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GEORGETOWN UNIVERSITY
McCourt School of Public Policy
Center for Retirement Initiatives

State Retirement Initiatives:
Out of Crisis Comes Opportunity

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Presented by:

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Is Outliving Your Savings a Fate Worse than Death?

- 77 percent **of Americans surveyed are more afraid of outliving their saving in retirement than of death itself,** (according to a survey by financial-services company Allianz of people in their late 40s found)

- Those who are married with dependents are even more terrified, with **82 percent saying that running out of cash is a more chilling prospect than death** (according to a survey by financial-services company Allianz of people in their late 40s found)

Source: Reuters

- From **2001 to 2014**, retirement has remained Americans' top financial concern

86% **of Americans believe that the United States faces a retirement crisis**

Source: Gallup

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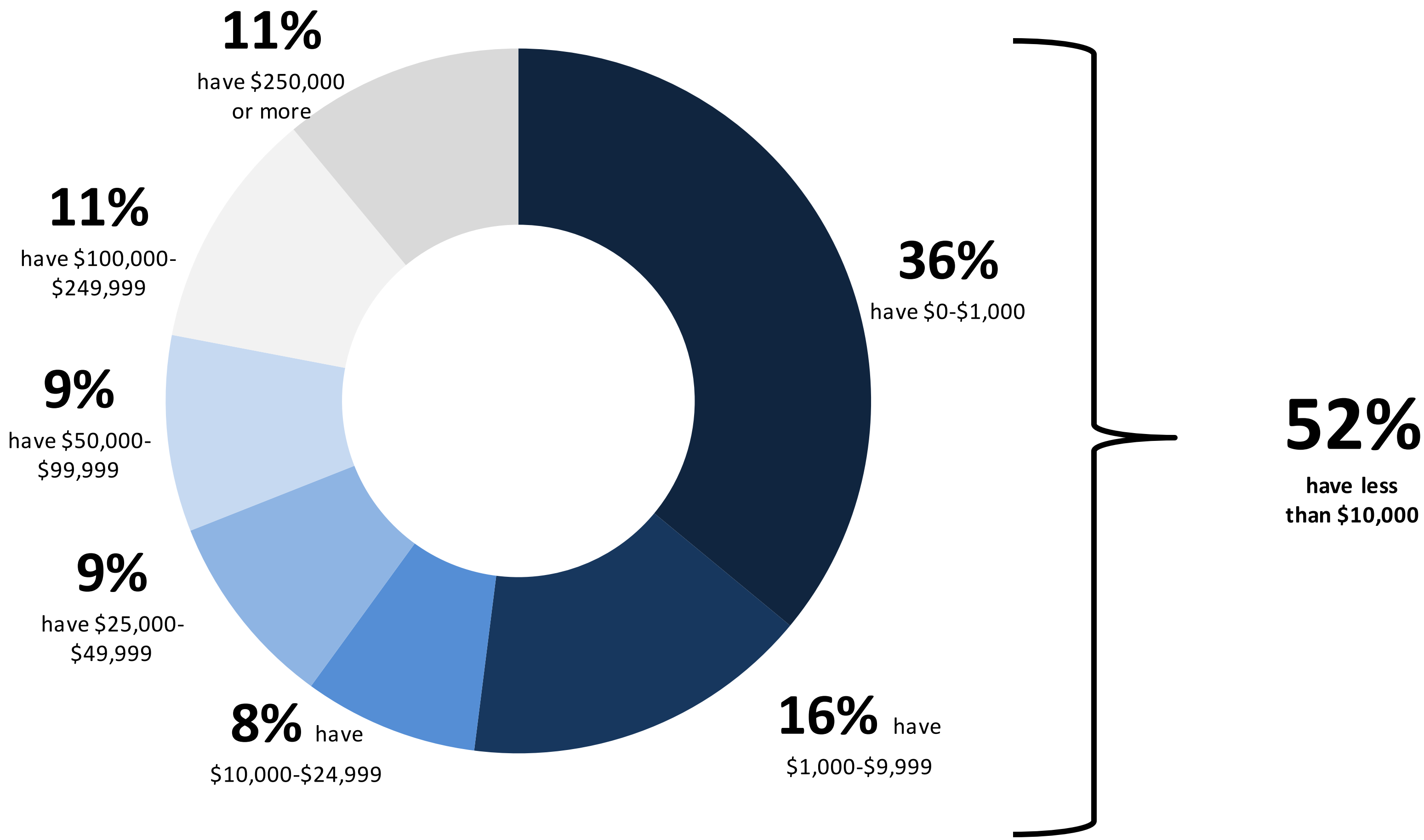
➢ Why Is There a Crisis?

- ➢ Americans are living longer
- ➢ Meager Savings
- ➢ Quantity and Quality of Employer Based Retirement

➢ Americans are living longer

- ➢ Less Smoking
- ➢ More Exercise
- ➢ Better Healthcare

Meager Savings



Source: Employee Benefit Research Institute

Meager Savings

- ➢ If you give Americans the opportunity to save they believe they could do it, if employers made it easy

- ➢ 70% of Americans believe they could save $25 more per week by giving up:
  - Eating out / ordering in (46%)
  - Soft drinks or snacks (13%)
  - Movies, videos, DVDs or streaming (12%)
  - Coffee from specialty shops (11%)
  - Lottery tickets (8%)

- ➢ But, half of all Americans can't raise $2,000 in 30 Days … Because it's not easy!

- ➢ **$120,000** needed for a worker making $30,000 to reach 78% of pre-retirement income

Source: Retirement Confidence Survey, EBRI, Greenwald and Associates, Time Magazine

Reduction in Quantity

➢ **Reduction of the *Quantity* of Plans Offered by Employers**

➢ Half of working Americans were not offered a retirement account by their employer — the result of a longer trend in which, from 1999 to 2013, the percentage of workers being offered such plans declined from **61% to 51%**

➢ In 1978, 2/3 of dedicated retirement assets were held in traditional pensions; by contrast, only 1/3 are today

(Source: The Hamilton Project, Brookings Institute)

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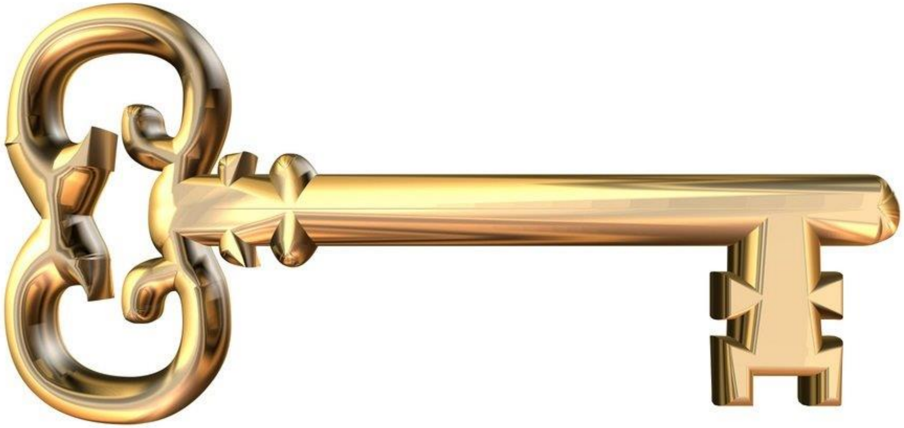
The Key

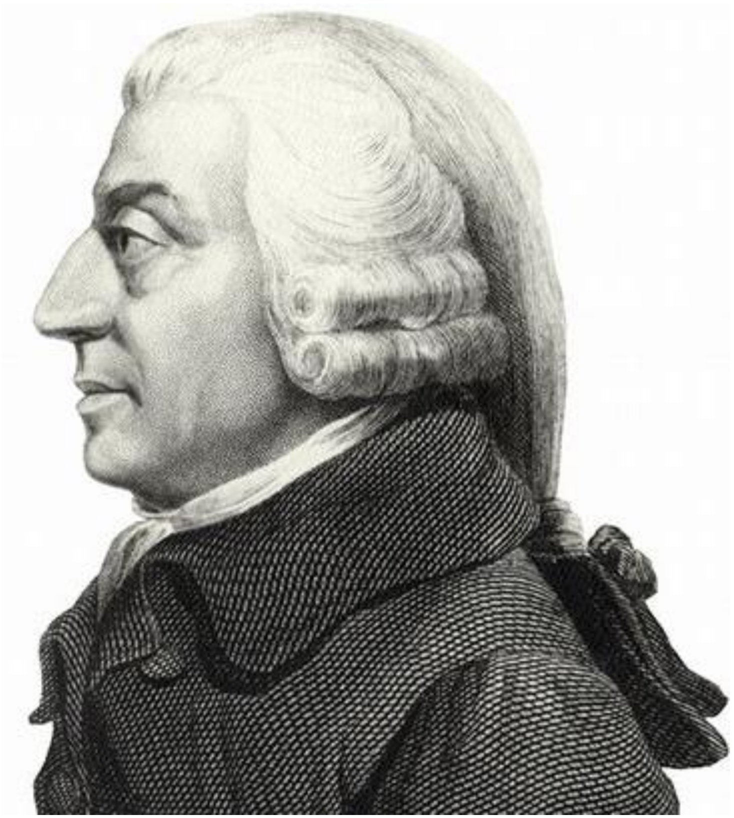


is employer-based plans

➢ Who has pensions?

ECONOMIES OF SCALE

- Unions: 82%
- Large Employers: 74%
- Government: 82%



Adam Smith, The Wealth of Nations

➢ Who doesn't?

SMALL BUSINESSES

- At employers with fewer than 10 workers, just 17% of workers have access to a retirement plan

Source: AARP

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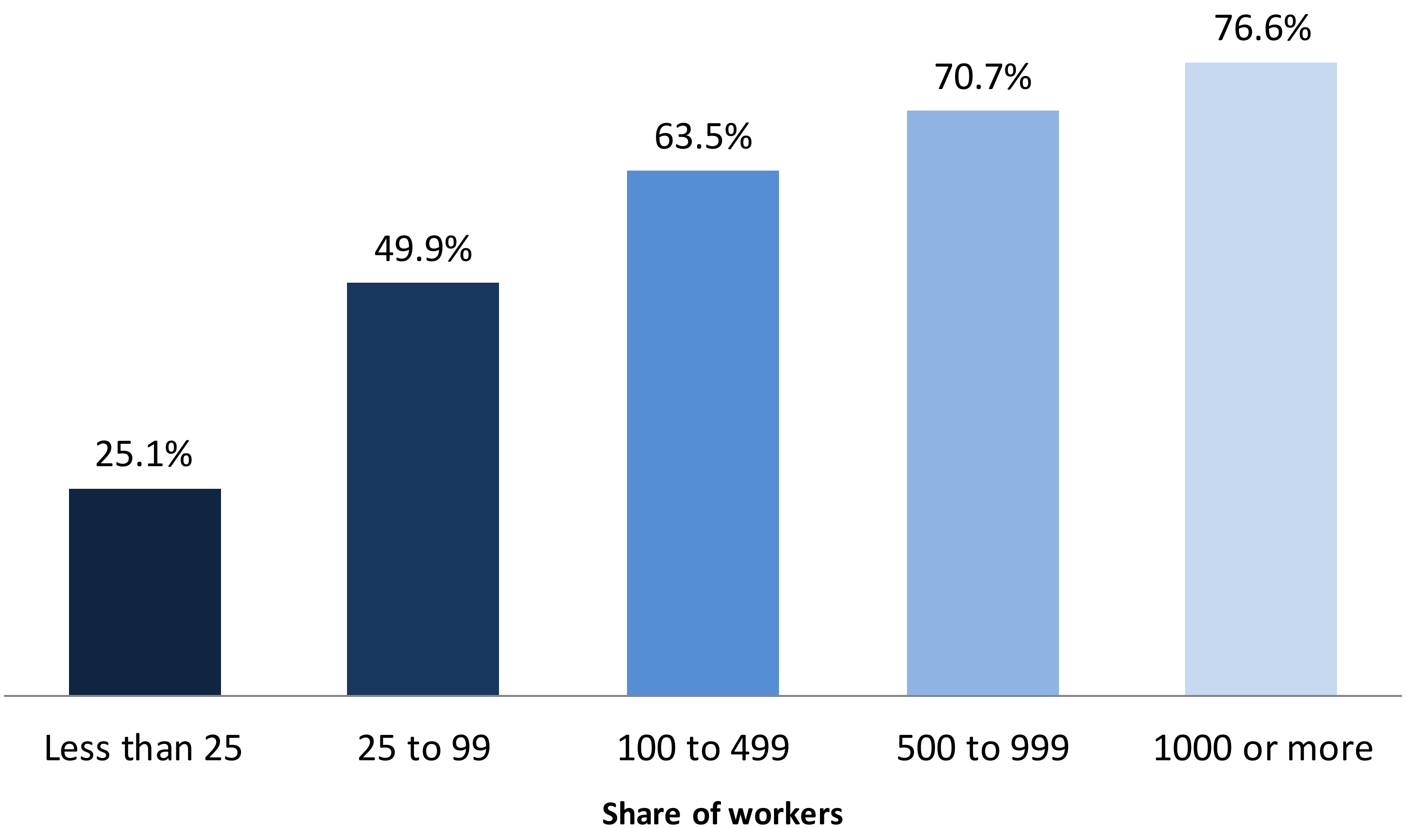
Most Small Businesses Don't Offer Any Plan

➢ Employer sponsored retirement plan by firm size



Source: The Hamilton Project, Brookings Institute

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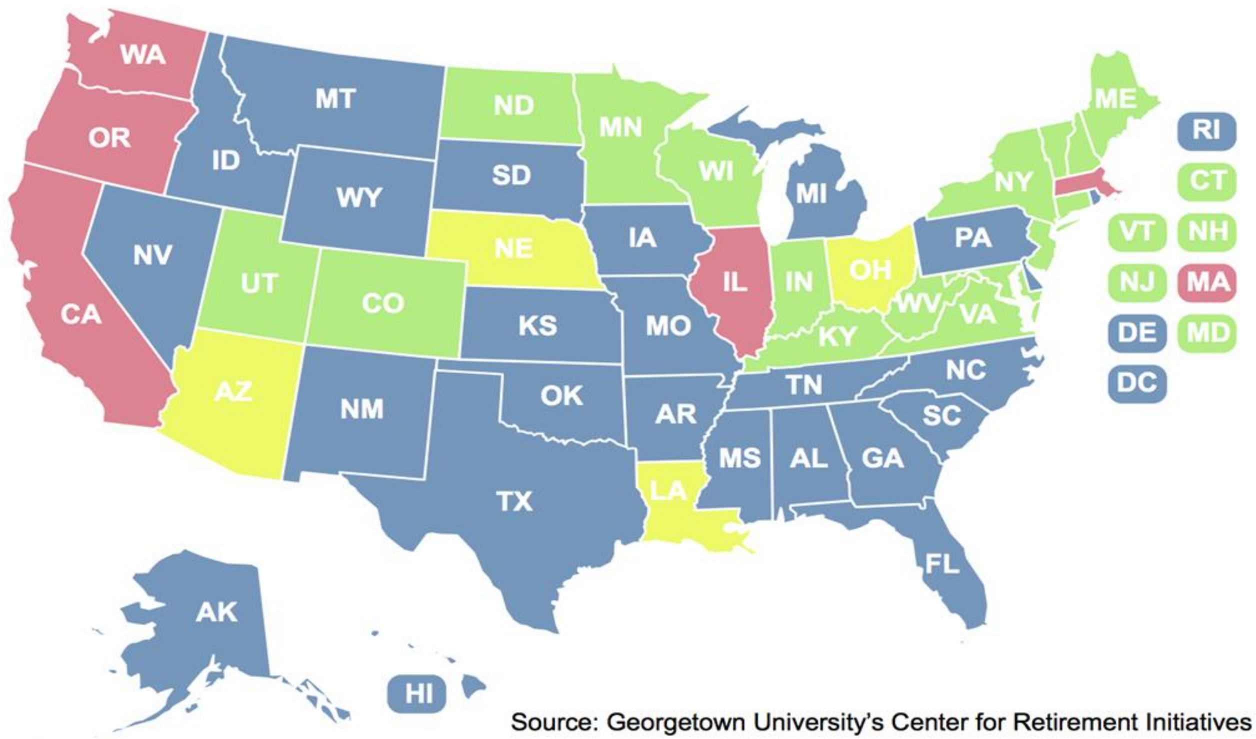
- 25 States Have Considered or Enacted Private Sector Retirement Initiatives



Source: Georgetown University's Center for Retirement Initiatives

= legislative proposal and/or study in 2015

= laws enacted (2012-present)

= recent state efforts (2012-2014)

What Should Be Features of Savings Plan

- Universal – all employers
- Reasonable monthly retirement benefits
- Automatic payroll deduction
- Simple
- Affordable
- Portable
- Professionally managed
- Low fees
- Pooled risk

➢ Simple & Effective

- ➢ 85% of employees started saving sooner than they would have without auto-enroll

97% of enrolled employees were satisfied with the service and glad it was offered

90% of those who opted out were still glad it was offered

Source: Retirement Made Simpler

Who Chooses to Save with Auto-Enrollment

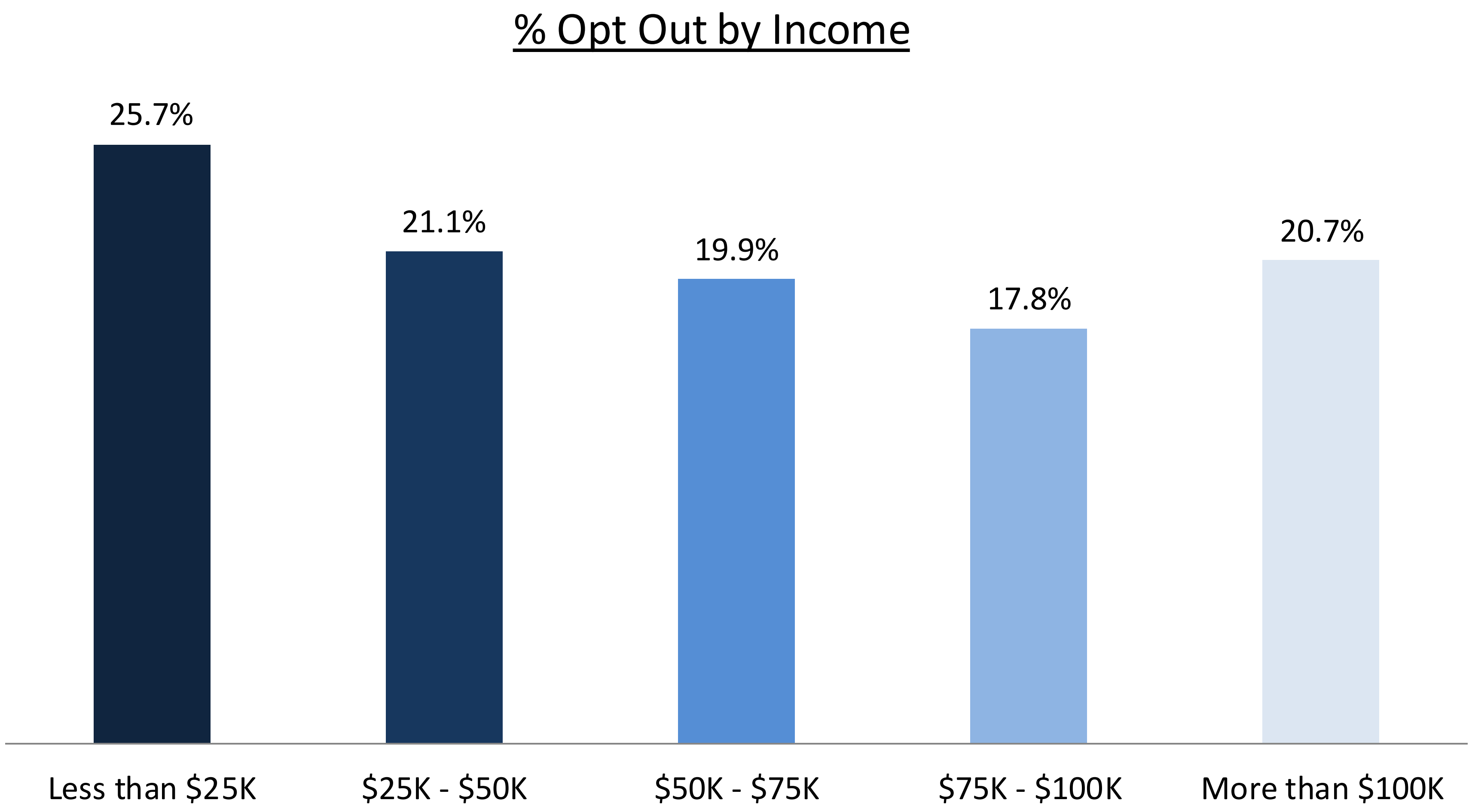
80%

- Women, minorities & young people opted out at lower rates than whites, males and older workers

- Opt-out rates did not differ significantly between 3% vs. 6% contribution rates

Source: Employee Enrollment Survey, Center for Retirement Research at Boston College, Connecticut Retirement Security Board

75% of Lowest Income Employees Choose to Save



Source: Employee Enrollment Survey, Center for Retirement Research at Boston College, Connecticut Retirement Security Board

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Guaranteed Returns

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What Does it Cost to Guarantee Returns?

- Historically, low return guarantees would have had no effect on replacement rates because while they are cheap they don't guarantee a reasonable return

- On the other hand, high guarantees are prohibitively expensive and the costs of these guarantees significantly reduce the final return to the retiree

- The only way to provide high return guarantees is if there is a sponsor who is willing to offer the guarantee on a less expensive basis, i.e., DB plans

Source: Golub-Sass, Munnell, Webb & Kopcke, 2009, Center for Retirement Research at Boston College

Options for Structuring Guaranteed Returns

Options

1. Guarantee the rate of return on the assets accumulated in the Program.

2. Contract with a third-party insurance company to provide a guaranteed rate of return on assets accumulated in the Program.

3. Offer a stand-alone investment option, such as a stable value fund, that provides an explicit guaranteed rate of return on invested assets.

4. Offer a stand-alone investment option that guarantees the investment through yields generated or an insurer-provided guarantee.

5. Offers a money market fund, which guarantees principal value of investments.

Source: Mercer, Memo to Connecticut Retirement Savings Board, Oct 2015

Risk vs. Return? Let's Ask California

- Survey found respondents preferred more risk with better returns over low risk with low returns

Source: Mercer, Memo to Connecticut Retirement Savings Board, Oct 2015

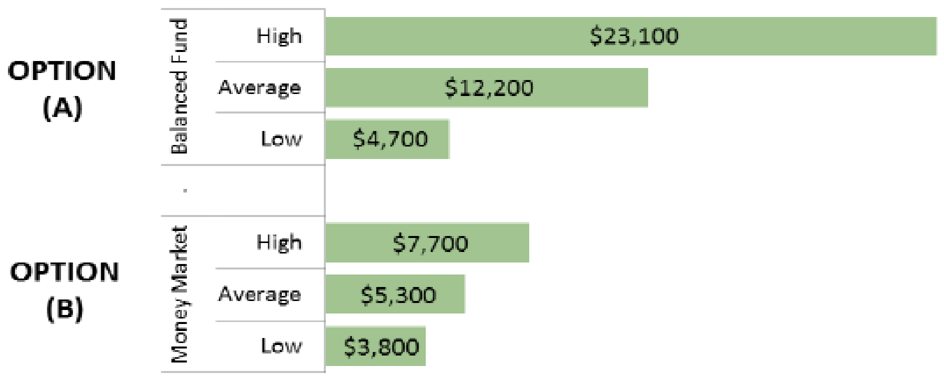
Respondents were Shown Two Investment Fund Options for the Program

➢ The retirement savings program could be set up with different fund options. Two examples are described below:

a. A "Balanced Fund" that has a mix of 60% stocks and 40% bonds. This is expected to provide significant investment growth over the long term. However, performance will vary a lot from year to year, and there is a 1-in-50 (2%) chance of losing some of the principal (your contributions) after 20 years

b. A "Money Market Fund, " an interest-bearing account that protects the principal. You will never lose your deposit, but interest rates may fail to keep pace with inflation

Low / Average / High Investment Gains after investing $50/month for 20 years



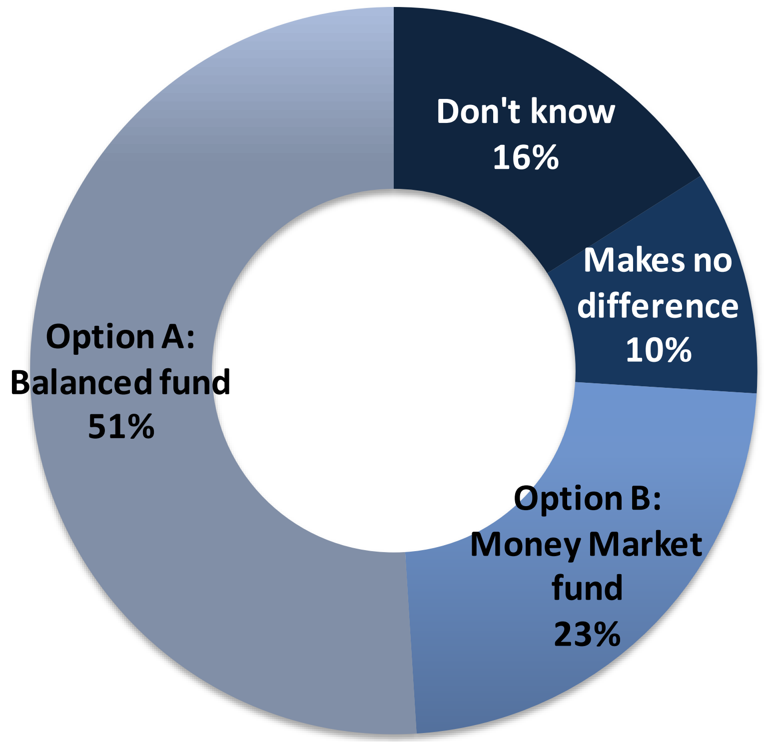
Note: Projections are net gains (total account balance minus $12,000 total contributions) based on historical financial market returns. Past performance does not guarantee future results. High = cutoff for top 5% of outcomes. Low = cutoff for bottom 5% of outcomes.

Source: Greenwald & Associates 2015

About Twice as Many Prefer a Balanced Fund over a Money Market Fund

- Half (51%) prefer a Balanced Fund compared to 23% who prefer a Money Market Fund. Another 10% do not have a preference and 16% don't know

  - Preference for the Balanced Fund increases with education and income



Base: Total, n=1,000
Source: Greenwald & Associates 2015

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Target Date Fund Option

➢ Option: Vanguard Target Retirement Fund

➢ IRA: 17bps (2,000 people)

➢ 401K: 10bps (2,000 people)

	10bps Fee	50bps Fee	The Difference
Top 5%	$45,656	$42,571	$3,085
Average	$22,952	$21,400	$1,552
Bottom 5%	$9,564	$8,834	$730

Source: Greenwald & Associates 2015

Choice & Default

- While people say they like choices, too many choices make people freeze, as they do not know what to do; therefore, they do not act

- The vast majority – particularly low income participants – “choose” the default plan

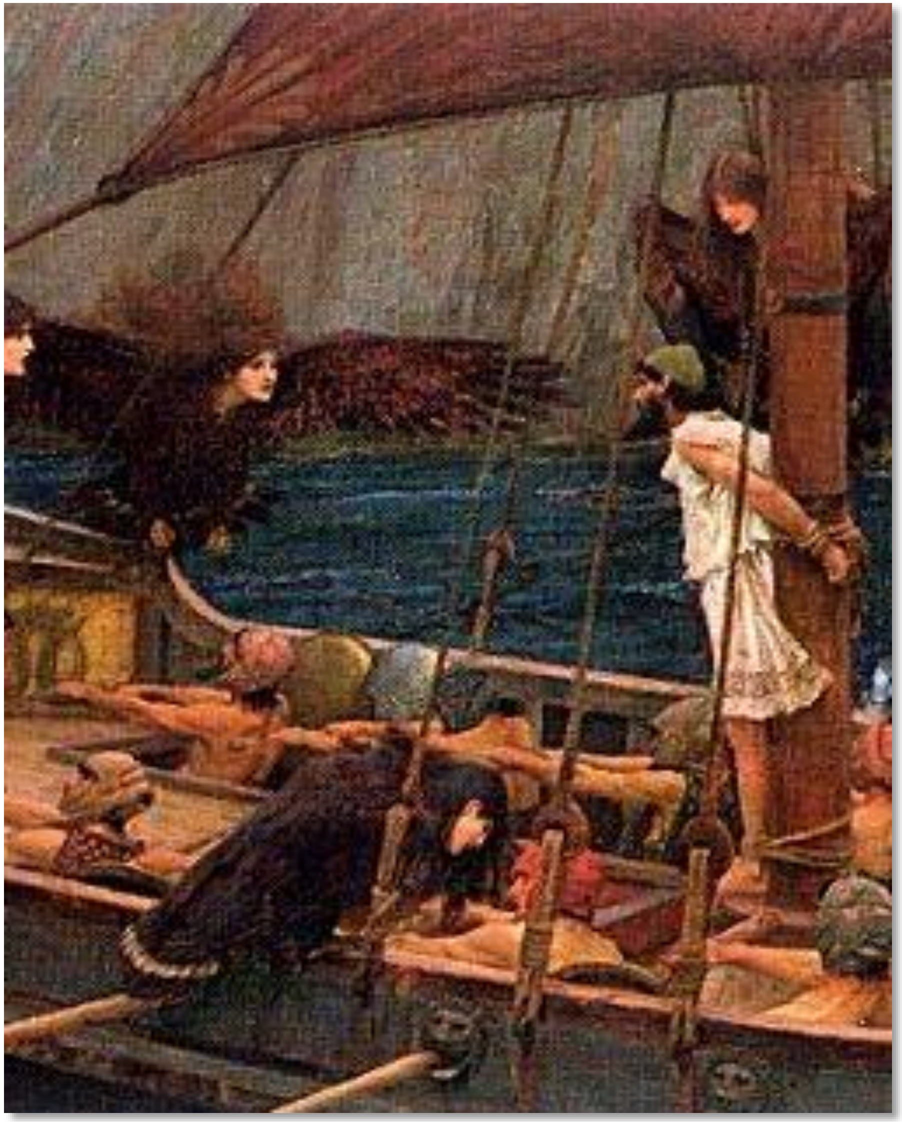
- It is critical, therefore, that the default plan should meet the needs of low income workers

Source: Greenwald & Associates 2015

Default

- Connecticut default investment option is: **target date fund**

- Connecticut default payout option is:
  - One half mandatory monthly payment
  - Other half is also monthly payment unless specifically requested for otherwise



Source: Greenwald & Associates 2015

Possible Design Plans

Individual Retirement Account

(Non-ERISA)

Multiple Employer ERISA Plan (like a 401K)

- w Partial Lifetime Income (Annuity) Portion
- w No-loss Guarantee

Clearinghouse/Exchange/Marketplace

Source: Josh Gotbaum, Brookings Institution Retirement Security Project.

Design Plans to Achieve Secure Choice Goals

- **DOL is now encouraging consideration of ERISA plan designs (401K like) that better achieve Secure Choice Goals**
  - ERISA plans allow optional employer contributions. State IRAs do not
  - ERISA protects spouse & death benefits; IRAs do not
  - ERISA plans permit much higher annual contributions than IRAs, generally $18,000 vs $5,500 per year
  - ERISA plans have pooled funding & much lower fees than IRAs
  - ERISA plans can more easily incorporate protects against loss & lifetime income
  - ERISA plans have a wider range of available choices, either pooled or non-pooled
  - ERISA plans will be state-sponsored
- **DOL is now working to clarify that there will be no employer fiduciary duty under a state-sponsored plan**

Source: Josh Gotbaum, Brookings Institution Retirement Security Project.

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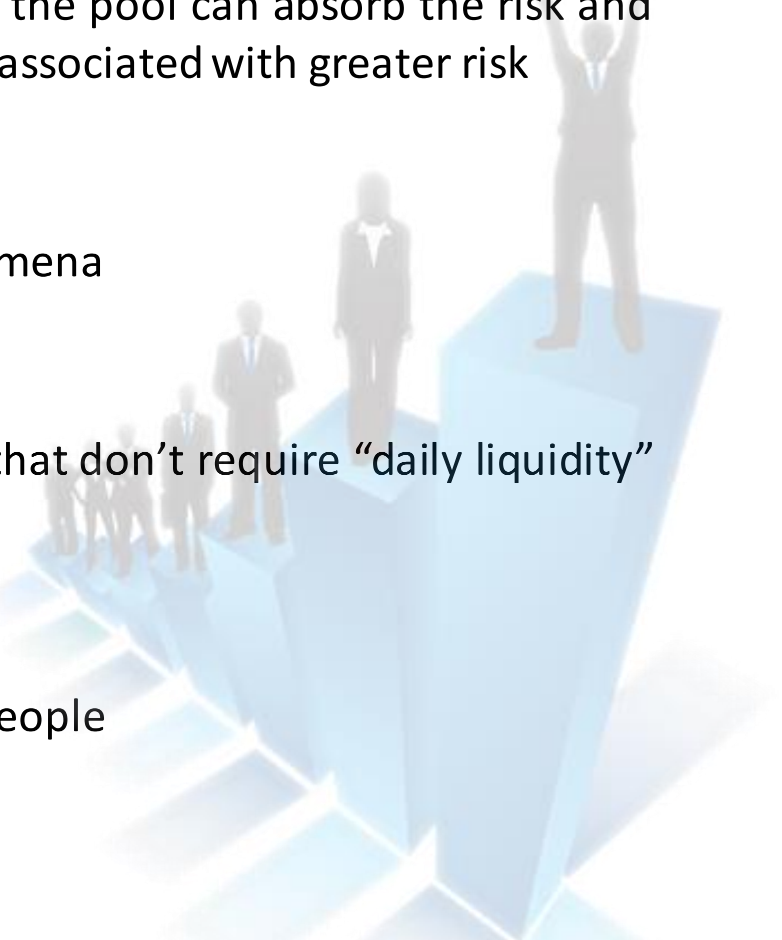


- **Multi generational risk allocation**

  \- Multi generational pooling means that individual does not have to decrease risk close to retirement. The younger generations in the pool can absorb the risk and the older individual can enjoy the higher returns associated with greater risk

- **Professionally Managed**

  \- More easily resists the buy high, sell low phenomena

- **Access to More Asset Classes**

  \- More balanced portfolio because asset classes that don't require "daily liquidity" can be included

- **Fees**

  \- Lower fees because spread over thousands of people

Individual Characteristics and Post-Retirement Income

Individual Characteristics

Age:	25
Retirement Age:	65
Life Expectancy:	85*
Salary:	$30,000
Annual Contribution Rate:	3%

Market Assumptions

Inflation:	2.5%
Fixed Income Returns:	4.0%
Equity Returns:	7.0%
60% Equity, 40% Fixed Income Return (nominal):	5.8%

Post-Retirement Income from Personal Savings:

$677 Monthly

(27% of salary)

Post-Retirement Income from Social Security:

$1273 Monthly

(51% of salary)

Total Post Retirement Income:

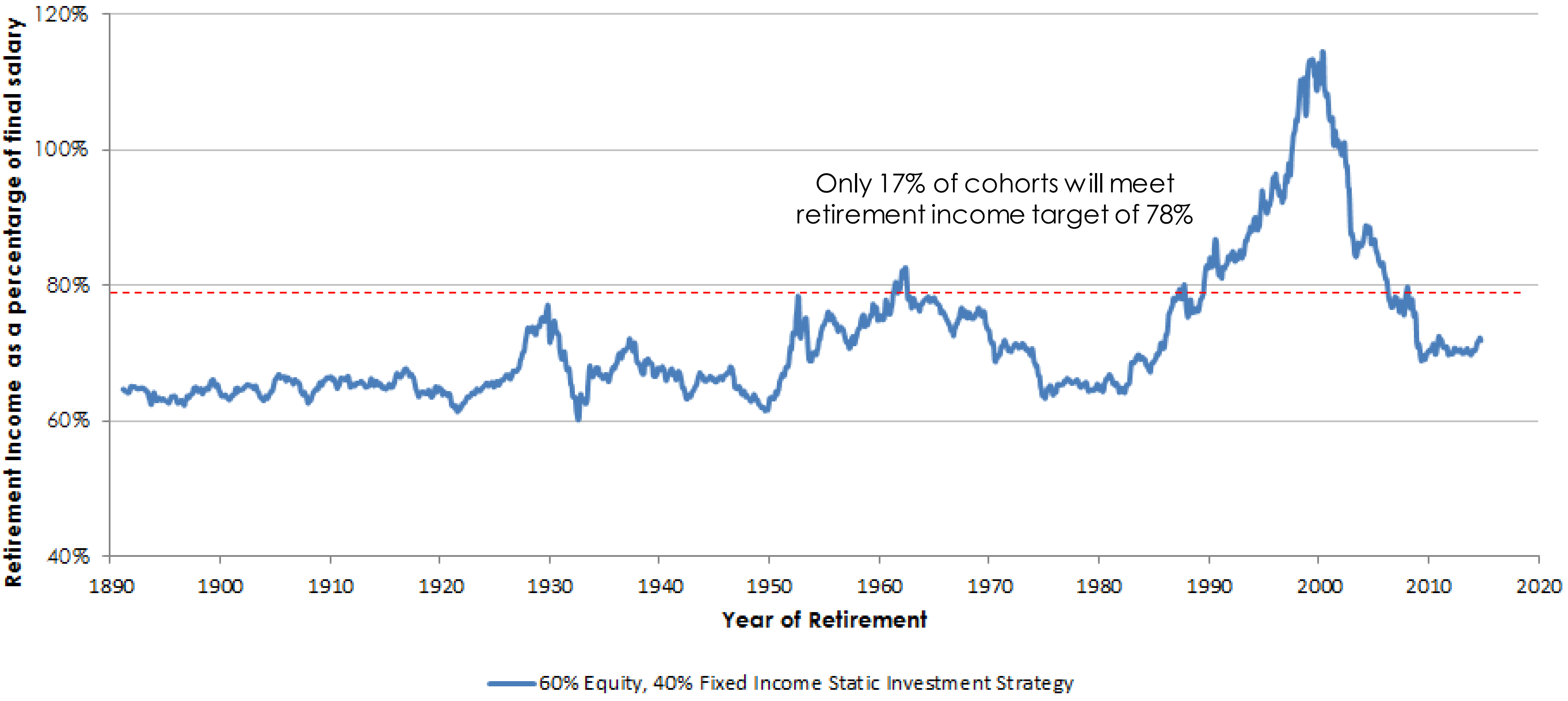
$1950 Monthly

(78% of salary, i.e., replacement ratio*)

** According to Aon consulting a total replacement ratio target of 77%-78% is required to maintain a person's pre-retirement standard of living*

** Life expectancy of a person reaching 65 is 84.5 for men and 86.6 year for women*

With Individual Accounts, Retirement Income Fluctuates Depending on When People Retire. That makes them less secure, not more



- The retirement benefit can fluctuate significantly depending on the year of retirement

Source: Rock Creek

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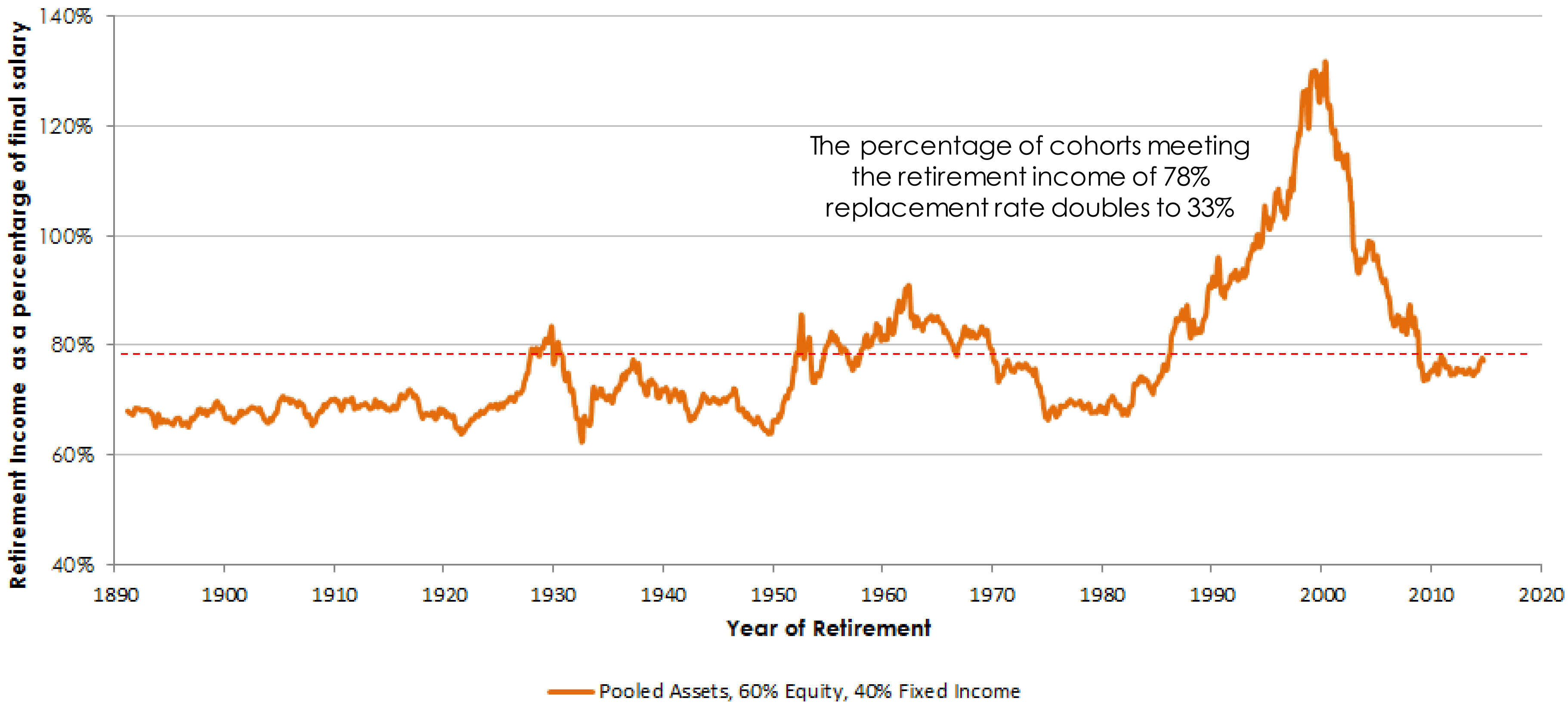
Pooled Investment Funds Get Better Returns at Lower Cost



- ➢ Pooling assets will enhance investment returns and increase the probability of individuals meeting their retirement targets

Source: Rock Creek

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