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# The Retirement Revolution: Regulatory Reform to Enable Behavioral Change

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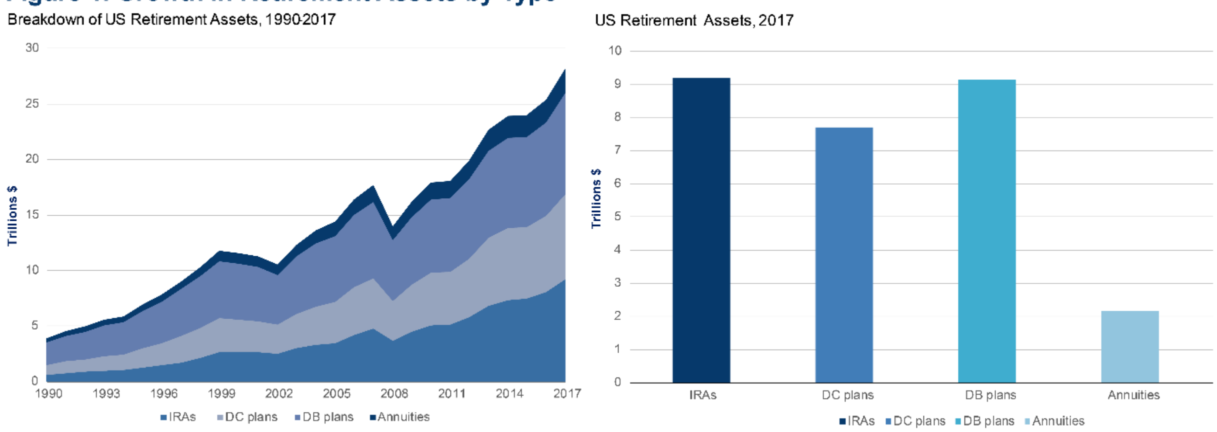
## STATEMENT OF INDEPENDENCE

The author did not receive financial support from any firm or person for this article or from any firm or person with a financial or political interest in this article. He is currently not an officer, director, or board member of any organization with an interest in this article.

The American retirement landscape is constantly in flux. American retirement went from an experience dominated by short retirements and pensions for some to one financed increasingly by 401(k)s with decades-long retirements for many.[1] The slow demise of pensions for workers has changed the risk profile to both saving before retirement and managing assets and spending afterwards. Pensions are beneficial to workers in that they typically provide a guaranteed stream of income that protects them from risky investments and absolves them of the risk of outliving their assets. But pensions aren't all beneficial, either. Workers who leave a pension before they are vested can surrender substantial value, while workers also bear risk that their pension will be underfunded or discontinued. Also, the flipside to not bearing investment risk is not benefiting from the upside to stock ownership.

As shown in Figure 1, defined benefit plan assets are still large and provide an important source of retirement income to many retirees or those nearing retirement (legacy employees). However, as the figure shows, defined contribution plans (DC plans) and IRAs now account for a larger proportion of total retirement assets. Annuities amount to $2 trillion in assets and have grown in size, but they are small relative to the other categories. Looking at the flow in and out of retirement plans is especially illustrative. As shown in figure 2, net contributions to defined contribution accounts only recently turned negative, and is close to zero. By contrast, net contributions to defined benefit accounts has been negative since 1985 and the outflow now exceeds total inflow. Moving forward, defined benefit plans will become a smaller and smaller share of total retirement assets and will be largely confined to public-sector employees, unless they nearly disappear entirely.

**Figure 1. Growth in Retirement Assets by Type**




*Source: Investment Company Institute. 2018. "The US Retirement Market, Fourth Quarter 2017" (April).*

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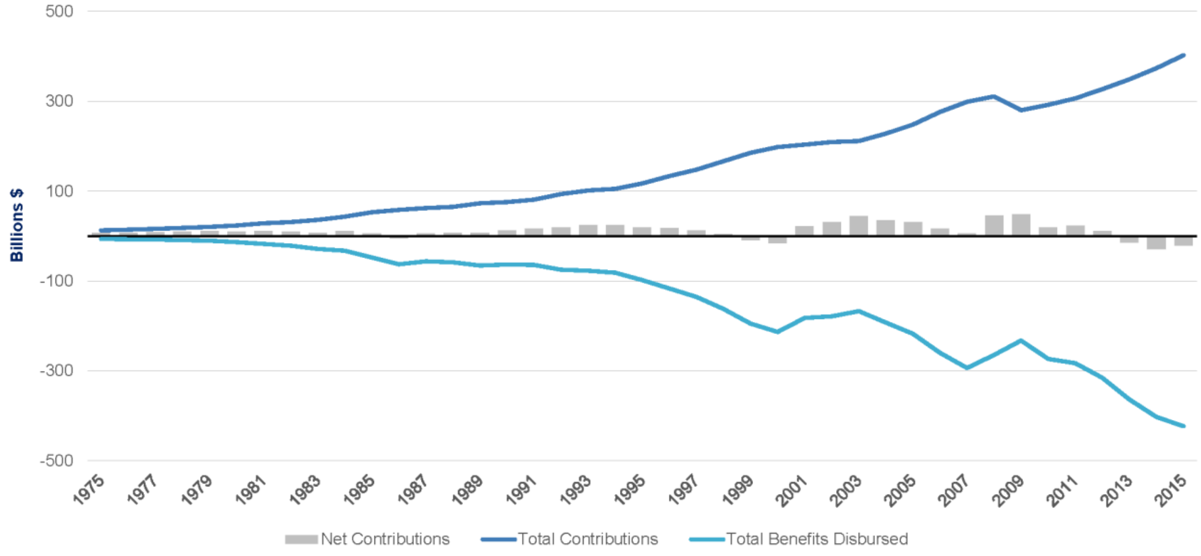
1. The extent of the decline in defined benefit pensions is a contentious topic. Snapshots of the share of workers in any given year who participate in a pension understate the magnitude of individuals who will eventually benefit—in particular workers who had previously participated in a pension and spouses of workers who have accrued, or are accruing, benefits. Regardless, what's clear is that while pension coverage was never universal in the United States, private-sector support for defined benefit plans has fallen sharply over the past three decades.

**Figure 2a. Net Contributions to Defined Contribution Accounts**

Flows In and Out of Private-Sector Defined Benefit Accounts, 1975-2015




*Source: Investment Company Institute. 2018. "The US Retirement Market, Fourth Quarter 2017" (April)*

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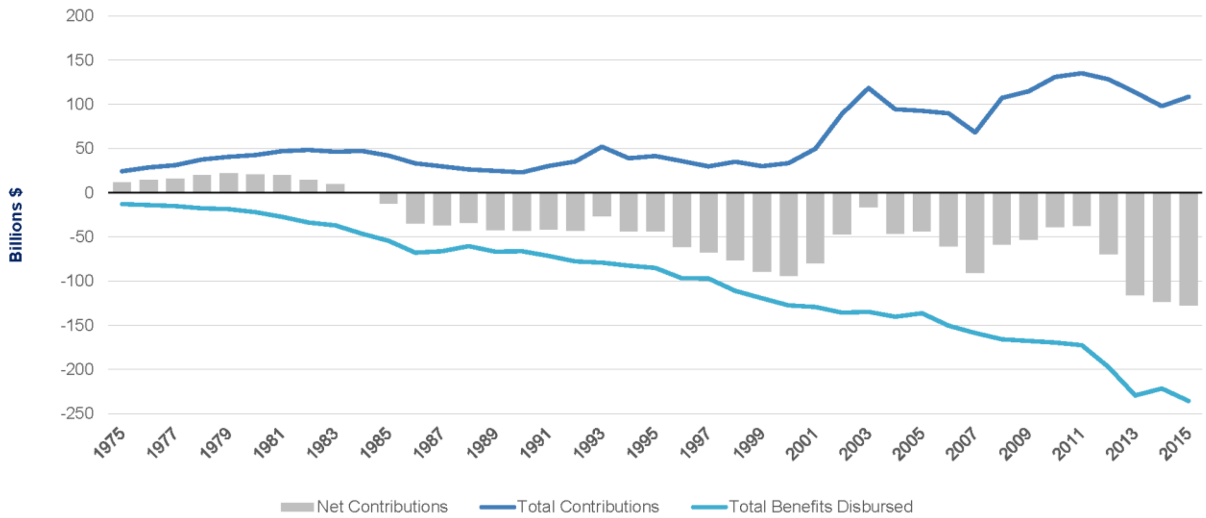
**Figure 2b. Net Contributions to Defined Benefit Accounts**

Flows In and Out of Private-Sector Defined Benefit Accounts, 1975-2015




*Source: Investment Company Institute. 2018. "The US Retirement Market, Fourth Quarter 2017" (April)*

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While this evolution has advantaged some workers, it has also resulted in serious challenges that have been exacerbated by both inadequate and poorly designed saving incentives, as well as a private insurance market that is insufficient to meet the needs of millions of retirees wanting to achieve a secure retirement. Fixing this system is a complicated endeavor, requiring widespread changes across the landscape. We need better-targeted tax incentives, easier saving mechanisms, cultural and legal advances that enable longer working lives, laws that better enable long-term care insurance and deferred annuities, a reformed reverse mortgage market, and help for households in managing their retirement assets and achieving greater security. As we outline in this brief, much progress can be made on these goals with regulatory advancements directed as either retirement saving or the products designed to help improve security in retirement.

Unfortunately, many households of retirement age, even those with no pension income, have very low levels of financial assets and are therefore reliant on Social Security and are compelled to work beyond the age at which they hoped to retire. The problems of this group are serious and will be one of the focal points of our future retirement research. However, the middle-class households that have been able to save in retirement accounts also face serious challenges. Americans, in aggregate, have accumulated nearly $15 trillion in 401(k)s, IRAs and related retirement vehicles, but these savings have not translated into retirement security. The *de facto* retirement paradigm has become to save as much as possible and hope you don't live too long.

Managing retirement assets is an important concern of the middle class and is an issue that will impact more and more households as defined benefit pensions become less common or disappear.

The authors of this brief are launching a policy-research project with the goal of helping Americans improve their retirement security. To ensure an adequate retirement, middle-class households need to save enough and work enough years to ensure they avoid running out of money, while also understanding the risks faced in retirement and the strategies that can best manage that uncertainty. At the same time, policymakers and regulators must ensure savers have access to the saving and insurance products they need to create a secure retirement without paying excessive fees. *Unfortunately, neither household behavior nor financial policy and regulation have caught up with the retirement revolution that has taken place.*

This brief provides an introduction to the issues with the aim of providing background information that will inform future work. It lays out some of the challenges involved for households as they save for retirement and draw down their assets after they've left the workforce. It points to gaps in the retirement saving system, shortcomings in insurance markets, and areas where financial regulation can improve the retirement landscape.

# The Build-Up: Accumulating and Managing Retirement Assets

Many households now have the responsibility of choosing how much to save and how to invest their savings in the accumulation stage of their lives. These two objectives are often far more complicated and challenging than presented in the popular press—with substantial barriers to achieving a low-fee, simple, tax-preferred path to an adequate retirement nest egg. Several targeted regulatory reforms can improve this experience for millions of middle-class households.

*Choosing how much to save*. There has been a lively discussion in the *Washington Post* lately based on the financial advice column written by Michelle Singletary, who was asked by a reader whether it is enough to have saved $1 million at retirement.[2] From the outset, we note that the concept of having saved "enough" depends on each person's circumstances—the goal of retirement saving is to allow a person to live as comfortably and happily in retirement as they did during their working years. For any given amount, like $1 million, such a sum may represent far over-saving for one family but severe under-saving for another.

That major caveat aside, a $1 million nest egg would yield a healthy stream of income throughout a typical retirement. One rule-of-thumb states that drawing 4 percent a year from a retirement fund will be sufficient to preserve income for life. Under this rule, a million-dollar fund will yield $40,000 a year to supplement Social Security benefits—which in many cases are substantial. For example, in 2014 half of Social Security beneficiaries received $17,760 or more in benefits; one-quarter received at least $25,000.[3] That amount, added to a 4 percent draw from a million-dollar fund, would total $57,760 to $65,000 a year, seemingly enough to generate a comfortable retirement. If the household also owns their own home and is eligible for Medicare, the income stream generated by the combination of the $1 million in retirement savings and Social Security benefits could likely maintain a comfortable middle-class livelihood in retirement.

Even so, there could be financial problems facing this example household. Medicare does not pay the full cost of health care, which means having a cash reserve to pay for unexpected health expenses, or purchasing a supplemental insurance policy. Many retirees still make mortgage payments and, beyond that, are responsible for the costs of property taxes and maintenance. Elderly adults frequently require long-term care spanning multiple years, and extended stays in a nursing home—which can cost as much as $100,000

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2. Singletary, Michelle. 2018. "Is $1 Million Enough to Retire? Why This Benchmark Is Both Real and Unrealistic". *Washington Post*. https://www.washingtonpost.com/news/get-there/wp/2018/04/26/is-1-million-enough-to-retire-why-this-benchmark-is-both-real-and-unrealistic/?utm_term=.2e800efd892a.

annually in some states—can quickly consume a large fraction of even a million-dollar retirement nest egg.[4] In many cases, a spouse or child ends up serving as a caretaker due to the high cost of formal care.

As Singletary points out, most households have much less than $1 million when they retire, and it is easy to see why that is the case. What would it take to accumulate a $1 million retirement fund? A family with $100,000 in wages that annually deposits 14 percent of its earnings in a retirement fund, returning 5 percent after inflation, will have $1 million in their fund after 30 years. Saving 14 percent of income consistently for 30 years is a lot of saving; very few people are saving at these rates.5 The personal saving rate reported by the Bureau of Economic Analysis has fallen from around 12 percent of income in the 1970s down to around 3 percent currently.6

Annually saving 7 percent of wages consistently for 30 years would still put the household above average for retirement saving, but would generate only $500,000—five times annual pay. Drawing 4 percent would realize $20,000 a year —adding in typical Social Security benefits would yield roughly $40,000 to $45,000 annually—less than half the family's earnings during its working years. Even with the tax advantages afforded Social Security benefits, this amount would require careful budgeting and may not allow many luxuries.

This example assumes a 5 percent rate of return after inflation, but this may be unrealistic in the future. Historically, investing in the stock market has earned returns at that level over the long run, but some experts in finance predict that such a return is unsustainable.7 And investing in the stock market is risky, as we discuss below. Further, if this example family experiences a divorce, or a health problem, or has not saved enough to support their children in college, they may not reach retirement with their retirement fund intact.

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3. For example, the median cost for a semi-private room in Washington, DC is just over $110,000 a year. On average those who go into nursing home care die within a fairly short time-period, but not everyone. Those who suffer from dementia at a young age can remain in long-term care for years. A study in the UK by Bupa, the private insurance company, reported an average stay of 2.5 years, but the longest stay was 20 years. The Administration for Community Living indicates that the average length of nursing home stay was 3 years and that 70 percent of patients over age 65 require some long-term care services.

4. Forder, Julien, and Jose-Luis Fernandez. 2011. *Length of stay in care homes*. Report commissioned by Bupa Care Services. PSSRU Discussion Paper 2769. Canterbury: PSSRU.

5. Administration for Community Living. 2017. "How Much Care Will You Need? - Long-Term Care Information". *Longtermcare.Acl.Gov*. https://longtermcare.acl.gov/the-basics/how-much-care-will-you-need.html.

6. Many households' outlook is even worse. Most workers have lower incomes when they are younger, so a constant percentage saving rate will concentrate lower dollar amounts of saving in the earlier years when compound interest is most powerful. To adjust for inflation, the actual dollar amount of saving would have to rise by around 2 percent a year.

7. See https://fred.stlouisfed.org/series/PSAVERT The saving rate is defined as personal saving as a percent of disposable personal income. The definition of savings is complex but there is no question that many households reach retirement without adequate levels of financial assets to sustain their standard of living.

In short, saving for a comfortable retirement is very expensive and hard to achieve, even assuming Social Security continues to provide the level of support that has been promised to workers. Middle-class American households will need to take a very different view of how long they work and how much they spend and save if they are to manage their retirements in a way that comes close to an old-fashioned pension.8

Managing retirement assets. There are a lot of investment options for retirement savers, including managed equity or bond funds, exchange-traded funds, global funds, real estate funds, and many more. Retirement savers in employer-sponsored funds are often automatically enrolled in retirement accounts and their contributions are automatically directed into a default option—usually a lifecycle fund that invests primarily in equities when the person is young and then gradually shifts into bonds as the person ages. The traditional rule-of-thumb used to be that the proportion of a retirement fund in bonds should equal the age of the individual. After a number of years of low interest rates, that norm has shifted and lifecycle funds nowadays have a higher share of equities.

Lifecycle funds adeptly shift risk away from retirement savers as they age, but it is important that savers understand the tradeoff. While the bulk of investments in lifecycle funds are in low-cost, passively managed funds, a sizable share of assets are invested in actively managed funds, where high fees erode the value of a saver's assets over time. In addition, the economic "cost" of lifecycle funds is foregone exposure to risk. It is a mistake to take on too much risk, but taking on too little risk can result in lower returns over the long run. The tradeoff is hard for most savers to figure out.

Suppose the household in our earlier example decides they do not want to incur the risk of investing in the stock market and held bonds instead. A bond fund that earned a real rate of return of 1.5 percent a year would be doing well. In order to have a retirement fund of $1 million after 30 years of saving, the household would have to save a breathtaking $25,500 a year. That figure is well beyond the reach of all but very affluent households. Even accumulating a $500,000 retirement fund would take $12,750 in annual saving over 30 years, still a very high saving rate.

Many financial advisors today suggest that young people invest primarily in the stock market for their retirement funds, in part because interest rates have been so low for so long. Indeed, as shown in Figure 3, funds invested purely in domestic equities continue to dominate the landscape for defined contribution assets. Figure 3 shows the breakdown of defined contribution plan holdings and it shows that domestic equities are the largest category followed by hybrid funds that hold both equities and bonds.

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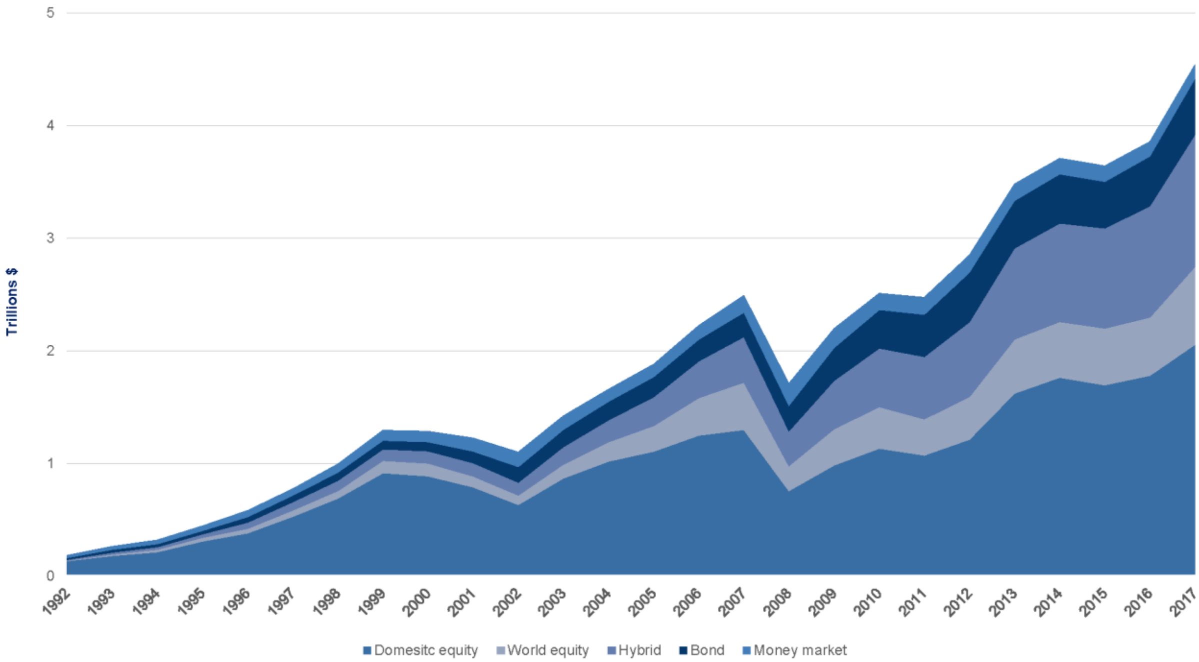
8. Lower-income households often rely primarily or exclusively on Social Security benefits for retirement, a decision that is not necessarily inconsistent with economic theory. However, many in this group would be well-advised to postpone the age when they collect Social Security if they are healthy enough to work longer.

**Figure 3. Defined Contribution Plans are Largely Invested in Equities**
Breakdown of Defined Contribution Plan Holdings of Mutual Funds by Type of Fund, 1992-2017




*Note: Hybrid funds hold both equities and bonds*
*Source: Investment Company Institute. 2018. "The US Retirement Market, Fourth Quarter 2017" (April).*

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Savers have to be aware of the risks involved in holding equities. The S&P 500 index has fallen 10 percent or more eight times since 1990, including a fall of 49 percent after a peak in 2000 and 57 percent during the financial crisis. Retirement savers who decide to invest in equities to gain higher expected returns may find the market crashes at the wrong time. The S&P 500 index was 2,200 at its local peak in 2000 and did not exceed this value again until 2015. Over the long run, it's true that equities have provided much higher returns than bonds, but savers have to make sure they have the stomach for the risks involved. Put differently, much of the risk in equity investing relates to the timing of the desired cash-out: those needing funds in a downturn may have to accept a steep discount for the privilege.

Navigating financial market decisions is hard even for those with experience and can be bewildering for those who do not follow markets. Getting sound financial advice is valuable and for most households is worth paying for. An advisor can help with drafting a will, setting up a 529 plan for children or grandchildren, avoiding the pitfalls of taking on too much risk or too little risk, reducing the tax burden, and making an assessment of when a household can live comfortably on the amount they have accumulated. The tricky part is obtaining that advice at a reasonable price and in a way that does not undermine the investment returns needed to reach retirement goals. Fees that reduce the rate of return received by the saver can make a big difference to the amount available at retirement. These fees include both advisory fees—which are fees paid to financial advisors for insight on a host of topics, including the selection of funds—and fund management fees—which are expenses charged by a given fund. These combined fees can add up and deteriorate the value of retirement assets, especially if a saver pays an advisor to select high-cost funds. For example, if the person who invested in equities in the example above were to pay one percentage point in combined management and advisory fees, lowering their rate of return to 4 percent instead of 5 percent, the amount available at the end of 30 years would be $838,400 instead of $1 million, a loss of around $162,000. If the combined fees paid were two percentage points, the amount accumulated after 30 years would be $706,600, a loss of nearly $300,000. Total fees of two percentage points for managing retirement assets were commonplace in the past and, although on the extreme end of the scale, still exist today.9

One issue is that savers often do not know the fees they are paying and part of this opacity may relate to the way they are expressed. Despite playing very different roles, advisory fees and fund management fees are often charged in the same form—a set percentage of assets under management, such as 1 or 2 percent. Such an expression may make more sense for advisory fees, which often pay for advice related to account maintenance (although advisory fees can also cover advice related to asset management). Alternatively, if the fees are charged to pay for active fund management, expressing the fees as a share of the inflation-adjusted return may make more sense—but would make the costs seem much larger. For example, if investors expect their investments to return 3 percent annually in real terms, a 1.50 percent fund management fee—which comprises half the real return—would seem massive.

Looking at this same issue from the perspective of a financial advisor, it is often not cost-effective to spend a lot of time with a client that has only a modest amount of assets. A family in their forties with $100,000 in retirement savings is well-positioned compared to most families, but a financial advisor with an annual fee of 1 percent of assets under management would receive just $1,000 a year in revenue—a sum that may prove unprofitable for some.

One alternative to both target-date funds and financial advisors is financial technology or robo-advice. In fact, many of the investment houses that offer personal advice are actually using such technology to generate the advice that is given to the client, even if that advice is delivered in-person. Robo-advice has its pitfalls, however, namely that it is not geared to the specific circumstances of each family, which can create a wide gulf between the optimal advice and the advice delivered.

There are no easy answers. Families not only have to save a lot for many years, they also have to manage their holdings wisely in order to build up enough assets to ensure a comfortable retirement, especially to allow for end-of-life care. There are many advantages to having a financial advisor who can help families make the right saving and investment decisions, including navigating tax rules. Unfortunately, finding good advice at an affordable price can prove difficult.

Regulatory reform to improve retirement saving. Changes in regulations can improve the outlook and give savers the best chance of reaching their retirement goals. According . . .

9. Information on the average cost of advisory fees is difficult to find. This makes it harder for savers to tell if they are getting a good deal, which can lead to high prices.

10. Harris, Benjamin. 2018. "How Do Your Financial Adviser's Fees Compare? Good Luck Figuring It Out". *WSJ*. https://blogs.wsj.com/experts/2018/02/07/how-do-your-financial-advisers-fees-compare-good-luck-figuring-it-out/.

to Joshua Gotbaum, a pension expert and former director of the Pension Benefit Guaranty Corporation, there have been several failures to improve the regulations governing retirement. These failures include efforts to require disclosure of the lifetime income that could be reasonably generated by each defined contribution account; disclosure of the value of lump-sum distributions versus annuities; and elimination of bias against annuities in 401(k) plans. One recent success was a Department of Labor reform that required the disclosure of fees in defined contribution plans, spurring plan sponsors to demand more transparent fee disclosure.

Perhaps the most high profile of regulatory attempts to improve the retirement saving landscape is the "Fiduciary Rule." This rule refers to an effort by the Obama administration's Department of Labor to change the guidelines governing how advisers can provide financial expertise to savers. The administration argued that financial advisors suffered from conflicts of interest and pushed savers into funds that gave the advisors higher commissions without corresponding gains in expected returns— estimating that conflicted advice shaved a whole percentage point off returns each year.10 This triggered an acrimonious debate between defenders of the Rule (including the American Association of Retired Persons) and the financial industry, who objected to both the rule's content and the characterization of advisors as conflicted.

That rule now looks to be dead.11  The Trump administration undertook a series of administrative actions that have delayed the rule's implementation, including in particular an 18-month delay published by the Department of Labor in November 2018 that will effectively delay the rule indefinitely. Legal challenges have not proved an effective strategy for proponents of the Rule, with the Fifth Circuit Court of Appeals overturning the Rule in March 2018 and rejecting an appeal of that ruling.

The Trump administration is instead looking to the Securities and Exchange Commission (SEC) to come up with an alternative.  Jay Clayton, the Chair of the SEC, unveiled a package of rulemaking proposals, which include a best-interest standard for brokers; new disclosure requirements for brokers and investment advisors; financial adviser title reform; and an interpretation of the fiduciary standard that currently applies to investment advisers.

These new proposals have also been criticized on the grounds that they fail to define what constitutes the best interests of investors and create two-levels of investor protection, with substandard safeguards for consumers using broker-dealers.  For example, when SEC Commissioner Kara Stein voted against the proposals, she noted that the great majority of scams against investors are by broker-dealers and their salespeople.

From a consumer perspective, there is a pressing need to resolve the uncertainty with fiduciary safeguards and provide widespread access to advice that is as unconflicted as can be reasonably achieved.  At a minimum, consumers should know the size of the fees they are paying and whether or not the person advising them has a financial interest in the investment choices they make.

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11. Council of Economic Advisers. 2015. "The Effects of Conflicted Investment Advice on Retirement Savings". Washington, DC.

12. Still, progress on the rule likely had practical effects on some mutual funds' pricing policies and some brokerage firms' remuneration policies. These companies anticipated that DOL's rule would go into effect and changed their practices accordingly.

To help achieve this second goal, another potential reform is better benchmarking for advisory fees and better transparency more generally. On benchmarking, or knowing how fees compare to others in the market, there is a stark asymmetry between advisory fees charged to individuals and expenses charged by mutual funds to shareholders. While advisory fees are typically well-disclosed, investors have no idea how their particular fee compares to others in the market—reducing the amount of price competition. Compare this to expense ratios, the distribution of which can easily be accessed by anyone with an online brokerage account. The SEC, or another financial regulator, could call for an annual survey of advisors or amend the reporting requirements in the ADV forms to allow for better benchmarking.12 Similarly, investors don't always know or understand all the fees they're paying when investing in mutual funds, which is why the SEC investor advisory committee recently called for displaying dollar amounts on statements and for the fees to be put in context—such as a "low, medium, high" designation.

## Managing Assets during Retirement: Better Insurance to Turn Savings into Security

Once Americans retire, they have to figure out how to manage their money in the "decumulation" stage of their lives. The life-cycle model of consumption and saving developed by economists many years ago was based on the idea that people save and invest during their working years and then consume out of their savings once they stop working. In particular, the model provides the level of saving that can allow a household to be as happy as possible, and how changes in economic conditions can impact the desired level of saving. The insight from this model underpins much of the discussion in this document.

Our nation's income tax rules are, to an extent, built around the life-cycle model. In general, workers can contribute to retirement accounts out of before-tax income and then, starting at age 70½, are required to take a minimum distribution from those accounts.[13] The amount of the required distribution rises as the retiree ages, from 3.65 percent of the account balance at age 70 to 4.87 percent at age 75 to 5.35 percent at age 80, all the way to 15.87 percent at age 100. These rules are intended to recapture the tax revenue lost when the funds were put into a retirement fund, which is why the amount withdrawn is subject to ordinary income tax.

It is a curious fact, however, that many retired households do not draw down their savings systematically but rather hoard their financial assets. The *New York Times* recently reported an extreme case where a legal secretary worked for 67 years in the same law office and saved part of her salary consistently, making the same investment choices as

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13. The ADV form is the standard form completed by investment advisors for both the SEC and state regulators.

14. The required distribution is from traditional defined contribution accounts. Someone who continues to work and has an employer-based 401(k) plan or equivalent, is not required to withdraw from that account; withdrawals start after they stop working. While the owner is still alive, this framework does not apply to Roth-type accounts, which trade the up-front deduction for contributions for the right to grow contributions indefinitely without tax.

her bosses in the law firm.[14] She died at age 96, soon after retiring, and donated over $8 million to charity. Hers is not a model for most people's retirement, of course. Most people are unwilling or unable to work to such an old age, nor should they.

Her story illustrates the challenges with retirement planning, and the idiosyncratic elements that make "rule-of-thumb" guidance so difficult. In this case, one assumes she enjoyed her work and we can admire her willingness to give such a large legacy to help low-income students in New York. And her experience shows that working long enough and making regular and sound investments yields a substantial retirement fund even if the individual does not command a high salary. But the combination of a long working life and high accumulated assets would violate the life-cycle model's premise of lifetime consumption smoothing, with eventual spenddown of assets. Most people would be happier if they retired earlier and lived off their savings.

This situation begs the question: Among the households that have accumulated significant retirement assets, why do more of them not draw down those assets and enjoy a more comfortable or affluent retirement? A big reason is that retirees are fearful of running out of money, scared of an expensive illness, and worried about the need for end-of-life care. Managing these uncertainties is an important part of managing asset decumulation.

Insurance products can protect against these risks. Supplemental health insurance can cover the gaps in Medicare and many seniors buy such policies. Long-term care insurance will pay for nursing home care or in-home long-term care, and annuities provide protection against running out of money. However, most families do not buy the latter two of these forms of protection. One-in-six Americans in their fifties do not qualify for long-term care insurance because of an existing medical condition.[15] Even those who do qualify generally do not buy the policies.

Fixed annuities provide a solution to the problem of running out of money. (Throughout this section, "annuities" refers to traditional, fixed annuities. Variable annuities are also an important part of the retirement landscape, but operate more like mutual funds.) Retirees can direct the funds accumulated during their working years to buying an annuity policy that pays a fixed amount monthly or quarterly indefinitely. Annuities, in effect, insure against the greatest source of uncertainty in retirement: unknown lifespan.

Despite their theoretical appeal, annuities are generally unpopular. Buying an annuity means surrendering a large share of a household's financial assets, leaving limited liquidity to address unexpected shocks and lesser wealth for bequests. Returns on annuities are mostly backed by bond holdings, and with the stock market apparently on an endless upward trend, retirees would often rather hold onto their assets invested in stocks. Annuities are also complicated products that are usually not offered in workplace saving plans.[16] Annuities can also be regarded as financial products, rather than insurance products, which may make Americans adverse to situations in which they get a negative return from their

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15. Kilgannon, Corey. 2018. "96-Year-Old Secretary Quietly Amasses Fortune, Then Donates $8.2 Million". *nytimes.com*. https://www.nytimes.com/2018/05/06/nyregion/secretary-fortune-donates.html.

16. American Association for Long-Term Care Insurance. 2015. "The 2015 Sourcebook for Long-Term Care Insurance Information." Westlake Village, CA: American Association for Long-Term Care Insurance.

17. Rightly or wrongly, many employers appear to fear legal liability if they offer an insurance product to their employees and the insurance company were to fail in the future.

"investment" in an annuity contract. Despite the best efforts by economists to encourage more Americans to buy annuities, the products have yet to catch on.

One answer to this problem is deferred or longevity annuities. In this case the annuity is purchased around retirement age, say age 60 or 65, but does not start to pay out until the individual or couple reaches, say, age 85. The attraction of these products is they provide insurance directly targeted at the problem of running out of money. They are longevity insurance. The retiree can apply only a portion of their retirement assets to buy the annuity, but still receive a substantial regular payment when they enter their final years. For example, one academic paper found that it was optimal for a retirement-age saver to put about one-eighth their assets in a longevity annuity and personally manage the remainder.[17] Longevity annuities are only in their infancy, but it would be worthwhile to make them widely available under workplace retirement plans, together with counselling as to their value.

Most families, even those in the middle class, have only modest levels of financial assets as they approach retirement. That makes Social Security especially important, as we noted earlier, but there is another way families can support themselves in retirement: by capturing the value they have accumulated in their homes. The extent to which housing wealth can ease retirement will greatly depend on individual circumstances. Someone who bought a house in California 30 years ago and has paid off the mortgage may have a million-dollar asset, or more, that can be realized. Someone living in the rural Midwest who took out a second mortgage to pay for an emergency may have very little home equity. Still, housing wealth is an important asset for many middle-class families.

*Reverse Mortgages.* Reverse mortgages are products available that allow families to turn their housing wealth into cash, either in the form of an annuity or lump-sum payments.[18] Under the annuity payout structure, a retired couple will receive a payment as long as they live, but the issuer of the mortgage will then own the house when they die or move. Decades ago, these products earned a reputation for being fraudulent and carrying high fees. There have also been stories of heartbreak because elderly couples failed to understand the obligations they faced under the terms of their reverse mortgage and ended up losing their home and being evicted. Though rare, this could happen if property taxes or insurance payments are left unpaid. Perhaps as a result, mainstream financial services companies have been reluctant to enter this market. These problems need to be solved so that reverse mortgages can become one of the legs supporting the retirement stool.

*Long Term Care.* The long-term care market in the U.S. is small and shrinking, with a declining share of older Americans purchasing insurance, and a paucity of insurers offering products. A major impediment to a more robust long-term care market is the structure of Medicaid. This program provides funding for nursing home care for seniors who medically require long-term care, but who do not have sufficient assets to pay for the care. The nursing homes that accept Medicaid patients are often not of very high quality, but do provide

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18. Gong, Guan and Anthony Webb. 2010. "Evaluating the Advanced Life Deferred Annuity- An Annuity People Might Actually Buy." *Insurance: Mathematics and Economics* 46(1): 210-221.

19. From one perspective, owning a home—without a reverse mortgage—is a form of an annuity since it covers the cost of housing indefinitely, equivalent to an annuity that paid the cost of rent for one's lifetime. However, under this scenario, the homeowner has no access to the value of the home's equity. Reverse mortgages allow for access to home equity, while also allowing a retirees housing costs to be covered.

an option for low- and moderate-income retirees that need such care. The option of subsidized long-term care through Medicaid discourages people from buying long-term care insurance. Low- and moderate-wealth retirees are incented to draw down their assets if they need care and, once these are exhausted, accept Medicaid benefits—avoiding private insurance altogether.

*Regulatory reform to improve retirement spending*. Just as regulatory reform can enable better accumulation of retirement assets, it can also provide for better private insurance products. As outlined in a 2016 paper by one of us and co-author Katherine Abraham, one such reform would be to amend the safe harbor for employers seeking to provide life insurance products—such as annuities—to their workers.[19] Under the current safe harbor, employers must assess the long-term financial viability of an insurance carrier—a task many might find daunting. Clarifying the safe harbor by, for example, stipulating that a carrier is deemed "financially stable" if it has been certified by a given number of state insurance commissioners might provide reassurance to well-intentioned employers.

Another reform would build upon the forward-looking guidance issued by the Treasury Department in 2014. These regulations, which were instrumental in building the foundation for these products, allowed the lesser of 25 percent of an account or $125,000 to be directed towards a longevity annuity without violating required minimum distribution rules (which, as described above, stipulate that a fraction of retirement assets must be withdrawn beginning at age 70 ½. Expanding the share and dollar amount allowable would further bolster the market on the margin.

The reverse mortgage market, currently dominated by the Department of Housing and Urban Development's Home Equity Conversion Mortgage (HECM) program, could be substantially revised to better account for low-risk borrowers subject to high fees. Under the current structure, even retirees who borrow only a small share of their housing equity are required to pay exceptionally high fees to account for the potential of default. This program should be revised, as was tried under the HECM "Saver" program, so that low-risk borrowers with low relative borrowing do not have to pay higher fees to subsidize higher-risk borrowers.

Lastly, the private market for long-term care will never reach its full potential as long as Medicaid beneficiaries pay a large implicit tax on their private long-term care insurance distributions. While this reform is a difficult one given the potential for its negative impact on low-income seniors, strengthening anti-abuse provisions for asset runoff and lowering the implicit tax on private policyholders is essential to the long-term care market.

# Conclusion

Private-sector employers are eliminating or shrinking the scope of traditional defined benefit pension plans, transforming the retirement landscape. Most employers realize their employees need help in managing their assets in both the accumulation and decumulation phases of their lives but they are reluctant to take a more active role in helping current or

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20. Abraham, Katharine G., and Benjamin H. Harris. 2016. "The Market for Longevity Annuities". *The Journal of Retirement* 3 (4): 12-27. doi:10.3905/jor.2016.3.4.012.

former employees because of concerns about legal liability and regulations that make it difficult to include a full range of retirement options.[20]

When it comes to supporting the retirement revolution, financial regulation has not yet caught up. Regulation must be enabling, designed to make markets work better while providing consumers with both protection and access to the products that will bring them a more secure retirement. Barriers to the availability of insurance products should be removed, while regulators must make sure that retirees are protected against fraud, misunderstandings, and excessive fees. Admittedly, this is a tall order.

There are many steps that are necessary if Americans are to have a more secure retirement in a world where traditional pensions are no longer the norm. In this brief we discussed issues faced by people struggling to decide how much to save and how to allocate their savings, how to insure against the most severe risks, and how financial regulation can contribute to improving their decisions.

We did not cover all the issues. With some important exceptions, Americans are living longer and will either need to save more or work longer, or both. Behavioral economics can is both an explanation and solution to under-saving. For example, many people intend to increase their retirement saving but then do not actually do it; implementing policies that automatically enroll workers in saving plans or default savers into generally sound investments can help. We will be exploring these issues in future research and writing.

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21. For a discussion of some of the problems for employers in making annuities available see:

22. TIAA. 2017. "Closing The Guarantee Gap: How Policymakers Can Restore The Role Of Lifetime Income In Workplace Retirement Plans." New York: TIAA.

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