Measuring Retirement Income Adequacy

Knowledge from Aon's *The Real Deal 2018*

Prepared by Aon for National Institute on Retirement Security Webinar, April 21, 2020

Prepared by Aon

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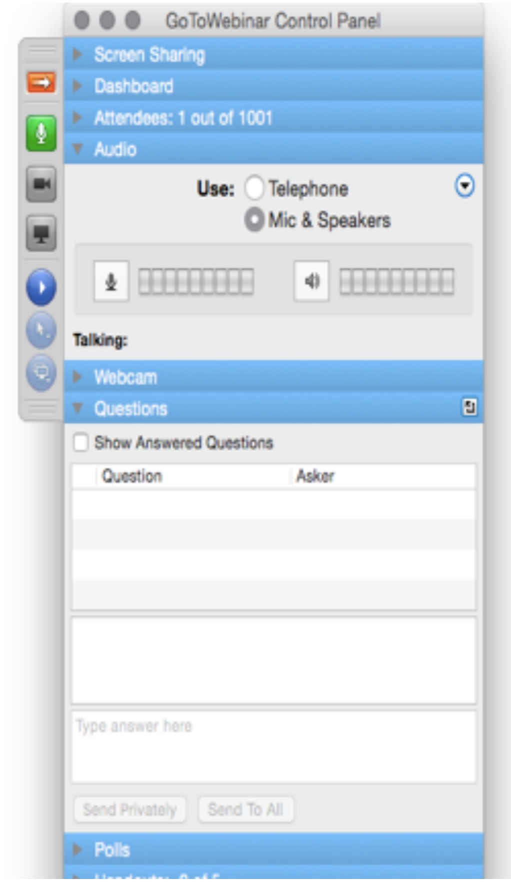
Webinar Agenda

- Logistics and Introductions
- Measuring Retirement Income Adequacy in the Public Sector
- Questions

Logistics

- Attendees in listen only mode.
- Questions welcome. Type question using "Question" function on control panel, and we will answer following the presentation.
- Audio, technical issues during webinar, call GoToWebinar at 1-800-263-6317.
- We are recording this session and a replay will be available at www.nirsonline.org/events/webinars.



Speakers

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COVID-19 Impacts All Aspects of Wellbeing

Wellbeing is a **state of balance** that consists of having the **appropriate resources, opportunities and commitment** needed to **achieve optimal health and performance** for the **individual** and the **organization**

Attitudes and reactions to everyday living

Energy to complete daily living tasks and make healthy lifestyle choices

Confidently manage financial life today, while preparing for the future and anything unexpected along the way

Connections to others

Positive work experiences that produce pride, satisfaction and value

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Best Pensions Paper
(North America)
Savvy Investor Awards 2018
WWW.SAVVYINVESTOR.NET

Aon's *The Real Deal*

Only **1** in **3** workers will have saved enough to retire comfortably by age 67.

- Measures retirement income adequacy at U.S. private plan sponsors
- Industry-leading analysis
- 7th Real Deal study (started in 2003)
- Incorporated data from Aon's Benefit Index®, Alight Solutions, and the U.S. Bureau of Labor Statistics (BLS)
- Project each individual retirement resource and need
- Focus on baseline case
  - Projected to save for retirement for a "full career"
  - Age 67 retirement
  - Middle-of-the-road assumptions

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The Big Picture—*The Real Deal* 2018 Key Findings

11.1

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

70
years old

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** for a typical employee**,** including employer contributions, 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

Results from *The Real Deal: 2018 Retirement Income Adequacy at U.S. Plan Sponsors* based on the population of full-career contributors.

Retirement Income Adequacy Defined

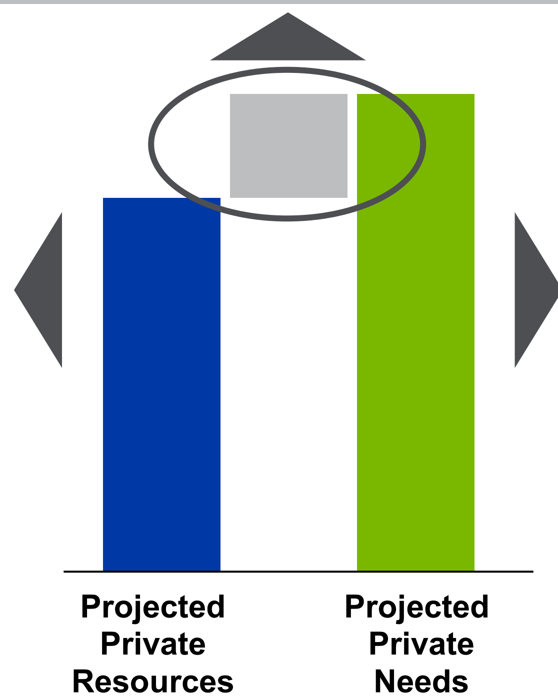
Definition in *The Real Deal*:

- Accumulating the resources required to maintain preretirement standard of living for a postretirement lifetime (in addition to Social Security benefits)

Resource shortfall results in lower standard of living if not compensated by other assets or postretirement employment

Private Resources

- Employee contributions to employer-sponsored plans
- Employer-provided benefits
  - Defined Contribution (DC) (matching plus profit sharing)
  - Defined Benefit (DB)



Private Needs

- Preretirement pay adjusted to reflect:
  - No longer saving for retirement
  - Change in taxes
  - Higher medical costs
- Offset by Social Security benefits

Comparable Ways to Quantify Needs and Resources

How much do I need to accumulate to retire?

- Asset value expressed
  as a multiple of pay at retirement
  (e.g., 11.1x pay)
- **Resources**
  DC plan account values and single sum value of pension benefits
- **Needs**
  PV at retirement of postretirement income needed to preserve standard of living through retirement

What income will I need after retiring?

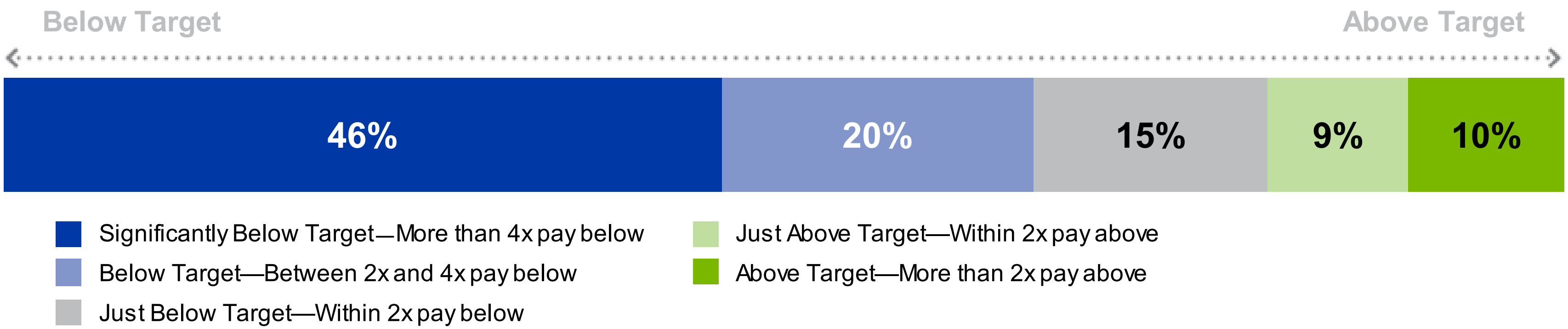
- Replacement ratio stated as
  a fraction of pay at retirement
  (e.g., 85% of pay)
- **Resources**
  Annual income equivalent of DC account plus pension benefits
- **Needs**
  Pay replacement required to maintain preretirement standard of living at retirement

The Real Deal 2018

Private Sector

More than half of workers are projected to fall well short of the target resources needed to maintain their standard of living at an age 67 retirement

Distribution of Surplus/(Shortfall) of Projected Resources Vs Target Needs



Who's "on track"?

2 out of **3** employees with a defined benefit plan

50% of employees over age 50

3 out of **4** employees saving at least 8%

20% of employees retiring at age 65

Note: Employees who are "on track" are projected to be within 2x pay (or better) of their savings target.

Results from *The Real Deal: 2018 Retirement Income Adequacy at U.S. Plan Sponsors* based on the population of full-career contributors retiring at age 67.

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Private Sector

One Size Does Not Fit All—Private Sector

Needs vary per person. Age and pay are key factors.

Current Age

Projected needs increase for younger workers because of higher future medical costs and gradually increasing life expectancy

Current Pay

Projected needs vary as a result of tax rates, progressive Social Security benefits, savings rates, and near-flat dollar medical costs

Results from *The Real Deal: 2018 Retirement Income Adequacy at U.S. Plan Sponsors* based on the population of full-career contributors retiring at age 67.

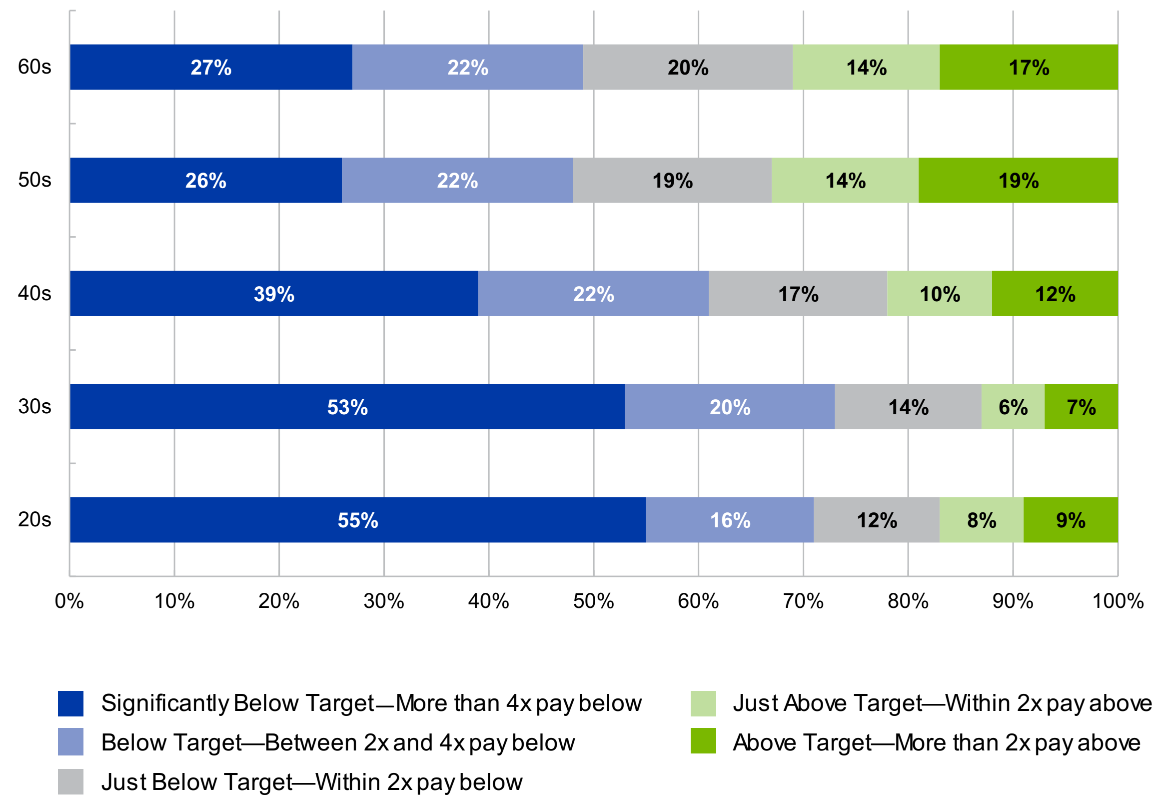
Private Sector

Retirement Readiness Varies by Generation—Private Sector

Retirement benefits have decreased over time, so older workers have received more help from employers than younger workers 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



Results from *The Real Deal: 2018 Retirement Income Adequacy at U.S. Plan Sponsors* based on the population of full-career contributors retiring at age 67.

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Comparing Private Sector and Public Sector—Retirement Resources

Private	Public
Defined Benefit (DB) Plan —Increasingly closed, frozen, or terminated	Defined Benefit (DB) Plan —Cost of Living Adjustments (COLAs) —Employee contributions
Defined Contribution (DC) Plan —Often the primary retirement savings vehicle	Defined Contribution (DC) Plan —Secondary to DB plan, if at all —More often discretionary; ER match is not common
Social Security (SS) —Employees participate in SS —Some plans integrated with SS	Social Security (SS) —State and Local governments may have opted out of SS for some employees
Retiree Welfare (RW) —Many closed or terminated —Retiree paid	Retiree Welfare (RW) —More widespread usage —Cost shared

Private Resources
—DB plus DC
—Excludes Social Security

Annuity Resources
—DB plus SS plus Retiree Welfare
—Excludes DC

Results from *The Real Deal: 2018 Retirement Income Adequacy at U.S. Plan Sponsors* based on the population of full-career contributors retiring at age 67.

Baseline Plan Design and Strawperson

	Plan Design
Defined Benefit	2.00% of 5-yr FAP
DB EE Contributions	6.00%
COLA	None
Social Security	Yes
Retiree Welfare	50% ER Subsidy
DC ER Contributions	No DC
DC EE Contributions	No DC
Unreduced Retirement Age	62

	Strawperson
Age	45
Service	20
Current Pay	$85,000
Gender	Male
DB EE Rate	6%
DC EE Savings Rate	0%
Total EE Rate	6%

[1] FAP: Final Average Pay pension plan

Understanding Retirement Needs

Needs in the First Year of Retirement Vs. Throughout Retirement

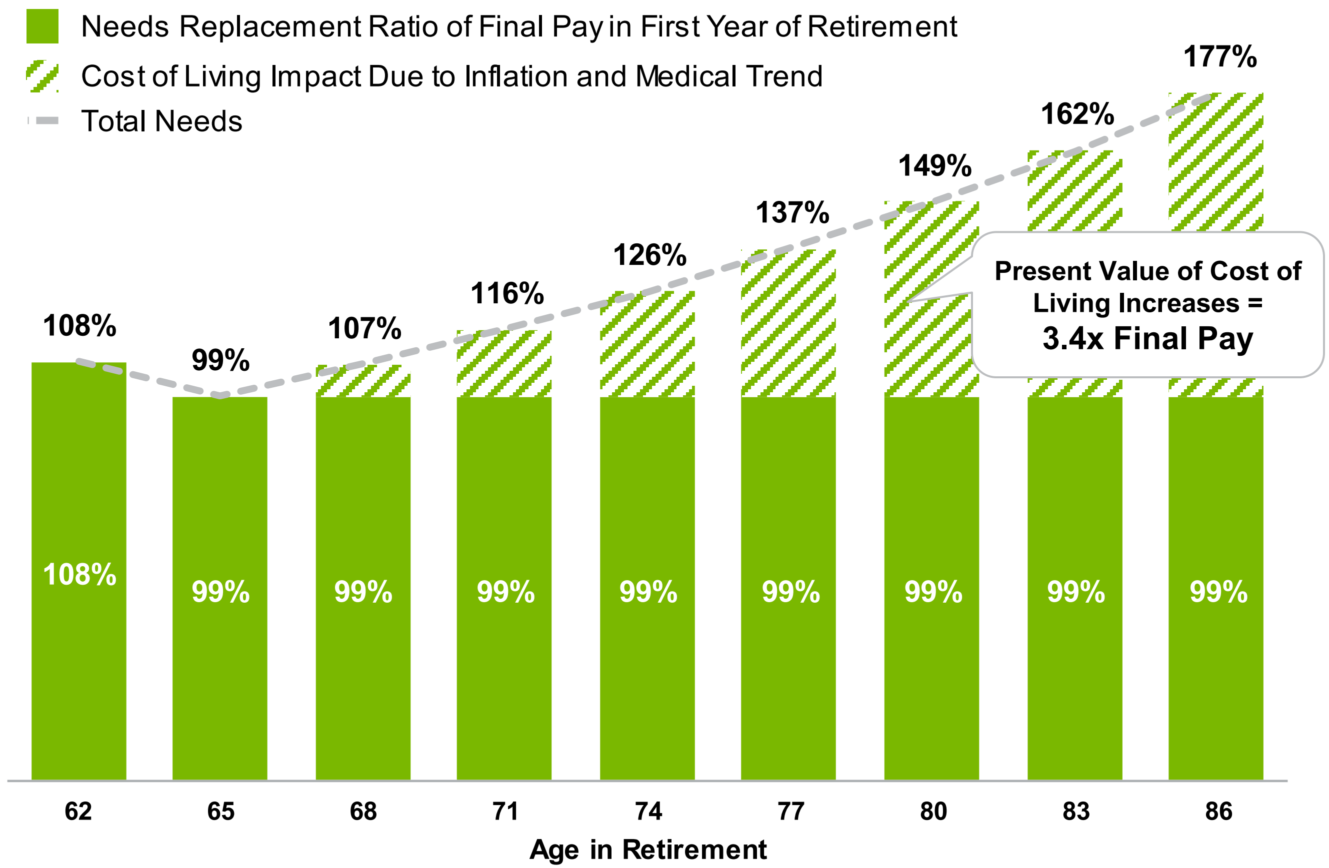
First Year Replacement Ratio:

Final Pay = 100%

- Savings = 6%
- Tax Change = 7%

+ Additional Medical Costs at 62, Before Retiree Medical Subsidy = 21%

First Year Replacement Ratio = 108%



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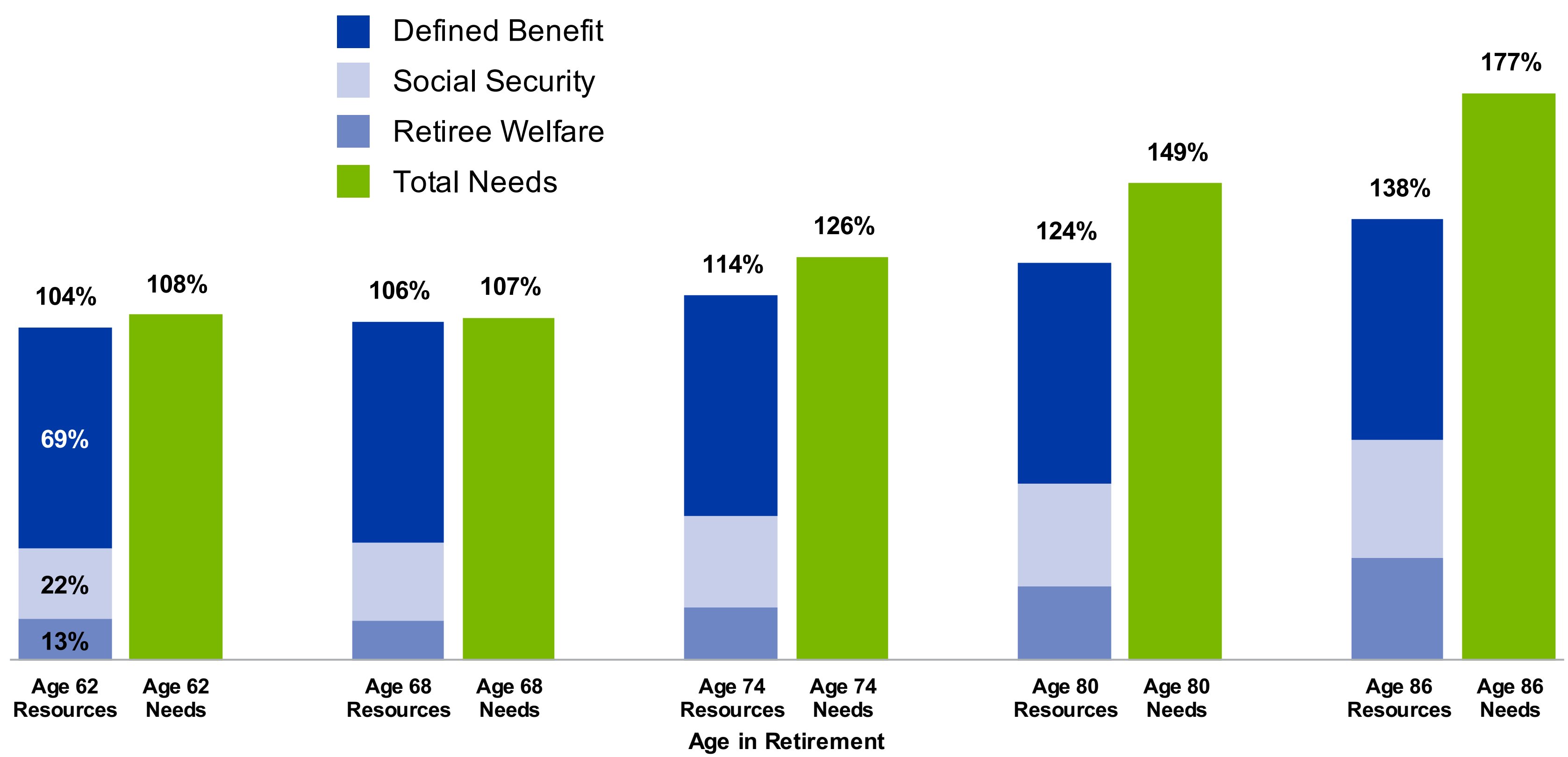
Comparing Annuity Resources and Total Needs

- Projected Annuity Resources versus Needs through retirement
  - Annuity Resources and Needs as a percent of pay at retirement



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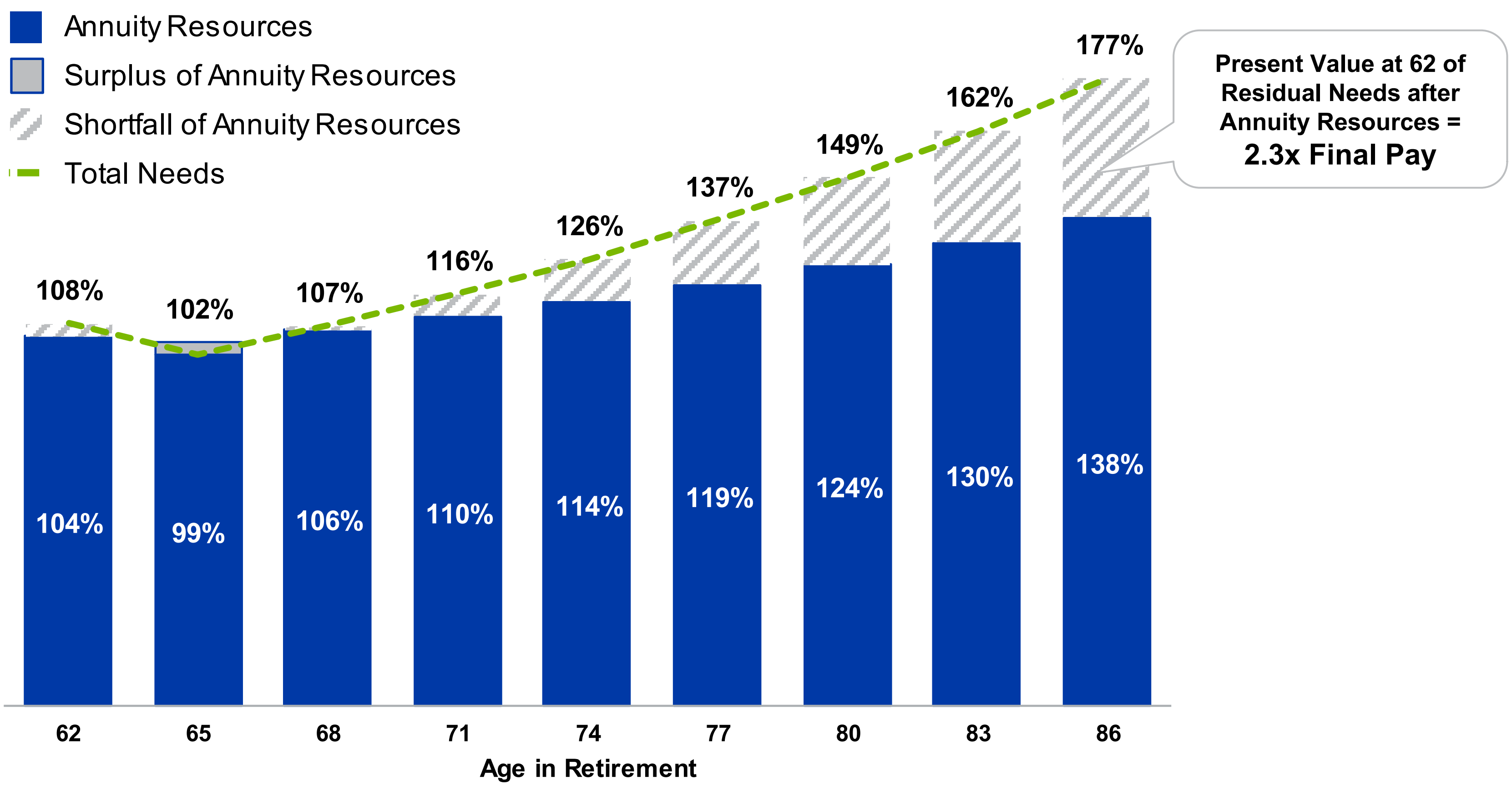
Understanding the Gap Between Annuity Resources and Total Needs

- Projected Annuity Resources versus Needs through retirement
  - Annuity Resources and Needs as a percent of pay at retirement



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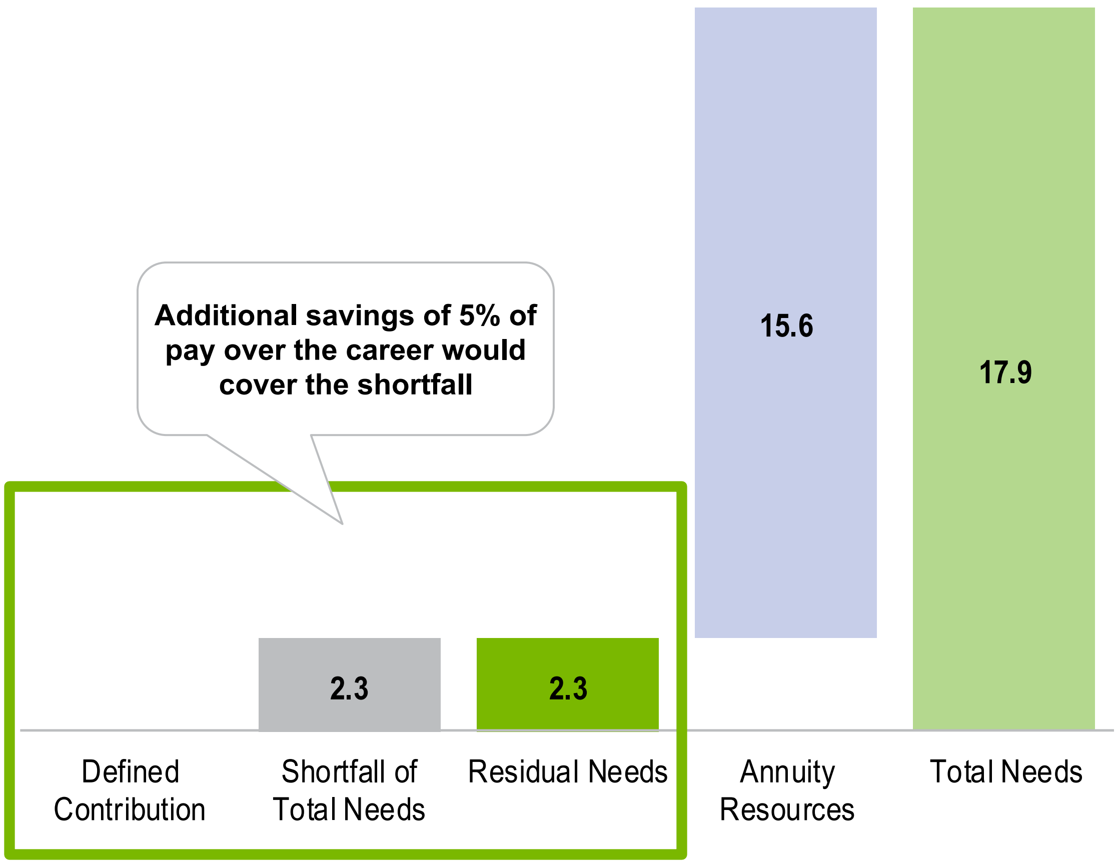
How Much Additional Savings is Needed?

Present Value of Needs and Resources as a Multiple of Final Pay at Retirement Age 62



Present Values of Annuity Resources

(multiple of final pay)

- DB = 10.0
- Social Security = 3.9
- Retiree Welfare = 1.7
- Total Annuity Resources = 15.6

Residual Needs

- Needs after Defined Benefit, Social Security, and Retiree Medical Resources

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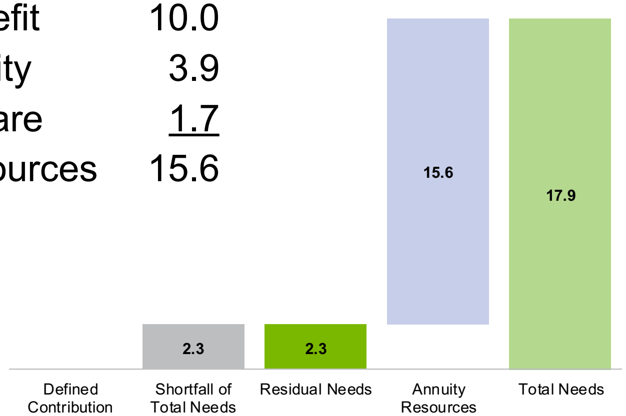
Demographic Variations—Age 62 Retirement

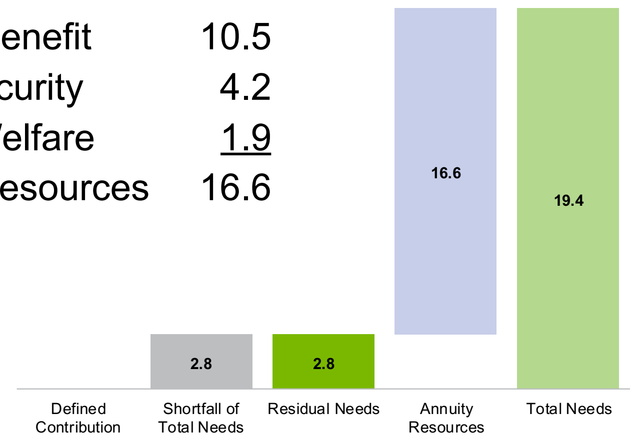
Baseline

Defined Benefit	10.0
Social Security	3.9
Retiree Welfare	1.7
Annuity Resources	15.6



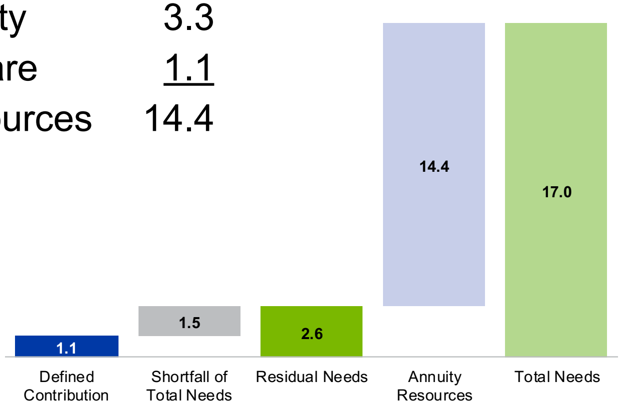
Female

Defined Benefit	10.5
Social Security	4.2
Retiree Welfare	1.9
Annuity Resources	16.6



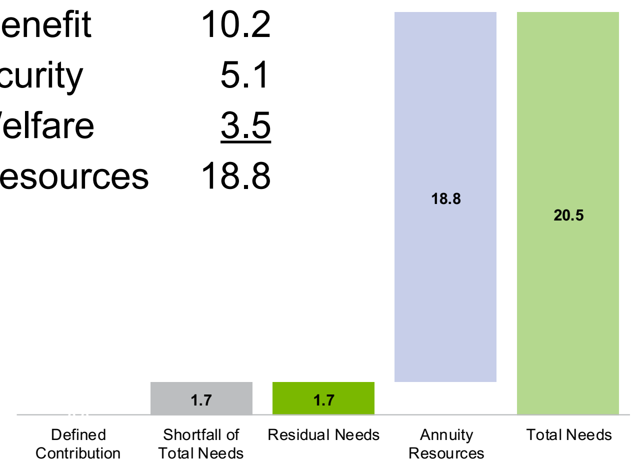
Higher Income, Older, Saving 2%

Defined Benefit	10.0
Social Security	3.3
Retiree Welfare	1.1
Annuity Resources	14.4



Lower Income, Younger

Defined Benefit	10.2
Social Security	5.1
Retiree Welfare	3.5
Annuity Resources	18.8



Variations in Plan Design

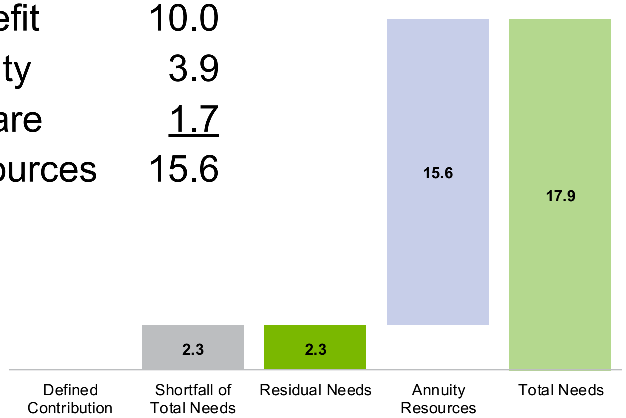
	Baseline	Plan 1	Plan 2	Plan 3
Defined Benefit	2.00% of 5-yr FAP	2.25% of 3-yr FAP	1.25% of 5-yr FAP	None
DB EE Contributions	6.00%	8.00%	6.00%	None
COLA	None	2.25%[1]	None	None
Social Security	Yes	Yes	Yes	Yes
Retiree Welfare	50% ER Subsidy	80% ER Subsidy	50% ER Subsidy	50% ER Subsidy
DC ER Contributions	No DC	No DC	2%	8%
Assumed DC EE Contributions	No DC	No DC	4%	8%
Unreduced Retirement Age	62	60	62	65

[1] Equal to inflation assumption.

Variations in Plan Design

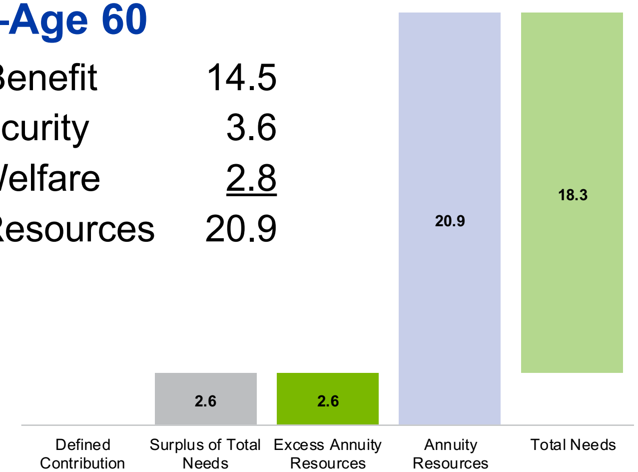
Baseline—Age 62

Defined Benefit	10.0
Social Security	3.9
Retiree Welfare	1.7
Annuity Resources	15.6



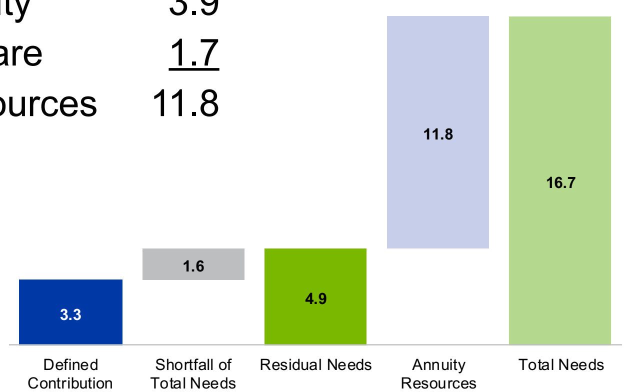
Plan 1—Age 60

Defined Benefit	14.5
Social Security	3.6
Retiree Welfare	2.8
Annuity Resources	20.9



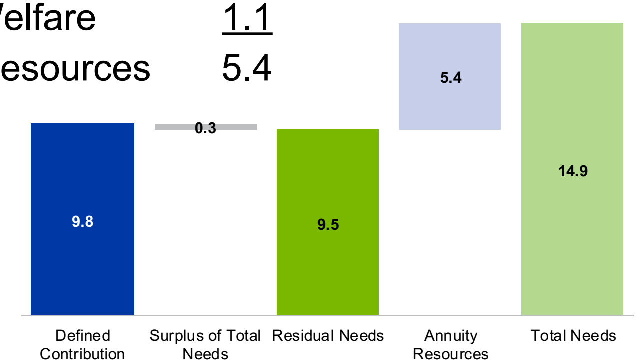
Plan 2—Age 62

Defined Benefit	6.2
Social Security	3.9
Retiree Welfare	1.7
Annuity Resources	11.8



Plan 3—Age 65

Defined Benefit	0.0
Social Security	4.3
Retiree Welfare	1.1
Annuity Resources	5.4



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What You Can Do with This Information

Measure the retirement readiness of your workers

- Current/future workforce trends and emerging patterns
- Influence of recent or pending changes in plan design or investments
- Possible need for early retirement incentives or phased retirement programs

Focus on participant behaviors

- Help workers know where they stand, and tangible steps to improve results
- Communicate regarding appropriate savings rates and milestones toward adequacy

Monitor changes in retirement readiness

- Measure the impact of
  - Investment alternatives and fees
  - Plan design changes and automation
  - Communication efforts, resources, tools, and segmentation

Increase focus on financial wellbeing

- Budgeting and debt management
- Retirement vs. other savings goals, including
  - Retiree medical funding/HSAs
  - Education savings/529 plans
  - Housing needs
- Lifetime income solutions

What Questions Do You Have?

Please type your question(s) into the "Question" field in your control panel.
We will read aloud and reply.

Follow Up Questions:

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- For more answers, visit aon.com/therealdeal (case sensitive)

Appendix

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Demographic Variations

Multiple of Final Pay at Retirement Age	**Baseline**	**Lower Income, Younger**	**Higher Income, Older, Saving 2%**	**Female**
Retirement Age	***62***	***62***	***62***	***62***
Total Needs	**17.9**	**20.5**	**17.0**	**19.4**
Defined Benefit	10.0	10.2	10.0	10.5
Social Security	3.9	5.1	3.3	4.2
Retiree Welfare	1.7	3.5	1.1	1.9
Total Annuity Resources	**15.6**	**18.8**	**14.4**	**16.6**
(Residual Needs)/ Excess Annuity Resources	**(2.3)**	**(1.7)**	**(2.6)**	**(2.8)**
Defined Contribution	0.0	0.0	1.1	0.0
Surplus/ (Shortfall) of Total Needs	**(2.3)**	**(1.7)**	**(1.5)**	**(2.8)**

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Variations in Plan Design

Multiple of Final Pay at Retirement Age	Baseline	Plan 1	Plan 2	Plan 3
Retirement Age	***62***	***60***	***62***	***65***
Total Needs	**17.9**	**18.3**	**16.7**	**14.9**
Defined Benefit	10.0	14.5	6.2	0.0
Social Security	3.9	3.6	3.9	4.3
Retiree Welfare	1.7	2.8	1.7	1.1
Total Annuity Resources	**15.6**	**20.9**	**11.8**	**5.4**
(Residual Needs)/ Excess Annuity Resources	**(2.3)**	**2.6**	**(4.9)**	**(9.5)**
Defined Contribution	0.0	0.0	3.3	9.8
Surplus/ (Shortfall) of Total Needs	**(2.3)**	**2.6**	**(1.6)**	**0.3**

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Strawpeople

	Baseline	Low Income (Baseline Plan)	High Income (Baseline Plan)	Female (Baseline Plan)	Person 1 (Plan 1)	Person 2 (Plan 2)	Person 3 (Plan 3)
Age	45	35	50	45	45	45	45
Service	20	10	25	20	20	20	20
Current Pay	$85,000	$40,000	$125,000	$85,000	$85,000	$85,000	$85,000
Gender	Male	Male	Male	Female	Male	Male	Male
DB EE Rate	6%	6%	6%	6%	8%	6%	0%
DC EE Savings Rate	0%	0%	2%	0%	0%	4%	8%
Total EE Rate	6%	6%	8%	6%	8%	10%	8%

The Real Deal 2018 Assumptions

	Baseline Assumption
Retirement age	67
Preretirement rate of return	6.0%
Postretirement rate of return	5.0%
General inflation	2.25% pre- and postretirement
Medical inflation	5.5%
Pay growth	3.75%
National wage base increase rate	2.75%
Postretirement mortality	50^{th} percentile life expectancy from the headcount-weighted RP-2006[1] table projected with MP-2017 scale for healthy annuitants projected generationally (i.e., approximately age 90 for females and age 88 for males)

[1] “RP-2006” refers to the 2006 base rates in the RP-2014 mortality study from the Society of Actuaries.

The Real Deal Calculation of Residual Needs Example—Retirement Age 65

	Dollar Amount	Percent of Pay		Multiple of Pay
Pay at age 65 retirement	$ 171,000	100%		
Decrease for savings rates	(10,000)	(6%)		
Taxation difference	(13,000)	(8%)		
Preretirement medical expenditures	(13,000)	(8%)		
Pre-medical needs in first year of retirement	**$ 135,000**	**78%**	2.25% inflation, 5% return on resources postretirement to age 88	13.1
Postretirement medical expenditures (enrolled in Medicare)	20,000	12%	5.5% medical inflation, 5% return on resources postretirement to age 88	2.6
Needs in first year of retirement, including medical	**$ 155,000**	**90%**		**15.7**
Defined benefit in first year of retirement	(127,000)	(74%)	5% return on resources postretirement to age 88	(10.1)
Social Security in first year of retirement	(45,000)	(26%)	2.25% inflation, 5% return on resources postretirement to age 88	(4.3)
Retiree medical resource in first year of retirement	(10,000)	(6%)	5.5% medical inflation, 5% return on resources postretirement to age 88	(1.3)
(Excess Resources)/Residual needs	**$ (27,000)**	**(16%)**		**(0.0)**

Scenario:
- Male, age 45
- Current salary of $85,000
- DB employee contribution of 6%