# Discussions

## Patricia Scahill

### *Retirement Issues for Women*

Our national retirement income policy is unclear at best and nonexistent at worst. If the retirement system is intended to provide security in old age, we should focus on the adequacy of retirement benefits. If the system is a vehicle for deferred income, the focus should be on capital accumulation, and early access to the money should be allowed.

Regardless of the focus of any national retirement income policy, people have retirement needs. Educating citizens about those retirement needs is difficult, partly because it forces them to plan for aging and infirmity. However, we need a strong national retirement system, and individuals must bear at least part of the responsibility for a secure retirement.

There are some legislative changes that can improve the retirement system. I strongly encourage recoupling executive retirement benefits with the qualified retirement system. Low compensation and benefit limits force many executives to rely on nonqualified plans for most of their retirement income. Raising these limits to allow a reasonable portion of their retirement benefit from qualified plans will renew executive interest in the level of benefits these plans provide.

In light of the information presented in Karen Holden's paper, we should consider raising the Qualified Joint and Survivor Annuity (QJSA) percentage from 50% to 75%. Since the participant generally bears the cost of the survivor benefit through a smaller annuity amount, this change will not add to the plan sponsor's cost of the retirement program. The Qualified Pre-retirement Survivor Annuity (QPSA) death benefit could also be increased from 50% to 75%. Since sponsors typically underwrite the cost of this death benefit, they would absorb the small (approximately 1.5%) liability increase resulting from this larger death benefit protection.

I disagree with Jon Forman's recommendation of mandating pension division upon divorce unless the judge orders otherwise. It would be very difficult for a federal law like ERISA to work smoothly with the wide diversity of state family laws. Also, pensions are rarely overlooked in divorce actions, so I do not think the change is needed.

From a retirement income policy perspective I am sympathetic to Jon's suggestion of mandating annuities from defined contribution plans. Since women tend to live longer than men, they are more likely to outlive their retirement savings. A lifetime annuity transfers the mortality risk away from the individual. Those plans that aren't equipped to administer annuities could buy them. This mandate would make a retirement plan act like one rather than acting like a savings account. However, participants like lump sums, and they would probably resist the mandate that eliminates a popular payment method.

The increased early access to defined contribution accounts makes me concerned as Congress considers adding an individual account component to Social Security. I think they will receive at least as much pressure for early access to the Social Security accounts as they have gotten for retirement account access. There is no reason to believe they will be better able to withstand the pressure in the context of Social Security than they have with retirement plans. Early access often means early consumption, which will eventually put pressure on public assistance programs. Since women are more apt to outlive their retirement savings, they face an added risk if Social Security begins to change into a defined contribution system.

Employee education can make a significant contribution to retirement security if it increases the savings rate for workers. Workers need to understand the effect of their work patterns on their retirement income. Some of the newer defined benefit designs are intended to accommodate the new work patterns. Cash balance plans resemble defined contribution plans, but the sponsor retains the investment risk. Unfortunately, it appears that a media attack against cash balance plans is mounting. A December 4, 1998, front page article in the *Wall Street Journal* takes a hard line against cash balance plans.

Educated employees are more apt to question the amount of administrative expenses they pay in defined contribution plans. When the workers pay administrative expenses, they have less income in retirement.

Often these administrative charges are hidden in a lower investment return rather than shown separately.

Employee education needs to encourage young savers, but at the same time it can't discourage those midcareer workers who did not save earlier. We need to develop some simplified rules of thumb about how much should be saved for retirement. Mutual fund companies could offer "life cycle" investment packages in which the investment allocation gradually changes as the workers nears retirement.

# Ron Solomon

## *Examining Preconceived Notions*

These are three well-prepared papers that contribute quite a bit to the analysis of retirement needs and individual behavior. Existing analyses can produce inconsistent and contradictory conclusions. This can be explained by several factors: there are many variables impacting behavioral decisions; in some areas there are little or no data; and it is very difficult to quantify the impact of "big picture" changes, for example, the Baby Boom cohort, increasing prevalence of PRBs, and the change from defined benefit to defined contribution plans. Compounding the problem may be the fact that some analysis is produced by people with a particular bias that interferes with objectivity.

## *Stallard Paper*

Overview: Eric has done an outstanding job of analyzing voluminous data and contributing to the public discourse. It is important to note that collecting these types of data is difficult and there are still many unknowns. For example, the data do not include free long-term care (LTC) provided by family. Although Eric has included an estimate, it is not clear what the "cost" is now, much less the implications as the Baby Boomers age and dependency ratios increase.

Medicaid LTC: Moses's article "LTC Choice" (1998) presents an uncommon viewpoint that Medicaid LTC coverage is perceived as entitlement, not welfare, and that people will not insure when they know the government will step in. Furthermore, people know how to shelter income and assets to qualify without "impoverishing" themselves. However, Moses cites data (Sloan and Shayne 1993) that 78% of beneficiaries are already Medicaid eligible. This may be inconsistent with his thesis, depending on how "already eligible" is defined. Other data (Wiener 1996) show that 40% are Medicaid-eligible at admission, and another 30% become Medicaid-eligible during their nursing home stay.

Medicare projections: It is true that the HCFA projections do not take explicit account of the disease category death rates developed by SSA, but they are implicitly recognized. HCFA actuaries have begun a more thorough review of assumptions in the past few years. So far both productivity and mortality assumptions have been analyzed thoroughly. Note also that the intermediate assumptions used in the Trustees' Reports are the trustees' "best estimates," but while reasonable, they are not optimal. It is more likely that future experience will be worse rather than better.

## *Brown Paper*

PRBs: Rob's thesis is that multiphase retirement is on the rise in both the U.S. and Canada. However, he does not explicitly recognize the impact of employer PRBs in the U.S. or any analysis of the possible correlation between early retirement with or without bridge jobs and vested PRBs.

Retirement age trends: Rob uses labor force participation rates to support his contention that the trend to earlier retirement has ended. This conclusion is perhaps unjustified by the data he cites (Quinn 1998). It is clearly contrary to Gendell's 1998 analysis, which shows that declines continue in the mean, median, and first quartile age at retirement in the U.S. It may be necessary to compare labor force participation rates with unemployment rates for a more thorough analysis.

## *Brothers Paper*

Factors influencing retirement decision: Linda points out that the trend to earlier retirement results from many factors. One she may have overlooked is the impact that the Baby Boom cohort's entry into the job market has had on older workers, and the retirement incentives employers have provided.

Proposal for further research: Linda recognizes the need for more analysis because of conflicting results from studies that included PRBs. Although it is clear that this is a subject that could benefit from further analysis, other changes may have a dramatic impact on future behavior. For example, existing data are from the mainly defined-benefit pension world we have been living in; market fluctuations in the value of

defined contribution accounts can impact behavior in a new way.

## Henry Winslow

I believe *retirement needs* for which one tries to save and later maintain resources are designed to provide an acceptable life style (picked by choice or compromise). In addition, these needs should include an allowance for contingencies such as health crises, living too long, and inflation.

An age is chosen for retirement, and the needs are often expressed as a percentage of average income earned in a period close to the retirement date.

To meet these needs, one must usually save a lot, unless one is unusually wealthy or expecting to depend only on Social Security and any employer pension, like many low-wage earners are.

These two papers by Palmer and Jones discuss aspects of this endeavor and what might befall it.

To begin, a primary need for retirement is somebody else. I am not writing about love and companionship here, but rather some financial aspects. Sometimes two frail people's needs and remaining abilities mesh so they can care for each other temporarily, thus reducing health care expenses. Likewise, a disabled retiree needs someone to check that health care providers are giving the care they should, on schedule.

### *Palmer's Paper*

The process described in Palmer's paper is to determine the assets needed at retirement for a retirement need income goal versus assets projected to be available from current plans, then to raise savings to make up the difference. However, if the required savings is too high, retirement needs are modified, or retirement is delayed, then the required savings is refigured.

I feel that several of the factors listed in the paper to measure needs or income are quite important, and I will concentrate on them.

- Inflation is a key assumption for yearly income needs after retirement. Also, salary and some asset values will correlate with inflation. Some assets will correlate imperfectly, while others won't. Covering inflation in the plans will lead to continued growth in savings after retirement for a few years, especially if assets are noninflation responsive like corporate pension plans and fixed-income investments. Beyond these points, inflation, salary growth, and investment return must be consistent, or nonsense can result.
- Social Security: The amount received depends on the retirement age as well as the earnings history. If one is worried about the future of Social Security as many are, one can arbitrarily assume Social Security benefits grow at 1/2% or 1% less than inflation instead of with inflation, as they legally do. There is no such proposal to change Social Security, but one reads of the system's need for some long-term change, which could somehow lower benefits. This technique really is an arbitrary precaution.
- Life expectancy: The savings plan must assume that one will live several years beyond one's life expectancy at retirement. Otherwise, there is a significant possibility of running out of savings because of living "too" long.
- Taxes: They impact some types of income and savings accumulation differently; for instance, dipping into principal in a 401(k) plan creates taxable income, whereas it may create no or realized capital gains (losses) for financial assets. These differences do need to be reflected.
- Measurement: It is important to measure the retirement plan periodically, since so many things change, and investment experience can be volatile.
- Psychological Element: It is quite possible that the savings requirement may be so high as to discourage savings altogether. Another problem deserving mention is that the required savings rate will vary from measurement to measurement, and that too can be disturbing.
- Situation Today: There is evidence that many Americans are falling short of their savings rate required for their hoped for retirement age and income need. In October 1998 the pension Research Council prepared a working paper showing that additional annual savings of 16% of earnings is needed for retirement at age 62.[1] The same paper showed additional required savings would drop to 7% of earnings if retirement were deferred to age 62. Although deferring one's retirement is a powerful tool to help meet one's retirement needs, it is not always available. Health, layoffs, norms of industry, and the employer may make such deferral awkward.

[1]James Moore and Olivia Mitchell, *Projected Retirement Wealth and Savings Adequacy in the Health and Retirement Study,* Pension Research Council Work Paper 98-1, October 1998, p. 11 and table 11.

- Emergency lump sum: I think an adequate retirement plan would also build a lump sum (a year's income?) to be available for emergencies in any year and not used otherwise. This probably wouldn't cover all the risks the paper outlines, but it would help.

## *Jones's Paper*

Jones's paper probabilistically puts retirees through several distinct health states with income needs rising geometrically as health deteriorates. Then it shows how a level present value income need would be tested by the random sequence of health shocks and mortality. An early death allows this average income need to be sufficient financially.

I think an advantage of this type of analysis is the picture (probability distributions) it can produce as the math and simulations meet the data and/or the assumptions. Even partly proven data or assumptions, when combined with the math, can show in general terms what is to be expected for a population. However, one does need real data, and I wonder how credible these analyses would be perceived in the face of any critics and politicians if the data are not the best.

The data utilized in the paper are a population age 55 and older. Most people retire at older ages than 55. Thus, I would be curious to see tables for people retiring at 60, 62, and 65, also using Jones's techniques. Incidentally, the tables show the phenomenon of women living longer but with more illness than men on the average.

Table 4 is interesting, because it shows the distribution of income adequacy (inadequacy) through the vehicle of the level annual income needed given specific health-death patterns.

I wish a fifth table had been prepared showing the distribution of the difference between the present value at retirement of the average *adequate level annual income* and the present value of *actual adequate level income* for a specific individual. This table would show how much health-death patterns would reduce (increase) savings held at retirement.

Presumably, any deficits would be made whole first from financial assets, which per the Health and Retirement Study are roughly 20% of projected retirement assets for typical households.[2] Since \$2–\$3 of financial assets would produce about 20% of the Jones's paper average adequate level income, losses in excess of that range would be noteworthy and would hypothetically threaten resources implicitly needed for other purposes.

In any case, if you live long, you won't prosper unless you are fortunate to stay healthy, as this paper shows.

I think both papers are thought-provoking and informative forays into the worlds of retirement and savings for retirement.

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[2]Olivia Mitchell and James Moore, *John Phillips: Explaining Retirement Savings Shortfall,* Pension Research Council, Work Paper 98-13, table 1.