Rev Up Your Readiness to Retire

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Fidelity study finds more than half of Americans at risk. Consider six steps to get on track.

Despite improvements in the economy, many Americans are falling behind on the road to retirement, with 55% of preretirees in only "fair" or "poor" shape to completely cover essential expenses like housing, health care, and food in their golden years. This puts Americans as a group in the "yellow zone," although there is wide variation within income and age groups. This is according to the newly-introduced Retirement Preparedness Measure (RPM) that is part of Fidelity Investments' latest Retirement Savings Assessment.

"The average household will be in retirement for 25 years or more," says John Sweeney, executive vice president of Retirement and Investing Strategies at Fidelity Investments. "Fidelity's analysis indicates that a majority may not be adequately preparing for those years. The good news is there are steps people can take, no matter their age or income, to help improve their retirement readiness, and get towards 'green.' But the time to act is now."

Fidelity's new RPM score provides a single retirement readiness measure that enables easy comparisons across generations and income levels. The score is based on real worker data from Fidelity's 2013 Retirement Savings Assessment, an extensive survey of more than 2,200 households that is then analyzed using Fidelity's financial modeling engine.[1]

"We believe a goal-centered approach provides a clear picture of the state of America's retirement readiness," says Sweeney. "We ran more than 2,200 retirement income plans from a cross-section of the population against our planning models to see how well Americans are positioned to cover estimated retirement expenses, and how they might do better. We hope that by educating people we can motivate them to actions that lead to success."

The new measure places preretirees into four categories on the retirement preparedness spectrum, which are linked to a numeric range (the higher, the better):

> **Red: Poor (less than 65).** Not on track to sufficiently cover all essential retirement expenses in a down market. Significant adjustments to planned lifestyle are likely.
>
> **Yellow: Fair (65-80).** Not on track to sufficiently cover all essential retirement expenses in a down market. Modest adjustments to planned lifestyle are likely.
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> **Green: Good (80-95).** On track to cover at least estimated essential expenses, but not discretionary expenses like travel. (The survey assumes 80% of estimated retirement expenses are essential.)
>
> **Dark green: Very good or better (95 or higher).** Even in a down market, these

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households are on track to cover at least 95% of total estimated expenses, such as travel, and essential expenses, including health care, housing, and food.[1,2]

Only Boomers are in the green-but all generations can get there

According to Fidelity's analysis, the median American household is on track to replace 74% of its estimated retirement spending goals, placing the group's RPM in the yellow zone, and meaning a good portion could be forced to make budget cuts in retirement that may diminish their quality of life. Best off are baby boomers (born 1946-64), who are on track to reach 81% of their goals, placing them just into the green zone. Gen X (born 1965-1977) is on track to reach 71%, putting them in the yellow. In most urgent need of improvement based on current behaviors is Gen Y (born 1978-1988), who fall into the red, at 62%. "Generally, young people do not have access to pensions, which puts them at a disadvantage to older workers," notes Sweeney. "But they have time on their side and with the right adjustments can still reach their goals." (Note: All scores presented in this article represent cohort median values, and there can be wide variations in RPM scores within groups.)

"The biggest problem overall is that one-third of the population has a seriously low saving rate," says Steven Feinschreiber, senior vice president of Fidelity Strategic Advisers, which produced the study. "We generally suggest a total annual savings goal of at least 10% to 15% or more, including 401(k) and other workplace plans, IRAs, and other savings. But that's only a rough guideline, and assumes continuous savings for 40 years of work and an age-appropriate asset allocation. Start saving later or invest too conservatively, and you may need an even higher savings target."

In our survey, 40% of people reported that they are currently saving less than 6% of their salary-including any employer match to a 401(k) or other workplace savings account. Members of Gen Y are even more likely to be saving less than that; 51% save less than 6%, versus 43% for Gen X and 34% for boomers. Add to that expectations of early retirement, increasing longevity, and sometimes overly conservative asset mixes, and you can see why many people in the survey are just not prepared to cover their expected expenses in retirement.

Despite these sobering findings, Fidelity's analysis shows that all three generations, regardless of income levels, can improve their retirement readiness and many can move their score to green. Indeed, taking all six of the action steps listed below boosts the median RPM for all Americans by almost a third, putting them solidly in the dark green category, on track to cover 105% of total estimated expenses in retirement.

First things first: Set a goal.

How do you get on track? First, estimate how much you will need to spend in retirement-for your house, food, healthcare, vacations, etc.-and what income sources you can depend on-including Social Security, pensions, lifetime annuity payments, as well as accumulated savings [IRAs, 401(k), etc.]. As a starting point, Fidelity recommends setting a retirement spending target of 85% of your estimated preretirement after-tax income. This is because Fidelity research indicates that expenses tend to drop once a person stops working-on average, by about 15%, because there's no longer a need to incur costs like commuting, work-related expenses, saving for retirement, etc.

Of course, your personal income replacement goal in retirement could be much higher or lower than 85%, depending on key factors like income level, your health and lifestyle choices. Indeed, in our study, individual income replacement goals varied widely. (For details, read *Viewpoints*: What will you spend in retirement?) Remember, these guidelines are just starting points for a retirement plan. Particularly as you approach retirement, we strongly recommend that you prepare your own retirement budget.

Then consider the composition of your expenses. No matter what your stage of life, you have essential expenses such as housing, healthcare, and food, as well as discretionary expenses such as travel, entertainment, dining out, and other "nice to haves." In retirement, we think you should aim to cover your essential expenses with guaranteed income sources like Social Security, pensions, and lifetime annuities, and your discretionary spending with portfolio withdrawals.

Consider six ways to accelerate your retirement preparedness

Are you behind? Don't fret. Consider six ways to accelerate your progress-three to take before retirement and three after (for details see "Assumptions and impact of hypothetical changes," below). Of course, not all these steps will be possible or appropriate for everyone. But we think they are solid starting points to help you determine what is right for you.

Steps to consider before retirement	
	Raise savings now. As a general guideline, set an annual savings goal of 10% to 15% or more of your income, and increase your savings rate in small steps until you achieve that goal. That's a total of your savings and any employer match. While it may seem daunting, even modest increases can add up to major improvements in retirement readiness over time. Adjusting the savings rate of all survey respondents to the 15% level improves the overall RPM score from 74 to 82, just into the green.
	Revisit asset mix. Although you can't control market behavior, you can affect its long-term effect on your portfolio through investment choices. By replacing portfolios that are either too conservative or too aggressive with an age-appropriate allocation, the median RPM increases from 74 to 77.
	Retire later. The longer you can wait, the more time you have to build savings. Also, waiting until age 70 to take Social Security may help you maximize your benefit, assuming you expect a long retirement. By adjusting the reported expected retirement age to secure the full Social Security Retirement Benefit (between 65-67) the median RPM increases by 9, from 74 to 83.

Steps to consider in retirement	
	Return to work part-time. This can boost retirement income-and help keep you active and involved. In our survey, 50% of households plan to have at least one person working in retirement. In the analysis, if we assume all respondents work in retirement for one to five years, depending on their retirement age, the median RPM increases from 74 to 79.
	Realize home equity. If you own your home, estimate the impact of downsizing and investing the proceeds. The median RPM score increased three points by converting 25% home equity into investible assets for retirement. What's more, property maintenance costs will most likely decrease, freeing up assets for other retirement expense needs.
	Reallocate part of your savings into an annuity. Combining a lifetime fixed income annuity with an investment portfolio can reduce the risk that you will outlive your assets. The median RPM score increased by four points with the inclusion of an annuity.

Which steps pack the biggest punch?

The answer varies by generation and income, as well as within each group. For **younger people**, the single most powerful step to take is to **increase savings**. As a rule of thumb, we suggest that people aim to save at least eight times (8X) their ending salary at retirement. But that rule of thumb assumes all the best behaviors-including starting saving early and retiring around 67 with no interruptions in work and an age-appropriate asset allocation.[3]

In reality, people are not perfect. Markets surprise. Life intrudes. In our study, for example, people started saving later and planned on retiring earlier, on average at 64.5 years old. Also, we found people's asset mix was often too conservative for their time horizon. That's particularly true for Gen Y; where we found 28% of respondents were in all cash or bonds. That is down slightly from 2011, but still far too conservative to provide the growth potential they will need to reach their retirement goals.

As a result, we estimate that the savings goals of our survey participants need to be considerably higher than 8X. Overall, we estimate they should aim to save 11X their ending salary on average, but are only on track to save 4X. Boomers are a bit better off-needing a 9X target and on track to save only 4X. Gen X is about average. But Gen Y is even further behind-needing to target 14X but on track to save only 5X. "This study should be a wake-up call for many Americans, particularly the young," says Sweeney. "But the good news for younger people is that they have time on their side, so even small steps now can make a big impact by retirement."

How can younger people catch up? Fidelity's recommendation is to begin boosting their savings rate as soon as possible to the 10%-15% range, which may require some belt-tightening or simply being smarter about how they spend their income. Doing so would boost Gen Y's average score 17 points, from 62 to 79. While saving 10%-15% a year may

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seem like a challenge, even a modest increase in savings can have a powerful impact, given time and the power of compounding.

Adopting a **more age-appropriate investment mix** would also help. In our study, we found young people in particular were underinvested in stocks. Indeed, 28% of Gen Y respondents reported that their retirement assets were invested in all cash or bonds. That's down slightly from the results of our 2011 survey, but likely still too conservative to provide the growth potential many may need to reach their retirement goals. Combine more savings and a more age-appropriate asset allocation, and Gen Y's median score rises to 84, nicely in the green.

For baby boomers who are nearing retirement, saving more and adjusting their asset mix has less impact for the simple reason that they have less time to accumulate wealth-though it may still help. For them, **postponing retirement** is generally the most effective step. Delaying retirement from 64.5-the average age people planned to retire in our study-to their full Social Security retirement age boosted baby boomers' median retirement readiness score by seven points, to 88.

Even **after you retire**, there are still steps you can take to improve your retirement security. For example, **working part-time in retirement** can help. By our estimates, boomers could boost their median score by five points by working part-time for another one to five years.

Of course, not everyone who wants to delay retirement can, due to health issues or the job market. Our research suggests that the percentage of retirees who actually work in retirement is meaningfully lower than the percentage of workers who, before retirement, state an intention of doing so. But whether you retire early by choice or necessity, doing so requires higher savings to cover income needs in a retirement that could last 25 years or more. Currently, a healthy 65-year-old man has a 25% chance of living to age 92. For a woman, the age is 94. A healthy 65-year-old couple has a 25% chance that one of them will reach 97.[4]

Boomers may also be able to **tap into home equity**. Today, 62% of Americans own a home, and 41% of retirees between the ages of 65 and 74 have paid off their mortgage.[5] So, home equity can be a significant help in retirement. What if people downsized, selling a home and repurchasing a smaller place that freed up 25% of the reported equity to reinvest for retirement? Fidelity estimates that could boost the median baby boomer's retirement readiness by three points.

Finally, if you can reasonably expect to live into your late 80s or even 90s, you might consider **annuitizing some of your assets**. The biggest plus of buying a lifetime income annuity is that you create a stream of income you can't outlive. (Note: All guarantees are subject to the claims-paying ability of the issuing insurance company). The flip side, of course, is that you generally have little or no access to the principal used to purchase the annuity, so before buying an annuity, you need to research the insurer and be sure you understand the expenses and the investment and withdrawal rules for the product. For this reason, we counsel people heading into retirement not to annuitize more than half of their

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savings. In our study, adding a hypothetical lifetime fixed income annuity with a 3% annual inflation adjustment adds four points the RPM for all generations.

Tips by generation

How do you get on your green line to retirement security? Here are some practical tips by generation to help you get started now.

Gen Y: Start early

You have time on your side, so focus on revving up your savings and getting your asset mix right from the start.

- **Put savings on autopilot.** Pay yourself first by directing a portion of your salary directly to savings. As a general guideline, set a goal to save 10%-15% of your income-including the employer match-and increase your savings rate in small steps until you achieve it.
- **Take the match.** If your company offers any match for your contributions to workplace savings plans, including 401(k)s, 403(b)s, 457s, and Health Savings Accounts (HSAs), make sure you contribute at least enough to get it.
- **Get tax smart.** Make the most of tax-deferred saving vehicles like 401(k)s, IRAs, HSAs, and tax-deferred annuities. Also consider a Roth IRA or 401(k), where contributions are after tax but withdrawals are income tax free.[6]
- **Invest for your timeline.** Having an asset mix that includes appropriate levels of risk and growth potential can help you meet your goals. Investing too conservatively might require more savings down the line.

Gen X: Put pedal to metal

Your career is progressing, and your life, too. So be careful not to lose sight of retirement savings goals as you focus on boosting your earnings, saving for children's education, buying a home, and perhaps caring for older relatives.

- **Prioritize retirement savings over other savings goals.** Pay yourself first by saving what you need for a more secure retirement.
- **Maximize tax-smart savings.** Maximize contributions to 401(k) and other tax-deferred workplace savings vehicles, IRAs, tax-deferred annuities, and, if your employer offers them, HSAs and deferred compensation plans.
- **Fix your asset mix.** Make sure you have an age-appropriate asset mix.

Baby boomers: Shift gears

You're getting close to the point when you will stop working full time. So now is the time to test drive your retirement income plan.

- **Ramp up saving.** Your income is likely peaking so ramp up your savings if you can. Use a Fidelity planning tool to estimate your retirement income and expenses and to find out the savings you may need.

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- **Consider postponing your retirement date and/or working part time in retirement.** The longer you can wait to retire, the longer you'll have to grow your savings-and possibly your Social Security benefit.
- **Take advantage of catch-up contributions.** If you are age 50 or older, you can contribute an extra $5,500 a year to a 401(k), an extra $1,000 a year to an IRA, and at age 55 you can contribute $1,000 more to an HSA.
- **If you own your home, estimate the impact of downsizing and investing the proceeds.** Turning home equity into retirement savings and reducing your living expenses can help to improve your retirement lifestyle.
- **Consider annuitizing.** Combining a lifetime fixed income annuity with an investment portfolio can reduce the risk that you will outlive your assets.

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1. **About the Fidelity Retirement Savings Assessment**

These findings are the culmination of a yearlong research project with Strategic Advisers, Inc., a registered investment adviser and a Fidelity Investments company, which analyzed the overall retirement readiness of American households based on data such as workplace and individual savings accounts, projected Social Security benefits, home equity and pension benefits. The analysis for working Americans projects the income replacement rate for the average household, compared with preretirement income, and modeled the estimated effect of specific steps to help improve readiness based on the anticipated length of retirement.

Data for the Fidelity Investments Retirement Savings Assessment (RSA) was collected through a national online survey of 2,265 working households earning at least $20,000 annually with respondents aged 25-73 from June through October. Data collection was completed by GfK Public Affairs and Corporate Communications using GfK's KnowledgePanel,[?] a nationally-representative online panel. Fidelity Investments was not identified as the survey sponsor. GfK Public Affairs and Corporate Communications is an independent research firm not affiliated with Fidelity Investments.

About the Retirement Preparedness Measure

The retirement preparedness measure (RPM) attempts to reflect all reported retirement investment assets, retirement guaranteed income sources, and earned income in retirement. The score illustrates the percentage of the retirement income goal we estimate a given population is on track to replace.

The target is an estimate based upon income brackets using Fidelity research and data from the Bureau of Labor Statistics Consumer Expenditure Survey, and is adjusted for stated health expectations using Medical Expenditure Panel Survey data, U.S. Department of Health and Human Services and Fidelity research, and lifestyle expectations based on data from the International Council on Active Aging, Bureau of Labor Statistics Consumer Expenditure Survey, and Fidelity research. The survey assumes a planning horizon of 92 for a male and 94 for a female based on the Society of Actuaries Annuity 2000 table. Actual individual circumstances and results will vary.

The assessment calculations rely on the proprietary asset-liability modeling engine of Strategic Advisers, Inc., which has been providing asset allocation, retirement and tax-sensitive investment management services to Fidelity's individual and institutional clients for nearly two decades. The same modeling engine is used in Fidelity's retirement planning tools. Using its modeling engine, Strategic Advisers generates the percentage of potential pre-retirement net income that each individual American household surveyed is likely to replace upon retirement. Strategic Advisers uses Monte Carlo simulations for this projection and uses a down market assumptions-meaning that in the simulations actual results would have been better 90% of the time and worse 10% of the time. The RPM represents the median (or midpoint) for accumulator households and income and age cohorts.

The hypothetical illustrations are for educational purposes and do not reflect actual investment results and are not guarantees of future results. Actual investment fees or expenses are not reflected in these hypothetical illustrations. An investor's actual account balance and ability to withdraw assets during retirement at any point in the future will be determined by the contributions that have been made, any plan or account activity, and any investment gains or losses that may occur.

What the retirement score indicates

- **Dark Green: Very good or better (95 or higher).** Even in a down market, these households are on track to cover 95% or more of discretionary expenses, such as travel, and essential expenses, including health care, housing, and food.
- **Green: Good (80-95).** On track to cover at least estimated essential expenses, but not discretionary expenses like travel. (The survey assumes 80% of estimated retirement expenses are essential.)
- **Yellow: Fair (65-80).** Not on track to sufficiently cover all essential retirement expenses in a down market. Modest adjustments to planned lifestyle are likely.
- **Red: Poor (less than 65).** Not on track to sufficiently cover all essential retirement expenses in a down market. Significant adjustments to planned lifestyle are likely.

Assumptions and impact of hypothetical changes

Investment mix: The study looks at the reported asset mix from the survey results and estimates the potential effect of adjusting the asset allocation for investors who are more conservatively or aggressively invested than our age-based investing guidelines would suggest. The results are then adjusted to account for the long-term investment performance potential of an age-appropriate asset allocation.

Enroll in an automatic increase program: The base results reflect the reported level of annual savings contribution in the survey results-the national median savings rate was 7%. The automatic increase program assumes a 1 percentage point annual increase up to a combined employer/employee cap of 15%. The results are then adjusted to reflect the potential impact of the increased savings and investment potential.

Retirement age/delay retirement: The base score reflects the reported planned retirement age-the median reported planned retirement age was 65. The option to delay retirement adds two years to the projected working life reported by each individual and the score is adjusted based on the assumption that current earnings trajectory, savings, and investment behavior is extended for those two additional years.

Work part time in retirement: The base score assumes that all work and income from work ceases in the year of retirement. The work part-time in retirement option adds a percentage of the reported earned income and a duration of part-time work based on each individually stated retirement age from the survey. The maximum duration is five years of part time work and the minimum duration is one year.

Annuitize: The annuitize option assumes 40% of the individual's investable assets are invested in a single-life fixed income annuity with an annual 2% cost-of-living adjustment and a 10-year guarantee period. Age at annuitization is assumed to be 67 for generations X and Y and 66 for boomers. Results are based on best available male rates as of August 2013 from lifetime fixed income annuities available through Fidelity Insurance Agency, Inc., and issued by third-party insurance companies. A guarantee period provides annuity income through a specified date even if no annuitant lives to the end of the guarantee period. Guarantees are subject to the claims-paying ability of the issuing insurance company.

Downsize: The base score assumes that the retiree maintains his or her current housing situation. The downsize option assumes the sale of the home and repurchase of a home that frees up 25% of the projected equity for each individual survey participant at the time of sale based on reported value in the survey. The equity is then reinvested as part of the retirement portfolio.

All of the above: Combines the effects of each accelerator described above.

2. Fidelity uses a down market for planning projections based on Monte Carlo simulations, and our asset liability model. Down market indicates that in 10% of market simulations the market would be worse, and in 90% of simulations, the market would perform better. Using down markets as a planning measure leads to conservative results. Using a lower confidence level would improve results, but increase the risk that investors would fall short of projections.

3. The baseline 8X hypothetical assumptions in the interactive graphic are based on the following selections: starting age of 25 and starting salary of $40,000; retirement age of 67; pretax deferral rate beginning at 6% and increasing to 12%; annual salary growth of 1.5%; salary replacement goal in retirement of 85%; life expectancy of 92; the account balances grow at a hypothetical expected rate of return of 5.5%. All seven factors will change based on your selection of other variables. Additional assumptions for all: Assumes systematic withdrawal of savings in retirement; 85% replacement rate is for a hypothetical average employee and may not factor in all anticipated future living expenses or needs, such as long-term-care costs; dollars expressed are in real dollars (all dollars in today's 2013 dollars, not future value). All savings are based on pretax earnings, and taxes will be due upon withdrawal. The maximum annual qualified retirement plan contribution limits in 2013 are $17,500 (if age is 50 or older, an additional $5,500 of catch-up is allowed); for a SIMPLE 401(k) plan, the annual contribution limit is $12,000 (with additional catch-up contributions of $2,500 allowed for those age 50 and older).

Social Security data from ssa.gov. In the base 8X case, a hypothetical worker who at age 25 commences his or her career with a $40,000 annual salary with an ending salary of approximately $72,000 at age 67, would receive benefits of about $1,920 per month. For other retirement age selections, such as 63 or 70, Social Security payments may be higher or lower. Please see, Social Security's Retirement Estimator.

Actual average annual income increases are based on 1.5% real wage increases plus 2.3% inflation adjustments. Also assumes the participant took no loans or hardship withdrawals from his or her workplace plan.

4. Annuity 2000 table, Society of Actuaries.

5. Data on percentage of retirees between the ages of 65 and 74 who have paid off their mortgage: Zillow Real Estate Research.

6. A distribution from a Roth account is tax free and penalty free provided that the five-year aging requirement has been satisfied and at least one of the following conditions is met: you reach age 59½, become disabled, make a qualified first-time home purchase, or die.

A distribution from a Roth 401(k) is tax free and penalty free, provided the five-year aging requirement has been satisfied and one of the following conditions is met: age 59½, disability, or death.

Diversification/asset allocation does not ensure a profit or guarantee against loss.

Investing involves risk including the risk of loss.

Stock markets are volatile and can fluctuate significantly in response to company, industry, political, regulatory, market, or economic developments. Investing in stock involves risks, including the possible loss of principal.

In general, the bond market is volatile and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa. This effect is usually more pronounced for longer-term securities.) Fixed income securities also carry inflation risk, liquidity risk, call risk, and credit and default risks for both issuers and counterparties. Unlike individual bonds, most bond funds do not have a maturity date, so holding them until maturity to avoid losses caused by price volatility is not possible.

Guarantees apply to certain insurance and annuity products (not securities, variable or investment advisory products) and are subject to product terms, exclusions and limitations and the insurer's claims paying ability and financial strength.

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