Thinking About the Future of Retirement

By Anna M. Rappaport

The United States has shifted to a primarily defined contribution (DC) environment for pensions. Many defined benefit (DB) plans are frozen and being phased out. This essay will focus on actions that can improve the future, assuming a DC world, and provide suggestions about how actuaries can assist. If we think about what would make a good system, then we can work together to move closer to it. Where we will arrive is the result of the actions and interactions of individuals, advisers, financial services organizations, employee benefit plan sponsors and policymakers.

This essay about the future of retirement will focus on retirement ages, how we retire and retirement risks.

RETIREMENT AGES AND HOW WE RETIRE

The shift to DC plans has meant that retirement plans no longer incorporate incentives to retire at specific ages. The United States and other nations have experienced major increases in life spans in the last 100 years. Social Security has a major role in setting expectations (or signals) about retirement and has defined a retirement age range of 62 to 70. While Social Security includes strong incentives to start benefits at later ages, the most popular benefit claiming age remains 62. When they were first introduced, formal retirement systems often started with retirement ages around 65; earlier retirement was introduced later. Over a long period, retirement ages gradually dropped, so that many people retired in their late 50s or early 60s. But in recent years, labor force participation at higher ages has increased, and work is being accepted as part of retirement. In the United States, mandatory retirement has generally been forbidden, but many people are still faced with retiring earlier than they expected, and often not by choice.

Society of Actuaries' Risks and Process of Retirement research tells us:

- Thirty-five percent of pre-retirees say they don't expect to retire.
- Retirees have retired at a much earlier age than pre-retirees expect to retire. In 2013, retirees had retired from their primary occupation at a median age of 58, while pre-retirees expected to retire at 65.
- The majority of retirees, including voluntary retirees, were pushed rather than pulled into retirement. The push came from loss of a job, unpleasant circumstances at work, illness or family members needing care.
- There appears to be a significant gap between expectations about working in retirement and what actually happens.

Work at later ages will depend on there being adequate opportunities for older workers. Without increases in actual retirement ages, increases in normal retirement age requirements may result in a reduction in monthly benefits paid at time of retirement. Without indexing of retirement ages, the value of monthly pension benefits starting at a fixed age increases as life spans increase. With indexing, their value would be much closer to remaining the same as life spans increase.

- There is a societal need to rethink retirement ages and think about retirement based on the period to the end of life. Actuaries can help move the conversation forward by focusing people on demographic realities.
- A gradual shift from work into retirement is better for many people and can also accommodate the needs of employers. There has been quite a lot of informal phased retirement, but very little formal phased retirement in the United States. Actuaries can help further the development of phased retirement.
- If we want to increase retirement ages without creating undue hardship, we need to recognize that some jobs are very physically demanding and look at better integration of retirement, disability and death benefit coverage. We should also note it is possible to shift to different jobs that may be less demanding physically. Shifting can include moving to different types of work and/or a different schedule. This will work for many people in demanding jobs, but not all.
- Actuaries can explore the issues surrounding signals and terminology with regard to termination about retirement ages. It would be desirable to replace the terms "early retirement age" and "normal retirement age."
- It would be very helpful if everyone did an evaluation of the impact of retiring at different ages before they choose a retirement age. Research shows big gaps in knowledge about the impact of retiring at different times. In a presentation at the 2015 Society of Actuaries Annual Meeting & Exhibit, Grace Lattyak pointed out that AonHewitt research shows that a one-year increase in retirement age reduces the shortfall in the amount of assets needed for a comfortable retirement by about one times pay. This results from an increase in resources from more savings and a reduction in what is needed since the retirement period will be one year shorter. See Table 1.
- I hope that new and better job options will open up to older workers, and that they enable choices for phasing into

retirement. These options should consider the value older workers bring to the table, their abilities and preferences and how they intersect with business needs. Actuaries can help to move this discussion forward.

Table 1: Adequacy of Retirement Resources for Average Career Workers; Resources Needed and Available for Average Worker at Retirement (Amounts Shown as Multiple of Pay)

Age at Retirement	Resources Needed for Adequate Retirement	Resources Available	Shortfall
60	14.5	6.8	7.7
65	11.0	8.4	3.4
70	7.6	10.0	−2.4
75	6.5	11.7	−5.2

Source: AonHewitt's "The Real Deal: 2015 Retirement Income Adequacy at Large Companies." Data is from Grace Lattyak's presentation at the 2015 Society of Actuaries Annual Meeting & Exhibit, and is for a full-career contributor. Amounts shown are in addition to Social Security. (Note that the resources available in this study are greater than the resources for most of the American workforce at average pay levels because this assumes a career worker with the same firm. In addition, the study focuses on large firms, and such firms often have better benefits than smaller firms.)

- If job options are to work out well, individuals who want to work in retirement need to be realistic about how they need to prepare and about what they expect. Often this may mean moving from a senior position to a lower position, and being flexible and willing to adapt to assuming a new role. This also means keeping computer and other skills up to date and being prepared to work with people of all generations. Often pay will be considerably lower than the pay one earned before retirement.

RETIREMENT RISKS

Traditional DB plans place most of the risk on the employer, and traditional DC plans place most of the risk on the employee. Newer benefit designs offer hybrid structures, sharing risk differently. This essay assumes the system is primarily DC.

Financial well-being in retirement depends on disability, death, length of employment, type of plan, health care needs, long-term care needs, method of withdrawing funds, amount of savings and investment results. Fraud can derail a program. Family needs can also divert funds that were to be used for retirement. We can think of risks in a DC environment as being "inside the plan" and "outside the plan." Employers help employees manage the risks by the way they structure the plan, including default options, and by offering education, guidance and advice. A great deal of attention has been paid to structuring investment default options and to auto-enrollment and increases, to get employees into the plan. Much less attention has been paid to how funds are withdrawn and used. These can be inside-the-plan or outside-the-plan risks. In addition, little attention has been paid to disability and long-term care risk, both of which are outside the plan but have a big affect on security in retirement.

In a DC environment, the most common methods of payout include lump sums and installment payouts of account balances. Annuities that guarantee income for life or for the life of the annuitant plus a survivor are used much less often. The individual is often left to figure out on their own, or with an adviser, what risks they face and how to deal with them. But SOA research shows that many people do not focus on the long term. Financial products that offer a path to risk protection include products offered within the employee benefit program, or products by an insurance company or mutual fund, but such products are often complex. Public understanding of many of them is poor with some individuals not focused on the risk or the product.

I have identified several changes I believe would improve retirement security within the context that retirement savings in the workplace is most often in a DC system.

- It would be desirable for plan sponsors to again become more active in helping employees identify, understand and manage risks that affect their financial security. It would also be very desirable for employees to understand the issues surrounding risk and options for providing risk protection. This, however, seems very unlikely. Actuaries can play a role in bring these important messages to both groups. Employers who implement financial wellness programs are taking important steps to help employees focus on risk. The first message is one that actuaries understand well—long-term thinking is very important.
- It would be desirable for disability coverage to be added to DC plans so that these plans have an embedded disability benefit so added savings in DC accounts is continued during periods of long-term disability. This would be accomplished through embedding disability insurance into the DC plan, probably as an investment option, or through providing such coverage next to the plan. Prior to disability, this coverage could be paid for by the employer or the employee, or the cost shared. Actuaries can play an important role in making this happen. The first step however is helping employers and employees recognize the seriousness of the disability risk.
- It would be very desirable for the payout options in DC plans to be expanded so that plan funds can be applied to provide lifetime income, to provide survivor benefits, to help pay for unexpected medical expenses during retirement, and to help finance long-term care. I would like to see the DC plan post-retirement thought of more like a lifetime financial security account. Actuaries can help to develop this idea, model alternatives and develop a range of options and solutions.

- The reality is that often financial products will be purchased by individuals, maybe linked to their employer and maybe on their own. Many products are complex and hard to compare. It would be desirable for financial products to be simplified, and terminology standardized. If this was done, hopefully products could be designed so that they can readily be compared and purchased in a competitive marketplace. Actuaries could play an important role in making products more comparable and understandable.
- Many middle income class Americans have not had access to unbiased and affordable advice. It would be very desirable for individuals to be able to choose automated and easy-to-use advice systems that will respond to the issues and concerns of the middle class including risk management and protection. I hope there will be widespread acceptance of such systems and they will be designed to integrate with in-person support and offer advice easily accessible to the middle income class. I also hope that many employers will support them and use them as part of their employee benefits communication or financial wellness programs.

POLICYMAKERS CAN HELP

Employee benefit legislation is often linked to taxation and federal revenue. The benefits part of the legislation can be subsidiary to the impact on taxes. It would be better if retirement saving was viewed realistically as a deferral of taxation to provide for the future security of our citizens. Currently, savings are too often viewed as today's tax expenditures.

Here are some suggestions for policy improvements:

- Change the Medicare secondary rules so that working individuals over age 65 who have signed up for Medicare have Medicare as their primary coverage. This will remove a disincentive to hiring such employees.
- Clarify the uncertainty with regard to bona fide termination of employment. This will make it easier to rehire retirees on a limited basis, with confidence that there is no regulatory problem.
- Make it easier for employers to implement phased retirement programs.
- Examine wage and hour and independent contractor rules in order to support phased retirement and seniors working on a limited basis.
- Encourage employers who offer DC benefits as their primary retirement vehicle to offer more payout options and better risk protection. Use safe harbors to make it easier for them to do so.
- Where a benefit or type of coverage is subject to regulation by multiple agencies or by state and federal agencies, try to unify and simplify the regulation.
- Modify the legal structure governing DC plans to enable them to offer a range of payout options.
- Create safe harbors to give employers a path forward with regard to more options for the payout period.
- Create safe harbors with regard to offering retirement advice.

POST SCRIPT

I realize the proposals discussed in this essay will require change on many fronts. Many stakeholders will need to participate in making that happen. I encourage you to focus on what you think will make a better future and hope that you will participate in making it happen. I hope that the actuarial profession will be leaders in this regard.

Anna M. Rappaport, FSA, MAAA, is an actuary, consultant, author and speaker, and is nationally and internationally recognized expert on the impact of change on retirement systems and workforce issues. She can be reached at anna.rappaport@gmail.com.