THE FUTURE OF RETIREMENT

Big Ideas That Are Reshaping the U.S. Retirement System

By Bob Collie, FIA

The structure of the retirement system in the United States did not come about by conscious design. Rather, we arrived here largely by happenstance, with separate policy initiatives in several areas and wider societal trends interacting somewhat haphazardly to create the system as we know it today.

The system continues to change. There are several pressure points: Close to half of all corporate defined benefit plans are now closed to new entrants, with corporations moving instead to a defined contribution structure; the public pension system’s funding challenges are increasingly in the news; the multi-employer system is reeling; savings rates in the 401(k) system are frequently inadequate; questions remain about the Pension Benefit Guaranty Corporation’s sustainability; employers are weary of the costs, risks, and administrative burden of pension provision; voices are calling for tax reform.

We do not expect the debate around retirement policy to subside, so it’s important to be deliberate in considering the choices before us. We are not working from a blank sheet of paper, and each new proposal should be considered in its wider context.

As well as many moving parts, multiple perspectives need to be considered: that of the individual saver, the employer, the Treasury, the wider public interest. The financial industry is also a stakeholder in these questions. Finding a balance between these perspectives is ultimately a political question, which can make it difficult to adopt a genuinely long-term view.

This article addresses three ideas that could reshape the retirement system, and it seeks to encourage a long-term view, raise the level of discussion, and focus debate about the U.S. retirement system.

Three Ideas

The three ideas are risk sharing, automatic saving, and multiple-employer plans (MEPs). In 2015, at an institutional client conference hosted by Russell Investments, I polled attendees on their attitudes regarding these ideas. For each, I started by asking, “Do you like this idea?” and followed up with the question, “Do you think this will happen?” (see sidebar “Three Ideas—Poll Questions”).

Eighty-six respondents voted in the session. Some were representatives of corporate plan sponsors, and others were from public plans or other institutional programs such as endowments or foundations. A handful of investment managers and consultants were in the room. So the sample was a mixed audience of investment professionals, skewed toward the corporate pension market.

Risk Sharing

On the question of whether risk sharing should happen, a majority of the audience was positive (see figure 1). Around half of the respondents were cautiously positive toward the idea, selecting the option “Probably. Tell me more.” A further 24 percent were very enthusiastic, selecting “Yes. Sign me up right now.”

Risk sharing can, of course, take many forms. Cash balance plans share risk, although I would argue that the design of cash balance plans is primarily about achieving a transition from a DB to a DC plan, so risk sharing is really just an incidental feature. Better examples can be found in proposals in the United Kingdom, where the concept is referred to as “defined ambition,” and in Canada, where a number of provinces have made moves toward what they call “target benefit plans.” Dutch collective DC plans are run along these lines; these can be thought of as providing a core defined benefit with contingent add-ons, such as cost of living allowances (COLAs) that are paid only if plan experience allows it.

The audience’s hesitation about whether this idea was likely to gain traction in the United
### THREE IDEAS—POLL QUESTIONS

#### Risk Sharing

Should we, as an industry, be looking for a way to build a pension system that shares risk in some way between the employer and the employee?

Risk sharing might take a number of different forms. The question is not about the mechanics of how this would best be done. The question is about the principle of whether it is desirable.

The poll questions are below and, before reading further, you may want to take a moment to consider your own responses.

**Poll question:** Risk sharing: What if neither the benefit (DB) nor the contribution (DC) were fixed, but we made both vary according to plan experience?

**Q1:** Should we share risk?

**Answer #1:** “Yes. Sign me up right now.”

**Answer #2:** “Probably. Tell me more.”

**Answer #3:** “Meh.”

**Answer #4:** “No. I do not like this idea.”

**Q2:** Will we share risk?

**Answer #1:** “Definitely.”

**Answer #2:** “Probably.”

**Answer #3:** “Possibly.”

**Answer #4:** “Definitely not.”

#### Automatic Saving

**Automatic Saving**

Should retirement saving be mandatory?

The “coverage gap” has become a topic of interest in Washington, DC. The Obama administration points to the fact that about half of all American workers do not have access to an employer-sponsored retirement plan, and many who do have access do not participate.

Although the questions below use the term “mandatory,” it is important to distinguish between true compulsion and the softer compulsion of a default-with-opt-out design—the “nudge” approach.

**Poll question:** Mandatory saving: Should workers be required to participate in the retirement system?

**Q3:** Should retirement saving be mandatory?

**Answer #1:** “Everybody should be required to set some money aside for retirement.”

**Answer #2:** “Default everyone in, but offer an opt-out.”

**Answer #3:** “It’s a tough call.”

**Answer #4:** “No—there are already plenty of choices for those who want to save.”

**Q4:** Will retirement saving be mandatory?

**Answer #1:** “Yes—a mandate is likely.”

**Answer #2:** “Yes, but with opt-outs.”

**Answer #3:** “Not really.”

**Answer #4:** “Definitely not.”

#### Multiple-Employer Plans

**Multiple-Employer Plans**

What if employers didn’t have their own defined contribution (DC) plans but instead participated in plans that were open to a much wider group?

This question would take on greater importance under a mandatory savings regime. If retirement saving is to be mandatory, then somebody needs to manage those savings. Even without that impetus, interest in the idea of multiple-employer plans has been growing in the past few years.

The choice of answers allowed respondents to make a “yes” answer contingent upon regulatory clarification that under this model the employer would be able to outsource all fiduciary responsibility except the responsibility for selecting and monitoring the provider.

**Poll question:** Getting the sponsor out of the plan: Should there be multi-employer DC plans available, allowing employers to participate in a plan without sponsoring or running it?

**Q5:** Should we get the sponsor out of the plan?

**Answer #1:** “Yes. This is how I would like my plan to work.”

**Answer #2:** “I like this idea, but only if we get the right fiduciary reassurance.”

**Answer #3:** “Maybe.”

**Answer #4:** “I do not like this idea.”

**Q6:** Will we get the sponsor out of the plan?

**Answer #1:** “Yes.”

**Answer #2:** “In the right regulatory framework, it will take off.”

**Answer #3:** “Maybe.”

**Answer #4:** “Definitely not.”

### States seems to me to be realistic, at least as far as the corporate sector is concerned. With the trend toward DC firmly established, the ship may have sailed. Although risk sharing represents a middle way between the DB and DC systems, its prospects for widespread adoption in the United States do not, in the short term at least, appear strong.

#### Automatic Saving

A strong majority favored the idea of automatic saving, with 90 percent of respondents favoring either mandatory saving or a default-with-opt-out. Opinion was divided, however, on the question of whether this was likely to happen (see figure 2).

Repeated proposals at the federal level for a national auto-individual retirement account (IRA) in recent years have not moved far through the legislative process. There has been significant progress at the state level, however. In 2014, the Illinois Senate passed The Illinois Secure Choice Savings Program Act, which requires employers with 25 or more employees but not offering a retirement plan to auto-enroll employees into the Secure Choice program at a default contribution rate of 3 percent or to offer a private market savings vehicle. Structured as a Roth IRA, the Secure Choice program is due to be running in 2017.

Legislation that includes auto-enrollment also has passed in California, Oregon, Connecticut, and Maryland. Study bills directing the investigation of similar programs have been passed in a handful of other states. There also have been (to date) unsuccessful attempts to pass legislation in a dozen or more other states including New Hampshire, Louisiana, and Hawaii.

One potential roadblock to these initiatives has been the possibility that they may be deemed to fall under the Employee Retirement Income Security Act (ERISA), which would trigger a mountain of complications. In response to this concern, in

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Evidence that these issues are not insurmountable can be found in the experience to date of the United Kingdom’s National Employment Savings Trust (NEST). NEST was established in the wake of the introduction at a national level of auto-enrollment in 2008—a move that by the time it is fully rolled out in 2018 will have brought an estimated 11 million people into the United Kingdom’s retirement savings system.

Can Automatic Saving Be Efficient?
Any broadening of participation in the retirement system would force consideration of the system’s efficiency. The typical account balance of someone brought into the system under a mandatory saving regime would not be large. Thus, the fixed costs of administering these accounts would have a proportionately larger impact. Leakage of retirement assets out of the system (for example, if account balances are cashed out on a change of employment) potentially would undermine the system’s effectiveness. Portability and making it easy for individuals to aggregate accounts from multiple sources would be necessary conditions for success. Fees—already a major area of focus—would take on even greater importance. These and other issues of efficiency are key considerations in a mandatory system.

NEST—an independent nonprofit trust—was created to ensure that every employer had at least one place to turn in order to fulfill that requirement. It charges employers nothing, and charges to participants are a one-off 1.8-percent on contributions and a 0.3-percent annual management fee. NEST’s share of the auto-enroll market earlier this year was estimated at slightly below 50 percent, although that number most likely will increase as the smallest employers are brought into the program in the final phase of the legislation’s roll-out.

Multiple-Employer Plans
Sixty-five percent of the respondents were in favor of MEPs, with most of those conditioning their responses on a clarification of the employer’s fiduciary obligations. On the question of whether it is likely to happen, around half of respondents selected “In the right regulatory framework, it will take off” (see figure 3).

MEPs take on greater importance in the context of efforts to expand the coverage of the retirement system. Employers who do not offer work-based retirement saving vehicles are more likely to be attracted to a
system that places fewer demands on them. Retirement-plan coverage is weakest among smaller employers; such employers may like the idea of helping their workers to save, but it is generally neither straightforward nor cost-effective for a small employer to run a plan.

The responses to our questions also underline just how important fiduciary obligations have become to plan sponsors. The move from defined benefit to defined contribution reduces employers’ exposure to investment and longevity risk, but it has tended to add to their litigation risk. Placing clear limits on the extent of the employer’s fiduciary responsibility removes another important barrier.

Who Would Run an MEP?
It is natural to ask: If the employer isn’t responsible for the plan, then who would be? There is more than one possible answer to that question. These multiple-employer plans might be run by the federal government or state governments (this is, in effect, what has been proposed in Illinois) or by private providers offering master trusts open to anyone (a model that has been in place in Australia for a number of years). The employer’s role would be limited to selecting a provider (if there is a choice) and handling the payroll deduction.

Multiple-employer plans do exist, but their scope is restricted. Most notably, DOL has ruled that an employment-based or other organizational relationship among employers is generally required if an MEP is to be treated as a single entity, as opposed to a collection of single-employer plans. There have been a number of proposals to remove this restriction. Another sticking point is that a failure by one participating employer to meet tax-qualification requirements may lead to the whole plan being disqualified.

When DOL issued the proposal to exempt state auto-IRAs from ERISA (see above), it also issued an interpretive bulletin asserting that if a state were to run an MEP, then the organizational relationship requirement is satisfied. This is because, in DOL’s view, “a state has a unique representational interest in the health and welfare of its citizens that connects it to the in-state employers.” This interpretation was intended to have the effect of enabling a new form of retirement plan, the state MEP. However, the wheels remain in motion on this issue.

For starters, it seems unlikely that many states would want to run an MEP because it would involve submitting to ERISA—legislation that is regarded much more fondly within DOL than in state capitols. Further, the sentiment of “trust me, I’m from the government” has not gone unchallenged. Many have argued that the private sector is just as capable as the states—if not more so—of competently and effectively running MEPs. If state MEPs are to be enabled, why not private-sector open MEPs, too?

As well as offering the convenience of payroll-deduction and the protection of ERISA, an open MEP that operates within the 401(k) system would provide for employer contributions and higher contribution limits than those that apply to IRAs. What’s more, fees may be lower than those possible within the retail IRA market.

These arguments seem to have bipartisan support in Congress, and various bills have been introduced in recent sessions. In February 2016, the Obama administration’s budget proposals included private-sector open MEP provisions. So the prospects of open MEPs becoming a reality have increased sharply since our straw poll was taken little over a year ago.

Here, as with the idea of a mandatory savings regime, care is needed in the design of the system, with particular attention to the questions of efficiency and scalability.

A Final Question
At the end of the discussion, we asked the audience one final question: Which of the three ideas did they like most? We allowed them to choose only one, or to select “none of the above.”

Each of the three concepts got support, but the idea of mandatory saving was the clear winner, selected by more than half of respondents.

Where Do We Want to Go from Here?
The polling we conducted was only on a small scale and the audience was not representative of the broad population as a whole. The answers are informative.

Continued on page 29
nonetheless. They reveal a greater openness to change than we expected: A majority of respondents was at least somewhat positive toward each of the three areas of change we set out. The extent of the support (among this group at least) for some form of automatic saving was particularly notable.

Asking questions such as these is important in a world that will continue to evolve, but whose direction is likely to remain subject to several distinct policy goals and dependent on the swirling currents of the policy-making process. These are important issues and it seems worthwhile to at least ask where we want to go.

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