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Perspectives from Anna: Responding to Challenges to Old-Age Security

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In May 2017, I attended the Pension Research Council symposium "Saving and Retirement in an Uncertain Financial Environment" as well as the Plan Sponsor Council of America (PSCA) annual meeting, "The World of Retirement." Both meetings focused on strategies for improving retirement outcomes in a world where employers have shifted to defined contribution (DC) plans, the population is aging, and lower interest rates have changed the investment environment. The Pension Research Council symposium is a research-focused meeting bringing together academics, plan sponsors and those who advise them, financial services organizations and policymakers. The PSCA is primarily an organization of plan sponsors and those who support them. Its focus is on practical solutions and doing things that will work for plan sponsors in the current and next few years. I found quite a lot of overlap in the themes and discussion in the two meetings and some key differences. I was very happy to be able to participate in each of the meetings and to talk with people who have a variety of different roles with regard to the retirement system.

I have grouped what I heard into four categories: the environment today, strategies to deal with the environment, public policy issues and ideas, and interesting research. The PSCA meeting focused on the United States, whereas the Pension Research Council symposium was much more international in scope. That brought home the idea that the big picture issues discussed often have parallels in many countries. Many issues were covered in both meetings, and I have blended together what I heard in the two settings.

THE ENVIRONMENT TODAY

Asset Returns

Low interest rates have been with us since 2008, and there was a lot of focus on the changed investment environment. Equity returns are also lower than they were a few years ago. The consequence of the lower return investment environment is that people need to save much more as a percentage of pay today than they did 20 years ago in order to provide an adequate retirement fund. The discussion indicated that there is an expectation of continued low interest rates on fixed income investments and considerable uncertainty about equity returns in the future. This investment environment affects both individuals saving in DC plans and sponsors of defined benefit (DB) plans.

The Impact of Debt

Many employees are financially stressed, and this stress affects their day-to-day performance at work. It is common for individuals to graduate from college with much more debt than in the past. While interest rates paid on investments are very low, interest charged on student debt is approximately eight percent, and that on credit card debt is often 18 percent or higher. Payday loans carry even more exorbitant rates and are another problem. Effective financial decisions about saving need to consider outstanding debt and the interest charges on it. Financial wellness programs may offer employees assistance in managing these decisions on an integrated basis. Many employers are increasing their role in helping employees understand these trade-offs.

Demographics and Longevity

Longer life spans, together with different numbers of births in different years, mean that society is aging markedly. This is an issue in many different countries.

Other Findings

An examination of today's retirees using data from the Health and Retirement Survey shows that since 2008, the 10 percent with the largest assets have fared well. Their assets, which are often invested in equities, have grown very nicely. In contrast, the 25 percent with the lowest financial assets have not done well, and many have spent down the assets they had and, in some cases, have used their housing equity as well.

Workers are more concerned about having employee benefits than in the past, in part because of fear about what may happen to government programs.

Social Security remains critically important to much of the population.

While a substantial number of today's retirees still have income from DB plans, that number is gradually changing; an increasing number of retirees will have only DC plans. Many people will also not have any employer-provided retirement benefit.

People are much more likely to save for retirement if they have access to an employer-sponsored plan.[1] The number of people without any employer-sponsored retirement benefit has not decreased; however, the savings rates have dropped.

Medical costs are increasing more rapidly than general inflation, and Medicare premiums have risen rapidly.

Some people are working longer, and it is becoming increasingly common for retirees to work part-time. Individuals wanting to work longer find that it is challenging to do so. Relatively few employer programs encourage and facilitate longer work or provide innovative arrangements.

STRATEGIES TO DEAL WITH THE ENVIRONMENT

The major strategies for individuals include saving more, retiring later, managing assets effectively, managing assets in retirement and spending less in retirement. Investments can be chosen to increase risk, making it possible to earn more investment income but also making it possible to lose.

Saving More

The use of good default options is a method of getting more people to save and of getting people to save more. Examples include auto-enrollment and auto-escalation in contributions. However, these defaults may not be as effective in increasing savings as they are in getting more people into the plan. People who would have saved more than the default contribution may drop back to the default. One of the challenges with default options is getting people engaged. Using messaging and designing programs that link to employee concerns can improve engagement.

Managing Assets Effectively

Efficiency is a concern. Areas of plan sponsor focus when thinking of efficiency include not only planning expenses, but also using annuitization to increase payout efficiency, fine-tuning investment options, reducing leakage, getting more people to save and improving financial wellness.

Financial products are being fine-tuned to respond to the current environment. Target date funds are commonly used as the investment defaults in 401(k) plans.

Health Savings Accounts are growing rapidly and are increasingly recognized as an important part of the retirement savings portfolio. Some participants are using these accounts to prefund retiree medical costs.

Employees are often not focused on the issues that experts think are most important. There has been continued research on how people make decisions and what messages fit with their current interests. It is widely recognized that most people are not making decisions based on a long-term financial analysis. There is a growing focus on how to make financial issues relevant to the day-to-day concerns of employees and how to communicate effectively.

Financial wellness programs have moved beyond retirement savings and try to teach employees and assist them in broader management of their finances. Emphasis is placed on issues like maintaining an emergency fund, debt management, budgeting and saving for retirement.

Retiring Later

Delaying retirement is a way to increase the buildup of retirement assets and at the same time shorten the period of time over which benefits are to be drawn. A two- to three-year increase in retirement age can make a big difference. Social Security retirement benefits can be claimed between ages 62 and 70. Monthly Social Security income increases for later claiming, and claiming later is often a good deal for the retiree. The average age of exit from the labor force has been increasing, but few employers offer options to help employees who wish to phase down

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before retirement. Labor force participation at higher ages is an important issue in many countries.

Managing Assets in Retirement

A major concern is the method of benefit payout and how assets are used during retirement. When assets are annuitized, those who live longer receive more benefits compared to those who die earlier. Annuitization is a method of increasing effective retirement income. Defined contribution plans most often pay benefits as lump sums, but they may offer other options, including installment payouts and life annuities. At one time, there was a popular rule of thumb that it was safe to withdraw 4 percent of assets each year. That may not be sustainable in today's investment climate. The most common practice is that individuals over 70½ years of age must take a Required Minimum Distribution from tax deferred accounts. Retirees have told the Society of Actuaries (SOA) that they prefer to hold on to assets and not withdraw more from funds than is required.

There is a need to provide more help to people in planning for the post-retirement period. Employers interested in moving forward with new post-retirement solutions are concerned about fiduciary issues. However, it is also important to understand retiree preferences.

PUBLIC POLICY ISSUES AND IDEAS

United States DC plan sponsors are concerned about what impact tax reform might have on DC plans. Possibilities include reduced limits for tax-preferred saving.

Public policy should support later retirement. Raising retirement ages in the Social Security systems is one way to do this, but there is also a great concern that the population is split between segments that are living longer and segments that are dying sooner. Other policy issues can serve as a support for or a barrier to later work.

In regard to payout options, there is a need for regulatory actions that make it easy for plan sponsors to include lifetime income options in their portfolio of options.

As many companies have cut benefits, the importance of Social Security and other social benefits has grown. However, the public is very concerned that these benefits may also be cut and worried about what will happen to their benefits.

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Social Security claiming and claiming ages could be modified so that benefits increase for claiming ages beyond age 70. There were also suggestions that people should be able to partially claim of Social Security benefits.

Fiduciary responsibility is an important part of the plan sponsor role, and major changes in the Department of Labor's fiduciary rules are being implemented in 2017. However, there is uncertainty about how these new rules may change and exactly what they mean.

One of the big policy issues today is how to get people who do not have employer plans into the retirement system. Several states have enacted legislation providing state-run programs for people without an employer plan, and there have been proposals of a federal auto-IRA program. The state plans face added uncertainty about the regulatory climate for these plans going forward.

The potential exists for improving 401(k) requirements to reduce leakage and improve savings. There have also been proposals and discussion of focusing on a lifetime savings approach.

There was a call for greater simplicity. Regulatory complexity and instability have long been problems.

INTERESTING RESEARCH

Repeated discussion focused on several strategies for the individual: save more while working, retire at a later age, spend less in retirement, manage assets effectively, manage assets in retirement and take more risk in the hope of earning more on savings. Note: The Pension Research Council symposium is supported by working papers that will be posted on the Pension Research Council website[2] later this year.

The paper "Global Developments in Employee Benefits" provides an overview of major trends and shows their similarity across a number of countries. The biggest shift is from DB to DC in funding retirement benefits. There is now a parallel shift taking place for health benefits. The paper points out that employees are becoming more interested in employers playing an ongoing role in benefits because of concerns that government-provided benefits may be cut. Financial wellness programs offer an increased focus on employee well-being. Newer technologies and choice architecture enable new benefit structures, and there is widespread understanding of the power of auto-enrollment. There is also increased acknowledgment of the importance of offering structures that work for different demographic and generational groups.

Several Pension Research Council papers included data analysis and modeling. The paper "Low Returns and Optimal Retirement Savings" showed how the amount that is needed for retirement varies based on different rates of return. Moving from historical averages to the current low returns in estimating needed retirement savings increases the rate of savings needed by about 50 percent for lower income households and nearly doubles the amount that higher income households need to save. The structure of Social Security benefits is a big factor in the difference by type of household. This paper offers a prospective look at what must be saved under different return scenarios.

The paper "Household Reactions and Strategic Responses to Retirement Wealth Building and Decumulation in a Low Interest Rate Environment" looks at a nationally recognized database, the Health and Retirement Study,[3] and reports how the low interest rates have affected actual retirees for the last few years. That paper shows that the top 10 percent of retirees by wealth had substantial gains in wealth and hold significant amounts of equity. It also shows that many of the retirees with the lowest quartile of wealth ended up spending down their assets, and a significant number also started to draw down their housing equity. Eighteen years of retirement was a typical period for this group to deplete wealth.

The paper "Investing for Retirement in a Low Return Environment: Making the Right Decisions to Make the Money Last" looks at the interaction between savings rates, retirement ages and replacement rates. It shows how Social Security is much more important to lower income households and offers commentary on the different challenges at low and high income levels. It discusses policy in several areas and provides insights about interventions designed to promote more savings and make it easier for people to work longer. Policy examples include insights about required savings in the United Kingdom and Australia. Policies to encourage longer work include abolition of mandatory retirement and the possibility of being able to claim retirement benefits on a partial basis, as well as phase-in claiming.

The paper "Challenges and Opportunities of Living and Working Longer" looks at several factors that point to longer work. When an individual reaches the early 60s without adequate retirement savings to maintain a living standard, longer work is an option, but saving more will not enable immediate retirement. Reducing one's living standard is also an option. This paper offers a discussion of alternative paths to retirement, including bridge jobs and working part-time. It shows that the labor force participation for men in their late 50s and 60s declined for many years from the mid-1900s but has been increasing in the last 20 years. Women's labor force participation at higher ages has been steadily increasing. It is my opinion that the increases in labor force participation at higher ages are occurring without much support from the business community. With more support, there is the potential for a considerably greater increase.

At the PSCA meeting, Harry Conaway of the Employment Benefit Research Institute (EBRI) presented results of the 2017 Retirement Confidence Survey.[4] One of the interesting findings was how much more confident employees are who have an employer-sponsored retirement plan. In 2017, 71 percent of those respondents who had a plan were very or somewhat confident that they would have enough money to live comfortably through retirement. This compared to only 33 percent of those who had no employer-sponsored plan. Retirees were more confident than workers. Three in 10 workers reported that preparing for retirement causes them to feel mentally or emotionally stressed, and another three in 10 said they worry about their personal finances while at work. The 2017 study is one of a long series of annual studies from EBRI. It documents the value and importance of employer plans, gaps in the retirement system and the emerging stress of employees at work. (All of the series can be downloaded from the EBRI website.)

Research conducted by the SOA also provides insights that help in understanding and dealing with these issues. The Financial Wellness Essay Collection[5] published in 2017 provides a range of ideas for plan sponsors and individuals. Of particular interest in thinking about the issues related to the structure of DC plans is the essay "The 401k as a Lifetime Financial Wellness Solution." The Post-Retirement Risk Surveys also illustrate how employees and retirees are thinking about risk and planning for it.[6]

CONCLUSION

It is a challenging time for all stakeholders focused on old-age security. Over the last 100 years, life spans have increased significantly, retirement systems have become well established in many countries, and investment returns have varied greatly. Many of today's retirees have done very well. The situation is more murky when we think about the future. When they think of retirement in the future, all stakeholders today find themselves with greater challenges than many anticipated. ■

Anna Rappaport, FSA, serves as chairperson of the Committee on Post-Retirement Needs and Risks (aka the Committee on Post- Retirement Risk).

ENDNOTES

1 However, very small employers are much less likely to provide such benefits.

2 *https://pensionresearchcouncil.wharton.upenn.edu/publications/papers/*

3 *http://hrsonline.isr.umich.edu/*

4 *https://www.ebri.org/surveys/rcs/2017/*

5 *https://www.soa.org/News-and-Publications/Publications/Essays/2017-financial-wellness-essay-collection.aspx.*

6 Carol Bogosian and I were pleased to have the opportunity to present some highlights of the Post-Retirement Risk surveys at the PSCA meeting.