The Real Deal

2015 Retirement Income Adequacy at Large Companies
Real Deal Definitions

**Total Retirement Needs.** The amount of money a retiree needs in order 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); and
- Defined benefit (DB) plan funds.

**Full-Career Contributors.** The population emphasized in this study—participants with the opportunity to accumulate at least 30 years of service by age 65 with their current employer and who are participating in their defined contribution plan.

**Retirement Age.** Age 65 is the baseline age at which The Real Deal study assumes participants to retire.

*Please see the report for additional details*
About This Study

Aon Hewitt’s sixth installment of The Real Deal study analyzes the financial retirement readiness of 2.1 million employees of 77 large U.S. employers. The study projects employees’ retirement needs and resources, assuming their current behaviors continue. The report analyzes retirement risks, measures employer and employee actions to help improve retirement outcomes, and provides our answers to the critical questions employees and employers need to consider while preparing for a financially successful retirement.

The results of this study provide an indication of how financially prepared for retirement employees at large companies will be. The net results are similar to those of prior studies—gains from strong asset returns over the last two years and lower than expected healthcare cost increases were offset by longer life expectancies and a lower expectation of returns from future defined contribution investments.

Overall, this year’s study found:

Employees need an average of 11 times their final pay for an adequate age 65 retirement.

Only 1 out of 5 employees are projected to have retirement savings that exceed the amount needed at age 65. An additional 1 out of 5 may have reasonably adequate savings for retirement with some lifestyle adjustments.

The median employee is expected to be financially ready to retire at age 68.
How much do workers need to retire and maintain their standard of living?

Workers typically need to accumulate retirement assets and benefits (beyond Social Security) worth about 11 times their pay at retirement at age 65 to maintain their preretirement standard of living over an average life expectancy.

Retirement needs differ based on individual circumstances. The chart below illustrates how needs can vary with age and income. Income impacts needs due to taxation differences and because medical costs are typically a much larger proportion of spending for lower-income individuals. Needs vary by age because medical costs are increasing faster than salaries are expected to increase, and because life expectancies are also increasing.

### 2014 Pay

<table>
<thead>
<tr>
<th>Current Age</th>
<th>&lt;30K</th>
<th>$30K–$60K</th>
<th>$60K–$90K</th>
<th>$90K–$120K</th>
<th>$120K</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;30</td>
<td>8.0</td>
<td>7.5</td>
<td>6.9</td>
<td>8.1</td>
<td>9.6</td>
</tr>
<tr>
<td>30–40</td>
<td>9.5</td>
<td>8.7</td>
<td>8.3</td>
<td>9.4</td>
<td>10.6</td>
</tr>
<tr>
<td>40–50</td>
<td>11.0</td>
<td>10.0</td>
<td>9.9</td>
<td>10.8</td>
<td>11.8</td>
</tr>
<tr>
<td>50–60</td>
<td>12.2</td>
<td>11.0</td>
<td>10.8</td>
<td>11.7</td>
<td>12.5</td>
</tr>
<tr>
<td>60+</td>
<td>13.4</td>
<td>11.6</td>
<td>11.1</td>
<td>11.9</td>
<td>13.1</td>
</tr>
</tbody>
</table>

---

The Real Deal
Are today's workers prepared to meet their needs at retirement?

Roughly **two out of five workers** who participate in their employer’s benefit plans for their entire career are expected to be on track to retire with reasonably adequate retirement income. About half of these participants—22% of full-career contributors—are projected to accumulate more assets than needed. The resources for the other half—19% of all full-career contributors—will fall close enough to their targeted 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 three out of every five full-career contributing employees (59%) who are not expected to have saved enough to retire at age 65. Even with adjustments in spending, these employees will either need to increase their savings or delay retirement.

**Distribution of Projected Resources vs. Targeted Needs**

<table>
<thead>
<tr>
<th>Significantly Below 35%</th>
<th>Below Target 24%</th>
<th>Just Below Target 19%</th>
<th>Just Above Target 13%</th>
<th>Above Target 9%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Significantly Below</td>
<td>More Than 4x Pay Below</td>
<td>Between 2x and 4x Pay Below</td>
<td>Within 2x Pay Below Target</td>
<td>Within 2x Pay Above Target</td>
</tr>
<tr>
<td>Below Target</td>
<td>Below Target</td>
<td>Just Below Target</td>
<td>Just Above Target</td>
<td>Above Target</td>
</tr>
<tr>
<td>Just Below Target</td>
<td>Between 2x and 4x Pay Below</td>
<td>Within 2x Pay Below Target</td>
<td>Within 2x Pay Above Target</td>
<td>More Than 2x Pay Above</td>
</tr>
</tbody>
</table>

**What about other employees?** These results are for full-career contributing employees, meaning these employees are saving in their DC plan and could work a full career at their current employer. When you include mid-career hires and noncontributors, only one out of every five employees (22%) is expected to be within 2x pay, or better, to meeting their retirement income needs by age 65.
When will employees be able to retire with adequate retirement resources?

**Age 68 is the median age** at which full-career contributors are projected to have sufficient resources to maintain their standard of living. The graph below shows the percentage of the population who are projected to accumulate adequate resources by a given age. Sixteen percent of the population is not expected to be able to retire by age 75.

**Percent Adequate At or Before Given Age**

Earlier retirement may be financially feasible for some employees if they decide to reduce their standard of living. On the other hand, there may be reasons—like poor health or the need to care for a loved one—that impede a worker’s ability to wait until they are financially ready to retire.
How much retirement income are employers providing?

Employers provide 40% of target private needs, on average. However, this varies greatly by employer, by the employee’s age, and by whether the employer provides a defined benefit plan.

The chart below demonstrates how employer-provided retirement benefits have become less generous as the prevalence of defined benefit plans has declined. Younger generations need to save more to achieve an adequate retirement compared to those currently close to retirement age.

Percent of Financial Needs Provided from Private Sources

Employer benefits and employee savings are not sufficient to meet target needs for the average participant, as shown below. Employees are projected to have saved only 4.1 times pay which, when combined with the average value from employer-provided defined contribution (2.4 times pay) and defined benefit (1.9 times pay), leaves an average gap of 2.6 times pay at retirement.

Projected Age 65 Resources vs. Targeted Private Needs
How can workers know if they are on track?

On average, employees need to add **17% of each year’s pay** to their retirement resources from age 25 to 65 in order to accumulate adequate retirement income. This includes employee savings and employer benefits. Doing so will allow employees to accumulate resources over their career roughly in line with these retirement resource milestones (expressed as multiples of pay):

**Target if Saving Begins at 25**
(Multiple of Pay)

<table>
<thead>
<tr>
<th>Age When Savings Begin</th>
<th>Percent of Pay if Retire at 65</th>
</tr>
</thead>
<tbody>
<tr>
<td>35</td>
<td>17%</td>
</tr>
<tr>
<td>45</td>
<td>25%</td>
</tr>
<tr>
<td>55</td>
<td>25%</td>
</tr>
<tr>
<td>60</td>
<td>40%</td>
</tr>
<tr>
<td>65</td>
<td></td>
</tr>
</tbody>
</table>

If employees save lesser amounts, start saving later than age 25, or are not investing appropriately, they may need to contribute more in future years to make up the shortfall. For example, for every five years retirement savings is delayed after age 25, an additional contribution of 4-5% of pay per year is needed. Conversely, delaying retirement to age 67 reduces the average annual contribution needed from 17% to 14%.

**Total Savings Rates Required**

In this study, the typical employer contribution is about 5% of pay, leaving the employee to save the remaining 12% (or more).
Automatic savings features in defined contribution plans can significantly improve results. Companies with automatic enrollment have savings plan participation rates of 84%—more than 20% higher than those companies without automatic enrollment.

Employees who are automatically escalating their contributions are much more likely to be on track. Over 70% of full-career contributors who are escalating are projected to have near-adequate resources at age 65. The good news is that 22% of full-career contributors with access only to DC benefits are escalating their contributions. The better news is that this percentage is on the rise.

Distribution of Projected Resources vs. Targeted Needs for Employees Automatically Escalating

More than 70% of those escalating are projected to be within 2x pay (or better) of their savings target at age 65.
What are employers doing to help employees make their retirement investments last a lifetime?

Generally, employees have several alternatives to help ensure their money will last throughout their lifetime. These include:

1. Saving for an average lifetime and cutting back spending as necessary to accommodate living longer than average
2. Saving for a longer than average lifetime
3. Buying an annuity to assure a steady income for their entire lifetime
4. Buying a deferred annuity to provide longevity protection while maintaining the flexibility of having cash on hand during the first 20 years of retirement

All the options (other than saving for an average lifetime) require additional resources, which this study quantifies. Here’s a comparison:

**Private Resources Needed to Achieve These Drawdown Strategies**

<table>
<thead>
<tr>
<th>Drawdown to 50th Percentile Life Expectancy</th>
<th>Drawdown to 80th Percentile Life Expectancy</th>
<th>Annuitize Entire DC Balance</th>
<th>Purchase a Deferred Annuity to 85</th>
</tr>
</thead>
<tbody>
<tr>
<td>11.0</td>
<td>13.5</td>
<td>11.9</td>
<td>12.1</td>
</tr>
</tbody>
</table>

Employers are beginning to increase their focus on helping employees with drawdown strategies by **including drawdown or annuitization options** within their defined contribution plans. Providing employees access to providers and favorable group pricing can help retirees stretch their retirement dollars through their retirement years.
The study indicates employees who save for retirement over long periods of time and who invest efficiently can accumulate benefits reasonably close to what they might need to maintain their preretirement standard of living during retirement. However, the study also indicates almost 60% of full-career contributing employees are not projected to be close to retiring with adequate financial resources. This highlights the importance of helping employees save more and invest their savings appropriately for retirement.

Specific future action steps can improve the projected results. Employer actions can include:

- focusing on financial wellness with services and tools for budgeting, debt management, health care spending (e.g., Health Savings Accounts), and financial planning;
- expanding the use of automation (e.g., automatic enrollment, automatic contribution escalation, and automatic rebalancing) to get more money in the defined contribution system and refining the defaults associated with automated features;
- helping employees improve their results by providing access to an array of investment advisory solutions;
- reducing the costs associated with the defined contribution plan through careful selection and monitoring of investment alternatives (e.g., institutional pricing, separately managed funds, custom target date funds, fund of funds/white label alternatives, and appropriate delegation of decision making authority to investment professionals);
- adding lifetime income management options to plans to help participants effectively manage longevity risk in defined contribution plans; and
- considering the impact of their retirement plan design on their employees (e.g., defined benefit plan versus defined contribution plan, stretch match concepts, offering flexibility through pretax, aftertax, Roth, and catch-up contributions).

Conclusion

Employers take action!
Focus on financial wellness, expand automation, and provide investment advisory options.
Employee actions can include:

• becoming educated in retirement income adequacy;
• targeting a realistic retirement age;
• identifying ways to save more in employer-sponsored retirement plans (e.g., saving at robust rates that are typically well beyond the maximum match threshold);
• taking advantage of financial wellness services, tools, and resources when made available; and
• pursuing lifetime income solutions rather than relying on lump sum distributions or “pay as you go” strategies.

Other action steps, beyond the scope of this report, include plan sponsors working to minimize leakage (e.g., retirement plan loans and withdrawals) and increase the effectiveness of retirement plan communications with employees.

The ability to improve retirement readiness in the U.S. will require a concerted effort by all stakeholders. There are many ways to address the risks of retirement adequacy. Important future initiatives include employers measuring and monitoring the projected results for their workforce and focusing on key influencing factors such as automation, investment help, and plan design, while increasing awareness and promoting employee action through personalized tools and communication. Ideal solutions will improve outcomes for both employer and employee, with little or no increase in employer cost.
Contacts

Grace Lattyak
Associate Partner, Aon Hewitt
+1.415.486.6931
grace.lattyak@aonhewitt.com

Rob Reiskytl
Partner, Aon Hewitt
+1.952.807.0843
rob.reiskytl@aonhewitt.com

About Aon Hewitt

Aon Hewitt empowers organizations and individuals to secure a better future through innovative talent, retirement and health solutions. We advise, design and execute a wide range of solutions that enable clients to cultivate talent to drive organizational and personal performance and growth, navigate retirement risk while providing new levels of financial security, and redefine health solutions for greater choice, affordability and wellness. Aon Hewitt is the global leader in human resource solutions, with over 30,000 professionals in 90 countries serving more than 20,000 clients worldwide.

For more information, please visit aonhewitt.com.
About Aon
Aon plc (NYSE:AON) is a leading global provider of risk management, insurance brokerage and reinsurance brokerage, and human resources solutions and outsourcing services. Through its more than 69,000 colleagues worldwide, Aon unites to empower results for clients in over 120 countries via innovative risk and people solutions. For further information on our capabilities and to learn how we empower results for clients, please visit: http://aon.mediaroom.com.

© Aon plc 2015. All rights reserved.
The information contained herein and the statements expressed are of a general nature and are not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information and use sources we consider reliable, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.