



Hewitt Associates LLC

# Three Generations Prepare for Retirement

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# Three Generations Prepare for Retirement

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The retirement system is evolving. As defined contribution plans become increasingly central to employees' retirement income security, more responsibility for retirement financial preparedness is shifting directly to employees. Whereas employees may have once been able to rely heavily on pension plans and retiree medical benefits, in employer-sponsored retirement programs of the future, workers' own savings are becoming increasingly critical to retirement success. Such changes to the employer-sponsored retirement system are likely to affect many workers—but to different degrees. Younger workers are more likely to find themselves relying primarily on their own savings than older workers. Newer employees may find that the retirement benefits available to longer-tenure workers (that may sit in cubicles right next to them) are no longer part of their own retirement equation.

In this analysis we examine employee actions and employee sentiment with regard to retirement saving and investing across three generations: Baby Boomers, Generation X, and Generation Y. This analysis is based on four recent Hewitt reports: 1) *How Well are Employees Saving and Investing in 401(k) Plans*, which examines the actual saving and investing behavior of 2.5 million employees eligible to participate in defined contribution plans, 2) *Employee Perspectives on Retirement Saving and Investing*, a survey of more than 3,500 employees eligible for defined contribution plan participation, 3) *Total Retirement Income at Large Companies: The Real Deal*, which provides data on projected retirement income levels for 1.8 million employees, and 4) *Your Future Financial Security*, a survey of more than 600 employees eligible for defined contribution plan participation.

The findings show that each generation faces its own challenges in preparing for retirement.

## Overview of the Generations

### Baby Boomers (Ages 42–59)

With retirement so close, Baby Boomers are more prone to participate in their 401(k) plan than workers of other subsequent generations. They are also more likely to contribute at greater levels than either Generation X or Generation Y workers. However, more than a quarter of Baby Boomers still fail to contribute to their 401(k) plan—and the median plan balance accumulated by Baby Boomer participants is just \$44,330. What is getting in the way of retirement saving? More than two-thirds (67%) of Baby Boomers say that day-to-day expenses provide an obstacle for saving for retirement. Nearly half (47%) say that saving for emergencies gets in the way of retirement saving. Nonetheless, most Baby Boomers are thinking about retirement saving a great deal or sometimes (81%).

Baby Boomers who are not saving should do more than think about it: A full-career Baby Boomer, who has worked at a large employer for 30+ years, and who is nearing retirement (age 55-59) is projected to be on track to replace 88.4% of income through the defined contribution plan and with

Social Security. However, if this same individual had never contributed to the 401(k) plan, projected income replacement drops to 61.5%. Younger Baby Boomers (45-49) who expect to work for a large employer and contribute to their 401(k) plan throughout their career are projected to be on track to replace 86.8% of preretirement income in retirement. However the average younger Baby Boomer who does not contribute to the 401(k) plan may expect to replace just 43.8% of preretirement income in retirement.

With 41% of Baby Boomers expecting to retire within the next ten years, the other significant challenge for this generation is transitioning from the accumulation to the disbursement phase. Most (91%) of Baby Boomers plan to support themselves during retirement through their company-sponsored retirement savings plan. Most (91%) also expect to rely on other investments, and about three-quarters expect to receive income from a pension (73%) and/or from Social Security (78%). More than two-thirds (69%) of Baby Boomers are somewhat or very confident that they will be able to maintain their preretirement standard of living in retirement—making this group the least confident of the three generations.

### **Generation X (Ages 26–41)**

Over one-third (37%) of Generation Xers are not saving in their 401(k) plan, and when they do save, their rate of contribution is lower than Baby Boomers (7.2% versus 8.5% respectively). The typical 30-34 year old workers can expect to replace just 44.1% of income in retirement if he or she is not saving in the 401(k) plan (and does not expect to have defined benefit income). In contrast, if that same worker did contribute to the 401(k) plan, the projected retirement income replacement rate jumps to 95.7%. Generation Xers are more likely to admit that they are not saving enough than are Generation Y workers. They are also less likely to say that actively managing their retirement account is not a priority (14%). However, they are more likely than any other generation to say that saving for their children is a priority that gets in the way of retirement saving (53%). Saving for a home purchase is also more likely to get in the way of retirement saving for this generation than for Baby Boomers (31% and 15% respectively).

Like Baby Boomers, Generation Xers expect to rely on their employer-sponsored savings plan in retirement, with 93% noting this as a source of potential income. Even more—96%—believe they will support themselves through other investments in retirement. Fewer Generation Xers expect to rely on a pension plan or Social Security than Baby Boomers—still the majority do view these as sources of retirement income (66% and 60% respectively). Nearly two-thirds (61%) of Generation Xers believe they will support themselves through savings they will put away at a later date. Despite greater reliance on their own savings and less reliance on Social Security and pension income, Generation Xers are more confident than Baby Boomers that they will maintain their preretirement standard of living in retirement (76% are somewhat or very confident).

### **Generation Y (Ages 18–25)**

Only 31% of Generation Y employees who are eligible to participate in their employer-sponsored 401(k) do so. The average Generation Y participant contributes just 5.6% of pay—less than is required to obtain the common full company match of 50 cents on the dollar up to 6% of pay. Not only is the typical Generation Y worker less likely to invest in the 401(k) plan, he or she is also unlikely to save outside of the plan: only 10% of Generation Y workers say they have an IRA (compared to 39% of Baby Boomers and 31% of Generation Xers). More than a quarter (28%) of

Generation Y workers don't know if they are saving enough in their plan. And 63% say they don't have enough information and really don't know what to do to actively manage their retirement account. Lack of urgency and other priorities top the list of things that get in the way of the typical Generation Y worker's efforts to save for retirement. More than three quarters (78%) of Generation Y workers say that day-to-day needs provide an obstacle to retirement saving, and 61% say that lifestyle purchases do. Generation Y workers are more likely to put off saving because they believe they have more important goals (28%) compared to other generations, and they are more likely to say that they are not in a situation to save for retirement (36%). The typical Generation Y worker who is not saving in his or her 401(k) plan is projected to replace just 43% of income in retirement (without a defined benefit plan).

Nonetheless, this generation is more likely than other to believe that it will maintain its preretirement standard of living in retirement (89%), suggesting that distant proximity results in greater confidence. Indeed, many Generation Y workers believe that retirement will be funded by savings they put away at a later date (81%). Unsurprisingly, fewer in this generation believe they will fund retirement through pension income or through Social Security—although the majority are still expecting income from these sources (64% and 57%, respectively). Like Baby Boomers and Generation Xers, almost all Generation Y workers believe they will fund retirement through their company-sponsored retirement savings plan (92%).

### Three Generations of Defined Contribution Plan Utilization

Proximity to retirement is positively related both to participation and contribution levels, with Baby Boomers being the most likely to save and saving at the highest levels, followed by Generation X and Generation Y.

#### Participation Rate

Generation	Participation Rate
Generation Y	31.3%
Generation X	63.1%
Baby Boomers	72.0%

*Source: How Well Are Employees Saving and Investing in 401(k) Plans, 2005*

#### Contribution Levels

Generation	Contribution Levels
Generation Y	5.6%
Generation X	7.2%
Baby Boomers	8.3%

*Source: How Well Are Employees Saving and Investing in 401(k) Plans, 2005*

Despite recent efforts to catch up, the median Baby Boomer participating in a 401(k) plan has still managed to save only \$44,330 for retirement in their current 401(k) plan. Meanwhile, those participating in a 401(k) from Generation Y—while very confident about their prospects for maintaining their preretirement standard of living—have currently amassed a median plan balance of just \$1,280.

### **Total Plan Balance**

<b>Generation</b>	<b>Average Total Plan Balance</b>	<b>Median Plan Balance</b>
Generation Y	\$3,200	\$1,280
Generation X	\$31,240	\$14,730
Baby Boomers	\$93,190	\$44,330

*Source: How Well Are Employees Saving and Investing in 401(k) Plans, 2005*

Despite their longer time to retirement, Generation Y investors typically have a higher allocation to fixed income investments than do Generation X investors—suggesting less investment confidence. Meanwhile, despite their greater proximity to retirement, Baby Boomers hold about the same allocation to company stock as do other generations—26% of total balances, or 38% of equity balances.

### **Asset Allocation**

	<b>Fixed Income</b>	<b>Diversified Equity</b>	<b>Company Stock</b>
Generation Y	34.7%	37.8%	27.3%
Generation X	26.6%	47.0%	26.5%
Baby Boomers	31.4%	42.1%	26.3%

*Source: How Well Are Employees Saving and Investing in 401(k) Plans, 2005*

## Three Generations of Views on Retirement Saving

Not surprisingly, those closest to retirement—the Baby Boomers—are most likely to think about retirement saving a great deal or sometimes. In contrast, 56% of Generation Y workers say they rarely or never think about retirement saving.

### Thinking About Retirement Saving

	Baby Boomers	Generation X	Generation Y
I think about my retirement savings a great deal	40%	21%	13%
I think about my retirement savings sometimes	41%	55%	30%
I rarely think about my retirement savings	12%	21%	43%
I never think about my retirement savings	6%	3%	13%

*Source: Your Future Financial Security, 2005*

All three generations struggle with meeting day-to-day needs, and report this as the most common deterrent to retirement saving. However, Generation Y also finds lifestyle purchases get in the way, followed by saving for a home purchase. Generation X, in contrast, is most commonly struggling to also save for their children (e.g., college education). Saving for emergencies is the second greatest deterrent in retirement saving for Baby Boomers.

### What Gets in the Way of Retirement Saving?

	Baby Boomers	Generation X	Generation Y
Day to day needs	67%	71%	78%
Lifestyle purchases	40%	46%	61%
Saving for home purchase	15%	31%	45%
Saving for emergencies	47%	49%	38%
Saving for children	40%	53%	21%
Saving for other investments	24%	30%	23%

*Source: Employee Perspectives on Retirement Saving and Investing, 2004*

All three generations struggle with finding enough time to actively manage their retirement account, and have concerns about stock market volatility. Generation Y most commonly notes that active management of their retirement account is prevented by lack of information and knowledge. This is also high on the list for Generation X and Baby Boomers, however Generation Y is more likely than others to admit that retirement saving is just not a priority for them.

### **What Prevents Workers From Actively Managing Their Retirement Account?**

	Baby Boomers	Generation X	Generation Y
It is a priority for me, but I just don't have the time to focus on it	39%	46%	40%
It is not a high priority for me right now	9%	14%	27%
I don't have enough information and really don't know what to do	44%	47%	63%
I am worried because of the recent ups and downs in the stock market	44%	44%	38%
The plan is difficult to access to make changes	9%	8%	8%
The investment fund choices are too complicated in my savings plan	14%	14%	11%
There aren't enough investment fund choices in my savings plan	10%	8%	10%
Other	6%	6%	4%
None of the above—I invest well in my savings plan through my own efforts	21%	16%	14%
None of the above—I receive outside help in investing in my plan	11%	12%	10%

*Source: Employee Perspectives on Retirement Saving and Investing, 2004*

A majority of workers in all three generations find that other financial obligations rank higher in priority than contributing to the retirement savings plan. Generation Y is materially more likely than Generation X or the Baby Boomers to say that they are not in a situation to save for retirement. Meanwhile, Generation X and the Baby Boomers are materially more likely to cite worries about the market as deterrents to higher contribution levels.

### **Reasons For Not Contributing More or Contributing at All to Savings Plan**

	<b>Baby Boomers</b>	<b>Generation X</b>	<b>Generation Y</b>
I am worried because of the recent ups and downs in the stock market	40%	32%	16%
I do not have enough information to know how much to save	22%	27%	35%
Other financial obligations are taking greater priority for me right now	51%	56%	58%
I do not understand the plan well enough	15%	21%	31%
I have more important savings goals right now	10%	16%	28%
There is too much uncertainty in the economy right now	25%	19%	7%
I am not in a situation to save for retirement right now	14%	14%	36%
Other	12%	12%	12%
None of the above—I save adequately outside of the company-sponsored plan	16%	17%	10%
None of the above—it isn't necessary as I have other assets available to fund my retirement	4%	2%	3%

*Source: Employee Perspectives on Retirement Saving and Investing, 2004*

Most workers in all three generations expect to rely on their company-sponsored retirement savings plan. And, a majority in each generation believes they will also be able to rely on Social Security and pension income—although fewer Generation Y workers than Baby Boomers cite this as a source of income in retirement. The second most commonly cited source of income in retirement for Generation Y is savings that will be put away at a later date. For Generation X and Baby Boomers, the second most common source of income in retirement is other investments outside of the employer sponsored retirement plan. And indeed, significantly more Generation Xers and Baby Boomers say that they currently have IRAs and other investments outside of their company-sponsored retirement plan.

### **Means of Support During Retirement**

	<b>Baby Boomers</b>	<b>Generation X</b>	<b>Generation Y</b>
Through my company-sponsored retirement savings plan	91%	93%	92%
Through my spouse's company-sponsored retirement savings plan or pension plan	38%	51%	67%
Through my pension, which will provide me with a fixed monthly payment in retirement	73%	66%	64%
Through savings I will put away at a later date	40%	61%	81%
Through Social Security	78%	60%	57%
By working part-time or working at my own business during retirement	56%	48%	45%
Through help from my children or other relatives	3%	3%	4%
Through the value that is built up in my house	28%	28%	18%
Through an inheritance	11%	11%	11%
Through income on rental properties that I own or plan to buy	12%	17%	24%
Through other investments	91%	96%	63%
Through other sources of retirement savings	42%	36%	0%

*Source: Employee Perspectives on Retirement Saving and Investing, 2004*

All three generations are more likely than not to express confidence that they will maintain their preretirement standard of living in retirement. However, the closer a generation is to retirement, the less confident it is. Whereas 89% of Generation Yers are somewhat or very confident about maintaining their standard of living, 76% of Generation Xers are, and 69% of Baby Boomers are.

### **Confidence in Maintaining Preretirement Standard of Living in Retirement**

	Baby Boomers	Generation X	Generation Y
Not confident at all	7%	3%	2%
Not very confident	24%	21%	9%
Somewhat confident	54%	55%	54%
Very confident	15%	21%	35%

*Source: Employee Perspectives on Retirement Saving and Investing, 2004*

### **Retirement Income Adequacy Across Generations**

The “hotzone” charts on page 11 show the projected retirement income replacement rate by age and service of employees of large companies who are either participating in their defined contribution plan, or failing to participate. Each cell in these charts summarize key results for employees within five-year age and service groups—including the number of employees in the cell, average pay, and pay replacement percentage (percent of preretirement income projected to be replaced in retirement). Also, the cells use color to reinforce those areas in need of attention—the lowest replacement ratios are shown in “hotter” colors (shades of red and pink), while the highest ratios (over 100%) are in “cooler” colors—shades of yellow and blue.

The average worker who is contributing to his or her defined contribution plan, and who also expects to receive Social Security benefits, is projected to replace 82.5% of preretirement income in retirement (lower right cell).

**Baby Boomers.** A full-career Baby Boomer, who has worked at a large employer for 30+ years, and who is nearing retirement (age 55-59) is projected to be on track to replace 88.4% of income through the defined contribution plan and with Social Security. However, if this same individual had never contributed to the 401(k) plan, projected income replacement drops to 61.5%. Younger Baby Boomers (45-49) who expect to work for a large employer and contribute to their 401(k) plan throughout their career are projected to be on track to replace 86.8% of preretirement income in retirement. However the average younger Baby Boomer who does not contribute to the 401(k) plan may expect to replace just 43.8% of preretirement income in retirement.

**Generation X.** Meanwhile, the typical 30-34 year old workers can expect to replace just 44.1% of income in retirement if he or she is not saving in the 401(k) plan (and does not expect to have defined benefit income). In contrast, if that same worker did contribute to the 401(k) plan, the projected retirement income replacement rate jumps to 95.7%.

**Generation Y.** The typical Generation Y worker who is not saving in his or her 401(k) plan is projected to replace just 43% of income in retirement (without defined benefit income) versus 102.8% if he or she did participate.

**Projected Retirement Income Replacement From DC and Social Security**

**Contributing Employees**

Age	Service							Total
	0 - 4	5 - 9	10 - 14	15 - 19	20 - 24	25 - 29	30+	
Under 25	14,840 \$29,698 103.0%	1,417 \$30,158 100.8%						16,257 \$29,738 102.8%
25 - 29	29,589 \$46,128 102.8%	16,632 \$50,963 105.0%	404 \$41,452 96.9%					46,625 \$47,812 103.5%
30 - 34	28,589 \$58,785 90.9%	28,883 \$63,864 99.4%	6,118 \$62,039 99.9%	413 \$52,274 101.5%				64,003 \$61,346 95.7%
35 - 39	24,553 \$66,586 78.9%	27,898 \$74,052 87.8%	11,607 \$77,461 96.9%	6,495 \$74,549 107.3%	314 \$69,693 110.4%			70,867 \$72,050 88.1%
40 - 44	22,606 \$67,705 67.2%	26,163 \$74,603 75.7%	11,763 \$76,567 84.5%	11,542 \$84,900 100.0%	8,737 \$94,555 106.2%	525 \$65,072 107.8%		81,336 \$76,513 81.5%
45 - 49	18,866 \$64,460 59.1%	22,350 \$73,637 66.9%	10,383 \$73,567 74.0%	8,894 \$81,911 86.8%	13,516 \$103,834 97.9%	10,284 \$92,527 103.3%	435 \$72,732 105.6%	84,728 \$79,559 77.7%
50 - 54	14,087 \$60,372 53.4%	16,761 \$68,972 60.4%	8,124 \$68,294 66.4%	6,768 \$75,711 76.7%	7,652 \$95,054 86.7%	11,286 \$98,469 94.0%	5,724 \$89,239 98.8%	70,402 \$77,032 72.6%
55 - 59	9,298 \$56,613 47.9%	11,355 \$62,109 53.9%	5,549 \$64,452 59.1%	4,422 \$68,237 68.1%	4,477 \$85,090 76.7%	5,642 \$89,644 82.7%	8,293 \$92,770 88.4%	49,036 \$72,336 65.9%
60+	4,242 \$49,127 45.3%	5,607 \$52,947 49.6%	2,897 \$61,094 53.8%	2,093 \$63,756 60.5%	1,710 \$74,073 66.2%	1,779 \$73,694 71.5%	4,177 \$95,110 77.1%	22,505 \$65,352 58.4%
<b>Total</b>	166,670 \$56,717 78.8%	157,066 \$67,212 80.2%	56,845 \$71,235 80.2%	40,627 \$77,825 88.9%	36,406 \$95,764 93.5%	29,516 \$92,625 94.0%	18,629 \$91,742 89.5%	505,759 \$69,500 82.5%

**Projected Retirement Income Replacement From DC and Social Security**

**Noncontributing Employees**

Age	Service							Total
	0 - 4	5 - 9	10 - 14	15 - 19	20 - 24	25 - 29	30+	
Under 25	31,993 \$23,914 42.9%	1,405 \$25,533 44.6%						33,398 \$23,982 43.0%
25 - 29	31,218 \$31,159 44.3%	7,428 \$37,442 46.2%	184 \$36,234 50.9%					38,830 \$32,385 44.7%
30 - 34	24,191 \$39,054 42.4%	9,166 \$50,825 46.6%	1,955 \$64,283 52.1%	145 \$47,170 57.1%				35,457 \$43,521 44.1%
35 - 39	20,014 \$41,981 40.3%	8,086 \$58,086 44.3%	3,169 \$80,663 50.2%	1,675 \$71,574 57.8%	72 \$52,334 65.7%			33,016 \$51,162 43.1%
40 - 44	18,527 \$39,759 38.6%	7,646 \$53,443 42.2%	3,227 \$70,420 47.8%	2,732 \$84,097 56.5%	1,454 \$70,464 61.3%	137 \$60,566 70.5%		33,723 \$50,796 42.9%
45 - 49	16,269 \$38,162 39.2%	6,730 \$52,035 41.2%	2,861 \$60,804 46.3%	2,108 \$76,355 53.7%	1,997 \$90,975 59.3%	1,648 \$67,550 63.1%	105 \$62,487 59.6%	31,718 \$50,619 43.8%
50 - 54	12,726 \$36,952 40.3%	5,034 \$45,978 41.5%	2,244 \$52,518 45.4%	1,574 \$61,602 51.7%	1,283 \$70,468 57.5%	933 \$73,500 61.2%	933 \$61,543 63.8%	25,485 \$46,641 44.8%
55 - 59	9,258 \$33,325 41.5%	3,406 \$43,075 41.5%	1,373 \$51,061 44.2%	1,007 \$56,127 50.4%	764 \$56,212 54.1%	921 \$63,778 59.8%	1,397 \$64,786 61.5%	18,126 \$42,704 45.2%
60+	4,654 \$31,440 44.1%	1,861 \$43,192 43.2%	725 \$44,023 45.5%	536 \$42,059 48.8%	337 \$50,701 55.7%	346 \$52,550 55.6%	741 \$73,596 59.7%	9,200 \$40,322 46.4%
<b>Total</b>	168,850 \$34,382 41.7%	50,762 \$48,597 43.8%	15,738 \$64,115 47.8%	9,777 \$70,928 54.3%	5,907 \$74,207 58.6%	4,743 \$67,643 61.4%	3,176 \$65,813 61.7%	258,953 \$42,258 43.9%

**Legend**

Employee Count	Under 40%	
Average Pay	40% - 59%	
Pay Replacement	60% - 79%	
	80% - 89%	
	90% - 99%	
	100%+	

Source: Total Retirement Income at Large Companies: The Real Deal, 2005

## Conclusions

So what does all this mean for employees and their ability to save for retirement? The workplace is changing and availability of pension plans and employer-subsidized retiree medical benefits are less of a reality—particularly for those generations that are furthest from retirement. All generations need to honestly evaluate how much of the retirement equation falls to them, and many may find that they need to significantly increase their own retirement saving, plan to work in retirement, or even delay retirement in order to maintain their preretirement standard of living.

Plan sponsors, meanwhile, are doing their part by urging employees to save more, and finding ways to make retirement saving easier. This includes providing:

- Personalized, targeted communication that demonstrates the importance of saving early and robustly.
- Tools that allow employees to evaluate what their sources of income in retirement may be—and how much they may need.
- Investment guidance and advice provided either in the form of online tools, third-party sources of financial planning, or turnkey investment solutions such as premixed portfolios.
- Automated defined contribution plan features that may automatically enrollment employees into the savings plan, automatically increase their contributions over time, and automatically rebalance employees investments.

For many plan sponsors, support for employees' retirement saving also acknowledges differences in learning styles and needs across the generations. Younger workers may prefer to receive their communication electronically, whereas older workers may prefer a more high-touch approach, particularly if they are close to retirement. Younger workers may gravitate toward turnkey solutions out of a desire for simplicity and because they lack financial savvy, whereas older workers with greater investment knowledge and more complex investment needs may require highly tailored and flexible investment support. Yet evidence shows that workers across all groups tend to prefer simplicity and effortlessness, and will respond to approaches that make their retirement saving lives easier.