The Retirement Income Menu: An Idea Whose Time Has Come
Testimony Statement on Retirement Income
for ERISA Advisory Council
August 15, 2018

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I've worked all my professional life – over 43 years – with retirement plans, and I've given a lot of thought to financing a long, healthy retirement.

Starting in 1975, I had a 30-plus-year career as a consulting actuary, helping employers design, manage, and communicate their retirement programs. I retired as a vice president from Watson Wyatt in 2006.

During my career, I was on the front lines of the transition from defined benefit (DB) to defined contribution (DC) retirement plans, and I helped many large employers convert to a DC environment. I understood the reasons why employers didn't want to sponsor DB plans any longer, but I also never thought it was a good idea to require ordinary workers to be their own actuaries and investment managers for their 401(k) and other DC plans.

To help workers and employers address these challenges, I developed an encore career over the course of the past 12 years that uses my actuarial expertise and experience, as follows:

- Since 2006, my wife and I have operated a consulting and boutique publishing company, *Rest-of-Life* Communications. We've published three books and one DVD/workbook package, all on retirement issues.
- Since 2007, I've conducted dozens of retirement planning workshops to help older workers transition into retirement.
- Since 2010, I've published more than 1,000 blog posts for CBS MoneyWatch on various retirement topics.
- Since 2013, I've worked as a research scholar at the Stanford Center on Longevity (SCL), where we research retirement income strategies and behavioral economics as they apply to retirement decisions.

My encore career has created an effective and productive cycle: My face-to-face interactions with ordinary workers struggling with their retirement challenges informs our research and strategies at SCL. And I incorporate SCL research into my writing and workshops.

Lately, my work has been getting more personal. I recently turned age 65, and I'm applying most of the strategies and research that I write about to my own situation.

Today I'm testifying on my own behalf, incorporating my experience from all aspects of my professional career as described above. At no point in my career have I ever sold investments or insurance, which enables me to share unbiased perspectives without worrying about my compensation or promoting specific products.

Retirement planning requires complex decisions

As older workers transition from the workplace into retirement, retirement planning decisions become more complex – and more critical. These decisions will impact workers' financial security and enjoyment of life for the rest of their lives.

Here are the most important decisions they face:

- When to retire
- Whether to work part time for awhile
- When to claim Social Security benefits
- Whether to use retirement savings to optimize Social Security benefits
- How to use their savings to generate retirement income
- Whether to deploy home equity, and if so, how
- Arranging for health insurance, both pre- and post-eligibility for Medicare at age 65
- Managing and reducing reduce living expenses to fit their retirement income, including where to live
- Maintaining their health

I've seen various studies that show the statistics on the savings of older Americans.[1,2,3,4] I can state with confidence that most older workers will find it very difficult to retire full time at age 65 with their pre-retirement standard of living.

Some people call this conclusion a "retirement crisis." I prefer to call it a "serious retirement planning challenge" that might eventually lead to a personal crisis if an older worker makes inappropriate choices with the decisions listed above. If older workers make the proper assessments of their financial resources, most will conclude that they need to:

- work longer, and/or
- reduce their standard of living.

My testimony focuses on these key questions:

- How can employers and financial institutions help their older workers and customers decide when to retire, develop a retirement income portfolio that meets their needs and circumstances, and determine whether they need to reduce their standard of living?

- How can employers enable their older employees to work longer, if they need or want to?
- How can governmental policies enable employers and financial institutions to meet these goals?

Modern portfolio theory (MPT) – developed in the last half of the 20^{th} century – worked well for accumulating assets to meet targeted goals. Our research at SCL applies MPT to the retirement phase by using stochastic forecasts and efficient frontiers, sophisticated tools used by DB plan sponsors to devise funding and investment strategies. Our research suggests that DC plan sponsors can help their workers and retirees build diversified portfolios of retirement income with the continued use of MPT techniques and concepts.

One conclusion is clear from our research:

- Ideally, older workers and retirees shouldn't decide how to deploy their retirement savings in isolation.

Instead, they should make retirement income decisions that consider the level of their Social Security benefits and pensions if they have one, whether they should work for a while in their retirement years, and what their spending on basic and discretionary living expenses will be.

The next evolution in defined contribution plan design

The next evolution in defined contribution plan design is to offer older workers and participants the ability to convert their hard-earned savings into streams of retirement income. This is a complex task that is usually beyond the skills and expertise of the vast majority of older workers.

Left to their own devices, older workers and retirees tend to exhibit two distinct "strategies" for deploying their retirement savings:

1. They conserve their savings for a rainy day by minimizing their withdrawals and treating their savings as an emergency fund,[5,6,7] or
2. They "wing it" by treating their savings as a checking account to pay for an unrealistic level of living expenses, often withdrawing too rapidly at an unsustainable rate.[8]

Neither strategy is optimal – both camps can do better.

To address these challenges, employers often suggest that workers consult a financial planner. But finding an adviser who is both skilled with retirement income planning and isn't conflicted by how they're paid can be a roadblock for many workers. As a result, only about one-third of workers contact advisers for any purpose.[9]

The plan sponsor is in the ideal position to offer retirement income options that an older worker can either "check the box" to implement or allow a default option to take effect. Plan sponsors are in a perfect position to provide unbiased, skilled help to enable workers and retirees to build retirement income portfolios that meet their goals and circumstances.

Research conducted by the Stanford Center on Longevity, in collaboration with the Society of Actuaries, demonstrates that there are many reasonable ways to deploy 401(k) and IRA savings in retirement.[10,11,12] Our research shows that the perfect retirement income solution doesn't exist, but there are many very good solutions that can help a worker craft a retirement plan that works for them.

Ideally, building a retirement income portfolio involves making a series of informed tradeoffs, including:

- maximizing expected income over the life of the retiree,
- choosing a desired level of liquidity,
- choosing sources that offer protection against inflation, and
- choosing sources that offer protection against stock market crashes.

The retirement income menu – an idea whose time has come

I recommend that DC plan sponsors help their older workers and retirees build retirement income portfolios by:

- designing and communicating a retirement income menu of income options that sits beside the investment menu that's familiar for the accumulation phase, and
- designating one of these options as a QDRIA (qualified default retirement income alternative).

The federal government could promulgate a safe harbor for the retirement income menu that uses, as a template, the ERISA Section 404c safe harbor that applies to the accumulation phase. With such a safe harbor, the plan sponsor would offer at least three distinct retirement income options that retiring workers can freely allocate their savings between:

1. Installment payments with invested assets, with the goal that payments would last for life (but with no guarantee)
2. A lifetime annuity guaranteed by an insurance company
3. A period-certain payout to help retirees optimize Social Security if they retire before the optimal age to start Social Security, aka a Social Security "bridge payment"

The annuity could be either "in-plan" or "out-of-plan" through an IRA rollover to an annuity bidding platform. Our research supports offering low-cost single premium immediate annuities

(SPIAs) or deferred income annuities (DIAs) that deliver a fixed monthly lifetime retirement paycheck.

SPIAs and DIAs typically don't allow an employee to change their mind once the annuity has been purchased. If a plan sponsor determines that this lack of liquidity would be a barrier to selection by their workers and retirees, plan sponsors should have the freedom to offer low-cost hybrid annuities that allow this liquidity yet still guarantee lifetime payments. A guaranteed lifetime withdrawal benefit (GLWB) annuity is one example. However, our research shows that such liquidity has a cost – a reduced expected income over retirees' lives, often due to the increased costs of these annuities compared to simple SPIAs and DIAs.

Employers should also have the freedom to designate the one of first two options identified above as the QDRIA, considering their participants' goals and circumstances. They should also have the freedom to designate different QDRIAs for worker and employer contributions.

I published a paper in 2011 that describes how the retirement income menu could work, and another paper in 2014 that describes how a safe harbor could encourage plan sponsors to offer such a menu. The ideas in these papers still apply today.[13, 14]

My anecdotal experience is that employers are very reluctant to offer retirement income options and/or this type of retirement income menu for fear of being sued by participants in a class-action lawsuit. To avoid this possibility, they need protection from lawsuits that such a safe harbor could provide.

The Pension Protection Act of 2006 demonstrated the power of legislation that enabled automatic enrollment and default investment options; the prevalence of these features increased significantly following that legislation and these features helped boost retirement plan participation and savings. We hope to realize similar success by enabling legislation or regulations that apply to the retirement phase.

A straightforward retirement income strategy

Here's a straightforward strategy for building a retirement income portfolio that most people could understand and implement, using any DC plan or IRA:

- Cover basic living expenses (housing, food, utility bills, medical insurance premiums and costs, etc.) with guaranteed lifetime income sources, such as:
    - Social Security benefits
    - A pension if they have one
    - A guaranteed lifetime annuity
- Invest and systematically draw down remaining assets to cover discretionary living expenses, such as travel and hobbies

Such a strategy helps address loss aversion among retirees, a key behavioral economics principle.[15] Loss aversion shows that people often feel the pain of losses about twice as much as they feel the joy of gains. For instance, retirees often display loss aversion by preferring retirement income that's guaranteed not to drop when the stock market crashes, such as income from Social Security, pensions, and annuities. However, our research also shows that it's still desirable to maintain a level of invested assets, often preferably in low-cost funds offered by 401(k) plans. Retirees can effectively manage their loss aversion by covering their basic living expenses with guaranteed sources of retirement income. This can provide the confidence they need to invest for growth with their remaining assets.

In 2017, the Stanford Center on Longevity published a paper that introduced the "Spend Safely in Retirement Strategy." This strategy can maximize retirement income and incorporate these behavioral economics principles. Here's how it works:

- Workers would optimize their Social Security benefits through a thoughtful strategy to delay starting benefits. If the worker retires before the optimal age to start Social Security benefits (which is often age 70), they would withdraw a "Social Security bridge payment" from their retirement savings until they've reached the optimal age to start their actual Social Security benefits. This bridge payment would be used to provide funds that would be equivalent to the Social Security benefits they would have received if they had started Social Security benefits before their optimal age. Our research shows that with this strategy, most middle-income workers will end up receiving from two-thirds to three-fourths or more of their total retirement income from Social Security. This income is guaranteed for life, protects against inflation, and protects against investment losses.

- They should invest their remaining assets and use the IRS required minimum distribution (RMD) to determine regular withdrawal amounts. They should invest their assets in a low-cost stock index fund, a target date fund, or a balanced fund.

Research conducted by SCL, in collaboration with the Society of Actuaries, systematically compared 292 different retirement income strategies, using eight different comparison metrics.[16,17] Using these metrics, the Spend Safely in Retirement Strategy compared favorably to the strategies we analyzed, most of which were more complex and costly to implement. These metrics included the expected amount of retirement income received over the retiree's lifetime and the expected amount of accessible savings.

The Spend Safely in Retirement Strategy can also help older workers with important life decisions, such as:

- Whether they have enough retirement income to retire,
- Whether they should work part time for a while, and
- How much they should reduce their basic and discretionary living expenses.

A plan sponsor's retirement income menu could enable older workers and retirees to implement the Spend Safely in Retirement Strategy with their DC accounts, and the safe harbor described previously can encourage employers and plan sponsors to offer such a menu.

As mentioned previously, many older workers may decide they'd like to work longer, as indicated by a few surveys.[18,19] Accordingly, enlightened employers may want to offer alternative career trajectories for their older workers as part of their overall retirement program.

Conclusion, or don't let "perfect" be the enemy of "very good"

Our sophisticated and unbiased research shows that there are several viable and reasonable retirement income solutions that employers and plan sponsors could offer in their defined contribution retirement plans. When determining whether to include them, we shouldn't let "perfect" be the enemy of "very good."

Employers and plan sponsors should have the freedom to design a retirement income menu that best meets the needs of their workers and retirees, without the fear of being sued by class-action lawsuits. A thoughtfully constructed safe harbor could encourage employers and plan sponsors to better meet the needs of their older workers and retirees.

Research citations

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