AMERICAN ACADEMY of ACTUARIES

National Retirement Policy—

Guiding Principles Series

In July 2019, the American Academy of Actuaries Retirement System Assessment and Policy Committee published an issue brief titled *National Retirement Policy & Principles*, which discusses the increasing need for a comprehensive national retirement policy based on certain guiding principles. This initial issue brief has been followed up by four additional papers in the series:

Retirement Security Challenges: Portability and Retirement Income **(APRIL 2020)** addresses the challenges faced by workers in a mobile workforce who accumulate retirement benefits at multiple employers over their careers.

New Retirement Plan Designs: Degrees of Risk Sharing **(OCTOBER 2021)** focuses on where the risk lies under alternative retirement plan models as well as legislative changes needed to allow more innovative plan designs in the private sector.

Retirement Policy: Potential for Changing Roles of Employers in Retirement Programs **(OCTOBER 2021)** addresses how employers can provide retirement plans to their employees through models in which many of the responsibilities are decoupled from the employer.

Retirement Policy: Aligning Plan Design With Effective Employee Engagement **(MARCH 2022)** explores how retirement program design can impact decisions that participants make with the goal of improving retirement security.

Taken together, these issue briefs lay out guiding principles that policymakers can look to as they consider the establishment of a comprehensive national retirement policy. They also discuss possible changes in plan design to broaden access and participation in retirement plans to better enable workers to retire with a secure lifetime income.

No. 1 in a series of 5

Guiding Principles Series

National Retirement Policy & Principles

JULY 2019

Key Points

- Securing adequate and reliable retirement income has become a growing concern for many Americans.
- Today, many Americans rely on a combination of Social Security, employer-sponsored retirement plans, and/or personal savings to fund their retirement needs. These systems are often overseen by different regulatory entities or levels of government, resulting in a complex and disjointed system.
- There is an increasing need for the establishment of a comprehensive national retirement policy that articulates guiding principles for the U.S. retirement system.

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Although Americans often have disparate opinions on many issues, one issue that does enjoy widespread support is the importance of experiencing a dignified and financially secure retirement. Who doesn't want comfortable retirement years with ample time for engaging in hobbies and spending time with family? Unfortunately, the debate on retirement security has not received the attention many think it deserves. Thus, despite some concern over a looming retirement crisis, significant thought has not been put into developing a comprehensive national retirement policy.

Today, issues involving retirement security in the United States are more pressing than ever. An aging population, increasing life expectancies, and changes in the way employers provide retirement benefits serve as a backdrop and provide a catalyst to review our current retirement system. Historically, the U.S. has not had a formal national retirement policy beyond the general concept of retirement security resting on a three-legged stool of Social Security, employer-provided benefits, and individual savings.

This issue brief explores the concept of a national retirement policy, including the potential benefits of such a policy and the various topics that it might address.

Background

Our national retirement system consists of a variety of programs that have evolved over time. Lawmakers and regulators have at times made changes to individual programs to address narrow issues or concerns, without always considering the longer-term impact on broader retirement security policy as a whole. Other changes to retirement programs were designed to achieve objectives unrelated to retirement security, such as a desire to increase tax revenues to fund infrastructure spending. The piecemeal approach under which the various types of retirement plans currently in use have developed has arguably led to inefficiency and a lack of coordination among the programs.

Over the years, several attempts to develop a cohesive framework for the U.S. retirement system have been initiated. In 1979, the President's Commission on Pension Policy was established by President Jimmy Carter. The Commission's report, which was never adopted, made recommendations related to employee pensions, Social Security, individual efforts, and public assistance. In June 2016, a Bipartisan Commission on Retirement Security and Personal Savings issued a detailed report of recommendations. Though not a call for a formal national retirement policy, the report has stimulated thought on the shortcomings of the current retirement system. Most recently, in October 2017, the Government Accountability Office (GAO) published a comprehensive evaluation of retirement security, which recommended that Congress establish an independent commission to examine the U.S. retirement system. Legislation was introduced in the Senate during the spring of 2019 that would create a federal Commission on Retirement Security. However, as of the date of this issue brief, the proposed legislation had not yet been acted upon.

Members of the Retirement System Assessment and Policy Committee who authored this issue brief include Eric Keener (*chairperson*) MAAA, FSA, EA, FCA; Anne Button MAAA, FSA, EA; Cynthia Levering MAAA, ASA; Andrea Sellars MAAA, FSA; Mark Shemtob MAAA, FSA, EA, FCA, MSPA; Claire Wolkoff MAAA, FSA, EA.

Purpose of a National Retirement Policy

A national retirement policy would ideally articulate a set of guiding principles designed to provide individuals with the opportunity to achieve financially secure retirements. These principles could incorporate and address such elements as: availability of retirement programs, benefit adequacy, allocation of risks, treatment of different income levels, use of incentives, individual choice, costs, and portability and leakage. Note that principles, once adopted, can change over time based on changes in demographics and economic and political circumstances. Well-chosen principles will be sufficiently broad and comprehensive to reflect and address the gender and race gaps in wealth, wages, and savings. An effective policy will also take into account the needs of individuals who are not in the workforce on a long-term basis or those who have significant gaps in their careers (e.g., women who leave the workforce during caregiving years). The rise and ramifications of a high-technology-based economy, in which temporary positions for short-term engagements are common, might also be considered.

Although clearly a primary objective of a successful retirement system is to provide financial security to workers after they stop working, difficult questions remain such as how much retirement income is sufficient, or what are the characteristics of the programs that will provide this income. Is it enough for the system to provide everyone with the tools needed to build a financially secure retirement, while placing the responsibility for using those tools on individuals? What role should employers be expected to play in providing retirement benefits? These are the types of questions that a national retirement policy could address.

A national retirement policy does not need to result in a sweeping overhaul of our retirement system to be successful. Rather, it could serve as a guide for future incremental changes that would promote the principles of the policy. Over time, consistently using a well-developed national retirement policy to evaluate existing retirement programs and proposed changes to those programs could help our retirement system become more efficient and effective, while minimizing unnecessary complexity and overlap.

In 2014, the American Academy of Actuaries released a framework—Retirement for the AGES (Alignment, Governance, Efficiency, and Sustainability)—to assist in formulating public policy to help sustain and improve employer-based retirement programs. The principles governing a national retirement policy must necessarily be broader than the principles for employer-based programs. However, the AGES principles, which are discussed in more detail later in this issue brief, continue to be useful in assessing the effectiveness of the employer-based component of the U.S. retirement system.

Elements of a National Retirement Policy

Below are descriptions of each of the possible elements of a national retirement policy noted above. To provide context, we offer illustrative approaches as to how each element could be incorporated into a national retirement policy. These potential approaches are illustrative only; they do not represent positions of the American Academy of Actuaries' Pension Practice Council.

Availability

In theory, all U.S. workers can voluntarily save for retirement through private after-tax savings, or through either tax-advantaged employer-sponsored programs or Individual Retirement Accounts (IRAs). However, many low-income workers may not have sufficient resources to save for retirement. With some exceptions (e.g., certain employees of state and local governments), almost all workers participate in Social Security. All public and private employers can offer defined benefit (DB) or defined contribution (DC) plans to their employees, but not all employers do so. A 2014 analysis by the Center for Retirement Research at Boston College estimated that roughly 65 percent of workers are covered by an employer-sponsored retirement plan, with approximately 50 percent of the workforce choosing to participate.[1] (For some employees, "coverage" might only include the ability to defer their wages into a tax-deferred account, with no benefits funded by employer contributions.) In other words, a large segment of the population is not covered by an employer-sponsored plan or does not participate in a plan that is available to them.

A national retirement policy could include a targeted level of availability for employer-sponsored plans. A relatively low target would imply a greater reliance on personal savings and Social Security. A higher target might require substantial incentives to encourage employers to offer plans. Universal availability could likely only be achieved by mandate.

A national retirement policy could also address whether requiring an employer to merely offer employees access to a structured retirement program without employer contributions is sufficient, or whether a targeted level of employer contribution or benefit is necessary. The targets could be different for different segments of the population. For example, lower-wage earners may need to rely more heavily on employer-provided benefits than higher-wage earners, who might be able to save more of their income independently.

Potential Approach: A national retirement policy could include a goal that all private-sector companies with a minimum number of employees should provide their workers with access to an employer-sponsored retirement plan.

1 See the report *Is Pension Coverage a Problem in the Private Sector?* from the Center for Retirement Research at Boston College.

Adequacy

Although what constitutes an adequate level of retirement income is not universally defined, a commonly cited goal is that people be able to maintain the same standard of living in retirement that they experienced while they were working. The portion of pre-retirement income necessary to meet this goal can vary widely from person to person based on factors such as marital status, medical expenses, homeownership, and the need to support dependents. Another possible objective is to target retirement income that exceeds some predetermined level, such as the poverty level or a minimum dollar amount.

The level of retirement income produced by personal savings and voluntary salary deferrals in employer-sponsored plans depends largely on employees' behavior and their ability to save. This behavior includes the amount of money an employee contributes to the plans while working, how the employee invests the assets, and how savings are drawn down in retirement. Because in these plans employees get to choose whether to contribute the maximum amount allowed or some amount less than that, a national retirement policy could differentiate between the level of retirement income that these plans have the capacity to produce and the level that is actually produced.

An adequacy target could address only total retirement income from all sources, or it could consist of individual objectives for the various sources of retirement income. A national retirement policy might focus on the level of retirement income that is considered to be sufficient for various cohorts of workers, taking into account the fact that not everyone is in the workforce for all of their working years and that income levels for some segments of the population may be too low to allow for significant savings. Alternatively, a more sophisticated approach might establish statistical goals, such as having at least a specified percentage of retirees with sufficient income to stay above the poverty level or to replace a certain percentage of their pre-retirement earnings.

Potential Approach: A national retirement policy could establish an explicit goal that individuals have retirement income from all sources that is sufficient to avoid old-age poverty.

Allocation of Risks

Retirement systems face investment risk as well as longevity and other demographic risks. At a very high level, when a risk produces adverse experience, it will either increase the cost associated with a retirement program or decrease the benefits that will be paid. Demographic and economic forecasts are inherently uncertain, which causes the cost of providing defined benefits, such as Social Security, to deviate from expected, perhaps significantly. Similarly, the level of personal savings or defined contribution account assets needed to support retirement income could be much different from expected—again, maybe considerably.

Longevity risk, if borne by an individual, can result in the individual outliving his or her retirement savings. Longevity risk can also be borne by the government (and therefore the taxpaying public), employers, and insurers. These entities can pool the risk among large groups of individuals, which can be an effective risk-mitigation technique because the average lifespan across a large population is more predictable than the lifespan of an individual.

An example of the federal government bearing longevity and other risks (e.g., birth rates and the growth of national average wages) is Social Security, although those risks could be ultimately passed on to beneficiaries in the form of lower benefits or to workers and employers through higher payroll taxes. Defined benefit plans are generally structured so that longevity risk is borne by the sponsoring employers, while in defined contribution plans individual participants generally bear the longevity risk. In the case of fixed-income annuity contracts, the longevity risk is borne by the insurance company.

The level of risk in a retirement plan can be managed. Both defined benefit and defined contribution retirement plans, for example, could greatly reduce the level of investment risk by allocating all of the plan assets into high-quality fixed-income securities. The downside is that the level of long-term investment returns would likely be substantially lower under a less risky approach, resulting in a combination of higher plan costs and reduced benefit levels.

A national retirement policy could address the level of risk that is incorporated into various components of the retirement system, how those risks are shared among stakeholders, and the extent to which adverse experience associated with those risks results in lower benefit levels or higher costs.

Potential Approach: A national retirement policy could call for the federal government to encourage the use of longevity pooling mechanisms, such as the payment of benefits as annuities under individual account-type plans or defined benefit plans.

Treatment of Different Income Levels

The traditional three-legged stool of retirement income consists of personal savings, Social Security, and employer-sponsored plans. These components can appropriately take on very different structures and roles based on the level of an individual's income and years of workforce participation.

A national retirement policy might reflect a belief that Social Security should be less about individual equity (benefits based on wages subject to payroll taxes) and more about social adequacy (income redistribution).[2] For individuals in the higher income brackets, Social Security could have a negligible role and those individuals will likely accumulate sufficient personal savings to achieve financially secure retirement. Employer-sponsored plans could function the same way for these individuals as they do for lower-paid workers, or a national retirement policy might encourage employers to provide more meaningful benefits to lower-paid employees than to high-wage earners. Conversely, most individuals at lower income levels might be unable to accumulate meaningful personal savings, leaving employer-sponsored plans and/or Social Security as the primary sources of retirement income.

Potential Approach: A national retirement policy could provide that Social Security gradually transition to a structure that focuses even more of the share of benefits toward low-wage earners than it already does.

Use of Incentives

To the extent that a national retirement policy anticipates that employer-sponsored plans will be a source of retirement income, the policy might also address the incentives that employers have to offer such plans. Competition for talent in the labor market, a desire for orderly transitions from one generation of workers to the next, and genuine concern for the well-being of retired employees are all factors that can motivate companies to offer retirement plans. A national retirement policy could recognize that the significance of these factors can change over time, and that regulatory incentives could help ensure that employer-sponsored plans consistently fulfill the role that is anticipated by the policy.

A national retirement policy could address the role that incentives have in encouraging employers to offer retirement plans. The most significant incentive under current law that encourages companies to sponsor retirement plans is the tax treatment available through qualified plans. A policy could also call for consistency between the time period used to measure the impact of tax incentives on the government budget and the long-term nature of retirement programs.[3]

2 The current Social Security system blends the concepts of individual equity and social adequacy. Benefit levels are a function of wages, with higher earnings resulting in higher benefits, but with substantially higher benefit accrual rates (based on a percentage of wages) applying to lower-wage earners than to higher-wage earners.

3 See, for example, *The Role of Tax Policy in Promoting Retirement Security*; American Academy of Actuaries issue brief; December 2017.

Additionally, the nondiscrimination rules for qualified plans provide an incentive for companies to offer plans to lower-wage workers (assuming the companies want to provide benefits to higher-wage workers). Other incentives could also be created, such as tax penalties on companies that do not offer retirement plans or exempting retirement benefits from taxation entirely.

Potential Approach: A national retirement policy could call for the use of tax incentives to raise the proportion of lower-wage workers who are covered by employer-sponsored plans to a specified level.

Individual Choice

Different components of a retirement system can involve different levels of choice. In the current system, individual savings and Social Security are at opposite ends of the spectrum with regard to individual choice. For individuals who have sufficient resources to save for retirement, every aspect of individual savings is subject to the discretion of the individual, including how much to save (if anything), how to invest the money, and how to convert savings into retirement income. Social Security, in contrast, only allows eligible individuals to decide when to begin receiving benefits.

Employer-sponsored plans contain a wide array of individual choice features. Certain defined contribution plans allow employee deferrals and provide only matching contributions at the employer level.[4] These plans provide no benefits unless employees choose to contribute to the plan. However, defined contribution plans can also provide employer contributions independent of an employee's decision to contribute. Employees often have wide latitude regarding how to invest their accounts. In some cases, this latitude means making investment decisions that employees do not have the knowledge or skill to make effectively, although this can be mitigated through the use of lifecycle or target date funds that automatically diversify the investments and adjust the allocations as participants age. In some defined contribution plans, the employer makes all of the plan investment decisions. Most employer-sponsored defined benefit plans allow a wide range of retirement ages and allow the employee (and spouse) to choose the type of annuity. Many defined benefit plans also permit employees to receive their benefits as lump sums instead of annuities.

4 Some plans sponsored by smaller employers that are deemed "top heavy" could be required to make non-matching employer contributions for some employees.

A national retirement policy could take into account the extent to which individuals have choices with respect to their retirement income vehicles. More choice will tend to provide people with the freedom to customize their retirement programs to meet their specific needs. However, additional freedom brings with it the consequences that result from suboptimal decisions. For example, a retirement system with fewer choices could reliably ensure that all retired workers have adequate income. But this approach might also provide retirement income to some people who do not need it, while providing inadequate income to others. Allowing more choice could address these shortcomings but could also lead to people making poor decisions that ultimately leave them with inadequate retirement income and possibly dependent on social safety net programs. In turn, greater dependence on social safety net programs could result in a need for additional tax revenues or reductions to other government programs to offset the increased social safety net spending. Balancing these competing objectives is difficult, and a national retirement policy could provide a framework for achieving this balance.

Potential Approach: A national retirement policy could specify that individuals are provided sufficient flexibility to customize their retirement programs to their specific needs, while not placing demands on them to make choices outside their area of knowledge or comfort level.

Cost

The value that a retirement system provides must be balanced against the cost of supporting it. The fact that the cost of providing retirement income can vary over time complicates this comparison. The cost of supporting Social Security is higher now than it was in past decades because it is a pay-as-you-go system, and there are more retirees for each worker today than there were in the past. The cost of providing retirement benefits through both employer-sponsored plans and individual savings can vary widely based on interest rates and asset returns.

Adequacy and risk are critical factors when evaluating cost. In general, higher levels of adequacy and lower levels of risk will correspond to higher costs.[5] The objectives of a national retirement policy are unlikely to be achieved if the associated costs are more than individual savers, employers, and taxpayers are willing and able to bear. For this reason, a national retirement policy might address not only the objectives of the retirement system, but also the costs of supporting the system.

Potential Approach: A national retirement policy could target a minimum level of benefits from all sources while constraining aggregate retirement plan contributions so that they do not exceed a specified percentage of gross domestic product.

5 For example, an approach that incorporates less investment risk will tend to provide more predictable retirement income but will also tend to achieve lower rates of investment return. Achieving a stated retirement income goal while taking less investment risk will likely result in greater costs.

Portability and Leakage

When employer-sponsored retirement plans were introduced, individuals commonly worked for a single employer for many years. Now, individuals might have many employers over their careers, resulting in a patchwork of benefits payable from multiple sources that can make retirement planning difficult. Retirees might completely lose track of some of their retirement benefits, potentially resulting in their loss. (Although plans are required to search for missing participants, finding these participants can be a long process, during which no benefits will be paid.) Plans may also incur higher administrative costs if they are required to keep track of a large number of small benefits, while those costs could be reduced if employees are able to consolidate their benefits in a single plan. A related concern is "leakage," which occurs when money that is set aside for retirement is actually used for other purposes, such as purchasing a residence or satisfying debts that are incurred prior to retirement.

Certain defined benefit plan designs accumulate much of their value in later years because they base all benefit accruals on employees' final salaries. Under these plans, even if a person switches to a new employer that offers the exact same plan, the benefit earned with the first employer will no longer grow with salary increases, and much of the value of the later years of service will be lost. This potential loss of retirement benefit value due to job changes can be viewed as an additional portability concern.

A national retirement policy could help alleviate these problems by supporting policies that make it easier for participants to transfer benefits—both from defined benefit and defined contribution plans—between employers or into IRAs. Making pensions more portable would greatly reduce the problems created by participants simply losing track of their benefits, because benefits will be paid from fewer sources. A national retirement policy could also provide employers with tax incentives to offer plans that do not penalize employees for switching jobs.

Potential Approach: A national retirement policy could call for a regulatory structure that minimizes the administrative burdens associated with rolling benefits earned with a previous employer into a plan sponsored by a new employer or an Individual Retirement Account.

Retirement for the AGES

The Academy's *Retirement for the AGES (Alignment, Governance, Efficiency, and Sustainability) initiative* is intended to provide a framework for assessing employer-based retirement programs, or policy changes that would that would affect them, to understand how well they meet the needs of each of the stakeholders.

The AGES framework initiative is based on four key principles:

- *Alignment*: Retirement income systems work best when stakeholders' roles are aligned with their skills. Important tasks, such as financial analysis, investment management, and retirement plan administration, should be the responsibility of those who have the knowledge and experience to perform them well.

- *Governance*: Making and implementing good decisions are essential for successful retirement plans. Good governance helps balance the complex needs of various stakeholder groups, as well as oversees significant trustee, administrative, and investment functions.

- *Efficiency*: Risk pooling, accurate pricing, appropriate use of guarantees, and other financial techniques should be adopted or incorporated to ensure that a retirement income system is efficient and maximizes income while avoiding excessive risk to stakeholders.

- *Sustainability*: Roles and skills, good governance, and financial efficiency should be structured to support a sustainable retirement income system that is able to withstand the financial shocks of recessions or times of extraordinary inflation.

A national retirement policy could incorporate these principles as a foundation for developing effective employer-sponsored retirement programs.

Conclusions

The establishment of a national retirement policy commission could be an important step forward. The overarching goal of such a commission would be to review the nation's current retirement systems and the state of individual retirement security. Such a commission could be charged with developing recommendations for an articulated, cohesive policy to guide and drive future retirement legislation and regulations.

Formulating a comprehensive retirement policy might not be easy to accomplish. A large and diverse population inherently includes individuals and employers with a wide range of economic circumstances and needs. An aging population introduces challenges that past generations did not face. Different ideological perspectives contain stark differences regarding the proper role of government in the lives of individuals. Economic considerations can pose significant challenges. For example, focusing heavily on saving for the future at the expense of current consumption might have short-term consequences on the U.S. economy. In addition, providing tax incentives can hinder the government's ability to provide other services.

Our current retirement system is disjointed, relying on a variety of laws administered by several regulatory bodies at different levels of government. A national retirement policy could bring focus and clarity to this complex system, ultimately helping to provide retirement income security more efficiently to as many Americans as possible. Whether reforms are undertaken piecemeal or as part of a comprehensive package, the considerations discussed in a national policy could serve as a roadmap for policymakers as they work to improve the effectiveness of our retirement programs.

APPENDIX—

ADDITIONAL RESOURCES FROM THE AMERICAN ACADEMY OF ACTUARIES

The American Academy of Actuaries has published a great deal of information related to retirement policy. Below are various Academy publications that might be beneficial to policymakers as they seek to introduce a retirement policy to help Americans achieve a more financially secure retirement.

A. **Social Security** benefits could be raised for certain parts of the citizenry. These cohorts include single women, low-lifetime wage-earners, and the very elderly. The program also might benefit from automatic benefit adjustments that would secure its sustainability. Changes would need to be evaluated in light of both financial and political constraints. Some Academy publications on these topics are:

- *An Actuarial Perspective on the 2019 Social Security Trustees Report* (May 2019)
- *Social Security—Automatic Adjustments* examines automatic approaches to maintaining long-term solvency. (May 2018)
- *Women and Social Security* examines specific challenges faced by women under Social Security. (May 2017)
- *Helping the 'Old-Old'—Possible Changes to Social Security to Address the Concerns of Older Americans* addresses possible ideas for assisting the very old who are vulnerable to outliving retirement savings. (June 2016)
- *A Guide to Analyzing Social Security Reform* explores different approaches to changes to the program. (December 2012)
- *Means Testing for Social Security* examines how the program can be modified to reduce benefits for employees without as much need. (December 2012)

B. **Retiree Lifetime Income** creation has become a much larger challenge with the decline of traditional defined benefit plans and increasing life expectancies. Individuals could need help recognizing and adapting to this challenge. Some Academy publications on this topic are:

- *Comments on the Report of the Commission on Retirement Security and Personal Savings*—provides comments on the recommendations of the Bipartisan Policy Center in its 2016 Report of the Commission on Retirement Security and Personal Savings (February 22, 2019)

- *Retirement Income Options in Employer-Sponsored Defined Contribution Plans*—position statement in support of policy and educational initiatives to increase retirement income options within employer-sponsored defined contribution plans. (October 31, 2017)

- *Risky Business: Living Longer Without Income for Life—Legislative and Regulatory Issues* examines the importance of a secure income that lasts a lifetime. (October 23, 2015)

- *Risky Business: Living Longer Without Income for Life—Actuarial Considerations for Financial Advisers* provides actuarial insights regarding lifetime income planning. (October 23, 2015)

- *Risky Business: Living Longer Without Income for Life—Information for Current and Future Retirees* explains how risk-sharing can help manage longevity risk. (October 23, 2015)

- *Retiree Lifetime Income: Choices & Considerations* explores key decisions and options available in the years leading up to and during retirement. (October 23, 2015)

- *Retiree Lifetime Income: Product Comparisons* examines general insurance and investment products to create lifetime income. (October 23, 2015)

- *Risky Business: Living Longer Without Income for Life*—A discussion paper by the Lifetime Income Risk Joint Task Force. (June 19, 2013)

C. **Multiemployer Plan Sustainability** threatens the retirement income of over a million current and future retirees. Solutions to this national issue involve no easy decisions. Some Academy documents on this topic are:

- *Follow-up Letter to Joint Select Committee on Solvency of Multiemployer Plans* summarizes key topics discussed during June 22 meeting regarding loan proposals and other solutions for troubled multiemployer pension plans. (September 26, 2018)

- *Multiemployer Pension Plans: Potential Paths Forward* explores options to address failing multiemployer plans and ways to strengthen the multiemployer pension system. (June 27, 2017)

- *Honoring the PBGC Guarantee for Multiemployer Plans Requires Difficult Choices* examines the Pension Benefit Guaranty Corporation's multiemployer pension program, which could exhaust its assets in less than 10 years. (October 20, 2016)

- *The Multiemployer Pension Plan System: Recent Reforms and Current Challenges* examines the future of the program and its many challenges. (March 17, 2016)

D. **Public Defined Benefit Plan Funding** issues have received much attention over the past several years. Although some public plans are well-funded, certain states and municipalities sponsor defined benefit plans that are significantly underfunded, and considerable debate has ensued as to how public sector plans should evaluate their funding levels. Some Academy publications on this topic are:

- *Assessing Pension Plan Health: More Than One Right Number Tells the Whole Story* explores various methods to measure the financial health of pension plans. (July 13, 2017)

- *Objectives and Principles for Funding Public Sector Pension Plans* introduces the objectives and principles for funding pension plans for state and local government. (February 19, 2014)

- *Measuring Pension Obligations* examines the different measurements of the obligations of defined benefit pension plans. (November 21, 2013)

E. **Multiple Employer Plans** are uncommon, but their expansion could benefit employees of small employers. Some Academy documents relating to this topic are:

- *Comments to Senate Aging Committee on Open Multiple Employer Plans (MEPs)* discusses changes to funding rules and administrative responsibilities for defined benefit MEPs and a new concept to offer retirees in defined contribution plans the opportunity to roll assets over to a provider specializing in retiree solutions. (September 1, 2016)

- *Retirement for the AGES Assessment of Proposal: USA Retirement Funds* contains an assessment of Senator Harkin's proposed USA Retirement Funds, which would be hybrid pension plans available to small employers. (November 13, 2014)

F. **Alternative Retirement Plan Designs** could offer an opportunity for employers to provide lifetime income to employees, while protecting employers from the financial risks present in the current DB/DC paradigm. The Academy discussed this opportunity in:

- *Retirement for the AGES Assessment: New Brunswick Shared Risk Model* contains an assessment of a risk-sharing defined benefit structure adopted by certain Canadian plans. The shared-risk model seeks to provide promised benefits with a high degree of probability while utilizing actuarial stress-testing and self-adjusting mechanisms to ensure sustainability. (November 13, 2014)

G. **Retirement Ages** should be evaluated and potentially updated to reflect current longevity experience. Some Academy publications on this topic are:

- *Essential Elements publication "Raising Social Security's Retirement Age"* is a paper on the benefits of raising Social Security's retirement age to help solve the program's long-term financial problems. It provides statistics on the demographics of the system from the 2017 Social Security Trustees' Report, the impact on beneficiaries, and the benefits of raising the retirement age. (July 2017)

- *Rethinking Normal Retirement Age for Pension Plans* states that raising the maximum allowable normal retirement age in defined benefit retirement plans would align U.S. pension policy more closely with Social Security's increasing retirement age and could benefit workers by allowing them to amass more retirement savings. (March 7, 2013)

- *Retiree Lifetime Income: Choices & Considerations* talks about when to retire and provides links to other sources of information. (October 2015)

- *Actuaries Advocate Raising Social Security's Retirement Age*: The Academy's first (and to this point only) public advocacy statement. (August 2008)

Retirement Security Challenges: Portability and Retirement Income

APRIL 2020

Key Points

- Today's mobile workforce faces challenges in keeping track of retirement savings accumulated from different employers and converting those savings into sustainable retirement income.
- Potential solutions include the creation of a centralized registry for benefits, providing periodic benefit statements, and offering basic education on retirement-related topics at different career stages to help demystify the retirement planning process.
- Secure retirement income can be facilitated by easy access to low-cost investments offering an opportunity for growth while managing risk, and making available at retirement a variety of easy-to-initiate, institutionally priced income options.

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Introduction

In July 2019, the American Academy of Actuaries published an issue brief titled *National Retirement Policy & Principles*. The focus of the paper was the increasing need for the establishment of a comprehensive national retirement policy based on several guiding principles. The Academy's Pension Practice Council plans to issue a series of additional issue briefs to expand the discussion to specific retirement issues that could be addressed in further detail by the national policies and guiding principles.

This initial brief specifically addresses the difficulty that workers in a mobile workforce face as they accumulate retirement benefits at multiple employers over their careers. Two specific risks addressed are 1) the potential for losing track of benefits and 2) the challenge of converting benefits into sustainable retirement income. The elements of a national retirement policy that would be impacted by these risks are: Availability, Adequacy, Allocation of Risks, Cost, and Portability and Leakage (for further discussion of these specific elements of a national retirement policy, see the *National Retirement Policy & Principles* issue brief). These risks are explored in greater detail below, along with ideas as to how they may be mitigated.

Background

Much has changed over the past several decades in how Americans achieve retirement security. In the private sector, the prevalence of the defined benefit (DB) plan as part of employers' ongoing retirement programs has dwindled, while employer-sponsored defined contribution (DC) arrangements have become more prominent. In addition, individual account arrangements and options for investment and retirement income products and solutions have grown. At the same time, life expectancies have increased, and the likelihood of spending one's working lifetime in the service of a single employer has declined.

Many employees of larger employers have access to retirement plans that provide opportunities for retirement planning education, transfer of funds from prior employers' plans, and projections of potential retirement income that the participant account may provide. Some employees may also have access to income options payable from the plan at retirement. With the passage of the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 discussed in the Appendix, DC plans will be required to provide participants with estimates of the lifetime income their account balance could provide, and the prevalence of lifetime income options in DC plans may increase.

However, not all employees have taken advantage of these services, and many other individuals have not had continuous access to these types of plans through their working careers. It is very common for individuals to have many different jobs during their working years. Individuals may lose track of where the benefits they accumulate over a career reside and may not currently control how those funds are invested, managed, and/or distributed. In addition, they could benefit from access to basic education and cost-efficient, unbiased advice on conversion of their retirement savings into retirement income, as well as access to low-cost investments. Stakeholders have observed that workers would benefit by simplifying the process for transferring funds between retirement vehicles when they change jobs. On occasion, funds that had been set aside for retirement are withdrawn and used prior to retirement. An estimation of these funds

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withdrawn could be as much as 2.9% of assets per year based upon tax data.[1] A portion of this leakage occurs when individuals change jobs. More seamless portability to a tax-deferred retirement vehicle could help to lower this leakage rate.

Workers could benefit from easier access to tools and services needed to assist in managing the retirement security challenges they face. Recently, the Department of Labor (DOL) granted approval to an "auto-portability" program to help facilitate the transfer of individuals' small balances earned in prior employers' plans into new employers' plans. However, there continues to be a need for additional and broader services and tools. This issue brief provides an overview of several types of services and tools that could be helpful.

Reasons for Policy Changes to Encourage New Solutions

There are several reasons why the above enhancement in services and tools in our retirement system may be attractive to workers, and why policy changes to encourage those solutions should be considered. Applicable elements of a national retirement policy are highlighted in italics below.

A. **Decline in prevalence of DB plans** (*Availability, Allocation of Risks*): The traditional DB plan providing guaranteed lifetime income has become less prevalent for private-sector employees. According to data from the Employee Benefit Research Institute (EBRI), only 11% of private-sector U.S. workers were covered by a DB plan in 2017.[2] As a result, most employees are assuming the majority of both longevity- and investment-related risks.[3] This is a challenge for many individuals, especially those who lack basic financial literacy and are unable to obtain sufficient financial education and unbiased advice.

B. **Multiple jobs throughout an individual's working lifetime** (*Availability, Portability and Leakage*): The Bureau of Labor Statistics' news release dated Aug. 22, 2019, noted, "Individuals born in the latter years of the baby boom (1957–64) held an average of 12.3 jobs from ages 18 to 52."[4] Many will also have periods when they will be self-employed. Retirement savings through these different employment periods are often spread across a variety of institutions with no coordination among the various plans or accounts. In

1 *Why Are 401(k)/IRA Balances Substantially Below Potential?*; Center for Retirement Research at Boston College; November 2019.
2 "*Tracking the Shift in Private-Sector, Employment-Based Retirement Plan Participation From Defined Benefit to Defined Contribution Plans, 1979–2017*"; EBRI; June 6, 2019.
3 Social Security being an exception for nearly all retirees.
4 "*Number of Jobs, Labor Market Experience, and Earnings Growth: Results from A National Longitudinal Survey*"; Bureau of Labor Statistics economic news release; Aug. 22, 2019.

addition, funds accumulated for retirement may be spent prior to retirement. There is a need to enable individuals to more easily centralize their holdings, either in a single place or through a portal that keeps track of all retirement funds, to facilitate the coordination of investment and decumulation decisions.

C. **Challenges in accessing lifetime income options under employer retirement plans** (*Availability, Cost*): Over the past decade, there has been increasing interest in encouraging employers to provide employees with financial education and advice, as well as to offer alternative retirement income strategies and options for benefits to be paid by employer-based plans. However, the number of employers offering lifetime income solutions within qualified DC plans remains relatively low due to a number of factors, including cost, complexity, and perceived fiduciary liability. This is especially true among smaller employers.[5] If retirees cannot get access through their employers, where can they turn?

D. **Lack of access to low-cost, unbiased advice** (*Availability, Cost*): Individuals without meaningful levels of retirement savings may be unable to obtain quality, unbiased financial advice at a reasonable cost upon retirement. In addition, those who do obtain advice may not be provided with a broad enough array of options or in some cases may even be subject to large per-account fees and what may be considered elder abuse.

Improvements in these areas could help close the gap between retirement income needs and resources, positively impacting the element of *Adequacy*. Greater efficiencies in the accumulation phase can lead to larger accumulations, and greater efficiency in converting accumulations to lifetime income can lead to higher and more stable income.

Description of Desirable Services and Tools

One key objective would be to facilitate workers' ability to track and manage retirement savings they have accumulated from multiple sources, such as qualified retirement plans (e.g., 401(k) plans) offered by prior employers or individual tax-advantaged savings (e.g., Individual Retirement Accounts, or IRAs). There are currently challenges associated with direct transfers between qualified plans, which create the potential for leakage (for additional detail on these challenges, see the 2016 report of the ERISA Advisory Council mentioned in the Appendix). Even if leakage doesn't occur, it often results in workers' savings being spread across multiple institutions and vehicles with a lack of coordination among their investments. The ability to easily consolidate or manage such savings could

5 This could change with the recent passage of the SECURE Act, described in the Appendix.

reduce the likelihood that there will be workers who will lose track of their savings or use it for non-retirement purposes. Consolidation would also provide an opportunity for greater efficiency in areas such as recordkeeping and investment management.

A secondary goal should be to provide assistance to retirees in converting retirement savings into stable retirement income. There are a variety of approaches to convert retirement savings into retirement income, each with pros and cons. Unfortunately, there are retirees who may not be aware of the options they may have.

Specific services and tools that could address these issues include:

- Facilitating transfers and rollovers between IRAs and qualified retirement plans with the goal of having all retirement savings either under one "roof" or, if spread out, easy to track and manage.
- Offering a centralized registry for all qualified retirement funds associated with a given Social Security Number. Such a registry would allow for an easy process for locating "forgotten" IRA and qualified plan accounts.[6]
- Facilitating on a default basis (when other options are not elected) investments in low-cost passive funds (similar to those offered by the Federal Government Thrift Savings Plan), including target date funds, which offer an opportunity for growth while managing risk.
- Providing periodic statements and basic education on retirement-related issues that would help demystify the retirement planning process during both the accumulation and decumulation phases. Statements could include projections of potential retirement income available from workers' savings, such as those required by the SECURE Act for qualified DC plans.

Offering unbiased and reasonably priced personalized retirement income advice.

Upon retirement, making available a variety of easy-to-initiate, institutionally priced lifetime income options that include managed payout funds, structured withdrawals from investment accounts, insured annuities (both immediate and deferred), and life insurance company variable annuities with guaranteed minimum benefits.

6 Participants of DB or DC retirement plans who terminate with vested benefits left in the plan are "reminded" of benefits from prior plans by a notification from the Social Security Administration when applying for benefits. Plan sponsors provide the information as part of the annual IRS Form 8955-SSA reporting. However, this notification comes at retirement age, while most workers should address their retirement savings much earlier than this.

Considerations for Policymakers

It is easy to articulate in a general manner the types of tools and services as outlined above that could help enhance retirement security for workers and retirees. It is more challenging to determine how to make them a reality. An argument can be made that the services and tools can be implemented currently without any further legislation or regulation. This may be true. However, the services and tools can often be complicated and beyond the reach of many workers and retirees —and those workers and retirees are the ones who are most vulnerable to being unable to secure a dignified retirement.

Another argument may be made that the employer plan is the best place to provide these tools and services. However, most of these services are not required by law, and many employers do not wish to take on the additional responsibility voluntarily. In addition, many workers are self-employed or work for employers without retirement plans. Where do they get the help they need? The employer plan is not the answer for everyone, even with government mandates.

The DOL, Securities and Exchange Commission (SEC), Consumer Financial Projection Bureau (CFPB), Pension Benefit Guaranty Corporation (PBGC), and other regulatory organizations have mandates to support the retirement system. It may be prudent to investigate whether they can help facilitate some of these services without hampering what works well in the private sector.

Conclusion

The improvements suggested in this issue brief could help close the gap between retirement income needs and resources. There have been recent efforts in a number of related areas (see the Appendix for more detail), but more can be done. A portion of the workforce (especially those who are more mobile in their jobs) is vulnerable to being unprepared for retirement. This paper does not propose a specific solution but proposes that system stakeholders consider regulation and legislation that could help advance the goal of enabling American workers to accumulate and enjoy dignified retirements.

Appendix —Related Efforts and Issues

Below is a summary of some related topics and current initiatives that are underway that address elements of the subject of this issue brief:

A. The Retirement Clearinghouse: As mentioned earlier in this issue brief, a recent DOL advisory letter addresses a request for "auto-portability" between retirement plans.

B. 2016 ERISA Advisory Council Report: The challenges to efficient portability are highlighted in this report.

C. Thrift Savings Plan: Millions of Americans who work for the federal government have access to a retirement plan that encompasses many of the features outlined above with respect to investments and decumulation options.

D. DOL Safe Harbor IRAs: In 2004, the department published a safe harbor regulation, at 29 C.F.R. § 2550.404a-2, allowing mandatory IRA rollover distributions of amounts of $5,000 or less for terminated participants. These auto-IRAs must be invested in a product that meets the requirements for preservation of principal and provide a reasonable rate of return, the fees and expenses must not exceed those charged by the provider for a comparable, non-automatic rollover IRA, and the participant must have the right to enforce the contractual terms of the IRA. The summary plan description must describe the plan's automatic rollover provisions.

E. Recent legislation and legislative proposals: The Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), which was enacted as part of the 2019 year-end budget legislation, aims to increase access to tax-advantaged accounts and prevent older Americans from outliving their assets. Other legislative proposals such as The Retirement Enhancement and Savings Act (RESA) would also provide enhanced portability.

F. PBGC's Expanded Missing Participant Program: This program allows plan sponsors to transfer accounts for missing participants from terminated DC plans to the PBGC for retention and investment. Accounts are free from fees, held in perpetuity, and retain ERISA rights and protections. There has been some discussion of extending the program to other voluntary transfers, though there is currently no statutory authority to do so.

G. Auto-Portability Proposals—EBRI Research: *The Impact of Auto Portability on Preserving Retirement Savings Currently Lost to 401(k) Cashout Leakage* examines the possibility of automatically taking participants' accounts from former employers' retirement plans and combining them with their active accounts in new employers' plans with the intention of keeping the DC assets in the retirement system and—in theory—reducing leakage from cash-outs upon employment termination.

New Retirement Plan Designs: Degrees of Risk Sharing

OCTOBER 2021

Key Points

- The traditional defined benefit plan, designed to provide lifetime income to retirees, has fallen out of favor among most private-sector employers. This is primarily due to the financial implications of the employer's obligation, as they face investment and interest rate risks, and the longevity risks associated with promising lifetime retirement benefits.
- Traditional defined contribution plans eliminate such risks to employers but are not structured to promise lifetime benefits. When all investment and longevity risks are borne by individual participants, retirees face the challenge of living without a reliable lifetime income.
- The retirement system is in need of newer plan designs that facilitate more effective sharing of risks between employers and employees. Programs that present acceptable levels of risk for employers while not overly relying on retirees to manage their own retirement assets may produce better retirement outcomes.

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Introduction

In July 2019, the American Academy of Actuaries published an issue brief titled *National Retirement Policy & Principles*. The issue brief focused on the increasing need for a comprehensive national retirement policy based on certain guiding principles. In April 2020, the Academy followed up that issue brief with a paper titled *Retirement Security Challenges: Portability and Retirement Income*, which addressed the challenges faced by workers in a mobile workforce, who must accumulate retirement benefits at multiple employers over their careers. The *Portability and Retirement Income* issue brief focused on two specific risks, the potential for workers to lose track of benefits and the challenge of converting benefits into sustainable retirement income. Building on these prior efforts, this issue brief offers some thoughts on newer employer-based retirement plan designs that highlight the issue of risk sharing between plan sponsors and participants, as well as novel plan designs that provide lifetime income but where all the risk is borne by plan participants.

The concept of risk is related to the principles of allocation of risks and cost highlighted in the original *Policy & Principles* issue brief. As noted in the issue brief, "a national retirement policy could address the level of risk that is incorporated into various components of the retirement system, how those risks are shared among stakeholders, and the extent to which adverse experience associated with those risks results in lower benefit levels or higher costs." Further, "adequacy and risk are critical factors when evaluating cost. In general, higher levels of adequacy and lower levels of risk will correspond to higher costs."

The first section in this issue brief examines the shifting of risk that results from the transition in the private sector from defined benefit (DB) to defined contribution (DC) plans. This is followed by a discussion on the challenges faced by many workers in securing sustainable retirement income from defined contribution plans. The risk assumption question is then briefly explored. This is followed by a discussion on risk pooling and its advantages in retirement plan design. Some current risk sharing plan designs are then briefly covered. This is followed by a consideration of some legislative changes that would be required to allow for more innovative plan designs in the private sector. The potential use of insurance or other financial products to manage risks is addressed along with the ongoing challenge of portability.

Background

The traditional DB plan (designed to provide a lifetime income to retirees) has fallen out of favor among most non-public-sector employers. A primary reason for this is the difficulty of maintaining adequate funding when faced with investment and interest rate risks while providing lifetime retirement benefits. Although these risks could, in theory, be mitigated to a large extent through investment policy (e.g., investing in high quality fixed-income assets with expected cash flows that better align with anticipated payouts), employers have generally been reluctant to make this change (at least for plans that are not frozen to future accruals) because of the associated ongoing costs. The rate of future benefit accruals could, of course, be scaled back to keep costs at an acceptable level while still reducing risk. However, considering that lifetime income is a long-term commitment, the price of reducing risk—accepting fixed-income returns over the entire investment period—strikes many as too high. To a large extent, private sector DB plans have been replaced by DC plans, which eliminate these risks for employers while still offering participants the potential for the accumulation of assets for retirement. However, they require individual participants to take on the responsibility and challenge of managing their own retirement income programs—a challenge for which few participants are well prepared. Longevity risk pooling (discussed below) enables lifetime income to be delivered more efficiently. It is a standard feature in most U.S. DB plans but not typically employed in DC plans.

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Most DB plans were originally designed to provide a fixed or cost-of-living-adjusted lifetime retirement income based on an underlying benefit formula. These benefit levels depend on a commitment by the plan sponsor (employer) to fund the plan to provide the benefits. In many cases, unanticipated events—frequent changes in pension funding laws and regulations, historical contribution limitations, financial recessions, lower than expected interest rates, unforeseen business hardships, and demographic changes in the workforce—have increased the cost of the DB promise well beyond initial expectations. In other cases, employers' commitment to providing a DB plan may not have been as long-lasting as initially anticipated, even when the cost of benefits has remained affordable. The Employee Retirement Income Security Act of 1974 (ERISA) did envision that some plan sponsors would not be able to meet all plan benefit obligations. This was a primary reason behind the formation of the Pension Benefit Guaranty Corporation (PBGC). However, the PBGC does not guarantee all benefits. In some cases, DB plan sponsors have made business decisions to discontinue their plans (after fully funding all obligations) to avoid the applicable financial risk. Employers often replaced their DB plans with DC plans, which require only that employers contribute at a predetermined rate,[1] with no requirement that the accumulated balances be sufficient to provide a guaranteed lifetime income goal at retirement.[2]

Since DC plans are not inherently designed to provide lifetime retirement income, many experts have suggested plan sponsors offer retirement income options to help retirees achieve a steady retirement income. It may be advantageous to participants for plan sponsors to provide income features, which may provide pricing efficiency, enhanced provider and product due diligence, ease of transaction, access to general retirement education planning, and access to guidance on longevity risk management. Even though retirement income options would not create additional employer funding risk, few DC plan sponsors have offered them. Among the primary reasons they have not done so are the additional administrative effort required and fiduciary liability risk. *The Setting Every Community Up for Retirement Enhancement Act of 2019* (the SECURE Act) should mitigate the fiduciary risk by allowing a safe harbor option for annuity provider selections.

1 Some defined contribution plans can vary the employer contribution levels from year to year. 401(k) plans with matching contributions (unless using a safe harbor match) can vary the level of match annually.
2 Plan sponsors do have some fiduciary responsibilities, including the selection of plan investment advisers.

This issue brief outlines plan designs that can reduce the need for retirees to create their own retirement income streams and that enable employers to incorporate risk pooling features while also minimizing (or eliminating) the employer risk associated with providing lifetime retirement income benefits.

Risk Assumption

Understanding the risk implications of alternative retirement plan designs is important. The two primary risks are mortality/longevity risk and investment risk. The DB model looks to the future in terms of the accumulation of sufficient assets to provide benefits promised under the plan. Contributions are adjusted as needed for actual investment and mortality/longevity[3] experience each year. Under the DB structure, the plan sponsor typically assumes these risks, and must absorb the resulting impact on plan contributions. Although this paper focuses on these primary risks, other risks may also apply (such as death, disability, and timing or form of payment), and may also be incorporated into the design variations discussed in this paper.

The DC model generally does not project future benefits in setting employer contributions.[4] The benefits ultimately paid to individuals from DC plans are based on the contributions actually made to the plan, accumulated with investment returns. Investment risk lies fully with plan participants, which could result in decreasing account balances. Most DC plans permit the participant to control the level of risk (and expected return) by selecting their asset allocation among offered investment options. The DC model also places the risk of outliving the asset accumulation (i.e., longevity risk) on the participants. Therefore, there is no requirement that the employer make additional contributions.

The goal of this paper is to explore retirement plan designs that allocate all or some of the risk to the individual, while also providing lifetime retirement income. Such designs may be either DB or DC in nature. In general, these designs would adjust the benefits paid to participants in response to plan experience that differs from expected, rather than increasing or decreasing employer contributions. The result may be that the lifetime benefit would not necessarily be a fixed amount.

3 Mortality experience applies only to defined benefit plans.
4 Target benefit plans, which are no longer popular with plan sponsors, do use actuarial assumptions to calculate the contribution by individuals. However, once the contribution is determined, the plan is treated as a traditional defined contribution plan.

Longevity Risk Pooling

Risk pooling is an underlying principle of insurance.[5] Traditional DB plans as well as Social Security rely on longevity risk pooling. The assets they hold are not allocated to specific individuals; instead, they are pooled so that assets are available to provide benefits to any plan participant or beneficiary. If a participant terminates employment prior to eligibility for benefits, or the participant dies after commencing benefits, no further benefits will be paid to the participant. Depending on the form of benefit elected, benefits may still be paid to a beneficiary. Otherwise, the assets accumulated to make such payments will be used instead to pay those who continue to qualify for benefits, which reduces the overall cost of the program. In this respect, DB plans are more cost-efficient than DC plans, which do not incorporate longevity risk pooling features and instead provide each individual participant an account that is dedicated to him or her; vested individuals have a right to their full accounts, with any assets remaining upon their death passing to their designated beneficiaries.

As an example of the benefit of longevity risk pooling, consider the following: An individual with an account balance in a DC plan or individual retirement account (IRA) and who is planning to use that money to meet retirement income needs will want to consider the period over which to draw down those assets. To mitigate the risk of prematurely exhausting these funds, the individual will likely need to spread withdrawals over a period extending well beyond their average life expectancy. For a hypothetical example, a 65-year-old retired female nonsmoker in average health can expect, on average, to live to age 88—an additional 23 years.[6] However, there is a 10% chance that she will live at least an additional 10 years—to age 98—and may therefore either reduce spending in retirement or wait until she has accumulated more assets before retirement in order to cover this possibility. Assuming a 4% rate of return on assets, the amount that could be spent each year would have to be reduced by 19% to extend the payout period for the additional 10 years. At the same time, the 88-year-old retiree would have a 90% likelihood of dying prior to age 98, leaving any unspent assets to her heirs. While leaving money to one's heirs might not seem like a bad outcome, the potential cost is a reduced standard of living in retirement or a delay in retirement. Longevity pooling, in effect, takes the money that would otherwise go to heirs and instead redirects it to providing income for other retirees in the pool, so that those who die at earlier ages subsidize those who outlive their life expectancies. The result is a lifetime income promise that can be provided more efficiently for all members of the pool.

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5 In traditional insurance, the premiums are paid by individuals and benefits paid to those individuals that experience a loss.
6 See the Actuaries Longevity Illustrator.

Examples of Current Risk Sharing Plan Designs in Use

There are several plan designs currently in use in the U.S. that incorporate risk sharing features:

Market-return cash balance plans

These are DB plans that base benefits on participants' notional accounts, which grow with interest credits based on the actual investment returns[7] of the plan's assets (or a subset) or on specific outside investments. The accounts are referred to as "notional" because, unlike those in a DC plan, they are not actually funded for each individual participant. They are similar to DC accounts in that pay-based credits are added periodically along with the interest credits. However, as in all DB plans, the asset mix is typically selected by the plan sponsor, rather than by individual participants.[8] At retirement, the participant is offered the choice of a lifetime annuity or (usually) a lump sum.[9] The plan may offer fixed annuities or annuities with cost-of-living adjustments (both of which require the plan to take on investment risk) or variable annuities (which pass investment risk to participants). The plan typically retains longevity risk when a plan-paid annuity is selected. Private-sector plans are required to provide a participant with an account at commencement that is not less than the sum of his or her pay credits—effectively a guarantee of no less than a cumulative 0% return. This guarantee provision forces the plan sponsor to assume some pre-retirement investment risk. By shifting the plan's interest crediting rate to the actual investment return from a different plan-based rate, the plan sponsor shifts more risk to the individual participant.

'Pure' variable DB plans

These plans provide annual accruals in a manner similar to a traditional DB plan. For example, a plan might increase each participant's accrued benefit each year by 1% of pay. Once accrued, the benefit level is not guaranteed, but varies based on how investment returns compare to a specified "hurdle" rate. For example, in a plan with a hurdle rate of 5%, contributions are made to completely fund new benefit accruals assuming annual investment returns of 5%. If asset returns in a given year exceed 5% (e.g., 7%), then the plan would have more money than needed to provide the calculated benefit; in this case, plan benefits would be increased accordingly (roughly 2% in this example) to avoid creating a surplus of assets over liabilities. Similarly, in years in which returns are less than the hurdle rate, benefits are decreased to compensate for that loss and avoid creating a deficit. The result is a plan that remains fully funded regardless of investment market conditions. However, plan funding is vulnerable to demographic changes—

7 Traditional cash balance plans allocate interest to participant accounts based on a plan-specified rate, often based on the yield on fixed income instruments.
8 Final regulations issued in 2014 indicate that the Treasury and IRS were continuing to study the issues related to participant investment direction in cash balance plans.
9 Though not required, the majority of these plans do offer a lump sum option.

primarily changes in longevity—that could result in a need for additional contributions, or, conversely, which could lower the future contributions required of the plan sponsor. These plans are able to provide lifelong, though variable, income to participants.

'Modified' variable DB plans

These plans typically provide annual accruals and benefit adjustments in the same way as "pure" variable DB plans but add design features to minimize the volatility of benefits in pay status. These features may include averaging returns over a period of years, allowing benefits to vary but not below a floor benefit, allowing benefits to vary while participants are active but fixing the benefit in retirement, or capping benefit increases in high investment return years to build a reserve that is then used to protect benefit levels when they would otherwise decline. Depending on the method(s) used to minimize benefit volatility, some risks may apply that were eliminated in the "pure" variable design. For instance, incorporating a floor benefit could lead to underfunding if the floor applies more frequently than anticipated, which would require higher contributions. On the other hand, the capping and reserving strategies may actually reduce contribution risk relative to a "pure" variable design, since the reserves can also be used to cover the cost of mortality and other demographic changes. These plans are able to provide more stable lifetime income to participants compared to pure variable benefit designs. Such designs are gaining popularity among multiemployer plans, and a few have been implemented in single-employer plans.

Public-sector plan designs and plan designs in other countries

To date, many public-sector plans and retirement programs in other countries have begun to incorporate innovative risk-sharing features. Among these are designs that allow for adjustments to employer or employee contributions, or to benefits accrued or in pay status, that depend upon the funded status of the plan. These designs incorporate limitations on how much contributions can increase as well as the types of benefits that can be decreased. In addition, the basis for the determination of funded status will vary from plan to plan.[10] Below are brief summaries of three public-sector or non-U.S. programs to illustrate some risk-sharing features:

10 For a summary of the types and prevalence of risk-sharing designs in the public sector, see *In Depth: Risk Sharing in Public Retirement Plans*, a publication of the National Association of State Retirement Administrators.

Maine Participating Local District Consolidated Retirement Plan (Maine PLD)

The Maine PLD is part of Maine Public Employees' Retirement System (MainePERS). It generally covers employees of Maine's 'local districts,' e.g., counties, municipalities, towns, special districts, etc.; teachers and state employees are covered by separate plans. It was changed in 2018 and 2019 to modify the existing risk sharing between members and employers in response to market volatility and to promote long-term sustainability. The goal was to ensure that members would receive their fixed core benefits throughout their retirement. The protected core benefits are the basic retirement benefit at the normal retirement age. Early retirement subsidies, automatic cost-of-living adjustments (COLAs), and certain death and disability benefits are not guaranteed and may be modified as required to meet the funding goals of the system. Previously, Maine PLD used a traditional approach to risk sharing, with the employers bearing experience risk while members and retirees bore the effects of extraordinary market events through ad hoc changes in contribution rates, benefit reductions, and COLA cap reductions. Under the new plan, both employee and employer contribution rates change each year in a similar fashion. Employee contribution amounts that were fixed in the past will now vary with market performance. Total contribution rates may change from year to year based on an allocation of approximately 58% of the total change to employers and 42% to employees.[11] Both the employer and employee contribution rates are subject to aggregate contribution caps of 12.5% and 9.0%, respectively. In the event the contribution caps apply, retirees share the risk because the COLA will be temporarily reduced (but not below zero) to maintain cost-neutrality.

Switzerland Private-Sector Cash Balance Plans

These plans are funded jointly by the employer and employee, although at least 50% must be employer-funded. There are minimum contribution requirements. The plans require notional balances to be converted at least partially to annuities at retirement. Interest rates and annuity conversion factors are subject to minimum standards. Should a plan become underfunded, the following tools are available:

1. Change in annuity conversion factors for future retirees
2. Reduction in interest crediting rate
3. Increase in required contributions

Plans are managed by independent nonprofit foundations, not employers. When they change jobs, participants' accumulated accounts are transferred (when required) to the foundation used by the new employer. The foundations can use reinsurance to mitigate risk.

11 As of 2019; employee portions may vary based upon risk sharing framework adopted by the Board of Trustees.

New Brunswick Shared Risk Model

The New Brunswick Shared Risk model is a defined benefit plan funded by a mutually agreed-upon level of employer and employee contributions. Benefits are not guaranteed and can increase or decrease based on plan experience. The plan is administered by independent trustees, and the investment policy is set recognizing that the employer and employees share investment risk. The plan defines a set of "base" benefits that are funded for a 97.5% likelihood of payment without reduction over a 20-year period, and "ancillary" benefits that are funded for a 75% likelihood of payment without reduction over the same period. Annual actuarial stress-testing (including stochastic projections) is performed to demonstrate that these thresholds are met, and pre-determined actions may be taken to adjust benefits, contributions, or asset allocations as needed, based on the financial condition of the plan. While the Shared Risk Model was originally adopted in plans covering union workers of various governmental employers and hospitals in New Brunswick, the enabling legislation also applies to private sector employers, and some private sector employers have adopted or considered such a design.

New Plan Design Ideas for Private Employers and Policymakers to Consider

As noted previously, many individuals lack the financial education and skills to manage investments to create sustainable lifetime income. Creating such an income stream requires investment and/or annuity product knowledge as well as an ability to properly plan for a retirement lasting an unknown number of years. These challenges diminish the attractiveness of the DC plan model from a retirement income standpoint. In addition, many individuals do not appreciate the value of risk-pooling features. Though traditional employer-funded DB plans may provide a more secure retirement, employers today are inclined to avoid plans under which they assume all of the risk. So, is there an opportunity for new designs that combine an income model (which incorporates risk pooling) with features that reduce the employer's risk?

There are a variety of designs that can be used to achieve desirable goals in the development of new types of retirement plans for the private sector. Fundamentally, plans need to be sustainable. In the case of the private sector, this is more likely to be achieved when the cost is predictable and affordable, limiting the potential for significant additional contributions to cover benefits previously earned. Equally important, plans should be designed to provide an adequate retirement income. With present U.S. law and regulations, DB and DC plan structures have a limited ability to efficiently achieve these goals. Below are some public policy solutions and other ideas that might be considered that would allow for new plan designs.

1. Allow defined benefit plans that can vary benefit payments based upon both investment and mortality and other demographic experience. Such a plan design could target an "Aspirational Benefit" determined based on a formula that would likely reflect salary and/or years of service. Flat-dollar formulas are also possible. Contributions to the plan would be based upon the value of the additional benefit earned during the year. Aspirational Benefits would not be guaranteed, but rather would be adjusted based upon actual plan assets. The employer obligation could be limited to the initial contribution for each year's benefit accrual or could allow for some additional well-defined contingent obligation. Private-sector plans can currently vary benefits based upon investment performance, but it is less clear that plans can vary benefits based upon mortality and other demographic experience (see the above discussion of variable benefit plans). Such benefits would require periodic adjustments based on the overall experience of the plan. The Aspirational Benefit could be set in a similar manner to current DB benefit levels, or could more directly target a benefit level that, when combined with Social Security and other benefits earned under prior employer plans (if applicable), would result in an intended level of retirement income.[12]

2. Allow mandatory or voluntary employee contributions to defined benefit plans on a pre-tax basis. This is a standard feature of most public-sector pension plans. After-tax contributions are allowed in private sector plans but are rarely used because of (1) the complexity of administration, and (2) employees' preference for making pre-tax contributions to their 401(k) accounts. In the case of most private sector DB plans, when an employee makes a contribution, it is mandatory. It does not buy any particular level of expected benefit, because the gross benefit formula is unaffected by the contribution. If these mandatory contributions were pre-tax they would have a lower cost to the employee than on an after-tax basis. If they were voluntary, they could be used to buy an additional aspirational benefit.

3. Allow for the creation of open multiple-employer defined benefit plans ("open MEPs"), similar to the DC open MEPs that are permitted by the SECURE Act (referred to as Pooled Employer Plans, or PEPs). This would allow for the development of DB plans covering large numbers of employees and under which investment and longevity risk can be better predicted and managed. By decoupling plans from employers, the portability challenge may also be alleviated more easily. These plans could be based upon Aspirational Benefits thus limiting the risk exposure of the open MEP provider.

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12 The intended level of overall retirement income would likely be based upon a percentage of pre-retirement income, which would vary by income level.

4. Allow for the easier use of plan designs that target a specific level of total income replacement in retirement, including expected Social Security benefits. For most retirees, Social Security is an integral part of retirement income.

5. Allow DC plans to pay out lifetime income benefits based on the account balances at retirement, subject to adjustment for investment and mortality experience. Under this approach, employees would maintain control over the investment of their accounts during the accumulation period. At retirement, a participant's account would be pooled with those of other retired participants and converted to an Aspirational Benefit based on specified mortality and asset return assumptions. Periodic adjustments could occur in the same fashion as under the Aspirational Benefit model for DB plans described earlier. Certain plans available to church employers under Internal Revenue Code Section 403(b)(9) already use a similar approach, but this option could be expanded to non-church employers.

6. A major issue for today's mobile workforce is portability. Each employer could theoretically continue to maintain the benefits earned by its former employees, but this may not be efficient. Plan-to-plan transfers when employees change jobs is a potential solution, provided that the new employer has a plan that includes the same provisions and features as the transferring plan. This may seldom be the case. Thus, it may be necessary to have IRA-type programs that can accommodate these benefits. The portability and retirement income previously referenced as well as an upcoming paper on decoupling retirement programs from the employer address this issue in more detail.

Insurance Option

Retirement plan sponsors could potentially have the option of incorporating insurance or other financial products to manage some of the risks under existing and proposed designs if an insurer or other third party were willing to underwrite the risk. For example, rather than allowing benefits or employer costs to vary based on longevity experience, the plan could instead purchase contracts (to the extent available in the market at a price the sponsor or plan is willing to pay) to hedge or eliminate this risk. An example of such a contract is the longevity swap, which has been utilized by some plan sponsors in the U.K. The costs of these instruments could be paid for by employers, plans, or both. Some plans would have no need for insurance or other hedging products; consider, for example, a plan design that adjusted benefits to the level that could be provided based on plan assets alone with no additional funding required.

Conclusion

It is unlikely that employers who have already moved from a DB to a DC plan design, thus shedding some or all of the risks of sponsoring a DB plan, will reconsider offering a DB design. Therefore, designs that place risk on employees may be the only acceptable approach for many employers.[13] However, this does not mean that traditional DC plans, in which all investment and longevity risks are borne by individual participants, are the sole option. As noted above, there are many innovative approaches to sharing plan risks already in use. In order to usher in a new era of more effective and efficient employer-based retirement plan designs, there will need to be a much greater appreciation by all stakeholders of the importance of providing retiree lifetime income at a cost that is both affordable and reasonably predictable. A generation of retirees at risk of outliving their assets—or not spending down their nest eggs out of fear—affects society and the economy as a whole. The traditional retirement plan model is in need of newer designs. Efficient retirement programs that do not overly rely on retirees managing their own retirement assets are worth pursuing, as are plan designs that do not create undue, and thus nonviable, risk for employers.

13 It is possible that employers might accept some risk if they believe that the risk is low, there is sufficient value in the form of work force management, and there are clear mechanisms available to control the risks.

No. 4 in a series of 5

Guiding Principles Series

Retirement Policy: Potential for Changing Roles of Employers in Retirement Programs

OCTOBER 2021

Key Points

- Approximately one-third of all private-industry workers in the U.S. lack access to an employer-sponsored retirement plan. These workers are often employed at organizations that are small and lack the financial and human capital resources to sponsor a retirement program.
- Shifting retirement plan responsibilities and related liability to a third-party entity and away from the employer—"decoupling"—may be advantageous to both employers and employees. Employers may see reduced costs, risks, and administrative burdens, while employees may benefit from additional options and retirement income solutions.
- Decoupled retirement plans have been introduced in countries outside of the U.S., and they are becoming more prevalent in the U.S. through structures such as state and local government-based retirement initiatives and pooled employer plans under the SECURE Act. While some employers will likely retain their own single-employer plans, the trend toward decoupling will likely continue.

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Introduction

In July 2019, the American Academy of Actuaries published an issue brief titled *National Retirement Policy & Principles*. The brief focused on the increasing need for the establishment of a comprehensive national retirement policy based on certain guiding principles. In April 2020, the Academy followed up this issue brief with another titled *Retirement Security Challenges: Portability and Retirement Income*. That issue brief addressed the challenges faced by workers in a mobile workforce who accumulate retirement benefits at multiple employers over their careers. The issue brief focused on two specific risks faced by those workers: the potential for them to lose track of benefits and the challenge of converting accumulations/benefits into sustainable retirement income. Building on these efforts, a second follow-up issue brief titled *New Retirement Plan Designs: Degrees of Risk Sharing* was recently released; it identifies newer employer retirement plan designs that highlight methods of risk sharing and that have been used by some plan sponsors.

Driven by the ever-changing and -evolving relationships between employers and workers/employees, this issue brief explores redefining the role of employers involved in retirement programs by removing from employers many of the direct responsibilities for retirement plans. Under this approach, employers would not need to take on the full fiduciary or other responsibilities for a retirement plan; at least some of these responsibilities could be shifted to and fall on third-party entities (TPEs). These entities could be subject to government oversight as well as ERISA[1] regulations and guidelines. An employer's responsibilities could thus potentially be limited to the due diligence necessary for the selection of the TPE[2] and any transmission of employer and employee contributions to the TPE. Of course, employers could still choose the current approach and the associated responsibilities. In this issue brief, the approach of reducing employer involvement and responsibility is called "decoupling," and retirement programs that utilize some degree of decoupling are called "decoupled plans." A range of decoupling solutions could be available depending on the needs and goals of employers and employees.

Current Environment

A substantial percentage of employees (especially those working for smaller employers or as "gig" workers) are not covered by employer plans.[3] Some who are covered by employer plans may not be well-served by the specific offerings of those plans (for example, in defined contribution programs, there may be limited investment choices or high fee levels). Employers might avoid incorporating certain plan options (for example, in-plan annuities) because of the potential for additional fiduciary liability. A mobile workforce, where an individual could have many jobs during his or her working career, can have limited (or potentially no) retirement coverage or end up with a patchwork of retirement benefits from multiple employers.

Decoupling plans from employers has the potential to increase coverage,[4] better meet individuals' needs, provide for greater efficiency in the retirement benefit accumulation process, and offer distribution options or other features that employers on their own cannot offer or may choose not to offer. On the other hand, if an employer chooses to have only limited ongoing involvement with the program (e.g., leaving all employee

1 *Employee Retirement Income Security Act of 1974.*
2 In the case of the state and local government-based retirement initiatives discussed later in this issue brief, due diligence is not currently required of the employer; these programs may be required to be offered by employers that do not offer another employer-based plan.
3 According to the Department of Labor, in 2020 only 53% of private-industry workers at businesses with fewer than 100 employees, and 67% of all private-industry workers, had access to a workplace retirement plan (Bureau of Labor Statistics; *National Compensation Survey: Employee Benefits in the United States*; Table 2; March 2020.)
4 State and local government-based plans as discussed below have already achieved this to a certain extent.

Members of the Retirement System Assessment and Policy Committee, which authored this issue brief, include Eric Keener, MAAA, FSA, FCA, EA—*Chairperson*; Claire Wolkoff, MAAA, FSA—*Vice Chairperson*; Kelly Coffing, MAAA, FSA, EA; David Driscoll, MAAA, FSA, FCA, EA; Lee Gold, MAAA, ASA, EA; Scott Hittner, MAAA, FSA, FCA, EA; Cynthia Levering, MAAA, ASA; Esther Peterson, MAAA, ASA, EA; Timothy Robson, MAAA, ASA, FIA; Andrea Sellars, MAAA, FSA; and Mark Shemtob, MAAA, FSA, FCA, EA.

communications to the provider), decoupled plans can run the risk of employee confusion about the employer's role, employer and employee responsibilities, plan oversight, and fees. This could potentially lead to underutilization of the program.

This issue brief first provides some examples of decoupling approaches currently in use in the U.S. and elsewhere. Included among these examples are the Pooled Employer Plan (PEP) provisions of the *Setting Every Community Up for Retirement Enhancement* (SECURE) *Act* that allow defined contribution plan sponsors to join together in PEPs, broadening employers' options.[5] The issue brief then presents a summary of how decoupled plans can be consistent with the Academy's Retirement for the AGES principles[6] and concludes with a question-and-discussion section covering relevant issues and concerns.

Current Examples of Decoupling

State and Local Government-Based Retirement Initiatives

In recent years, a number of state and local governments[7] have adopted mandatory or voluntary initiatives in an effort to expand retirement coverage among private-sector workers. In a typical mandatory program, for example, a private-sector employer above a certain size operating in that state would be required to offer its employees the option to enroll in the state's program if the employer does not offer its own retirement plan. Participating employers would be responsible for collecting employee contributions via payroll deduction and remitting those contributions to the state program. However, employer contributions would not be required. The responsibility for maintaining the program and selecting administration and investment service providers would remain with the state. Many of these initiatives have been structured as automatic individual retirement account (IRA) or Roth IRA arrangements. In addition to expanding retirement coverage while minimizing employer roles and responsibilities, such programs are able to take advantage of economies of scale after achieving a critical mass. Some state programs allow self-employed and gig-economy workers to participate in the plans.[8] The effectiveness of these programs remains to be seen, especially with the availability of PEPs, as discussed below.

5 Prior to the SECURE Act, the existence of multiple employer plans provided some employers with an option for decoupling, but there were significant limitations to their availability and effectiveness. The SECURE Act allows a greater degree of decoupling for 401(k) plans; since the SECURE Act, further legislation has been proposed to allow a similar degree of decoupling for 403(b) plans.
6 See the discussion of the Academy's AGES principles later in this issue brief.
7 "State Initiatives 2021: More New Programs to Launch While Others Consider Action"; Georgetown University Center for Retirement Initiatives; 2021.
8 Certain state programs also permit small nonprofit organizations to participate in a state-sponsored qualified defined contribution plan, rather than sponsoring their own plan. Such a state-sponsored program would permit contributions by both employers and employees, in contrast to automatic IRA arrangements, which generally permit only employee contributions.

Pooled Employer Plans Under the SECURE Act

The SECURE Act includes a provision that has the potential to change saving for retirement in a fundamental way. Private-sector employer-sponsored retirement plans have historically been established and administered by individual employers. Exceptions have existed for related employers, employers whose employees are covered under a common collective bargaining agreement, or employers that have contracted with a Professional Employee Organization. Under the SECURE Act, unrelated employers will now be permitted to join PEPs. These defined contribution PEPs will be administered by Pooled Plan Providers (PPPs) operating under rules established by the U.S. Department of Labor (DOL). Though the intent of this provision of the SECURE Act is primarily focused on smaller employers without plans, another significant outcome may be further decoupling of the administration of retirement plans from the employers in general.

The Australian Superannuation Guarantee Program (Super)

This is a savings scheme wherein employers set aside contributions on behalf of their workers to provide for their retirement. Employers are required by law to make at least minimum Super contributions into a registered Super Fund of an eligible employee's choosing (or into an employer-chosen default Super Fund if employees do not make an election), referred to as Super Guarantee (SG). Penalties may apply if employers fail to meet the SG obligation, fail to properly offer a choice of Super Funds, or for other administrative violations.

TIAA

TIAA serves as the retirement plan for many universities and select not-for-profit employees/employers. Employers make contributions and direct employee contributions to TIAA. Participants can purchase a traditional or variable annuity, which pays out benefits for a lifetime. This benefit provides insurance protection, and TIAA acts essentially as a not-for-profit mutual insurer. The employer is neither a sponsor nor a financial guarantor.

Netherlands: Collective Defined Contribution (CDC) Plans

In these plans, employees earn benefits based on their compensation—essentially a career average formula under a traditional defined benefit (DB) plan. Benefits are paid as inflation-indexed lifetime annuities. There are no individual accounts. Rather, all contributions are pooled and invested together. In these respects, the plans appear to be traditional DB plans. Employees and employers each contribute a fixed percentage of compensation in order to fund these plans. The percentages are designed to target a funded ratio of 130%. Employers have no risk of higher contributions. There is a notable difference between these CDC plans and traditional DB plans. The risk of investment losses is borne entirely by employees and retirees. If the plan suffers losses, the governing board (with representation from employees, retirees, and employers) decides what adjustments will be made. Adjustments can include an increase to employee contribution levels, elimination of indexing on the benefits, and reductions in future years' benefit levels. Overfunding will go to the benefit of employees rather than reducing employer contribution levels.

Swiss Cash Balance Plans

These plans operate much like defined contribution plans, but have minimum investment guarantees and minimum interest rate and mortality standards for the conversion of account balances to annuities. Benefits are funded jointly by the employer and employee, with employer contributions required to make up at least 50% of total contributions. The plans are managed and administered by independent nonprofit foundations. The employer is responsible for tracking participant status and communicating it to the plan, as well as remitting employer and employee contributions. The plan foundation board is responsible for investment strategy (operating within certain legal constraints) and plan compliance with applicable legal and regulatory requirements. While the board is at least partially responsible for participant communication and plan design, the employer can communicate with participants as well, and half of board members are employer representatives.

Single-Employer U.S. Defined Contribution (DC) Plans

U.S. defined contribution plans do not exhibit any significant degree of decoupling. While most employers will utilize outside providers for certain functions—such as recordkeeping, compliance testing, investment management, and participant communication—and the outside provider may act as a fiduciary in some cases, the employer retains the ultimate responsibility for these functions as plan fiduciary. This may make some smaller employers reluctant to offer plans to their employees.

Comparison of Above Examples of Decoupled Plans

The functional responsibilities generally involved in the maintenance of a retirement plan include:

- **Participant Status:** Initial employee enrollment in the plan and updating employment status
- **Administration:** Processing of benefits, updating of vesting percentages
- **Remitting Required Contributions:** Facilitating the withholding of employee contributions and the transfer of funds from the employer to the plan provider
- **Compliance:** Maintaining plan document and compliance with other regulatory requirements, including government filings
- **Investments**: Selection of prudent investment choices and/or selection of qualified investment adviser; plan design may or may not allow investment choice by participant
- **Communication:** Provide information about investment options and account balances
- **Design**: Selecting plan provisions

The following table indicates who is primarily accountable for each of these responsibilities under each of the seven plan types noted above. In a decoupled plan, some of these responsibilities could possibly be shared by the employer, TPE, and employee/participant. The degree to which responsibilities may be shared will depend on the details of the arrangement.

	Program						
Functional Responsibility	**State & Local Initiatives**	**PEPs under SECURE Act**	**Australian Super**	**TIAA**	**Netherlands CDC**	**Swiss Cash Balance Plans**	**U.S. Private Sector Single Employer DC**
Participant Status	Employer	Employer	Employer	Employer	Employer	Employer	Employer
Administration	TPE	TPE	TPE	TPE	TPE	TPE	Employer, TPE
Remitting Required Contributions	Employer	Employer	Employer	Employer	Employer	Employer	Employer
Compliance	TPE	TPE	TPE	Employer, TPE	TPE	TPE	Employer, TPE
Investments	TPE, Supervisory Entity	Employer, TPE	Employer	Employer, TPE	TPE	TPE	Employer, TPE
Communication	TPE	TPE	TPE	TPE	Employer, TPE	Employer, TPE	Employer, TPE
Design	Supervisory Entity	Employer, TPE	Supervisory Entity	Employer	Employer	Employer	Employer

Legend for Color Coding:
- Employer has primary responsibility, even if outsourcing tasks to an outside provider
- Employer shares responsibility with another party/entity
- Primary responsibility lies with a party/entity other than the employer

Decoupling in Defined Benefit Plans

The plans analyzed above are for the most part DC plans. DC plans may be better candidates for decoupling than DB plans. The main reason is the inherent design of DB plans. DB plans generally require that plan sponsors assume financial responsibility beyond any fixed annual contribution levels. For decoupling to work effectively, it is important that employers have a known financial exposure.[9] For example, plans that are structured to pay out lifetime income would require adjustments to mitigate the possible need for additional employer contributions, such as benefit adjustments in a variable defined benefit plan. See the issue brief *New Retirement Plan Designs: Degrees of Risk Sharing* for more thoughts on this topic.

There are already several examples of partially decoupled DB plans. The most well-known is with the U.S. multiemployer plan system, which covers employees in the same union who work for different employers. Participating employers have very few administrative responsibilities, other than to provide TPEs with employee data and contributions. Most other plan functions such as investment management, hiring of providers, etc., fall to a board of trustees. These plans provide many economies of scale, but generally do not shield individual employers from financial exposure. Employers make pre-negotiated fixed contributions to the plan on behalf of their plan members. These contribution levels are periodically reset based upon collective bargaining. When a plan is poorly funded, there can be large required contribution increases. Should an employer leave the plan (voluntarily, or if the plan is being dissolved), it is generally required to pay its share of any underfunding of the plan. If the employer is unable to meet this obligation, the other employers in the plan may need to assume it. In some cases, the plan may become insolvent and the Pension Benefit Guaranty Corporation may need to provide financial support.

Other decoupled DB designs are found in public employee plans in states, counties, and municipalities. Many states have statewide municipal retirement systems in which local governments may enroll their employees in lieu of establishing their own pension plans. These systems typically allow employers to select among different levels of benefits for their employees, with associated differences in contribution requirements.[10] Statewide municipal systems allow for economies of plan administration and investment activity

9 While a DB plan sponsor could potentially purchase annuities from an insurance company on a periodic basis to cover DB accruals, thus eliminating further financial exposure for those accruals, the cost of purchasing annuities could vary significantly from year to year and the plan sponsor would still retain primary responsibility for the design and administration of the plan.

10 As an example, see the Academy's *Retirement for the AGES Assessment—Maine Participating Local District Consolidated Retirement Plan*

that might be difficult to achieve in a standalone municipal pension plan. Additionally, through their statutory authority, the states have the ability to enforce a greater commitment to funding by their municipalities, which has sometimes been lacking in plans that are only under the control of a municipality.

Social Security provides another example of decoupling in a DB retirement system. Employers' responsibility under the system is to remit payroll taxes to the federal government. This program is, however, different from the others noted here in that it is mandated and administered by the federal government.

Decoupling and the AGES Principles

In January 2014, the American Academy of Actuaries published a public policy monograph, *Retirement for the AGES* (**A**lignment, **G**overnance, **E**fficiency, and **S**ustainability). This monograph lays out a framework for assessing employer-based retirement programs, or policy changes that would affect them, to understand how well they meet the needs of each of the stakeholders. The AGES principles are as follows:

(A) Alignment—Retirement income systems work best when stakeholders' roles are aligned with their skills. Important tasks, such as financial analysis, investment management, and retirement plan administration, should be the responsibility of those who have the knowledge and experience to perform them well.

(G) Governance—Making and implementing good decisions are essential for successful retirement plans. Good governance helps balance the complex needs of various stakeholder groups, as well as oversees significant administrative and investment functions.

(E) Efficiency—Risk pooling, accurate pricing, appropriate use of guarantees, and other financial techniques should be adopted or incorporated to ensure that a retirement income system is efficient and maximizes income while avoiding excessive risk to stakeholders.

(S) Sustainability—Roles and skills, good governance, and financial efficiency should be structured to support a sustainable retirement income system that is able to withstand the financial shocks of recessions or times of extraordinary inflation.

As noted below, certain features of decoupled plans can be consistent with these principles. Note that decoupling may have value for both employers and employees. The letters in parentheses relate to the AGES principles as noted above:

Employers

1. *Possibly lower administrative costs:* Outsourcing of administrative responsibilities to a provider that is in the business of administering plans will likely reduce overall costs of administration as a result of economies of scale. (A, E)

2. *Possibly lessen internal administration efforts:* Under a decoupling approach, much of the routine plan administration could be transferred from the employer. This allows employers to focus on their core businesses. (A, E)

3. *Potentially lessen fiduciary liability:* TPEs can take on the legal responsibility for some of the operational functions under a plan. (A, G, E)

Employees

1. *Pricing:* Through the economies of scale, TPEs may be able to offer institutionally priced investment options and insurance product pricing. The lower the costs, the greater the potential for larger ultimate benefit accumulations. (E)

2. *Access to retirement plans through an employer:* Lower employer costs and administration efforts and liabilities will likely increase the attractiveness for smaller employers to participate. (S)

3. *Possibly easier access to education and advice:* Many employers do not advise their employees about the finances of retirement security at both the accumulation and decumulation stage. TPEs will likely consider this a key feature in their offerings to attract clients. (A)

4. *Potentially providing employees with greater access to retirement income solutions:* Many employers (especially smaller ones that may not have access to unbiased advice) will find selecting appropriate retirement income options very challenging. Larger TPEs will likely be better suited to provide this critical service to employees of those participating in the TPE. (A, S)

Questions and Discussion Regarding Decoupling

1. What will the government regulations require for TPEs? How will ERISA rules apply? A TPE, depending upon its role, may be expected to act in a fiduciary capacity serving the best interests of the plan participants. Disclosure items should be robust and easy to understand.

2. What, if any, limitations will be placed on investment options offered? Will low-cost, passive investment funds be required as an option? Modern design features in retirement savings plans have focused on making it easier for participants to save enough money and select appropriate investments. Providing a limited number of low-cost, diversified investment options could help participants avoid several tendencies that are common among individual investors: failure to consider impact of high fees, "churning" their investments, and selecting overly conservative investments.

3. Does a TPE offer a range of retirement income distribution options, including both insured products and those based on structured withdrawal strategies?[11] A larger TPE might be better able to offer a range of retirement income distribution options than an individual employer.

4. How will an employer select a TPE (or multiple TPEs)? Selecting a TPE can be a challenge, especially for smaller employers. Many employers might look to independent experts to help review their options.

5. Depending on the functional responsibilities of a TPE, does it offer education and advice to employees? In giving specific advice, will a fiduciary standard be required? Individuals often find long-term retirement planning complex and very difficult, and often look to and rely on their employer to provide education and a clear path to retirement. TPEs that provide education and advice to employees would ideally include education about retirement planning and unbiased advice when it comes to selection of investments. Therefore, requiring a fiduciary role and responsibility for those entities providing advice would be important.

11 For example, use of the 4% rule or payout of required minimum distributions.

6. How will TPEs attract the interest of one-person businesses in the gig economy who may jump from project to project? Gig workers are, almost by definition, on their own for their livelihood, financial wellness, and retirement savings. Several states have established state-based retirement savings programs, and some have allowed self-employed and gig workers to join. Those states implemented outreach initiatives targeting gig workers. It would be very beneficial if PEPs or other decoupled arrangements establish an outreach program and a clear path for gig workers to participate as individuals.

7. How will private-sector plans that utilize TPEs to decouple functional responsibilities compare to the state-based programs that are currently being established? Select states, as well as at least one municipality, have recently enacted their own retirement initiatives (such as automatic IRA arrangements), attempting to address retirement coverage and adequacy concerns.[12] In some of these, the programs are required to be offered by employers that do not sponsor a workplace retirement plan. Many of these programs are limited to an IRA structure and its associated contribution limits. Can TPEs offering lifetime income solutions use longevity risk pooling directly, or must they use insured annuity products? In general, direct longevity pooling is not permissible in DC plans in the current legal and regulatory environment. However, should this change in the future, TPEs could be well-positioned to offer such solutions. Ultimately, the impact of mortality experience that is different from expected mortality will most likely be borne by plan participants, because employers might be reluctant to expose themselves to an unknown level of risk. As a result, TPEs may hold an attraction if they minimize employer liability exposure.[13]

8. Does a TPE serve as a vehicle to consolidate retirement accumulations from prior plans? The issue brief *Retirement Security Challenges: Portability and Retirement Income* outlines the challenges employees face in trying to manage accumulations from multiple plans of their former employers. The ability to easily consolidate and manage such savings could reduce the likelihood that workers will lose track of their savings or use them for nonretirement purposes.

12 "State Initiatives 2021: More New Programs to Launch While Others Consider Action"; op. cit.
13 See Academy issue brief *New Retirement Plan Designs:Degrees of Risk Sharing*.

9. Will plans utilizing TPEs for decoupling totally replace traditional single-employer plans? Such arrangements are likely to appeal to employers that want to offer retirement benefits to their employees while eliminating or reducing the employer's involvement (e.g., administration, communication, cost and risk of operating the plan, fiduciary responsibility). For example, PEPs under the SECURE Act are expected to gain some popularity.[14] Most likely, some large employers (in both the private and public sector) with existing plans custom designed for their own needs will continue to maintain those plans, as those plans may have relatively low administrative costs and low-cost investment options.

Conclusion

Approximately one-third of all private-industry workers in the U.S. lack access to an employer-sponsored retirement plan. These workers are often employed at organizations that are small and lack the financial and human capital resources to sponsor a retirement program. In addition, businesses of all sizes may prefer to focus their energies on their business proposition rather than administering benefit programs. In this environment, shifting retirement plan responsibility and related liability to a third party can be a sound business and risk management approach.

Outsourcing some of the functional responsibilities for a retirement program could provide benefits in cost and risk reduction as well as the ability to offer options and features that otherwise would not be possible or would be too costly. Single-employer plans will continue to be a viable option for many employers; however, decoupled plan structures, such as PEPs under the SECURE Act and state and local government-based retirement initiatives, have expanded the options available and provide new opportunities to private-sector employers.

14 See Academy issue brief *Pooled Employer Plans—Employer Considerations*.

Retirement Policy: Aligning Plan Design With Effective Employee Engagement

MARCH 2022

Key Points

- Some plan participants of defined contribution (DC) plans may lack the resources and/or knowledge needed to make informed choices during the retirement savings accumulation and decumulation phases.
- Well-designed plan features considering the demographic makeup of the workforce can lead to better participant decisions by providing either no choice or a range of options, including defaults and incentives.
- Legislators and regulators might consider changes that enable and encourage plan sponsors to use plan designs that could further improve participation and retirement security.

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In July 2019, the American Academy of Actuaries (Academy) Retirement System Assessment and Policy (RSAP) Committee published an issue brief titled *National Retirement Policy & Principles*, which focused on the increasing need for a comprehensive national retirement policy based on certain guiding principles. This initial issue brief was followed up by three additional papers in the series. *Retirement Security Challenges: Portability and Retirement Income* addressed the challenges faced by workers in a mobile workforce who accumulate retirement benefits at multiple employers over their careers. This issue brief was followed by *New Retirement Plan Designs: Degrees of Risk Sharing*, which focused on where the risk lies under alternative retirement plan models as well as legislative changes needed to allow more innovative plan designs in the private sector. The next issue brief, *Retirement Policy: Potential for Changing Roles of Employers in Retirement Programs*, addressed how employers can provide retirement plans to their employees through models in which many of the responsibilities are decoupled from the employer.

This issue brief addresses how retirement program design can impact decisions that participants make with the goal of improving retirement security. The principle of individual choice—and the degree to which such choice might be permitted in a retirement system—is highlighted in the original *Policy & Principles* issue brief. Most defined contribution (DC) retirement plans, such as 401(k) plans, leave important and sometimes complex choices to the individual. These decisions include not only whether to contribute but also how much to contribute and how to invest contributions (employee and any employer contributions). In addition, employees have to decide when to withdraw the funds they have accumulated, as well as how to structure those withdrawals so they last for an unknown lifetime.

Underlying the DC retirement plan structure is the assumption that individuals are equipped to make decisions in their own best interests, and that they will do so. However, this assumption might not always be accurate, especially if individuals lack the resources and/or knowledge needed to make informed choices. For example, access to easy-to-use quantitative tools may be helpful to assess expected outcomes based upon different scenarios and decisions such as when to commence Social Security benefits and employ various drawdown strategies.[1] Tools that use actuarial principles, reflecting future life expectancy and investment return, can be extremely helpful. One example of a tool for educating individuals about future life expectancies is the Actuaries Longevity Illustrator, developed by the American Academy of Actuaries and the Society of Actuaries.

This issue brief separates plan provisions or features that affect retirement plan outcomes into four categories. The first is where no choice is provided. The second is where some level of choice is provided and a range of options is offered. The third is the use of defaults, for which options exist but, if no action is taken, a selection is automatically made according to the terms of the plan. The last one is where incentives (or disincentives where penalties apply) are used, where certain decisions are encouraged or rewarded (or penalized). Note that these provisions or features may, and often do, overlap. Some may not be plan provisions but rather provisions under the law.

This issue brief will provide a brief overview of the concept of behavioral economics, followed by a discussion of alignment, one of the fundamental principles in the RSAP Committee's "Retirement for the AGES" (**A**lignment, **G**overnance, **E**fficiency and **S**ustainability) framework.[2] This will be followed by a look at the decisions that individuals may need to make in DC plans (and occasionally in defined benefit [DB] plans). Next will be a discussion of the four categories of plan provisions or features as noted above. The framing of options and how such framing may impact decision making will then also be addressed. This analysis is followed by a brief discussion of how plan provisions designed to impact behavior might influence different demographic groups in different ways. The issue brief will conclude with some suggestions for consideration by legislators and regulators of how retirement outcomes can be improved through provisions that focus on employee behavior.

1 See, for example, the Academy issue brief *Actuarial Perspectives on Determining a Retirement Income Budget*, July 2020.
2 See https://www.actuary.org/Retirement-for-the-AGES.

Members of the Retirement System Assessment and Policy Committee, which authored this issue brief, include Eric Keener, MAAA, FSA, FCA, EA—*Chairperson*; Claire Wolkoff, MAAA, FSA—*Vice Chairperson*; Kelly Coffing, MAAA, FSA, EA; David Driscoll, MAAA, FSA, FCA, EA; Lee Gold, MAAA, ASA, EA; Scott Hittner, MAAA, FSA, FCA, EA; Cynthia Levering, MAAA, ASA; Esther Peterson, MAAA, ASA, EA; Timothy Robson, MAAA, ASA, FIA; Andrea Sellars, MAAA, FSA; and Mark Shemtob, MAAA, FSA, FCA, EA.

Behavioral Economics

Behavioral economics is the study of psychology as it relates to self-interest in decision-making when applied to economic choices. Employee decision-making with respect to retirement plans can be a daunting task for many individuals. Plan sponsors can help address this by making appropriate options available. Even when the appropriate options are available, some individuals may not have sufficient knowledge and quantitative skills to make informed choices, and research shows that individuals are prone to behaviors that may not lead to desired results. For example, individuals:

- Can exhibit risk aversion tendencies by applying greater weighting to potential losses than potential gains. In accumulating retirement savings, avoiding investments such as equities could actually increase the risk that accumulations will not be sufficient.
- Tend to discount the value of future needs when compared to near-term needs.
- Generally use "rules of thumb" or other "educated guesses" as substitutes for a more rigorous quantitative analysis.

Another factor influencing economic decision-making is how options are presented, also known as framing. The early work in this area stemmed primarily from the writings of Daniel Kahneman and Amos Tversky that were published over four decades ago in *Prospect Theory: An Analysis of Decision Under Risk*. Since then, much additional research has been performed in this area. While a discussion of this broad topic is well beyond the scope of this brief, an understanding of decision-making by individuals can be crucial in the development of sound retirement policy and plan design. This concept is more important today than in the past because most individuals rely on DC plans that pose multiple, complex options and decisions to achieve their retirement security. In contrast, many traditional DB plans, which are now less prevalent than DC plans among private-sector employers, provide only limited choices to individuals.

Consideration of the impact of "behavioral economics" in retirement plan designs and the public policies that support them is recommended.

Alignment

The Academy's "Retirement for the AGES" framework is intended to assist policymakers and other key stakeholders in formulating policy, structure, operational practices, and plan designs that improve employer-based retirement programs. The Alignment principle states that retirement income systems work best when stakeholders' roles are aligned with their skills. Important tasks—such as financial analysis, investment management, and retirement plan administration—should be the responsibility of those who have the knowledge and experience to perform them well. As many private-sector retirement programs have transitioned from DB to DC plans, participants are being asked (and required) to make more choices, both in terms of investing their accounts during employment and in planning for decumulation during retirement. Plan design should be structured to facilitate desired outcomes, and, where choice is provided, it is important that employees have the education and skills to understand and make the choices and decisions to improve their long-term outcomes.

Plan Decisions

Among the major decisions DC plans might require plan participants to make are the following:

Whether to participate in the plan: It is difficult for individuals to decide on the trade-off of the utility of current income versus saving for a more secure retirement, especially when retirement is decades in the future. Receipt of current income tends to be valued more than future income. In addition, the benefits of tax deferral may not be adequately understood and appreciated. It could be that a decision not to participate fully (or at all) is rational based on near-term financial needs.

How much to contribute to the plan: Once individuals have committed to participating in a plan, they must determine how much to contribute. Often the contribution elected is based upon an employer match, but this level of contribution might not provide sufficient accumulations for a successful retirement. And again, in certain cases, not contributing enough to maximize the employer match may be a decision based on near-term financial needs.

How to invest accounts: Plan participants might have limited experience with investing. Understanding how to assess the amount of risk to assume can be challenging for many, and the appropriate amount of risk will vary over time. Individuals might deal with investment gains and losses reactively, behaving in a manner that is inconsistent with their long-term goals. In addition, individuals could fail to properly account for the impact of fees and expenses on their investment choices.

Whether to withdraw funds before retirement: DC plans generally provide an option to take distributions upon the occurrence of a hardship, or to borrow from the plan up to certain limits. While for many individuals this might not be their only source of available funds, it might be the one that is the most readily accessible. Penalties and taxes may apply if these funds are not repaid to the plan. In addition, individuals are generally provided access to their funds when they change jobs. Though the option exists to roll over funds to an individual retirement account (IRA) or possibly a new employer's plan, there may be technical obstacles to an easy rollover as well as temptation to use those funds for other purposes, even though penalties and taxes might apply (as with loans or hardship distributions that are not repaid to the plan).[3] Consuming these funds prior to retirement could result in significant loss of retirement savings.

When to retire: Plan participants are in many cases unaware of the value of their account balance in terms of the potential lifetime income it will provide. While the *Setting Every Community Up for Retirement Enhancement (SECURE) Act* requires annual lifetime income disclosures in DC plans effective Sept. 18, 2021, those disclosures might not provide sufficient information for a participant to understand whether they are on track for retirement.[4] Insufficiencies could be rooted in one's uncertainty of longevity and future capital market returns as well as a misunderstanding of how working longer potentially impacts retirement security. Certain decisions regarding the form and timing of retirement benefits could be irrevocable. Economic and business changes can result in an earlier retirement than planned.[5] As a result, the decision-making process as to when to retire can be complex, and individuals might not have the information they need to make decisions.

3 A similar decision may also come into play for DB plans that offer lump sums.
4 The Academy's comment letter to the Department of Labor regarding lifetime income disclosures regulation pursuant to the SECURE Act can be found here.
5 When to stop working and when to commence receiving retirement benefits are decisions that are also applicable to DB plans and Social Security; in some cases, DB plans may offer early retirement subsidies, further complicating the decision-making process.

<u>*How to create reliable income during retirement:*</u> There is no one "right" way to turn retirement accumulations into predictable lifetime income. Decisions are driven by health, lifestyle choices, desire to leave funds to heirs, risk tolerance, integration with other income sources such as Social Security, as well as access to education, advice, and easy-to-use strategies. In addition, ongoing evaluation is needed, and prior decisions might need to be revisited during retirement as actual returns, inflation, health status, life expectancy, and other factors change over time.

Plan Design Elements That Influence Behavior

As discussed, the various decisions to be made under DC plans can be challenging to many participants. Directing individuals toward better decision-making can be achieved through legislation and plan design. The strategic inclusion of plan design elements by plan sponsors can improve retirement outcomes, as discussed below.

No Choice: Not all aspects of plan design allow individual choice. For example, a plan could require that all contributions be invested in a single investment portfolio. Though this is not common with 401(k) plans, it is not unusual in DC plans where the participants make no contributions. Another example of offering no choice would be a requirement that a portion of one's account balance be used to provide lifetime income. Though this is not common in DC plans subject to the *Employee Retirement Income Security Act of 1974* (ERISA), it is a possible approach to improving lifetime income. Individual circumstances differ for each person (e.g., age, health, marital status, desire to bequeath an inheritance, level of financial literacy). Consequently, plan provisions that do not allow for choice could provide favorable outcomes for most participants but may lead to less favorable outcomes for some participants.

Range of Options: While a wide range of options can add tremendous flexibility and customization of plan benefits to fit employee preferences and circumstances, the inclusion of too many options can potentially confuse some plan participants. More choices could increase the need for education to assist individuals in making selections that are appropriate for them. The use of only low-cost, well-designed target date funds is an example of a restriction of investment choices that can benefit some plan participants.

Defaults: When plans offer choices, it is common to include a default selection that becomes effective in the absence of a plan participant's election. This approach is the cornerstone of autoenrollment and default automatic contribution arrangements. Examples include plan designs where, absent an affirmative election, the participant is deemed to have elected to participate and contribute to the plan at a predetermined level.

Default contribution arrangements can also provide automatic escalation of participant contributions up to a specified maximum level. This approach is also used for default investment choices when participants fail to select an investment option. For instance, the use of a well-designed target date fund as a Qualified Default Investment Alternative, or QDIA, in a 401(k) plan has the potential to improve retirement outcomes.

Incentives: Participant decisions can be influenced by incentives. An example is the use of matching contributions to encourage plan participation. Another incentive (though not one established by the plan) is the favorable tax treatment for those who participate. A penalty tax on early withdrawals also discourages the use of retirement savings for non-retirement purposes.

The Impact of Framing the Design Elements

Framing is not an element of plan design, *per se*, but the manner in which plan design and associated options are communicated to participants is extremely important. Framing can have a significant impact on individual decision-making. How an option is presented can influence the actions one might take. For instance, consider a plan that offers target date funds as well as funds that invest in specific market sectors. The target date fund, which is associated with a target retirement year designation, is presented as an all-in-one option that is designed specifically for someone planning on retiring in or near that year. Plan participants who find portfolio creation challenging could be drawn to this simple-to-use alternative, although they still should "do their homework" with regard to investment style, fees, and expenses to align with the individual participant's investment objectives.

The Impact of Plan Design Elements on Different Demographic Groups

It would be ideal if all plan design elements that are based on improving individual outcomes were appropriate for all participants. However, this is not always the case. For example, consider a plan with automatic enrollment in which salaries are reduced at a default percentage and those amounts are contributed to the plan. If a participant in such a plan has a financial emergency and needs to take a hardship withdrawal from the plan, that withdrawal could be subject to taxes and a penalty, which may not be a desired outcome.[6]

6 Participants have the ability to change the default election, including opting out completely.

Younger individuals may be interested in different types of investment options than older individuals (e.g., cryptocurrencies and environmental, social, and governance [ESG] funds). Plan designs that offer these alternatives may thereby increase plan participation. The plan sponsor must satisfy the fiduciary obligation when adding certain options, and including such nonstandard types of investments would likely necessitate additional education regarding risk.

Plan sponsors might consider the impact their plan design can have on different demographic groups covered by the plan and whether there are specific features or communications that may be appropriate. For example, while encouraging positive saving behavior, employer contributions that rely on matching employee contributions negatively impact those who do not contribute. Each employee has unique financial circumstances that may inhibit their ability or willingness to contribute to the plan and obtain the full match. While matching contributions provide a strong incentive for first-dollar savings to go to the retirement plan, other uses may be a higher priority for any particular individual. In contrast, non-matching contributions do not provide a direct incentive for employee contributions but guarantee some level of contribution to all participants, regardless of an individual's circumstances.

Suggestions for Consideration by Legislators and Regulators

Legislators and regulators might consider changes to enable and encourage plan sponsors to use plan designs that would be beneficial to some groups of people who are not currently fully participating in retirement plans.[7]

Link emergency funds with retirement benefits: There are groups of people who are unable—whether due to age, salary level, or other financial obligations—to save enough to produce an adequate retirement income. From a financial viewpoint, it could be more important for some to address near-term needs and start saving to build an emergency fund. Under current law, savings for retirement are distinct from savings for emergencies and paying off existing debt. Linking these savings to some extent could produce better outcomes. For example, having access to an emergency fund without a tax penalty might encourage some individuals to participate in a retirement plan, especially if there is an employer match. Such linkage has been included in recent proposed legislation.[8]

7 *Gaps in Retirement Savings Based on Race, Ethnicity and Gender*; Advisory Council on Employee Welfare and Pension Benefit Plans; December 2021.
8 *Enhancing Emergency and Retirement Savings Act of 2021.*

Student loan considerations: Many employees are repaying college or other student loans and may not be able to start saving for retirement while they are paying off the loans. One approach in certain legislative proposals is to allow employers to make matching contributions to a defined contribution plan, such as a 401(k) plan, based on the employee's student loan payments.[9] The employee would then have retirement savings and might be more likely to start contributing when financially able. Such a provision could help those with lower incomes.

Tax and other incentives: Legislative changes can include expanded tax incentives to encourage small employers to provide retirement benefits for their employees. These employer incentives could cover some of the start-up costs for such plans. Credits can also be provided to low-income employees to help them start saving for retirement (for example, the Saver's Credit under current law). Matching contributions are a long-term incentive to encourage plan participation. Employers could also be allowed to offer small immediate, short-term incentives (e.g., gift cards in small amounts) to encourage plan participation.[10]

Plan-provided retirement income options: Changes to the law, such as expanded safe harbors that would encourage plan sponsors to offer more than insured annuities to retirees, could be of value. Many employees could benefit from plan alternatives that seamlessly transition to providing income in retirement as opposed to requiring the purchase of an insured irrevocable annuity contract.

Increase use of target date funds: The use of target date funds has become very popular and has helped millions of participants by relieving them of the complexities of selecting and adjusting asset allocations over time and rebalancing when appropriate.[11] Regulations to encourage the expanded use of target date funds, including appropriate disclosure of potential risks, may further benefit participants.[12]

Disincentives: Increased penalties for premature non-hardship withdrawals might be considered. This could discourage more individuals from consuming retirement savings when changing jobs.

9 *Securing a Strong Retirement Act of 2021* ("SECURE 2.0"), Section 109.
10 Short-term incentives unrelated to matching contributions are generally not allowed under current law.
11 In addition to traditional equity and fixed income investments, insured lifetime income options recently have become a feature of some target date funds.
12 Members of Congress have requested that the Government Accountability Office study the use of target date funds and associated risks.

Conclusion

It can be difficult for individuals to recover from delays in starting sufficient retirement saving and from insufficient investment performance. In addition, many workers might not be adequately engaged with their retirement plans, nor have the education and expertise needed to make decisions in this area. Targeted and effective plan designs can facilitate favorable outcomes despite these realities. Financial education is of value in helping individuals to make savings and investment decisions. However, not all individuals will have access to proper education or know how best to use it. Therefore, it is important to consider how plans can be designed to help retirees achieve the goal of securing their retirement.