Reimagining Retirement 2030: A Roadmap for Action

CRI Annual Policy Innovation Forum

October 22, 2020

Social media: #2030CRIForum

GEORGETOWN UNIVERSITY
McCourt School of Public Policy

CENTER FOR RETIREMENT INITIATIVES

What Could a 21st-Century Lifetime Income "Pension" Look Like?

Moderator | Charles Millard
Former Director, Pension Benefit Guaranty Corporation (PBGC)

Panel Participants

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David Pratt
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Tamiko Toland

Head of Research

CANNEX

2020 Guaranteed Lifetime Income Study

2020 CRI Annual Policy Innovation Forum

October 2020

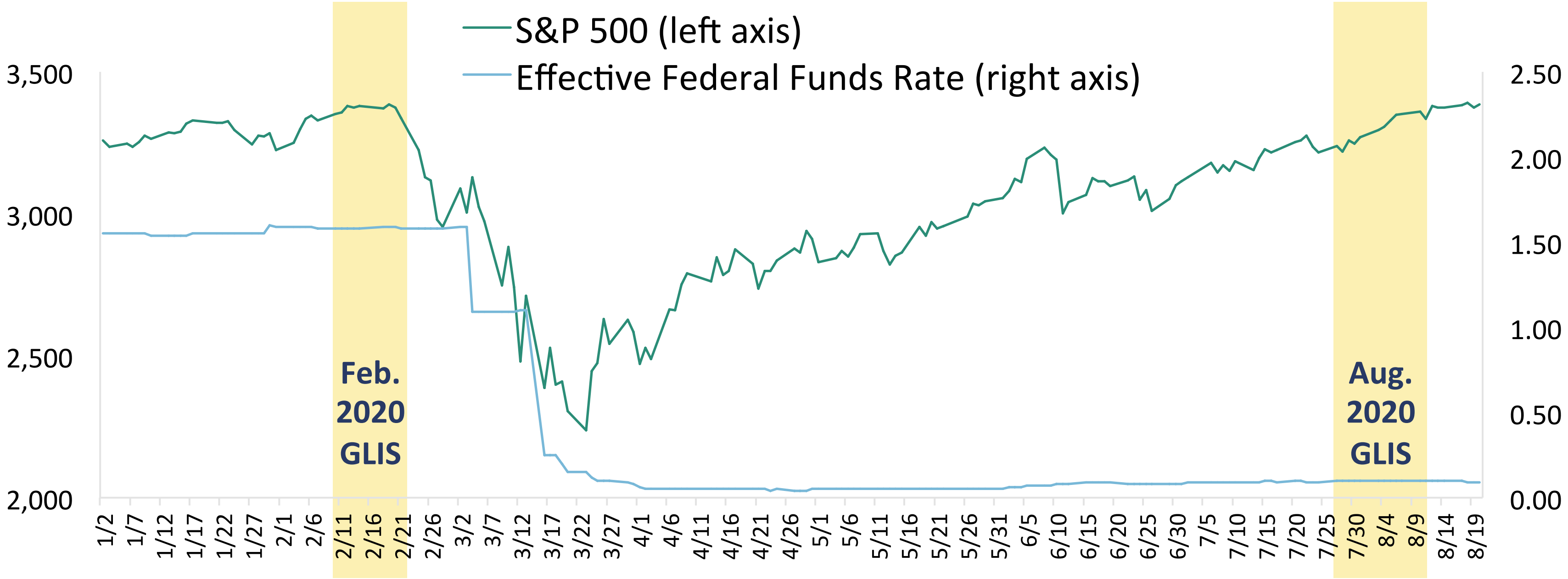
About the Study

- Annual **consumer** survey trended since 2014
  - Respondents are ages 55–75 with investable assets of $100K+
- Annual **financial advisor** survey trended since 2019
  - Respondents work with individual clients and 50% of their clients must be age 55+
  - Mix of advisor channels and AUM and experience requirements as well

- In 2020, the annual surveys fielded in February, days before the market crashed in response to COVID-19
- A mid-year update of the surveys was then fielded in August to compare

Context for the February and August Waves of GLIS

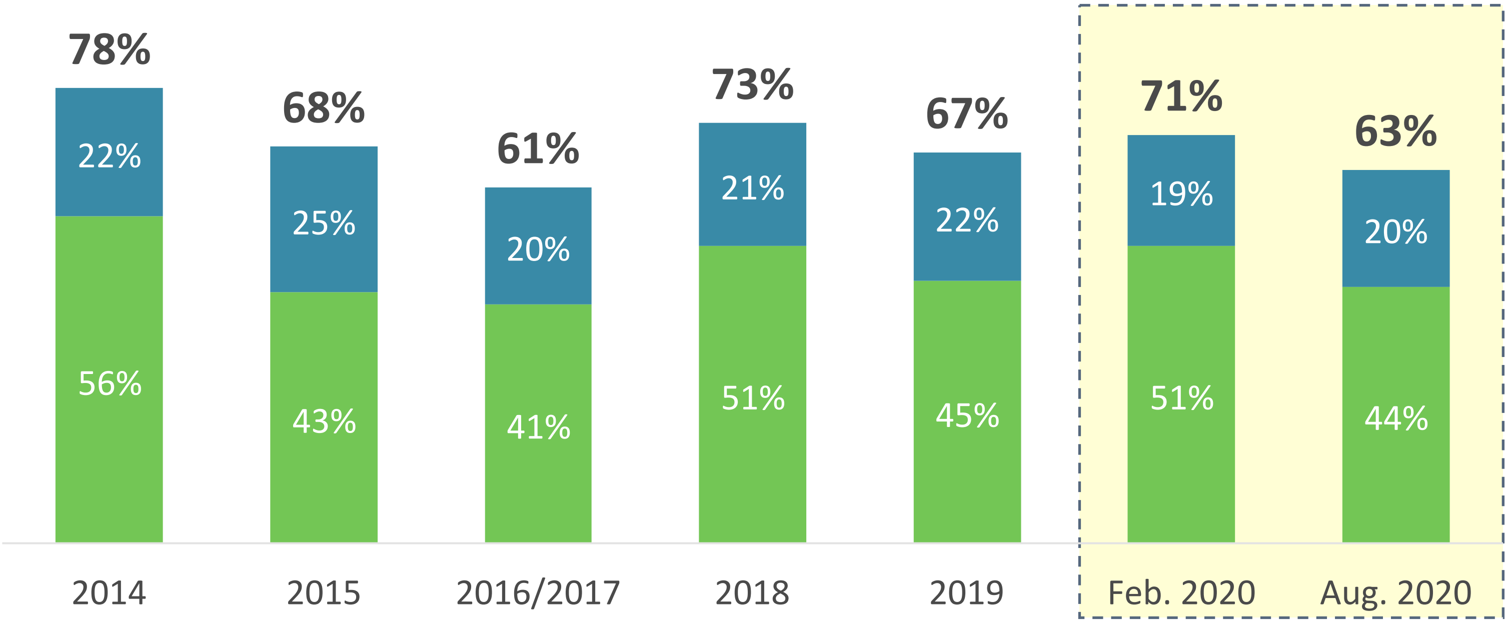
S&P 500 and Effective Federal Funds Rate: January 2020–August 2020



Perceived value of GLI has always been very high among consumers, but it decreased between Feb and Aug 2020.

Perceived Value of Guaranteed Lifetime Income in Addition to Social Security

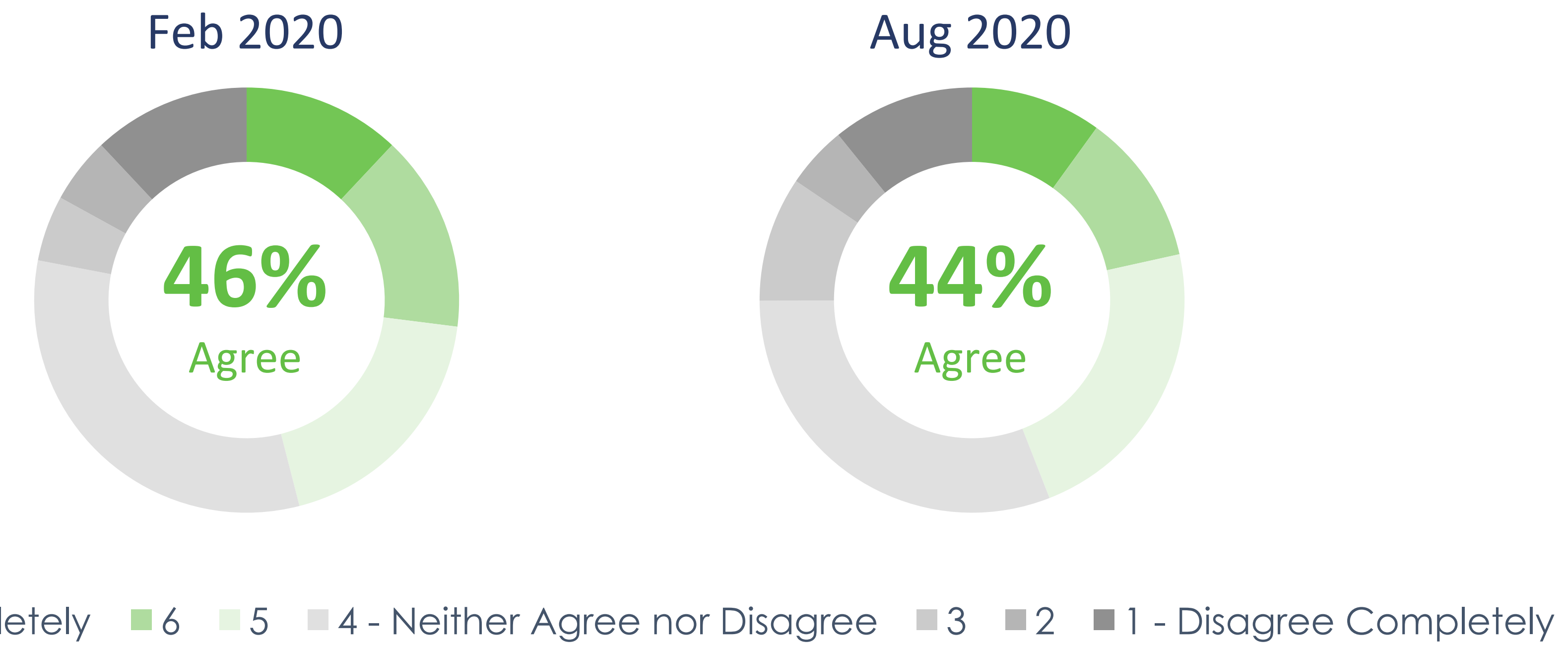
Highly Valuable: Rated 6–7 out of 7



Consumer interest in in-plan GLI products has remained stable from February.

"I would be more interested in purchasing a product that provides GLI if it were available through my employer-sponsored retirement plan"

Among Pre-retirees, Non-GLI Owners

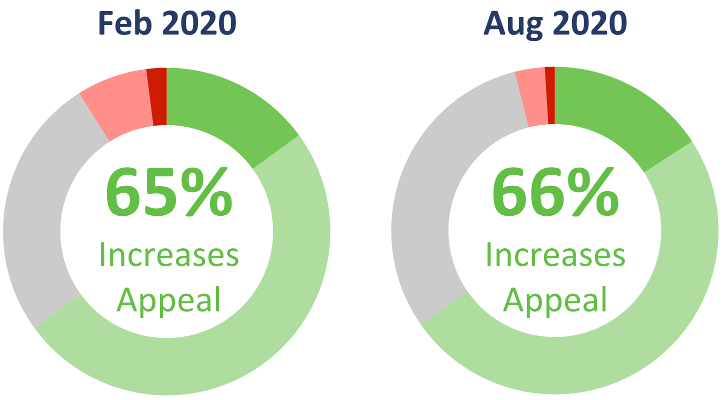


Advisors consider the current market and interest rate environment to be favorable for GLI products.

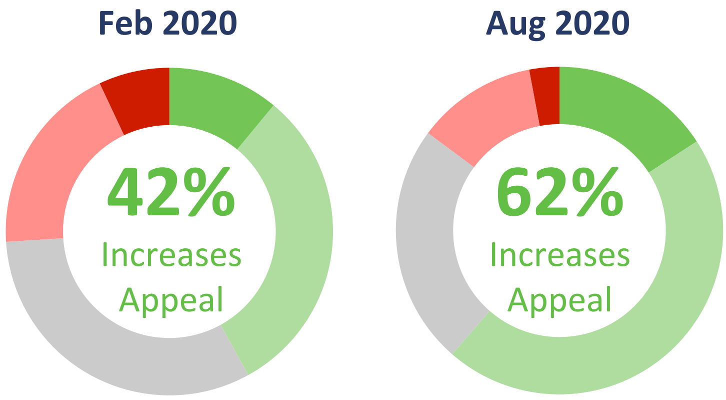
Appeal of Recommending GLI Products to Clients

Among Advisors

Impact of Current Stock Market Conditions

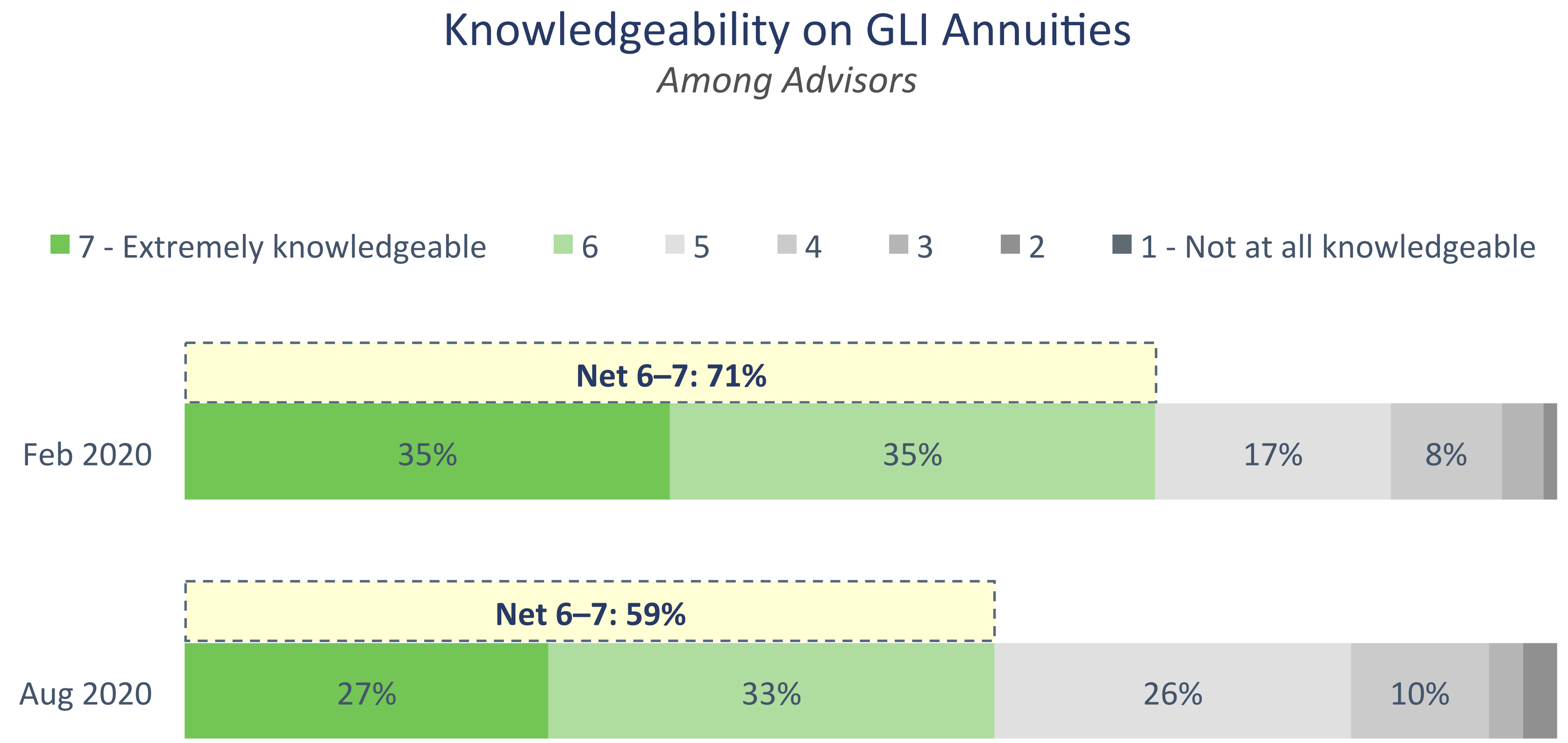


Impact of Current Interest Rate Environment



■ Increases significantly ■ Increases somewhat ■ Does not change appeal ■ Decreases somewhat ■ Decreases significantly

Advisors are significantly less confident in their knowledge about GLI annuities than they were in February.



Thinking about the Plan Sponsor perspective

- A double-edged sword: Education around **set it and forget it** has both worked and been reinforced.
- High time to educate participants about sequence of returns risk and the value of income protection.
- Participants are certainly ready, as interest in GLI within an employer-sponsored retirement plan remains steady (nearly half).
- Professionals recognize that the current environment increases the appeal of these products.
- Sponsors and everybody else upstream in the plan space desperately need education on income protection.

More on the Mid-Year Update

- Top 5 Key Findings and a related data supplement are available on our websites.
- White paper in progress.
- Greenwald Research: https://greenwaldresearch.com/glis/
- CANNEX: http://www.cannex.com/index.php/2020-gli-study-u-s/

David Pratt
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LIFETIME INCOME IN 401(k) PLANS

David Pratt

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LIFETIME INCOME IN 401(K) PLANS

- What is the problem?
- Is a 401(k) a retirement income plan?
- Are there barriers to lifetime income in 401(k)s?

LIFETIME INCOME IN 401(K) PLANS

- What is a legal or regulatory barrier?
- ERISA and fiduciary responsibility
- Important changes under the 2019 SECURE Act
- Limitations of the new safe harbor

LIFETIME INCOME IN 401(K) PLANS

- Changing the mindset from accumulation to income
- Lifetime income as a default
- Longevity annuities and partial annuitization
- Need to inform and educate insurers, investment advisors, employers, recordkeepers and plan participants

LIFETIME INCOME IN 401(K) PLANS

- Insufficient accumulations and leakage
- Multiple small accounts
- Financial and wellness counseling
- IRAs must also be addressed

David Pitt-Watson

Visiting Fellow

Cambridge Judge Business School (UK)

UNIVERSITY OF CAMBRIDGE
Judge Business School

The benefits of Pooled Pensions

The Logic, the Evidence and some History

David Pitt-Watson

For Georgetown Centre for Retirement Initiatives
Policy Innovation Forums
22nd October 2020

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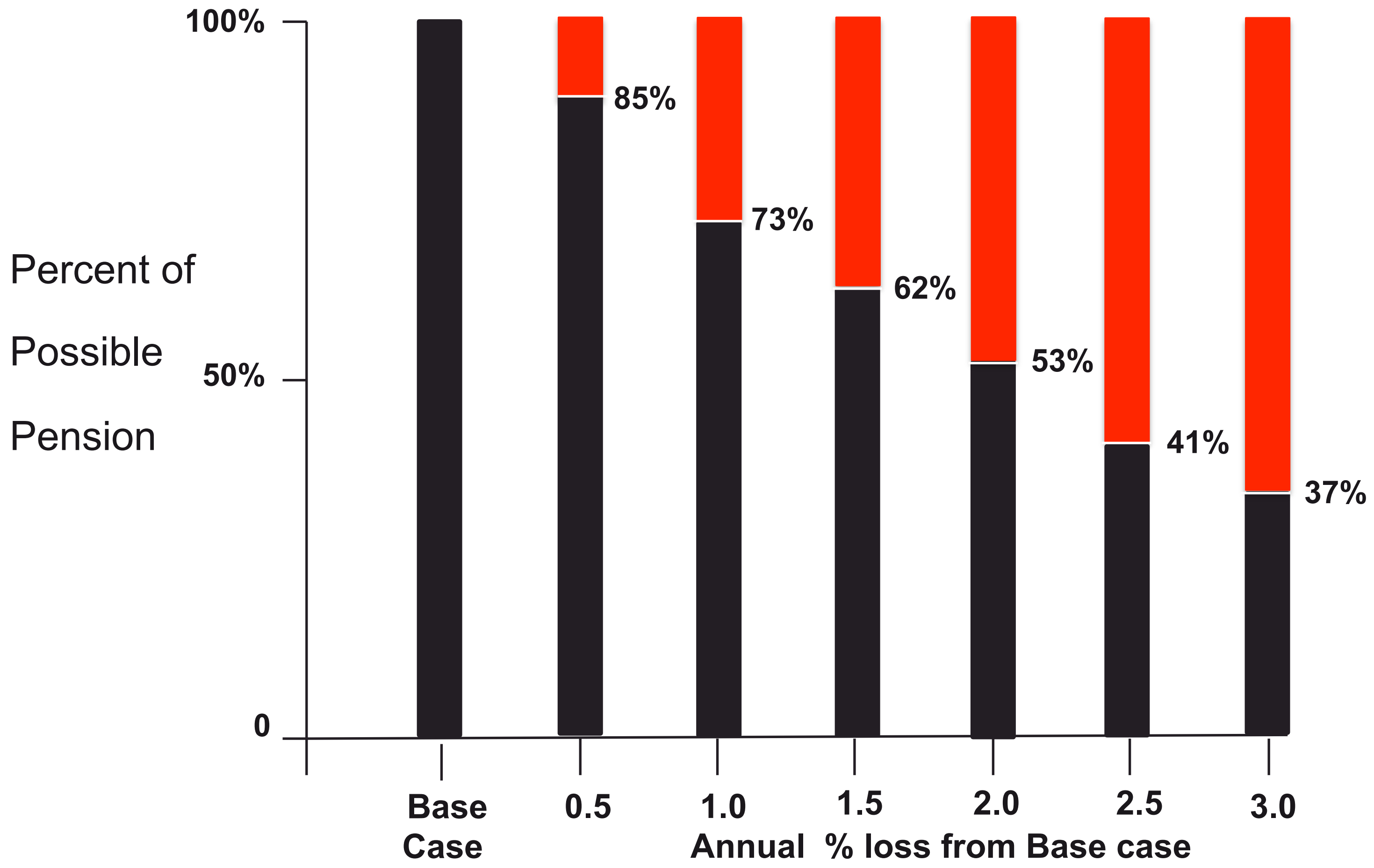
The world's best pension systems are characterised by effective systems of pooling

- "I want an income which will last from the time I retire until the time I die' (RSA Citizen Juries)
- That is the aim of the world's best pension systems
- They all use pooling because:-
  - 1) It facilitates professional management—low cost risk adjusted returns
  - 2) It allow a sharing of longevity risk
  - 3) It creates long term pools of capital
  - 4) It mitigates timing risk
- These advantages make a big difference to outcomes
  - Failure to use pooling results in a huge drop in productivity

Loss to pension-in-payment of higher charge or loss of return

60 Year pension



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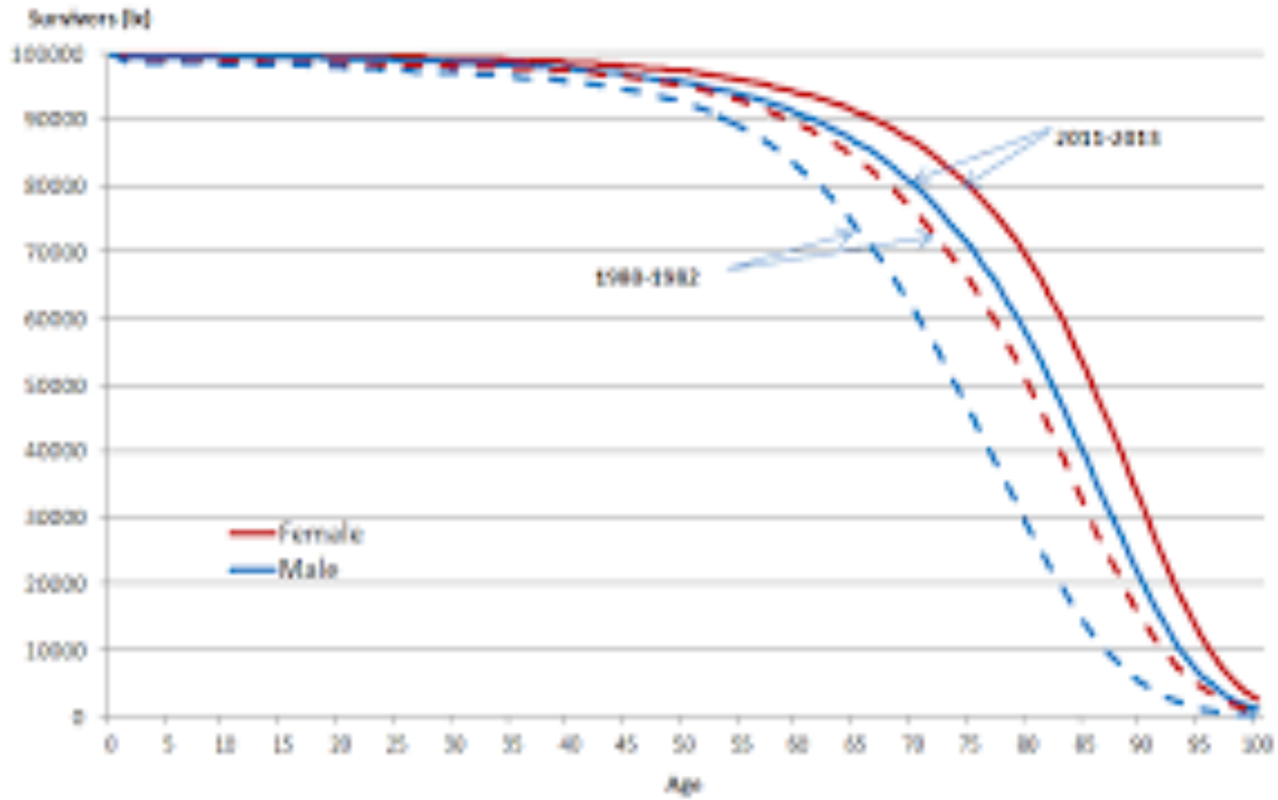
'I know not the day of my death' Genesis 27.2

Survivorship by age in UK



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Studies of Pooled Pensions

Study	Comparison made/methodology	Key Variables	Upside
Almeida and Fornia	DB vs DC for same expected lifetime income	Longevity risk Investment portfolio	**85%**
UK Government Actuary	DC+Annuity vs CDC Various scenarios, Monte Carlo Simulation	Investment portfolio	**39%**
Royal Society of Arts (RSA)	DC+Annuity vs CDC Simple cost modelling	Costs	**37%**
AON Hewitt (+RSA)	DC+Annuity vs CDC Modelling on historic returns 1930-Present	Historic returns	**33%**
Pension Policy Institute	DC+Annuity vs CDC Modelling expected returns	Investment returns	**Over 40%**
Willis Towers Watson	DB vs CDC Typical asset allocations and returns c2020	Investment returns	**40%**
	DC+Annuity vs CDC returns c2020	Investment returns	**70%**

What are the Problems of (non-DB) Pooling?

- Participants bear all the risk. So as in all DC, benefits can vary. (Though variance is manageable)
- So communication vital
- All design features and judgements need to be fair between generations
- Skilled, accountable, trustee governance is vital

Why we forgot the advantages of pooling?

Path dependency or why history matters

- Fifty years ago, the UK and the Netherlands might have been judged to have similar collective DB/DC hybrid occupational pensions
- Over time in the UK the pensions became DB
  - That then proved unaffordable and DC+Annuity was introduced
  - That then proved expensive and simple DC savings became the norm
- The Netherlands continued with a collective system which operated very like DB
  - Hit problems in 2010 when pensions needed to be cut
  - However the average cut was only 2% (max 6%)
  - Reform now in place-but no abandonment of pooling
- The UK is now (re-)introducing collective DC
  - Which will immediately be adopted by Royal Mail

Implications

- For very obvious reasons the world's best pension systems use pooling to create a lifetime retirement income.
- But the traditional pooled DB system is being abandoned
- A most urgent need to think through how we introduce a more effective and productive system
- The benefits of doing so are vast

Richard Fullmer

Founder

Nuova Longevità Research

GEORGETOWN UNIVERSITY CENTER FOR RETIREMENT INITIATIVES

REIMAGINING RETIREMENT 2030: A ROADMAP FOR ACTION

WHAT COULD A 21ST-CENTURY LIFETIME INCOME "PENSION" LOOK LIKE?

20-22 OCTOBER 2020

MODERN TONTINE PENSIONS

RICHARD K. FULLMER

NUOVA LONGEVITÀ RESEARCH

N∞L

New Longevity

Background

Many retirees are underprepared for retirement

- Lack of access to retirement saving programs
- Under-saving
- Lack of financial literacy and knowledge

Defined contribution (DC) plans are typically savings oriented…

…but retirees need a way to transform that savings into lifetime income

…and traditional withdrawal strategies are highly uncertain (longevity risk)

…and people tend not to purchase annuities on their own (annuity puzzle)

Modern tontines

Tontines combine an investment with a payout scheme

- Investment is irrevocable
- Upon death, account balances are transferred to surviving members
- In this way, investors collect a longevity yield (survivor credits) for as long as they survive

Tontines pool and diversify the individual longevity risks of their members

- Members collectively share longevity risk
- No third-party guarantor/insurer
- No guarantee premiums, no reserves, no counterparty risk

Payouts self-adjust to ensure the tontine *remains fully funded at all times*

Think of tontines as *actuarially-fair*, *non-insured* annuities

Brain teaser...

Q) Are tontine arrangements a subset of collective defined contribution (CDC) schemes?

Or are CDC schemes a subset of tontine arrangements?

Perhaps it depends on how one defines these terms – there is a lot of overlap

“Pure” tontines make no attempt at intergenerational wealth transfer

Modern tontine *pensions*

Structured as an open-ended, perpetual membership pool

Pays out in the form of a life annuity (with variable payments)
- Adheres to a strict “budget constraint” (must always remain fully funded)
- Fully funded status applies to each and every member

Like mutual funds, but:
- Longevity risk is pooled and shared
- Contributions are irrevocable to enforce the risk-sharing arrangement
- At death, account balances are *fairly* redistributed to surviving members (survivor credits)
- Pays out in the form of lifetime income

Like commercial life annuities, but:
- Is actuarially-fair (lower cost)
- Payout levels are not guaranteed, may rise and fall
- Investors share systematic mortality risk

The retiree's dilemma: invest or insure?

Commercial annuities embed two components

Self Drawdown + Longevity Risk Pooling + Third-Party Guarantee = Guaranteed Annuity

Self Drawdown

~~Longevity risk pooling~~
~~Mortality credits~~
~~Third-party guarantee~~

~~Irrevocable~~
~~Guarantee costs~~
~~Counterparty risk~~

Full control

Longevity Risk Pooling

Utility Maximizing
for most

(high value, low cost)

Third-Party Guarantee

Opaquely Priced
& Expensive

(subjective value, high cost)

Guaranteed Annuity

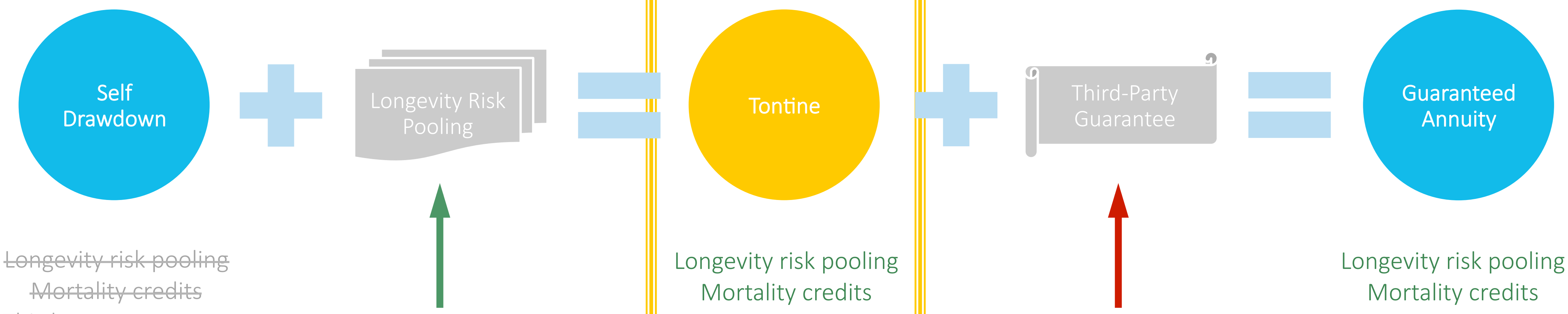
Longevity risk pooling
Mortality credits
Third-party guarantee

Irrevocable
Guarantee costs
Counterparty risk

No control

Can't these components be separated? Of course they can!

High value. Low cost.



~~Longevity risk pooling~~
~~Mortality credits~~
~~Third-party guarantee~~

~~Irrevocable~~
~~Guarantee costs~~
~~Counterparty risk~~

Full control

Utility Maximizing for most

Longevity risk pooling
Mortality credits
~~Third-party guarantee~~

Irrevocable
~~Guarantee costs~~
~~Counterparty risk~~

Partial control

Opaquely Priced & Expensive

Longevity risk pooling
Mortality credits
Third-party guarantee

Irrevocable
Guarantee costs
Counterparty risk

No control

State or private sponsorship

States have begun rolling out their own retirement saving programs for workers that lack access to a DC savings plan (e.g., 'Secure Choice' plans)

These programs address the *access* and u*nder-saving* problems…

…but not the problem of transforming savings into *lifetime income*

Tontine pensions are a natural solution

States could sponsor and outsource operations to private companies (similar to 529 plans)

Alternatively, private entities could sponsor (e.g., corporate DC plans, private companies)

Benefits to plan sponsors

Lifetime income

- Well-suited to the DC model (individual accounts, investment options)
- Lifetime income is assured (to some maximum age, such as 120)
- Income may begin immediately at retirement or deferred to an advanced age
- No counterparty risk with third-party guarantors

Efficiency

- Participants enjoy significantly higher returns than traditional investments
- Lower cost structure than conventional annuities
- May be offered with the same investment choices that already exist in the DC plan

Sustainability

- Perpetually fully funded

Summary

Tontine pensions:

- Are self-correcting and thus fully sustainable
- Offer low-cost universal access to pension-like lifetime income
- Offer freedom of portfolio selection
- Offer freedom to choose from a variety of payout options
- Represent a partial remedy to the annuity puzzle
  - Lower cost
  - Greater transparency

Payout volatility can be minimized by:

- Encouraging a large membership pool (the law of large numbers)
- Using conservative investments and employing duration matching techniques

Selected additional reading

Tontines: A Practitioner's Guide to Mortality-Pooled Investments
Fullmer, R. K. (2019). Charlottesville, VA: CFA Institute Research Institute.
https://www.cfainstitute.org/-/media/documents/article/rf-brief/fullmer-tontines-rf-brief.ashx

The Case for Tontine Pensions as a Lifetime Income Solution for State-Sponsored Retirement Savings Programs
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https://cri.georgetown.edu/the-case-for-tontine-pensions-as-a-lifetime-income-solution-for-state-sponsored-retirement-savings-programs/

State-sponsored Pensions for Private Sector Workers: The Case for Pooled Annuities and Tontines
Fullmer, R. K. and Forman, J. B. (2020). Wharton Pension Research Council Working Papers.
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