Are Your Employees Retirement-Ready?

Much of the discussion on the decumulation phase of retirement savings has focused on the lack of any lifetime annuities. But there is a whole range of options sponsors can employ to facilitate the generation of retirement income and bolster financial wellness. As U.S. employers show no sign of substantially increasing spending on compensation or benefits, it is imperative that human resources professionals help employees—particularly the retiring baby boomers—to maximize what they have saved. This article presents five first-step ideas toward achieving that goal.

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There has been a great deal of attention recently in the media and among human resources (HR) professionals on fostering retirement readiness and financial wellness in the workforce, particularly among the Millennial generation (born since the early 1980s). Efforts to foster retirement readiness presume participants will have many years to build up balances and ride out any fluctuations in the financial markets. But what seems to have been lost in these discussions is the need to ensure that the baby boom generation (born between 1946 and 1964, though the peak years ended in 1957) is actually "retirement-ready." Baby boomers represent the largest and wealthiest component of the U.S. population. Large-scale underpreparedness has the ability to create significant challenges for the generation itself as well as succeeding generations charged with taking care of baby boomers as they age.

Sixty-five still is widely seen as the "default" retirement age. In 2011 baby boomers began turning 65, and by 2029 the last of this generation will all be at least 65. But for the majority of this group affected by the decline of defined benefit plans, as well as some serious financial downturns, there is no clear signal when to retire. Instead, they face a dizzying array of conflicting and, at times, concerning messages about their retirement decision:

- While the eligibility age for Medicare retiree benefits remains 65, normal retirement age for Social Security is now 66 and rises to 67 for those born in or after 1960. At the same time, some experts believe the best strategy, among the 2,700 choices for claiming Social Security benefits, is waiting until the age of 70 while using up other assets in the interim if needed (Kotlikoff et al., 2015).
- The Medicare Access and CHIP Reauthorization Act of 2015 raised the Medicare Part B and/or Part D premiums of certain high-income individuals already subject to the income-related monthly adjustment amounts (IRMAA). Beginning in 2018, a married couple with a modified adjusted gross income of $320,000...
401(k) Plans

(based on their 2016 income) can pay as much as an additional $7,200 per year in premiums above the standard Medicare rate. Some of the 2016 candidates for U.S. president, most prominently Governor Chris Christie of New Jersey, are talking about further means-testing of federal retirement benefits.

- In the aftermath of the 2008 financial crisis, there were an untold number of media reports about individuals intending to retire before their 401(k) balances lost so much value that they needed to remain in the workforce (Greenhouse, 2012). And even though most 401(k) balances have recovered their precrisis values, there remains a great deal of uncertainty about locking up financial security without the benefit of a monthly pension.

- Over time, the share of large employers (with 200 or more employees) offering retiree health benefits has declined, and employers that continue to offer benefits have made changes to manage their costs, often by shifting costs directly or indirectly to their retirees. Since 1988, the percentage of large firms offering retiree health coverage has dropped by more than half, from 66% in 1988 to 28% in 2013, according to the 2013 Kaiser/HRET Employer-Sponsored Health Benefits Survey (The Henry J. Kaiser Family Foundation, 2014).

- And even when people are fortunate enough to be offered postemployment welfare benefits, the decisions can be extraordinarily complex. A colleague of ours from a major financial services firm was retiring at the age of 65 and was offered the opportunity to participate in her employer’s postretiree medical plan at 100% of the cost. The employer’s plan is a Medicare carve-out, which generally reduces the benefits available under the insurance contract by the amount payable by Medicare. Alternatively, retirees could purchase a Medicare Part B wraparound plan, which provides them with additional coverage for out-of-pocket expenses, including the cost of coinsurance and deductibles, along with a separate Part D policy. Unfortunately, her employer provided virtually no tools to help her decide which of these programs best suited her given her income, expected medical costs, drug usage or other variables, and it became virtually impossible to make an informed decision.

Despite an almost daily diet of media accounts regarding the new retirement paradigm of continuing to work (albeit frequently part-time) past the age of 65, a January 2015 survey (Gallup, 2015) indicated that only a third of those ages 67-68 reported they are still in the workforce. With so many people projected to be leaving the workforce over the next 15 years in this difficult environment, there is a great opportunity for HR professionals to structure and communicate programs designed to assist baby boomers with this momentous transition.

Here are some relevant strategies:

Rethink the Paradigm of Terminated Participants
Retaining Account Balances in the Plan

After leaving a job, individuals are encouraged, through what seems an unending series of advertisements from major financial institutions, to roll their balances from an employer-sponsored plan to an individual retirement account (IRA). But is that the best course of action? While 401(k) plans—the public’s shorthand for all defined contribution programs—have gotten a bad rap lately, a well-governed plan can offer several advantages to retirees and include:

- **Independent oversight:** Sponsors of retirement plans should have a rigorous process in place for monitoring ongoing plan operations. These sponsors have a basic fiduciary duty of complete loyalty [29 U.S.C. Section 1104(a)(1)(B)] to participants. Thus, plan sponsors are tasked with ensuring investment funds offered, fund expense ratios, administrative fees charged, services and operations are optimal for plan participants. For any individual, this can provide a sense of security as they move into retirement.

- **Lower expense ratios:** Single investors often cannot access institutional investment funds. However, many 401(k) plans with pooled assets may have lower cost funds available. As history has shown, lower fund expenses can provide a higher rate of return than a like retail fund. Leveraging lower expense ratios for greater
savings makes sense for any individual and can mean more savings to tap into for retirees.

- **Access to stable value/fixed account funds**: These vehicles offer yields comparable to intermediate term fixed income securities or certificates of deposit (CDs) but without the potential of market value fluctuations or withdrawal restrictions. However, these types of funds are not available outside of employer-sponsored plans. These alternative funds certainly can be more desirable if a retiree needs to access resources for unexpected expenses, since the withdrawal penalty on a CD can be severe.

There are tangible benefits to having terminated participants retain assets in the plan as well. Some of the largest accounts in a 401(k) plan might include long-term, ready-to-retire participants. Since many 401(k) plans are charged based on the number of accounts or level of the assets held, keeping these participants in the plan might actually reduce administrative costs for active participants. Further, retaining plan assets can help the plan satisfy any minimum balance requirements to invest in institutionally priced funds.

A recent survey indicates that most plan sponsors are receptive to retaining terminated participant assets for their plans but have not yet taken action to further this goal (Pacific Investment Management Company LLC, 2015). One of the most common reasons cited is that the time and expense of having to locate “lost” participants is somewhat burdensome. However, if a person makes an active, informed decision to keep assets in the plan, this individual won’t be lost and should not increase work for the benefits staff.

Sponsors are also wary of the complexities that may be foisted upon them by the recently proposed Department of Labor (DOL) fiduciary rules. The proposed rules suggest a sponsor could be deemed an investment fiduciary by highlighting to a participant the benefits of retaining his or her assets in a plan. However, if done correctly, we have seen examples of sponsors educating participants about the factors to consider without actually providing advice.

**Make Plans More Baby Boomer-Friendly**

There are plan changes a sponsor can make that—though applicable to all participants—could particularly benefit the baby boom group as they reach the age of 65 and begin leaving the workforce.

Among ideas for a sponsor to consider include:

- **Allow loan repayments after termination**: Immediate taxation of a preexisting loan upon termination of employment can further erode precious retirement savings. Many plan recordkeepers can now accept loan repayments for terminated participants through an automated clearinghouse (ACH) payment or other automatic debit on behalf of a sponsor. The process is completely outsourced, and the recordkeepers automatically will send participants notices if debit payments are not made and report a loan that goes into default as a distribution. In this way, Internal Revenue Service (IRS) rules are followed but participants have the ability to continue payments after leaving the company, further fostering retirement savings.

- **Customize target-date fund (TDF) glidepath based on plan demographics**: DOL guidance on selecting a TDF points out that fiduciaries should consider the demographics of their workforce and other relevant factors, such as other plans maintained by the plan sponsor, salary levels, turnover rates, contribution rates, withdrawal patterns and so on (U.S. Department of Labor Employee Benefits Security Administration, 2013). Each glidepath is built on a set of underlying assumptions that may be inconsistent with the demographics of an individual plan. For instance, if a plan determines that most participants withdraw their balances well before retirement, is a glidepath that doesn’t reach its most conservative asset allocation until the age of 72 appropriate? There are so many TDF alternatives in the marketplace now that most sponsors can find an appropriate “off-the-shelf” solution for their plan even if they don’t choose to build a custom solution from existing plan investments.

- **Offer more flexible distribution options**: While many sponsors have rejected the idea of offering annuities in 401(k) plans, sponsors could allow terminated participants to elect a fixed number of periodic payments to be made on a regularly scheduled basis (e.g., monthly,
quarterly, annually, etc.). The payment amount can be determined either as 1/n, where n = remaining number of payments, or as a fixed dollar amount. Permitting systematic withdrawals can simulate some of the benefits of annuity payments by providing a regular stream of income. In the short term this will allow time for regulators, sponsors and insurers to develop products that address the fiduciary and administrative concerns currently slowing the widespread adoption of the other lifetime income alternatives.

Add Social Security Modeling Tools to Recordkeeping Platforms

For most people, any decision to delay commencing Social Security benefits is tied directly to the availability of other retirement income. Since 401(k) assets often are touted as the largest investment holding for a participant, it makes sense to include a Social Security claim modeling tool as part of a plan's online tools. And while some providers do offer a link to the Social Security Administration online benefit calculators, they don't help guide the decision on when to commence benefits. The best tools try to guide the decision on whether to use existing assets (including 401(k) balances) or commence Social Security benefits based on income requirements, expected longevity, marital status, etc.

Offer Impartial Advice

Currently, retirees are predicted to live longer than their parents and will require different benefits during retirement. Offering financial and wealth planning solutions to help an employee prepare for a secure retirement is a key factor in today's world. Wall Street's self-regulator, the Financial Industry Regulatory Authority (FINRA), recently announced a service for older adults referred to as the “FINRA Securities Helpline for Seniors.” FINRA agents will field calls regarding investments, advisor credentials and various statement inquiries.

While applauded, this type of service doesn’t go far enough for unsure preretirees. Many firms have recognized the need for impartial advice and programs that offer financial and wealth planning solutions. We expect more of these types of services to become available that will allow a retiree to plan, save for and live a secure retirement. Forward-thinking HR professionals should continue to review the current market of advice providers, ensure any advice being provided to participants is impartial and modernize advice as new services become available.

Facilitate the Purchase of Voluntary Benefits

The advent of the Affordable Care Act will allow terminating employees to have guaranteed access to health insurance upon termination of employment but before Medicare eligibility. But employers provide a host of other benefits, both employer-paid and voluntary programs. Many HR professionals we work with report employees frequently ask how they can replace their existing coverages after termination of employment. Employers may want to consider making voluntary benefit platforms available to preretirees. These platforms typically could include life, dental, vision and even pet insurance as well as legal or travel advice at institutional prices. The best of these platforms will be ones that are “open” and present several different options to an individual so that a sponsor is not seen as endorsing a single firm or solution. Further, in order to make this type of benefit effective, the employer would want to find a service that includes counseling employees regarding their needs and income requirements today and in the future.

Conclusion

Much of the discussion on the decumulation phase of retirement savings has focused on the lack of any lifetime annuities. But there is a whole range of options sponsors can employ to facilitate the generation of retirement income and bolster financial wellness.

As U.S. employers show no sign of substantially increasing spending on compensation or benefits, it is imperative that HR professionals help employees—particularly the retiring baby boomers—to maximize what they have saved. The ideas we've presented here are first steps toward achieving that goal.
References


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