EBRI – ERF Policy Forum

Are traditional measures of success for retirement plan programs adequate for either the employer or the employee?

December 2014
Adequacy is the desired intersection of a host of ever-changing factors and constraints.

- Longevity
- Risk transfer in plan design
- Changing role of benefits in labor contracting
- Ex-ante vs. ex-post legal risk
- Viability of future market return assumptions
- Ability of individuals to merge own assets and draw down
Traditional Employer Objectives

“We define success as building and preserving purchasing power to meet retirement income needs for the majority of the people regardless of the economic environment”

Sample for illustrative purposes only
The income replacement target illustrates an example of the percent of their income that most plan participants will need to replace at retirement.
Falling benefit coverage

Retirement plan participation rates¹

- Orange line: Any Plan, Age 40
- Yellow line: Any Plan, Age 50
- Green line: Any Plan, Age 60
- Blue line: DB Plan, Age 40
- Dark blue line: DB Plan, Age 50
- Light blue line: DB Plan, Age 60

Falling Absolute Coverage
Falling Longevity and (Nominal) Income Coverage

Percent of households with account

Birth Cohort


¹ “Any Plan” represents households that report owning a DB Plan, a DC Plan, or Individual Retirement Account
Income sources at retirement:
The stool’s legs are of vastly different length

- **Social Security**: 47% in 25-50, 34% in 50-75
- **Labor Earnings**: 2% in 25-50, 10% in 50-75
- **Pension Income**: 3% in 25-50, 3% in 50-75
- **Asset Income**: 13% in 25-50, 4% in 50-75
- **Annuitized Housing Wealth**: 17% in 25-50, 13% in 50-75


1 Income Sources represent the mean income share multiplied by the mean income for the indicated income quartile.
2 Annuitized Housing Wealth represents the actuarially fair twenty year annuity purchasable given interpolated real estate equity in the indicated income quartile subject to a 25% haircut. Annuity is calculated using the 20 year TIPS yield on the as of date.
3 Pre-retirement income and Housing Wealth by quartile represent linearly interpolated quantiles assuming that household income is 1.6 times personal income (corresponding to the ratio of median household income to median personal income in the United States).
Is there a linkage between the choice to retire and market variables?

\[
y = 0.071x^2 - 1.681x + 21.528
\]

\[ R^2 = 0.55 \]

SOURCE: Bloomberg, Bureau of Labor Statistics
Before assessing adequacy, do we need to address our assumption set?

- Market-implied long-term real yields have been below Social Security Trustee’s valuation assumptions for a decade
Australia: My home is my castle
First pillar system design creates its own set of risks

All values represent the mean holdings for that quantile. US Net Worth includes the cumulative Social Security contributions of the household at age 64.
Main factors in retail retirement product selection: What are the implications for a D.I.Y. Retirement?

Tradeoffs become trickier when you are working with legacy frameworks designed in bygone eras.

- Social Security (1935)
- ERISA (1974)
- 401(k) (1980)
- Today (???)

If we fundamentally want to address adequacy, will an incremental approach work?