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Lifetime Income Score V: Optimism and opportunity

A white paper

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America faces a major — but eminently solvable — challenge: enabling working families to save enough to supplement Social Security and replace in retirement the incomes they earned while working. This report aims to assess how well households are meeting that challenge. It highlights the key elements of the workplace savings system that are working well today. And it illustrates the need to spread those best practices and make them more accessible so everyone can create a successful strategy.

Viewed independently and as a whole, the findings — from this year and years past — reveal a strong sense of optimism and opportunity about the workplace savings system. Though the median Lifetime Income Score℠ (LIS) has dipped slightly this year — to 58 — the report suggests that much higher LIS results can be a reality within the system.

When this strategy is followed — namely participating in a workplace savings plan and incrementally increasing savings rates to at least 10% — we believe these plans genuinely work.[1] In fact, the LIS metric suggests nearly 30 million working Americans are on track to replace 100% or more of their income in retirement. That is success by any reasonable measure.

The next step — for advisors, providers, plan sponsors and policymakers — is to expand best practices more broadly to reach all American workers.

Working with Brightwork Partners, Empower Retirement is pleased to offer this fifth annual Lifetime Income Score℠ (LIS) report for the 2014 year. Based on a detailed survey of more than 4,000 respondents, this report estimates the percentage of working income — the Lifetime Income Score, or LIS — that American households are on track to replace in retirement.

The LIS metric includes projected Social Security benefits, defined benefit and defined contribution assets, personal savings, home equity, and even business ownership. It provides a comprehensive overview of Americans' current readiness for retirement — and suggests ways to raise it.

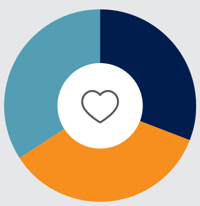
Key demographics

This survey is conducted with thousands of working adults who represent a wide cross section of the nation in terms of age, household income and retirement preparedness. In addition, it includes people who participate in different kinds of plans across all market segments to include 401(k), 403(b) and 457 plan types. The following statistics provide a snapshot of the 2015 survey population.

Sex

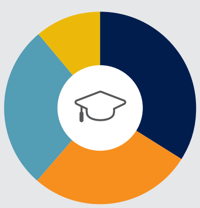
- Women = 47%
- Men = 53%

Age



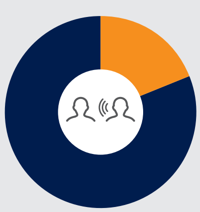
- 18-34 = 35%
- 35-49 = 34%
- 50-65 = 31%

Education



- High school or less = 37%
- Some college = 30%
- Four-year college = 21%
- Graduate school = 12%

Work with an advisor



- With = 19%
- Without = 81%

Median household income

Median investable assets

Section I: Value of the advisor

Access to professional advisors correlates strongly with a higher LIS. People who work with a paid advisor have a nearly 30 percentage point advantage in LIS over those not currently receiving professional advice.

Lifetime Income Score: Having an advisor

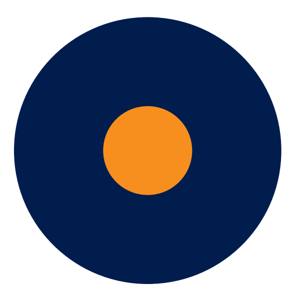
Advisors also play a key role in the development of a retirement planning strategy. This tried and true method of success must not be ignored — specifically, the value a professional advisor plays in helping people make a plan. With a formal, written action plan in place, LIS results improve significantly. The data suggests that people with a documented strategy are on track for a much higher LIS result, compared with the mean LIS.

Lifetime Income Score: Having a strategy

Based on the analysis, advisors can help drive LIS success. We see consistently — and significantly — higher LIS results for people who work with a paid advisor. Additionally, this year's study shows that people with an LIS of 100 or more are three-times more likely to be working with an advisor than those with an LIS less than 45.

Lifetime Income Score ≥100

- Working without an advisor
- Working with an advisor



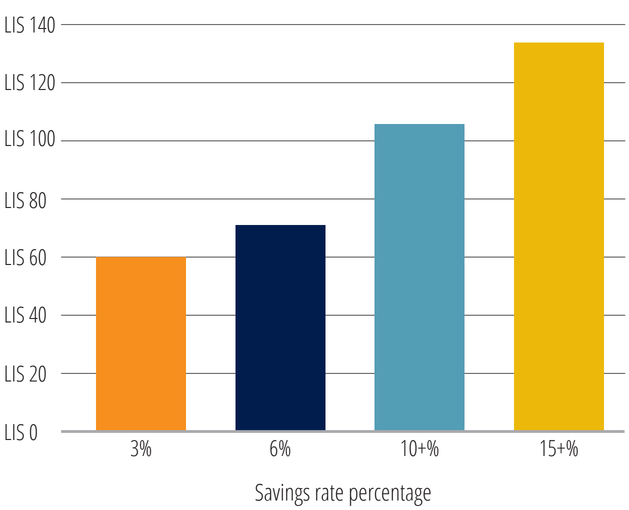
The correlation between the use of an advisor and an LIS of 100 or more provides clear evidence that the advisor can, and should, play a prominent role in an individual's overall retirement strategy. Making professional advice more widely available, regardless of historical perceptions related to socio-economic status dictating who is best suited to get this type of assistance, is an important next step.

Knowing this, retirement service providers and advisors should be connected at the hip. They need to work in partnership with one another to deliver better results that may not be possible when they work independently of one another. The service providers and advisors that recognize the potential of combining efforts are best positioned to bring a higher level of value to their shared clients.

Section II: Savings rates dictate success

Savings rates influence LIS results more than any other element of a person's retirement strategy. There is a dramatic rise in LIS results as people contribute more to their future.

Lifetime Income Scores



With a 3% savings rate being a common default for plans that automatically enroll people, the LIS of 60 gives clear evidence that 3% may not prepare workers to replace their income in retirement.

Those saving **10%+** are on track for an LIS of **106+**.

Section III: Engagement with income planning tools

Income planning tools are an important component of the overall solution to improve the workplace savings system. These tools appear to drive higher savings rates, which are the single most important factor in terms of raising LIS results.

Only slightly more than one-quarter of survey respondents say they have access to planning tools that show how changes to their savings rate affect their outcome. And only about half actually use these tools for those purposes.

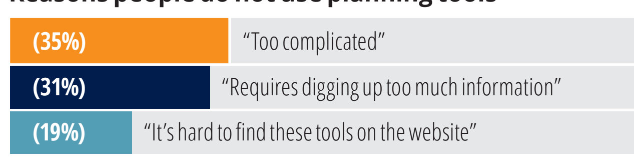
Access to planning tools

The numbers are similar when it comes to people having the availability of a planning tool that estimates the percentage of income they will be able to replace, based on their household's current savings and investing behavior.

Access to planning tools with estimates

Interestingly, when looking at reasons why those who do have access to these types of planning tools are not using them, the top three reasons speak to simplicity and accessibility in some form or fashion.

Reasons people do not use planning tools



This sends some clear messages to service providers offering these tools:

- They must be intuitively designed with simple, interactive components that make it easy for people to model different scenarios.
- They should include pre-populated data relative to each individual using the tool whenever and wherever possible.
- They need to be front and center of the individual's experience, being easily accessible both on the Web and in a mobile environment.

In the absence of a professional financial advisor or income planning tools, the media — and more increasingly, social media — shape people's financial thoughts and beliefs. The 2015 LIS report seems to reflect the idea that those mediums do contribute to people's perceptions related to topics such as Social Security.

This year's report shows the widest gap in the past five years in terms of income expected from Social Security in comparison to income expected from workplace savings plans.

Expected retirement income sources

(32%) Social Security

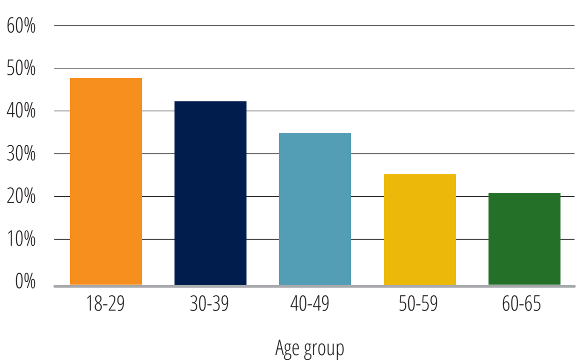
(22%) Workplace savings plans

Again, conclusions can be drawn here based on the common notion that perception is reality. As Social Security challenges fade from the front-page news, people's ideas about its viability show an uptick in confidence. True or not, it is a variable retirement services providers need to keep in mind.

Income planning tools can separate fact from fiction specific to personalized estimations on the amount of income Social Security may replace. Built correctly — and intuitively — retirement income planning tools that include Social Security estimations tailored to each individual, and based on demographic data and individual inputs, can add value.

Section IV: Health care expense planning tools

Retirees are a vital component of the overall economy. Without reliable replacement of their working income, it is difficult for that demographic to contribute to economic growth. They won't actively spend when they have concerns about having the means to cover key expenses, such as health care. This is a valid concern because the percentage of healthy households declines with age.



So while tools estimating health care expenses may not traditionally be seen as a responsibility for retirement service providers, evidence suggests otherwise. In fact, nearly half of LIS respondents have interest in access to a tool that offers guidance in this area.

49% show interest in a health care expense planning tool.

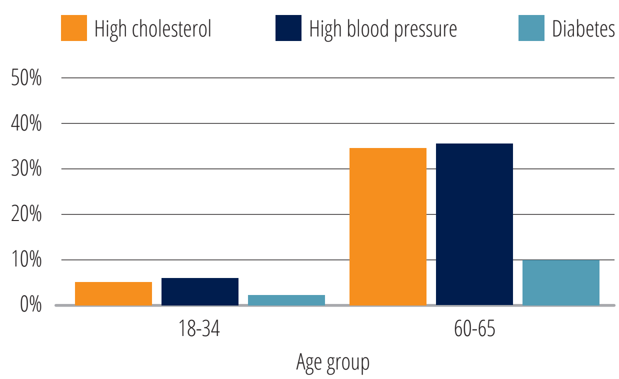
Support for broader availability of health care expense planning tools is further supported by the fact that the LIS report suggests people lack confidence in knowing how much they will need to cover their health care expenses.

Confidence in covering health care costs

(26%) Not at all confident about how much is needed

(38%) Not very confident about how much is needed

Health and wellness and retirement do go hand in hand. As age catches up with people, the expense necessary to control common health-related issues rises. The common diseases below become more likely with age.

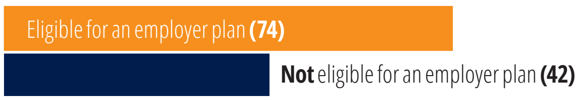


If people have planning tools that help them estimate health care expenses, they gain confidence in how much they can spend on other discretionary purchases. That leads to retirees being a more integral part of economic growth.

Section V: Value of a well-designed workplace savings plan

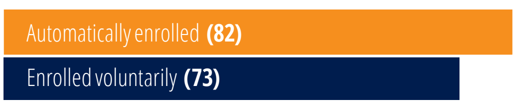
Planning tools lead to engagement. But first, people must have access to a plan at work. LIS results are more than 30 percentage points higher for people who have the opportunity to contribute payroll savings.

Lifetime Income Score: Employer plans



But it's more than just having access to a plan — it's having access to a plan with modern design features, such as auto-enroll and auto-escalation. When people have access to a plan and are automatically enrolled, LIS results move even higher — giving those with an auto-enroll feature a nearly 10 percentage point advantage in LIS.

Lifetime Income Score: Automatically enrolled

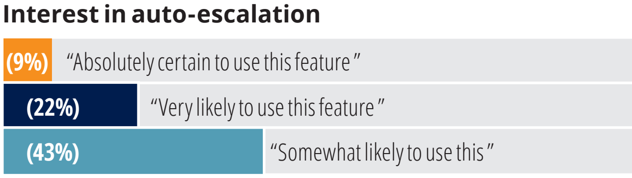


Auto-escalation is another example of how modern plan design positively affects retirement outcomes. It correlates with a LIS that is nearly 20 percentage points higher.

Lifetime Income Score: Auto-escalation

And people who are currently contributing to their plan see value in an auto-escalation program that increases their savings rate up to the IRS maximum. In fact, 74% show some level of interest in using a program that gradually steps up their savings rate.

Interest in auto-escalation



This data helps support a plan sponsor's decision to offer auto-escalation. It removes the perception that people believe this to be an infringement on their own personal choices and decisions.

Section VI: Innovative investment solutions

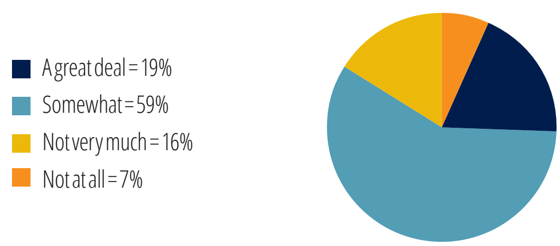
Beyond automatic features, there is growing interest in more innovative investment options, specifically in-plan guaranteed income investment solutions. People recognize the importance of the spend-down phase of their retirement strategy.

And they realize a good thing when they see it. As the graphic below illustrates, 74% have a level of interest in guaranteed income investment options.

Interest in guaranteed income investment options

The opportunity to take advantage of a guaranteed income investment boosts people's confidence in terms of feeling more secure about their retirement income stream. This gives traction to enacting legislation that makes guaranteed income investments easier to provide inside workplace savings plans and approve them as a qualified default investment alternative.

A large majority — 78% — of those surveyed say they would feel more secure about their retirement income if they had a guaranteed income investment option.



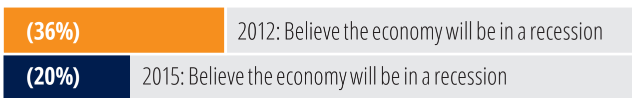
Guaranteed income investments can help people put a strategy in place because they provide the stability of a steady, predictable amount on which to build that strategy.

Section VII: Positive momentum to drive change

The time is right to make workplace savings plans more widely available. The 2015 LIS report shows that optimism as a whole reigns supreme. Positive feelings surrounding the economy and job security are at a peak in comparison to previous years.

A significantly lower percentage of the people surveyed believe that the economy will go into a recession in the next 12 months, compared with three years ago.

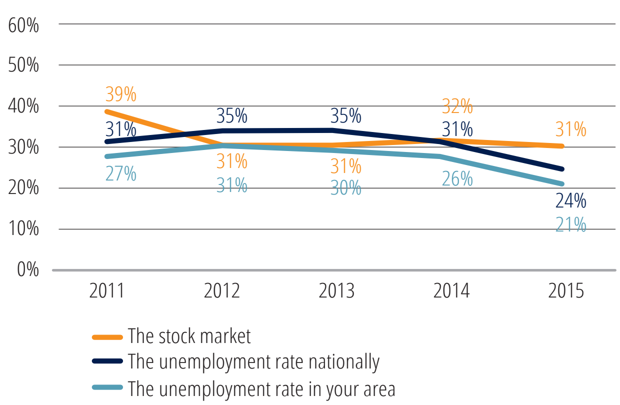
Expect economy to enter recession



Nearly three-quarters of people say that they have very little to no concerns at all about their job security. This also represents positive momentum when looking back at the results three years prior.

Concerned about job security

Beliefs about unemployment also show improvement. People think unemployment rates — both nationally and locally — will trend lower over the next 12 months. At 24% and 21%, respectively, this represents the lowest figure in five years.

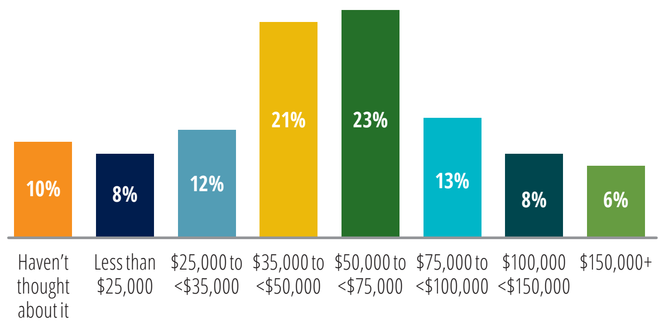


Even as average savings rates remain flat over the past five years — hovering between 12 and 14% — people today have an optimistic outlook relative to the household income percentage they expect to replace in retirement. A mean amount of $68,000 represents 93% income replacement — well above the median 58 LIS.

Target household income in retirement

(Mean $68K replacing 93% of income in retirement)

Thinking realistically, in today's dollars, what would you like your household income to be in retirement?



The good news is that the 2015 LIS report suggest that ways do exist within the workplace savings system to move people toward the outcome they want and deserve.

Conclusion

If there is one finding that leaps out of the data of this year's LIS study — as well as prior years — it is this: Access to a payroll deduction savings plan is the most critical variable in securing retirement readiness. We believe expanding such access to all Americans should be a fundamental goal for everyone involved in U.S. retirement policy.

Beyond simply having a plan at work, that plan's design and the savings rate it leads to are the next most critical drivers of success. Automatic enrollment, annual re-enrollment, automatic savings escalation, and the attainment of savings rates of 10% or more make success much more likely when taken together. Drawing on the advice of a professional financial planner also has a powerful, positive effect.

There will also — always — be a level of responsibility squarely on the shoulders of the American worker. But we believe there is a clear path — with nearly 30 million people on pace for 100 or higher LIS results as evidence — that people can follow to improve their outcome.[1]

Nearly 10 years after the Pension Protection Act of 2006 endorsed auto-features in plan design, the data shows these features work — and work well — to attain the goal the workplace system is meant to achieve: enabling workers to replace their working income — for life. We believe adoption of these design elements should become the industry norm.

All parties engaged in retirement services and policy — advisors, plan sponsors, service providers, regulators and public officials — have the chance now to work toward a tipping point that transforms our workplace savings system into a viable, sustainable solution that delivers security for all.

We believe the path to that goal is clear from the LIS data:

- Make modern, automatic workplace savings plans available to all.
- Lift deferral rates to 10% or higher.
- Promote the value of a professional advisor.
- Offer tools that estimate retirement income and health care costs.
- Provide innovative investment options inside of workplace savings plans.

Americans' optimism is rising. Recovery is finally easing the budget pressures of recent years. Now is the time to recapture the American dream of a dignified retirement that Americans work so hard to earn — and certainly deserve.

1 Source: Based on applying LIS results to U.S. Census data as of 2013

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The Lifetime Income Score℠ represents an estimate of the percentage of current income that an individual might need to replace from savings in order to fund retirement expenses. This income estimate is based on the individual's amount of current savings as well as future contributions to savings (as provided by participants in the survey) and includes investments in 401(k) plans, IRAs, taxable accounts, variable annuities, cash value of life insurance, and income from defined benefit pension plans. It also includes future wage growth from present age (e.g., 45) to the retirement age of 65 (1% greater than the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W)) as well an estimate for future Social Security benefits.

The calculations also take into account mortality rates for a variety of commonly diagnosed health conditions, including high blood pressure, high cholesterol, Type 2 Diabetes, cancer of any type, and cardiovascular disease of any type apart from high blood pressure. In addition, the model also takes into account the consistent use of tobacco on a household basis.

The Lifetime Income Score estimate is derived from the present value discounting of the future cash flows associated with an individual's retirement savings and expenses. It incorporates the uncertainty around investment returns (consistent with historical return volatility) as well as the mortality uncertainty that creates a retirement horizon of indeterminate length. Specifically, the Lifetime Income Score procedure begins with the selection of a present value discount rate based on the individual's current retirement asset allocation (stocks, bonds, and cash). A rate is determined from historical returns such that 90% of the empirical observations of the returns associated with the asset allocation are greater than the selected discount rate. This rate is then used for all discounting of the survival probability-weighted cash flows to derive a present value of a retirement plan.

Alternative spending levels in retirement are examined in conjunction with the discounting process until the present value of cash flows is exactly zero. The spending level that generates a zero retirement plan present value is the income estimate selected as the basis for the Lifetime Income Score. In other words, it is an income level that is consistent with a 90% confidence in funding retirement. It is viewed as a "sustainable" spending level and one that is an appropriate benchmark for retirement planning.

The survey is not a prediction, and results may be higher or lower based on actual market returns.

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