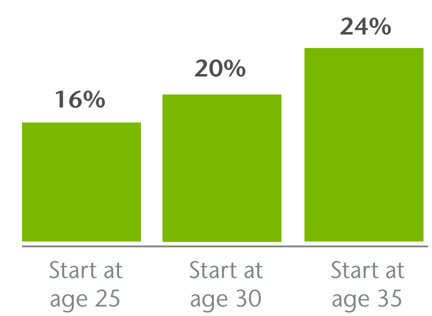
Savings Rate Targets

What percentage of annual pay might employees need to save in order to accumulate 11.1 times pay by age 67?

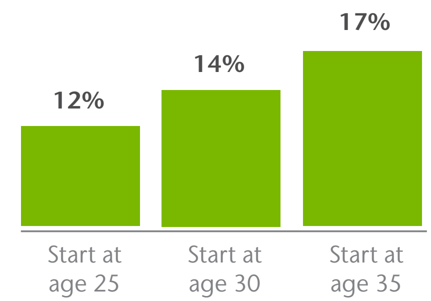
Example: *If there's a 100 percent match on 6 percent of pay, a 25-year-old employee should aim to save approximately 10 percent of pay each year.*

Total Annual Contribution

Percentage of pay: Employee plus employer



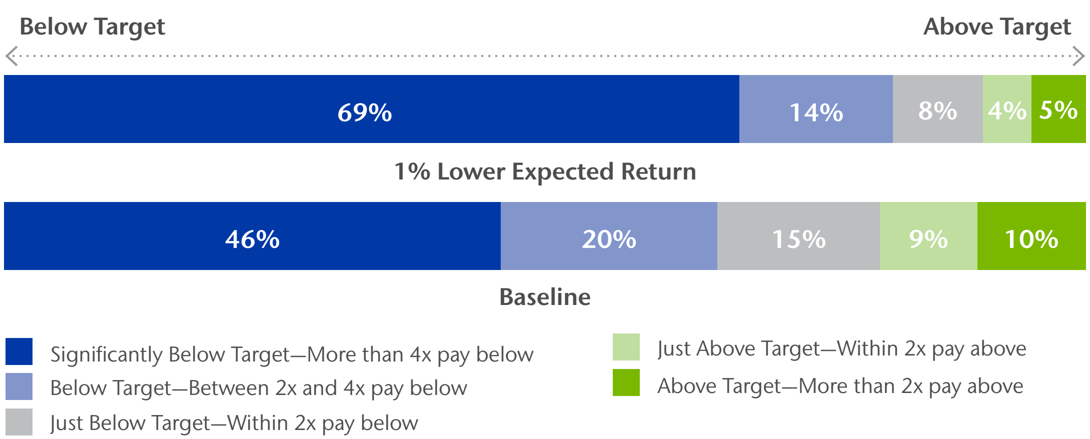
What about accumulating 8.9 times pay by age 70?



Generations (cont'd.)

It is critical for employers to make investing as easy as possible for employees through implementing best-practice approaches. Providing financial help such as online guidance, managed accounts, or premixed portfolios, such as target date funds and target risk funds, is shown to improve participant outcomes.[1] Most plan participants are not investment professionals, but their retirement future depends on them making smart choices when it comes to investing their defined contribution balances.

Investment Returns Matter



How HSAs Help with Retirement Readiness

Health Savings Accounts are becoming an increasingly relevant way for workers to save for retirement. Since HSAs are never taxed, a small amount contributed in an HSA can really add up to significant income in retirement to cover medical costs.

[1] *Financial Engines and Aon Hewitt's Help in Defined Contribution Plans: 2006 through 2012*

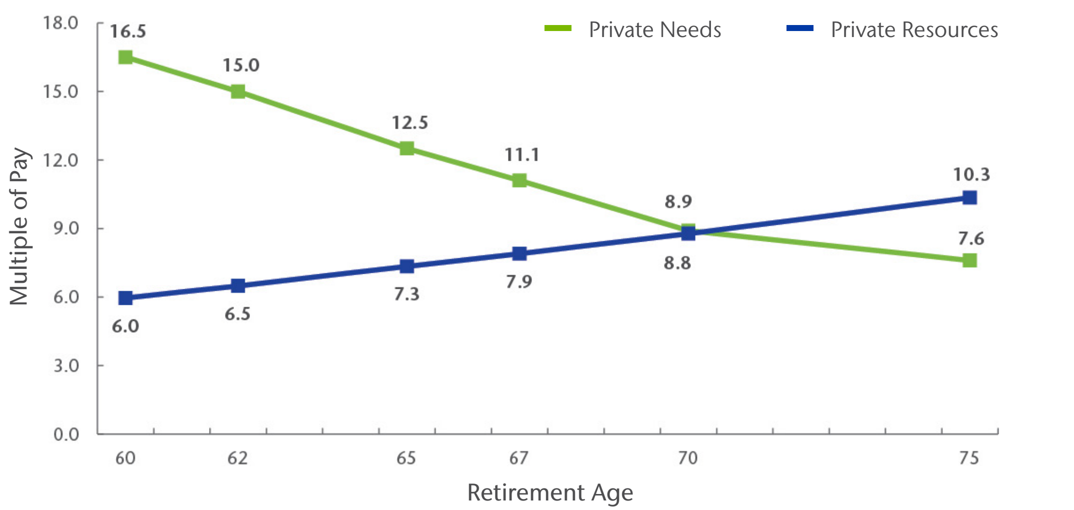
Generations (cont'd.)

Beyond saving more for retirement, younger employees will likely have to work longer. While the median retirement adequacy age for today's older workers will be in the high 60s, most younger workers won't be prepared for retirement until age 70 or later. This will require a cultural shift away from the idea that the traditional age for retirement is 65.

Employers play a role in helping workers of all ages reach their retirement and financial wellbeing goals. These are actions you can take to give your employees an edge:

- Target younger workers with communication materials that explain how they should realistically project their expected retirement age.
- Reduce the costs associated with your defined contribution plans that are passed on to employees through careful selection and monitoring of investment options to enable strong investment performance over a career.
- Provide financial wellbeing education and tools that help younger workers budget and save more.

How Retirement Readiness Changes if Average Worker Defers Retirement

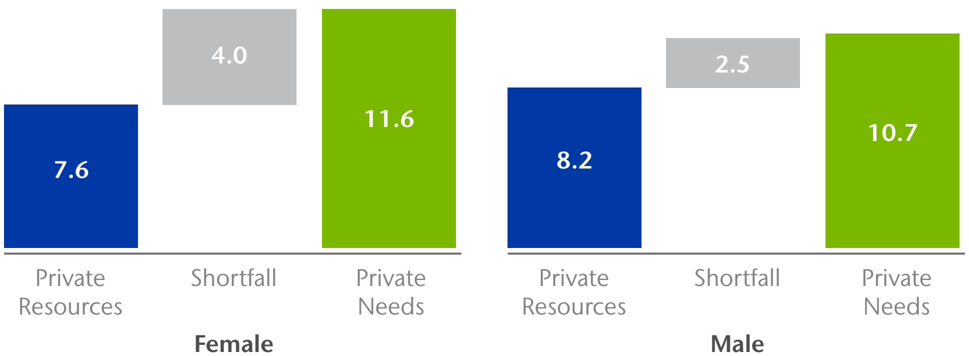


While the median retirement adequacy age for today's older workers will be in the high 60s, most younger workers won't be prepared for retirement until age 70 or later.

Gender

Gender

Female employees are less well prepared for retirement than their male counterparts because their retirement needs are larger, on average, and resources smaller. Needs are larger for females because female employees have longer life expectancy (on average, age 90 versus age 88 for males). Also, females' compensation is lower, so medical needs represent a larger burden for them and must be funded over the longer retirement period. Resources are smaller for women because lower compensation leads to lower savings rates and lower retirement plan balances. More time out of the workforce also results in lower account balances. Because women need more but have lower resources when they retire, a larger retirement income shortfall exists for women than for men.



Key Takeaways:

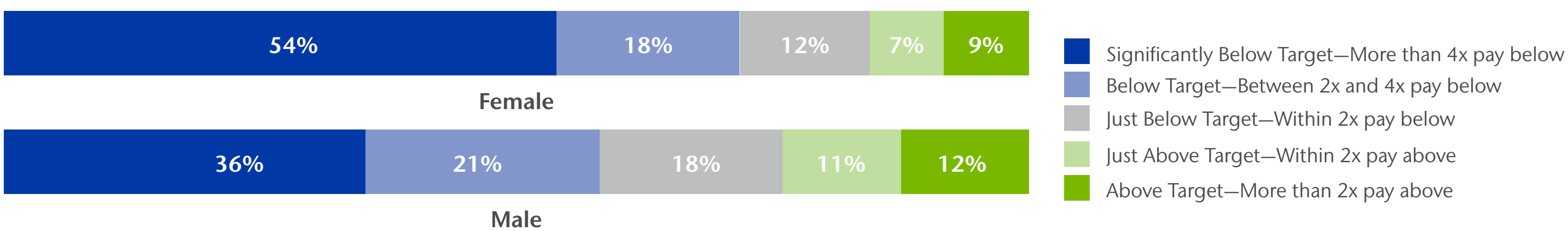
- Female employees will need to save more for retirement than male employees because women have a longer life expectancy.
- Female workers typically earn less and spend more time out of the workforce on average than their male peers, leaving them with less retirement savings.
- All of these factors mean female employees will typically need to save more or retire later than their male peers.

Average	Females	Males
Age	36.9	38.8
Service	11.4	12.8
Savings Rate	7.2%	8.1%
Pay	$70,000	$96,000
Account Balance to Date	$94,000	$165,000

Distribution of Retirement Income Surplus/(Shortfall) by Gender

Retirement Age 67

Female workers may need to defer retirement or increase their savings rates to boost their readiness. In particular, the 54 percent of females trailing their needs target by 4x pay or more is a population for whom employers may want to focus on education and retirement planning tools.



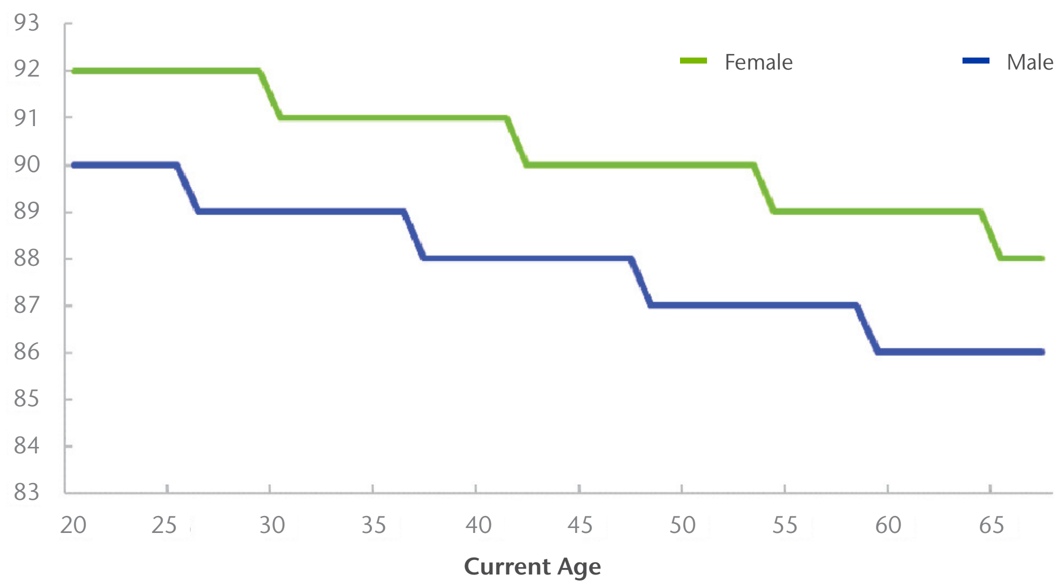
Gender (cont'd.)

For men and women alike, longevity, or the possibility of outliving one's assets, is a major concern. Some of the shortfall for women is offset by Social Security because they will typically receive more payments over their lifetimes. Meanwhile, plan sponsors should consider how lifetime income solutions can help increase retirement security for all employees.

Here's what employers can do to better support their female employees:

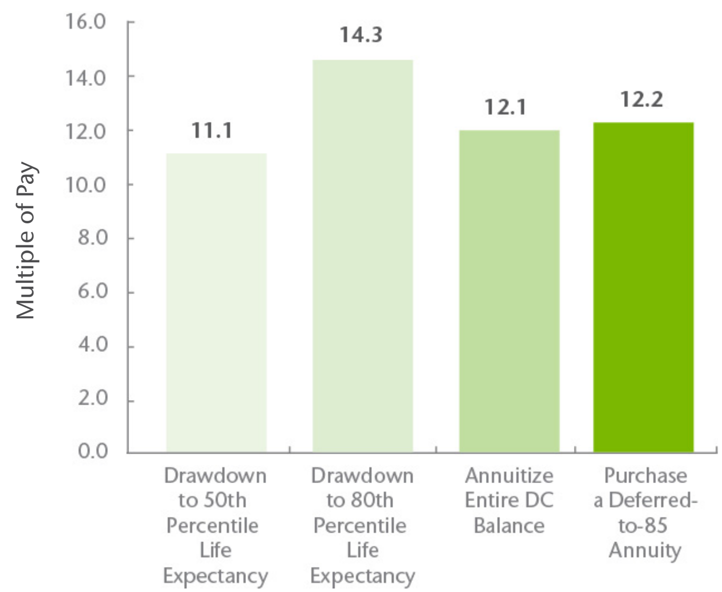
- Measure the differences in retirement readiness between male and female employees.
- Develop targeted communications and tools to encourage female workers to save more, defer retirement, and maximize Social Security benefits.
- Provide lifetime income solutions to help defined contribution plan participants, especially women, better manage longevity risk.

Projected Female Employee Life Expectancy Compared to Male Employee Life Expectancy



How Annuities Help Employees Meet Their Retirement Needs

Females generally have a longer life expectancy to manage. Here's how annuitizing retirement plan balances compares to workers managing their own longevity risk. Workers need to meet a higher needs target if they want more longevity protection.



Industries

Industries

The industry in which an employee works can significantly affect their retirement readiness. The market dynamics driving these industry differences come down to employee pay, benefits, and savings rates.

Not all industries provide robust retirement benefits—some employers have a different workforce strategy. A technology company may lack robust retirement benefits but instead offer generous stock options to its employees, whereas a utility company may provide a defined benefit plan to retain its workers for decades.

Key Takeaways:

- Retirement adequacy varies widely by industry.
- Industries that offer more defined benefit plans tend to have better retirement readiness than industries that primarily offer defined contribution plans.
- Workers in industries that offer higher compensation typically have better retirement benefits to maintain a competitive workforce, but that's not always the case.

Age of Adequacy by Industry

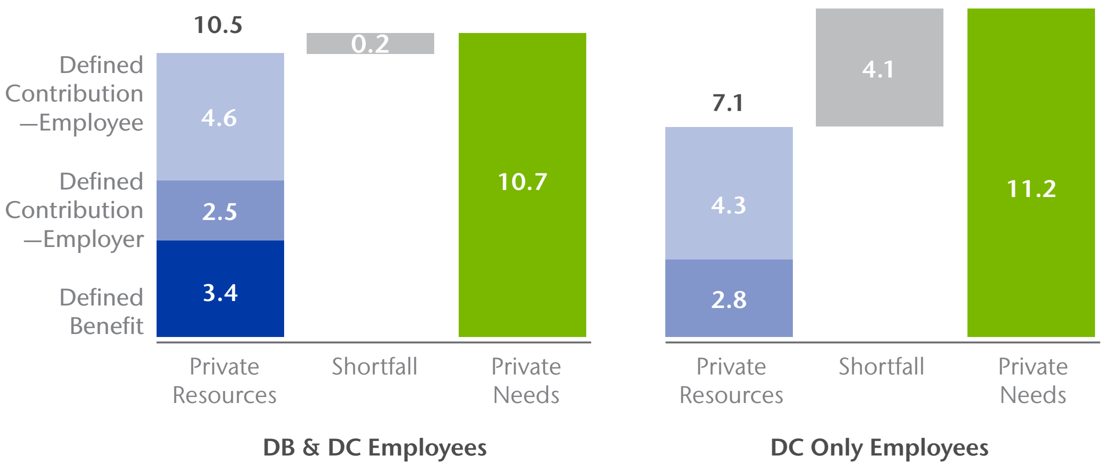
Age of Adequacy = the median age at which employees are able to retire and expect to maintain their preretirement standard of living

67	Aerospace Chemicals Energy, Oil, and Mining Food and Beverage Utilities
68	Forest Products and Packaging Industrial Equipment Personal and Consumer Products Pharmaceuticals Research and Testing
69	Accounting Agriculture Electronics Insurance Publishing and Printing Telecommunications Transportation
70	Automotive Banking and Finance Building Materials Engineering and Construction Media and Entertainment
71	
72	
73	Health Care Services and Hospitals Medical Products
74	Technology
75+	Food Service Hotels, Resorts, and Casinos Retail Distribution

Industries (cont'd.)

Benefits offered by industries change as the markets in those industries evolve. Some employers may have historically provided defined benefit plans, but have had to close or freeze those plans to remain competitive.

Benefits offered by industries change as the markets in those industries evolve.



Industries (cont'd.)

Industry benchmarks help employers know the competitive landscape, but each employee population is unique. A retirement income adequacy analysis at the employer level gives decision-makers the tools to craft benefit plans that employees will use and find valuable throughout their careers and beyond.

Here's what employers could do to better understand how competitive and effective their benefits are in achieving retirement adequacy for employees:

- Benchmark your retirement plan's competitiveness against peer organizations.
- Measure your employee population's retirement readiness against your broader industry's performance.
- Develop an appropriate total benefits strategy based on your company's employee population and unique position within your industry.

Measure your employee population's retirement readiness against your broader industry's performance.

Retirement Readiness by Industry

Retirement Age 67

6 in 10 workers

Aerospace
Chemicals
Energy, Oil, and Mining
Food and Beverage
Utilities

5 in 10 workers

Accounting
Agriculture
Electronics
Forest Products and Packaging
Industrial Equipment
Insurance
Personal and Consumer Products
Pharmaceuticals
Publishing and Printing
Research and Testing
Telecommunications
Transportation

3 in 10 workers

Automotive
Banking and Finance
Building Materials
Engineering and Construction
Health Care Services and Hospitals
Media and Entertainment
Medical Products

2 in 10 workers

Technology

1 in 10 workers

Food Service
Hotels, Resorts, and Casinos
Retail Distribution

= those within 2x pay of Target Needs

Personalizing Retirement Benefits

Personalizing Retirement Benefits

Employees who save steadily for retirement and who invest efficiently can accumulate benefits reasonably close to, or beyond, what they will need to comfortably retire. It is important to remember that competitive retirement benefits may not be enough to guide your individual employees toward a viable retirement plan, so additional features and communication may be needed to help employees understand their responsibility in saving for retirement.

If your goal is to help your employees save more and invest their savings appropriately, you'll need to address the special combination of factors at play for each of your workers. Retirement readiness is ultimately about each individual's goals and resources, and every person's adequacy calculations are unique.

And that means your population's needs are also unique. Once you understand your employee population with a retirement income adequacy analysis, you can build better benefits that prepare your workforce for the future.

Retirement readiness is ultimately about each individual's goals and resources, and every person's adequacy calculations are unique.

The Real Deal Definitions

The Real Deal Definitions

Total Retirement Needs: The amount of money a retiree would need to maintain their standard of living through retirement.

Private Needs: Total retirement needs adjusted for Social Security income—the amount of money that must be accumulated through personal savings or employer benefits.

Private Resources: Retirement resources other than Social Security:

- Defined contribution (DC) savings and employer contributions (assuming current behavior continues).
- Defined benefit (DB) plan funds.

Full-Career Contributors: The population emphasized in this study—participants with the opportunity to accumulate at least 32 years of service by age 67 with their current employer (i.e., hired by age 35) and who are participating in their defined contribution plan.

Retirement Age: Age 67 is the baseline age at which *The Real Deal* assumes participants would retire.

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