

Enhancing Retirement Readiness: *Consensus on a Course of Action*

In March 2012, six members of the Retirement Advisor Council gathered to discuss the concept of retirement readiness and what it means for the industry. Steve Davis – Regional Vice President, Mid-market Sales at The Hartford moderated the discussions with Jim Robison, Principal of White Oak Advisors; Phil Callahan, Managing Director, Investment Managing Division at Goldman Sachs Asset Management; Peggy Santhouse, Vice President of National Business Development and Retirement Advisor Relations at Diversified; Gene Huxhold, Senior Managing Director of Investment-Only Retirement Plans at John Hancock Mutual Funds; and Jon Shuman, Vice President and Head of Business Development at MassMutual.

Our panel concludes that retirement readiness measured as an income replacement ratio is driven largely by contribution levels and the number of saving years. For many, target income replacement ratios should be higher than the 70-75% ratio conventionally accepted as a rule of thumb to reflect the projected cost of health care in retirement, traditional financial planning concerns and individual circumstances such as personal health, children education funding needs, and the cost of caring for elderly parents factor into the equation. Regardless of the target income ratio, the six panelists call for consistent contributions equal to 10% to 16% of pay over a 30-year or 40-year career.

To gauge the retirement readiness of participants at the plan level, sponsors and their advisors need to rely on one set of measures for younger participants and a different set for workers nearing retirement who have not saved enough to begin with. Enhancements in income replacement ratios may be a valid measure for new labor force entrants, but the focus is on process for those with limited savings and a short horizon to retirement. The ability to synthesize comprehensive data into a visual aid with a small number of suggested levers for participants' immediate consideration appear to be most impactful on behavior.

A myriad of self-service tools and calculators are available to help participants plan for retirement. Low usage of available tools makes the personal intervention of an advisor very beneficial, however. Working with an advisor can help participants take into consideration individual circumstances and health factors affecting needs and spend-down patterns.

Automatic enrollment and automatic deferral escalation can theoretically contribute to enhancing retirement readiness. However, our six panelists advocate for a default deferral election in the range of 6% to 10% that far exceeds the 2% or 3% many employers adopt out of fear of disruptions, which experience suggests are unfounded.



Steve Davis



Jim Robison



Phil Callahan



Peggy Santhouse



Gene Huxhold



Jon Shuman

Steve Davis: What does retirement readiness mean, and how can advisors measure it?



Jon Shuman: Number one, I think retirement readiness means that people can actually retire with a decent quality of life. Advisors can measure retirement readiness in terms of outcomes and in terms of efficiency. We've spent the last decade discussing efficiency: ways to lower fees and to create better arrays of investment options. The focus has been on the 3 Fs: Funds, Fiduciary, and Fees but the pendulum is now swinging toward

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—Jon Shuman

retirement outcomes. Unfortunately, a third of those in the workforce start saving too late to support a comfortable retirement. A good 20% to 30% earn a comfortable living but never save enough in their retirement plan. So, is the number of those in the workforce who can retire comfortably 40%, 50%, or 60%? Determining the number can help plan sponsors understand what their advisors can do to help their workforce achieve a successful retirement. Fundamentally, this is what we're trying to do: Help advisors explain how a plan can move from X percent to Y percent of participants who will actually be ready for retirement.



Phil Callaban: Retirement readiness isn't so much about participation rates or deferral rates. It's about targeted replacement; and I mean targeted replacement in a holistic sense. For example: Let's calculate what medical expenses will be for broad numbers of individuals post-retirement. Historically, many in the industry estimate that health care costs in retirement would call for 70% to 75% income replacement ratio post-retirement.

The reality, at least according to our testing over the past 24 months, is that today's health care costs demand an income replacement level closer to 90%, considering income from all sources. The cost of medical care in retirement is the greatest unknown variable. Projected inflation in health care expenses can have a major impact on the level of retirement funding required. Long term, the amount required could be far larger than what some in our industry estimate.



Jim Robison: Still, the key driver for retirement readiness is how much fuel (Employee deferrals) is poured into the tank. Younger workers deferring 10% of earnings are typically on the right track. Anecdotally, we find a more realistic target number to be 15% to 16%. Participants

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— Jim Robison

who initially, and continue to, set aside this level of earnings will likely be right where they need to be when they hit ages 55 plus. It's about getting started early; the adage of "save ten, give ten, and live off the rest." This saving behavior and lifestyle pattern fosters participants being much further down the road toward a healthy financial retirement. Setting money aside; "fuel in the tank" is paramount.



Jon Shuman: Timing is a major issue. Whether the large growth fund costs 87 basis points or 93 basis points is less important than the length of time over which a worker is saving, and – to Jim's point – the adequacy of the amount set aside. We frequently tell our clients, someone saving 5%

for the first 40 years is much better off than another person saving 15% for the last 20. The time value of money is amazing – absolutely amazing.



Gene Huxhold: Well, I guess one important question is: What can be done to convince the person who waited 20 years to save 15% of his or her pay? What can be done for the folks in a difficult position in their mid-fifties? How to measure their success is another question. When looking at data points to measure the success of getting people ready for retirement, the distortion due to the past behavior of the 50 to 55-year-old population needs to be factored out of the success rate.



Jon Shuman: Some older and highly-paid Generation Xers will be too late. The focus should be on Generation Y, many of whom will never participate in a defined benefit plan. Measurements should focus on younger workers - particularly new entrants into the labor force - figuring out what the right replacement ratio is at the plan level. For older workers, the measurement is one of availability to facilitate the planning process.



Phil Callaban: Communicating benchmarks to each plan sponsor is critical to success. Equally critical is the segmentation of the employee population and developing a plan of action for each segment. It may sound cliché but retirement readiness is about getting a message out to each sponsor, and to their participant population. It is about communicating with the goal of driving action.



Peggy Santhouse: Retirement readiness is about getting participants involved as early as possible and motivating them to take the steps necessary to achieve a funded retirement.



Jon Shuman: Some in the industry have made measuring retirement readiness more complicated than it needs to be. Retirement readiness has a lot to do with time and deferral and little to do with returns. Everyone would benefit from returning to basics and to measure retirement readiness using normalized returns.



Peggy Santhouse: At Diversified, we're committed to helping participants on track toward one key goal—a funded retirement. Everything we do helps them continually take stock of where they are and then take action to get closer to that goal. We focus on motivating behavior change, not just offering education. Our program is designed to provide participants with the kind of clarity they need around key issues affecting their retirement

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-Peggy Santhouse

security... how much to save, how to invest and whether they on track to achieve a funded retirement. We use weather icons to make it easy for participants to quickly evaluate whether their retirement savings strategy is on track. Each icon represents a percentage range of how much of their targeted retirement income goal their current strategy is likely to provide. Participants have gravitated toward it. If their icon reads "cloudy", participants know their financial picture is not good. They call the customer contact center or meet with a representative and say, "I just got my statement /reviewed my outlook online and I'm 'cloudy'! I want to be 'sunny'!" They're using the terminology! It sounds simple, but it resonates with people.

Steve Davis: What tools for use by participants are you hearing about?



Jon Shuman: Some participants use Quicken®, Mint, Morningstar® Advice OnlineSM, or Morningstar® Retirement ManagerSM to help plan for retirement. One problem is that out of a thousand participants, there may be only 8 or 9 who use self-service advice tools.



Phil Callahan: Mike Castner of Retirement Benefits Group talks about tools like eMoney Advisor. The software allows participants to enter their mortgage, credit cards, and other financial data. Participants use the tool and data can be rolled up at the plan level to support sponsor

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decisions. Participants using the tool tend to be higher-end, but some advisor practices may be able to assign a staff to support rank-and-file employees.



Jim Robison: Retirement plan providers, with which White Oak Advisors partners, offer robust retirement income calculators to help determine how much each participant needs to accumulate to support a given income level in retirement. Participants are seeing a much clearer

picture of the cost of health care in retirement from research outside the retirement industry. For instance, some Health and Welfare providers have developed pro forma statements of projected health care costs in retirement by age bands - projected cost of health care in retirement for those 50 to 60 today, projected cost for employees who are just starting work now and so-on. We can weave these projections, along with other items such as debt management and cash flow management, into discussions with participants. Having comprehensive discussions and thoughtfully identifying the cost-of-living post-retirement more accurately helps free-up dollars for retirement savings now.



Gene Huxhold: Participants should also take personal health into consideration to evaluate retirement readiness. Two individuals – one in great health and the other with a history of heart disease, diabetes, and other health issues would have very different accumulation needs. Family health history is one factor. Health is also a driver of spending in retirement. From empirical observation of older friends and relatives, spending levels early in retirement are pretty high. As mobility decreases, however, somewhere around seventy-eight to eighty, discretionary spending zooms down to almost zero.

Steve Davis: Some plans with automatic enrollment use deferral increases, others don't. What are the factors in a plan sponsor's decision?



Phil Callaban: Most plan sponsors are hesitant to introduce auto enrollment with a default contribution rate above a couple percent or so. Just as many plan sponsors are concerned that auto escalation will affect participation. We tell them to get over it; it's time to be adults in the room. If we're not going to provide defined benefit pension plans anymore, let's substitute them with an approach that performs the same function in essence, even if the cost and responsibility are on the employee. Let's create an environment that encourages the behaviors and the patterns that lead to retirement success. "Folks, we're the employer, we bear some responsibility for this function, and we're going to help you get there. You can opt out if you want to, but we're going to point you in the right direction to start with." Give people a choice, but make it a difficult choice to opt out.



Jim Robison: Establishing the "proper" beginning deferral percentage is the most key decision point. Our reply is to "aim high". What's the worst that's going to happen?



Jon Shuman: Recently, data has shown that the opt-out rate for plans that use a 6% default contribution level is the same as it is for plans that use a 3% default election. So why wouldn't an employer start employees at 6%? Some employees automatically enrolled at 3% of pay may not realize that they their employer could be matching contributions with employer dollars to up to 6% pay, or more. Why not start at 6% of pay?



Peggy Santhouse: Why not start at 10%?



Jim Robison: Intuitively, when we're working with an employer going from a DB-centric to DC-only, the percentage we're starting at in recommendations is 6% to 8% - for everybody. The goal is to be at 10% average deferrals in 2-3 years.



Gene Huxhold: One major reason why employers don't use automatic enrollment is the fear of employee unrest. Speaking from experience, the fear appears unfounded. My two adult children, who just entered the workforce, were both automatically enrolled in their plan at a default rate of 4%. Many new labor force entrants assume the rate at which they are defaulted is standard

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and don't question it. On the other hand, I am not confident many would just do what we tell them to when we recommend they enroll at a higher default rate of say, 10%. Especially if it reduces their pocket money.