EDUCATION

Retirement...Disrupted: Is the US Facing a Crisis?

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On our latest “Talking Markets” podcast, we listen in on a panel of experts discussing the potential US retirement crisis and the fear factors surrounding retirement disruption. Drew Carrington, head of Defined Contribution at Franklin Templeton Investments is joined by Lori Lucas, president and CEO at the Employee Benefit Research Institute (EBRI), Ed Murphy, CEO and president, Empowers Retirement Business and Lew Minsky, president and CEO at Defined Contribution Institutional Investment Association.

Tune in to hear more in our latest “Talking Markets” podcast.

Here are some highlights of the views of the speakers presented:

- Lori Lucas: A lot of good things happening in the employer-sponsored defined contribution system. I think we have to understand how well-loved 401(k)s are and how many people want to really preserve that system even though maybe we need to think differently about it.
- Drew Carrington: I think one of the potential crises in talking about retirement would be this notion of the emerging workforce in the US known as the “gig economy” that doesn’t have access to traditional benefits.
- Lew Minsky: I’m going to resist the term crisis, but we definitely have a puzzle that we need to solve and a part of it is just the framing around retirement. What we consider retirement is changing, what people need to ultimately secure is changing.
- Ed Murphy: We still have millions and millions of Americans that aren’t covered by workplace retirement plans. And we know if there is no access to workplace savings [through payroll deductions], most don’t save.

A full transcript of the podcast follows.

Host/Richard Banks: Hello and welcome to Talking Markets with Franklin Templeton Investments: exclusive and unique insights from Franklin Templeton. I’m your host, Richard Banks.

Ahead on this episode—an expert panel discusses the fear factors surrounding retirement disruption.

Our guest speakers on the panel are: Lori Lucas, president and CEO at the Employee Benefit Research Institute, Ed Murphy, CEO and president, Empowers Retirement Business (EBRI), and Lew Minsky, president and CEO at Defined Contribution Institutional Investment Association.

Leading the conversation is Franklin Templeton’s Drew Carrington. We hope you enjoy their conversation.

Drew: My opening question for the panel is, do we have a retirement crisis? If we do have a retirement crisis, is it a crisis of savings? Have we saved enough to finance these longer retirements? Is it a crisis of access or coverage or is it a crisis of measurement and we are not actually asking the question the right way?

So Lori, I'm going to start with you because you sit on top of a mountain of data at EBRI, so do we have a crisis?

Lori: Well, I think all three of the categories you stated are applicable, but I'll start with measuring the crisis and what we find is that when you look at it from one perspective, it looks like there is a crisis and yet from another perspective it doesn't.

So it's really a "haves" versus "have-nots" kind of a scenario and we have a retirement security projection model at EBRI in which we projected out the likely outcomes for workers in general and specifically for those that have 401(k) plans and what we find is that across the US population, 43% are projected to run short in retirement, and that creates in excess of $4 trillion deficit in terms of what people need to have saved and have for retirement. But then if you look specifically at people that have employer-sponsored retirement plans, it's a very different picture. And what we find is that some were one short in that scenario as well, but only 27% are projected to run short versus that 43% that don't have the employer-sponsored retirement plans. So it's a little bit of who you are looking at and how you are measuring it, but certainly it argues, it does argue strongly for some success what that we have seen in employer-sponsored retirement plans.

Drew: Ed, you want to…

Ed: Yeah, the term "crisis" gets used a lot. I mean, I would say that, you know, the retirement DC [defined contribution] system, the voluntary system is arguably one of the most successful public-private partnerships that we have in this country. It's only 30 years old and we've got 94 million Americans, 75 million that are active in a plan. So, from that standpoint, I think it's been a success. Where the challenges lie has to do with what Lori was saying, we still have millions and millions of Americans that aren't covered by workplace savings. And we know if you don't have access to workplace savings, you just flat out don't save. And you look at people making $35,000-$40,000 a year, if they have access to workplace savings through payroll deductions, 75% of them save. Conversely, that group that doesn't have access, 5% save. So, I think the access issue is a significant one. A lot of us are obviously working on that. I think it's a combination of legislative and regulatory and private sector innovation that will begin to address that. So, I think that's the primary challenge. I think the other thing is savings. We also know, we have done a number of studies that would suggest that people who save a rate of 10% or more irrespective of their income are on track to replace more than 100% of their pre-retirement income. We know it works. It's just a question of getting people to adopt some of those best practices.

Drew: Anything to add Lew?

Lew: I guess I'd start by saying I think we have a semantic problem. So, you know, I'm going to resist the term crisis, but we definitely have a puzzle that we need to solve and a part of it is just the framing around retirement. What we consider retirement is changing, what people need to ultimately secure is changing. I think we need to better understand that. I guess I would fall back to we have a measurement problem. We were currently not really capable of measuring who has access and who doesn't. We don't do a great job at a broad level of measuring the levels of success, people who do have access ultimately have in the system. I think we know through some of the great work that EBRI has done that there are things that ultimately drive better outcomes. So, you know we are doing a good job of refining the way and ultimately, hopefully, perfecting the way we get people to secure financial status later in life. But for us to fully solve the puzzle, we need to improve the way we measure these things, so we know what it is we are solving for.

Drew: That's probably the first step in solving the problem. What problem is that you are trying to solve? So on that front, if we sort of all agree that maybe the biggest gap right now is this access or coverage problem. We know there's a lot of movement out there now to try and address that. States are trying to do this with mandatory auto-IRA [individual retirement account] programs, in some cases I think we are up to 12 or 13 states that have rolled something like that out. There are a number of pieces of legislation that had been proposed in Congress. And we even have talk about whether or not there should be a federal mandate, and we can even talk about the difference between a hard mandate and a soft mandate. But, what is it that we are likely to do? What, changes do you think we are likely to see that will meaningfully move the dial on the access front?

Lori: So we have got a great experiment that's going on with these states and from a perspective of a research organization, that's what we do is research on these topics, when we look at states like Oregon and we see that what they have put in place in terms of is a soft mandate in Oregon requiring employers to auto- enroll people into plans and it's being rolled out and we are beginning to see how that is helping workers. But also, I think the other thing is how does it affect employers, and this is a very critical part of this equation as well. If we move to any kind of mandate softer or otherwise what does it do to the existing DC system? Because I just made the point that the existing DC system is doing pretty well, especially since the Pension Protection Act. We have seen a very strong system with many plans offering automatic enrollment, escalating people up to very high levels, putting them into target-date funds, which are well-diversified; a lot of good things happening in the employer-sponsored defined contribution system to the extent we make other systems available, do they become alternatives that employers find attractive to move their employees to and take themselves out of the equation? And again, we don't know, but we were beginning to see some data coming out of the states and I think this is extremely valuable when we think about what to do at the federal level.

Lew: I think one of the by-products of what's going on at the state level, at least I hope one of the by-products is it's forcing the industry to evaluate its reflexive opposition to a broader federal solution. You know, for years the auto-IRA bill was introduced during the Obama administration every year. It really came out of an idea that was a collaboration between Brookings and Heritage. So you talk about bi-partisan support, I mean, there are a very few things in our history that came out of a collaboration between Brookings and Heritage, but this is one and fundamentally I think we are not going to solve this problem, this puzzle without some kind of mandate and that mandate makes more sense at a federal level. So whether that ultimately is soft or hard, whether it looks more like what's going on in the UK or what's happened in Australia, we can debate, but I don't think there are serious people now that debate the idea that for us to meaningfully close the coverage gap, we have to have some kind of federal-level mandate.

Drew: Do you agree with that?

Ed: I do. I think what's interesting, you know there is a lot of opposition to mandates, but the reality is we have mandates everywhere, I mean social security's a mandate. So, I think to Lori's point and Lew's, the states were addressing a gap and, you know, they've moved down this path and I think Oregon has gotten off to a good start. I think they are seeing the challenge in doing this. I think they have got 28% opt-out rate right now, but I think the key is, as someone that is a provider and administrator and supports these plans, we don't want 50 solutions. We want a national solution and I think the mandate is the way to go. Now, it's all how you define a mandate. The mandate is at the point where you are requiring an employer to set up a plan and you are simplifying the plan and you are putting tax credits in place and other things to offset startup cost. But the employees have the right to opt out and unlike the Australian system or the UK system where employers have to make a contribution, that's not in the bill. Employers are not required to match. So on a comparative basis, it feels more like a soft mandate. And as we discussed earlier, we know it works, like there are best practices happening and it's all around the auto suite and it's all around things like auto escalation and auto re-enrollment and those types of things. And that's what we should be putting in place for national program.

Lori: Ed, just to your point though, when you talk about the no requirement for employer match. I think that's what I was trying to allude to is to the extent you have an employer that looks at this alternative system and says, you know, this is appealing to me because I won't have any fiduciary requirements and maybe I won't get sued. And you know, there's a lot of reasons for me to just want to move to this system and besides I don't have to match. What does that do for coverage? I mean, you are really changing the dynamic for individuals who otherwise might have been covered and gotten a match.

Ed: I think the marketplace takes care of that. So if you are matching and I am not matching, I am going to have a tough time keeping my employees and that's what you have seen in the system today, that's what you saw with tax reform, that's what you have seen with the earnings windfalls that we have seen the number of companies that have increased profit sharing and increased contributions. I think that's how it gets addressed. I don't necessarily think we have to mandate that employer match contributions.

Drew: Do you think we might see something like that in the next few years? If it does happen, does it transform the retirement landscape? Kind of along the lines of what you are driving at Lori, does that become a new leg in the stool?

Lori: I remember I think it was 2010 when the DOL [Department of Labor] and the Treasury wanted to explore annuity actions in plans and they did a request for information and were trying to gather information. They got bombarded by Americans writing in and saying, keep your grubby hands off my 401(k) basically. I mean, there was just a very visceral reaction to the federal system coming in and trying to do something that could be perceived as, you know, taking away this 401(k) and we saw that last year as well with the Rothification. I think we have to understand how well-loved 401(k)s are and how many people want to really preserve that system even though you make the point that, you know, maybe we need to think differently about it.

Lew: Look, if I were betting, I would say, it happens in the reverse order. So what we see is ultimately probably not this year we are going to see a bill go through that opens up MEPs [multiple-employer plans] in a way that allows pooling on a broader basis without some kind of connection between employers. To me, once that model opens up, the system has to evolve and we have employers that are very comfortable with what they are doing that may want to stay the course but it definitely opens up the whole different model for people to take advantage of.

Ed: I don't think we will see retirement legislation this year, but there are a lot of proposals across a myriad of topics and there are several with bipartisan support including open MEPs, and I think open MEPs will pass in the next Congress.

Drew: We all know each other and get caught up sometimes in our acronyms, Rothification is moving the entire system from pre-tax contributions into the defined contribution plan to post-tax contributions and then you can make the withdrawals tax-free. A MEP is a multiple-employer plan, this is the ability to link multiple employers together in a single plan.

You know, we talked a little bit about other countries and there's a tendency sometimes when here in the States when we talk about the Australian system or what they have done in the UK with NEST [National Employee Savings Trust] that those are better. They are better designed, and we should learn here in the US from what they do outside of the US, but it also seems they are still trying to figure it out there as well. What is it they can learn from us, what can we learn from them?

Lew: There's a lot, we can learn from what they are doing, frankly, their commitment to not just study, but to implement things that work. So to me, the biggest thing we can learn from both is a commitment to identifying what drives better outcomes and then moving in that direction. You know they are not there in all cases, but there's definitely a greater commitment to do what they think is right from the policy perspective.

Lori: Yes, I completely agree with Lou. I think the one thing we can take away, is to be thinking about the retirement system with a goal of improving it as opposed to looking at it from revenue generation. We look at what the UK and Australia have done—they thought about how do we create a retirement system that really functions and works? And yes, it's a cost, but it also has a benefit. I don't think we look at the benefits side nearly enough and I think we could take that lesson away.

Drew: I think one of the other potential crises would be this notion of there is an emerging workforce in the US, the "gig economy" that doesn't have access to traditional benefits. Lori, I'll kick it to you first there.

Lori: We are evaluating the potential impact of the gig economy and right now. You know, among the Gen X, 19% are in a volatile category of gig workers and only 16% of gig workers have access to these types of employer-sponsored retirement programs. So what does that do in terms of changing the dynamic as far as coverage and also further in terms of retirement income adequacy? The problem we have is we don't know how big the gig economy is going to get. We don't know how long people will stay in their gig jobs. The evidence is they don't stay that long, but they just go to different gig jobs or do they go back to the traditional workforce. So there's a lot of question marks out there, but we do know that if the gig economy continues to grow and potentially doubles, that's definitely going to have an impact on the number I gave you earlier in terms of retirement shortfalls that we can project.

Ed: I think companies need to address it. This is a growing phenomenon. It's not going to stop. We live in a virtual world and most companies are using contingent contract-type workers all the time. So whether it's, you know, joining an open MEP or whether it's revisiting the classification of an employee and what that means, this will ultimately get resolved.

Lew: I mean, I think it points to the broader structural issue we have to. We have this system today where it matters who you work for, who record keeps your plan and as we move to this environment, whether it's your gig workers or just the mobility or the workforce and people are moving from company to company, plan to plan, you know the fact that we are in a system that's not interconnected, it just doesn't make any sense.

Talking about another thing we can learn from the UK, one of the initiatives they are pursuing is what they call the pot follows the member, so that making sure that the system itself is interconnected so that when somebody moves from job to job that their planned balance follows them. I think we are going to have to get there.

Lori: I think that kind of gets back to the point about the role of the employer and I think we are in a really interesting point where when I talk to employers, they fall into two very distinct camps. We've got some that are feeling like they are taking or want to take on more responsibility for the financial well-being of their workers. And they are thinking about everything from student debt, the millennials coming in with student debt, how do I help these people, you know, beyond just offering them a retirement plan because they are not going to save in the retirement plan until they pay down their debt. So thinking more holistically about the financial security of their workers on the one hand.

And on the other hand, having employers who are saying, you know, I feel like maybe there's this relationship is more transactional in nature and I can stock options, you know, compensation and that feels like the right relationship with my employees and not providing all these benefits which they may or may not value. So you know, and it kind of falls into by industry as well, you can see it happening in more traditional industries. They are competing using benefits, whereas some of the newer companies are thinking more in terms of just compensation in different ways. So it's a really kind of interesting bifurcation we are seeing in attitudes by employers.

Drew: One of the things we talk a lot about accumulation, helping people get ready, you know, saving enough, getting them in the system, in fact, all of the stuff we have talked about up to now has been coverage, access, saving levels, getting people into the system. There's also this point about the transition into the decumulation phase. One of our least attractive, made-up words, where people are moving from savings into actually drawing down their wealth and retirement. I know there's a lot of really interesting research about that. Lori, you guys have published some stuff that says people don't spend it down quite like we think. How do we help in that transition as a system, what are the implications?

Lori: Our research absolutely found that. Certainly a good chunk of people do spend down their money in retirement. They are struggling just to make their day-to-day needs but there are others that we have kind of refused to spend their money. And we also see at the high-income levels, where they are living potentially way below their needs because they are spending only a very small fraction of their money even 18, 20 years into retirement. Why are they doing this? Is it a rational reason like they want to save their money because they want to bequeath it to their children or something along those lines or is it irrational that they are afraid to spend their money because they are afraid of something like catastrophic health care costs that actually, you know, it's very improbable that somebody is going to be hit by astronomical catastrophic health care costs out of pocket in retirement, but people may fear that it's more common than they think. And these are the types of products I think we have to think about developing, you know, helping people if they are afraid, developing products that can help them overcome their fears and be able to spend what they've saved their lifetime and why not enjoy their retirement if they have the means to do it.

Drew: You mentioned something earlier today where you said you want to get people to stop thinking about the balance on their statement and think about what kind of income it could produce, maybe that would be a step in the right direction.

Richard: That's it for this edition of Talking Markets with Franklin Templeton. Thanks to all our contributors. If you enjoyed their insights and would like to hear more, check out our archive of previous episodes and subscribe on iTunes, Google Play, or just about any other major podcast provider. So until next time when we uncover more insights from our on the ground investment professionals, goodbye!

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