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Grace Lattyak, Associate Partner, Aon Hewitt
Melissa Hollister, Consultant, Aon Hewitt

The Changing Nature of Retirement

Today's grandparents and great-grandparents are generally comfortable in their retirement. They worked hard for many years and were rewarded for it; they have employer-provided pensions and retiree healthcare plans. However, with each subsequent generation, the scale has started to tip away from rich employer-provided retirement benefits.

According to data from Aon Hewitt, 91 percent of plan sponsors provided a defined-benefit pension plan in 1985, 73 percent provided one in 2000, and by 2014, only 20 percent of plan sponsors still had a DB plan. Likewise, employer-provided retiree healthcare plans have declined in recent decades. In 1985, Aon Hewitt's data showed 93 percent of employers had employer-subsidized post-65 health coverage (after Medicare eligibility), 62 percent had it in 2000, and by 2014, only 14 percent of employers still provided coverage.

In addition to less abundant retirement resources, the amount of income needed in retirement is increasing. Since the 1980s, life expectancy has increased by three years and is expected to continue to rise. And, as life expectancies have increased, so, too, have healthcare costs. Since 2000, retiree-healthcare costs have been increasing by an average of 6 percent per year, according to the Centers for Medicare & Medicaid Services.

These colliding factors mean U.S. workers need to rethink the amount of resources they'll need to retire comfortably. The 70 percent to 80 percent replacement ratio "rule of thumb" recommended by the President's Commission on Pension Policy in the early 1980s has become outdated.

The average worker, who contributes to his or her defined contribution plan, will need 11 times his or her final pay (beyond Social Security) to achieve an adequate age-65 retirement, according to estimates from Aon Hewitt. However, since retirement goals and needs are so unique to each individual, that projection should be considered a guide.

With longer life expectancies, projected needs are higher for women than for men (11.5 times pay compared to 10.6 for men). Similarly, younger employees will need to save more because they will likely live longer and will also likely have higher healthcare costs in retirement. For example, employees in their 20s need an average of 12.1 times their final pay while employees in their 50s are projected to only need 8.1 times their pay.

Addressing the Changing Retirement Landscape

As the generations move to and through retirement, these results paint an increasingly somber picture. Key questions emerge, such as: "At what age will workers be able to retire with adequate retirement resources?" and "How can workers tell if they are on track?"

With a later retirement age, retirement income grows, and the amount needed at retirement decreases. Aon Hewitt projects age 68 will be the median age at which employees with a full career at their current employer and who are contributing to their defined-contribution plan are expected to be financially ready to retire.

With careful planning, today's younger workers could be financially ready to retire at age 65. If 25-year-olds save 17 percent of their annual salary (including both employer and employee contributions), they should be able to accumulate adequate retirement income by age 65.

However, life rarely goes as planned, and it may be more feasible to target milestones along the way. For example, for that 25-year-old, The Real Deal suggests targeting 2.0 times pay at age 35, 4.3 times pay at age 45, 7.3 times pay at age 55, and 9.0 times pay at age 60.

This means a 45-year-old making $50,000 needs to have $215,000 in his or her DC account to be on track. Hitting those targets may help employees achieve their retirement income goals.

Employers can help their employees become more successful on the path to adequate retirement income. Automatic features in DC plans can significantly improve results. More than 70 percent of The Real Deal's full-career contributors who are automatically escalating their contributions are projected to have adequate or near-adequate resources at age 65.

Lifetime-income solutions within DC plans will also become more important to retirees. Previously, DB plans provided natural pooling of longevity risk; DC plans require the retiree to manage the risk of living too long. Managing this risk is expensive to do, particularly with the expectation of longer lifetimes.

With the changing retirement landscape, employees need to accept greater responsibility to finance their retirement income and retiree-healthcare benefits. And employers must recognize and react to the changing needs for retirement planning resources and incentives in their workforce.

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