Callan

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Policy Implications of Pre-Retirement Risks

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Importance of the Definition—and the Assumptions

- Why it's important: GAO study found that retirement income adequacy analyses range widely in their conclusions about the degree to which Americans are likely to maintain their pre-retirement standard of living in retirement, largely because of different assumptions about how much income this goal requires.
- The studies generally found about one-third to two-thirds of workers are at risk of falling short of this target.
  - The Center for Retirement Research at Boston College concluded that 52% of households faced risk of having insufficient retirement income to maintain their standard of living.
  - NIRS finds that approximately two-thirds of workers have savings below the suggested benchmark.
  - Scholz, Seshadri, and Khitatrakun find that only 16% of households have savings below the predictions of their model.

Variations in Studies of Retirement Income Adequacy

Sample of May 2015 GAO Report on Retirement Security

Organization (year of study)	Retirement adequacy benchmark (replacement rate unless otherwise specified)	Percentage of sample projected to be below benchmark	Other notes and statistics
Aon Hewitt (2012)	85%, or 11 times pay at age 65.	85% of sample	Estimates that savings shortfall relative to target for full-career contributing employee is 2.2x pay.
Biggs-Schieber (2014)	Able to maintain standard of living in retirement, but no specific target stated	N/A	For those who work to full retirement age, SS replaces 62% of final-avg earnings; income from 401(k)'s and IRA's underreported by SSA.
Center for Retirement Research at Boston College (2014)	69% for highest-third income, 72% for middle, 79%, for lowest.	52% overall; 60% of low-income and 43% of high-income households.	Projects retirement income at age 65. Assumes annuitization of wealth, including housing equity.
Employee Benefit Research Institute (2012)	Sufficient to meet basic expenses, including health expenses, throughout retirement.	44% of 1948-1954 birth cohorts; 87% of lowest income quartile, 13% of highest income	Assumes age-65 retirement; housing equity converted to savings only when other resources are exhausted.
Scholz-Seshadri-Khitatrakun (2006)	Wealth consistent with predictions of lifecycle model.	16% of households overall; 30% of lowest-income decile, 5% of highest-income decile	Sample from 1992 wave of the Health and Retirement Study. Progressive Social Security benefits, other transfers, and children leaving household account for much of lower-income savings adequacy.
Urban Institute (2012)	75% replacement rate at age 70.	30-40% of 1956-65 birth cohorts	Calculates working-years income using age 50-54 income and 35 years highest earnings.

Importance of Understanding Impact of Modifying Coverage

State IRA Programs

Summary of Efforts to Expand Workplace Retirement Savings Program Coverage for Private Sector Workers in Selected States: September 2015, U.S. Government Accountability Office.

	California	Illinois	Massachusetts	Maryland	Washington	West Virginia
Recent Approach	State-run program	State-run program	State-run program	State-run program	State-facilated market place	State-run program
Status	Enacted; conducting feasibility study	Enacted; developing implementation	Enacted; developing implementation	Not enacted	Enacted	Not enacted
Savings Vehicle	Payroll deducation IRA	Payroll deduction IRA	Employee benefit plan	Combination	Payroll deduction IRA	Employee benefit plan or IRA
Target employer size	Employers with 5 or more employees	Employers with 25 or more employees	Not for profits with not more than 20 employees	Employers with 5 or more employees	Employers with fewer than 100 employees	Employers with no more than 100 employees
Employer participation	Certain employers are required to automatically enroll employees	Certain employers are required to automatically enroll employees	Voluntary	Certain employers are required to automatically enroll employees	Voluntary	Voluntary
Exempted employers	Employers that already offer a qualified plan or automatic enrollment payroll deduction IRA	Employers in business for 2 years or less, or that already offer any qualified plan	N/A	Employers in business for 2 years or less, or that already offer an employer sponsored plan	N/A	N/A

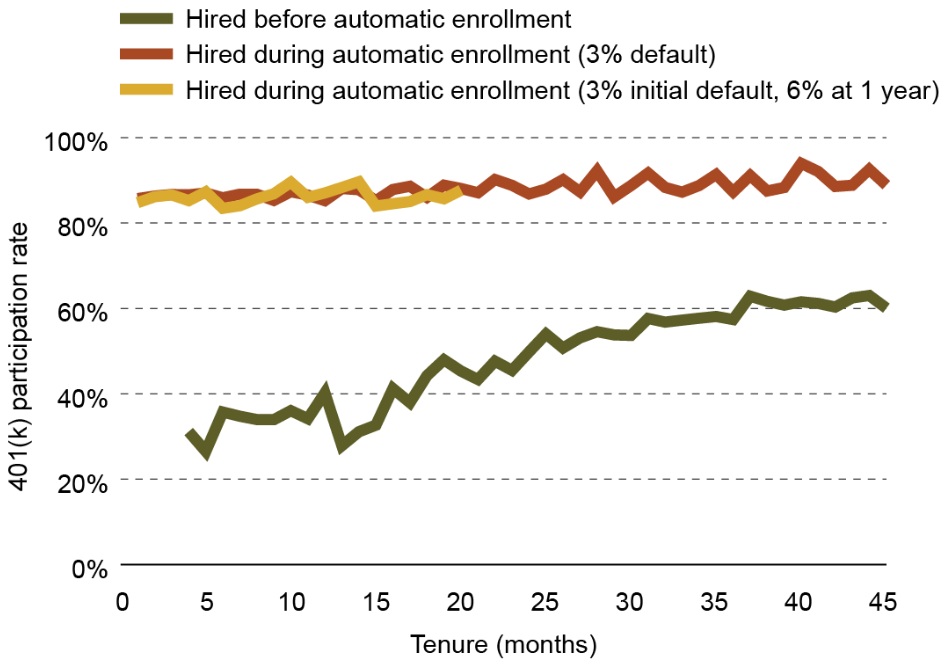
Assessing the Impacts

- Cannibalization of existing DC plans
  - AB conducted a survey in 2012 asking what plan sponsors would do if they were no longer allowed to deduct retirement savings plan contributions from their taxable income.
  - 12% said they would terminate their plan.
  - A similar study would be interesting to understand the impact on employer-sponsored plans of Universal or State IRAs.
- "True" likely opt out rates
- Value/role of employer
- Low contribution rate defaults will prove sticky

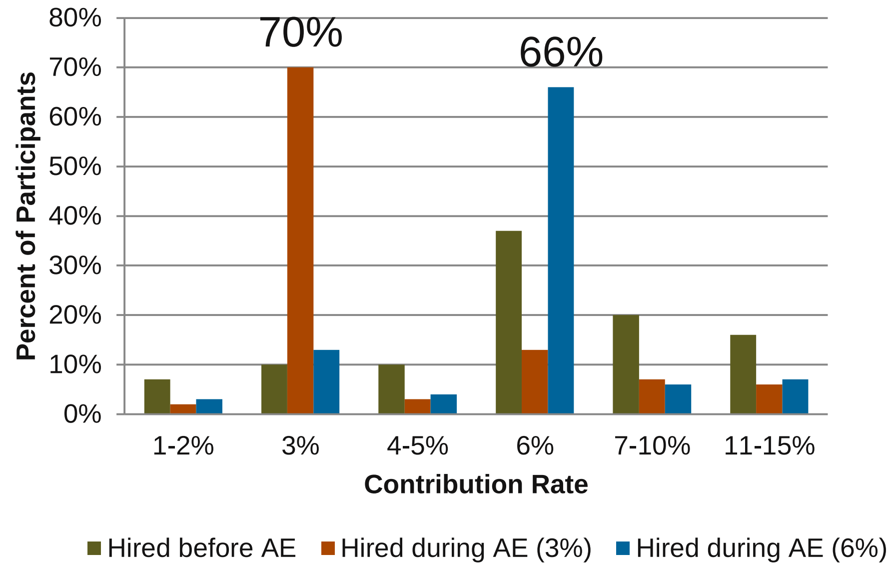
The Pitfalls of "Starter" Auto Enrollment Programs

Company C

Plan Participation by Tenure with various Default Contribution Rates

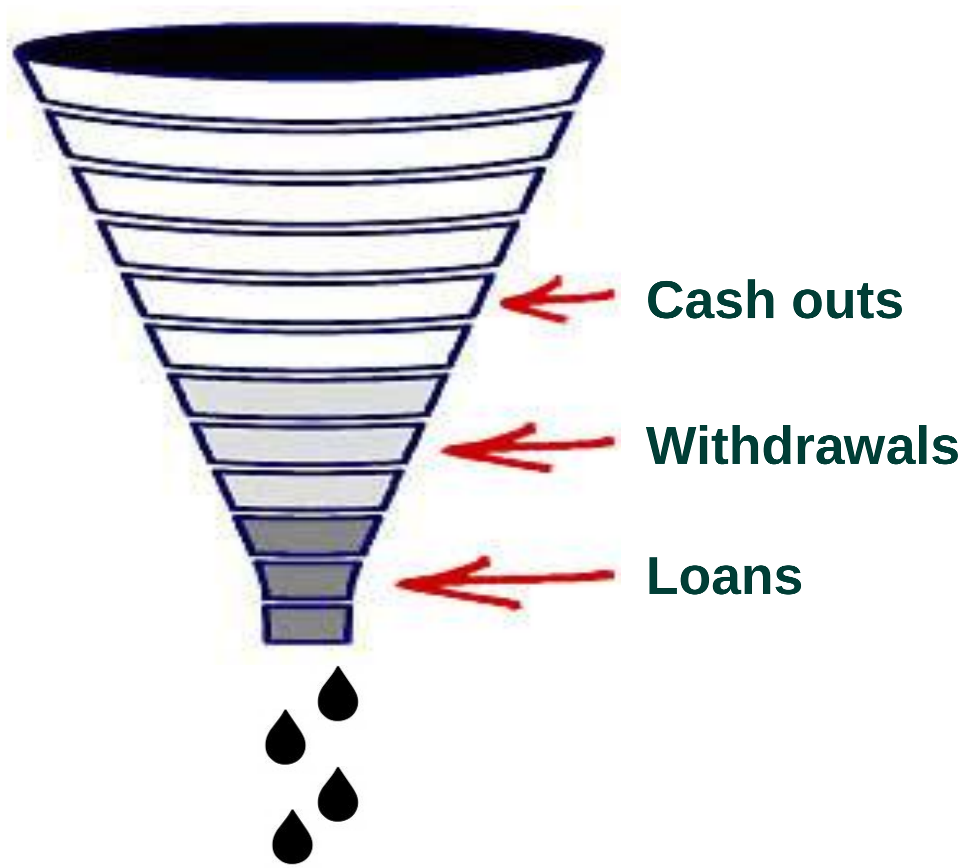


The Distribution of 401(k) Contribution Rates



Saving For Retirement on the Path of Least Resistance: Choi et al.

Identifying the Size of the Leaks



Leakage Impacts: Policy Implications

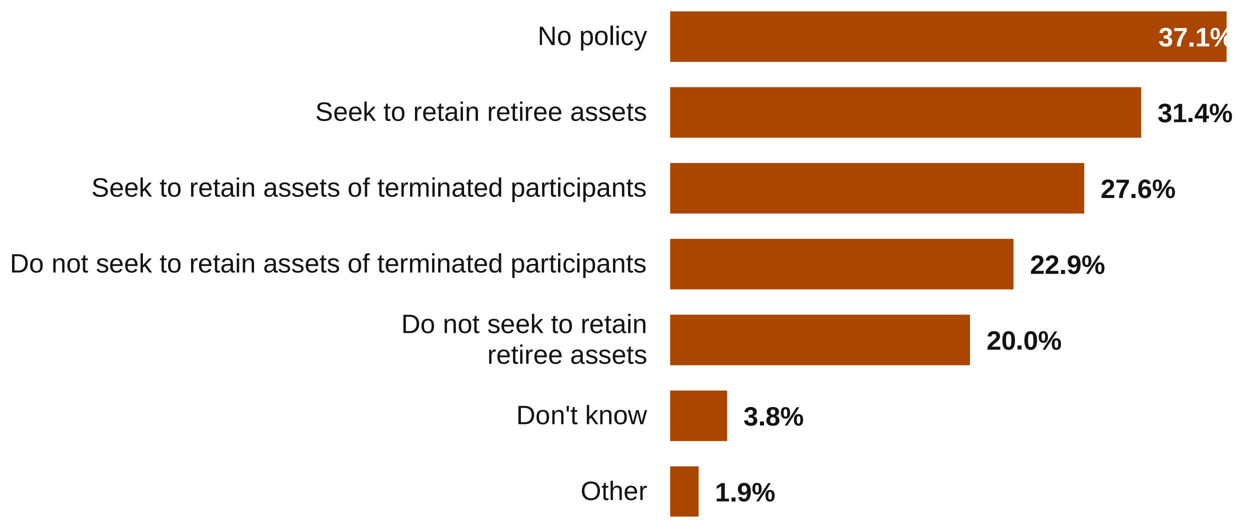
Value of initiatives to:

- Reduce loans
  - Some studies find that loan availability improves plan participation:
    - *Beshears et al find that adding a loan option to the DC plan increases plan participation between 3.5% and 7.2%.*
    - *Meanwhile, reductions of contributions by participants with loans due to loan repayments ranged from 0.5% to 1% of pay.*
- Eliminate hardship withdrawal suspensions
  - EBRI’s sensitivity analysis shows that 6-month suspension results in shortfall increase of about 1%.
- Prevent cashouts
  - AonHewitt finds that among participants who terminated employment, 43% took a cash distribution in 2014.
  - These are mainly low balance workers.
  - According to the Bureau of Labor Statistics, 27% of workers between the ages of 25 to 34 have been with their employer one year or less.
  - Another BLS study of 10,000 individuals shows they have held 10.8 jobs, on average, between ages 18 and 42.

Post-Employment Assets

- Nearly 60% of plan sponsors have a policy for retaining retiree/terminated assets.
- Reasons cited by those that do not seek to retain assets include that it is too hard to keep addresses up to date and “we are not big brother.”

If you have a policy with respect to retaining retiree/ terminated assets within the plan, what is that policy?*



Source: 2015 Callan DC Trends Survey

*Multiple responses were allowed.

Stretch Match

Pros

- Helpful in overcoming cost considerations surrounding auto enrollment and auto escalation
- Can encourage higher savings levels

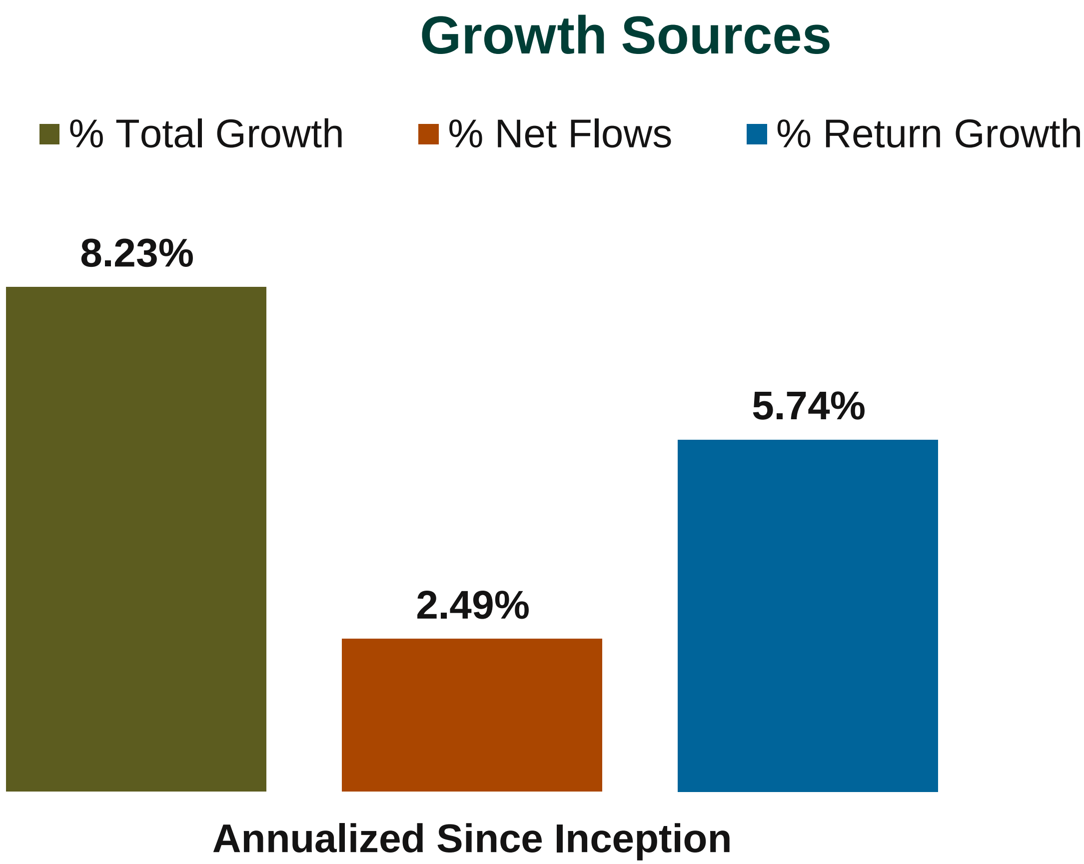
Cons

- May reduce overall company contributions
- May unduly penalize lower wage workers
- Difficult to socialize

Callan's DC Trends Survey found that 2% of plan sponsor "stretched the match" in 2015.

Impact of Rates of Return

Growth of DC Plans since 2006

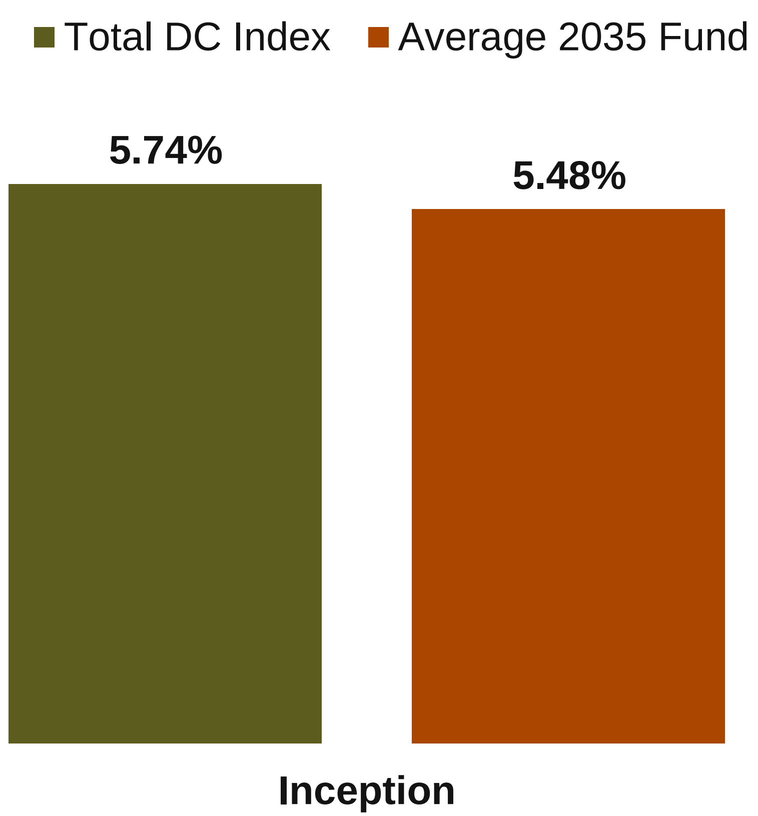


Source: Callan DC Index, as of June 30, 2015.

Impact of Rates of Return

Investment Performance of DC Plan Participants vs Target Date Funds

Investment Performance
2nd Quarter 2015 and Annualized Since Inception (1/1/06)



Target date funds now hold 25 cents of every dollar in DC plan assets.

Source: Callan DC Index, as of June 30, 2015.

Rates of Return

August 2015 GAO Report: Clearer Regulations Could Help Plan Sponsors

Choose Investments for Participants

- In the preamble to the final QDIA regulations, DOL indicated that the regulations are sufficiently flexible to accommodate future innovations and developments in retirement products.
  - Specifically, DOL officials noted that the examples were included solely for the purpose of providing guidance as to what might be within the defined categories and were not intended in any way to limit the application of the QDIA regulations to other products.
- However, GAO found that sponsors believed that until they were certain that other products qualified for QDIA protection, they were unlikely to deviate from strict adherence to the safe harbor conditions or consider products other than the three named QDIA types.
- GAO found that other stakeholders concluded that product developers would be unlikely to take initiative to create new QDIA products and services as long as uncertainty in the regulations persists.
- Recent lawsuits reinforce this position.

Conclusions

Potential Policy Implications of EBRI Research:

- Assumptions are critically important and influential from a policy perspective.
- Initiatives to increase coverage are proliferating—but may have many unintended consequences.
- When it comes to leakage, policymakers should focus on cashouts as the greatest area of concern.
- Stretch match has promise, but again, unintended consequences should be considered
- With all the talk about coverage and savings, investment returns shouldn’t get lost as an important component of retirement income adequacy.