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Smart Steps Employers Can Take to Help Older Workers Transition Into Retirement

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When they eliminated traditional defined benefit (DB) and retiree medical plans, many employers discarded powerful succession planning tools for their workforce. So how will they manage their baby boomer employees' transition into retirement, given the modest level of retirement savings this demographic cohort has accumulated? And will boomers hang on past their "expiration date," afraid they can't afford to retire? Is "working longer" the default election for older workers uncertain about their financial security? Or can employers and older workers band together to find a graceful and productive transition into retirement?

I've wrestled with these questions for the last five years in my current encore career as a retirement researcher and educator, following more than 30 years as a consulting actuary working in the private sector. I've been exploring new tools that employers can use to help manage an aging workforce in a defined contribution (DC) world.

DC World Challenges

American workers face three challenges in a DC world:

1. **Inadequate savings.** Various studies show that roughly half of all older American workers (age 55+) have less than $100,000 in retirement savings, a number that's not close to adequate for a traditional retirement of "not working."[1] Roughly one-fourth of workers have between $100,000 and $500,000, and another one-fourth have more than $500,000.

2. **Leakage.** According to one study, an estimated one-fourth of DC accounts experience an outstanding loan, hardship withdrawal or early withdrawal upon job separation.[2]

3. **Generating retirement income.** Only half of all DC plans offer any options for converting balances into periodic retirement income, and typically fewer than one in five plans offer guaranteed lifetime payouts.[3]

This essay describes one useful solution to the third challenge—generating retirement income—while acknowledging the importance of the first two challenges.[4] This essay also describes other tools that employers can use to help manage the succession of their older workforce.

We Need Straightforward Retirement Income Solutions

There's a clear need for DC plan sponsors and financial institutions to help their older workers and customers generate reliable, lifetime retirement income—to "pensionize" their individual retirement and DC accounts, so to speak. This can help reduce their older workers' uncertainty about financial security in retirement.

Annuities are one viable method to deliver guaranteed lifetime income to retirees, but not many older workers buy annuities on their own. And many employers are reluctant to offer annuities in their DC plans.

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1 Transamerica Center for Retirement Studies, "17th Annual Transamerica Retirement Survey: A Compendium of Findings About American Workers," TCRS 1335-1216 (December 2016), *https://www.transamericacenter.org/retirement-research/17th-annual-retirement-survey/retirement-survey-of-workers-full-survey-results*; Employee Benefit Research Institute, "2017 Retirement Confidence Survey," March 21, 2017, *https://www.ebri.org/surveys/rcs/2017/*.

2 Transamerica Center for Retirement Studies, "17th Annual Transamerica Retirement Survey."

3 Callan Institute, "2017 Defined Contribution Trends," survey, 10th anniversary edition, Dec. 23, 2016, *https://www.callan.com/wp-content/uploads/2017/01/Callan-2017-DC-Survey.pdf*; Aon Hewitt, "2017 Hot Topics in Retirement and Financial Wellbeing," report, 2017, *http://www.aon.com/attachments/human-capital-consulting/2017-hot-topics-financialwellbeing-report-final-january.pdf*.

4 U.S. Bureau of Labor Statistics, "Automatic Enrollment, Employer Match Rates, and Employee Compensation in 401(k) Plans," *Monthly Labor Review*, May 2015, *https://www.bls.gov/opub/mlr/2015/article/automatic-enrollment-employer-match-rates-and-employee-compensation-in-401k-plans.htm#top*; Aon Hewitt, "Pulse Survey: The Impact of Automatic Enrollment," January 2015.

Furthermore, many employers worry about accepting fiduciary liability when designing and implementing any retirement income solution.

The Stanford Center on Longevity (SCL), collaborating with the Society of Actuaries (SOA), recently produced research that can help address these challenges.[5] This research provides a framework for systematically assessing and comparing different retirement income strategies. The research team included myself; another actuary, Joe Tomlinson, FSA; as well as retirement researcher Wade Pfau, Ph.D. One encouraging result of this research is a straightforward retirement strategy that can work for most middle-income retirees.

To learn more about the analyses that support the strategy and how older workers can implement this strategy, see these two essays:

- "A Smart Way to Develop Retirement Income Strategies"
- "Smart Decisions Older Workers Can Make for Retirement"

Introducing the Spend Safely in Retirement Strategy

The SCL/SOA research identified a strategy that produces a reasonable tradeoff among various goals for middle-income retirees (those with between $100,000 and $1 million in savings). We call this the "Spend Safely in Retirement Strategy."

This strategy begins with a recommendation to delay Social Security benefits until age 70 for the primary wage-earner. Married couples would use common Social Security optimization tools or advisers to help determine the best claiming strategy for the spouse who isn't the primary wage-earner.

This strategy then uses the IRS required minimum distribution (RMD) to calculate income from savings to supplement Social Security income. For this RMD portion of income, the retiree would use low-cost index funds in the DC plan, such as balanced, target date or stock funds.

The Spend Safely in Retirement Strategy offers a significant advantage to both retirees and employers: It can be readily implemented from virtually any IRA or 401(k) plan without having to purchase an annuity. Many administrators can calculate the RMD and automatically pay it according to the frequency elected by the retiree.

Working Longer—the Best Way to Implement the Strategy

The most effective way for an older worker to implement the Spend Safely in Retirement Strategy is to work just enough to pay for living expenses until age 70; this enables them to delay drawing Social Security benefits and their savings for as long as possible. In essence, "age 70 is the new 65" when it comes to retirement. To make this method work, retirees may also need to significantly reduce their living expenses.

We acknowledge there can be serious challenges for both workers and employers with this "working longer" solution. To address these challenges, employers may want to develop alternative career paths that enable older workers to work longer, by offering job-rotation programs or positions with fewer hours or reduced responsibilities. They can also offer training programs to help older workers maintain their job skills.

Older workers will need to maintain their health so they can continue working; participating in their employer's health wellness program can help. They'll also want to enroll in their employer's job-training programs.

In spite of these challenges, the working longer solution can provide benefits to both employers and their older workers. Provocative evidence supports the notion that workforces that mix older and younger workers are more productive than workforces composed primarily of just older or younger workers.[6] The same research supports the conclusion that working longer and

5 Wade Pfau, Joe Tomlinson and Steve Vernon, *Optimizing Retirement Income by Integrating Retirement Plans, IRAs, and Home Equity: A Framework for Evaluating Retirement Income Decisions* (Stanford, CA: Stanford Center on Longevity/Society of Actuaries, November 2017), *http://longevity.stanford.edu/2017/11/29/optimizing-retirement-income-by-integrating-retirement-plans-iras-and-home-equity-a-framework-for-evaluating-retirement-income-decisions/*.

6 Stanford Center on Longevity, "Working Longer and Retirement: Applying Research to Help Manage an Aging Workforce," post-conference report, April 2017, *http://longevity.stanford.edu/2018/03/14/working-longer-retirement-applying-research-help-manage-aging-workforce/*.

remaining engaged with life can help older workers maintain their health and keep their wits longer. Employers can also organize volunteer programs to help engage older workers and retirees, which also facilitates their transition into retirement.[7]

The Second-best Way to Implement the Strategy

If a worker isn't willing or able to delay full retirement until age 70, the next best way to implement the Spend Safely in Retirement Strategy is to use a portion of savings to enable delaying Social Security benefits for as long as possible but no later than age 70. This might require setting aside a "retirement transition bucket" of money that retirees could use to replace the Social Security benefits they're deferring. These funds could also help facilitate the transition from full-time work to part-time work to full retirement.

The retirement transition bucket could be invested in a safe, liquid investment in the DC plan, such as a stable value fund, a money market fund or a short-term bond fund. To help the older worker delay starting Social Security benefits, the DC plan could offer a period-certain payout option together with these funds.

RMD can be Default Retirement Income Option

Auto-enrollment and default investment options have demonstrated the power of default elections for accumulating savings. As a result, plan sponsors and their consultants have been seeking a default payout option that can be utilized for retiring workers to improve retirement outcomes.

The RMD, combined with the plan's qualified default investment alternative (QDIA), might be a viable default retirement solution that offers fiduciary protection to the plan sponsor.

Using the RMD as a payout strategy complies with IRS regulations; the retiree will incur substantial penalties if the minimum amounts aren't withdrawn from the plan. As a result, both retirees and plan sponsors have a significant incentive to comply with the RMD. In addition, our analyses show the RMD helps maximize expected retirement income.

As a refinement or alternative to the default solution, a retiree can make a positive election to meet various retirement planning goals, such as deploying a portion of retirement savings to build their retirement transition bucket, starting withdrawals before age 70-1/2 or electing another payout option offered by the plan.

Planning Tools Can Help

Plan sponsors and financial institutions could use the Spend Safely in Retirement Strategy to prepare retirement income statements for DC plan participants that don't involve making assumptions about interest rates or product features. Retirement income statements can help older workers understand their expected retirement income at various retirement ages that they would receive from Social Security and savings. Preparing these statements should be a straightforward task since the calculation rules for Social Security and the RMD are readily available. These statements can help older workers decide when they can afford to retire.

Plan sponsors and financial institutions could also arrange for qualified, unbiased advisers to help older workers implement the Spend Safely in Retirement Strategy. For example, advisers could:

- Develop a strategy to help older workers optimize Social Security
- Select a fund to implement the RMD portion of the strategy
- Help older workers build the retirement transition bucket with the plan's funds

This type of one-time help might be more efficient for retirees than the common arrangement of paying advisers an ongoing asset charge throughout retirement.

Future Research Can Provide Useful Insights

Future research could help employers and older workers understand:

7 Stanford Center on Longevity, *Hidden in Plain Sight: How Intergenerational Relationships Can Transform Our Future*, monograph, June 2016, *http://longevity.stanford.edu/wp-content/uploads/2017/04/Monograph_web_07_11_2016.pdf.*

- Circumstances when the Spend Safely in Retirement Strategy could be most helpful, by examining retirement ages different from age 65, Social Security start dates other than age 70 and various hypothetical employees
- How to refine the strategy for married couples
- How to modify the strategy to address common situations (for example, income from working that eventually stops) or future reductions in living expenses (for example, paying off a mortgage)
- The prevalence and number of older workers who could be helped by the strategy
- Communication strategies to encourage implementation among middle-income retirees

In addition, future research could explore considerations for building the retirement transition bucket to enable workers to delay Social Security benefits, as well as help with a smooth transition from full-time work to part-time work to full retirement.

New Tools to Manage an Aging Workforce

The Spend Safely in Retirement Strategy emphasizes that it's smart for employers to help their older workers develop retirement income strategies by adopting the following policies and DC plan features:

- Automating the RMD as a payment option in their DC plan
- Offering period-certain payouts in the DC plan to enable optimizing Social Security
- Adopting the RMD together with the DC plan's QDIA as the default payout option
- Offering low-cost index funds in the DC plan
- Providing education, tools and retirement income statements to help with retirement planning
- Shopping for qualified, unbiased assistance with retirement income planning
- Designing alternative career paths for older workers

Employers can further help their older workers transition into retirement by:

- Continuing health wellness programs for retirees
- Offering retiree medical plans before eligibility for Medicare at age 65
- Assisting older workers and retirees with navigating the Medicare maze
- Offering group purchase programs for long-term care insurance
- Providing volunteer opportunities to give older workers and retirees a sense of purpose and valuable social contacts

The Spend Safely in Retirement Strategy can be an important part of a new toolkit employers can use to help manage an aging workforce in a post-DB world.

The fact is, it's smart for employers to help allay the natural fears older workers have about outliving their savings and being hit with high medical bills in retirement. It's also smart to help their older workers make important life decisions, such as how long they should continue to work full time, whether they should transition into retirement with part-time work, when they can fully retire and how much money they can afford to spend in retirement.

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