# The New Reality of Retirement Spending
## Podcast Transcript

**David Ireland:** Hello. My name is David Ireland. I am the Global Head of Defined Contribution at State Street Global Advisors and I am excited to be part of today's conversation with Olivia S. Mitchell, who is Professor of Business Economics and Public Policy and the Executive Director at the Pension Research Council at the University of Pennsylvania's Wharton School. I am also excited to be here, virtually at least, with Melissa Kahn, who is the head of Retirement Policy here at State Street, and Brendan Curran, Head of US Defined Contribution Investment Strategy.

Today we will be talking about retirement income. And Planning for this conversation has been in process for several months – and during that time the world changed. So, while we continue to be excited about addressing key retirement income issues, from Olivia's academic insights to what Melissa's hearing from public policy advancements, to what we're working through in terms of client implementations, we're going to delve into these issues through the lens of the new reality. What does retirement income mean in the wake of a pandemic?

So with that in mind, I want to introduce Olivia S. Mitchell. Olivia, you recently published a paper entitled, Putting the Pension Back in 401(k) Retirement Plans. Can you share what catalyzed the paper and what were some of your key findings?

**Olivia S. Mitchell:** Pleased to be here with you. Thanks Dave. So in the paper that I put together with some colleagues from Goethe University in Frankfurt, we set out to focus on 2 questions:

- First of all, should Americans convert some of the trillions of dollars they hold in employer-sponsored defined contribution plans into a predictable income stream through a deferred longevity income annuity?
- And secondly, if so, what percentage of their retirement account assets should they annuitize?

Our research study showed that, at retirement, workers should convert about 10% of their 401(k) money into a deferred or longevity annuity. This is an income payout which would begin paying a benefit at age 80, or even age 85, and it would last for the rest of the retiree's life. And doing so would help people avoid running out of money in old age, and it would also substantially enhance elderly consumption. Now, there have been some impediments that sponsors faced when offering annuities. Some of these include:

- Very Low participant awareness of how long they could live in retirement
- Also some distrust of insurance companies
- And sponsors' concern over potential fiduciary risk

But fortunately, the SECURE Act of 2019 has changed the rules of the game. It encourages plan sponsors to include annuities in the 401(k) withdrawal phase and also gives them a "safe harbor" with regard to fiduciary liability. What remains now is to educate participants about the very real chances of living a long time, and how to prepare for this.

So our paper, which appears in the Journal of Banking and Finance, is unique in that we have developed a richly detailed and comprehensive model, which includes the key roles of:

- Taxes during the work life and in retirement, including required minimum distribution rules.
- The role of housing and medical care costs
- A quite realistic representation of Social Security benefits.
- And a longevity income annuity.

We show that including these longevity annuities in the retirement package provides substantial improvement in wellbeing, at a surprisingly a low cost. The benefit of having longevity hedge instrument in the retirement portfolio is surprisingly high and I think insufficiently recognized among plan sponsors.

**David Ireland:** That's great, thanks Olivia.So the need just from a participant standpoint and the researched benefit of annuitizing a percentage of retirement assets seems to be clear. Brendan, you and your, and the DC investment strategy teams are having ongoing conversations with plan sponsors – you're ranging from those who are implementing retirement income strategies, to those who are interested in doing so and frankly those who are hesitant. What are you hearing from plan sponsors?

**Brendan Curran:** Yup, thanks, Dave.

While we haven't hit a tipping point yet, there are quite a few vocal proponents moving to adopt retirement income solutions into their defined contribution plans. In fact, on a recent Pension & Investments webinar, I spoke to three such plan sponsors: the University of California, Yale University and the Presbyterian Church. Each plan sponsor shared a unique perspective on the solution that they are adopting but they offered a common perspective on the path toward implementation:

- First, it was important to foster investment committee education and engagement in sort of embracing the unknown. This includes the thoughtful modeling around different income solutions and analysis of the entire plan ecosystem.
- Second, really important to determine the essential elements of the solution, as you're likely seeking to balance the desire for flexibility with the desire for security
- And last but certainly not least, and I think it ties back to a point Olivia raised, important to craft relevant and resonant participant communications, which can be shared strategically with employees over time and really across their retirement income journey.

**David Ireland:** So Melissa, building off of that plan sponsor foundation, we often say that policy drives change. What policy developments are in flight that might lend support to sponsors who are interested in retirement income, but finding themselves hesitant to move forward?

**Melissa Kahn:** Thanks, Dave. Yeah, the SECURE Act's passage at the end of December of 2019, which seems like a lifetime ago, helped in a number of ways: It did so at both the plan sponsor and the participant levels. And as Olivia was mentioning earlier, for the former, it addresses an issue that we've heard from plan sponsors repeatedly over the years, and that's being the concerns about the fiduciary risk in evaluating an insurer's financial capability over time. Now, SECURE has shifted that burden from the plan sponsor to the insurer. The insurer has to certify that they have met all financial capability tests under state insurance law.

And with regard to the plan participant, again picking up on Olivia and her paper as well as what Brendan was talking about, plan participants have never fully appreciated or understood the value of lifetime income products, the dreaded "A" annuity word. So SECURE does address this financial literacy gap by requiring all plan sponsors to provide not just the account value of the assets in the participant's account but also what that balance would translate into in terms of monthly income. It's not a silver bullet by any means, but we really do believe that this type of education will help participants not only understand the value of a guaranteed lifetime income stream but also that, in many cases, they need to increase their savings levels in order to achieve a standard of living in retirement to which they may aspire.

**Olivia S. Mitchell:** I agree completely, Melissa. From my research – and this is echoed by some of the adopting plan sponsors that Brendan referenced – the optimal solution really does balance security and flexibility by including deferred annuities. So here's what I think plan sponsors should look to:

- First of all they should be thinking about Incorporating the deferred income annuity into the default
- They should establish a minimum size of the annuity
- And they must support and regularly review annuity provider selection
- And finally and this is certainly last but not least, they must facilitate end-to-end education, from the investment committee to the participant base

**Brendan Curran:** That really syncs from a client perspective, particularly the care that sponsors need to take in assessing their participant populations, both in understanding the needs and in communicating the solution. As we work with clients and exploring retirement income solutions, one point that we continue to emphasize is the importance of collaboration. That is, we work with client sponsors to coordinate across consultants, record keepers, insurance and communication teams to really increase the likelihood of success, from both the plan sponsor perspective, but also from a participant perspective.

**David Ireland:** So Melissa—now that SECURE has passed do policymakers think that retirement income products will take off or are there more things to do from a policy standpoint?

**Melissa Kahn:** So, from a policy standpoint, the SECURE Act has definitely paved a way forward. It's really a giant step towards where we need to go, its really good news. But Congress and regulators are looking to do more. There are already provisions in other legislation that was introduced last year that would further promote the use of deferred annuities and really go to the points that Olivia and her colleagues make in their paper. The caps on qualified longevity annuity contracts or QLACs, as we like to refer to them in the industry, should be lifted and we should encourage more plan sponsors to consider defaulting participants into these types of deferred annuities with at least a portion of their account balances. And as Olivia's paper really points out that will go a long way towards helping participants. These are all things that Congress is looking to do and we and others are encouraging them to do these things. As an economist at a think tank in Washington said to me years ago, "Human beings are not economically rational beings—they will not do what necessarily is in their financial best interest." Therefore, we really have to help them to these things through defaults and other behavioral carrots and sticks. It is only then that individuals are going to be able to retire with dignity.

**Olivia S. Mitchell:** Yes, many people under-estimate how long they will live in retirement, which simply means they don't understand their potential longevity. Every time life expectancy goes up, people have an ever-greater chance to live to even older ages. In fact, the baby who will live to age 200 has already been born, according to the demographers. Becoming a centenarian, that is living to age 100 is simply not that rare any more, in the developed world. So, this underscores the main benefit of the annuity: it helps people avoid running out of money in old age. The Covid-19 crisis aside, we are still living longer and must prepare for that far better. In fact, in my view, preparedness may be the greatest lesson we need to learn from the pandemic, which should have resonance here.

**David Ireland:** Thanks, Olivia, I fully agree. And maybe just to close, I want to thank you all for your time today. And we at State Street believe that solving for retirement income – or said another way, spending in retirement – is the next innovation towards improving retirement readiness and outcomes. And as we've heard today, the SECURE Act is pushing policy forward, thought leaders like Olivia have executed and published strong supporting research and leading plan sponsors are creating a journey management roadmap for the industry to follow. At State Street, we're working to create solutions to support this next generation and we believe an enhanced target date fund with an embedded deferred annuity is the right step forward. I believe that times of crisis helps us reconnect with what's important and necessary – the safety and security of our families now and in the future – and we believe the time for action couldn't be better, frankly. In closing, I want to thank my fellow speakers for their time, and importantly I want to thank you for your time, for your partnership and for listening. This is David Ireland from State Street Global advisors. Thank you.

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