Retirement Adequacy

…has always mattered the most
and can no longer be ignored

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*Please find the ABCorp 401k Plan sheet
and review the instructions.
You'll be asked to follow those instructions shortly.*

Session focus…

How to help
401k novices begin
acquiring the **knowledge** and
personal motivation
to accomplish the **difficult task** of
accumulating enough money for an
adequate retirement income
by **starting early** and
contributing enough.

2

Retirement Education Simulation

Follow the instructions on
the ABCorp 401k Plan sheet.

Toss your savings contributions ball
and hit your target.

3

You just experienced the prevailing approach to 401k retirement education

You had an opportunity to succeed…
But without knowing how
to set and hit your target,
is it really an opportunity?

You had encouragement…
But without it being personally
meaningful, is it really encouraging?

You were told what to do…
But without personal motivation,
is it likely you'll do what you're told?

4

How well has the prevailing approach worked for the past 30 years?

87% of plan sponsors say most
of their employees will ***not*** be
financially prepared for retirement.
(Deloitte/CEBS)

'401k plans are ***not*** working well as
retirement plans.' Fred Reish
(PLANADVISER magazine 'Legend')

5

What's the problem?

Voluntary 401ks are ***ok***…
but if they didn't exist,
bank accounts could work.

Is the critical problem
operator error
…like lecturing novice drivers on physics,
then putting them in race cars and
wondering why they crash?

Could the 401k education be causing
401k operators – employees – to crash?

6

401k education is the largest failure ever of any adult-education effort

The 'best' results are devastating

$400 a month for life

expected for typical *households* headed by employees 55-64 ...with total median balance from all their 401k and IRA accounts.

Does not include households that have no retirement accounts. (Federal Reserve)

$120,000 × *'4% guideline'* ÷ by 12

Worse...about **$200** a month from median balance of *individual* 401k accounts for employees 55-64. (Vanguard)

7

Has 401k ed been done wrong for 30 years?

Fire
some money into a 401k until we're nearly...

Ready
to retire...then we learn our

Aim
was far short of the amount we need...and it's too late to fix it.

A test all employees should pass...

8

What's the highest-priced purchase you'll want to make?

Say you want to spend $**40,000** each year after you stop working at **65**...and you expect to live to **90**.

That's **25** years **x** $**40,000** = $**1,000,000**

'Wow, nobody explained retirement that way before.'

Do you feel the need to *improve* this by using 'the way' that's always been used?

9

'The way' is how the retirement industry ***tells*** people what to do

'The way' hides assumptions about social security, investment performance, pay, longevity and other factors...

to make an indiscernible calculation of a **'precise' number**... **or replacement ratio.**

'The way' does not help employees ***discover*** factors that influence the price...and it's **not personally meaningful** or **motivating.**

10

'The way' is how the retirement industry ***tells*** people what to do

'The way' has failed.

It's information most 401k beginners don't understand, don't find motivating, don't believe and worse – don't use.

To 'the way' defenders: It seems right – but it hasn't worked for 30 years. **How much longer?**

11

How did we get here?

401ks were widely wanted in the early 1980s...

Employers wanted
lower costs, easier admin, relief from DB plans.

Employees wanted
tax-advantages, 'opportunity for $100,000+,' DB plans were under appreciated.

Mutual fund industry wanted
more customers.

12

How did we get here?

In the early 1980s…

The Peter Lynch
Fidelity Magellan Fund era.

From 1977 to 1990, it
beat the S&P 500
11 out of 13 years
and averaged
29% annual growth.

That's what everyone wanted.

13

With a few keystrokes …and ***no sinister motives***

14

401ks were built with parts that are unfamiliar to most employees

supplemental thrift plans
…the 'dessert' of the
DB pension 'full-course meal.'

mutual funds
…for people with pensions,
above-average wealth and
basic understanding of investments.

15

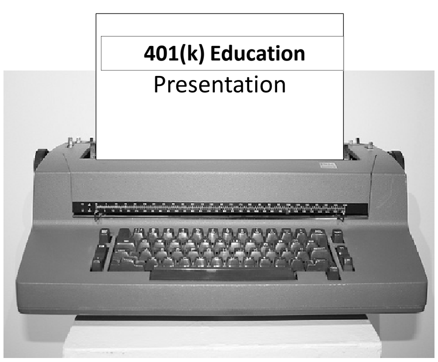
The trend quickly became the norm

In early 1990s…
401ks surveyed for 'best practices' –
'benchmarked' with other employers'
plan provisions and **services.**

Employee **outcomes**
never the focus of 401k
designs, regulations or
retirement education.

16

401k ed was created from mutual fund sales – **not adult education**



17

401k ed was created from mutual fund sales – **not adult education**

When 401k education was created…

Not pilot tested.

Not modeled after successful programs.

Not designed using adult-ed principles.

Not based on competencies needed to operate a 401k successfully.

Not equipped with success testing tools.

And that's how it stayed…employers rationalized, 'It's how the retirement industry says to do it…and it's *free*.'

18

401k ed was created from mutual fund sales – **not adult education**

Fund sales presentations were…

- Designed to sell funds to motivated, financially savvy customers who had pensions.
- Based on the selling approach of experts ***telling*** people what to do.

Unfortunately…

19

'Telling' is ***ineffective*** for unmotivated, non-financially savvy adults …most young employees

2400 years ago, Socrates demonstrated ***telling*** doesn't create learning.

Today, adult-ed experts say **'telling isn't teaching'** …adults must be motivated to learn.

20

'Telling' is ***ineffective*** for unmotivated, non-financially savvy adults …most young employees

'Questions are places in your mind where answers fit. If you haven't asked the question, the answer has nowhere to go.

You have to want to know the answer.'

Clay Christensen
(Harvard Professor, Awarded #1 Management Thinker in the World)

21

'Telling' is ***ineffective*** for unmotivated, non-financially savvy adults …most young employees

Rather than tell people what to do, head of Financial Engines' research center says,
'The best way to set a retirement target is to imagine your future….'
(J. Scott, Financial Engines – largest independent investment advisor)

Asking yourself, 'How much income will I want when I end my full-time career?' is more meaningful than having an expert tell you.

22

'Telling' is ***ineffective*** for unmotivated, non-financially savvy adults …most young employees

'Unsolicited advice has **no** causal effect on investment behavior – yet individuals who actively solicit advice (ask for it) ultimately improve performance.'
(Hung and Yoong, RAND Corporation)

If workers are not motivated to know about building retirement accounts, telling them how is a waste of time.

Quiz: How many workers use free online advice when it's offered? (AON Hewitt)
● 6% __16% __26% __36% __50+%

23

Questions… if you were responsible for ***Your Personal Pension Plan***?

What if I was 65 and expected to live on \$100,000 for 25 years…to 90?

Say I put it in a bank CD (FDIC protection)…and it earns the same rate as inflation.

If I divide 25 years into \$100,000 …that is \$ **4,000** buying power a year… \$ **333** a month?

Advice…or just questions?

Example 24

Behavioral finance is insightful… but can naive employees be 'nudged' to success?

Auto-enrollment is 'anchoring' employees.
70% auto-enrolled at **3%.** (Mercer)
40% would elected higher rate! (AON Hewitt)

Employee with no idea of her retirement cost…auto-escalated to 12% contributions…learns if she drops to 6% (gets full match) has extra $200 a month to buy her Ford Mustang dream car…rather than a Ford Fiesta.

25

New retirement world reality

Individual employees are fully responsible for their own adequate retirement income.

After trying everything else – 'telling,' auto-everything, nudging etc. – isn't it time to help 401k beginners acquire the motivation and knowledge to build the retirement income they want?

26

There's proof I don't know exactly what I'm talking about

Apparently, no one does.

'…a systematic method of evaluation of financial literacy programs (retirement education) does not exist.'
(Financial Literacy and Education Commission)

There is no universal definition of retirement education, and no agreed-upon content.

27

If retirement adequacy is part of the purpose of your plan…

Plan sponsors have the obligation to ask education providers… 'When the education you provide is working well, what will employees know and how will it be measured?'

Otherwise, how can you measure progress of employees and value the provider?

28

If retirement adequacy is part of the purpose of your plan…

My definition:
'Ensure employees before age 30* acquire the basic knowledge needed to begin using a 401k successfully.'
* 25 would be better.

Education providers should have their own definition.

29

Achieving retirement adequacy is about achieving <u>a personal goal</u>.

Humans do not voluntarily achieve **difficult** personal goals they have not personally set**.**

How difficult?

80% of financial pros say save **17%** – including employers' $ – throughout working career. (Principal Financial)

Wait to age 45, save **31**%. (Center for Retirement Research)

Quiz: Why don't 401k ed programs help workers discover the price of their retirement?

30

Benchmark 401k ed with winners

People who accomplish difficult things – run marathons, climb mountains, earn advanced degrees, save lots of money – have:

1. **A specific, personal, meaningful goal** that they understood, defined and measured…and over time, improved with advice they trusted.
2. **Desire and motivation** to learn, improve and do what's necessary to achieve the goal.

31

Benchmark 401k ed with winners

Successful people have:

3. **Meaningful learning experiences** to understand the content and to trust the new knowledge they acquire.
4. **Confidence** they can succeed – but realistic assessment of the difficulty …believing it's easy significantly increases odds of failure. (Harvard)
5. **Perseverance** to keep doing what's difficult when things get tough.

Is your 401k ed program instilling what winners have?

32

What can employees do using 401ks?

In simple, practical terms…

Price – define the financial lifestyle they want and the account balance it costs.

Contribute – fund the account to buy that lifestyle.

Invest – help fund the account.

Receive – create an income flow to last a lifetime.

It's what actuaries and fund managers do for DB plans…now employees are responsible to do it for their 401k – an **individually defined benefit plan.**

33

Helping employees discover the **price** of retirement adequacy

Most people know how much they spend and what things costs.

Use that to help them discover their realistic, personally meaningful price for retirement…

what 70% admit they've never tried to calculate or guess.

(about half who say they tried cannot state any amount)

(Lusardi & Mitchell)

34

Discovering the price

Imagine you're 'fast forwarded' to your last day of full-time work – and things cost the same as today:

How much do I want to spend each year…….$_______

Compared to today, the same, more, or less?

How many years might I need the income.….x _______

Example: Age 65 to 90 = 25 years

My personal estimate…$_______

Is this advice…or just questions?

Is it realistic?

Is it more meaningful than an expert's replacement ratio?

'But it's not precise!!!'

Example 35

'How much money will I need?'

Unfortunately, if you're run over by the party bus at your 'last day of full-time work' celebration, you'll need around **$0** future income.

Or…

36

‘How much money will I need?’

If you want generally the same standard of living that you have now…and you stop working full-time at 60 and live to102 (42 years), you may need **more money than you made in your entire working career.**

One million Americans in their 50s today are expected to reach 100. (National Institute on Aging)

37

Getting 20 and 30 year-old employees started?

All are important…

Price Contribute
Invest Receive

Which is the least important for 401k beginners?

Which is emphasized the most?

Is it because it’s most interesting to the people hiring the education provider…and to the person delivering that content?

38

Getting 20 and 30 year-old employees started?

Investing doesn't matter as much as:

Price – no personally defined account target = no personal motivation.

Contribute – no contributions = nothing to invest…early on, contributions grow accounts more than investments.

Receive – no knowledge of how long account will last = no understanding of how much to save…or why not to take money when changing jobs.

39

Contributing trumps investing

Morningstar…

‘The most important thing we can do is encourage participants to save more.’

Putnam Investments…

‘Saving more is the most powerful way to end up with more. Searching for the perfect fund or allocation is a far less effective approach.’

Simple math…

For a 401k beginner earning $30,000 with $6,000 account:

2% bigger contribution ($600)
5% higher earnings ($300).

40

What would the inventor of Modern Portfolio Theory do?

Dr. Harry Markowitz – how he invested for retirement…

‘I visualized my grief if the stock market went way up and I wasn’t in it – or if it went way down and I was completely in it…so I split my contributions 50-50 between bonds and equities. I wanted to minimize my future regret.’ (TheStreet.com)

He won a Nobel prize for his theory …but didn’t use it for his investments.

41

Helping employees discover how much to **contribute** today

Perhaps the hardest to simplify.

One way…set account target, then estimate how much needs to be contributed each year.

Early in careers, employees may not be able to contribute the calculated amount…but is it a realistic amount?

Employees with big expectations may need added investments outside a 401k.

42

Discovering how much to contribute

You can roughly estimate annual contribution by dividing your target by the number of years you expect to work full-time.

Let's say Taylor intends to work full-time to 70 ...is currently 30...and has a target of $300,000.

70	minus	30	equals	40	divided into	$300,000	equals	$7,500
age to end full-time work		current age		years remaining		Savings & Investment Target		estimated annual contribution

Good news – employer contributions!

Plus possible compound earnings, larger contributions later in career and...calculators.

43

Helping 401k beginners put **investing** in perspective

Provide basic information about stocks, bonds and cash.

Focus on what employees control: contributions and diversification ...but not market changes.

44

Why 401k beginners need to know about **retirement distributions**

Knowing how much income account can likely pay for a lifetime helps employees understand the size of the account they'll need.

Many experts say withdraw only **4**% of initial balance to have lifetime income.

Most people think **10**% is ok. (Wells Fargo)

It's tough to understand – even Peter Lynch said 7%...then 5% when the Trinity Study showed 4%.

Shouldn't employees discover this at 30 – not 65?

45

Remember this?

Say you expect to live on $100,000 for 25 years. If you divide 25 into $100,000 you get **$4,000** a year.

Coincidently, what percent is that?

$4K ÷ by $100K is **4** %

By helping employees discover $100K provides about $4K a year, perhaps they'll wonder... 'Gee, how many $100k accounts will I need to provide the lifestyle I want?

Asking questions makes room for answers.

46

They **can** handle the truth

In today's economy, now is not a good time for employees to discover the enormous price of retirement

...but now is better than later.

The current approach of hiding the realist cost of retirement is cruel. It steals employees' time and opportunities to save that they can never get back.

47

They **can** handle the truth

'Rather than giving up, workers who have calculated how much they need are more likely to be very confident about having enough money than those who have not made a calculation.

44% of those who make a calculation took action...59% of them saved more.' (EBRI/MGA)

48

They **can** handle the truth

74% of employees plan
to work longer
to make up for small accounts
…but that might not happen.

45% of retirees were forced
to retire early (63% health reasons,
23% job vanished, 18% family matters)

Only 23% of current retires
actually work (health, job issues, etc.)
(EBRI/MGA)

49

Many essential adult education elements are missing from 401k education

To succeed, content must be:
- received by motivated learners,
- trusted,
- believable based on their experiences and knowledge and
- explainable by the person receiving it.

50

Many essential adult education elements are missing from 401k education

The most powerful ingredient in
adult learning is… **motivation**

Experts ***telling*** <u>un</u>motivated employees,
'Here's your Monte Carlo simulation…
your replacement ratio…
your gap-analysis…or ***advice***'
may be perfect information.

But because it won't be used,
it's nearly worthless.

Yet it's invaluable when motivated
learners **ask** for this information.

51

If employees don't trust the messenger, will they trust the message?

Employees trust…

3% say investment companies.

85% say their employer has
their best interest in mind. (EBRI/MGA)

Are trusted messengers
sending your 401k messages
and offering advice?

52

Content must be understood by the people receiving it

It must make sense to the
'non-math fluent'…those of us who
struggle to figure a gratuity.

In basic retirement education,
allow only simple explanations
that employees are
able to explain back to you.

Build on what employees know
…simple math and life experiences
like shopping and buying things.

53

Content must be understood by the people receiving it

Why not show how buying future
financial income is like other purchase:

Retail price – total needed if
'fast forwarded' to your last day
of full-time work.

Discounts – amounts already paid
(current savings, projected pensions,
saleable assets, social security and any pay
earned working after your full-time career).

Layaway payment – additional
amount needed to purchase your
future income target.

54

Your financial future…a realistic guesstimate

Your estimated ***retail price*** of future lifestyle income

$48,000 **annual spendable**	**X**	25 **years**	**=**	$1,200,000

Your estimated ***discounts*** – what's already paid

- Current single sums (401k, personal savings, etc.) – $54,000
- Lifetime payments (pensions and social security)

$19,000 **annual benefit**	**X**	25 **years**	**=**	– $475,000

Your estimated additional ***layaway*** **=** $671,000

Is this a realistic estimate that's personally meaningful and understandable…that they could explain back?

Still think 'the way' is better for 401k beginners?

What can you do to strengthen retirement adequacy in your 401k?

What you can do

Key Step – Require educators to ensure every employee over age 25 can answer and explain:

1. What's the realistic **estimated dollar amount** I'll need to have the **future financial lifestyle I want**?
2. How much money should I be **contributing today** to reach my goal?
3. How should I be **investing** to help reach my goal?
4. How will I make sure **following my full-time career that income from my account will last as long as I live**?

What you can do

2. Require educators to define 'what's the ***least*** 401k beginners must know to get a good start building the realistic financial future they want?' And how that will be measured.
   Consider a Retirement Education Policy Statement (Ackley, *Plansponsor* magazine, Feb. 2002)
3. Celebrate progress – recognize employees who have set realistic account targets – pins, ribbons, certificates or cash.
   (you don't need to know the amount)

What you can do

4. Ask the provider for proof their teaching techniques work (or hire adult-ed expert for review) – at least Google 'adult education principles' to see if any are in your 401k ed.
5. Involve your financial staff in evaluating *investment* ed and advice for employees over 35 or with $35K accounts…but not 401k novices.

What you can do

6. Ask providers how they ensure employees trust the provider's people and materials.
7. Make retirement communication upbeat and positive – but eliminate 'saving is fun and easy' messages
8. For plan success measures, use median ($12,655 – 50% above / 50%below) Avoid averages (about $46,000). (EBRI)

What you can do

9. Discuss incentive fees: full fee if certain success is reached, X% less if not, X% bonus if exceeded.
10. Offer professional advice to help the motivated learners become more sophisticated retirement income consumers and investors – but it will not help unmotivated learners.

61

What you can do

11. Avoid math and numbers concepts that are not understood – and cannot be explained – by all your employees. They deserve to know how to buy the future lifestyle they want – not just math and finance majors.
12. If most employees do not know how to operate a 401k successfully, ask senior leaders if they believe the organization has any responsibility?

62

In closing…

Don't ***tell*** employees what to do
…help them discover it.

Be open to ideas…at least 'new ways' are not proven failures.

Before releasing any 401k communication, know answer to;
'How will this help us end up with more 35-year-olds – and fewer 55-year-olds – with $50,000 balances?'

63

In closing…

Make this pledge:

By this time next year,
every employee I want to help
achieve an adequate
retirement income
will have a personal
and realistic answer to;
'When my full-time career ends,
how much income will $100,000
likely provide each year
for as long as I live?

64

Retirement Adequacy

…has always mattered the most
and can no longer be ignored

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