

Driving Successful Participant Retirement Outcomes

Jerry Huggins CFP, MBA

The dream of a secure retirement seems to be fading away for millions of workers as they face the tremendous challenge to accumulate enough savings for an adequate retirement. Americans' confidence in their ability to attain a secure retirement has reached a new low, according to the 2011 Retirement Confidence Survey produced by the Employee Benefit Research Institute (EBRI).

The 2011 EBRI survey indicated that the percentage of workers with "no confidence" in having enough money for a comfortable retirement reached 27 percent, the highest level measured in the 21 years of the survey. At the same time, the percentage of "very confident" workers declined to the previous low of 13% measured after the market declines in 2008 and early 2009. What is more surprising than the loss of confidence is that these workers are not making any adjustments to their savings and spending to get themselves back on track. Instead, they are modifying their expectations about how they will transition from work to retirement, by retiring later and working during retirement.

Unfortunately, as more workers lose confidence and become more complacent about taking responsibility for their retirement savings, defined contribution plans are being blamed for failing to provide an adequate retirement. We do not believe that defined contribution plans are the problem. Nonetheless, plan sponsors can do much to ensure retirement is a pleasant destination for their employees. Plan sponsors need to begin focusing on providing employees a better retirement planning experience. Effective sponsors move beyond offering only a competitive employee benefit and towards providing their employees with a secure retirement. The following are some relevant strategies that can help defined contribution retirement plans jump-start employee confidence and drive successful participant outcomes.

Show Room Floor

As a steward for your employees, it is crucial that you are committed to ensuring that everyone is participating and working towards the goal of a secure retirement. The ideal plans we see are those in which employers take an active role in improving the behaviors and practices of their workers. It is not enough just to make it possible for employees to save. The plan needs to be easy for them to participate in, understand, set goals and manage. Employers need to be involved in making the plan visible and

promoting the retirement program's incorporation of the most current and effective best practices. Fiduciary oversight entails constant review of the plan's design, recordkeeping and administration, education and counseling, investments, and cost controls. It is crucial that each of these factors be prudently managed to encourage active involvement and to meet employees' needs.

Effective employers embrace the task of positioning and promoting their retirement plan on an ongoing basis. Employers need to continually reinforce to employees how vital the benefits of the retirement plan are to their future lifestyle and how the unique features of their plan have been designed to help them achieve a secure retirement. Employees want to be involved in something important and special. The more important you make the retirement plan, and the more you communicate the plan's special features and benefits, the greater attention and involvement you will get from employees.

Cruise Control

Employers have become increasingly concerned about those employees not participating in the plan, as well as those participants who may not be contributing sufficiently and diversifying their investments. Despite increased recognition of the value of defined contribution plans, employees continue to remain disinterested in spending the time to enroll and manage their retirement accounts. Employers are starting to respond to employee complacency by adding auto-features to their plans to drive what is in employees' best interest. To get employees ready for retirement, employers are utilizing these auto-features to automatically enroll employees, annually increase their contributions, provide investments that automatically allocate assets over time, and make available withdrawal programs to automatically distribute income in retirement.

Auto enrollment has become a very successful plan feature that has positively changed participation in defined contribution plans. Implementing an auto enrollment feature in a plan is an excellent way for employers to enroll new and existing employees in the plan and save for their retirement. When adopting this feature it is important to ensure that the initial default contribution rate is set at an adequate level (6%) and also include annual automatic contribution increases to help these participants move to a higher savings rate. It is believed that most participants will need a total savings rate (employee and employer contributions) in the range of 12% to 15%, to reach a sufficient savings amount.

Having employees participate and save at an appropriate rate is only part of the retirement plan equation. Equally important are the investment choices in the plan and the strategic role these investments play in a participant's success. Since most employees are not sophisticated investors and have no desire to construct, reassess, and rebalance portfolios, employers have been simplifying investing for participants by including auto-investment alternatives. Investments of this type include retirement target-date funds, risk-based model portfolios, and managed accounts. For the majority of participants, these investment alternatives make investing easier and provide them with a single

investment option that gives them broader diversification and more consistent investment performance.

In January of 2011 the first Baby Boomers turned 65 years old, and millions of them are preparing to retire. Unfortunately, many Boomers are worried about withdrawing too much money during retirement and outliving their retirement savings. To help participants manage their withdrawal rate in a “safe” or “sustainable” way, employers are now including automatic withdrawal features in their plans. These auto-withdrawal features include systematic withdrawal plans, lifetime income options, and guaranteed minimum withdrawal benefits (GMWB). They are designed to benefit participants with a convenient solution to receiving retirement income without having to worry about the premature depletion of their retirement savings.

Personal Road Map

A recent survey conducted for the American Institute of Certified Public Accountants (AICPA) demonstrated American workers’ growing concerns about affording retirement. For the second year in a row, the workers surveyed ranked retirement as their most important financial concern. The survey also reported that more than half of working adults (55%) do not know how much they need to save to retire comfortably.

To help reduce these concerns, employers cannot merely continue to tell employees that they need to save. Rather, the most effective employers provide employees with real numbers on how much they need to save. In plans where employers have provided employees with retirement savings goals, employees are more engaged in actively planning for their retirement, have higher savings rates, are more attentive to their investment allocations and returns, and generally put more time into monitoring the progress of the retirement accounts. Recent studies demonstrate that workers who have identified a retirement saving goal are much more confident that they are on track to achieving a secure retirement.

The employer, assisted by the current plan provider or an outside advisor, can furnish employees with both an income replacement ratio and a savings goal. The income replacement ratio is the traditional metric that identifies how much of an individual’s current salary will need to be replaced in retirement. Once the income replacement ratio has been determined it can be translated into a personal savings goal by using any number of retirement savings tools available through plan providers or outside advisors

Below is a chart taken from AON Consulting’s 2008 Replacement Ratio Study, showing income replacement ratios for different income levels.

Estimated income replacement ratios by income level

Pre-retirement Income (\$000)	Replacement ratios		
	Social Security %	Private and employer sources (%)	Total (%)
20	69	25	94
30	59	31	90
40	54	31	85
50	51	30	81
60	46	32	78
70	42	35	77
80	39	38	77
90	36	42	78

Source; AON Consulting’s 2008 Replacement Ratio Study. This graph illustrates three significant points about the replacement ratio calculations

1. Social Security replaces a larger portion of pre-retirement income at lower wage levels. This is by design and has the effect of redistributing income from higher paid employees to lower paid.
2. Total Replacement Ratios that are required to maintain a person’s pre-retirement standard of living are highest for the very lowest paid employees. This is primarily for two reasons. First, before they retire, lower paid employees save the least and pay the least in taxes as a percentage of their income. Thus, they spend a higher percentage of their income and need higher Replacement Ratios to maintain that level of expenditures. Second, age- and work-related expenditures do not decrease by as much, as a percentage of income, for the lower paid employees. This also means they need more income after retirement (as a percent of their pre-retirement income) than the higher paid employees.
3. After reaching an income level of \$60,000, the total required Replacement Ratios remain fairly constant at 77 percent – 78 percent. This is primarily because post-retirement taxes increase as income levels increase. Post-retirement taxes increase from 0.1 percent of post-retirement income for a \$60,000 person to 6.7 percent for a \$90,000 person. To pay the additional taxes, higher paid employees need more retirement income.

Once an employee has set a personal retirement goal it is equally import to make sure that they receive ongoing assessments of how they are doing relative to their goal. The retirement plan provider or outside advisor needs to update participants at least annually on whether they are still on target to reach their personal goal. If the participant is no longer on target to reach their goal, the program that is monitoring participants retirement readiness should automatically provide alternatives that will get them back on track.

Sunday Drive

Employers need to help ensure that employees are ready for retirement by taking the time to understand the needs of their workforce and implement plan designs that remove the many road blocks preventing their employees from a successful retirement outcome. Employers need to concentrate on getting all employees into the plan, encouraging saving at an adequate rate, investing properly, and

measuring their success against their savings goals. Ultimately, it is not good enough just to offer a retirement plan to employees. The most effective plan sponsors offer a full service solution. Not surprisingly, employees participating in healthy and effective plans are best equipped to reach their retirement destinations.