Driving stronger plan outcomes through income replacement metrics

Your plan's income replacement ratio shows how well your employees can replace their current paycheck after retirement.

For employers and employees alike, the stakes for retirement planning are high. How can you tell if your retirement plan measures up, and whether you are most effectively using your time and resources to improve retirement outcomes for your employees?

Here's a look at how to gauge your plan's progress more precisely through a metric that measures your employees' projected level of retirement income.

How to measure retirement readiness

The main objective of any retirement plan is retirement readiness, or how well your employees are financially prepared to live after they stop working. It's not about building the biggest nest-egg, but rather about employees replacing enough preretirement income to cover monthly expenses and still living comfortably throughout retirement.

A plan's income replacement ratio can help you determine whether your employees are on track to meet their retirement income goals. It shows how well an individual employee can replace his or her current paycheck after retirement. Yet, only 25% of plan sponsors measure income replacement.[1]

Your plan's income replacement metrics should go further by distinguishing between how much income comes from guaranteed sources—such as Social Security and annuities—and from other investment options that aren't guaranteed. As a goal, your employees should target replacing between 70% and 100% of their preretirement income, with at least 50% coming from guaranteed income sources.

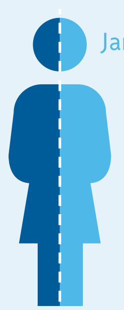
Calculating the income replacement ratio

The math behind the ratio is simpler than it sounds. The following example explains how it's calculated.

Assume Jane earns $60,000 annually before retirement and is on track to receive $51,000 annually from Social Security and other retirement income.[2] Her replacement ratio is 85% which falls within the recommended range.

Jane

Preretirement income **$60,000**



Retirement income **$51,000**

Recommended income replacement ratio
70%–100%

Jane's income replacement ratio
$51,000/$60,000=85%

Having a focused and comprehensive way to assess your employees' retirement readiness and your overall plan performance are key to meeting your retirement plan's goals. [Learn more about TIAA's approach to assisting you with your plan's health].

How can you improve plan and employee outcomes?

By measuring the income replacement ratio, you'll gain insight to where you should be directing resources to help improve retirement outcomes. There are four main drivers you can focus on to improve plan health and employee financial well-being:

1. Plan Management—It's critical for you to have a clear understanding of your retirement plan's goals. Measure progress by how well employees will be able to replace their income in retirement. Work with plan providers to compare your plan to peer institutions.

2. Plan Design—Reconsider your plan's design to drive better outcomes for employees and possibly reduce costs. Plan providers can show you how changing the vesting schedule, or adding a match or auto-enroll feature can help you encourage plan participation and savings rates. These changes can help strengthen your plan and support employees' lifetime income needs.

3. Investment Solutions—The investment menu your plan offers should include a wide range of investment options with various levels of risk, from higher risk/higher growth investment products to more conservative lifetime income solutions, such as fixed annuities. You can also work with your plan provider to evaluate how well your employees are doing in building a diverse portfolio.

4. Employee Engagement—You can measure the effectiveness of your plan by understanding how your plan management, design and investment choices are motivating your employees to take action. Looking at employee data and key indicators, like the income replacement ratio, can help you identify employees that are on track to meet their retirement income goals and those that need more help. You can then customize your engagement efforts based on employee needs and preferences.

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[1] Source: Rebecca Moore, Plan Benchmarking Measures, PlanSponsor Magazine, February 2015.

[2] Both Jane's pre- and post-retirement income are after taxes.

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