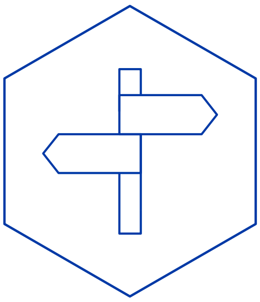
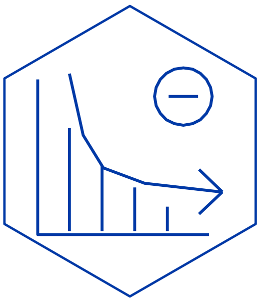
November 2020

Retirement Readiness During Times of Instability

Insights from Aon's *The Real Deal Study*



Unemployment and reduced wages will lead some people to stop saving or tap into their savings, compromising retirement readiness



The market downturn will more dramatically impair older workers' retirement readiness, even though they are often invested more conservatively than younger workers

Plan participants will bear the brunt of market losses primarily in their defined contribution plans. Employees who have a defined benefit pension plan, whether frozen or ongoing, will have more retirement income security at this time.

Retirement readiness may be far from the minds of many people as the world copes with the challenges associated with COVID-19. The good news that employers who have put work into both making their Funds run as efficiently and effectively as possible and providing financial education to employees can pay off in this time of instability. Best practices, such as appropriate risk allocation and rebalancing can help keep Occupational Schemes on track with minimal input from employees. But even with these practices in place, retirement accounts—and therefore, retirement readiness—may be diminished.

By understanding the impact of today's reality, employers can be better prepared to help their employees now and in the future.

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Disruptions in Savings are a Primary Threat to Retirement Readiness

During challenging economic times, individuals may experience reduced or lost wages within their families. In this situation, some people choose or are forced to stop contributing to their defined contribution Occupational Scheme or even tap into their plan balances to cover immediate expenses.

While their ultimate retirement readiness may not be an immediate concern to someone in this situation, it is helpful for employers to understand the impact of disruptions in savings or distributions from retirement accounts. When the employee is back in a more stable financial position, the employer can help the employee to get back on track for the future.

As an example, take a 43-year-old who saves 7% of their €35,000 salary and receives a one-to-one employer match on up to 5% of pay. If the participant stops saving for one year, the impact is expected to be fairly small—about a €9,000 reduction in their expected resources at retirement (including lost match)—but only if they resume saving at their prior level of 7% the following year. A more realistic savings pattern may be to gradually ramp up by 1% a year to the prior savings level. In this scenario, the reduction in projected retirement assets at age 65 could be as much as €32,000, equating to about a 7% reduction in the standard of living they might otherwise have had in retirement.

A large distribution from a participant's defined contribution account can also have a significant impact. For the 43-year-old example, withdrawing (for example via a job change) €25,000 today could reduce the balance at retirement by about €53,000, on top of any reduction due to suspended savings. A combined projected account balance reduction of €85,000 could require the participant to either defer retirement by 5-6 years in order to be in the same position as before or retire at age 65 with an 18% reduction in the standard of living.

Keep in mind, these examples exclude any impact of market losses, which is addressed in the next section.

Disruptions in Savings Example

A 43-year-old saves 7% of their €35,000 salary and receives a one-to-one employer match on up to 5% of pay	Reduction in Projected Retirement Assets at Age 65	Participant Adjustments
If the participant stops saving for one year, then gradually ramps up by 1% a year to the prior savings level	↓€32,000	~7% reduction in standard of living
If the participant also withdraws €25,000 today	↓€85,000	defer retirement by 5-6 years

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Market Losses Affect Individuals' Retirement Readiness Differently

Most people will have seen significant changes in their Occupational Schemes' accounts during the first quarter of 2020 due to the COVID-19 pandemic and resulting market downturn. However, the consequences for retirement finances vary widely based on several factors, including:

- The asset classes each participant is invested in;
- Future market returns;
- The proportion of the participant's balance already in the plan compared to expected future contributions; and
- The number of expected years until retirement.

Even though early-career participants may be more heavily invested in riskier assets, they will have more time to recoup losses and may have smaller accounts subject to the market losses, compared to their peers who are approaching retirement and have generally larger balances.

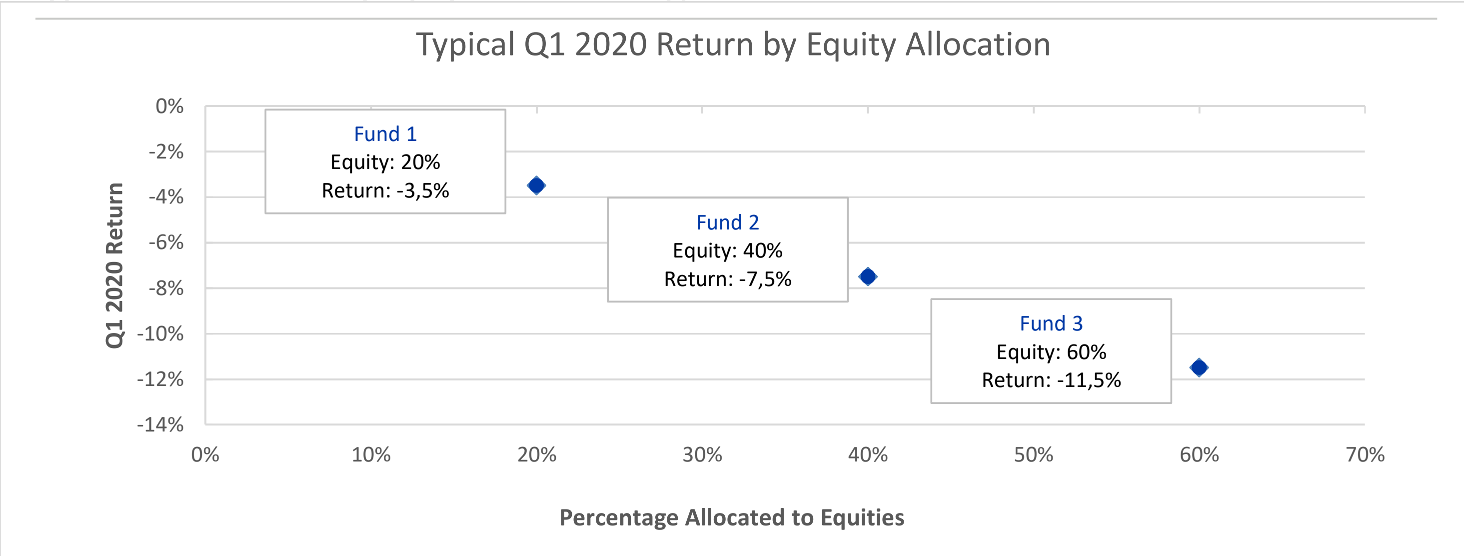
Exposure to Market Downturns Varies by Age

Where defined contribution Occupational Schemes permit individual investment choice, many participants follow the general principle of de-risking as they get older, so those closer to retirement may not have seen as much change in their retirement account balances as those who are earlier in their careers. However, we note that Greek defined contribution Occupational Schemes do not yet offer the possibility of individual investment choice.

This crisis has highlighted the benefits of offering individual investment choices, as those closer to retirement would have incurred smaller losses if invested in a defensive portfolio compared to a balanced 'one-size-fits-all' portfolio. Given the limited amount of time that an older participant has to recoup losses prior to retirement, their primary focus should shift from growth to capital preservation. This shift is not feasible without the possibility of individual investment choice.

Participants' market losses vary by asset allocation, which is typically correlated with age.

Typical Q1 2020 Return by Equity Allocation of Hypothetical Portfolios



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An Unpredictable Future

The future investment returns on a defined contribution balance are unknown and largely out of the participant’s control. Below, we have estimated the impact on retirement readiness for participants of various ages to illustrate that while those closer to retirement may not have initially experienced returns as negative as their younger peers, they will typically bear a larger burden in terms of retirement readiness when they reach retirement age. This is because younger participants have a longer period to recoup losses relative to members closer to retirement.

The magnitude of the strategies needed to adjust for the market downturn varies by age.

Sample Participant Adjustments

Age →	Save More	OR	Retire Later	OR	Reduce Standard of Living
60	9.5% more per year		1½ years later		7% reduction
45	1.6% more per year		1 year later		5% reduction
35	0.75% more per year		¾ year later		3.5% reduction
25	0.3% more per year		<½ year later		2% reduction

Baseline retirement age
65

Retirement shortfall = the gap between retirement needs and retirement resources

For the purpose of the above illustration, we have assumed all participants are invested in the same 'Moderate Fund' in order to isolate the impact that time remaining until retirement has on retirement readiness. We have also assumed that all participants were on track to retire at age 65 before the market downturn, and therefore older participants had significantly more savings exposed to the market event. In practice, the market downturn would, on average, have a smaller impact on participants of all ages given that the average Greek's retirement savings is currently not on track to permit retiring at age 65.

Regardless of the assumptions used, the message is clear; the impact of negative returns on retirement readiness is greater for older participants because they do not have as much time prior to retirement to recover from losses.

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How Might Participants Respond to Changes in Their Retirement Readiness?

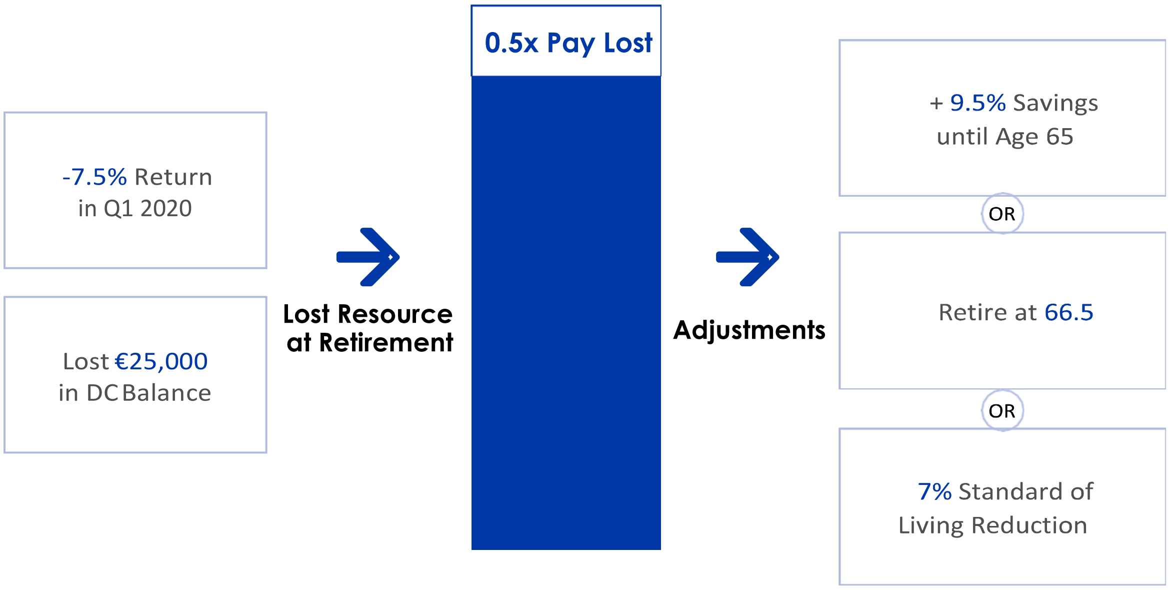
Ultimately, this market downturn may impair retirement readiness, depending on how future returns play out. Employees may have to save more, retire later, or prepare themselves for a lower standard of living in retirement.

Negative returns are typically more severe for younger participants. However, because they may have smaller current balances and the opportunity to make up losses over several decades in the future, the typical 25-year-old's retirement readiness picture is largely unchanged.

For a sample 60-year-old participant, this decline in assets may increase their retirement income shortfall by 0.5 times final pay. The participant has three primary strategies to adjust for this additional shortfall:

- Save an additional 9.5% of pay every year until an age 65 retirement;
- Defer retirement by 1½ years; or
- Reduce their standard of living in retirement by an additional 7%.

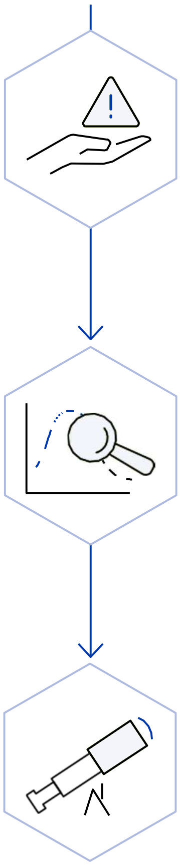
Impact of Market Downturn on 60-Year-Old Sample Participant - Moderate Recovery Scenario



Expected DC Resources at Age 65

As Multiple of Final Pay

What Can Employers / Occupational Schemes Do?



Managing Now

Employers can promote the financial education, access to advice, services, and tools that may not be available to employees. They should consider communications that respond to the current crisis, helping employees to recover and understand any changes available in their retirement plans. Providing and promoting these resources can help employees make informed decisions about their retirement contributions, investments, and any new loans or withdrawals.

Stabilizing Financial Wellbeing

As we emerge from this crisis, many employees will need to establish or beef up their emergency funds, reconfigure their budgets, resume paying off debt, and more before tackling their retirement saving, investing, and planning. Employers should consider whether they have the appropriate financial wellbeing initiatives in place to support their employees.

Planning for the Future

This crisis has highlighted the benefits of offering individual investment choices in Occupational Schemes, as well as lifetime pension options that provide stable retirement income. The relative benefit of lifetime pension options may not be applicable in Greece *at present*, given the current tax exemption of lump sum benefit payments which is not extended to lifetime pension payments. Employers should review the retirement readiness of their population in order to determine the most effective strategies that will enable employees to most efficiently and effectively save for retirement.

For more information on Aon's Retirement solutions, visit ***www.aonsolutions.gr***

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About Aon

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance. For more information, please visit aon.com.

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