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Education and Advice: Decisions, Decisions, Decisions From Work into Retirement

Reorienting Retirement Risk Management

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*The views expressed are my own and do not necessarily reflect the views of the Investment Company Institute or its members.

Overview

Discussion & Thoughts on Three Papers

- What guidance can employers offer?
 - Finkelstein & Kesmodel
- What do employers do?
 - Finkelstein & Kesmodel; Clark, Morrill & Allen
- What are the decisions retiring workers need to make?
 - Clark, Morrill & Allen; Ameriks, Hess & Ren
- What is plan sponsors' thinking on the process?
- What resources do retiring workers consult?
 - Clark, Morrill & Allen; also ICI DC Distribution Decisions Survey
- What about the annuity/lump-sum distribution decision?
 - Ameriks, Hess & Ren; Clark, Morrill & Allen; also, ICI DCDD Survey

Impact of The Pension Protection Act on Advice: What's Working & What Remains to be Done?

Lynn Pettus Finkelstein & R. Hall Kesmodel, Jr.

What Guidance Can Employers Offer?

Finkelstein and Kesmodel

History/Evolution of Education and Advice

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- 1996 — DOL Interpretive Bulletin 96-1
- Education
- Dec. 2001 — DOL Advisory Opinion 2001-09A, SunAmerica
- ‘Independent financial expert’ to give investment advice & offer managed accounts
- 2006 — Pension Protection Act (PPA)
- Service provider familiar with the investment options permitted to offer participant advice with controls
 - computer model certified to produce objective advice
 - ‘fee-leveling’ approach
- ? — DOL regs delayed {& *legislation introduced*}

Impact of PPA on Advice: What's Working & What Remains to be Done?

Finkelstein & Kesmodel

- Highlight what employers are doing, participants are using
- Offer opinion that 401(k) is only one piece of financial puzzle, what people need is holistic, full balance sheet advice
 - Issues with plan sponsor's ability to monitor, cross-selling

Think About/Clarify:

- With which advice ERISA is concerned?
- What are the implications of expanding or integrating advice beyond the scope of the plan? Interaction of fiduciary standards vs. suitability requirements?
- Roles of “employer” versus “plan sponsor” versus “fiduciary”?

What Do Employers Do? Plans Offering Investment Advice

- In 2007, PSCA data indicate nearly half (49%) of plans offered investment advice; 29% of participants used advice when offered.
- In 2007, Vanguard data indicate:
 - 6% of plans (28% of participants) offered a managed account program;
 - 8% of participants utilized managed account program when offered.

Why Don't More Plan Sponsors Offer Investment Advice?

- Deloitte consulting asked plan sponsors: If you do not offer counseling/investment advice, why not?
 - Most commonly cited reasons (multiple responses):
 - 53% said potential fiduciary liability
 - 39% said cost
 - 38% said employees are not requesting it
 - 28% researching this feature, may implement in future

Employer-Provided Retirement Planning Programs

Robert L. Clark, Melinda Sandler Morrill & Steven G. Allen

Can Employer-Provider Retirement-Planning Financial Education Work?

Clark, Morrill & Allen

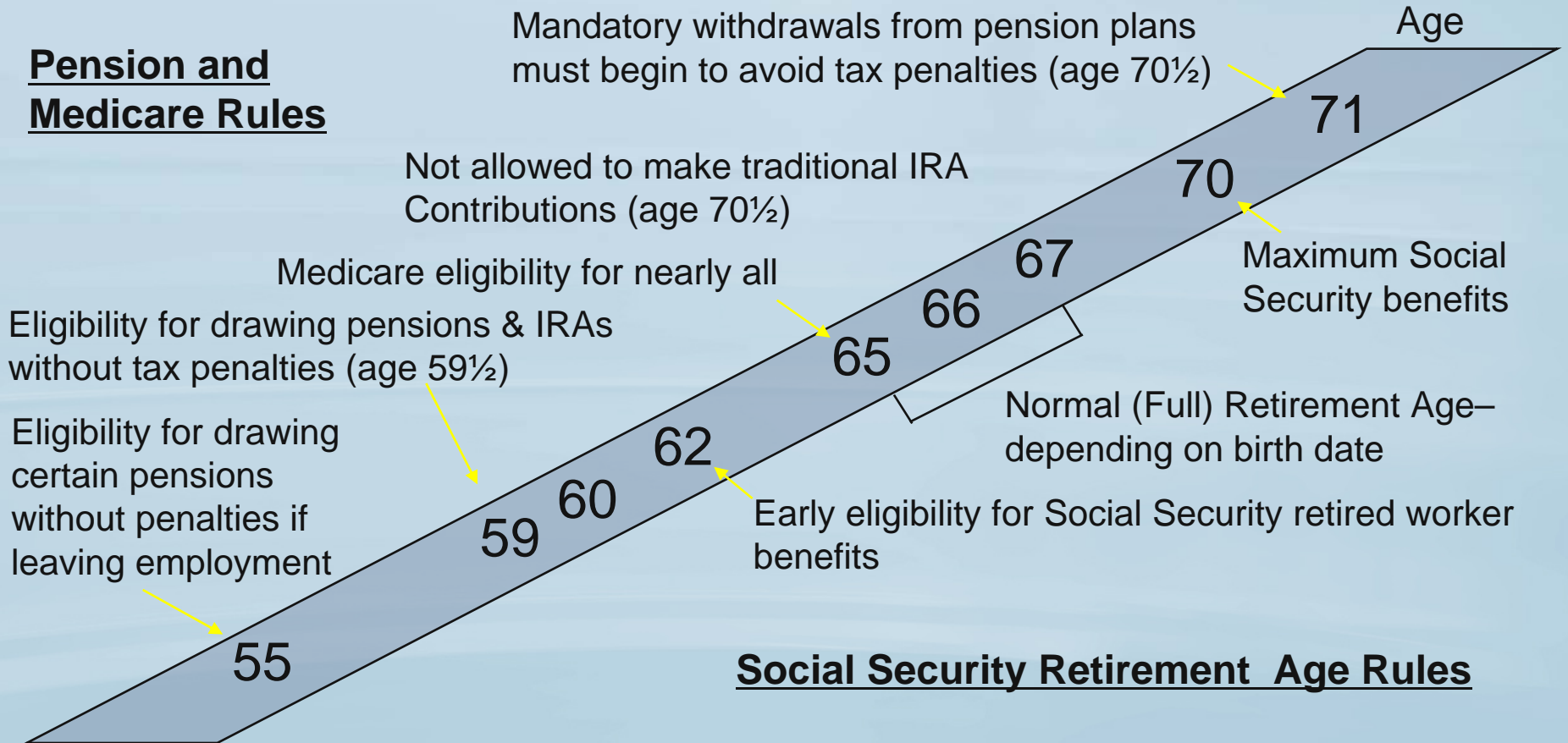
- Experiment: Interview near-retirees, before and after pre-retirement seminars sponsored by their employers (at 5 different employers)
- Yes – workers' knowledge increased and many adjusted their retirement plans.
- Employees benefited and employers were appreciated for their efforts.

Add: An ICI survey finds that retiring DC plan participants consult and appreciate employer-provided materials.

My Take-Away: Need to make it easier and encourage more employers to offer such programs.

Federal Retirement Age-Related Rules

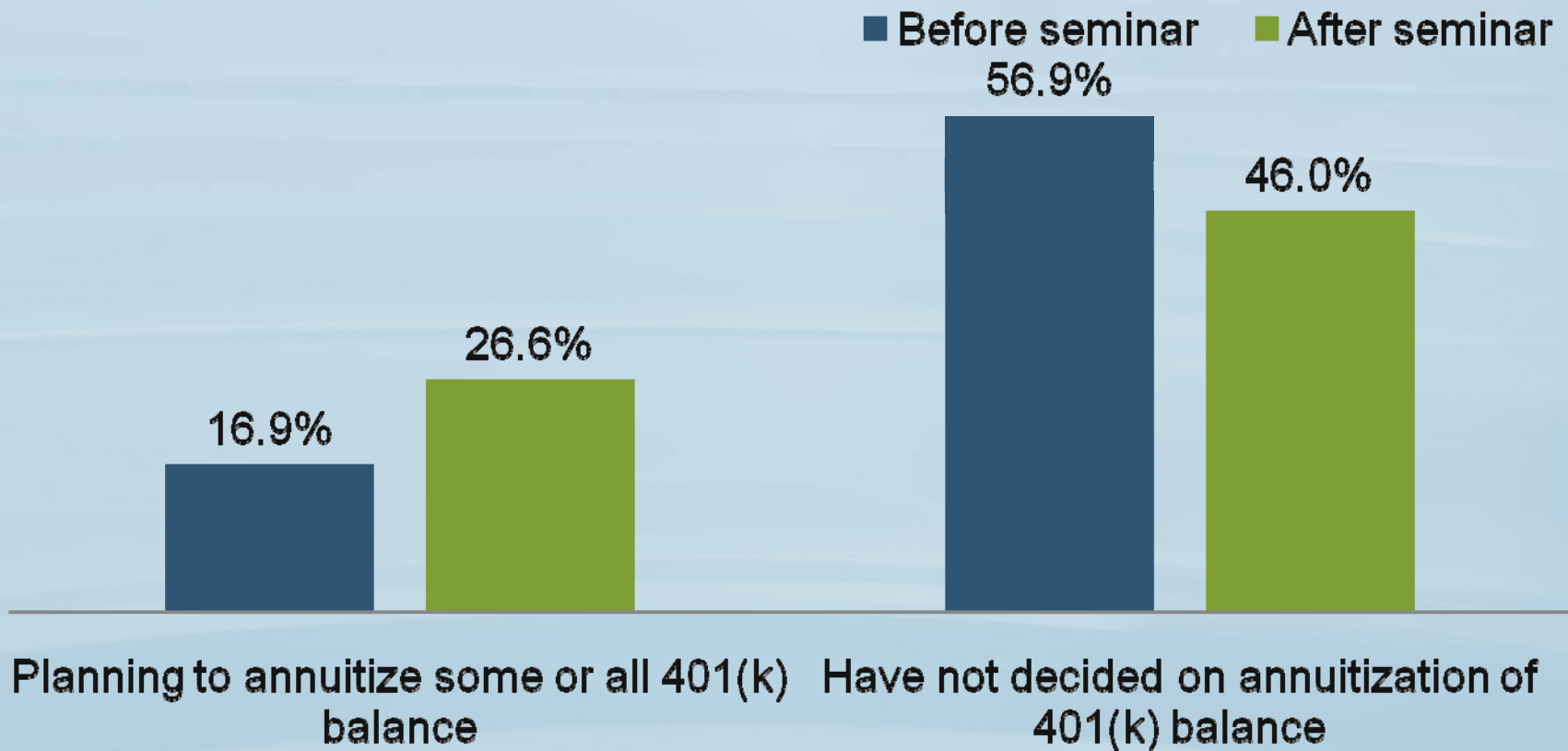
Pension and Medicare Rules



Social Security Retirement Age Rules

Plans of Respondents with Respect to 401(k) Balance

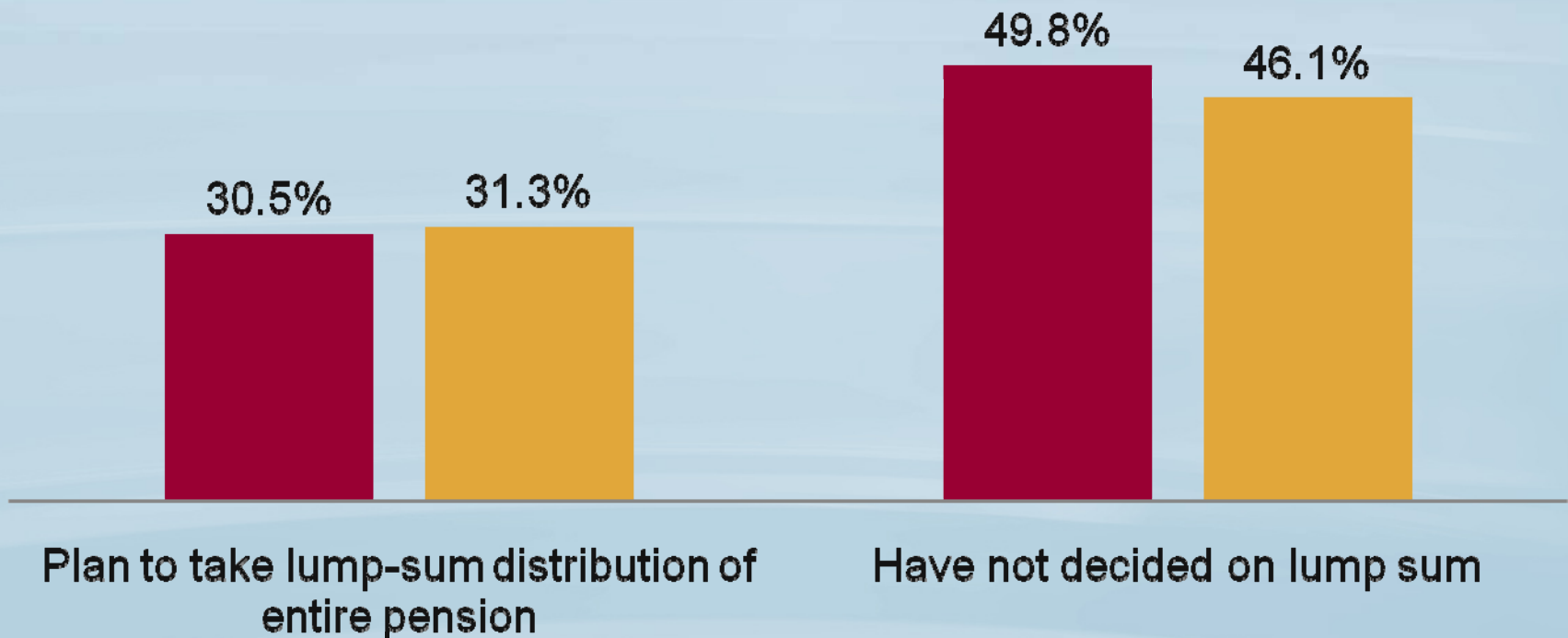
Percentage of respondents



Plans of Respondents with Respect to Defined Benefit Plan (Pension)

Percentage of respondents

■ Before seminar ■ After seminar



Annuity vs. Lump-Sum Distribution: Interaction Between DB and DC Important (and Social Security too)

Percentage of respondents, before seminar

Plans for DC/401(k) Balance

Plans for DB/Pension

	Annuitize some or all	Lump sum or defer?	Haven't decided	
Annuity payment?				
Lump sum of entire pension				30.5%
Haven't decided			"Indecision may or may not be my problem." <i>Jimmy Buffett</i>	49.8%
	16.9%		56.9%	

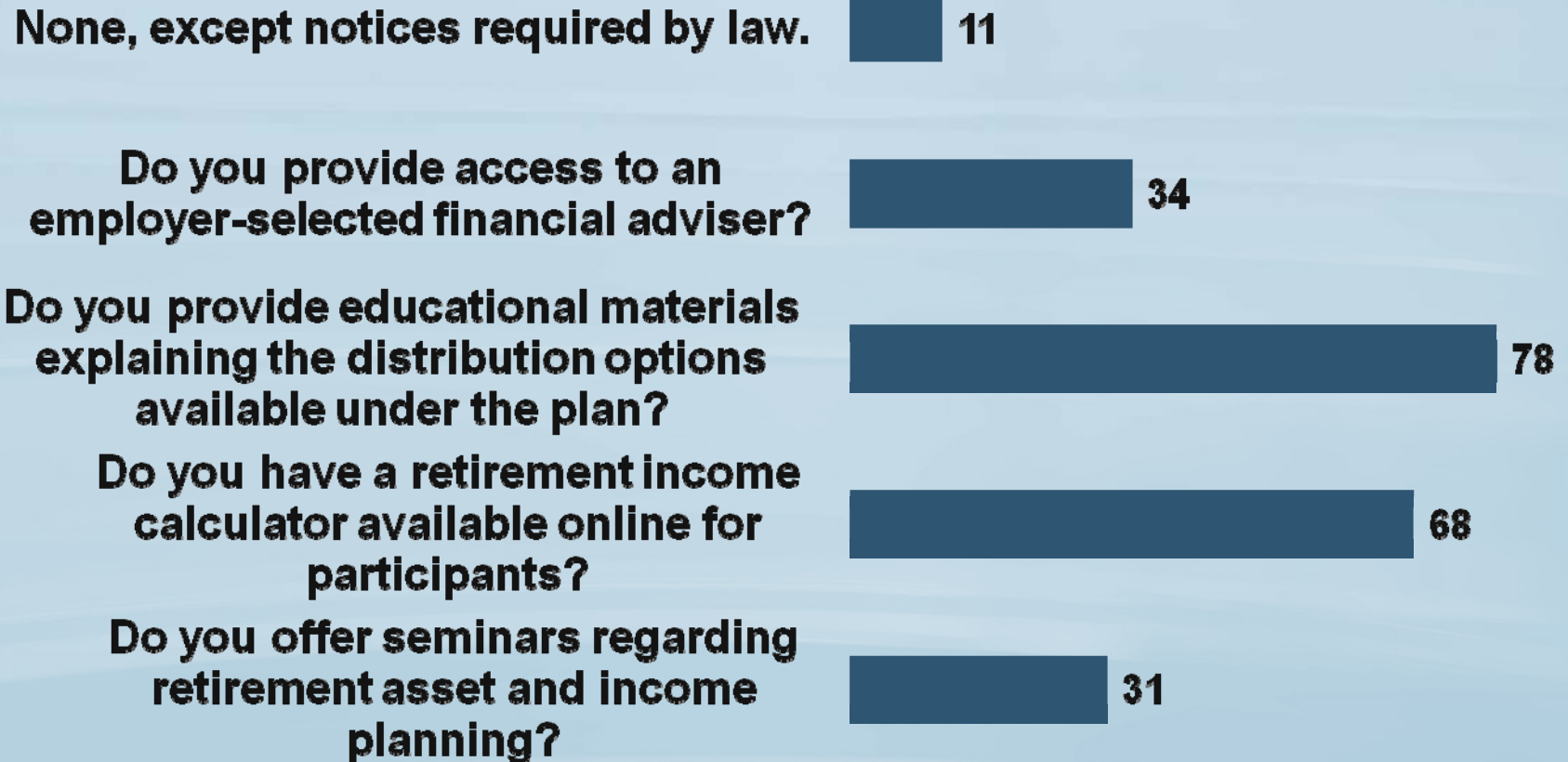
Additional Thoughts on Clark, Morrill & Allen

Think About:

- Additional analysis linking specific learning to the changes in future plans would be very useful:
 - e.g., 20% got Medicare age wrong and many did not understand Social Security benefits (before seminar):
 - Were they the people to change retirement age?
 - Were they the people to change expectations on working in retirement?
- Adding background/context describing the employers' benefits/plans (and respondents' demographics in a table) and as compared to the practices (and characteristics) in the broader DB and DC marketplace

Which of the Following Education, Guidance, or Information Does Your Company Provide to Retiring Participants?

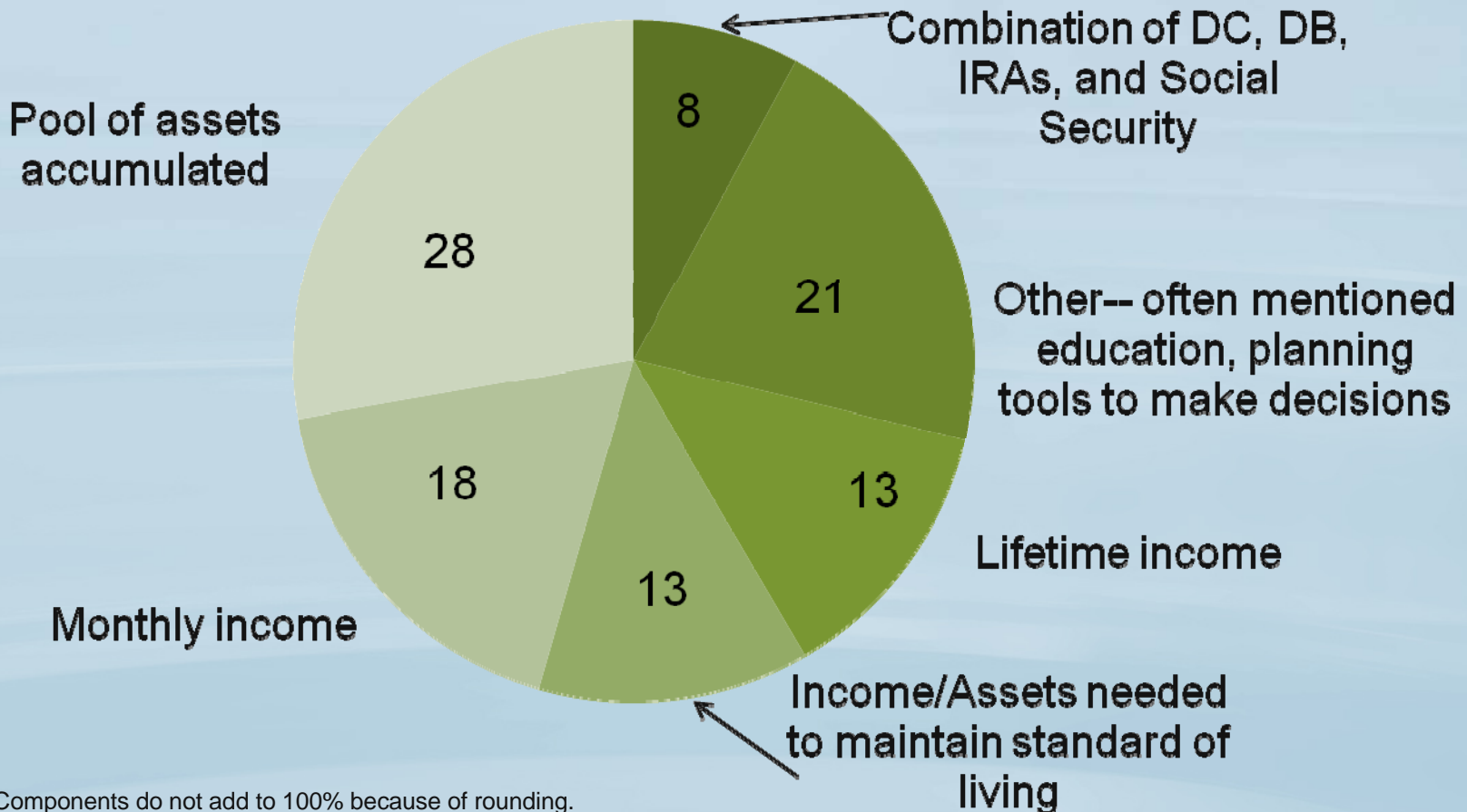
Percentage of plan sponsors answering “yes,” 2008



Note: Multiple responses are included. Survey conducted in early 2008; 213 plan sponsor respondents.

How Do DC Plan Sponsors Answer: What Is Retirement Income?

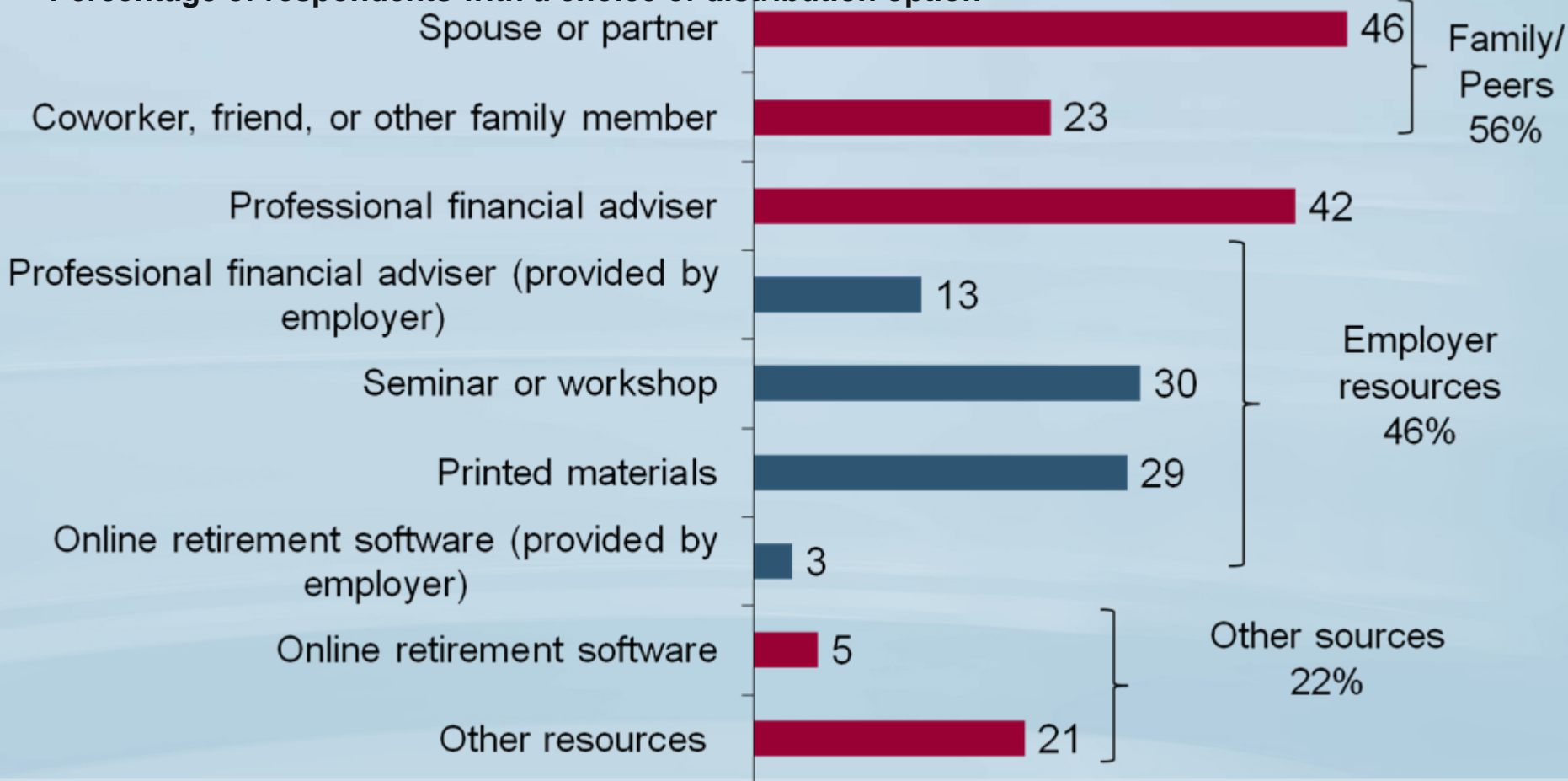
Percentage of plan sponsors responses falling into the category indicated, 2008



Note: Components do not add to 100% because of rounding.

Resources Consulted for Defined Contribution Plan Distribution Decisions

Percentage of respondents with a choice of distribution option*



*Multiple responses are included; 67 percent of respondents mentioned consulting multiple resources.

Source: ICI Defined Contribution Plan Distribution Decisions Survey, 2007 (See Sabelhaus, Bogdan, and Holden (2008))

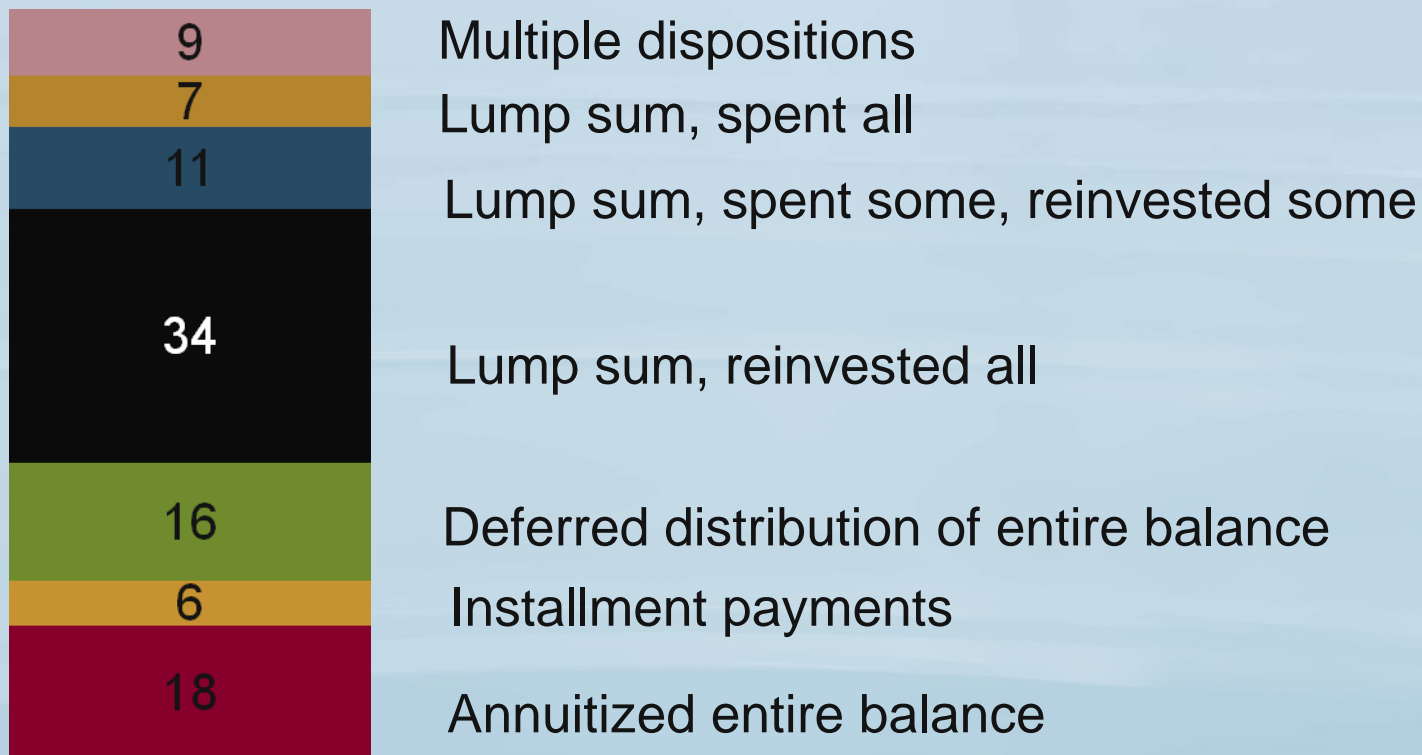
Extent to Which Respondents with Choice Followed “Advice”

Percentage of respondents with a choice of distribution option

	Sources of “Advice”	Extent to Which “Advice” Was Followed			
		Great Extent	Some Extent	Very Little Extent	No Extent
Professional financial adviser PROVIDED by your employer	13%	40%	36%	15%	9%
Seminar or workshop sponsored by your employer	30%	25%	59%	11%	5%
Printed materials provided by your employer	29%	25%	54%	17%	4%
“Advice” generated by online retirement software PROVIDED by your employer	3%	26%	25%	31%	18%

What Happened to Defined Contribution Accounts at Retirement?

Percentage of respondents*



*Based on respondents' recall; 70% of respondents reported having a choice of distribution options; 30% recalled having no choice. Responses are from a survey of employees retiring between 2002 and 2007, interviewed in the fall of 2007.

Note: Components do not add to 100% because of rounding.

Source: ICI Defined Contribution Plan Distribution Decisions Survey, 2007 (See Sabelhaus, Bogdan, and Holden (2008))

Comparing Spending Approaches in Retirement

John Ameriks, Michael Hess & Liqian Ren

Comparing Spending Approaches in Retirement

Ameriks, Hess & Ren

- Literature review – tees up the annuity vs. lump sum decision trade-offs
- Practical look at simulated outcomes of a variety of approaches (e.g., annuities, VA, GLWB, mutual funds, RMDs)
- No one solution dominates the others.

My Take-Aways:

- There's no one-size-fits-most with respect to managing income and assets in retirement.
- Innovation in a competitive market is generating many solutions – the challenges are explaining them; getting them on comparable terms; *{and helping households to find the appropriate combination of them}*.

Annuity vs. Lump Sum

Why Don't More People Annuitize?

- Loss of control of assets
 - Lack of liquidity (emergency fund)
 - Lack of exposure to potential gains in equities
- For all practical purposes, irreversible
- Soundness of financial institution issuing annuity
- Already sufficiently annuitized
 - Social Security
 - Pension income
- Bequest motive

Additional Thoughts on Why More People Don't Annuitize

- Would also add:
 - Cost of real annuities higher than nominal annuities
 - Literature suggests money's worth* is 85¢ for a nominal annuity. What if the cost calculus* for a real annuity is closer to 75¢?
 - Interest rate at time of decision
 - Annuitization trade-off may be different for married couples compared to singles
 - Quality of Medicaid nursing home care not the same as what can buy on your own

*The ratio of the present discounted value of payments and the cost of the annuity has been referred to as the "money's-worth" ratio (Mitchell, et al. (1999)), and the extent to which the ratio falls below 100% measures the difference between the price of an actuarially fair annuity and a market-rate annuity.

Additional Thoughts on Comparing Spending Approaches in Retirement

Think About:

- Exploring different asset allocation strategies combined with the payout strategies (e.g., RMD from different asset allocations)
- Developing a tool that would allow combining different degrees of the different strategies:
 - When annuity is part of strategy, could see higher exposure to equity in remaining account.
- Building life expectancy into the modeling exercise
- Developing a tool that allows laddering of decisions
- Exploring married vs. single male simulations

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