Workforce Retirement-Readiness: Five Questions Your Company Must Be Able to Answer

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How “retirement-ready” are your employees? Why should you care—and what can you do to help? No, those don’t count towards our five questions—they merely set the stage for the key questions to come.

Baby-boomers are reaching the age of 65—traditionally the benchmark retirement age—in droves. Daily, over 10,000 more from this group turn 65, leading to a 65-and-over crowd that now totals over 40 million, representing 13% of the U.S. population. By 2030, in just 14 more years, the expected percentage surges to a peak of 20%.

But just because this massive swath of workers is reaching retirement age doesn’t mean they will in fact be ready to retire. Members of the media regularly decry insufficient saving rates among baby boomers. Notably, Aegon, NV’s May 2014 Retirement Readiness Survey reports that in spite of perceptions of a stronger economy, “people still have little confidence that they will be able to retire with a lifestyle they consider comfortable.” In addition, the report continues, “only 32% of employees now expect to stop work completely at retirement age.”

THE SHIFT FROM DEFINED BENEFITS TO DEFINED CONTRIBUTION

The days of “the company” ensuring each worker a comfortable, financially worry-free retirement are nearing an end.

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To begin with, job-hopping is now the norm, meaning individuals cannot look to a single employer to fund their retirement. In addition, fewer and fewer organizations today offer a defined benefit (DB) style of retirement program.

This leads to an era where more and more employees are finding themselves in a position where they haven’t saved enough to fund their retirement. According to New York Life’s “2014 Financial Stress and Retirement Readiness Report,” nearly three-quarters of those surveyed (73%) reported feeling extreme or moderate financial stress over the last six months, two-thirds of survey respondents (60%) said they were behind or far behind schedule in saving for retirement.

This can spell trouble not only for individual employees, but also for the company. Anxious, distracted, working because they have to (and not because they want to) employees tend to be significantly less engaged without the traditional anchor of retirement benefits. This can lead to a host of concerns including harm to workforce morale and a company’s reputation; and lapses in productivity, quality and even customer satisfaction.

If all of this isn’t enough to spur a company to action, as the percentage of retirement-aged workers to the overall population increases, the likelihood of additional regulatory requirements increases. Recent actions from the Department of Labor and the House of Representatives indicate that regulatory pressure is mounting, the outcome of which is likely to be increased disclosure requirements including the inclusion of the potential lifetime stream of payments from both accrued and projected account balances on DC participant statements.

So forward-thinking organizations are now searching for ways to not only assist baby boomers who are uneasy or uncertain about whether they are retirement-ready but to also help other generations of workers save for retirement with confidence. And while there are nearly an infinite number of questions needing answers, we believe there are five key questions. Specifically:

#1 What Is The Right Retirement Age to Target?

With retirement imminent, the counseling needs of the boomer generation are greatest. But in truth, workers of all ages whose retirement planning is self-directed could benefit from greater analytical rigor around setting, and monitoring their progress towards their retirement income goals. Companies can help their employees by developing targeted savings and investment guidelines.

According to the U.S. Census Bureau, only 65% of those aged 65 and over are today actually retired. The question becomes—is that other 35% still working because they want to, or because they have to? What age is the ‘right’ age for the Company and its workforce to target for retirement?

Indeed, we are living longer, and in better health, than ever before—meaning more workers today should be able to work beyond the age of 65. Delaying retirement—working to age 70 instead of age 65, for example—results in not only two more years of earnings, savings and investment but also significantly increases the monthly payout from Social Security.

But there are other considerations—both for individuals and for businesses at large. For example, certain jobs are more physically demanding, such as working on an offshore oil rig or piloting a commercial transport vehicle. Here it may be in the interest of both the individual and the company that these workers be in a position to retire earlier than average for the general workforce.

Conversely, those working in less physically taxing knowledge roles are more likely to be able to work beyond more tra-
ditional retirement ages. These are also the sorts of workers companies more often hope to retain, either full-time or part-time, significantly beyond the age of 65.

From the individual perspective, each worker needs to make a conscious yet realistic determination of when they want to retire before they can chart a path to when they may actually be in a retirement ready position. And from the company perspective, benefits packages and accompanying advisory support/counseling should be tailored to try and steer various groups of “like” workers toward retiring at the most appropriate (or from the company’s vantage point desirable) ages.

Of course, individual circumstances will always vary. Under-prepared baby boomers may need to drastically rethink the timing of their retirement—perhaps retiring significantly later than hoped for. By comparison, younger workers are in a position where what may seem very slight alterations in planning and action can have a profound impact on eventual retirement readiness.

In short, the answer to the question, when do you want to retire?, will depend on individual circumstances including the answers to questions two through five below. Even so, while every employee will be different, a company should look at each category of worker to assess their needs as well as the overall company needs.

#2 How Much Income Should Employees Target for Retirement? (What Is Your Target Income?)

Designing effective plans requires developing realistic target retirement incomes. That is, how much income does each group of 'like' employees need to maintain their lifestyle in retirement? To help employees relate to this value, we often express it in terms of today’s dollars instead of inflated dollars at retirement and include the impact of taxes.

The development of realistic target incomes can be aided by looking at an employee’s actual pre- and post-retirement cash flows on an after-tax basis. Starting from current earnings (pre-tax income), post-retirement income requirements are reduced by such factors as the level of investment income earned annually, annual contributions to savings and the elimination of payroll and income taxes. Certain work-related expenses, such as the cost of commuting, will no longer be required and should reduce expected income needs in retirement. (See table.)
Re-Label X-Axis, Far Right: “Post Retirement Target Consumption” As “Target Retirement Income”

The above is a top-down approach. However, companies may also consider using a bottom-up approach working from government data such as the Bureau of Labor Statistics’ consumer expenditure survey. This approach may be more complex. However, it allows greater flexibility in making assumptions where the company wants to reflect more information specific to its workforce. Examples include whether employees are married or single, whether they have other assets or how their expenses can be distinguished by age groups. Each company will need to decide on which is the best approach for their circumstances.

#3 How Close Are Employees to Meeting Retirement Income Targets?

Put another way, how much of their retirement income target are employees currently on pace to achieve? This segment of the analysis involves determining the amount of retirement income—expressed in today’s dollars and adjusted for inflation and tax—that can be achieved based on employees’ current savings.

One of the most important elements of this analysis is risk. Individuals often take a simplistic approach to retirement planning, viewing income streams and living costs as fixed points. But sophisticated investment advisors know that in reality, would-be retirees encounter a range of possible outcomes. So in projecting employees’ retirement income, companies need to decide which risks to consider. Our analysis shows that the following risks can have a significant impact on results:

- Market volatility (How will investments perform?)
- Inflation (How much will living costs increase?)
- Interest rates (What fixed-income returns can we expect?)
- Longevity (How long will workers—and their spouses if applicable—live?)
- Health (How healthy is this group likely to be?)

When we introduce risk, or variability in the outcomes, we also need to introduce the concept of a success rate. We can think of a success rate in the following way: based on a large number of different outcomes, or combinations of the risk variables (i.e., market volatility, in-
flation, individual longevity and other variables), the success rate is the percent of the scenarios in which the employee is able to maintain the level of retirement income. For a given success rate and income level, we can solve for the resulting amount of savings necessary. As the table below shows, the higher the savings, the higher the confidence level. We can also switch around the analysis to solve for the level of retirement income that can be sustained for a given success rate and savings level, which we will refer to as the sustainable income.

### Indicative success rates

<table>
<thead>
<tr>
<th>Success rate</th>
<th>Joint couple</th>
<th>Single male</th>
<th>Single female</th>
</tr>
</thead>
<tbody>
<tr>
<td>99%</td>
<td>1,900,000</td>
<td>1,500,000</td>
<td>1,650,000</td>
</tr>
<tr>
<td>95%</td>
<td>1,400,000</td>
<td>1,050,000</td>
<td>1,150,000</td>
</tr>
<tr>
<td>90%</td>
<td>1,150,000</td>
<td>900,000</td>
<td>950,000</td>
</tr>
<tr>
<td>80%</td>
<td>950,000</td>
<td>700,000</td>
<td>750,000</td>
</tr>
<tr>
<td>70%</td>
<td>800,000</td>
<td>550,000</td>
<td>600,000</td>
</tr>
<tr>
<td>50%</td>
<td>600,000</td>
<td>400,000</td>
<td>450,000</td>
</tr>
</tbody>
</table>

We chose the following assumptions for the representative savings and income streams modeled:
- Age 66, retiring today
- Social security is $15,600 for single person and $24,000 for couple (starts age 66)
- No annuity products are purchased
- No LTC or life insurance is purchased
- Target consumption is $36,000 for single person and $48,000 for couple.

Other information can also be incorporated into the analysis. For example, companies should consider other retirement income sources such as Social Security benefits and other defined benefit retirement plans. Gender and marital status can also be considered. Virtually any factor that will have an impact on any employee segment’s ability to achieve desired retirement outcomes can be incorporated.

In general, people prefer to follow advice that would result in a smaller shortfall if not successful, provided it generated the same amount of sustainable income. In practice, a success rate in the 70–80% range tends to strike a good balance between safety (i.e., sustainable income risk tolerance) and sufficiency (i.e., ability to cover a good amount of the target income).

This type of analysis is an integral part of incorporating retirement readiness into plan design because it allows us to evaluate the effect of plan design changes on an employee’s retirement readiness. In addition, once the success rate is defined, plan sponsors can look at the results of the outcomes that led to failure and use the information to further customize plan design. What was the average difference between actual and target retirement income? What is the range of outcomes? Does the employee have significant protection from financial risks?

### #4 What Steps Can Be Taken to Help Employees Address Shortfalls to Their Income Target (Four Suggestions for The Underprepared)?

More than likely, companies will find they employ a significant number of workers who, though nearing retirement age, are by no means retirement-ready. One means of identifying such individuals might be to calculate individual “retirement-readiness scores.”

The retirement readiness...
score is defined as the ratio of sustainable income to target income for each employee. This measure can then be used to classify employees by retirement-readiness risk or gap. From there, employee education, communication and engagement plans can be individualized. These scores are also useful for monitoring progress over time and for evaluating the potential impact of alternative plan design changes.

Once “at risk” individuals are identified, there are a number of design changes that can be evaluated to help the underprepared. The impact of various actions can be readily observed by rerunning the analysis to calculate the change in the retirement readiness score. For example, assume the average retirement readiness score for a group of employees between 55 and 65 is 38% under the current plan design. A comparison of the actions available to would-be retirees might look like the following:

- **Plan to retire later.** Relative to retiring at age 65, by working to age 70, the group can improve its retirement readiness score by 10%.
- **Delay accepting social security.** Again, by waiting until age 70 to receive social security benefits (relative to age 65), the retirement readiness score can be improved by another 4%.
- **Buy long-term care (LTC) insurance.** Healthcare costs are a real wild card in retirement. Long-term assisted living and custodial costs can be significant and can decimate an employee’s retirement savings. We can easily quantify the benefit of purchasing LTC insurance for an employee by working it into our analysis: the result is a 10% increase in the retirement readiness score.
- **Increase contributions.** If this group of employees increased its contributions by 4%, the retirement readiness score would increase by 4%. For younger workers, the improvement would be even greater, as the positive impacts have longer to take effect. An employer has many ways to help its employees accomplish this change. For example, it could implement an auto-escalation provision in its defined contribution plan or provide targeted education.

<table>
<thead>
<tr>
<th>Consideration</th>
<th>Retirement readiness score*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base Scenario</td>
<td>38%</td>
</tr>
<tr>
<td>1. Delay Retirement until age 70</td>
<td>48%</td>
</tr>
<tr>
<td>2. Delay Social Security benefits until age 70</td>
<td>52%</td>
</tr>
<tr>
<td>3. Purchase LTC insurance</td>
<td>66%</td>
</tr>
<tr>
<td>4. Increase contributions</td>
<td></td>
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</tbody>
</table>

* A retirement readiness score of 100% indicates that the group is on track.
As the number of today’s underprepared retirees demonstrates, society’s transition from a culture of company-issued guarantees to one of self-directed outcomes may not have gone as smoothly as hoped-for. Issues of accountability aside, the question becomes, what can be done to improve the retirement-readiness of all workers— boomers and otherwise?

This begins with a fundamental revisiting of core assumptions and practices. Start with a review of program costs including compliance. Now look for ways to streamline or otherwise reduce costs such as automation, outsourcing or restructuring/simplification (e.g. moving to fewer plans or even one plan for both hourly and salaried employees).

All of these steps could create room to improve programs and expand benefits.

Now think what can be done to help not only underprepared, soon-to-be retiring boomers (the five steps just mentioned), but also Gen X, Gen Y, and (soon-to-be arriving) Gen Z employees. The goal is to proactively build awareness among employees about the importance of their taking responsibility for their own retirement readiness. But in addition, companies should design communications and tools that help individuals track their progress—as well as sound a warning when they’re off track. Steps that can be taken to “engineer” more desirable levels of future readiness include:

- **Implement automatic enrollment / escalation.** The “default setting” for employee participation is that they will contribute to their retirement plans and their contributions will increase as their incomes and regulations allow.

- **Provide employee financial education and counseling.** This can be tailored to specific levels of employees, with frequency/intensity in accord with the desired future outcomes. Leaders provide holistic advice, including cash and debt management, investing, insurance—as well as retirement planning. **Indeed, this can help reduce liability as a plan sponsor as ERISA 404(c) directs companies to provide unbiased, “conflict free” financial education and counseling services providing “sufficient information” to enable employees to make informed decisions regarding investment alternatives.**

- **Create help centers.** Leading companies offer access to certified financial planners and other professionals on a confidential basis either through call centers or in-person. While such services tend to be more “hands-on” for workers with higher earnings, online/virtual modules can be developed featuring a heavy self-service component including investment analysis tools and calculators.

Companies will see the best retirement readiness outcomes if they seek to engage employees by improving the quality of communications and communicate individual progress toward achieving retirement goals. Companies should take steps to elevate the employee’s overall financial experience and mindset. This goes beyond education, expanding to include programs that help employees develop the appropriate behaviors—plan, save, invest, control spending (budget)—to be retirement ready.
Review of Key Concepts

**Target retirement age:** A retirement age that is appropriate for each distinct group of workers.

**Target retirement income:** The level of income necessary to maintain a given set of employees’ standard of living in retirement.

**Sustainable income:** The level of income employees are currently on track to achieve in retirement (which may be less or more than the needed target requirement).

**Success rate:** The likelihood a retiree will be able to maintain the projected level of sustainable income throughout retirement.

**Retirement readiness score:** The ratio of sustainable income to target retirement income.

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**CONCLUSION: TODAY, DAMAGE CONTROL; TOMORROW, WORKFORCE ENABLEMENT**

The economy is soon-to-be flooded with those wanting to retire who are nonetheless not yet quite ready to retire—the baby boomers. For companies this is a both a risk (to be mitigated) and an opportunity (to observe and improve).

Near-term, companies should do what they can to help inform soon-to-be retirees of the options before them. Some may be disappointed to learn that they need to work to age 70 or beyond. But with a little positive reinforcement, companies can go a long way toward alleviating any retirement remorse by helping these underprepared individuals to see to the choices before them to improve their outcomes.

Long-term, companies should recognize and play an important role in their employee’s long-term well-being—even if those employees are mere visitors, just two, three or five years away from leaping to their next employer. Employees who are confident in their ability to control their financial lives tend to be more engaged, leading to higher quality and productivity. Companies can also expect better performance in areas such as employee recruitment, retention, satisfaction—and corporate reputation.

So does your company have answers in hand to the above five questions? And if so, when was the last time you took a hard look at your assumptions and conclusions? If your confidence isn’t high, or if there’s been some water under the bridge since you last look, it may be time to update your analysis.

*The views expressed are those of the authors and do not necessarily represent the views of Ernst & Young LLP.*

**NOTES:**


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