

# Notes

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## A T A G L A N C E

### **How Much Needs to be Saved for Retirement After Factoring In Post-Retirement Risks: Evidence from the EBRI Retirement Security Projection Model,<sup>®</sup>** *by Jack*

*VanDerhei, Ph.D., Employee Benefit Research Institute*

- This analysis helps answer one of the most important questions that many defined contribution participants face before retirement: How much do I need to save each year for a “successful” retirement? It includes three of the major post-retirement risks (longevity, investment, and long-term care) while allowing the participant to also choose the probability of “success” that is best suited for their circumstances.
- Given the assumptions used in this *Notes* article, a single male age 25 earning \$40,000 with no previous savings would need a total contribution rate (employee and employer combined) of less than 3 percent per year until retirement (age 65) for a 50 percent chance of success. A 6.4 percent contribution rate would achieve a 75 percent success rate and a 14 percent contribution rate would achieve a 90 percent success rate. But if a male earning \$40,000 were to wait until age 40 to begin saving, he would need a 6.5 percent total contribution rate for just a 50 percent chance of success and a 16.5 percent total contribution rate for a 75 percent chance of success; a 90 percent probability of success would be impossible even with a 25 percent contribution rate.
- The analysis also shows how large a participant’s current account balance needs to be, by contribution rate, to be “on-track” for a particular level of retirement success.

### **Employer and Worker Contributions to Health Reimbursement Arrangements and Health Savings Accounts, 2006–2014,** *by Paul Fronstin, Ph.D., Employee Benefit Research Institute, and*

*Anne Elmlinger, Greenwald & Associates*

- This report presents findings from the 2014 EBRI/Greenwald & Associates Consumer Engagement in Health Care Survey (CEHCS), as well as earlier surveys, examining the availability of health reimbursement arrangements (HRAs) and health-savings-account (HSA)-eligible plans (consumer-driven health plans, or CDHPs). It also looks at employer and individual contribution behavior.
- The percentage of workers reporting that their employers contribute to the account decreased in 2014 for the first time since 2009. Among individuals with individual coverage and employer contributions, the percentage with contributions between \$200–\$999 decreased while contributions of \$1,000 or more increased in 2014.
- Workers’ contributions to their HSAs decreased slightly in 2014.

# How Much Needs to be Saved for Retirement After Factoring In Post-Retirement Risks: Evidence from the EBRI Retirement Security Projection Model®

By Jack VanDerhei, Ph.D., Employee Benefit Research Institute

## Introduction

As defined contribution plans continue to become more important to retirement income for private-sector workers in the United States,<sup>1</sup> there is renewed interest in providing them with information on appropriate contribution rates, as well as benchmarks on appropriate levels of account balances at various ages. These actions would help workers determine whether they are “on-track” for an affordable retirement or will need to increase their contributions, delay their expected retirement age, modify their expected standards of living in retirement, or (implicitly) accept a lower probability of a “successful” retirement. The Employee Benefit Research Institute (EBRI) and others have previously published several studies dealing with this topic, ranging anywhere from “a simple Excel spreadsheet example”<sup>2</sup> to a full stochastic decumulation model focusing simultaneously on post-retirement investment risk, longevity risk, and long-term care costs.<sup>3</sup>

One of the inherent problems with not explicitly modeling these post-retirement risks is that the alternative method is often just to meet some generalized “replacement rate” of savings, whereby a worker’s projected post-retirement income is compared to preretirement income to determine the ratio of needed salary replacement. Unfortunately, this standard leaves several questions unanswered:

- What is the proper measure of the numerator? For example, how should one convert 401(k) and individual retirement account (IRA) balances to retirement income?
- What is the proper measure of the denominator? Should it focus only on the last few years of income, should it be a career-average, or should it be similar to the AIME (average indexed monthly earnings) calculation used to compute Social Security benefits?
- What is the proper measure of the threshold? Often these thresholds are computed to adjust for differentials in taxes pre- and post-retirement, as well as age- and work-related expenses. However, it is extremely difficult, if not impossible, to have any meaningful modifications for risk aversion.

Since very few households annuitize all (or even most) of their individual accounts in retirement, a replacement-rate focus would overlook the potential longevity risk of outliving one’s savings.<sup>4</sup> Also, one of the biggest obstacles to retirement income adequacy for households who might otherwise have sufficient financial resources at retirement age is the risk of long-term care costs for a prolonged period.<sup>5</sup> In the real world, few retirees have long-term care insurance policies that would cover the potentially catastrophic financial impact of this exposure. Consequently, any attempt to incorporate this into a replacement rate threshold (and many don’t) needs to be carefully assessed against actual implications.

The EBRI Retirement Security Projection Model® (RSPM®), which is detailed in the next section, uses a full stochastic simulation procedure for both the preretirement and post-retirement periods to determine the percentage of times households are simulated to *not* run short of money in retirement (i.e., a “successful” retirement). While this is extremely useful (and realistic) for public policy modeling of the impact of preretirement leakages,<sup>6</sup> considering the combined impacts of the recent crisis in the financial and real estate markets,<sup>7</sup> the impact of participating in a defined benefit (DB) plan,<sup>8</sup> the value of deferring retirement age,<sup>9</sup> the impact of the current low-interest-rate environment,<sup>10</sup>

and the impact of future contributions to defined contribution (DC) plans,<sup>11</sup> makes it difficult to display the results of a large number of alternative paths to retirement in a meaningful fashion.

Instead, this *EBRI Notes* article uses a variety of stylized preretirement examples<sup>12</sup> with different contribution rates, salary levels, and ages for both genders and then simulates the results with the full stochastic post-retirement module of RSPM<sup>®</sup> to find the overall probability of success for each stylized example. To simplify the analysis, the simulations performed for this article do not account for any net housing equity or any possible defined benefit accruals.<sup>13</sup>

The results are used first to assist in determining the percentage of compensation that would need to be saved if starting out at age 25 under stylized salary levels and contribution rates for males and females. In addition to the age-25 results, the contribution analysis is also expanded to those first beginning to save at ages 40 and 55.

The results are next used to provide information for those who have already been saving and want feedback on whether their account balances are large enough to provide for a successful retirement with a range of probabilities. In essence, this allows one to pick which of the three contribution rates they are most likely to choose for the future and then see the minimum existing account balance they should already have accumulated at that age.

The article begins with a brief description of RSPM,<sup>®</sup> followed by the specific methodology utilized in this analysis. Results are provided first for the required contribution rates for those starting to save at ages 25, 40, or 55. This is followed by the analysis of the account balances required by ages 40 and 55 for those who have already been saving for retirement. The final section summarizes the results for both analyses.

## **EBRI Retirement Security Projection Model<sup>®</sup>**

One of the basic objectives of RSPM<sup>®</sup> is to simulate the percentage of the population at risk of not having retirement income adequate to cover average expenses and uninsured health care costs (including long-term-care costs) at age 65 or older throughout retirement in specific income and age groupings.<sup>14</sup> RSPM<sup>®</sup> also provides information on the distribution of the likely number of years before those at risk will run short of money, as well as the percentage of preretirement compensation they will need in terms of additional savings in order to have a 50, 75, or 90 percent probability of retirement income adequacy.

VanDerhei and Copeland (2010) describe how households are tracked through retirement age and how their retirement income/wealth is simulated for the following components:

- Social Security.
- DC balances.
- IRA balances.
- DB annuities and/or lump-sum distributions.
- Net housing equity.

A household is considered to run short of money in this model if aggregate resources in retirement are not sufficient to meet average retirement expenditures, defined as a combination of deterministic expenses from the Consumer Expenditure Survey (as a function of age and income) and some health insurance and out-of-pocket, health-related expenses, plus stochastic expenses from nursing-home and home-health care (at least until the point such expenses are covered by Medicaid). It should be noted that the definition of retirement income adequacy used in RSPM<sup>®</sup> is not a simple replacement rate in which someone with twice the salary of another would require twice the resources in retirement (before factoring in Social Security benefits). While certain components of the decumulation of RSPM<sup>®</sup> are

income-related, several of them (especially those dealing with long-term care prior to qualification for Medicaid) will be income-invariant.<sup>15</sup>

The baseline version of the model used for this analysis assumes all workers retire at age 65, that they immediately begin drawing benefits from Social Security and defined benefit plans (if any), and, to the extent that the sum of their expenses and uninsured medical expenses exceed the projected, after-tax annual income from those sources, immediately begin to withdraw money from their individual accounts (defined contribution and cash balance plans, as well as IRAs). If there is sufficient money to pay expenses without tapping into the tax-qualified individual accounts, those balances are assumed to be invested in a non-tax-advantaged account where the investment income is taxed as ordinary income. Individual accounts are tracked until the point at which they are depleted. At that point, any net housing equity is assumed to be added to retirement savings in the form of a lump-sum distribution (not a reverse annuity mortgage (RAM)). If all the retirement savings are exhausted and if the Social Security and defined benefit payments are not sufficient to pay expenses, the individual is designated as having run short of money at that point.

## Methodology

The primary objectives of this *Notes* article are to:

1. Determine the probability of a “successful” retirement under various future total contribution rates for stylized individuals with no previous savings at ages 25, 40, and 55; and
2. Determine the minimum account balances that would need to be accumulated for a 50, 75, and 90 percent chance of a “successful” retirement for stylized individuals at ages 40 and 55 under different assumptions with respect to future contribution rates.

The analysis is undertaken for single males and females separately, given their differential longevity. Given the stylized examples used during the accumulation period, a simple 4 percent (nominal) wage growth was assumed for all ages and no preretirement cashouts, hardship withdrawals or loan defaults were included. The rates of return used in the analysis are generated from stochastic annual returns with a log-normal distribution and a geometric mean of 6.5 percent real return for stocks and 2.3 percent real return for bonds.<sup>16</sup> Net returns are computed by subtracting 78 basis points from the gross returns.<sup>17</sup> Asset allocation is assumed to be a function of age and is drawn from the average allocations for more than 24 million 401(k) participants at year-end 2013.<sup>18</sup>

Unlike the full accumulation module used in RSPM,<sup>®</sup> these stylized examples assume no defined benefit accruals, no individual-account savings other than that provided by the simulated defined contribution plan (e.g., no non-rollover IRAs), and no use of any net housing equity to finance retirement expenditures.

For purposes of the first objective (determining the probability of success associated with various contribution rates for those with no previous savings at ages 25, 40 and 55), six different total contribution rates are simulated ranging from 3 percent to 25 percent.

For purposes of the second objective (determining minimum account balances at ages 40 and 55), three different total contribution rates are simulated: 4.5 percent, 9 percent, and 15 percent. For each of the 48 combinations of salary, gender, age and contribution levels mentioned, 25 different initial account balances are simulated ranging from zero to \$1.5 million. For each of the resulting 1,200 scenarios, the accumulated balance at age 65 is simulated 100 times to reflect the pre-retirement investment risk. At that point, 100 alternative life-paths are simulated using the full stochastic decumulation portion of RSPM.<sup>®</sup> This provides 10,000 different simulations for each of the 1,200 combinations. In each case, the percentage of simulations where the stylized individual does *not* run short of money in retirement is computed and interpolation methods are used to determine the initial account balance that would be required such that a “successful” retirement would result 50, 75, and 90 percent of the time.

## Minimum Contribution Rate Results

### Age 25

**Males:** Figure 1 provides the probabilities of *not* running short of money in retirement for a male age 25, as a function of current salary and future total contribution rates (employee and employer combined) for three different current salary levels: \$20,000, \$40,000, and \$65,000. It is assumed that the 25-year-old has no previous savings. A stylized male employee at this age currently earning \$20,000 would need to have a total contribution rate of approximately 6.8 percent of salary each year until retirement (age 65) for a 50 percent probability of success (defined as *not* running short of money in retirement) and a 16.5 percent contribution rate for a 75 percent success rate. At this salary level, even if this individual would contribute at a rate of 25 percent of salary each year until retirement, he would reach only an 86 percent probability of success.

Under the same set of assumptions, a 25-year-old male currently earning \$40,000 would have a 58 percent probability of success with just a 3 percent future total contribution rate, but would need to increase it to approximately 6.4 percent of salary for a 75 percent probability of success. The rate would need to be increased even further (to approximately 14 percent) for a 90 percent probability of success.

For a 25-year-old male earning as much as \$65,000, a 3 percent contribution rate would provide a 69 percent probability of success while a contribution rate of 4.2 percent would provide a 75 percent probability of success and an 8.2 percent contribution rate would increase it to 90 percent.

It is worth noting how much the curves in Figure 1 flatten out beyond a 10 percent total contribution rate, especially for the higher salary levels. For example, a 25-year-old male earning \$40,000 would increase his probability of success by approximately 14 percentage points (from 70 percent to 84 percent) by increasing the total contribution rate from 5 to 10 percent. However, increasing the total contribution rate by another 5 percentage points (from 10 to 15 percent) will increase the success rate by about only 7 percentage points (from 84 percent to 91 percent).<sup>19</sup>

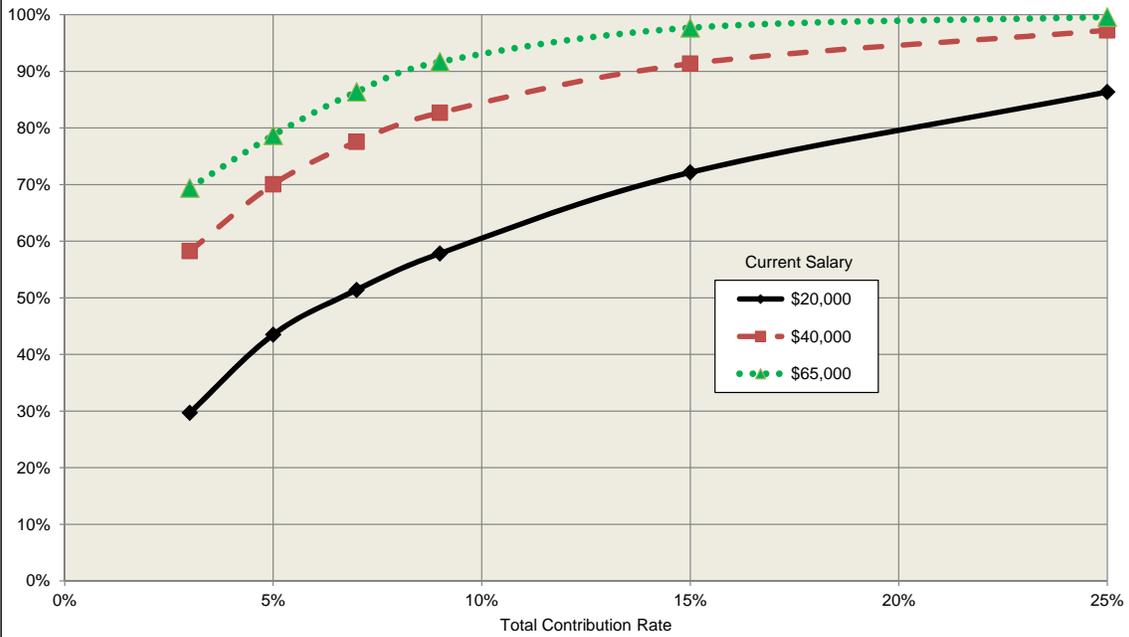
**Females:** Figure 2 provides the probabilities of *not* running short of money in retirement for a female age 25 as a function of current salary and future total contribution rates for the same three salary levels. A stylized female employee at this age currently earning \$20,000 would need to have a total contribution rate of approximately 9.6 percent of salary each year until retirement (age 65) for a 50 percent probability of success. At this salary level, even if this individual would contribute at a rate of 20.5 percent of salary each year until retirement, she would reach only a 75 percent probability of success.

Under the same set of assumptions, a 25-year-old female currently earning \$40,000 would have a 50 percent probability of success with just a 3 percent future total contribution rate, but would need to increase it to approximately 7.5 percent of salary for a 75 percent probability of success. The rate would need to be increased to 15 percent for a 90 percent probability of success.

For a 25-year-old female earning as much as \$65,000, a 3 percent contribution rate would provide a 66 percent probability of success while a contribution rate of 5 percent would provide a 75 percent probability of success and a 9 percent contribution rate would increase it to 90 percent.

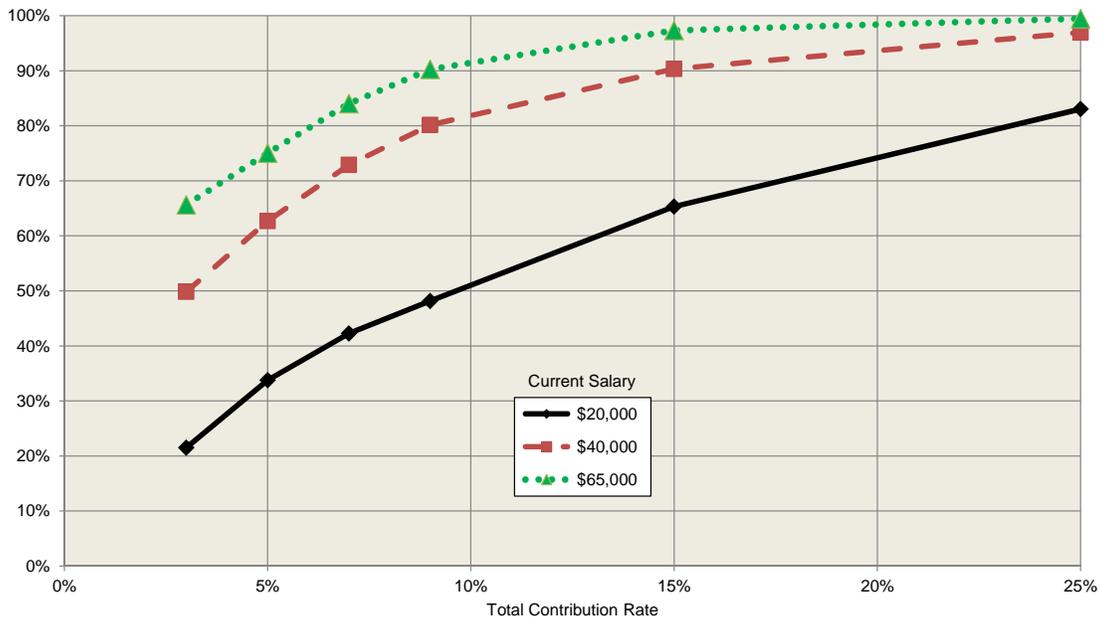
Overall, the probabilities of success for a female currently earning \$20,000 under these assumptions is 8 percentage points lower (given their increased life expectancies) than a male at a 3 percent contribution rate, and 7 percentage points lower at a 15 percent contribution rate. The gender-related difference at a \$40,000 salary is still 8 percentage points at the 3 percent contribution level but decreases to 1 percentage point at the 15-percent contribution rate.

Figure 1  
**Probability of Not Running Short of Money in Retirement for a Male Age 25,**  
**as a Function of Current Salary and Future Total Contribution Rates**  
 (see text for assumptions)



Source: Employee Benefit Research Institute Retirement Security Projection Model® Version 2207.  
 See text for assumptions and caveats.

Figure 2  
**Probability of Not Running Short of Money in Retirement for a Female age 25,**  
**as a Function of Current Salary and Future Total Contribution Rates**  
 (see text for assumptions)



Source: Employee Benefit Research Institute Retirement Security Projection Model® Version 2207.  
 See text for assumptions and caveats.

## Age 40

**Males:** Figure 3 provides the probabilities of *not* running short of money in retirement for a male age 40, as a function of current salary and future total contribution rates for three different current salary levels: \$20,000, \$40,000, and \$65,000. Again, it is assumed that the 40-year-old has no previous savings. Even with a total contribution rate of 16 percent each year until retirement age, a stylized employee currently earning \$20,000 would have only a 50 percent probability of success.

Under the same set of assumptions, a 40-year-old male currently earning \$40,000 and just starting to save would have a 50 percent probability of success with approximately a 6.5 percent future total contribution rate. But even if the contribution rate were increased to 16.5 percent, the probability of success would be only 75 percent.

For a 40-year-old male earning \$65,000, a 3 percent contribution rate would provide a 67 percent probability of success, while a contribution rate of 4.8 percent would provide a 75 percent probability of success and a 9.6 percent contribution rate would increase it to 90 percent.

**Females:** Figure 4 provides the probabilities of *not* running short of money in retirement for a female age 40, as a function of current salary and future total contribution rates assuming that she just started saving at age 40. Even with a total contribution rate of 23 percent each year until retirement age, a stylized employee currently earning \$20,000 would have only a 50 percent probability of success.

Under the same set of assumptions, a 40-year-old female currently earning \$40,000 and just starting to save would have a 50 percent probability of success with approximately a 9.5 percent future total contribution rate. But even if the contribution rate were increased to 19.5 percent, the probability of success would be only 75 percent.

For a 40-year-old female earning \$65,000, a 3 percent contribution rate would provide a 61 percent probability of success, while a contribution rate of 5.5 percent would provide a 75 percent probability of success and an 11.4 percent contribution rate would increase it to 90 percent.

Overall, the probabilities of success for a female currently earning \$20,000 under these assumptions is 4 percentage points lower (given a woman's increased life expectancy) than a male at a 3 percent contribution rate and 11 percentage points lower at a 15 percent contribution rate. The gender-related difference at a \$65,000 salary is 6 percentage points at the 3 percent contribution level but decreases to 1 percentage point at the 15 percent contribution rate.

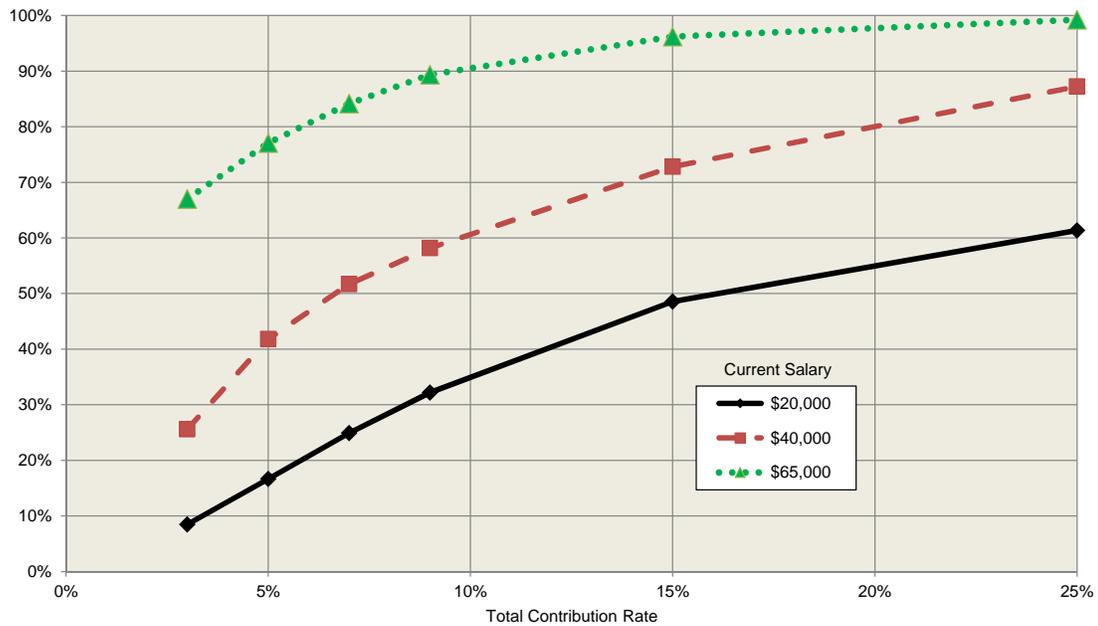
## Age 55

**Males:** Figure 5 provides the probabilities of *not* running short of money in retirement for a male age 55, as a function of current salary and future total contribution rates for three different current salary levels: \$20,000, \$40,000 and \$65,000. Again, it is assumed that the 55-year-old has no previous savings. Even with a total contribution rate of 25 percent each year until retirement age, a stylized employee currently earning \$20,000 would have only a 16 percent probability of success.

Under the same set of assumptions, a 55-year-old male currently earning \$40,000 and just starting to save would have only a 50 percent probability of success even if the contribution rate were 24.5 percent. For a 55-year-old male earning \$65,000, a 12.9 percent contribution rate would provide a 50 percent probability of success.

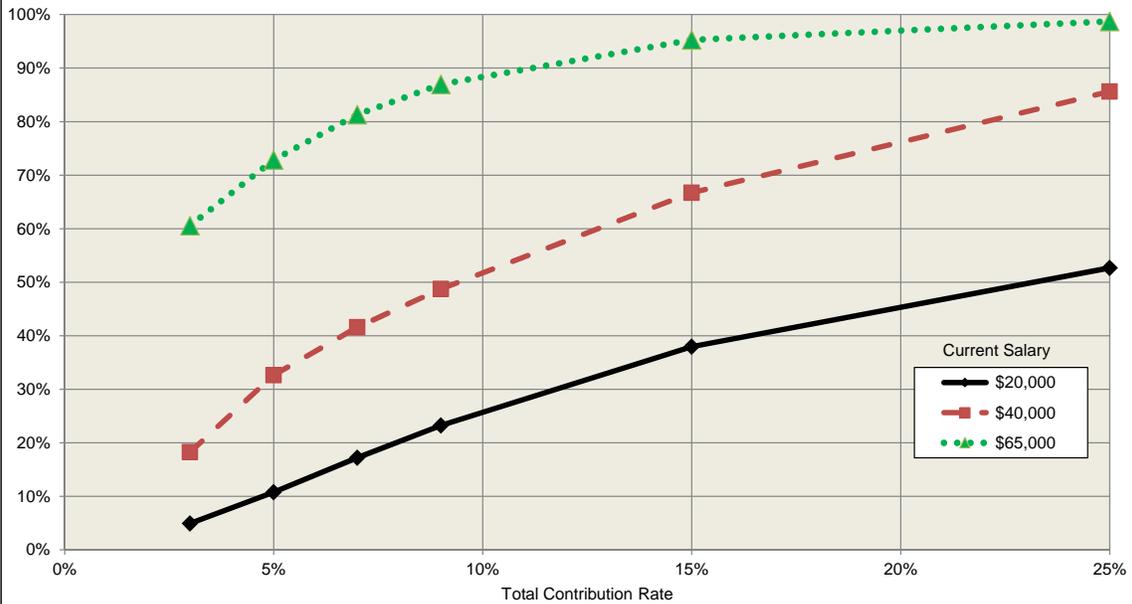
**Females:** Figure 6 provides the probabilities of *not* running short of money in retirement for a female age 55, as a function of current salary and future total contribution rates for the same three salary levels assuming there are no previous savings. Even with a total contribution rate of 25 percent each year until retirement age, a stylized employee currently earning \$20,000 would have only a 10 percent probability of success.

Figure 3  
**Probability of Not Running Short of Money in Retirement for a Male Age 40,**  
**as a Function of Current Salary and Future Total Contribution Rates**  
 (see text for assumptions)



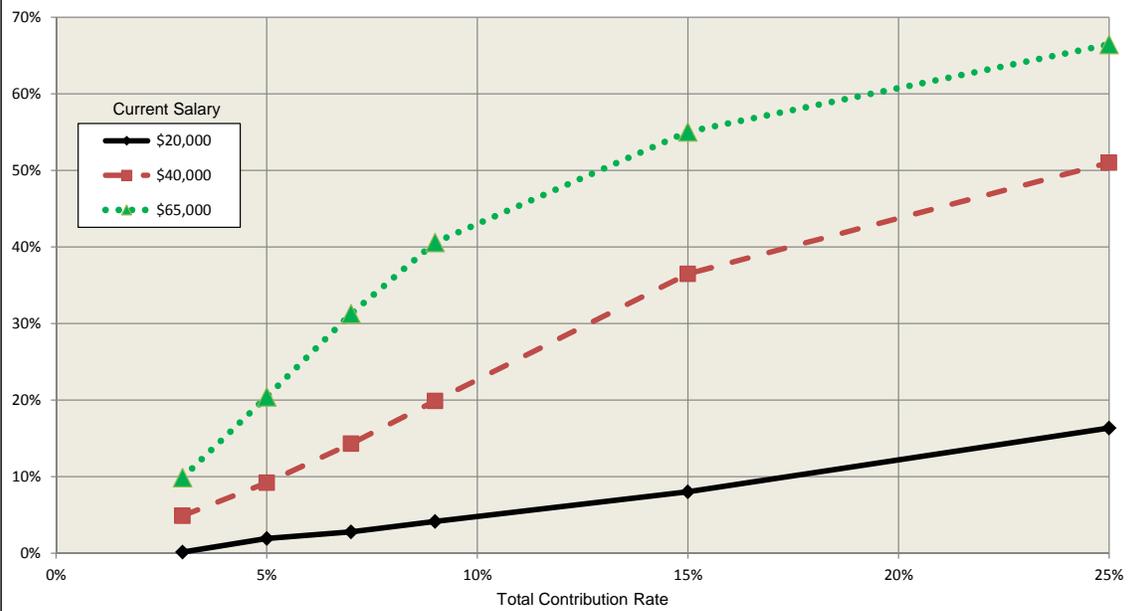
Source: Employee Benefit Research Institute Retirement Security Projection Model® Version 2207.  
 See text for assumptions and caveats.

Figure 4  
**Probability of Not Running Short of Money in Retirement for a Female Age 40,**  
**as a Function of Current Salary and Future Total Contribution Rates**  
 (see text for assumptions)



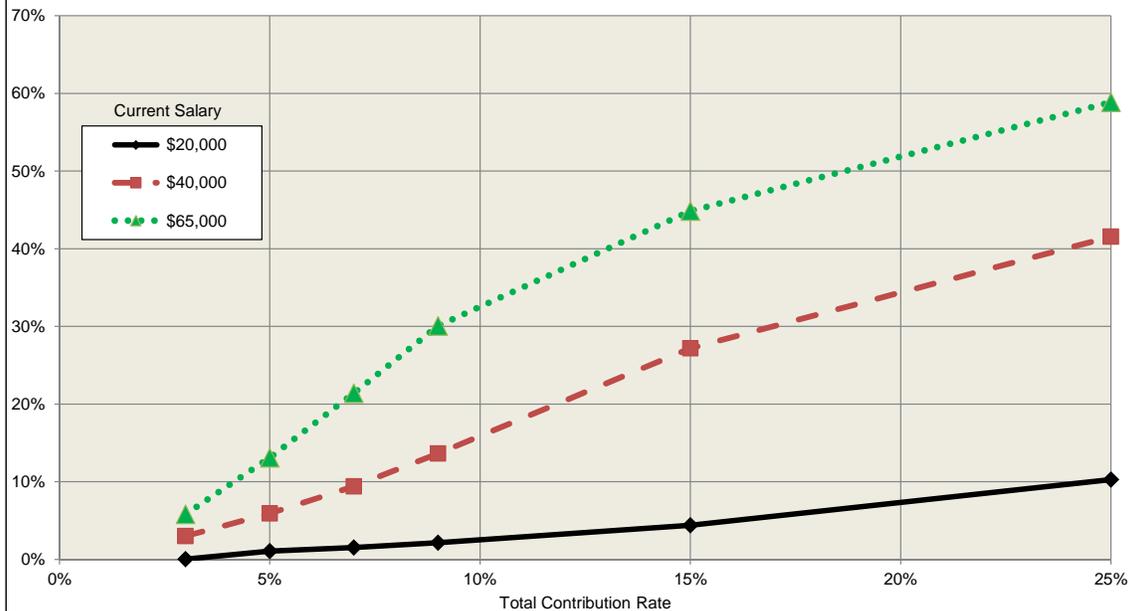
Source: Employee Benefit Research Institute Retirement Security Projection Model® Version 2207.  
 See text for assumptions and caveats.

Figure 5  
**Probability of Not Running Short of Money in Retirement for a Male Age 55,**  
**as a Function of Current Salary and Future Total Contribution Rates**  
 (see text for assumptions)



Source: Employee Benefit Research Institute Retirement Security Projection Model® Version 2207.  
 See text for assumptions and caveats.

Figure 6  
**Probability of Not Running Short of Money in Retirement for a Female Age 55,**  
**as a Function of Current Salary and Future Total Contribution Rates**  
 (see text for assumptions)



Source: Employee Benefit Research Institute Retirement Security Projection Model® Version 2207.  
 See text for assumptions and caveats.

Under the same set of assumptions, a 55-year-old female currently earning \$40,000 and just starting to save would have only a 41 percent probability of success even if the contribution rate were 25 percent. For a 55-year-old female earning \$65,000, an 18.5 percent contribution rate would provide a 50 percent probability of success.

## Minimum Account Balance Results

### Age 40

**Males:** Figure 7 provides the minimum account balances required for adequate retirement income at 50, 75, and 90 percent probability levels by total contribution rates and salary for a male age 40. The numbers in the first column of the grid show that, under these assumptions, a 40-year-old male earning \$65,000 would not need any existing balances at that age to achieve a 50 percent probability of success, even if his future total contribution rate is only 4.5 percent of salary per year. The \$12,956 value in the first column for the \$40,000 salary could be used as a guideline for the minimum balance that should already be accumulated if all other assumptions remain constant (e.g., future total contribution rate of 4.5 percent, retirement age of 65, and a desired 50 percent probability of success).

The \$35,326 value in the first column for the \$20,000 salary level suggests that this stylized individual would need to have accumulated an account balance of at least this size by age 40 to have a 50 percent probability of attaining adequate retirement income by age 65, if the future total contribution rate is 4.5 percent. It may seem counterintuitive to have a larger minimum threshold for a 40-year-old male currently earning \$20,000 than one earning \$40,000; however, the latter will have future contributions equal to twice the value of the former. Moreover, the definition of retirement income adequacy used in RSPM<sup>®</sup> is not a simple replacement rate in which someone with twice the salary of another would require twice the resources in retirement (before factoring in Social Security benefits). While certain components of the decumulation of RSPM<sup>®</sup> are income-related, several of them (especially those dealing with long-term care prior to qualification for Medicaid) will be income-invariant.

The second and third columns of the grid show the same results if the future contribution rates are increased to 9 and 15 percent respectively. In both of these cases, all of the stylized individuals are simulated to have sufficient funds for a successful retirement age at least 50 percent of the time even if they are just starting their contributions at age 40, except for those in the lowest-salary category. For males age 40 currently earning \$20,000, the minimum account balances required would be \$14,619 if future total contributions are equal to 9 percent of salary but only \$3,384 if they are equal to 15 percent of compensation.

If a 40-year-old male desires a 75 percent success rate instead, the results in columns 4 through 6 of Figure 7 provide the relevant results. In this case, with a 4.5 percent contribution rate, someone earning \$65,000 would need to have already accumulated \$1,387, whereas a 40-year-old male earning \$40,000 would need a minimum balance of \$60,937 and one earning only \$20,000 would need to have already accumulated slightly more than five times their current salary (\$107,118). Increasing the future contribution rate to 9 percent reduces the minimum account balances needed to zero at the \$65,000 salary level, \$47,493 at the \$40,000 salary level, and \$83,298 at the \$20,000 salary level. Further increasing the future contribution rate to 15 percent reduces the minimum account balances needed even more to \$2,003 at the \$40,000 salary level and \$72,793 at the \$20,000 salary level.

For a 40-year-old male desiring a 90 percent chance of success, columns 7 through 9 of the grid in Figure 7 show that even a 9 percent future contribution rate would require current balances for all three salary levels, whereas a 15 percent contribution rate would be sufficient for those earning \$65,000 even if they first begin saving at age 40.

**Females:** Figure 8 provides the minimum account balances required for adequate retirement income at 50, 75 and 90 percent probability levels by total contribution rates and salary for a female age 40. The relative results are quite similar to those for a male age 40 in Figure 7, with the exception that each non-zero minimum account balance is somewhat larger due to a woman's longer life expectancy.

## Age 55

**Males:** Figure 9 provides the minimum account balances required for adequate retirement income at 50, 75 and 90 percent probability levels by total contribution rates and salary for a male age 55. The numbers in the first column of the grid show that, under these assumptions, a 55-year-old male at a \$65,000 salary level would need to have accumulated at least \$30,286 by this age to have a 50 percent probability of success with a 4.5 percent future contribution rate, but only \$7,172 at a 9 percent future contribution rate (and no current balance would be required for this stylized individual to achieve a 50 percent probability of success at a 15 percent future contribution rate).

If the stylized 55-year-old male at a \$65,000 salary level would prefer a 75 percent probability of success instead, he would need a minimum account balance at that age of \$145,061 with a 4.5 percent future contribution rate. This decreases to \$122,095 at a 9 percent future contribution rate and only \$81,912 at a 15 percent contribution rate. If a 90 percent probability of success is desired instead, the minimum account balances needed would increase correspondingly: a minimum of \$272,769 would be required with a 4.5 percent future contribution rate, \$243,291 if the future contribution rate is 9 percent, and \$196,662 if the future contribution rate is 15 percent.

**Females:** Figure 10 provides the minimum account balances required for adequate retirement income at 50, 75 and 90 percent probability levels by total contribution rates and salary for a female age 55. The relative results are quite similar to those for a male age 55 in Figure 9, with the exception that each non-zero minimum account balance is somewhat larger due to a woman's longer life expectancy.

## Summary

This *Notes* article attempts to help answer two of the most important questions that many defined contribution participants deal with before retirement:

1. How much do I need to save each year for a "successful" retirement?
2. How large do I need my account balance to be after saving for several years to be "on-track" for a successful retirement given my future contribution rate?

The answers to the first question obviously will depend on what probability of success is desired at any particular combination of age, gender, and salary, as illustrated in the following table summarizing Figures 1 through 6:

## Summary Data from Figures 1–6

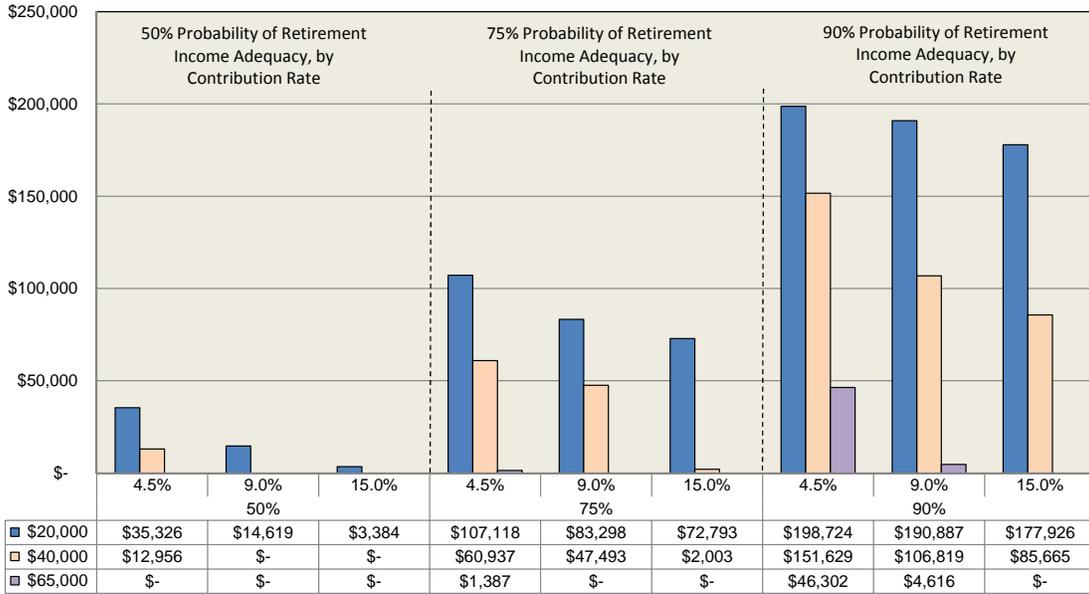
Gender	Age	Salary	Contribution Rate Required for a "Success" Rate of:		
			50.0%	75%	90%
Male	25	\$20,000	6.8%	16.5%	>25%
Male	25	\$40,000	<3%	6.4%	14.0%
Male	25	\$65,000	<3%	4.2%	8.2%
Female	25	\$20,000	9.6%	20.5%	>25%
Female	25	\$40,000	3.0%	7.5%	15.0%
Female	25	\$65,000	<3%	5.0%	9.0%
Male	40	\$20,000	16.0%	>25%	>25%
Male	40	\$40,000	6.5%	16.5%	>25%
Male	40	\$65,000	<3%	4.8%	9.6%
Female	40	\$20,000	23.0%	>25%	>25%
Female	40	\$40,000	9.5%	19.5%	>25%
Female	40	\$65,000	<3%	5.5%	11.4%
Male	55	\$20,000	>25%	>25%	>25%
Male	55	\$40,000	24.5%	>25%	>25%
Male	55	\$65,000	12.9%	>25%	>25%
Female	55	\$20,000	>25%	>25%	>25%
Female	55	\$40,000	>25%	>25%	>25%
Female	55	\$65,000	18.5%	>25%	>25%

For example, given the assumptions used in this *Notes* article, a male age 25 earning \$40,000 with no previous savings would need to have a total contribution rate (employee and employer combined) of less than 3 percent per year for a 50 percent chance of success. He could achieve a 75 percent success rate with a contribution rate of 6.4 percent and a 90 percent success rate with a contribution rate of 14 percent. However if a male earning \$40,000 were to wait until age 40 to begin saving for retirement, the situation becomes far more difficult: In this case, he would need a 6.5 percent total contribution rate each year until retirement (age 65) for just a 50 percent probability of success and a 16.5 percent total contribution rate to achieve a 75 percent probability of success. He would be unable to achieve a 90 percent probability of success even with a 25 percent contribution rate. If he were to defer his initial savings until age 55, he would be unable to achieve a 50 percent success rate unless he made a total contribution rate of 24.5 percent of salary each year.

The answer to the question of how large account balances need to be after saving for several years to be "on-track" for a successful retirement are provided in Figures 7 through 10 for a variety of future contribution rates. Figure 7 provides the minimum account balances that a 40-year-old male would need to have a successful retirement under various combinations of salary and future total contribution rates. As expected, for any given level of salary, any non-zero minimum account balances required will decrease as the future total contribution rate increases, but will increase as the

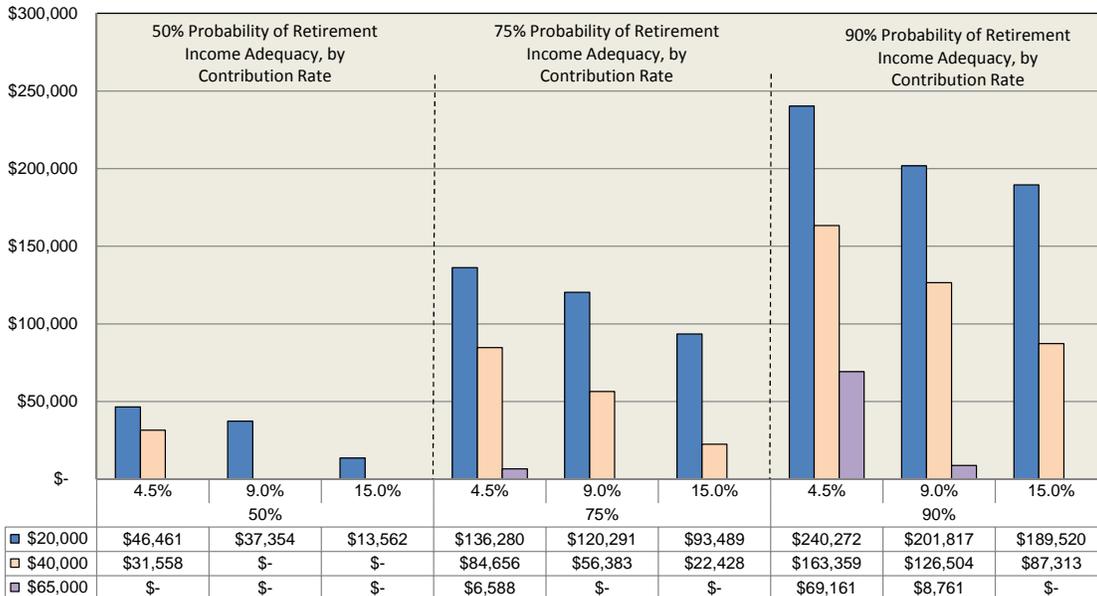
desired probability of success increases. Figure 8 provides similar analysis for a 40-year-old female. Figure 9 provides the minimum account balances that a 55-year-old male would need to have a successful retirement under various combinations of salary and future total contribution rates. Figure 10 provides similar analysis for a 55-year-old female.

**Figure 7**  
**Minimum Account Balance Required for Adequate Retirement Income at 50, 75, and 90% Probability, by Total Contribution Rates and Salary: Male Age 40**



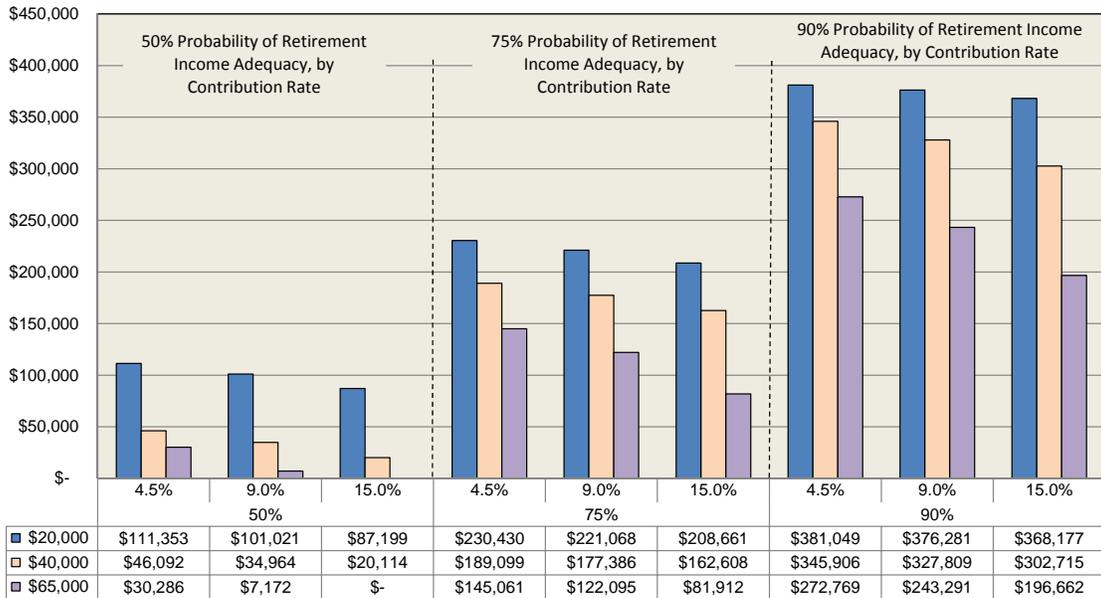
Source: Employee Benefit Research Institute Retirement Security Projection Model® Version 2207.  
 See text for assumptions and caveats.

**Figure 8**  
**Minimum Account Balance Required for Adequate Retirement Income at 50, 75, and 90% Probability, by Total Contribution Rates and Salary: Female Age 40**



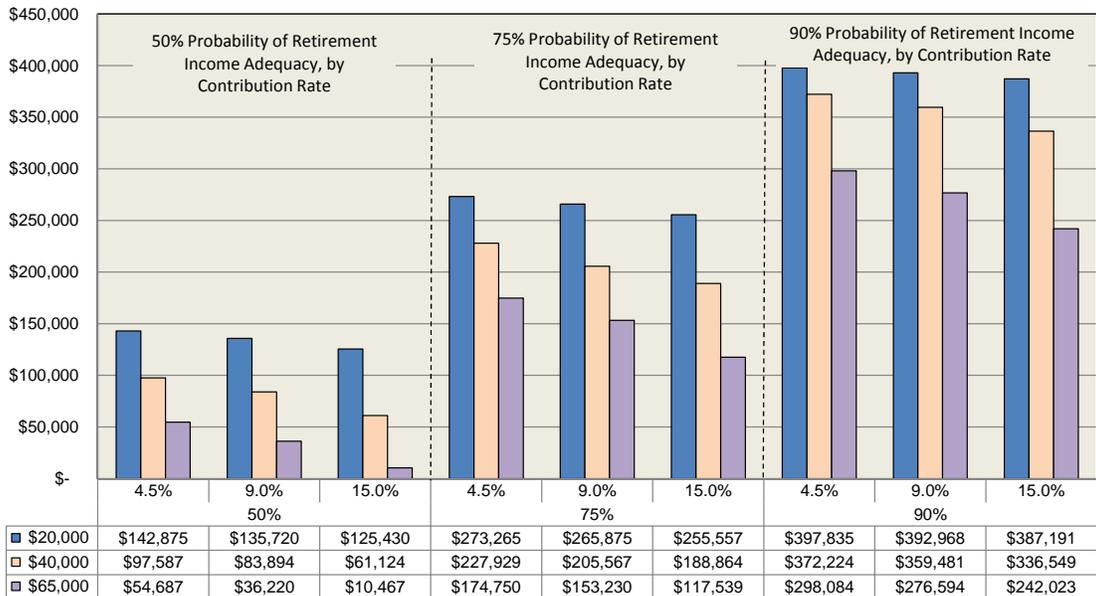
Source: Employee Benefit Research Institute Retirement Security Projection Model® Version 2207.  
 See text for assumptions and caveats.

**Figure 9**  
**Minimum Account Balance Required for Adequate Retirement Income at 50, 75, and 90% Probability, by Total Contribution Rates and Salary: Male Age 55**



Source: Employee Benefit Research Institute Retirement Security Projection Model® Version 2207.  
 See text for assumptions and caveats.

**Figure 10**  
**Minimum Account Balance Required for Adequate Retirement Income at 50, 75, and 90% Probability, by Total Contribution Rates and Salary: Female Age 55**



Source: Employee Benefit Research Institute Retirement Security Projection Model® Version 2207.  
 See text for assumptions and caveats.

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## Endnotes

- <sup>1</sup> The number of active participants in private defined benefit plans dropped from 27.2 million in 1975 to 15.7 million in 2012. During that same time, the number of active participants in private defined contribution plans increased from 11.2 million to 75.4 million. The active-participant definitions were changed beginning with the *2005 Private Pension Plan Bulletin* and added approximately 9.2 million active defined contribution participants but only approximately 200,000 active defined benefit participants. U.S. Department of Labor (2014).
- <sup>2</sup> Munnell, Webb and Hou (2014).
- <sup>3</sup> VanDerhei (September 2006).
- <sup>4</sup> See Figures 11 and 12 of VanDerhei (February 2014) for more detail.
- <sup>5</sup> VanDerhei (February 2014) and Bajtelsmit and Rappaport (2014).
- <sup>6</sup> VanDerhei (June 2014).
- <sup>7</sup> VanDerhei (February 2011).
- <sup>8</sup> VanDerhei (August 2011).
- <sup>9</sup> VanDerhei and Copeland (2011) and VanDerhei (August 2012).
- <sup>10</sup> VanDerhei (June 2013).
- <sup>11</sup> VanDerhei (August 2014).
- <sup>12</sup> A similar approach was used by the author for the March 2013 *Money* Magazine cover feature, “Dream Big, Act Now: Six Secrets of Retirement.”
- <sup>13</sup> A future publication will provide sensitivity analysis around both of these factors.
- <sup>14</sup> For a brief chronology of the EBRI Retirement Security Projection Model,<sup>®</sup> see the appendix of VanDerhei (February 2015).
- <sup>15</sup> This version of the model is constructed to simulate retirement income adequacy, as noted above. Alternative versions of the model allow similar analysis for replacement rates, standard-of-living calculations, and other ad hoc thresholds.
- <sup>16</sup> See Finke, Pfau and Blanchett (2013).
- <sup>17</sup> A 2011 study by Deloitte Consulting and the Investment Company Institute found that the median participant-weighted fee for 401(k) plans—including administrative, record-keeping, investment, and other expenses—was 78 basis points.
- <sup>18</sup> See VanDerhei, Holden, Alonso, Bass and Pino (2014).
- <sup>19</sup> This may have implications for the debate over whether a 10 percent or a 15 percent total contribution rate is the “correct” level for specific situations. In this stylized example, a 50 percent increase in the total contributing rate from 10 to 15 percent would provide only an 8.3 percent increase in the success rate. Obviously, these results and any similar cost/benefit analysis would vary for each stylized example.

# Employer and Worker Contributions to Health Reimbursement Arrangements and Health Savings Accounts, 2006–2014

*By Paul Fronstin, Ph.D., Employee Benefit Research Institute, and Anne Elmlinger, Greenwald & Associates*

## Introduction

Employers have been interested in bringing aspects of consumerism into health plans for many years. As far back as 1978, they adopted Sec. 125 cafeteria plans and flexible spending accounts. More recently, employers have increasingly turned their attention to consumer engagement in health care. In 2001, they introduced consumer-driven health plans (CDHPs)—a combination of high deductibles (at least \$1,250 in 2014) and tax-preferred savings or spending accounts that workers and their families can use to pay their out-of-pocket health care expenses. A few employers first started offering CDHPs in 2001, when they began to offer health reimbursement arrangements (HRAs) (Fronstin 2002). In 2004, they started offering health plans with health savings accounts (HSAs) (Fronstin 2004). By 2014, 27 percent of employers with 10–499 workers and 48 percent of employers with 500 or more workers offered either an HRA- or HSA-eligible plan.<sup>1</sup> As a result, by 2014 these plans covered 26 million people representing about 15 percent of the privately insured market (Fronstin and Elmlinger 2014).

This report presents findings from the 2008–2014 EBRI/Greenwald & Associates Consumer Engagement in Health Care Survey (CEHCS) and the 2006 and 2007 EBRI/Commonwealth Fund Consumerism in Health Care Survey.<sup>2</sup> It examines the availability of HRAs and HSA-eligible plans, as well as employer and individual contribution behavior.

## CDHP Eligibility

According to the 2014 CEHCS, 15 percent of the population was enrolled in a CDHP, representing about 26 million individuals with private insurance. Among the 15 percent of individuals enrolled in a CDHP, 57 percent (or 9.3 million) had an HRA or had opened an HSA, while 43 percent were enrolled in an HSA-eligible health plan but had not opened an HSA.

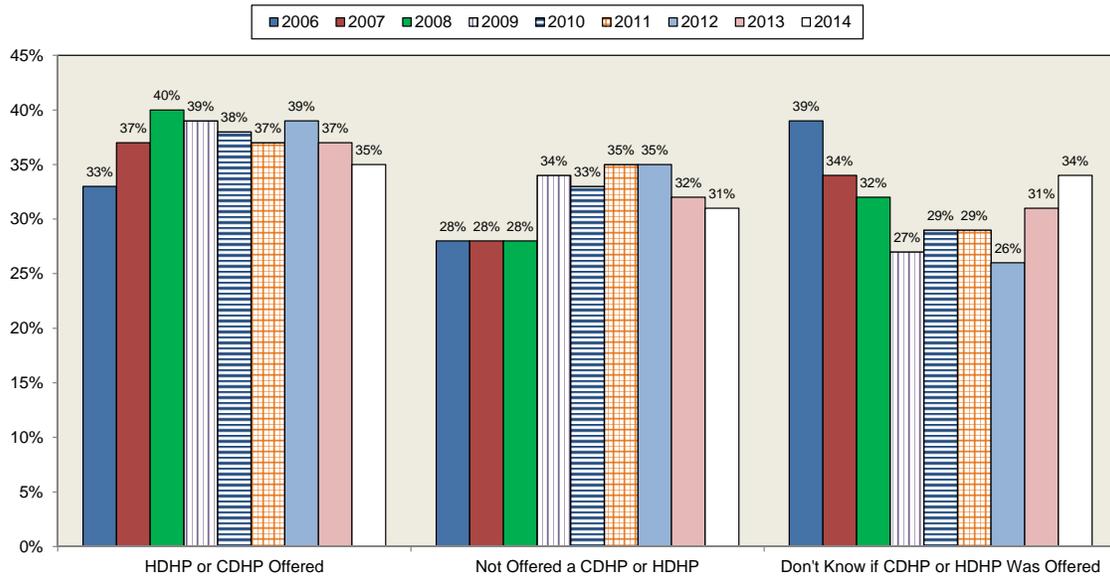
It was found that a significant percentage of workers with traditional health benefits were eligible for CDHPs. Among individuals with traditional, employment-based health benefits and a choice of health plans, 35 percent were eligible for an HRA or an HSA-based plan in 2014 (Figure 1). The percentage of individuals reporting that they were eligible for a CDHP or HDHP has fallen since 2012, but this may be due to an increase in the percentage reporting that they did not know if they were eligible.

## Employer Contributions

Two out of 3 workers (67 percent) with an HRA or HSA reported that their employers contributed to the account in 2014 (Figure 2). The percentage of workers with an HRA or HSA-eligible health plan whose employers contributed to the account had steadily increased since 2009 and reached its highest level of 71 percent in 2013 since the inception of the survey. It fell to 67 percent in 2014.

Among workers with an employer contribution, those with employee-only coverage saw their annual employer contributions increase between 2006 and 2008, and subsequently fall in 2009 and 2011. Between 2006 and 2008, the percentage reporting that their employers contributed \$1,000 or more to the account increased from 26 percent to 37 percent (Figure 3). It fell to 32 percent in 2009 and to 24 percent in 2011. More recently, the past few years have shown no clear trend. In 2012, the percentage of workers reporting that their employers contributed \$1,000 or more increased from 24 percent to 28 percent, fell to 23 percent in 2013, and increased to 34 percent in 2014.

**Figure 1**  
**Percentage of Individuals With Traditional<sup>a</sup> Employment-Based Health Benefits Offered HDHP<sup>b</sup> or CDHP,<sup>c</sup> 2006–2014**



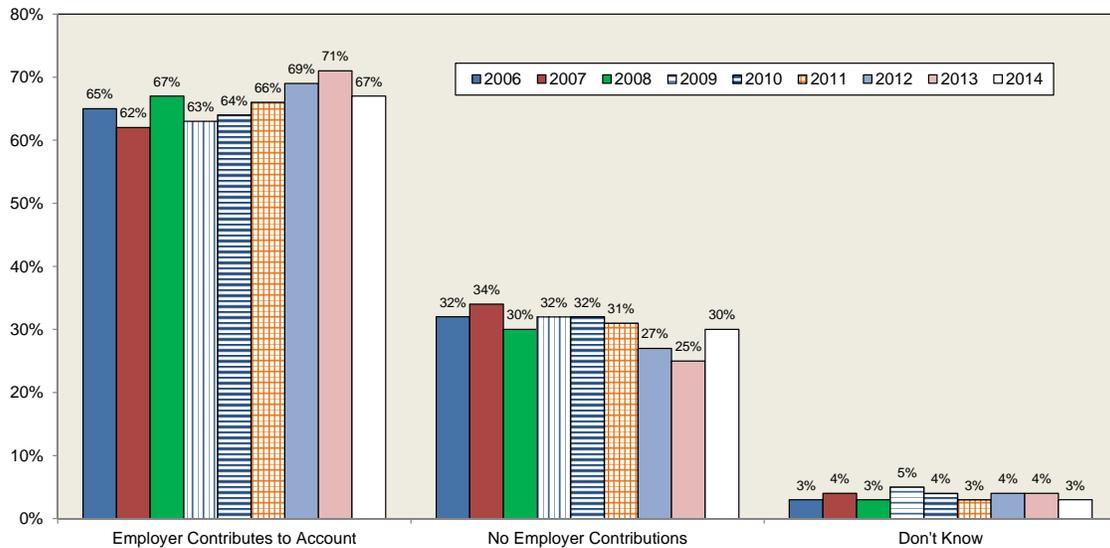
Source: EBRI/Commonwealth Fund Consumerism in Health Care Survey, 2006 and 2007; EBRI/Greenwald & Associates Consumer Engagement in Health Care Survey, 2008–2014.

<sup>a</sup> Traditional = Health plan with no deductible or <\$1,250 (individual), <\$2,500 (family) in 2014.

<sup>b</sup> HDHP = High-deductible health plan with deductible \$1,250+ (individual), \$2,500+ (family), not HSA-eligible in 2014.

<sup>c</sup> CDHP = Consumer-driven health plan with deductible \$1,250+ (individual), \$2,500+ (family), with HRA, HSA, or HSA-eligible in 2014.

**Figure 2**  
**Percentage of Individuals With Employer Contribution to HRA<sup>a</sup> or HSA,<sup>b</sup> Among People With Employment-Based Health Benefits and CDHP,<sup>c</sup> 2006–2014**



Source: EBRI/Commonwealth Fund Consumerism in Health Care Survey, 2006 and 2007; EBRI/Greenwald & Associates Consumer Engagement in Health Care Survey, 2008–2014.

<sup>a</sup> Health reimbursement arrangement.

<sup>b</sup> Health savings account.

<sup>c</sup> CDHP = Consumer-driven health plan with deductible \$1,250+ (individual), \$2,500+ (family), with HRA, HSA, or HSA-eligible in 2014.

Among workers with family coverage, employer contribution levels were mostly unchanged between 2010 and 2013. The percentage reporting employer contributions of \$1,000 or more was 59 percent in 2013 (Figure 4) but fell to 51 percent in 2014.

## Individual Contributions to HSAs

Individuals' contributions to HSAs had been growing until 2011, but have declined since then. Between 2006 and 2011, the percentage of individuals with employee-only coverage contributing nothing to an HSA decreased from 28 percent to 11 percent (Figure 5). At the same time, the percentage contributing \$1,500 or more increased from 21 percent in 2006 to 44 percent in 2011. More recently, between 2011 and 2014, the percentage of individuals reporting that they contributed nothing to their HSA increased from 11 percent to 23 percent, and the percentage reporting that they contributed \$1,500 or more fell from 44 percent to 30 percent.

Among people with family coverage, contribution levels fell slightly in 2014. The percentage not making any contributions fell from 14 percent in 2007 to 6 percent in 2013, and increased slightly to 8 percent in 2014 (Figure 6). At the same time, the percentage contributing \$1,500 or more increased from 50 percent to 59 percent in 2012, and fell to 54 percent in 2014.

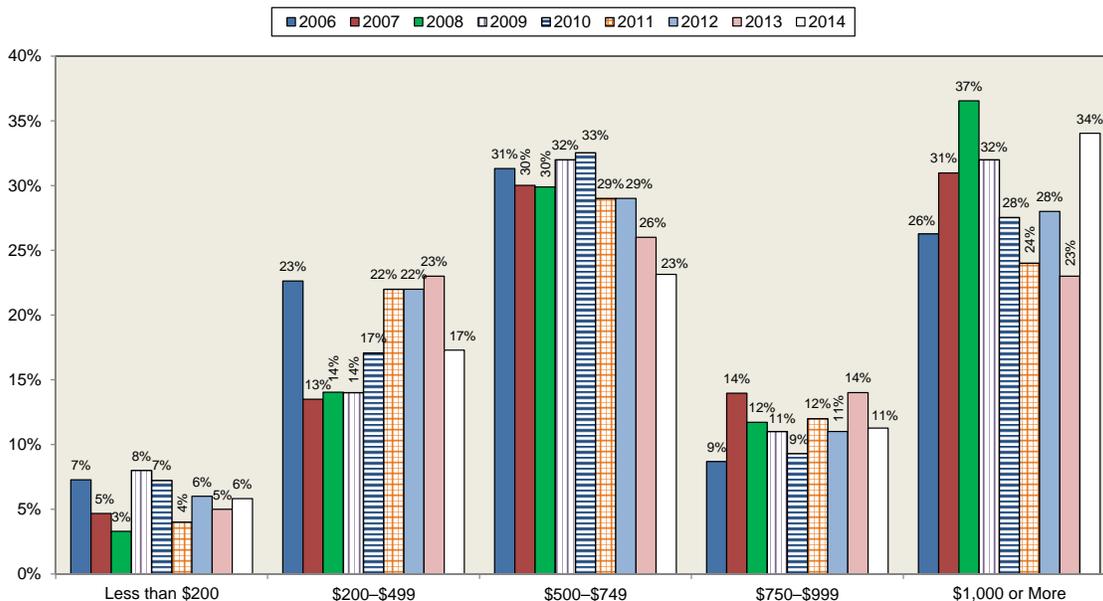
*Length of Time on the Plan:* The length of time with the account appears to have affected individual contributions among those with employee-only coverage. While those with an HSA for less than three years contributed less than those with an HSA for three or more years in 2014, contribution levels have been trending down for those with an account for three or more years. Among those with an HSA for less than three years, 25 percent contributed nothing in 2014, up from 13 percent in 2011 (Figure 7). Similarly, the percentage contributing \$1,500 or more was 25 percent in 2014, down from 39 percent in 2011. Similarly, among individuals with an HSA for at least three years, the percentage not contributing increased from 8 percent in 2011 to 21 percent in 2014 (Figure 8). The percentage of individuals with an HSA for at least three years contributing \$1,500 or more declined from 50 percent in 2011 to 37 percent in 2014.

*Income Differences:* Generally, lower-income people with an HSA are less likely to make contributions to the account than higher-income people. Seventeen percent of people in households with less than \$50,000 in income did not contribute to the HSA in 2014 (Figure 9), compared with 12 percent of people with \$50,000 or more in household income who did not contribute (Figure 10). For the lower-income group, the percentage contributing \$1,500 or more fell between 2012 and 2013 from 29 percent to 22 percent, and remained at 21 percent in 2014. Among the higher-income group, the percentage contributing \$1,500 or more also fell between 2012 and 2014 but was 51 percent in 2014.

*Health-Engagement Differences:* There is a correlation between health engagement and individual contributions to an HSA. Those defined as being engaged in their health reported that they did at least one of the following:

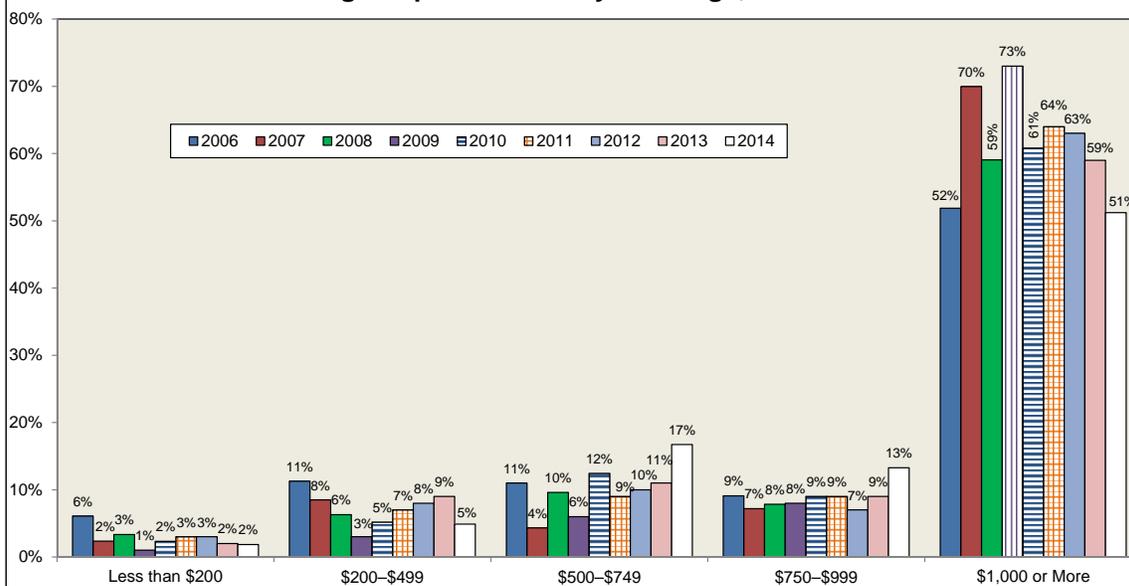
- Checked whether my health plan would cover my care or medication.
- Checked the price of a doctor's visit, medication, or other health care service before I received care.
- Checked the quality rating of a doctor or hospital before I received care from them.
- Talked to my doctor about prescription options and costs.
- Talked to my doctor about other treatment options and costs.
- Used an online cost tracking tool provided by my health plan to manage my health expenses.

**Figure 3**  
**Annual Employer Contributions to an HRA<sup>a</sup> or HSA,<sup>b</sup>**  
**Among People With Employee-Only Coverage, 2006–2014**



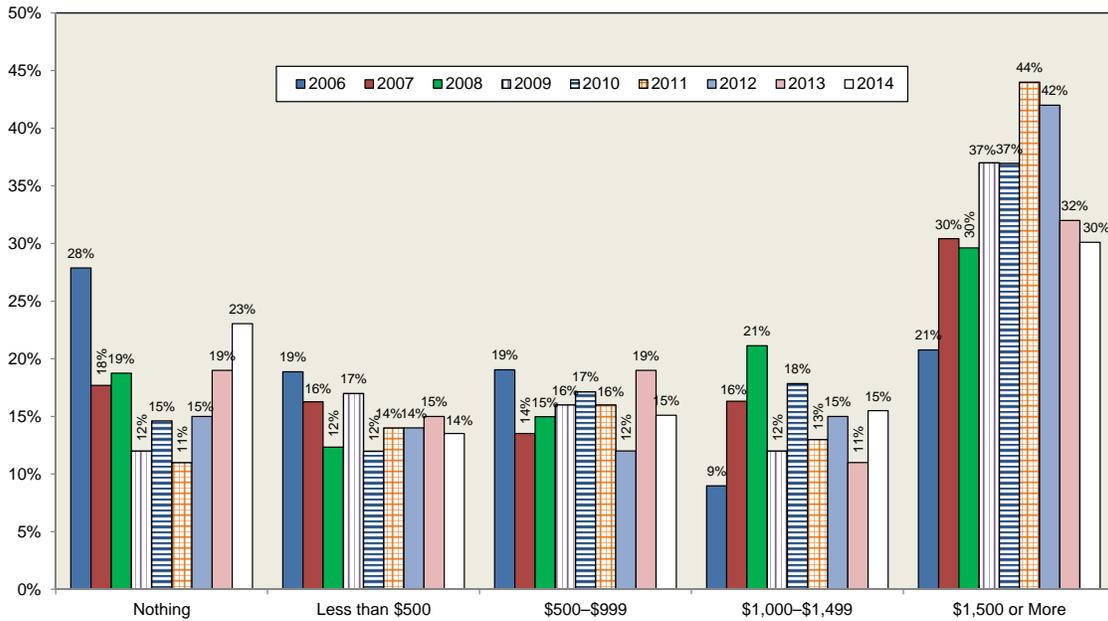
Source: EBRI/Commonwealth Fund Consumerism in Health Care Survey, 2006 and 2007; EBRI/Greenwald & Associates Consumer Engagement in Health Care Survey, 2008–2014.  
<sup>a</sup> Health reimbursement arrangement.  
<sup>b</sup> Health savings account.

**Figure 4**  
**Annual Employer Contributions to an HRA<sup>a</sup> or HSA,<sup>b</sup>**  
**Among People With Family Coverage, 2006–2014**



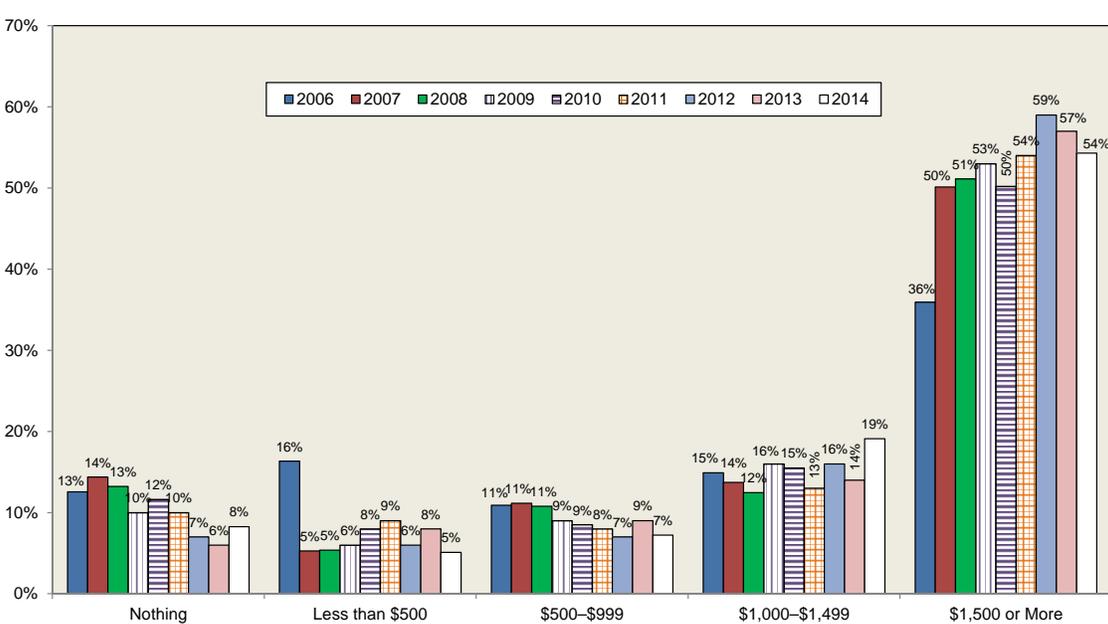
Source: EBRI/Commonwealth Fund Consumerism in Health Care Survey, 2006 and 2007; EBRI/Greenwald & Associates Consumer Engagement in Health Care Survey, 2008–2014.  
<sup>a</sup> Health reimbursement arrangement.  
<sup>b</sup> Health savings account.

Figure 5  
Annual Individual Contributions to an HSA,\*  
Among People With Employee-Only Coverage, 2006–2014



Source: EBRI/Commonwealth Fund Consumerism in Health Care Survey, 2006 and 2007; EBRI/Greenwald & Associates Consumer Engagement in Health Care Survey, 2008–2014.  
\* Health savings account.

Figure 6  
Annual Individual Contributions to an HSA,\*  
Among People With Family Coverage, 2006–2014



Source: EBRI/Commonwealth Fund Consumerism in Health Care Survey, 2006 and 2007; EBRI/Greenwald & Associates Consumer Engagement in Health Care Survey, 2008–2014.  
\* Health savings account.

- Developed a budget to manage my healthcare expenses.
- Asked for a generic drug instead of a brand name drug.
- Asked my doctor to recommend a less costly prescription drug.

It was found that individuals with some engagement with the health care system contributed higher amounts to their HSA than those with no engagement. In 2014, 20 percent with no engagement with the health care system contributed nothing (Figure 11), while only 11 percent with some engagement contributed nothing (Figure 12). In contrast, 40 percent of those with no engagement with the health care system contributed \$1,500 or more, whereas 49 percent of those with some engagement with the health care system contributed \$1,500 or more.

## Conclusion

About 15 percent of the population was enrolled in a CDHP in 2014, representing about 26 million individuals with private insurance. Among the 15 percent of individuals enrolled in a CDHP, 57 percent (or 9.3 million) had an HRA or had opened an HSA, while 43 percent were enrolled in an HSA-eligible health plan but had not opened an HSA.

The percentage of workers reporting that their employers contribute to the account decreased slightly in 2014, the first such decrease since 2009. However, among those with employer contributions, overall contribution levels for individuals with employee-only coverage increased from 23 percent to 34 percent in 2014. Worker contributions to HSAs dropped slightly in 2014. Both lower- and higher-income individuals slightly lowered their contributions in 2014, and lower-income individuals were less likely to contribute anything than higher-income individuals.

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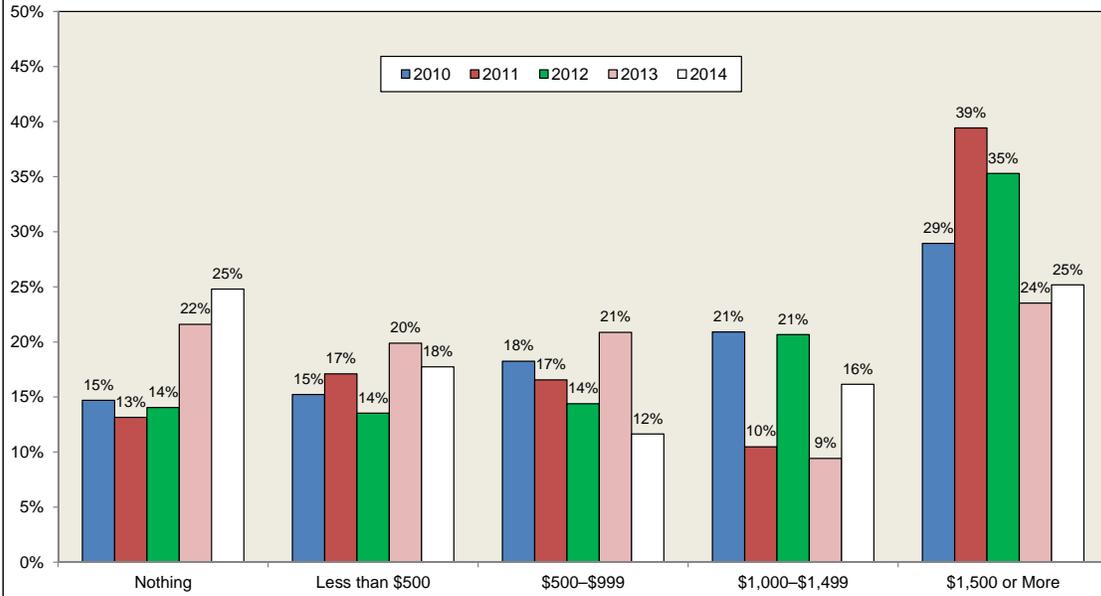
Fronstin, Paul, and Anne Elmlinger. "Findings from the 2014 EBRI/Greenwald & Associates Consumer Engagement in Health Care Survey." *EBRI Issue Brief*, no. 407 (Employee Benefit Research Institute, December 2014).

## Endnotes

<sup>1</sup> See <http://www.mercer.com/content/mercer/global/all/en/newsroom/modest-health-benefit-cost-growth-continues-as-consumerism-kicks-into-high-gear.html>

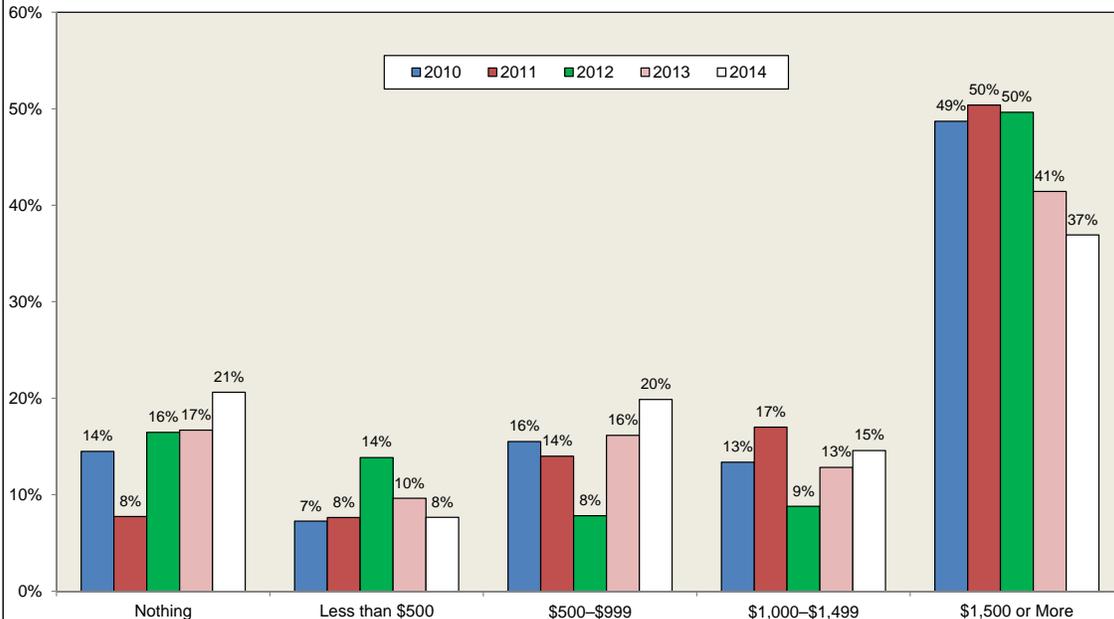
<sup>2</sup> More information about the surveys can be found in (Fronstin and Elmlinger 2014).

Figure 7  
**Annual Individual Contributions to an HSA,\*  
 Among People With Employee-Only Coverage and  
 an HSA for Less than Three Years, 2010–2014**



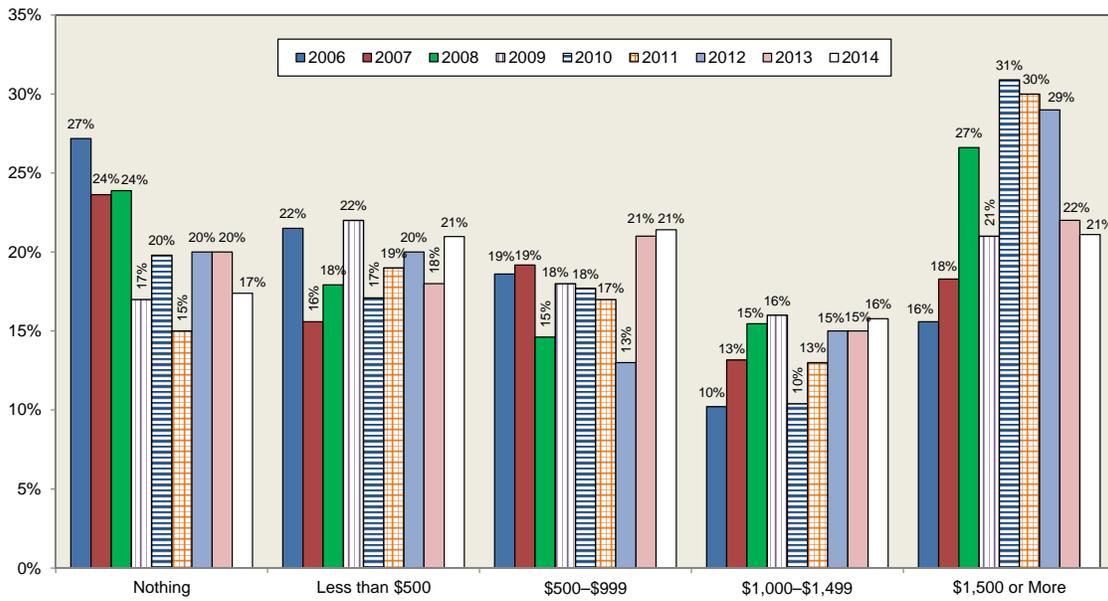
Source: EBRI/Greenwald & Associates Consumer Engagement in Health Care Survey, 2010–2014  
 \* Health savings account.

Figure 8  
**Annual Individual Contributions to an HSA,\* Among People With  
 Employee-Only Coverage and an HSA for Three or More Years, 2010–2014**



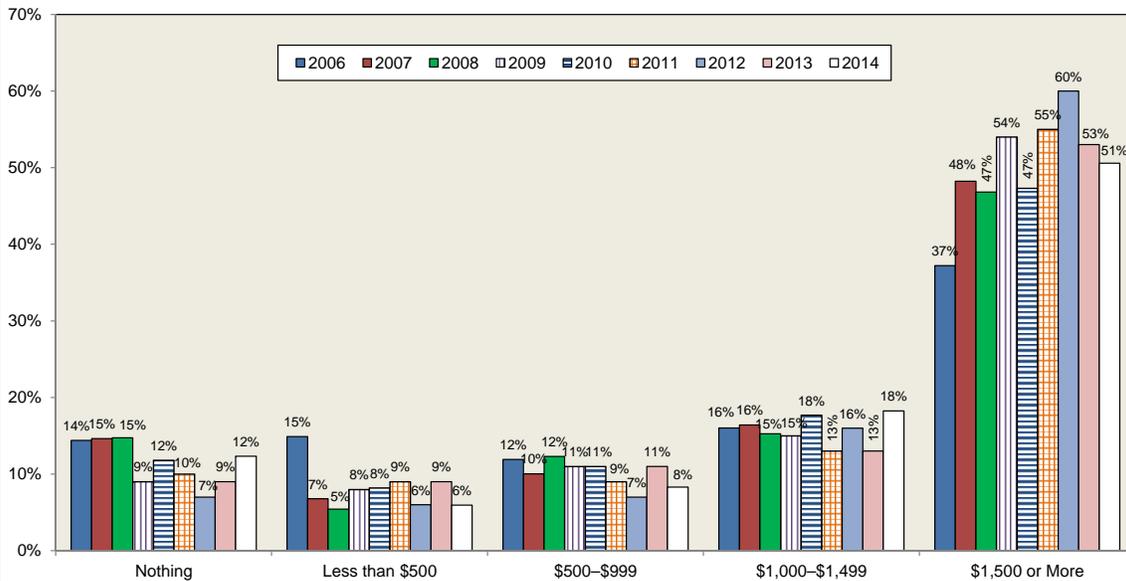
Source: EBRI/Greenwald & Associates Consumer Engagement in Health Care Survey, 2010–2014.  
 \* Health savings account.

**Figure 9**  
**Annual Individual Contributions to an HSA,\***  
**Among People With Employee-Only or Family Coverage**  
**and Household Income Under \$50,000, 2006–2014**



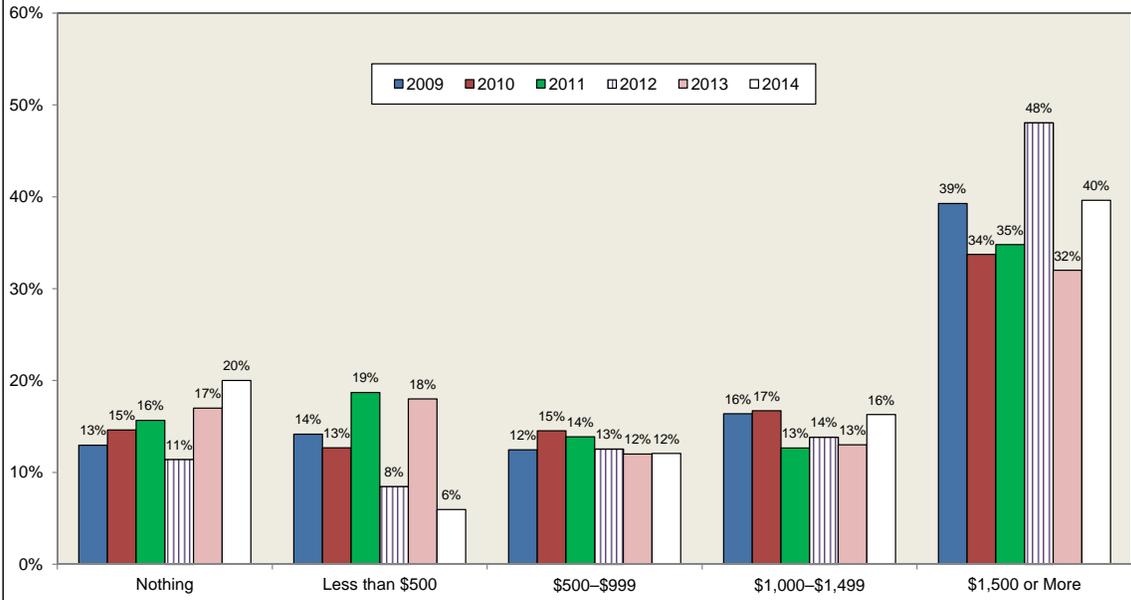
Source: EBRI/Commonwealth Fund Consumerism in Health Care Survey, 2006 and 2007; EBRI/Greenwald & Associates Consumer Engagement in Health Care Survey, 2008–2014.  
 \* Health savings account.

**Figure 10**  
**Annual Individual Contributions to an HSA,\***  
**Among People With Employee-Only or Family Coverage**  
**and Household Income \$50,000 or More, 2006–2014**



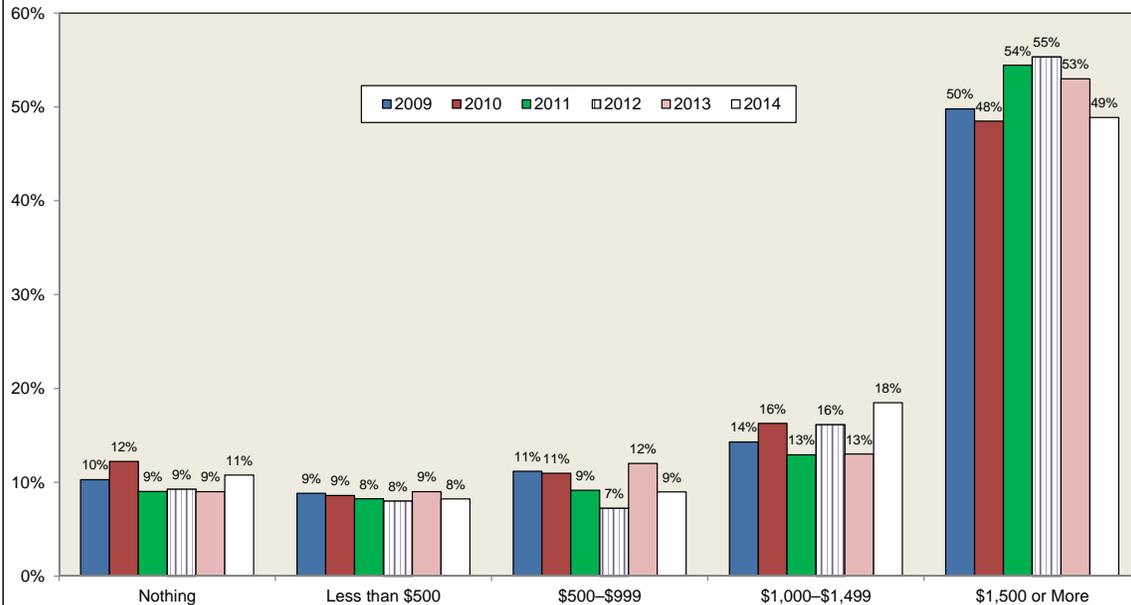
Source: EBRI/Commonwealth Fund Consumerism in Health Care Survey, 2006 and 2007; EBRI/Greenwald & Associates Consumer Engagement in Health Care Survey, 2008–2014.  
 \* Health savings account.

Figure 11  
**Annual Individual Contributions to an HSA,\*  
 Among People With Employee-Only or Family Coverage  
 and No Health Engagement, 2009–2014**



Source: EBRI/Greenwald & Associates Consumer Engagement in Health Care Survey, 2009–2014.  
 \* Health savings account.

Figure 12  
**Annual Individual Contributions to an HSA,\* Among  
 People With Employee-Only or Family Coverage  
 and At Least Some Health Engagement, 2009–2014**



Source: EBRI/Greenwald & Associates Consumer Engagement in Health Care Survey, 2009–2014.  
 \* Health savings account.

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*EBRI Employee Benefit Research Institute Notes* (ISSN 1085-4452) is published monthly by the Employee Benefit Research Institute, 1100 13<sup>th</sup> St. NW, Suite 878, Washington, DC 20005-4051, at \$300 per year or is included as part of a membership subscription. Periodicals postage rate paid in Washington, DC, and additional mailing offices. POSTMASTER: Send address changes to: *EBRI Notes*, 1100 13<sup>th</sup> St. NW, Suite 878, Washington, DC 20005-4051. Copyright 2015 by Employee Benefit Research Institute. All rights reserved, Vol. 36, no. 3.

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