



# Expanding Retirement Security Through Public and Private Innovation

A Rapporteur's Report from the Second Annual  
Aspen Leadership Forum on Retirement Savings

*by Ellen Stark*

September 2018



## ACKNOWLEDGEMENTS

The Aspen Institute Financial Security Program would like to thank Ellen Stark for serving as Forum Rapporteur and writing this report; David John and Anne Lester for reviewing a draft and making invaluable suggestions; Bonnie-Jeanne MacDonald for the wisdom she shared regarding replacement rates; Gary Belsky and Neil Fine of Elland Road Partners for their careful editing and polished wordsmithing; and Steve Johnson for designing and laying out this report.

The Aspen Institute Retirement Savings Initiative (RSI) would like to thank Michael Davis, Robin Diamonte, Jason Fichtner, Mark Iwry, David John, Jamie Kalamarides, Elizabeth Kelly, Michael Kreps, Anne Lester, Brigitte Madrian, Lisa Massena, and Debra Whitman for serving on the Advisory Board of the Aspen Leadership Forum on Retirement Savings, as well as all the attendees of the second annual Forum for sharing their insights throughout the two-day meeting.

Finally, Aspen RSI thanks AARP and J.P. Morgan Asset Management for their generous support of the Forum as well as this report. While this document, of course, draws on insights shared at the Forum and by the aforementioned individuals and organizations, the findings, interpretations, and conclusions expressed in this report—as well as any errors—are ours alone.

## ABOUT THE FORUM

In April 2018, the Aspen Institute's Financial Security Program hosted the second annual Aspen Leadership Forum on Retirement Savings at the Salamander Resort in Middleburg, Virginia. The Forum is a unique, invitation-only gathering comprised of roughly 80 senior leaders from industry, government, academia, and advocacy. It is designed to advance breakthrough solutions to one of the most critical financial challenges facing American households—the lack of adequate savings for retirement—by providing an opportunity for thought leaders from a diverse range of organizations to share their knowledge and perspectives, build trust, develop collective insights, and work together to produce results. The Forum is sponsored by AARP and J.P. Morgan Asset Management.

## ABOUT THE AUTHOR

Ellen Stark writes about personal finance, business, and entrepreneurship for a variety of publications, including *Consumer Reports*, *Crain's New York Business*, *Bloomberg Businessweek*, and *AARP Bulletin*. Previously, she had an award-winning tenure as both a writer and editor at *Money* magazine and Money.com.

# EXECUTIVE SUMMARY

As savings plans continue to replace traditional pensions, too many American workers struggle to set aside adequate funds to supplement Social Security. A lot of them have no savings options on the job, including the millions who freelance or work in the expanding “gig economy.” Even many of those who do manage to save doubt that they will enjoy a comfortable retirement. Their worries are not misplaced: Roughly 40 percent of American workers report having less than \$10,000 saved for retirement. Among households led by someone between the ages of 55 and 64 — the cusp of retirement — the median retirement account balance is only slightly higher, \$14,500.

Against that backdrop, the Aspen Leadership Forum on Retirement Savings held its second annual meeting in April. More than 80 policymakers, financial services executives, entrepreneurs, industry association leaders, researchers, and consumer advocates convened for two days in Middleburg, Va., to discuss creating a more robust and comprehensive retirement savings system and ensuring the financial security of all Americans.

Three realizations informed the discussions:

## **1. Extending retirement savings plan coverage to all Americans would require a blend of innovation and action from industry and government.**

- Product innovations that encourage and simplify saving and investing, from both fintech players and traditional financial services companies, could make the retirement system more inclusive.
- New products alone may not be sufficient to replace stricter savings requirements. At the moment, there is no strong federal support for state (or federal) auto-IRA programs for workers without employer options. A significant number of Forum participants assumed that would have to change over time.
- Private innovation and public policy need not be antithetical. For example, the British retirement system requires employers to enroll workers in some type of pension, be it private or public, and the market has responded.

- Greater collection and sharing of data on worker savings habits could lead to the development of more effective retirement products.

## **2. Improved short-term savings options could shore up Americans’ long-term finances.**

- With more than 40 percent of Americans unable to cover an unexpected \$400 expense, retirement plans often become de facto emergency funds, eroding retirement preparedness. Yet without such flexibility, some savers might not contribute.
- Supplemental savings accounts that let workers set aside short-term funds through the same system of automatic payroll deductions (“sidecar” or “rainy day” accounts) could provide savers with better options for immediate financial needs.
- Pairing rainy day accounts with tighter rules or penalties for early withdrawals could reduce leakage from long-term retirement savings.

## **3. With Americans living longer and shouldering more responsibility for the drawdown of their assets — a.k.a. decumulation — retirees need help creating a stable lifetime income.**

- Even for strong savers, the task of making their money last for 20-plus years is daunting. Although federal regulations eased the way for employers to offer annuities within retirement plans, few do so for reasons that include lack of employee demand and fear of litigation.
- Given their role in retirement savings, employers should assume a bigger role in decumulation, through the development of easy-to-adopt products.
- To spur adoption of income options within workplace plans, employers need more policy guidance, particularly in the areas of continuity (if plans switch or drop insurers) and protection from litigation.

Forum speakers and participants also identified three emerging themes that warrant further attention.

### 1. Health care costs are heightening overall financial risk and fragility.

- With the rise of high-deductible insurance plans and overall cost-sharing, Americans face greater out-of-pocket health care costs and exposure to financial shock from a serious medical problem. This can lead them to drain all types of savings.
- Health problems are a leading cause of involuntary early retirement. Nearly half of workers retire sooner than planned, and health is the top reason why.
- Health costs can explode in retirement. Even with Medicare coverage, a 65-year-old couple retiring today will spend an estimated \$280,000 on health care in retirement, including insurance premiums, co-pays, and out-of-pocket drug costs. An estimated 52 percent of today's 65-year-olds will require long-term care, at an average total cost of \$138,000.

### 2. Higher debt burdens are a growing threat to retirement security.

- Workers are approaching and entering retirement with higher debt loads than ever. One driver of this trend is the close-to-retirement-age purchases of pricier homes with relatively smaller down payments.
- For those in workplace plans, debt payments represent a growing portion of income, potentially impeding retirement savings. Workers with debt problems report less confidence in their ability to save for retirement.

- Debt repayments are a major cause of 401(k) plan leakage. The most frequently specified reason for taking out 401(k) loans is “paying off debt” (35 percent).
- Nudging workers to save appears to have a mixed effect on debt. Auto-enrollment is not associated with higher credit-card debt, but researchers observed higher mortgage and automobile debt some time after auto-enrollment took effect.

### 3. Measuring how much is “enough” to save for retirement is a challenge.

- The prevailing way to estimate retirement needs and preparedness involves an income benchmark. The rule of thumb: retirees need 70 to 80 percent of their final pre-retirement income once they stop full-time work to maintain their standard of living.
- But a recent study found that the 70 percent replacement ratio had very little predictive value when it came to the continuity of actual living standards after retirement.
- As an alternative, one researcher has proposed a replacement rate based on pre-retirement spending, not income. This model is already being used by financial institutions in Canada, including one actuarial firm that is studying plan design and a Canadian provincial government.

As much as anything, the Forum began to transition from a discussion focusing on retirement savings to one encompassing the broader financial security system. Participants were united in the belief that it was in fact possible to close the coverage gap and extend retirement security to all Americans. And though consensus wasn't reached on how to achieve that, the leaders who will drive this change left the Forum newly committed to doing so.



## INTRODUCTION

# CONTINUING THE CONVERSATION

By many measures, Americans should be feeling good about their finances. The United States economy continues to expand, and the unemployment rate is remarkably low. The stock market, though volatile, is entering the tenth year of a bull market. And newly enacted tax cuts mean that an estimated 65 percent of American households will pay less in federal income taxes in 2018, albeit with higher income Americans benefitting the most.<sup>1</sup>

Yet these economic tailwinds have done little to ease anxieties. In fact, Americans' financial anxiety is spiking, according to the American Psychiatric Association's annual survey, with two-thirds of respondents reporting worries about their ability to pay their bills.<sup>2</sup> In a survey of U.S. workers late last year, only 35 percent reported being satisfied with their financial situations, compared with the nearly half who felt satisfied two years earlier.<sup>3</sup>

This unease is especially acute in one crucial area of financial planning. Three quarters of Americans are worried about their ability to achieve a secure retirement, and for good reason.<sup>4</sup> In surveys, roughly 40 percent of American workers report having less than \$10,000 saved for retirement.<sup>5</sup> About half of households led by workers approaching retirement age have no money at all in a 401(k) plan or individual retirement account (IRA).<sup>6</sup>

The challenges to preparing for retirement remain daunting: Nearly half of workers have no access to workplace retirement plans,<sup>7</sup> and the proliferation of "gig economy" jobs has the potential to leave even fewer Americans with traditional workplace benefits. While a small number of states have introduced retirement savings programs for residents without workplace options, last year Congress and President Trump overturned a Department of Labor (DOL) regulation that would have made setting up such auto-IRAs easier.

Even those with retirement plans may have difficulty finding the funds to set aside. Despite low unemployment, wage growth remains slow. Income swings from year-to-year and month-to-month are common, and that volatility often goes hand in hand with lower savings and difficulty planning.<sup>8</sup> While the 2010 health reform law cut

the number of uninsured Americans, the rise of high-deductible plans has shifted more of the risk of burdensome medical bills onto consumers.<sup>9</sup> Working parents face the daunting challenge of paying for daycare as they save for their children's college education. Heavy debt loads, which many Americans carry all the way into retirement, eat into household budgets.

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At the same time, innovators continue to introduce products and programs with the potential to improve the system: A handful of state programs will automatically enroll workers without coverage in retirement plans, a small number of employers are in the vanguard of adding lifetime income options to their retirement plans, tech startups are creating new savings options, and data collaborations could shed greater light on what does and doesn't work in the retirement arena.

Today's leaders in business, academia, government, and non-profits are already helping to shape the retirement system of the future, and their decisions will continue to have an impact on millions of Americans. With that in mind, the Aspen Institute Financial Security Program convened the second annual Leadership Forum on Retirement Savings.

More than 80 policymakers, financial services executives, entrepreneurs, industry association leaders, researchers, and consumer advocates met for two days in Middleburg, Va., to discuss how to create a more robust and compre-



hensive retirement savings system and ensure the financial security of all Americans (see Rules of Engagement, below). In addition, this year a number of workers and small business owners offered their perspectives on the impediments to saving for retirement as well as the day-to-day financial decisions that impact their ability to get ahead.

The 2018 Forum picked up on the discussions that began at last year's inaugural meeting, advancing earlier progress in identifying the key barriers to retirement security and potential solutions (see 2017 Forum Highlights, below).<sup>10</sup>

Many of the same themes emerged, including the challenges posed by increases in longevity and Americans' overall financial fragility. But the second chapter of this conversation went further in finding common ground and building momentum around the paths forward. Many participants voiced support for programs such as "rainy-day savings accounts" and displayed a new openness toward policies that would make saving universal. Such sincere interest mirrors the goal of the Aspen Institute Financial Security Program: to spur leaders to build a retirement system that serves all Americans.

## 2017 FORUM HIGHLIGHTS

### PARTICIPANTS AT LAST YEAR'S FORUM IDENTIFIED FIVE BARRIERS TO WIDESPREAD RETIREMENT SECURITY...

- A coverage gap that leaves millions of Americans with no easy way to save for retirement
- Financial instability caused by insufficient or fluctuating incomes and a lack of liquid savings
- Lengthening lifespans for workers increasingly responsible for managing a lump sum over the course of retirement
- The rise of the gig economy that often leaves freelance and contract workers with sole responsibility for their retirement savings
- Political inaction at the federal level regarding retirement savings initiatives

### ... AND EXPRESSED CAUTIOUS OPTIMISM ABOUT FIVE POTENTIAL SOLUTIONS:

- Rethinking the role of employers, including required plan enrollment modeled on new savings programs run by a small number of states
- Increasing the availability of lifetime income products, with policy reforms that facilitate offering annuities within company retirement plans
- Leveraging the strengths of the retirement system to combat other threats to financial security by pairing retirement accounts with short-term saving products and debt assistance
- Strengthening the current workplace system with reforms to encourage savings, such as greater incentives for employers to adopt automatic enrollment or regulatory changes to allow companies to band together to offer a single retirement plan to all their workers
- Simplifying the rollover process for workplace plans and making portability more automatic to combat savings "leakage"

## RULES OF ENGAGEMENT

*To encourage frank discussions, build trust, and foster co-operation among representatives of diverse constituencies—employers, plan sponsors, asset managers, record keepers, policymakers, academics, consumer groups, and more—the Leadership Forum on Retirement Savings was modeled on the longstanding Pensions & Savings Symposium at the Gleneagles Hotel in the United Kingdom. So that participants could speak freely, conversations were not for attribution. While those in attendance may use the information they gleaned at the Forum, they cannot reveal the identity or affiliation of the speaker.*

## CONTEXT

# TAKING THE NEXT STEPS

Dire statistics about the overall state of the U.S. retirement system obscure vast differences in preparedness within the population, differences that cannot be reduced to a simple dichotomy of prepared vs. unprepared. Instead, in looking for solutions to America's retirement crisis, it may be useful to consider three distinct categories of workers: 1) those who are essentially on track for retirement; 2) low-wage earners at risk for retirement insecurity; and 3) a middle group that is somewhat prepared but needs to do more to catch up.<sup>11</sup>

"On track" savers typically enjoy continuous employment and high lifetime earnings; as much as half of all Americans fall within this group. Members of the "at risk" group tend to have low incomes, erratic employment, and clear difficulties saving money. Members of the "partially prepared" group are more likely to cycle in and out of good jobs, leaving them with intermittent access to workplace savings options. Workers in this segment make efforts to set aside money for retirement but still have more to do to cover a savings shortfall.<sup>12</sup> Both the "at risk" and "partially prepared" groups are sizable. What's more, given the fluidity in Americans' financial lives, the three groups are far from fixed in size and membership.

It was also noted that the difference between landing in any one group of retirement savers comes down in part to luck. For example, job losses are largely driven by the

failures of firms, not employee behavior. Similarly, the good fortune of a high-paying first job sets up higher lifetime earnings, whereas graduating college in a recession depresses income for an entire career.

Significantly, members of all three groups can and do encounter hurdles. In a given year, six in 10 American households report experiencing a financial shock, such as a costly hospital stay, a steep drop in income, death of a spouse, or an unplanned major home or vehicle repair.<sup>13</sup> A surge in U.S. household debt in recent decades threatens to impede saving while raising living costs in retirement.<sup>14</sup> Typically, though, the best-prepared savers are financially resilient enough, in terms of resources and tools, to absorb those shocks. Many other Americans are more vulnerable. Only half describe themselves as financially secure.<sup>15</sup>

Regardless of preparedness, workers will face another financial challenge when they reach retirement: decumulation. Because most defined contribution (DC) retirement plans require workers to make a lump sum last through retirement, longer lifespans increase the risk of those workers running out of money.

All Americans could benefit from a stronger retirement system, from the day they start saving through their post-work years. That's no small task. But even in three areas that present the most formidable challenges, Forum participants identified possible ways forward.

## 1. PLAN ACCESSIBILITY: USING INNOVATION TO FILL THE GAPS

### Challenges and Roadblocks:

Retirement security for all Americans hinges on broad access to the kinds of low-cost, automated retirement savings vehicles that millions of full-time employees enjoy today. Yet nearly half of private sector workers do not have access to a retirement plan at work.<sup>16</sup> That problem is especially acute in small businesses, where barely one in seven employers offer plans.<sup>17</sup> Worsening matters, the so-called "gig economy" has created a new category of freelance workers who lack employer-sponsored retirement plans. A recent government report estimated that 10 percent of workers were primarily employed in some form of "alternative work arrangement,"<sup>18</sup> a category that includes everything from Uber drivers to freelance designers to temporary health

workers. Another study, however, estimates that a third of the workforce is already freelancing in some way— either full-time, part-time, or supplementally — with that portion expected to exceed 50 percent within a decade.<sup>19</sup>

In recent years, government leaders began to take a meaningful role in filling that gap, with the advent of state programs that require employers that don't offer their own plans to automatically enroll workers in a state-sponsored IRA. In addition, in 2015 the U.S. Department of Treasury rolled out the myRA, a federal starter retirement account for low- and middle-income workers with no access to workplace plans.

But even those modest efforts have faltered. In 2017, the Trump administration cancelled the nascent myRA program, citing low uptake and high administrative expenses. Congress also reversed a rule that made it easier for states to set up auto-IRAs.

The millions of workers left on their own are typically ill-equipped to fly solo. A new survey of personal finance knowledge finds that most Americans lack the know-how to make even routine financial decisions. Those who had the most trouble correctly answering a series of questions about investing, risk, debt, insurance, and other financial concepts tended to be the most financially fragile (measured by the ability to handle an unexpected bill), and the least likely to plan for retirement.<sup>20</sup>

**Path Forward:**

With policy solutions that cover shortfalls on the wane, product innovations by employers and private companies remain a promising avenue, not to mention a more feasible one given the political environment. When it comes to innovation, most of the attention is paid to fintech, as a growing number of apps and websites target audiences that may be overlooked by employers and large financial institutions (See Figure 1, below). Companies focused on innovating around their own products and services tend not to dedicate the same resources to experimenting with their employee benefits. But innovation is happening within established firms as well, and employers and financial services providers expressed a willingness to follow suit.

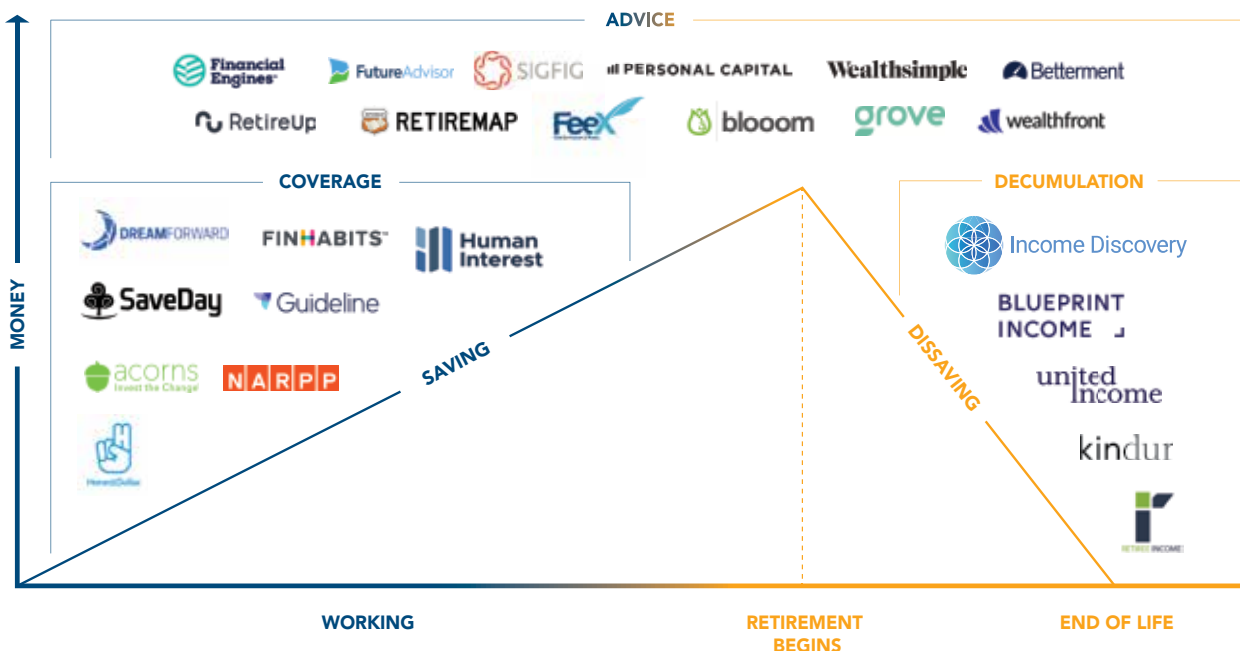
Forum participants suggested certain best practices for fostering the development of forward-thinking solutions. Chief among them is the need to listen to consumers, while recognizing that they self-regulate or otherwise answer inaccurately in surveys. People are often hesitant to share financial information in particular, for fear that they will be judged. So, instead of asking directly, it makes more sense to observe consumers in the context of their financial lives.

Leaders also need to make sure their own expertise doesn't get in the way of innovation, which can happen if they hold too tightly to what they believe in. In setting out to problem-solve, they need first to determine whether their "sacred cows" are real. Meanwhile, innovators should look for areas of commonality with the consumers they are trying to help. In the end, their own feelings about retirement may not be very different. Tapping into that empathy will help them as they try to solve other people's problems. Lastly, leaders will need to keep in mind that innovators are already working around the system. That is, some of the new ideas the retirement system needs may already exist.

Several Forum participants expressed skepticism that product innovation alone could take the place of more stringent coverage requirements, while others maintained that industry leaders need to be pragmatic, working within the existing regulatory system. Employer-focused retirement savings mandates are anathema to many, or at least unrealistic. Nonetheless, over the course of two days, the discussion of policy reforms vs. product innovation ended

**Figure 1**  
The Retirement Fintech Startup Landscape

*This list is meant to be illustrative, not comprehensive.*





with a growing sense that stricter requirements might be inevitable — that for more Americans to enjoy a secure retirement, some participants conceded, the U.S. may need policies that require the private sector to do more than it does now to nudge workers to save for it.

In fact, private innovation and public policy need not be antithetical, as evidenced by the British retirement system, which requires employers to automatically enroll workers in some type of pension, be it a private plan or the public National Employment Savings Trust (NEST).<sup>21</sup> Noteworthy is the fact that despite fears that the public NEST program would dominate the market, the focus on innovation in the private sector continues. At the Forum, supporters of state savings initiatives expressed hope that the private sector

in this country would come to see their innovations as an opportunity rather than a threat.

Emerging retirement marketplaces—like NEST as well as new state auto-IRA programs—also create the possibility of using data captured from millions of savers to better understand how consumers spend, save, and react to shocks. This, in turn, will aid the development of smarter financial tools of all kinds. In fact, a new collaboration between the Aspen Institute Financial Security Program and the NEST Insight Unit will emphasize data sharing and technology as it seeks to solve emerging retirement challenges. By linking the data collected by governments, philanthropies, nonprofits, and private business, the partnership hopes to accelerate the development of new products.<sup>22</sup>

## 2. FINANCIAL RESILIENCE: USING SHORT-TERM SAVINGS OPTIONS TO BOOST LONG-TERM STABILITY.

### Challenges and Roadblocks:

In the Forum’s opening session, participants heard from working Americans who were struggling with the kinds of financial challenges that keep many like them from saving enough for retirement and force them to drain whatever accounts they have managed to build. Those challenges include job losses, falling home values, income swings, health crises (see *The Health Care Hitch*, page 8), child care expenses, loan payments, and the costs of launching a small business. Despite savers’ best intentions, retirement preparation can take a backseat to more pressing demands (see *The Emerging Threat of Rising Debt*, page 10).

That’s why no discussion of retirement security can be separated from a broader look at overall finances, and why millions in this country live financially precarious lives. According to a recent Federal Reserve survey, more than 30 percent of Americans who had a DC account in 2017 didn’t have the cash on hand to cover an unexpected \$400 expense.<sup>23</sup> That comes to nearly 35 million working Americans who are saving for retirement, but not for the short-term.<sup>24</sup> As a result, retirement plans often become a de facto emergency fund, in the form of loans, hardship withdrawals, or cashouts during a job change. Indeed, those DC account holders who lack ready access to \$400 were 2.6 times more likely than those with liquid resources to report tapping a retirement account the previous year (See Figure 2, page 9).<sup>25</sup> Without adequate liquid savings, retirement security for all will remain an elusive goal.

Prohibiting any type of 401(k) loans or early withdrawals would in theory leave Americans with more money at retirement. An analysis of small workplace plans that are cashed out when employees switch jobs (balances under \$5,000) found that automatic rollovers that kept the accounts intact would produce \$1.5 trillion more in savings by retirement.<sup>26</sup> But many Forum participants noted that the ability to tap a retirement account — whether through

a loan or a hardship withdrawal for medical expenses or other emergencies, a home purchase, or college tuition — is a valuable feature. Without such flexibility, some savers might not contribute to tax-advantaged retirement accounts in the first place. Plus, if savers tap retirement funds to meet crucial immediate needs like housing and health care, not being able to access those accounts could leave them worse off financially, not only in the short run but over the long term as well.

### Path Forward:

A better solution would be the adoption of supplemental savings accounts that let workers set aside short-term funds separate from long-term retirement monies within the same system of automatic payroll deductions. In practice, the current 401(k) system is already dual purpose, with participants able to both save for the long term and tap accounts for more immediate needs. A separate so-called “sidecar account” would formalize this arrangement while also improving upon it.

These accounts could potentially be packaged with workplace retirement plans that are either offered individually by outside firms that partner with employers; managed by the state or federal government; or represent a hybrid of these approaches. Other major plan design questions include whether contributions would be made with pre-tax or post-tax dollars, as in Roth IRAs. (The new Oregon Saves auto-IRA uses the Roth model to create what might be considered a stealth sidecar account: contributions can be withdrawn at any time without penalty, and the plan leaves the first \$1,000 invested in a capital preservation fund.) An additional issue to settle is whether such an account would be housed within a retirement plan or a separate bank account, a choice that has regulatory implications.<sup>27</sup> Participants could access this “emergency” fund with a debit or prepaid card.

# THE HEALTH CARE HITCH

**IN THE FORUM'S OPENING SESSION, AS EVERYDAY AMERICANS SPOKE OF THEIR RETIREMENT CHALLENGES, AN ALTOGETHER DIFFERENT FINANCIAL WORRY TOOK CENTER STAGE: HEALTH CARE.**

A small business owner explained that after initially offering health insurance he reversed course when revenues slowed. A service worker discussed debts he continues to pay years after receiving a cancer diagnosis when he was uninsured. Throughout the Forum, in fact, the theme resurfaced frequently because the high cost of health care is a retirement story too. Specifically,

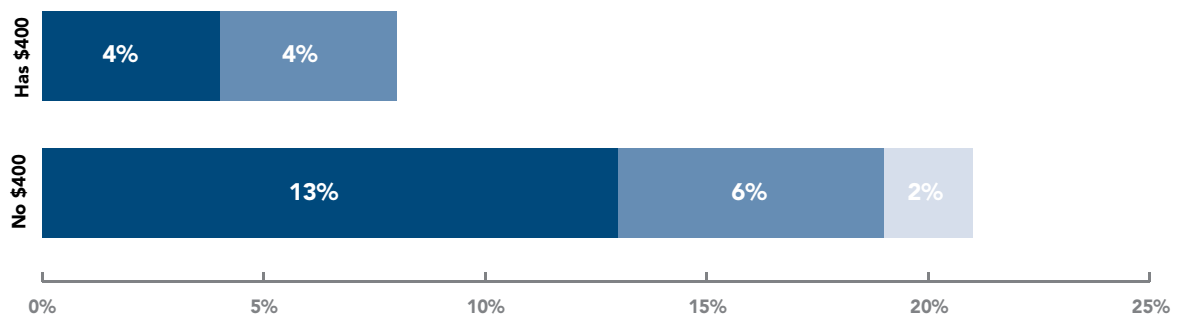
- **Consumers are shouldering more risk.** With insurance premiums increasing and employers looking to pass more costs to employees, patients face higher out-of-pocket costs.<sup>28, 29, 30</sup> Along with housing and education, health care is a pillar of middle class life that's becoming more expensive as incomes stagnate, potentially impeding retirement savings. What's more, an estimated 44 percent of Americans under age 65 are enrolled in a high-deductible insurance plan (at least \$1,350 for single coverage in 2018, \$2,700 for a family).<sup>31</sup> Since patients must pay for thousands of dollars in care before reimbursements kick in, these increasingly popular policies leave them vulnerable to financial shocks. (Surveys also find that having to bear more of the cost of care is leading patients to defer or skip medical treatments.<sup>32, 33</sup>)
- **Medical bills can undermine retirement savings.** A 2016 survey by the Kaiser Family Foundation found that one in five working-age Americans with health insurance reported problems paying a medical bill in the past year; nearly two thirds of that group drained most or all of their savings as a result.<sup>34</sup> A survey by the Transamerica Center for Retirement Studies found that nearly a quarter of retirement savers who took 401(k) loans cited medical bills as the reason, and 17 percent who have taken a hardship withdrawal did so to cover medical expenses.<sup>35</sup>
- **Health benefits are a major concern for employers.** Employers at the Forum noted that they devote much more time on employee health plans than retirement plans. What's more, private employers spend twice as much providing health benefits as they do on retirement plans for their employees.<sup>36</sup>
- **Health problems are a leading cause of involuntary early retirement.** While many Americans hope to postpone retirement to make up for savings shortfalls, nearly half leave the workforce earlier than planned, and medical issues are the leading cause.<sup>37, 38</sup>
- **Health costs can explode in retirement.** Even with near-universal Medicare coverage, retirees face high out-of-pocket costs – on premiums, deductibles, cost-sharing, and services not covered by the program.<sup>39</sup> An average 65-year-old couple retiring today will spend an estimated \$280,000 on health care in retirement, not counting long-term care.<sup>40</sup> Retirees may also see a spike in health care costs later in retirement, making planning for a sufficient income even more difficult. Increased longevity could exacerbate this financial challenge.

**LONG-TERM CARE IS A LOOMING THREAT.** Most Americans underestimate their risk of becoming disabled and fail to plan for potentially catastrophic costs. Yet researchers estimate that 52 percent of today's 65-year-olds will require long-term care. For many of them that will mean just a few months of care, but one in seven will see five-plus years of disability.<sup>41</sup> The private market for long-term care insurance is broken, as insurers exit the market and policyholders face double-digit premium hikes.<sup>42</sup> The 2010 Affordable Care Act allowed for a long-term-care program run by the federal government and funded by workplace or direct contributions, but it was dropped.<sup>43</sup> Self-funding by saving more is daunting and less efficient than insurance.<sup>44</sup> So, for millions of Americans, the only way to pay for an extended nursing home stay is to spend down their assets and rely on Medicaid.

**Figure 2**

## Defined Contribution Account Holders Without Easy Access to \$400 More Likely to Tap Retirement Funds

*Borrowed from or cashed out any retirement account in the past year*



**Source:** Aspen FSP calculations based on Board of Governors of the Federal Reserve System. "Report on the Economic Well-Being of U.S. Households in 2017," May 2018. <https://www.federalreserve.gov/publications/files/2017-report-economic-well-being-us-households-201805.pdf>

While Forum participants didn't delve deeply into these critical design details, there was broad backing for the concept (as well as consensus around the fact that a better name from a consumer standpoint would be "rainy day account"). These supplemental savings accounts were discussed at last year's Forum, but this year the proposal generated far more enthusiasm, with many agreeing that this is an idea whose time has come.

One benefit of creating a better system for amassing short-term savings might be less leakage from true retirement accounts, both because savers would have emergency funds to tap and because the establishment of rainy day accounts could be paired with tighter rules or penalties for early withdrawals. In fact, this pairing was the crucial factor for the many Forum participants who represent constituencies that would accept the earmarking of some plan savings as liquid only if tapping long-term retirement accounts was more difficult. Another benefit might be that workers

could invest the retirement portion of their accounts more aggressively as those funds are truly long term.

Other solutions to 401(k) leakage came up in the discussions, including automatic plan portability when workers switch jobs and a registry of orphaned plans. According to a report by the Government Accountability Office, nearly 90 percent of 401(k) plan leakage is the result of premature cashouts when workers switch jobs.<sup>45</sup>

Finally, some Forum participants expressed caution about diverting savings from retirement to short-term needs. Retirement savers will always have obligations that seem more pressing. By formalizing emergency savings within the retirement system, there is a risk of legitimizing short-term thinking at the expense of the long-term perspective needed to ensure a secure retirement. What's more, the question was raised about whether this addition amounts to asking too much of 401(k) plans, which were never designed to be all-purpose financial planning tools.

### 3. MAKING NEST EGGS LAST: HEDGING AGAINST LENGTHENING LIFESPANS

#### Challenges and Roadblocks:

The Forum continued to advance thinking on an issue that received considerable attention at the 2017 meeting: With Americans living longer and defined contribution plans shifting risk from pension managers to retirees, can the U.S. construct a system that ensures retirees don't run out of money? Specifically, can employers do more to help workers turn their savings into a steady annual income?

The obstacles are formidable: In 2015, life expectancy for a 65-year-old in the U.S. was 19.4 years (women, 20.6 years; men, 18). Medical advances may well continue to push up life expectancy in the coming years, although factors such as the opioid epidemic, obesity, and antibiotic-resistant bacteria could mitigate such gains.

Social Security and defined benefit retirement plans provide a guaranteed lifetime income. But today only about a quarter of America's workers are covered by a traditional

# THE EMERGING THREAT OF RISING DEBT

**DISCUSSIONS ABOUT RETIREMENT PREPAREDNESS TEND TO CENTER ON WORKPLACE PLANS, EMPLOYEE PARTICIPATION, CONTRIBUTION RATES, AND ASSETS ACCUMULATED BY AGE 65.** Yet the other side of the balance sheet can also have a crucial impact on retirement security, and a growing body of research is revealing the hidden dangers posed by rising debt loads among older households. This year's Forum delved into this interplay between retirement savings and consumer debt.

Several recent studies have chronicled the growing importance of debt in the finances of Americans 55 and older.<sup>46</sup> The Employee Benefit Research Institute (EBRI) found that 68 percent of households led by someone 55 or older carry some form of debt, up from 54 percent in 1992 (See Figure 3, page 11). Among households with heads older than 75, 50 percent still have outstanding loans.<sup>47</sup> Compared with earlier decades, loan balances and debit-to-asset ratios are higher for the 55-plus group. A primary culprit is mortgage debt, as families in this age group bought more expensive houses with smaller down payments than previous generations did.

Any debts carried into retirement will offset the assets retirees have accumulated, diminishing overall financial well-being. Not only will loan payments put pressure on retirement budgets, but the rates charged on loans can be higher than the payouts on the conservative fixed-income assets that increasingly play a central role in retiree investment portfolios over time. In addition, a sharp rise in interest rates may leave retirees with variable-rate loans susceptible to financial shocks, even if higher rates boost what savers earn on cash and bonds.

Debt payments can also hamper retirement saving. According to one study, active participants in defined contribution (DC) plans have been putting an increasing amount of income toward debt payments since the early 1990s. By 2010, those savers were spending 22¢ of every dollar earned on debt. Savers within 15 years of retirement saw the biggest jump in debt payments as a percent of income.<sup>48</sup> Compounding the issue, many DC plan participants are taking on debt faster than they are building up retirement savings. And the question of whether to deploy available cash to pay down debts or save for retirement can be a tough one. By prepaying high-rate debt, savers effectively earn a high rate of return. But waiting to save erodes the powerful effect of compound earnings over time, and can mean having fewer liquid assets to tap in an emergency.

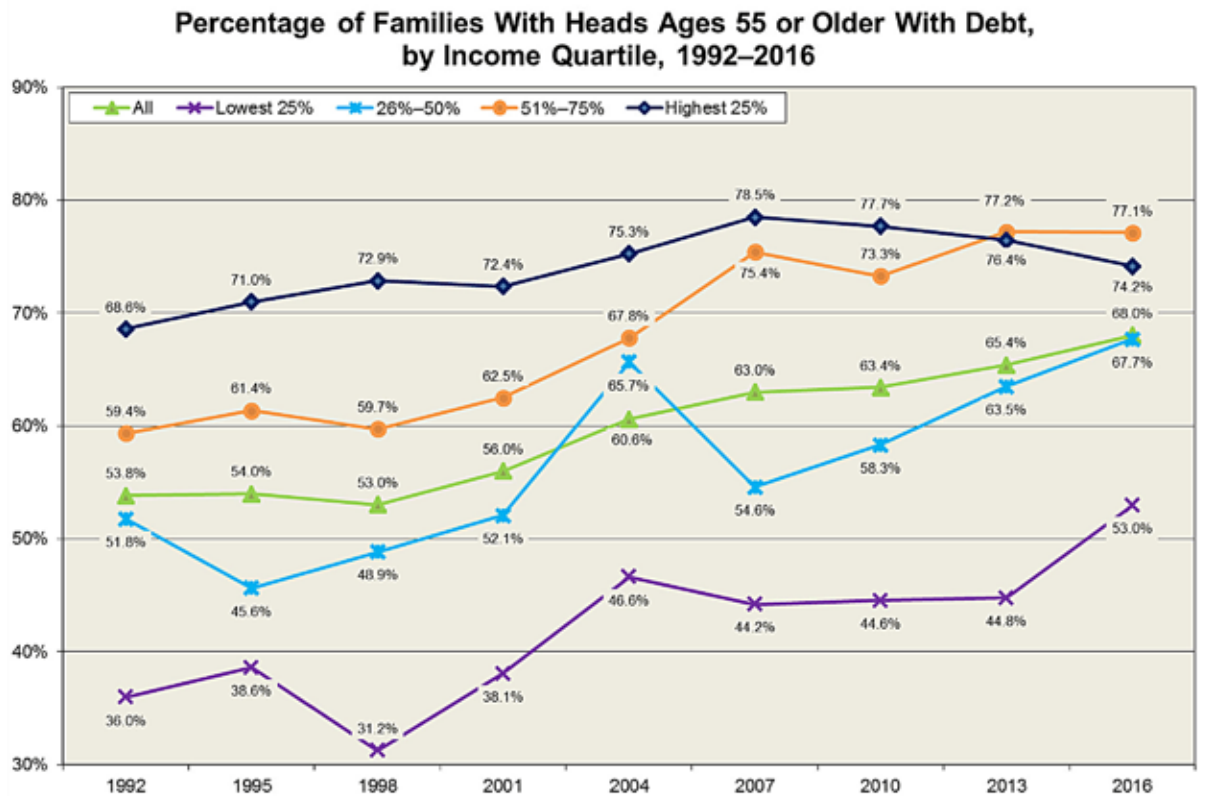
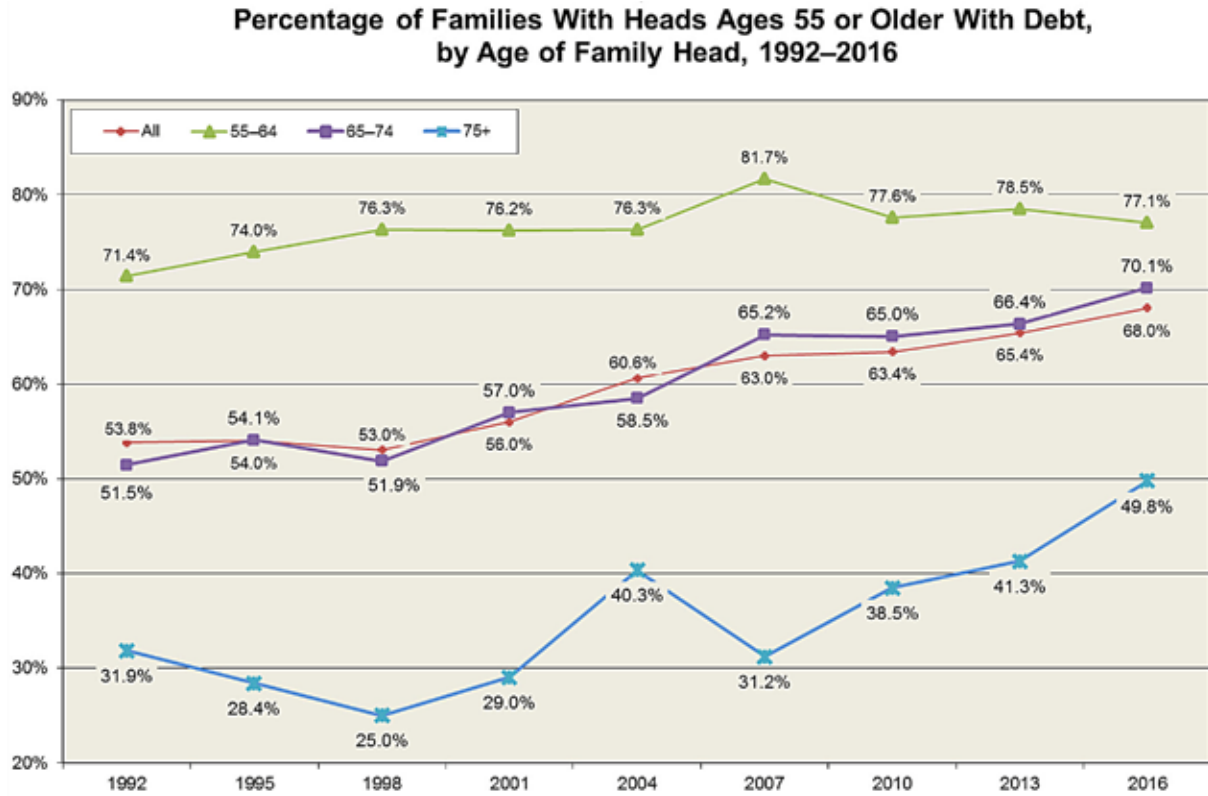
Similarly, EBRI reports that more than four in ten workers say that debt negatively affects their ability to save for retirement.<sup>49</sup> Workers with major debt problems also express less confidence in their ability to retire comfortably, and the most stressed among them report more difficulty with debt.<sup>50</sup> Even successful savers may find debt undermining retirement security: One recent survey found that debt repayment was the top reason given for 401(k) loans, cited by just over a third of borrowers.<sup>51</sup>

Finally, there is the issue of whether saving for retirement has any effect on debt. Given that households have limited funds, does nudging workers to save more reduce consumption, cut into non-retirement savings, or increase borrowing? Recent research offers clues.<sup>52</sup> One study found that auto-enrollment in retirement plans is not associated with higher credit-card debt, an indication that increased retirement savings is not leading to harmful borrowing practices.

But the researchers did find higher mortgage and automobile debt several years after auto-enrollment took effect. Savers could be borrowing more because setting aside money for retirement cut into outside savings available for a down payment. On the other hand, a growing retirement balance could help a borrower qualify for a larger loan, with that fatter nest egg emboldening bigger loans for bigger purchases. Going forward, bigger auto loans could have a negative effect on household wealth because cars depreciate. Then again, borrowing for a larger home could increase wealth over time because real estate generally appreciates, and a portion of the loan payments go toward building equity.

In general, the discussion of debt's role in retirement security is part of the larger conversation about retirement planning that takes into account the entirety of workers' financial lives. That challenge, though, is made more complicated by a fragmented market, where consumers often work with multiple financial services companies and debt can remain a hidden threat.

**Figure 3** Growing Number of Older Families Holding Debt



**Source:** Craig Copeland. "Debt of the Elderly and Near Elderly, 1992-2016," Employee Benefit Research Institute, issue no. 443, March 5, 2018. [https://www.ebri.org/pdf/briefspdf/EBRI\\_IB\\_443.pdf](https://www.ebri.org/pdf/briefspdf/EBRI_IB_443.pdf)



pension plan; among private-sector employees, fewer than one in seven are.<sup>53</sup> As a result, workplace savings plans are taking on a more central role: These plans are a major source of income for only a quarter of current retirees, but more than half of today's workers say they expect to rely on them.<sup>54</sup>

Even those workers who accumulate enough savings to adequately fund their hoped-for retirement lifestyle for as much as 20 or 30 years (see *A New Approach to Retirement Savings Targets*, page 13) will have to contend with decumulation. Figuring out a safe withdrawal rate and settling on a suitable asset allocation are daunting tasks. Simply asking retirees to self-insure against running out of money is unlikely to work.

As Americans build up a retirement nest egg, employers are often on hand to help, with automatic plan enrollment, payroll deductions, a menu of investment options that often include simple all-in-one target date funds, and in some cases financial education. But that assistance ends with the exit interview. Federal guidance from 2014 eased the way for employers to offer deferred annuities within retirement plans, and yet few do so.<sup>55</sup> The reasons for their reluctance include litigation fears, uneven demand from workers, administrative headaches of employee turnover, complicated product design, and a tendency to avoid getting too far ahead of their peers when it comes to employee benefits.

#### **Path Forward:**

Despite weak plan sponsor enthusiasm for in-plan retirement income options, Forum participants backed an employer role in this area, especially as employees see predictable pension payouts go away. Given how much of the nation's retirement savings is accumulated through the workplace, this might be the best place to make a difference. Employees are interested too: In a recent survey, eight in 10 workers with defined contribution plans expressed interest in an investment option that would guarantee income for life at retirement.<sup>56</sup>

One leg of this effort will be designing decumulation aids that employees will understand and embrace. Already, plan sponsors and companies that are in the vanguard of providing retirement income options are seeing what works and what doesn't. For one, employees tend to dislike giving up control and flexibility, as they must do if they purchase a traditional single-premium annuity. Workers are also typically disinterested in income options early in their careers. More promising options include target-date funds with an embedded annuity or an income drawdown feature.

Alternatively, help could be limited to data-driven guidance on how to spend down funds outside of an insurance product. Illustrations on plan statements of how retirement account balances translate into a monthly income could also be a helpful tool.

Forum participants contended, however, that greater employer participation is unlikely to happen without more policy guidance, especially in the area of portability, or what happens to a plan participant's annuity if the sponsor drops it or switches to another product. Despite existing Labor Department rules, fiduciaries remain uneasy about including lifetime income products and want more safe harbors from litigation risks. Without deeper input from the federal government, uncertainty over the portability of insurance contracts remains a stumbling block for plan sponsors and administrators.

A recently introduced Senate bill could help. Among other provisions, it offers fiduciaries just such a safe harbor, in connection with the selection of the provider of lifetime income; improves portability rules, allowing participants to avoid costly surrender charges and fees if plans change; and requires retirement account statements to include annual estimates of lifetime income. This bill is similar to one that passed the Senate Finance Committee unanimously in 2016, but the many political hurdles it must still overcome make enactment far from certain.<sup>57, 58</sup>

# A NEW APPROACH TO RETIREMENT SAVINGS TARGETS

**AS WORKPLACE AND INDIVIDUAL PLANS BECOME THE LINCHPIN OF RETIREMENT FOR MILLIONS OF AMERICANS, CALCULATING HOW MUCH SAVINGS WILL BE NEEDED TO SUPPLEMENT SOCIAL SECURITY BENEFITS AND A TRADITIONAL PENSION HAS BECOME VITALLY IMPORTANT.**

For decades, the prevailing way to estimate a retirement savings target and to measure retirement preparedness was based on an income benchmark, the rule being that retirees will need 70 to 80 percent of their final pre-retirement income to maintain their standard of living once they stop full-time work.

The assumption is that outlays drop in retirement because retirees are no longer saving money, covering certain work-related expenses, or paying as much in taxes. So retirement savers must aim to accumulate enough assets to cover whatever portion of that income target isn't met by Social Security and a pension (or in some cases part-time work).<sup>59</sup>

Experts have long recognized that a single replacement ratio will not apply to all retirees. A Morningstar study, for example, found wide variations in projected replacement rates depending on a variety of household income, expense, and tax scenarios, with targets ranging from 54 to 87 percent. As an example, replacement rate forecasts are typically higher for lower-wage workers because they are less able to lower their spending in retirement. Plus, spending levels are not constant throughout a multi-decade retirement. Instead, they typically fall over the years, then rise near the end of life as health care costs increase.<sup>60</sup> Despite the uncertainty and imprecision, the use of a rough 70 to 80 percent income replacement rate in retirement planning is widespread – and, absent other measurements, seen as a useful starting point.

But at the Forum, attendees heard a presentation on an alternative way to look at retirement preparedness. The presenter cited a recent study finding that a 70 percent replacement ratio has very little predictive value for the actual continuity of living standards after retirement.<sup>61</sup> According to the presentation, the major problem with such an approach is that a person's "living standard" is a complex concept that cannot be approximated by any proportion of a single year of earnings.

In place of the 70 percent heuristic, the presenter proposed a replacement rate based on pre-retirement spending. The "Living Standards Replacement Rate" (LSRR) calculation starts with how much a couple or single person spends on lifestyle now – essentially income minus taxes, savings, and money spent on other family members. It next compares current spending to how much the person anticipates having to spend in retirement. By focusing on current financial circumstances and anticipated retirement expenses, the LSRR framework provides – according to the presenter – a tangible and understandable focus for workers planning for retirement, enabling more constructive financial planning conversations and more informed decisions.

The LSRR framework is already being used by financial institutions in Canada, including an actuarial firm studying plan design and a Canadian provincial government,<sup>62</sup> and is reframing how financial professionals are approaching retirement income adequacy.<sup>63</sup>



## CONCLUSION

# A BROADER VIEW

Forum participants raised a myriad of concerns about Americans' retirement capabilities, shared insights into what does and doesn't work in the real world, and debated the proper roles for both government and private industry. Most important, they displayed openness to divergent points of view and made genuine efforts to find common ground.

A significant portion of this year's Forum involved discussions of topics that surfaced in the first. Such will doubtless be the case going forward until basic retirement system weaknesses are addressed. But a broadening of the discussion about retirement to include the lack of emergency savings, perils of household debt, and burden of health care costs resonated with participants. In fact, in some respects the emphasis of the Forum moved from the future of the

retirement savings system to a broader financial security system. Insights into the financial fragility of many Americans will continue to shape the context of any discussion about retirement security, with the voices of those who are struggling with real challenges playing an important role.

Forum participants shared the hope that the efforts of leaders like them could close the coverage gap and extend retirement security to all Americans, even if consensus wasn't reached on how to achieve that worthwhile goal. But the leaders who will drive change left the Forum with a renewed commitment to exploring retirement-saving solutions and finding ways to improve Americans' overall financial wellbeing.

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## ABOUT ASPEN FSP

The Aspen Institute Financial Security Program's (FSP) mission is to illuminate and solve the most critical financial challenges facing American households and to make financial security for all a top national priority. We aim for nothing less than a more inclusive economy with reduced wealth inequality and shared prosperity. We believe that transformational change requires innovation, trust, leadership, and entrepreneurial thinking. FSP galvanizes a diverse set of leaders across the public, private, and nonprofit sectors to solve the most critical financial challenges. We do this through deep, deliberate private and public dialogues and by elevating evidence-based research and solutions that will strengthen the financial health and security of financially vulnerable Americans. **To learn more, visit [AspenFSP.org](https://www.aspenfsp.org) or follow [@AspenFSP](https://twitter.com/AspenFSP) on Twitter.**

## ABOUT ASPEN RSI

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