

# Notes

## Is There a Future for Retirement? p. 13

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### E X E C U T I V E   S U M M A R Y

#### **Is There a Future for Retirement?**

**EBRI'S 68TH POLICY FORUM:** This article summarizes the presentations and discussions at the Employee Benefit Research Institute's May 12, 2011, policy forum, on the topic: "Is There a Future for Retirement?" This was EBRI's 68<sup>th</sup> policy forum and was attended by about 120 policy and professional experts.

**WORKING LONGER:** Various reports in recent years suggest that working an extra two or three years would solve the problem of inadequate retirement savings for most people, but this has not been well documented or quantified. New EBRI research presented at the policy forum addressed that question with comprehensive data from its Retirement Security Projection Model.<sup>®</sup>

**IMPLICATIONS:** A broad range of experts discussed a variety of key issues related to America's aging work force and the implications of working longer. These include such issues as whether financially feasible retirement ages can be kept within acceptable ranges, and the implications of Baby Boomers and Gen Xers working past age 65.

# Is There a Future for Retirement?

By Stephen Blakely, Employee Benefit Research Institute

## Introduction

An ever-growing number of older American workers are remaining in the work force. Data show the trend began in 1993, as more Americans over ages 55 and 65 began remaining on the job—a trend that continues today.

In the United States, Social Security and other pension programs are pushing up the age at which a retiree will be paid full benefits; more age increases are being debated in Washington and around family dinner tables. For years, the Retirement Confidence Survey<sup>®</sup> (RCS) has found that more and more workers expect to work to later ages. But even though many people say they always wanted to work into retirement, RCS and other data show that large numbers are forced to leave the work force early, due to health problems, layoffs, or economic changes—hardly the “dream retirement” most have contemplated.

The EBRI Retirement Readiness Rating<sup>™</sup> finds that many individuals will need to keep working past normal retirement age in order to have sufficient resources to pay the bills; said another way, they have insufficient resources, even including Social Security and Medicare, to pay their bills. Many articles and papers have been written in recent years suggesting that working an extra two or three years would solve the problem for most people, but this has not been well documented or quantified. But will it be enough if workers simply stay on the job just a few extra years?

New EBRI research presented at this May 2011 policy forum addressed that question with comprehensive data from its Retirement Security Projection Model.<sup>®</sup> In addition, a broad range of experts discussed a variety of key issues related to America’s aging work force and the implications of working longer.

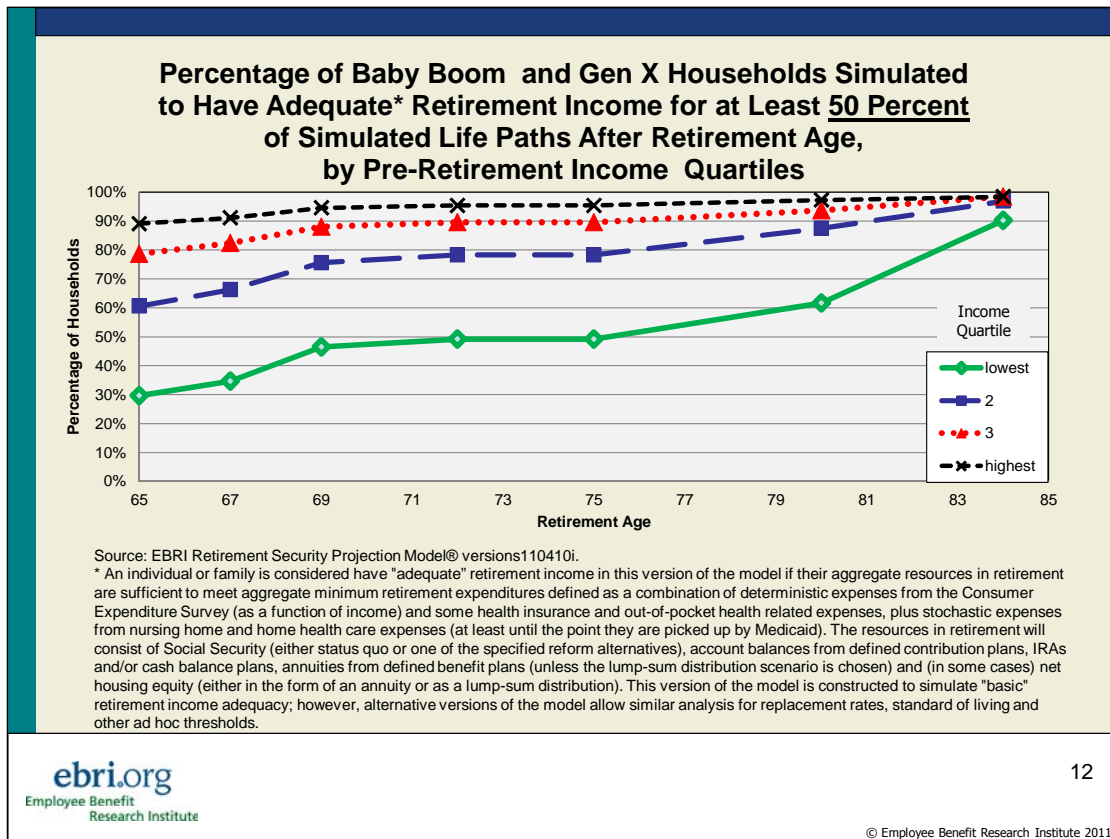
This article summarizes the presentations and discussions at the Employee Benefit Research Institute’s May 12, 2011, policy forum, on the topic: “Is There a Future for Retirement?” This was EBRI’s 68<sup>th</sup> policy forum held in Washington, DC, and was attended by about 120 policy and professional experts.

## How Long Will Boomers and Gen Xers Need to Work?

**Jack VanDerhei**, EBRI research director, presented new findings about the impact of deferring retirement age past 65 on retirement income adequacy. Since preretirement income is such an important factor in predicting retirement income adequacy, VanDerhei breaks out results from EBRI’s Retirement Security Projection Model<sup>™</sup> by income group.

The analysis looks at Baby Boomers (the post-World War II generation born between 1948–1964, currently ages 47–63) and Generation Xers (those born between 1965–1974, currently ages 37–46), and provides results for achieving retirement income adequacy 50 percent of the time (1 in 2 chances), 70 percent of the time, and 80 percent of the time. “Adequacy” is defined as being able to cover basic costs of living, and also being able to cover uninsured health care costs.

The results, published in the June 2011 *EBRI Issue Brief*, show that if Baby Boomers and Gen Xers delay their retirement past the age of 65, many of them still would not have adequate income to cover their basic retirement expenses and uninsured health care costs—especially low-income workers. Even if workers delay their retirement age into their 70s, there is still a chance the household will be “at risk” of running short of money in retirement.



Specifically, for those in the lowest income group, only about 30 percent of low-income households would have sufficient resources to avoid running short of money in retirement 50 percent of the time at age 65; but this increases to about 35 percent if retirement is deferred until age 67 and about 47 percent if retirement is deferred until age 69. These rates go down if a higher chance of success is desired. Because higher-income households start with a much higher chance of success, working longer has less of an impact.

VanDerhei noted that a major factor in improving retirement income adequacy by working past age 65 is whether the worker continues to participate in a defined-contribution retirement plan (such as a 401(k)). The increase in the percentage of households that are predicted to have adequate retirement income as a result of defined contribution participation varies by several factors (such as retirement age and preretirement income level), but this factor makes at least a 10 percentage point difference in the majority of the retirement age/income combinations, VanDerhei said.

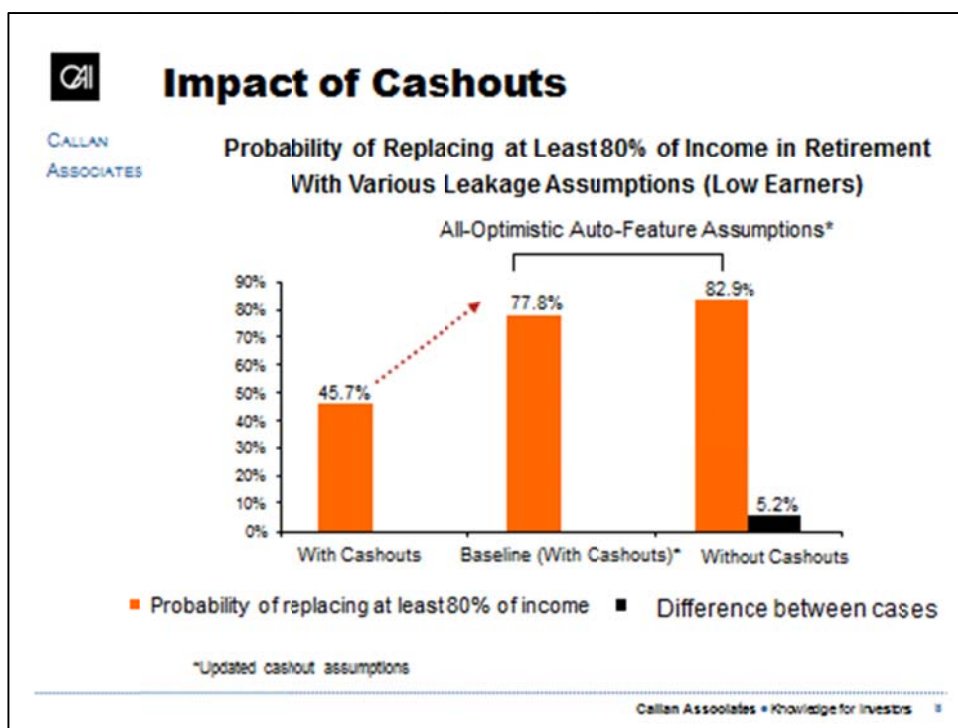
"Will deferring retirement age work? The answer is, obviously, it depends," VanDerhei said. "It depends on what probability of success you're looking for, where you were relative to everybody else in terms of preretirement income, and it certainly depends on whether you still are accruing benefits in a 401(k) plan."

## Can Financially Feasible Retirement Ages Be Kept Within Acceptable Ranges?

**Lori Lucas**, executive vice president and defined contribution practice leader at Callan Associates, focused on ways both plan sponsors and policy makers could help workers save more in their 401(k) plans, through plan design changes and restricting withdrawals for non-retirement reasons.

She presented an expanded analysis from the November 2010 *EBRI Issue Brief*, and a joint publication that month by the Defined Contribution Institutional Investor Association (DCIIA) and EBRI, on the impact of automatic features in 401(k) plans on retirement income adequacy, how automatic enrollment and automatic contribution escalation are being implemented, and what improvements could be made. She also discussed “leakage” of savings in 401(k) plans (such as through cash-outs at job change, hardship withdrawals, and loans), which she said is an increasing area of focus for policymakers and plan sponsors.

Regarding plan design, analysis shows that retirement income adequacy could be greatly improved by setting the default contribution rate for workers who are auto-enrolled into 401(k) plans at 6 percent instead of 3 percent of salary, and increasing the annual auto-escalation rate to 2 percent instead of 1 percent, Lucas said. These changes would be especially helpful if also tied to a couple of other plan-design changes such as a ban on opting out of the 401(k) plan.



Even though many recently enrolled workers appear to be staying at the typical 3 percent default contribution rate, Lucas noted that employers typically recommend they contribute at least 10 percent in order to achieve retirement income adequacy. Since workers often do not take the initiative themselves to increase their savings rate, she warned that a low auto-enrollment default rate may hurt the chances of success for many participants.

“There’s a real disconnect there between how people are being defaulted into the plan and where plan sponsors actually think they need to be,” Lucas said.

Regarding “leakage” from 401(k) accounts, Lucas cited EBRI research showing that participant loans appear to have a minimal impact on lowering retirement income adequacy, as long as they are repaid. She said the major threat to retirement income adequacy from leakage is from cash-outs, where workers leaving a job take out all their retirement savings in cash rather than rolling over the assets into an individual retirement account (IRA) or other tax-favored retirement account. She recommended that lawmakers focus on policies that would prevent this from happening.

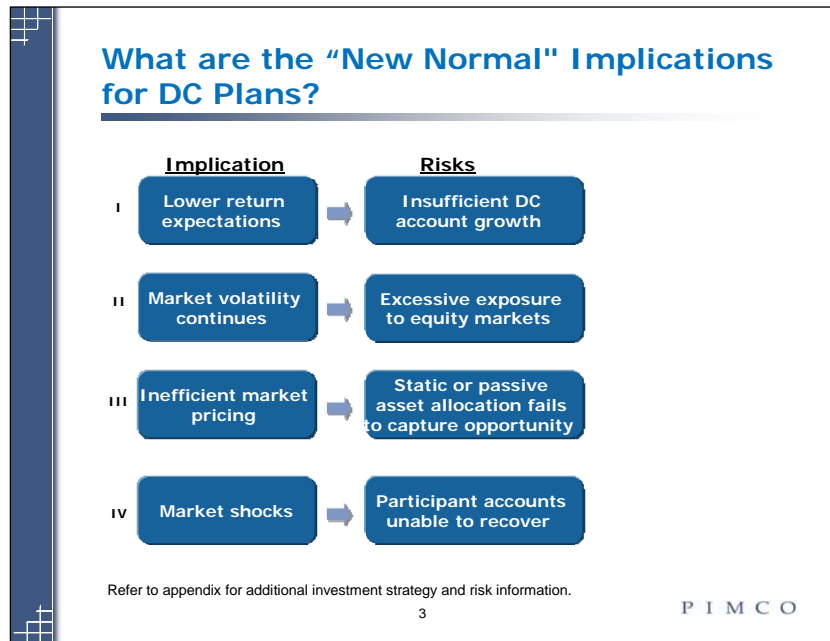
**Stacy Schaus**, senior vice president of the Defined Contribution Practice at PIMCO, focused on ways to improve 401(k) participants' investment behavior, with help from plan sponsors, given the fundamental changes that have occurred since the recent recession.

Schaus described "the new normal" for defined contribution plans as lower investment return expectations, continued market volatility, greater regulation, slower growth, inefficient market pricing, and market shocks. Her remedies for dealing with these problems: Lowering return expectations, increasing savings, and greater investment diversification.

Plan sponsors also need to make sure they continue to evaluate volatility, the need for diversification, and how to protect their participants from market shocks, she said, which means their models have to be updated to incorporate the current economic realities—since many have not been.

Schaus noted there are three key factors that will determine whether workers reach their retirement goals or not: saving more, investing better, or retiring later. Since many people may not be able to save more, and may not be able to work later, "investing better is what we usually focus on," she said. That means plan sponsors should provide workers with more help in investing. She presented some modeling results and research from PIMCO on such factors as market volatility, market shocks, and inefficient market pricing.

"We can't have unprotected, undiversified investment management and have any real confidence that we're going to get people to where they need to be. We need broader diversification of risks and we need to look at ways to reduce risk, such as through hedging or insurance," Schaus said.

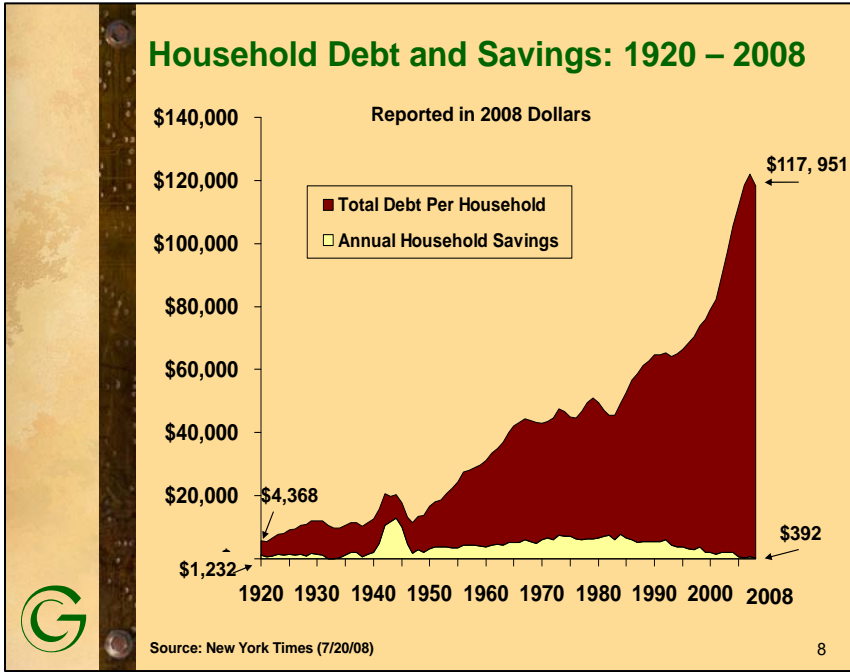


**Mathew Greenwald**, president of Mathew Greenwald & Associates, focused on how better asset management in retirement can increase financial security.

With the decline of employer-financed defined benefit pensions in the private sector, and the rise of self-directed 401(k) retirement plans that participants are responsible for managing themselves, Greenwald said workers need more help in managing the assets they accumulate over a working career.

"Sometimes when I'm in a bad mood, I say that the goal of defined contribution plans is to help people attain an amount of money they can't understand and they don't know how to manage," Greenwald said. "There are gains we can make if we help people do a better job of managing the money that they've been able to accumulate."

One sign of financial mismanagement is the frightening levels of debt and small savings most Americans have accumulated, he noted. This is especially worrisome given current trends that are weakening retirement security—such as the decline of guaranteed retirement income from fewer defined benefit pensions, likely



declines in entitlement program income, greater longevity, ever-higher health care costs, and higher lifestyle needs, he added.

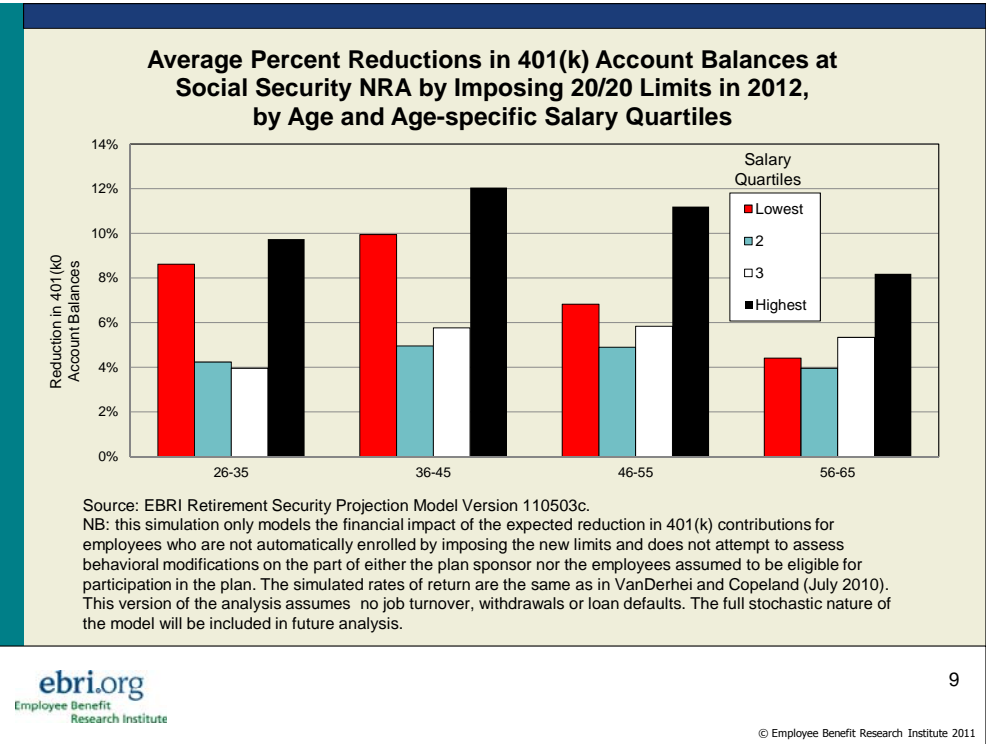
Greenwald said financial advice currently given by many financial planners is often “suboptimal,” because it fails to address longevity risk (clients outliving their money), automatically assumes people will live to 90–92 without assessing individual health conditions, and does not assess the risk from current spending levels. He also said life annuities are the most cost-effective way for most retirees to cover longevity risk and guarantee they will not outlive their assets.

Jack VanDerhei, EBRI research director, highlighted research from the EBRI/ICI 401(k) database, showing how the average account balance fared during and after the recent recession.

Among consistent 401(k) participants, the vast majority of accounts have more than recovered from investment losses suffered during the recession, he noted. Even in the worst-case scenario (workers with the longest job tenure), EBRI projections show that at least 3 in 4 participants have a nominal account value at least as great as where they were when the stock market hit its peak in October 2007, he said.

VanDerhei also presented new analysis showing that the National Commission on Fiscal Responsibility and Reform’s proposed tax reform for 401(k)-type retirement plans would cause the greatest reduction in retirement savings for both the highest- and lowest-income workers.

EBRI’s research verified that highest-income workers would be most affected by the Commission’s recommendation to “cap the annual tax preferred



contributions to (the) lower of \$20,000 or 20 percent of income” for 401(k)-type plans (known as the “20/20 cap”) starting in 2012. This is not surprising, since those with high income tend to save the most in these kinds of retirement plans. However, VanDerhei said the cap also would cause a big reduction in retirement savings by the lowest-income workers as well.

The analysis finds that for each age group (except for the oldest), the lowest-income group would have the *second-highest* average percentage reductions in 401(k) balances at retirement. Primarily, this is because their current or expected future contributions would exceed 20 percent of compensation when combined with employer contributions, he noted.


## Implications of Boomers and Gen Xers Working Past Age 65

**Sandra Timmermann**, vice president and director, Mature Market Institute, MetLife, highlighted research that indicates many people now plan to work longer than traditional retirement age, but noted that they often find themselves unemployed due to mergers, layoffs, poor health or age discrimination. Many older Baby Boomers in particular are financially vulnerable to these events and have little time to recover from a financial derailment, she said.

Timmermann questioned what a realistic working life is, noting there is a sharp decline in workers from age 65–69, and even sharper after age 70. “The older people who have higher assets and income are the ones who remain in the work force, often mainly for psychological rather than financial reasons, while the ones who need the money are most likely to be unemployable,” she said.

Since many workers will stay on the job at least a few years longer than they anticipated, Timmermann said employers can avoid generational conflict by tapping the expertise and loyalty of older employees while also adopting phased retirement and retirement income planning, finding part-time jobs for older workers, and recognizing that workers of different ages tend to have different priorities—such as the fact that younger Gen Xers tend to be far more interested in flex time and telecommuting than are older Baby Boomers who would prefer to phase into fewer hours. She added that younger employees are well aware they will be working longer than previous generations, and employers can help them prepare for a secure retirement by providing opportunities for continuous training so as to avoid job obsolescence and remain employable.

**Anna Rappaport**, principal of Anna Rappaport Consulting, discussed how disability benefits and disability issues are crucial to a later retirement but are largely ignored by workers and retirees. She presented data from a 2008 study from the Council for Disability Awareness showing that 3 in 10 workers who enter the work force today will be disabled sometime before they retire; 1 in 7 will be disabled for at least five years



### The Importance of Disability

#### Status of Americans Age 50-61 Not in Labor Force

	Retired	Disabled	Other Reasons
<b>Men (14% of Population)</b>			
% of Not in Labor Force	32%	64%	4%
% Poor	15%	24%	NA
<b>Women (24%)</b>			
% of Not in Labor Force	26%	40%	34%
% Poor	14%	34%	10%

Source: CBO, Disability and Retirement: The Early Exit of the Baby Boomers from the Labor Force, November 2004

Anna Rappaport Consulting, Challenges to Successful Later Retirement, May 2011

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before they retire; and 85 percent aren't particularly concerned that they'll suffer a disability lasting for three months or more.

The economic damage from disability is devastating, Rappaport noted. She cited data from the Congressional Budget Office showing that of people age 50–61 not in the labor force, 14 percent were men, and of those, 64 percent were disabled, while 32 percent were retired. A quarter of the disabled 64 percent were poor. The numbers are considerably worse for women.

Rappaport said far too many retirees' planning horizons are too short, and that their preparations for retirement are often incomplete or nonexistent and often ignore key issues. She cited a Society of Actuaries study showing that people nearing retirement and retirees have a less-than-10-year planning horizon. "Retirement ages, expectations, and reality are out of step," Rappaport said.

Rappaport noted there is huge variation in normal retirement ages by country, with the highest (74) in Mexico and the lowest (59) in France. She raised the question of whether retirement ages should be automatically adjusted to reflect the increase in longevity, going up periodically as people live longer.

**Sue Meisinger**, director of the National Academy of Human Resources, focused on steps employers can take to deal with an aging work force and the issues that attend to that reality. She noted that highly skilled and more highly compensated workers are more likely to be able to retire, which means those with fewer skills are more likely to be "staying on board and aging in place." That creates various problems for employers, especially related to age-related disability.

A crucial factor is whether current senior management decides to deal with the aging work-force issues now, or leave them to their successors, she said. "In corporate America, folks in leadership roles and executive positions tend to be older, more highly compensated. They're seeing their own finish line ahead of them and they simply are not dealing with it," Meisinger said.

Among the factors she said employers should focus on:

- Work-force planning, understanding the demographics of a company's work force, and—carefully—sounding out workers on their retirement plans. "It's not illegal," she said. "You have to do it carefully, because if you use the information inappropriately, you can make yourself vulnerable."
- Job design that accommodates older workers and provides more flexibility (such as telecommuting, part-time work, "snowbird" jobs, temporary labor pools, phased retirement), while also focusing on job engagement for all workers (such as technology training).
- Play to generational differences: Younger workers tend to be happy dealing with computers, while older workers more likely want to work with people. Change corporate vocabulary, such as referring to "corporate lattices" (moving around in an organization) rather than "ladders."
- Prepare for more litigation and age-discrimination complaints—something she said "is already happening."
- Help to educate the work force about financial security, Social Security benefits, retirement planning, so employees have a realistic picture on what they'll need for retirement income security.

Meisinger said it would help if Congress provided more flexibility in the Fair Labor Standards Act, which forces hourly workers to be paid overtime if they go over 40 hours a week. This is a major obstacle for private-sector employers who want to provide more flexible work schedules to hourly workers, she said.

## Is There a Future for Retirement?

The final segment of the policy forum included brief comments by various experts on the presentations and their thoughts on what lies ahead for the U.S. retirement system.

**Dan Rosshirt**, principal of Retirement Services Consulting at Deloitte, said the far more difficult question is “how are we going to structure a retirement policy that will allow people to retire?” Given the way the U.S. retirement system is engrained in the nation’s tax system and capital markets, Rosshirt said “what worries me about the future of retirement is the unintended consequences of what we do and decisions that we’re making today.”

As an example, he cited the growing cost of compliance with regulations being imposed by the federal government to make employers’ 401(k) plans better retirement savings vehicles. Employers are faced with the decision of passing these costs onto their employees or paying the compliance costs themselves. Considering that rising costs were a major factor in the decline of defined benefit pension plans, he noted, employers may now face “the same question of whether they can afford to offer a retirement plan to their workers.” He suggested that private-sector employers and retirement providers make the cost of regulatory compliance explicit both to policymakers and workers in a hope that it will instigate a streamlining of the regulations and make administration of 401(k) plans more cost-efficient.

**Deb Cohen**, chief knowledge development officer, Society for Human Resource Management, (SHRM) noted that in the aftermath of the economic recession most employers have been focused on survival and keeping their doors open, and not on “how to help people think about retirement.” Recent SHRM surveys have shown a sharp rise in workers’ worries about their retirement preparation, especially since many workers are also reducing their 401(k) contributions and extending their planned retirement date.

Cohen said employers—especially small and mid-sized ones—face a big challenge managing and engaging their work force, especially when it includes several generations that have significantly different interests and skills. She predicted retirement in the future “is going to look very different and feel very different” for both workers and employers.

**Randy DeFrehn**, executive director, National Coordinating Committee for Multi-employer Plans, described the nature of his sector: About 1,500 multi-employer retirement plans (mostly defined benefit pension plans) that cover about 10.4 million workers in highly mobile work forces, such as construction.

He noted that the demanding physical nature of these jobs prohibits workers from being able to stay on the job into their 70s and 80s. Since many of these workers are employed in seasonal or temporary jobs with high turnover, they have little disposable income and it’s difficult to provide them with secure retirement benefits. DeFrehn said leakage of retirement assets—workers cashing out their accounts as they move from job to job—is “an enormous problem for people who are in these kinds of employment relationships.”

He said a key feature of multi-employer plans is portability, or having one common retirement fund that employers pay into and that allows workers to still be mobile and work for many employers. DeFrehn noted that despite recent market growth, multi-employer plans have regained only about a third of their losses since the 2008–2009 recession, partly because hourly jobs “are not participating in the recovery.” Despite the burden of higher pension funding requirements imposed by Congress, he said most multi-employer plans are financially healthy and are meeting their funding requirements.

**Tom Johnson**, senior vice president, Retirement Income Security, New York Life Insurance Company, noted that with the decline of traditional pensions and the growth of 401(k)-type retirement plans, workers “will need to recreate their own defined benefit plan.” Some employers and plan providers are

starting to roll out solutions that “basically assemble a DB plan for an individual, including managing multiple risks in retirement,” he said.

The trend, he believes, will be retirement income planning that greatly simplifies what is now a very complex process for calculating and executing on retirement income, and employers that offer the retirement income planning (including income guarantees) and do so through or alongside their 401(k) plan.

**Josh Cohen**, director of Russell Investment’s Defined Contribution Practice, said his firm has done a lot of work trying to simplify the highly complex process of setting a retirement savings target rate for workers. They have developed what they call “the Rule of 30”—meaning that workers should be consistently contributing 30 percent of their salary (including the employer match) in order to obtain a 60 percent income replacement rate from their 401(k) upon retirement.

As a consultant who works closely with corporate plan sponsors, Cohen said he believes employers genuinely want to help their workers obtain financial security, but that “plan sponsors face a lot of roadblocks in trying to do the best thing for their individual participants.” Specifically, he said, regulatory and fiduciary requirements restrict sponsors’ ability to try something new or innovative, as do cost pressures from senior management and the threat of lawsuits.

Regulations and costs will have a big impact on the future of employment-based retirement plans, he suggested. “It’s going to be a real interesting several years to see what role the employer is going to play in this whole thing, especially as the budget discussions are coming up,” he said.

**Laurie Nordquist**, executive vice president, Institutional Retirement and Trust at Wells Fargo, suggested a balance is needed between worker and employer responsibility for retirement savings. While plan sponsors can (and are) helping to simplify the retirement plans through auto-enrollment and auto-escalation, and are expanding retirement planning tools, ultimately participants need to make their own decisions, she said. “We are not going to be able to take over all the decisions for the employee that’s in the plan.”

Nordquist said employers could do more to help workers make those decisions, by explicitly translating how much a seemingly large lump-sum distribution will actually generate on a monthly basis for life, and helping to dissuade younger workers from cashing out their retirement account on job change.

**Steve Utkus**, principal, Vanguard Center for Retirement Research, outlined his “more and less” view of the future of retirement: More savings before retirement and less medical intervention after retirement, to control the ever-rising expense of retiree health care.

Utkus said the key to successful retirement savings “is consistent and ongoing contributions over the life-cycle” of a worker, so as to maximize the effect of compound interest. The only two ways to get higher savings rates, he added, was for people to either devote a higher fraction of their earnings now to their retirement plan, or work longer. And given the exploding costs of health care, he suggested developing ways to limit the number of medical interventions people tend to receive after retirement.

“If you think that the future of retirement is early out in your 50s and a health plan that will pay for pretty much anything that comes along, the answer is, ‘There is no future for retirement,’” Utkus said. “If, on the other hand, you think it’s working longer into your 60s or late 60s and accepting some reduction in the level of medical interventions in your life before you die, then there’s very much a sustainable future for retirement in America.”



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EBRI's work advances knowledge and understanding of employee benefits and their importance to the nation's economy among policymakers, the news media, and the public. It does this by conducting and publishing policy research, analysis, and special reports on employee benefits issues; holding educational briefings for EBRI members, congressional and federal agency staff, and the news media; and sponsoring public opinion surveys on employee benefit issues. **EBRI's Education and Research Fund (EBRI-ERF)** performs the charitable, educational, and scientific functions of the Institute. EBRI-ERF is a tax-exempt organization supported by contributions and grants.

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