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.

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Retirement Education Simulation

Follow the instructions on
the ABCorp 401k Plan sheet.

Toss your savings contributions ball
and hit your target.

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You just experienced the prevailing approach to 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?

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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')

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What's the problem?

As ***voluntary*** plans go, 401ks are ***ok***…
even bank savings accounts
could work for retirement.

Is the critical problem
operator error
…like lecturing inexperienced 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?

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

The 'best' results are devastating

$400 a month

can be expected for typical *households* headed by employees age 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 times '*4% rule*' divided by 12

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

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Has 401k retirement 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...

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What's the highest-priced purchase you may ever make?

Say you want to spend $**40,000** each year after you stop working at age **63**...and you say you expect to live to age **88**.

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 example by using 'the way' that's always been used?

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

'The way' it's been done ***hides assumptions*** about social security, pay, investment performance, longevity, inflation, and other factors...

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

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

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Because '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.

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How did we get here?

Everyone wanted 401ks in the early 1980s...

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

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

Mutual fund industry wanted more customers.

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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.

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With a few keystrokes ...and ***no malice***

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401ks were built with parts most employees are not accustomed to using

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.

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The trend quickly became the norm

In early 1990s...
401ks were being surveyed for
'best practices'...and 'benchmarked'
based on other employers'
plan provisions and services.

Employee **outcomes**
have never been the focus
of 401k plan designs,
federal regulations or
participant education.

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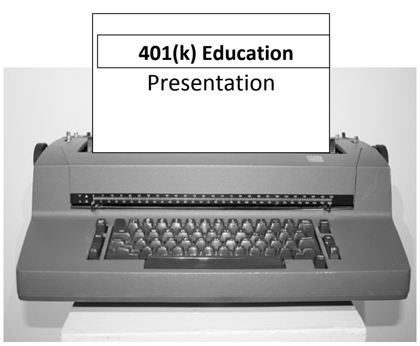
401k retirement ed was created from mutual fund sales – not adult education



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

When 401k retirement ed started

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.

That's how it stayed...employers rationalized, 'this is how the retirement industry says to do it...and it's *free*.'

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

Fund sales presentations were:

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

Unfortunately...

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'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.

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'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)

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

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

Asking yourself how much income you'll want when you end your full-time career is more meaningful than having an expert tell you.

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'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? (Hewitt)
● 6% __16% __26% __36% __50+%

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Questions... what if you were responsible for the ***Personal Pension Plan for You*** ... a 401k or 403b account?

What if you were 65 and expected to live on $100,000 for 25 years...to age 90?

Let's say you put it in a bank CD to get FDIC protection...and it earns about the same rate as inflation.

If you divide 25 years into $100,000... that's $ **4,000** buying power a year... and that's $ **333** a month?

'How many $100,000 accounts do think you'll need to have the future lifestyle you'll want?'

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 who has no idea of the cost of retirement has been 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.

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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?

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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.

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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 the progress of your employees and the value the provider?

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.

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Achieving retirement adequacy
is about achieving a personal goal.

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?

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Benchmark education with what winners have

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, to improve and to do what's necessary to achieve the goal.

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Benchmark education with what winners have

Successful people have:

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

Is your education program instilling what winners have?

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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.**

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

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

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've tried cannot state any amount)

(Lusardi & Mitchell)

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Discovering the price

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

How much do you want to spend each year.….$_______
Compared to today, the same, more, or less?

How many years might you need the income…X ______
Example: Age 65 to 90 = 25 years

Your personal estimate…$_______

Is this advice…or just questions?

Is it realistic?

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

Is it 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…

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‘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)

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What matters most in 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?)

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What matters most in 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.

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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).

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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.

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

Perhaps the hardest to simplify.

After setting an account target, employees can estimate how much needs to be contributed each year.

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

Employees with big income expectations may need additional investments outside the 401k.

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Discovering how much to contribute

You can roughly estimate how much to contribute each year 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 possibility of compound earnings...and your larger contributions later in your career.

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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.

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

Knowing how much income an 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 learn this at 30 – not 65?

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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.

What percent is $4,000 of $100,000?

($4,000 divided by $100,000 is **4** %)

By helping employees discover $100,000 is expected to provide about $4,000 a year ($333 a month), you can ask, 'How many $100k accounts do you think you'll need to provide the lifestyle you'll want?'

Advice...or just a question?

Many essential adult education elements are missing from today's retirement education

To succeed, content must be:

- received by motivated learners (***you cannot teach unmotivated adults***),
- trusted,
- believable based on their experiences and knowledge, and
- explainable by the person receiving it.

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Many essential adult education elements are missing from today's retirement education

What's the most powerful ingredient in adult learning? **Motivation**

Experts ***telling*** unmotivated employees, 'Here's your Monte Carlo simulation... your replacement ratio... or your gap-analysis calculation' may be perfect information.

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

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

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

What organizations do 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?

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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.

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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)

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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)

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Content must be understood by the people receiving it

Monte Carlo simulations and efficient frontier plot points are effective with financial pros.

But they aren't the ones attending basic 401k presentations.

Shouldn't plan sponsors fire any retirement educator who is telling ***401k beginners*** about efficient frontier…alpha…beta…yield… Sharpe ratio…present value…P/E… dollar-cost averaging…or any investment terms requiring a glossary?

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Content must be understood by the people receiving it

It must make sense to people 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.

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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.

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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 good for 401k beginners?

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Advice

Most employees will need advice …but it's valuable only if it's used.

Advice must be sought (pulled) …pushing it doesn't work.

If we help 401k beginners succeed in building sizable accounts and becoming more sophisticated retirement income consumers… will they see the value in professional advice – and want to use it?

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

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What you can do

Key Step: Commit that 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**?

Require your educators make this happen.

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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 will that be measured?
3. Hire an adult ed expert to assess the program's techniques or ask the provider for proof their teaching techniques work…or at least Google 'adult education principles' to see how many are used in your retirement education.

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What you can do

4. Involve your financial staff in evaluating *investment* education and advice for employees over 35 or who have $35,000 accounts… but not for 401k beginners.
5. Ask your provider how they ensure employees trust the provider's people and communication materials.
6. Send employees missing the full match a 'how much did you lose by not contributing 6% each paycheck?' letter.

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What you can do

7. For plan success measures, use midpoints / median ($12,655) – half have less…half have more. Avoid averages (about $46,000). (EBRI)
8. Discuss incentive fee performance levels…for example, full fee if certain success level is reached, X% less if not, X% bonus if exceeded.
9. If most of your employees do not have the knowledge needed to operate a 401k successfully, ask senior leaders and ERISA counsel if the organization has any responsibility…or liability?

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In closing…

Focus on getting more 35-year-olds – and fewer 55-year-olds – with $50,000 balances.

Celebrate progress – recognize employees who have set their realistic account targets –
(you don't need to know the amount)
award pins, ribbons, certificates or cash.

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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.

If the current voluntary 401k approach to employer-sponsored retirement plans can not provide success for the majority of employees, don't we need to find one that will?

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

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