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The Rug Has Been Pulled From Under Americans' Retirement Security

The coronavirus pandemic has revealed the fragility of retirement security in our current landscape and sparked conversation about design and policy needs.

The coronavirus pandemic has revealed that changes may be needed in all aspects of life—from the homes we trust to care for the most vulnerable or elderly members of our society to the health care system and the climate. And, for some, the need for changes to the retirement system has also been uncovered.

Financial crises have hit many times before, but none of them has been on the same scale as this one. The market fall sparked by fears of the pandemic started on March 9 with a record-setting 7.79% drop in the Dow Jones Industrial Average. Two more record-setting days followed—a 9.99% dive on March 12 and a 12.93% plunge on March 16 for the Dow.

That alone took a big chunk out of Americans' retirement savings, with those closest to retirement—presumably with higher account balances and definitely with less time to make up for losses—in the most precarious situation. "There were a lot of people nearing retirement in the best-case scenarios with planning who didn't expect this," says Dan Doonan, executive director of the National Institute on Retirement Security in Washington, D.C. The rug was pulled from under them.

After the market drop, as the disease labeled COVID-19 reached the American public, strict social distancing and stay-at-home orders were issued, resulting in numerous business closures and record numbers of unemployed Americans. In the week ending March 28, more than 6.8 million Americans filed for unemployment. The next two weeks, the numbers were more than 6.6 million and more than 5.2 million. And it's worth nothing that those were just the numbers of people who successfully filed for unemployment; as systems became overwhelmed, many more people who were unemployed were unable to file. So if an employee worked for an employer that sponsored a defined contribution (DC) retirement plan and participated in it, but lost his job, he and his employer (assuming there was an employer match contribution) are no longer contributing. Another rug pulled from under retirement savers.

With financial hits to many businesses and people, retirement savings may be facing—or may have already taken—more hits: Employees are decreasing or stopping deferrals because of financial hardships, employers are decreasing or suspending the company match to DC plans, employees have been taking withdrawals or loans from retirement accounts and some employers aren't adopting or are terminating employee retirement plans.

The 2019 Retirement Confidence Survey (RCS) from the Employee Benefit Research Institute (EBRI) found two-thirds of American workers (67%) felt confident in their ability to retire comfortably, up from 64% in the prior year's survey. It may take until next year to fully gauge the effects of COVID-19 on retirement confidence.

However, EBRI has already done some modeling about the effect on Americans' retirement savings shortfall. In a presentation, director of research Jack VanDerhei said that as of January 1, the aggregate retirement savings deficit of American households in which the head of household is between ages 35 and 64 is estimated to be $3.68 trillion. He explained that this is the additional money needed on after-tax basis at age 65 for people to not run out of money in retirement. Modeling for the effect of first quarter investment results alone increases that shortfall by $136 billion, VanDerhei said. The retirement

savings shortfall increases 2.8% for the youngest cohort (ages 35 to 39) of EBRI's Retirement Security Projection Model (RSPM) and 4.1% for the oldest (ages 60 to 64).

The EBRI research considers all potential hits to retirement savings including unemployment's effect on plan participation for three years and finds a potential average 6.3% increase in the retirement savings shortfall for all age groups.

"While employers and policymakers cannot control market fluctuations, they can be aware of the impact of plan sponsor and participant behavior on retirement income adequacy and develop approaches that can help mitigate damaging behavior today and position plans for robust utilization when the crisis passes," VanDerhei said.

Neil Lloyd, head of U.S. DC and financial wellness research at Mercer in Vancouver, Canada, who was also part of the EBRI presentation, said he encourages plan sponsors to monitor participants' investment behavior during the market volatility. However, he noted, early reports show participants have heeded the repeated message to "stay the course."

Lloyd also pointed out that plan sponsors are facing tough decisions. "Stopping the match is generally not a good idea, but one client noted that by stopping the match, he can retain employees longer," he said. He also suggested that plan sponsors consider not adopting special COVID-19 distributions and expanded loan limits allowed for by the Coronavirus Aid, Relief and Economic Security (CARES) Act, but he conceded that is a difficult decision if employees are directly affected by coronavirus or have a spouse that is.

Mixed Messages

A message that often gets repeated to DC retirement plan participants is not to dip into their retirement savings—take a loan from the plan rather than a hardship withdrawal, avoid a loan if possible to avert a default and roll over balances upon changing jobs rather than cashing out. However, DC plans are a go-to source for the government to help participants in crisis—after hurricanes, floods and other natural disasters, the IRS and Department of Labor (DOL) routinely issue regulations expanding loan limits and providing relief from tax penalties for hardship withdrawals from retirement plans.

With the COVID-19 crisis, Congress stepped in and, with the CARES Act, created a new emergency retirement plan distribution option dubbed the "coronavirus related distribution," or "CRD" for short. A CRD can be drawn from a DC plan or from individual retirement accounts (IRAs) in any amount up to $100,000. Under the terms of the CARES Act, the normal 10% penalty tax levied on early plan distributions by the IRS is waived. Furthermore, the individual taking a CRD can spread the reported income over three years for tax purposes, and the distribution also can be repaid within three years to avoid taxation. The law also doubled the amount of loans that participants can take—from $50,000 or 50% of their account balance, whichever is lower, to $100,000 or 100% of their account balance.

"I understand why the CARES Act provided additional abilities for individuals to tap into retirement plans with reduced penalties, but at the same time, we don't want to keep going to the retirement savings well to help individuals when they face financial hardship," says Josh Cohen, managing director of PGIM's Institutional Relationship Group in Chicago. "It solves one issue but creates new challenges." For Cohen, this highlights the need for individuals to have emergency savings accounts.

"Most people don't have emergency savings, so the CARES Act provisions work if they have retirement savings," Lloyd said. "It's a resource that can be mobilized if need be, we can't ignore that."

Despite the continued messaging that tapping into retirement savings will be really damaging for retirement security in the long run, it is now being incentivized, Doonan points out.

Lloyd noted that participants are focused more on day-to-day finances than saving for retirement right now. But that's often true for the majority of people even when there isn't a crisis. Lloyd urged plan sponsors to consider financial wellness programs. "When plan sponsors get the opportunity to be more strategic, they should look at what they have learned about the financial vulnerabilities of their staff and determine how best these can be addressed," he said.

Perhaps current financial wellness should be the first focus to ensure future financial wellness.

A Need for Progress in Plan Designs

Since the retirement landscape moved from mostly defined benefit (DB) pensions to mostly DC plans for employees, public policymakers and retirement plan sponsors, providers and advisers have realized the stress this puts on individuals and have made great strides to improve DC plan designs. Ironically, many have called it the "DB-ization" of DC plans.

Under these reforms, employees are automatically enrolled into their employers' DC plans, most often in an automatically diversified investment vehicle that automatically gets rebalanced periodically. In some plans, participants don't have to make a move to increase their savings, as that is done automatically as well.

"We have to give plan sponsors some credit; participants are in better shape than they were years ago," Cohen says. "Target-date funds [TDFs] have put people in diversified portfolios at appropriate risk targets for their age, and there are more advice tools and other guidance to help participants."

The next step—which lawmakers and regulators are making efforts to incentivize—is to include guaranteed retirement income in DC plans.

While there was never a dream world where every employee was covered by a DB plan and had guaranteed income they could count on for life, Cohen points out that the current crisis offers evidence of the challenges when all the risks to retirement preparedness are put on participants. "The market volatility and drop in interest rates are some of my biggest concerns, particularly for those closest to retirement who maybe had more risk than they could bear when sequence of returns risk matters most," he says. "Younger participants should be able ride the market out and hopefully take advantage of dollar cost averaging, to the extent they are still able to make contributions and get an employer match. But those closest to retirement face a double whammy of losses in portfolios and lower interest rates which make it harder to generate income through both fixed income investments and guaranteed income investments."

Doonan also says it is time for employers to look at how do-it-yourself retirement savings features perform during recessions. "In plans without risk pooling, you can't plan ahead for a situation like this—you're always a victim of timing," he says. "If you lose your job and your account balances are going down at the same time, it's hard to succeed."

He adds that pensions did a good job of handling this. "The funding rules have gotten so tight that employers moved away from them, but there are lessons to learn," Doonan says.

Plan sponsors should look more strategically at how to continue to enhance DC plans to deal with participants bearing so much risk, Cohen says. Investments offered should be well-diversified across different strategies—public and private investments and lifetime income solutions. He suggests plan sponsors think about investments for managing all types of risk—market risk, interest rate risk and longevity risk. "Participants need both guaranteed and non-guaranteed solutions," he says.

Cohen adds that policymakers have been supportive not only of including lifetime income solutions in DC plans but also of incorporating them in default options. "These are very complicated types of solutions, so by just adding it onto an investment menu, it's probably not going to get utilized as it should," he says. "Most individuals need professional management and customization to have both guaranteed and non-guaranteed solutions."

Cohen says plan sponsors need more fiduciary support from policymakers when it comes to including different investment strategies and types in DC retirement plans—including clear guidance on active versus passive investments and institutional type investments.

A Need for New Policies

Doonan contends that the biggest thing policymakers need to focus on right now is the health crisis. "If we miss getting the response to the health challenge right, I can't imagine a strategy that prevents a bad situation for retirement preparedness from becoming catastrophic," he says. As it is, the retirement outlook for many has already worsened as millions have lost their jobs and their ability to make contributions to retirement accounts. Once the health crisis is contained, improving retirement policy is one thing that should be addressed.Retirement policy took a big step forward with passage of the Setting Every Community Up for Retirement Enhancement (SECURE) Act

in December. Businesses are now allowed to join multiple employer plans (MEPs) without having a common nexus such as industry or locality, businesses starting a retirement plan for employees will be given a tax credit and DC plan sponsors have a clarified fiduciary safe harbor when selecting lifetime income products to include in their plans, just to name a few provisions enhancing Americans' ability to ensure a secure retirement.

Doonan says the SECURE Act took important steps to improving retirement plan access for employees, and finding a way to have guaranteed retirement income that is a good value from DC plans is important. However, he says, there is still room for improvement.

Another organization, the Insured Retirement Institute (IRI) issued a five-point plan, which it sent to the Trump administration and leaders of Congress, that suggested some enhancements to provisions of the SECURE Act. "The market disruptions caused by COVID-19 have affected the retirement accounts of many workers close to retirement, who may now need to work even longer to recoup losses," the IRI points out. The SECURE Act increased the required minimum distribution (RMD) age from 70 1/2 to 72; the IRI recommends it be increased again to at least 75.

"Small business owners and employees have been disproportionately negatively impacted by the COVID-19 pandemic. When these employers resume business operations, they should take advantage of tax credits to incentivize them to offer returning employees a retirement savings plan. The SECURE Act enhanced this credit to encourage small businesses to offer a retirement plan through a MEP or PEP. However, the credit is not available after a MEP or PEP's first three years of operation. Congress should amend current law to clarify the startup credit applies from the time a small business joins a MEP or PEP and not from the time the MEP or PEP begins operations. This would encourage more recovering small businesses to offer a retirement plan utilizing MEPs and PEPs," the IRI says.

It also asks Congress to amend the law to allow nonprofit, public educational organizations and religious institutions to offer their employees retirement benefits through a MEP.

Doonan points out that the current crisis and previous market crises highlight other challenges. He notes that an NIRS survey found 70% of those polled said part of their plan for a secure retirement was to stay in their job as long as possible. In addition, 42% planned to delay Social Security to get a higher benefit. "The current situation shows the folly of those strategies; it's not always a worker's choice," Doonan says.

"We know from the last recession that older workers have a harder time recovering from job losses," he says. "Having the ability to not totally disconnect from their jobs or return to their jobs can minimize damage."

Doonan notes that NIRS research finds a lot of Americans are largely dependent on Social Security for retirement income. "The cut to their benefits by taking Social Security early will be with them for the rest of their lives," he says. "The key is preventing people from making the decision to take Social Security early. We need a policy for helping people find or continue in jobs to bridge benefits."

There once was the idea of a three-legged stool for retirement savings—Social Security, pensions and personal savings—but pensions are waning and Social Security is in financial trouble. John Lowell, Atlanta-based partner and actuary for October Three, has noted that some of the arguments against offering DB plans were addressed by the Pension Protection Act (PPA) of 2006, and that a few pushes will ensure new plan designs can fix retirement for the future. As for Social Security, with passage of the CARES Act, Congress has demonstrated an ability to speedily enact ambitious bipartisan legislation of a large financial scale, and many are hoping the same attention can be turned to Social Security. ●