DRIVING RETIREMENT PREPAREDNESS

Reflections on the 2013 Retirement Savings Assessment

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As Americans increasingly rely on defined contribution plans for a growing proportion of their retirement income, it becomes ever more crucial to appraise whether people are saving enough to provide for a comfortable retirement. Since 2005 Fidelity has been examining the retirement savings behavior of Americans. Our current approach, the Retirement Savings Assessment (RSA), uses a survey to create a bottom-up assessment of retirement preparedness.

In broad terms, our results confirm what several top-down studies have found: America is facing a looming retirement crisis, not just because accumulators are not saving enough, but also because rising costs, market volatility, and even the boon of greater longevity all present challenges to the goal of achieving lifelong income in retirement. In the face of such complexity, many Americans have not taken the essential steps required to achieve "retirement readiness," despite ongoing efforts to educate and encourage them. Clearly, more work in that regard is needed.

In addition, the RSA allows us to perform deeper analysis on a variety of topics, including the potential impact on retirement preparedness of changes in behaviors or expectations. This article presents some of our key findings.

Measuring Preparedness

The RSA survey analysis focuses on outcomes, assigning each household a single score that represents the proportion of expenses that household likely will be able to cover in retirement. This Retirement Preparedness Measure (RPM) is calculated with Fidelity's retirement planning tools, using individual reports of all sources of retirement income (including pensions and Social Security). The calculation sets target goals based on respondents' reported expectations of retirement age, health, and lifestyle. To take a conservative approach, a "down market" scenario was used to calculate investment returns. (See "Methodology and Definitions.")

The RPM thus allows us to assess whether a wide array of Americans are "on pace" to meet their personal retirement goals. It also allows us to make broad comparisons between cohorts by looking at median results for each (Table 1). Additionally, we can conduct "before and after" analysis to see how various changes (e.g., saving more or retiring later) could potentially improve retirement readiness.

Retirement Savings Rates

Analysis of the survey data shows that a large percentage of working Americans are far removed from maintaining a savings rate sufficient to attain the retirement security they seek. For example, 41 percent of all surveyed working households have a total retirement savings rate of less than 6 percent, which *includes* employee deferrals into a workplace account, employer contributions on behalf of an employee, and personal savings into accounts that will serve to fund retirement. This low savings rate is even more pronounced for Generation Y, with 51 percent reporting a total retirement savings rate below 6 percent (Table 2).

As a rule of thumb, Fidelity suggests a total savings rate of 10 percent to 15 percent or more. In addition, Fidelity is a strong proponent of enrollment in workplace automatic escalation programs; these programs help savers move to higher savings ranges as time passes.

Not surprisingly, increased savings rates would have a significant effect on potential retirement preparedness. For example, when those in Generation Y who are currently saving less than 15 percent are modeled as if enrolled in an automatic rate escalation program that increases savings by 1 percent of income each year (up to a 15 percent cap), that group's median RPM score rises 11 points (an 18 percent increase toward fully meeting retirement needs). Generation X also shows an increase, but to a lesser degree (Table 3).

Age-Appropriate Asset Allocation

Many households have an asset allocation that is too conservative, in that overly conservative allocations can hurt their chances of saving enough to cover retirement needs. This tendency is particularly prevalent in young households. For example, 41 percent of Generation Y households are under-allocating their retirement assets. For Generation X and Boomers, 28 percent and 16 percent of respective households are severely under-allocating retirement assets (Table 4).

Table 1

Average Retirement Preparedness Measures, by Age and Annual Household Income

	All households	Gen Y (Born 1978–1988)	Gen X (Born 1965–1977)	Boomers (Born 1964 or before)*
All incomes	74	62	71	81
$20,000–$50,000	68	59	58	81
$50,001–$80,000	73	60	76	75
$80,001–$120,000	74	63	65	82
$120,001 or more	81	80	76	85

Poor: Less than 65% of expenses covered

Fair: 65% to < 80% of expenses covered

Good: 80% to < 95% of expenses covered

*Includes individuals of the Boomer generation (born 1946–1964) and those older than Boomers who are still working

Source: Fidelity Investments (2014)

Table 2

Low Savings Rates Are Common

	0 to <2%	2% to <4%	4% to <6%	6% to <8%	8% to <10%	10% to <12%	12% to <15%	15% to <20%	More than 20%
All	**18%**	**12%**	**11%**	**10%**	**8%**	**7%**	**9%**	**9%**	**16%**
Generation Y	22%	15%	14%	9%	9%	6%	7%	6%	12%
Generation X	20%	13%	10%	9%	10%	9%	8%	8%	13%
Boomers	15%	10%	9%	10%	9%	8%	9%	12%	18%

Source: Fidelity Investments (2014)

The effects of re-allocation, particularly for younger savers, are striking. For Generation Y, if the 41 percent of households under-allocating were to change to a more age-appropriate asset mix, the median RPM score of that group would increase a full 10 points, from 61 to 71. Generation X and Boomers also experience a meaningful gain, though to a smaller degree, as they have less time for investment gains to accumulate.

Planned Retirement Age

In our survey, 39 percent of respondents plan for a retirement that will begin prior to age 65. Of this group, one third intend to begin their retirement between ages 60 and 64, and the other two thirds are planning to retire before age 60.

Table 3

Median RPM Scores Before and After Simulating Savings Rate Escalation

	All households	Generation Y	Generation X	Boomers
All incomes, saving <15% to start	75→77	62→73	72→76	82→82

Fair: 65% to < 80% of expenses covered

Good: 80% to < 95% of expenses covered

Source: Fidelity Investments (2014)

Planning to retire before age 65 has implications for Social Security benefits, as well as for shortening the accumulation phase modeled in the projection. For many, setting an early retirement goal contributes to making their current savings plan inadequate for providing sufficient retirement security.

Modeling the group planning to retire before age 65 with extended worklife expectations or part-time work-in-retirement expectations resulted in measurable strengthening to their retirement security:

- By assuming two additional years of workforce participation, the aggregate median RPM score rose six points (an 8 percent increase toward fully meeting retirement needs).
- By assuming each respondent would remain in the workforce until the full Social Security benefit entitlement age (by age group), the aggregate median RPM score rose 10 points (a 15 percent increase toward fully meeting retirement needs).
- By assuming part-time work after retiring, the aggregate median RPM score rose five points (a 6 percent increase toward fully meeting retirement needs).

The good news is that some research shows the proportion of people planning to retire later has been growing over time. The Gallup Economy and Personal Finance study has been repeated over time (most recently in April 2013) and indicates an ongoing increase in the percentage of respondents planning for a later retirement. In 1995 only 14 percent planned to retire after turning 65, but

Table 4

Reported Retirement Savings Allocations by Generation*

	All cash	All bond	20% equity	50% equity	70% equity	85% equity	100% equity	Lifecycle
All	**18%**	**1%**	**12%**	**15%**	**10%**	**12%**	**19%**	**12%**
Generation Y	**26%**	**2%**	**13%**	11%	7%	10%	17%	15%
Generation X	**16%**	**1%**	**11%**	12%	11%	12%	22%	15%
Boomers	**15%**	**1%**	13%	19%	12%	14%	18%	9%

* Figures in red indicate overly conservative allocations. Numbers may not sum to 100% due to rounding.

Source: Fidelity Investments (2014)

that figure increased to 37 percent in 2013. The proportion of those planning to retire before age 65 decreased from 49 percent in 1995 to 26 percent in 2013.

An Appropriate Life Plan Age

Analysis of the Fidelity survey also shows that 45 percent of working Americans see age 85, or younger, as the suitable end of the retirement planning horizon. Conventional retirement planning guidance, though, strongly recommends individuals establish a planning horizon that ends no younger than age 90. Often the recommendation extends out to an age in one's mid- to late 90s.

To the positive, in comparison to the average planning age as measured in the Fidelity 2012 version of the study, individuals in 2013 are reporting a higher planning age by approximately two years. Fidelity strongly encourages that people plan at least to their 25 percent longevity age (the age at which 25 percent of healthy individuals of their age and gender will still be living). According to the most recent Society of Actuaries information, that generally means a planning age in the lower 90s for males and in the mid-90s for females.

The Implications of "Active Living" in Retirement

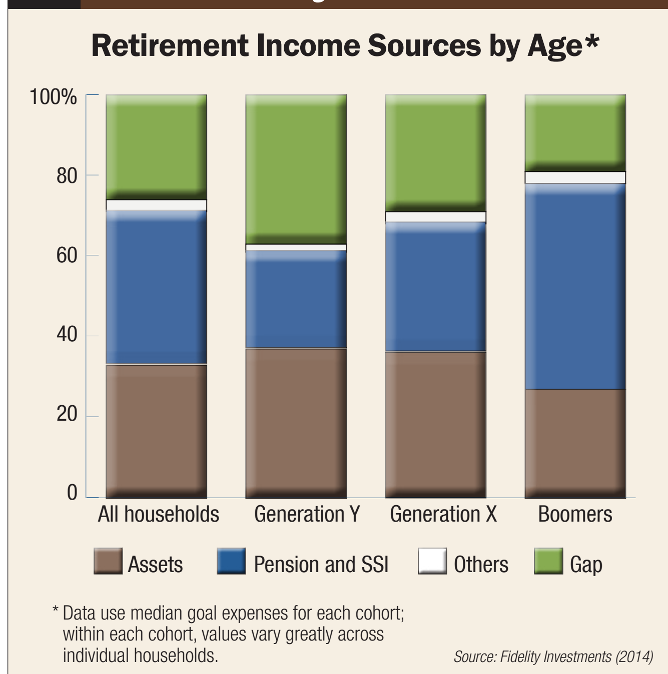
Starting with the Fidelity 2012 Retirement Savings Assessment, we asked respondents to answer a question regarding the retirement lifestyle they anticipate living. The question asks whether households see their retirement lifestyle as remaining similar to their pre-retirement lifestyle, as being less active than before retirement, or as being more active than before retirement.

To a high degree (5 to 1), respondents answered that they plan to have a more active lifestyle in retirement than during their working years. For some in this group, "active living" may be experienced through activities that may have no or low costs associated with them (e.g., walking clubs or lifelong learning programs); for others, the costs of activities may exceed those of pre-retirement vacations (e.g., "soft adventure" travel for active agers).

An anticipated active living retirement lifestyle may require adjusting one's retirement savings plan, to provide for recreational expenses in addition to necessities. If we model for five to seven years of additional costs typically associated with this retirement lifestyle, the aggregate median RPM score decreases four points (a 5 percent decrease away from fully meeting projected retirement expenses). If we model 10 to 12 years of additional costs — not unlikely, given the longevity and health

> "An anticipated active living retirement lifestyle may require adjusting one's retirement savings plan, to provide for recreational expenses in addition to necessities."

Figure 1



improvements we have seen and may continue to see — the aggregate median RPM score decreases seven points (a 9 percent decrease away from fully meeting projected retirement expenses).

Retirement planners who hope to pursue an active lifestyle after retirement therefore may benefit from concentrating on ways they can increase retirement preparedness to compensate (e.g., saving more, retiring later, holding an appropriate asset mix, or planning to annuitize some assets in return for guaranteed* lifelong income).

The Effect of Guaranteed Income

It should come as no surprise that pension coverage continues to decline, given reports by the media, financial institutions, and academia. Our survey reaffirms this trend and quantifies the decline across the generations. To further complicate matters, younger households are less likely to expect full Social Security retirement benefits. The combined effect is staggering: The total guaranteed income provided by expected pensions and Social Security drops from 51 percent of estimated retirement goal expenses for Baby Boomers to 32 percent for Generation X, and to only 24 percent for Generation Y (Figure 1).

Our expectation — based on actual expenditure data — is that average essential expenses are approximately 80 percent of total expenses. Because we believe most households should strive to cover a significant portion of essential expenses with guaranteed lifetime income (to offset longevity risk), we see a growing argument in favor of households annuitizing some of their retirement assets.

We found that if we model for households annuitizing 40 percent of their retirement assets at the time of retirement (using a simple, generically defined product), the median RPM score for all households would increase from 74 to 78, with a similar positive effect across all income groups. Our research suggests that finding innovative ways to supplement guaranteed retirement income may be broadly beneficial for retirement readiness.

Productive Approaches to Realizing Retirement Goals

Fidelity's annual RSA can help us understand the retirement saving practices of working households. With the introduction of a standardized RPM matched to each respondent's retirement expectations, we also can study which behavioral changes may yield the greatest benefits for different age and income groups.

While our analysis of the data is far from complete, the preliminary findings discussed here may suggest some productive approaches to helping people accomplish their retirement goals. Low savings rates, anticipated life plan ages shorter than actual longevity, and active retirement expectations are common, and all three factors make actual retirement security more challenging to attain. However, being willing to delay retirement and to annuitize some retirement savings can increase retirement preparedness for all age groups, while increasing savings and allocating assets more aggressively have more substantial impacts on younger members of working households.

Retirement security can be strengthened via fairly simple modifications to current retirement planning behaviors. By adopting guidance offered, the younger groups can measurably reduce any retirement income gap they, unfortunately, may be on track to encounter. Time is a significant ally to these individuals if they embrace appropriate savings and/or allocation strategies.

Methodology and Definitions

The Fidelity Investments Retirement Savings Assessment 2013 surveyed a national pool of accumulator households. Data were collected through a national online survey from June through October of 2,968 working households earning at least $20,000 annually with respondents aged 25 to 73. 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.

Results are composed of data from households surveyed, though only surveyed households with complete data were modeled for RPM scoring (n = 2,265 households). For the purposes of the survey, respondents born before 1946 but still working were grouped with the Boomer cohort. The Retirement Preparedness Measure basic calculation assumes a growing income, consistent savings rate, and a down market scenario (in this case, market returns worse than 90 percent of simulations using our capital market assumptions). RPM calculations used respondents' self-reported retirement age, but substituted life plan age from the SOA 2000 Individual Annuitant Mortality Table (i.e., 92 for males and 94 for females).

Adjustments for the purpose of measuring effects are as described in the text. Part-time work-in-retirement is defined as an additional income at a percentage of income just prior to retirement, for a duration of four years down to one year depending on age of retirement and reducing gradually from when work-in-retirement begins to when it completes. Simulation of simple annuitization assumes 40 percent of retirement assets will purchase a generic fixed annuity with a 2 percent COL adjustment.

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