Are Your Employees on the Path to Retirement Readiness? How to Tell—And What to Do About It

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Many organizations have no idea how financially prepared their employees are for retirement. But it is important to understand what constitutes retirement readiness and where each employee—not just those nearing retirement—stands on the readiness spectrum. This requires knowing what savings employees need in order to attain a secure retirement, gathering financial and other data on all employees, and then running the numbers to determine how each employee stacks up. Organizations then need to take steps to help their employees prepare to retire when they want.

Every organization should consider:

- **The importance of retirement readiness.** Employees who find they must work longer than they expected or who retire unexpectedly early may disrupt the natural progression of the workforce.
- **What constitutes retirement readiness.** This will include a discussion of the various metrics for measuring income adequacy: the replacement ratio, the wealth accumulation target and the retirement readiness grade.
- **How to help employees reach their retirement goals.** Targeted education and communication, autosavings arrangements, creative match formulas and asset allocation training are just some of the strategies organizations can employ.

The Importance of Retirement Readiness

One key question that organizations need to answer is "Where do our employees stand with regard to retirement?" Are any late-career employees working longer than they want? Are any younger retirement-eligible employees preparing for a sudden exit? Both situations can have significant implications for employees and organizations.

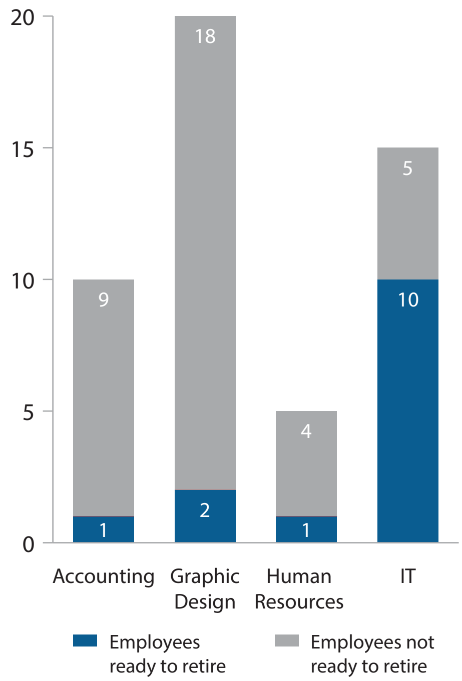
For example, an organization may find that a large portion of its workforce includes potentially less productive employees who would like to retire but who are financially unprepared to do so. These employees can slow the promo-

AT A GLANCE

- Having an understanding of their employees' retirement readiness can help organizations prepare for issues including skills gaps or loss of institutional knowledge.
- The key metrics in assessing retirement readiness are the replacement ratio, wealth accumulation target and retirement readiness grade.
- Targeted solutions, such as personalized education and communication, are often the most effective strategies in increasing retirement readiness.

FIGURE 1

One Organization's Retirement Assessment*



*Employees age 55 and over.

Source: Sibson Consulting, 2018.

tion pipeline. Moreover, they can consume a disproportionate share of the organization's resources.

Another problem is a skills gap that could suddenly occur if key employees retire sooner than expected. This can create a loss of institutional knowledge in an important area and leave the team unprepared to fill the vacated role. In some cases, an organization may be forced to pay a higher salary and/or a retention bonus to keep on board an employee who would like to retire.

For example, an organization that the authors are familiar with conducted a retirement assessment[1] that showed that a higher percentage of relatively young employees in the information technology (IT) department were financially ready to retire (Figure 1).

This analysis gave leadership an opportunity to identify and mentor internal successors and recruit new employees who could retain important knowledge. Not only was the organization more prepared in case the employees unexpectedly retired, but it reduced the financial burden of having to use retention incentives.

What Constitutes Retirement Readiness?

For the purposes of this article, *retirement readiness* is defined as the ability to retire with sufficient income to maintain the employee's current standard of living throughout retirement. (See the sidebar Overall Retirement Readiness.)

Overall Retirement Readiness

There are two important components of retirement readiness.

Retirement Income Sources

Of course, an organization's defined contribution (DC) plan is just one component of employees' overall retirement readiness. Not only will they have Social Security, but they also may have defined benefit (DB) plan benefits and individual retirement accounts (IRAs), as well as spousal and other sources of income. Ascertaining whether individual employees are ready to retire may involve a full assessment of their financial needs and all sources of income and/or wealth.

Expenses in Retirement

While it is paramount that employees ensure they have sufficient income, it is equally important that they plan for anticipated (and unanticipated) expenses in retirement. Foremost in this equation is preparing for the cost of postretirement health care. With fewer and fewer employers providing a significant subsidy for retiree health care, this has become an even more vital component of retirement planning.

Organizations can help their employees prepare for retirement by:

- Carefully considering retiree subsidy design while managing costs
- Helping them understand how to best navigate the available resources (e.g., employer subsidies, health savings accounts, long-term care insurance, Medicare)
- Educating them on best practices in wellness to mitigate health costs in retirement.

Most employees underestimate the significant out-of-pocket health care expenses they may face in retirement. Employers should be diligent in helping them factor these costs into any retirement readiness conversation.

There are three key metrics organizations can use to determine an employee's retirement readiness:

1. The replacement ratio
2. The wealth accumulation target
3. The retirement readiness grade.

The Replacement Ratio

The most direct metric for retirement readiness is the *replacement ratio*, which defines the required income for retirement as a percent of income just before retirement. According to a 2016 U.S. Government Accountability Office study on retirement security, most employees would need a replacement ratio of between 70-85% to maintain their preretirement standard of living.[2] Although there is certainly a range of acceptable percentages, many organizations consider 80% to be a reasonable benchmark.

Part of the replacement income will come from Social Security and other retirement vehicles. Savings and other assets will need to cover the rest. When employees start accumulating retirement wealth and when they begin drawing from this accumulation are key to determining an appropriate savings rate.

Most replacement ratios use a retirement age of 65. Employees who plan to retire before that age will need to accumulate more savings to attain the same replacement ratio for the additional years in retirement.

The Wealth Accumulation Target

Although using a replacement ratio as a measuring stick is easy to understand, it may be much harder for employees to assess their progress toward meeting their goals. That is because a large percentage of savings is account balance based (i.e., not expressed in terms of an annual income).

The *wealth accumulation target* defines retirement readiness as a specific amount of savings by retirement age. It is similar to the replacement ratio; however, it focuses on the total savings an employee needs in order to generate the required replacement income. According to one study, an employee would need 11 times pay to retire at age 65 and replace 85% of his or her income. At age 67, he or she would need eight times pay.[3]

Determining the wealth accumulation target can be complex. This is because some sources of retirement income are not easy to translate into an accumulation amount. For example, Social Security and benefits from defined benefit (DB) plans are usually expressed as an annual amount payable rather than an accumulation value.

Similar to replacement ratios, there is no one right answer for a wealth accumulation target (i.e., which multiple of pay is right for an individual). It is important to consider a range around the target the employee is striving to attain. With that said, assuming retirement at age 65, a multiple of ten is a reasonable target.

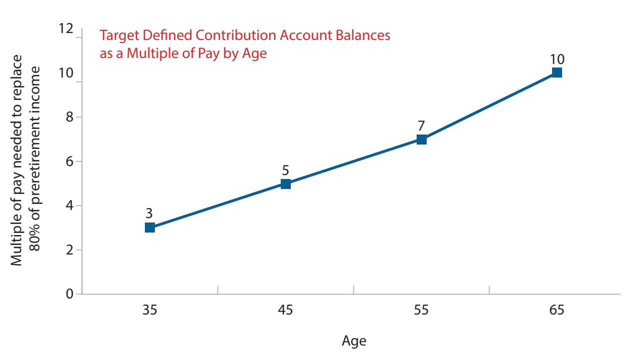
An important advantage of using a wealth accumulation target as a measure of retirement readiness is that it carves a path to retirement that employees and the organization can readily track along the way. For example, if an employee's target at retirement is ten times pay, and he or she plans to defer 6% annually until retirement, he or she should have saved about five times pay by age 45 and about seven times pay by age 55 (Figure 2).

However, these multiples will vary depending on certain factors, including:

- Future deferral rates
- Other sources of retirement income (e.g., a DB plan)
- The desired likelihood of having sufficient income (e.g., 75%).

FIGURE 2

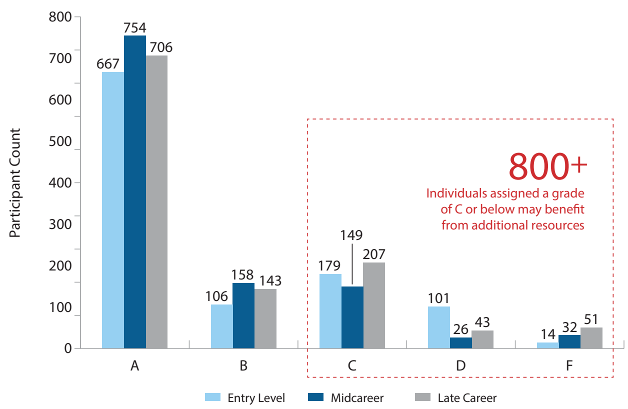
Tracking Employee Progress Toward Retirement



Source: Sibson Consulting, 2018.

FIGURE 3

Retirement Readiness Grade by Career Stage



Source: Sibson Consulting, 2018.

The Retirement Readiness Grade

Replacement ratios and wealth accumulation targets can provide specific goals. Without accompanying them with some detailed math, however, they tend to become just numbers that fail to give employees a feel for how they are doing. Providing a qualitative assessment of their progress so they can see if they are falling short can be the key to engaging employees. It can also encourage them to address any shortfalls.

Some organizations use an easy-to-understand *retirement readiness grade*: an A, B, C, D or F. This grade scores an employee's current standing based on his or her age plus the expectation that he or she will attain an appropriate level of retirement readiness. The grade is determined by projecting an employee's current profile and reflects the expected replacement ratio, the likelihood of attaining the threshold and the variability of potential outcomes.

Segmenting a population by grade can help isolate groups that need special attention. For example, Figure 3 reveals that employees early in their career have the largest proportion of grades of C and below.

Helping Employees Reach Their Retirement Goals

Successful strategies for promoting retirement readiness are not necessarily groundbreaking. Some tried-and-true tactics—like autosavings arrangements and creative match formulas—are very effective. Nevertheless, because every organization is unique, a customized workforce analysis can identify the right answers to meet specific needs. In fact, targeted solutions, such as personalized education and communication, are often the most effective strategies.

Targeted Education and Communication

A pivotal factor in helping employees improve their retirement readiness is opening the channels of communication and customizing the messages. To have a meaningful impact, plan-related communication must be actionable and personalized. Except in rare instances, *one size fits all* is a misnomer; it should be *one size fits few.* Communication should also be easy to understand and delivered on a regular basis, beginning well before retirement age. Further, the impact of the communication must be measurable so the results can be monitored. (See the case study sidebar.)

Using focused messaging requires identifying the different needs of each segment of the employee audience and then developing messages specifically for those segments. A common attribute for targeted retirement readiness mes-

Case Study—Quantifying the Impact of a Targeted Communication Campaign

One organization's quantitative analysis recently discovered that a proposed alteration to its profit-sharing contribution lacked sufficient impact. To address this, it enhanced the profit-sharing contribution and supplemented it with a communication campaign targeted at groups that were deferring an insufficient amount of income and/or suboptimally allocating their investments.

The campaign offered various communication messages depending on the specific groups. Figure 5 shows the impact of the approach of enhancing the profit-sharing contribution combined with a targeted communication campaign by indicating how likely individuals are to be retirement ready.

Because of the action, 155 more employees are now on track to be retirement ready. As illustrated, almost 1,390 employees are now 50% or more likely to be retirement ready. This compares with 1,235 employees before the alteration.

sages is an employee's work stage (e.g., new hire, midcareer, those within five years of retirement). However, there are numerous other attributes that organizations can isolate and target. Figure 4 presents several examples.

The organization can overlay these attributes with the participant's plan characteristics. These include deferral percentage, size of account balance, investment allocation and outstanding loans.

The messages delivered to each employee group should address the employees' specific retirement/financial concerns, explain why saving for retirement is crucial to them and promote how the organization can help.

For example, a new hire right out of college will most likely have education loans to pay off and might want to know more about a debt servicing plan, while a midcareer employee may be trying to save for a child's education, so a 529 plan could be more attractive. Alternatively, the messaging to those in the engineering department (who have a consistent pay cycle paycheck to paycheck) would be very different from those in sales (whose pay structure leads to a more volatile pay stream). In each case, the messages should take into account the recipient's specific situation and focus on what that individual should understand and do to make smart, efficient choices, which should include saving some money for retirement. Using a variety of delivery channels (e.g., personalized statements, email, videos, apps) can also help retirement messages stand out and capture each employee's attention.

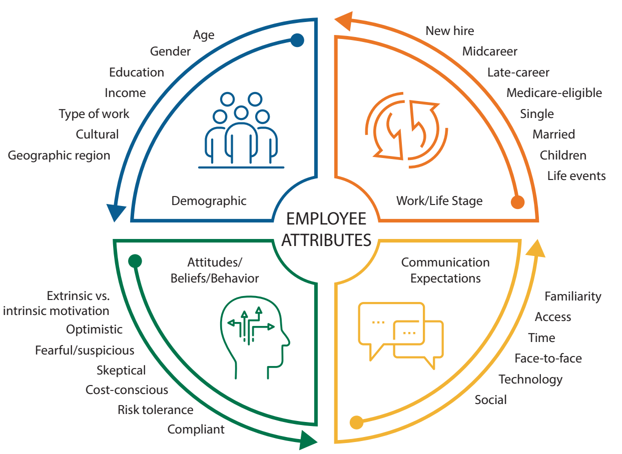
Many organizations rely on communication materials available from their defined contribution (DC) plan recordkeeper. While these "free" offerings can be helpful as supplements, they are not branded for the organization, are usually based on a generic template and lack consistent frequency. They typically have little to no audience segmentation and may not be designed to drive behavior that supports the organization's goals and objectives.

Organizations may be better served by creating their own customized materials that put their goals and branding—not the recordkeeper's—front and center. The visual familiarity of organization-branded pieces, along with targeted messages, will capture employees' attention and reinforce the benefits the organization provides.

Targeted communications that focus the participants' goals toward building their own retirement income can be the best solution (Figure 5). One example is an individual retirement readiness statement, which provides information such as current estimated DB pension benefits, DC account balance, as well as an assessment of the participant's performance on measures including wealth accumulation, replacement ratio and a retirement readiness grade.

FIGURE 4

Targeting Employee Attributes Can Enhance Retirement Readiness Communications



Source: Sibson Consulting, 2018.

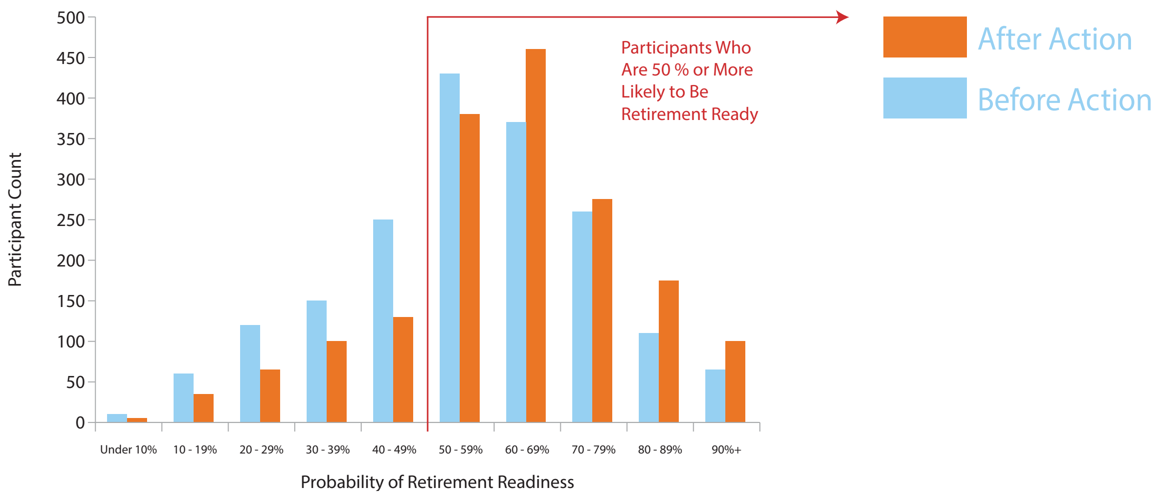
Autosavings Arrangements

While targeted education and communication are designed to combat inertia, other tools use this human tendency to their advantage. Autosavings arrangements in DC plans (e.g., autoenrollment, autoescalation, target-date funds and other qualified default investment alternatives) help ensure that employees are saving at an appropriate rate and in suitable asset classes, regardless of whether they actively try to do so. With proper design and implementation, inertia can be a powerful tool.

DC plans with autoenrollment see an average participation rate of 78%, compared with a participation rate of 69% among plans without autoenrollment. The participation rate

FIGURE 5

Results of an Enhanced Employer Profit-Sharing Contribution and a Targeted Communication Compaign



Source: Sibson Consulting, 2018.

for plans with autoenrollment and autoescalation of contributions is 80%.[4]

Although autosavings programs are a great way to help employees overcome their natural biases against saving for the future, these programs are not a solution for everyone. This is partly because they are typically one size fits all and do not consider the relative financial wellness or other considerations of individual employees. For example, they may not increase savings quickly enough to help a midcareer employee with a low account balance get on a viable path to retirement.[5] For these employees, the other solutions discussed later in this article may be more helpful.

Creative Match Formulas

Employees who find it difficult to overcome savings inertia may benefit from a contribution formula that incentivizes significant deferrals (e.g., a more "stretched" match formula) and provides a larger profit-sharing contribution. Changing a contribution formula can help midcareer employees catch up to where they should be. Also, because an organization may not want to offer such contributions to all employees, it can target critical individuals, as long as it ensures that the plan does not unfairly discriminate in favor of the highly paid.

Figure 6 provides an example of how these types of formula changes can increase total contributions to targeted individuals (without necessarily increasing the cost of the plan in aggregate).

Whether they are just starting out or are nearing the end of their careers, employees benefit from knowing they are on a path that leads to a financially secure retirement. Targeted education and communication, autosavings arrangements and creative match formulas are three valuable strategies to consider.

Key Takeaway

Organizations that understand the importance of retirement readiness, what constitutes retirement readiness and how to help their employees reach their retirement goals—relating to both income and expenses—will be better equipped to predict and address problems that could alter the natural progression of the workforce. While some

FIGURE 6

Sample Contribution Formula Change

Age: 55   Years of Service: 20   Salary: $100,000

Goal: To generate faster account accumulation for certain participants by providing an incentive for them to save more (through higher deferrals) and with targeted employer contributions aimed at these participants

	A	B	C	D	E	A + C + E
	Employee Deferral	Matching Formula	Resulting Employer Match	Profit-Sharing Formula	Profit-Sharing Allocation	Total Deferrals and Contribution
Before	6%	67% of first 6%	4%	7%	7%	17%
After	8%	50% of first 8%	4%	Age/service-based (4% to 16%)	16%	28%

Source: Sibson Consulting, 2018.

organizations may measure retirement readiness as employees approach retirement age, a more comprehensive strategy is to track employees throughout their careers to help ensure they are financially on target to retire when they want. BQ

Endnotes

1. Retirement assessment tools can include culture evaluations, employee surveys, leadership interviews, focus groups, data analytics, workforce analyses and workforce projections.
2. *Retirement Security: Better Information on Income Replacement Rates Needed to Help Workers Plan for Retirement*, United States Government Accountability Office, March 2016.
3. *The Continuing Retirement Savings Crisis*, National Institute on Retirement Security, March 2015.
4. *Inside America's Retirement Plans*, Ascensus.
5. An employee who starts saving at age 35 will need to save 14-25% of pay in order to likely be able to retire at age 65.

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