Hoping for a Miracle Is Not a Strategy: Helping Employees Make Better Retirement Decisions

Defined contribution (DC) participants who simply have not saved enough cannot expect any available solutions to magically create a cushy retirement income stream out of nothing. However, plan sponsors can be proactive in working with participants to counter magical thinking, help them set reasonable goals and develop a coherent path to and through retirement. This article explains some of the key drivers of DC participants’ retirement decision making, common missteps by those making retirement decisions and how employers can help workers formulate a better retirement plan.

by Lori Lucas | Callan Associates

When two fugitives find themselves trapped by police on the rim of the Grand Canyon at the end of the movie *Thelma & Louise*, their solution is to clasp hands as Louise floors their convertible’s gas pedal, sending the car hurtling over the canyon edge. At first the car takes flight as though it may very well “keep going,” as Thelma had hoped. Then, the movie freeze-frames with the car suspended in the air before it crashes into the canyon.

Research shows that retirement decision making can bear a considerable resemblance to the *Thelma & Louise* approach: flooring it and hoping for a miracle. Misconceptions and fallacies about when to retire, how much income is needed in retirement and even what retirement will look like are rampant. As a result, evidence shows that those contemplating retirement are often prone to throwing up their hands and jumping off the cliff, hoping all the pieces will fall together to create a sustainable plan.

Consider how a focus group of retirees described their approach to determining whether they could afford to retire:

“I don’t have much, but I don’t worry about it. I don’t worry about the fact that I’m not making any money.”

“[W]hen I stepped out, of course I had no idea. Way far away from Social Security, Medicare or anything like that. It was just a leap of faith.”

“I prayed over it and looked at all my options and presented them over the Lord, and I made my decision.”

In this article, we will explain some of the key drivers of defined contribution (DC) participants’ retirement decision making, common missteps by those making retirement decisions and how employers can help workers formulate a better retirement plan.
Retiring or Just Giving Up?

The annual Retirement Confidence Survey (RCS) by the Employee Benefit Research Institute (EBRI) highlights the disconnect between the age when people think they are likely to retire and when they actually do. According to the 2017 RCS, 38% of workers expect to retire at the age of 70 or beyond, while only 4% of retirees report this was the case. Likewise, just 9% of workers say they plan to retire before the age of 60, compared with 39% of retirees who did. EBRI reports that “many retirees who retired earlier than planned cite hardships for leaving the workforce when they did, including health problems or disability (41%), changes at their company such as downsizing or closure (26%) and having to care for a spouse or another family member (14%). Others say changes in the skills required for their job (4%) or other work-related reasons (16%) played a role.

Of course, some retirees mention positive reasons for retiring early, such as being able to afford an earlier retirement (24%) or wanting to do something else (10%).”

According to a Society of Actuaries (SOA) retiree focus group report, the decision to retire is most often based on the perceived difficulty of continuing to work. “Some retired because they were tired of working, and others were forced into retirement. Others did not have a choice about continuing to work because they developed debilitating health issues. Fewer retired because they had planned to retire and their finances were in order for retirement.”

The retirees in the focus group paint a disturbing picture of decision making driven by frustration, lack of motivation and even default.²

“I retired at 65, and I think the workforce was such that you felt intimidated. For those who stayed longer, it was like you were taking someone else’s position.”

“I got to the point where it was becoming a little too much for me every day, getting up early and working every day.”

“I had a hard time getting used to everything being on the computer. I was not that good with it.”

Research by Beehr et al. confirms that frustration with one’s job situation is a driving factor in retirement. The researchers studied 197 older public employees to determine what factors—outside of finances—caused people to decide to retire.³ Consistent with the SOA focus group findings, Beehr et al. determined that being tired of working was a significant factor in the decision to retire early.

Notably, another significant factor cited in the study was “planning to engage in other employment activities.” However, RCS has consistently found that workers are far more likely to expect to work for pay in retirement than retirees are to have actually worked. According to the 2017 RCS, 79% of workers plan to work for pay in retirement, but just 29% of retirees report they have worked for pay.

Belbase et al. show that the job frustrations expressed by workers—even white-collar workers—may stem from cognitive declines. The researchers created a Susceptibility Index to show the relationship between changes in cognitive ability and the likelihood of early retirement. They found that crystallized cognitive abilities, such as vocabulary, tend to be sustained well into an individual’s 60s and even 70s. “Workers in white-collar occupations [who] rely on these abilities—like college professors or bookkeepers—may be able to work longer without noticeable declines,” the researchers conclude. In contrast, fluid cognitive abilities, such as episodic memory, working memory, and inductive and deductive reasoning that people—such as CEOs—need to acquire new information and make decisions, steadily decline with age.⁴ The researchers concluded: “Simply put, even for some white-collar workers, working longer is made more difficult by the abilities required by their job.”

All of these findings have implications not only for retirement planning but also for workforce management. Helping employees properly calibrate their retirement date with their need to retire can help reduce the likelihood that workers either remain on the job when they no longer have the ability or interest to do so or leave before they are truly ready—taking valuable intellectual capital, institutional knowledge and/or skills with them.

Calculating Income in Retirement and Magical Thinking

RCS reports that just 41% of workers say they and/or their spouse have tried to calculate how much they will need to save to live comfortably in retirement. Complicating things further, sufficient retirement savings is the subject of considerable controversy in the retirement industry.

A 2015 Government Accountability Office report investigated what consumption looks like in retirement and
how retirement income replacement rates are defined, calculated and used to assess retirement preparedness. It found that “[i]income replacement rates may be a helpful gauge . . .” At the same time, “The wide range of recommended target replacement rates cited in research indicates that there is no rule of thumb that will work for everyone.” Indeed, not only did the researchers cited in the report vary dramatically in terms of how much income retirees might need, they even differed on the appropriate way to view retirement income adequacy. Some described it as sufficient income to meet basic expenses in retirement (EBRI). Others believed retirees should be able to maintain a standard of living in retirement (Biggs-Schieber). Yet other researchers focused on wealth consistent with predictions of a lifecycle model (Scholz-Seashadri-Khitatrakun) (see table).

Research by Michael Finke and others questions long-held assumptions about how much people should spend in retirement. In their paper “The 4% Rule is Not Safe in a Low-Yield World,” Finke et al. challenge a longstanding financial rule of thumb—that drawing down 4% of assets per year in retirement coincides with a low failure rate (defined as the probability of wealth depletion before the end of retirement). Finke et al. note that the original analysis of the 4% rule was predicated on an environment where real returns were higher than they are likely to be going forward. Under scenarios with lower real returns, failure rates can soar. The

### Table: Selected Studies of Retirement Income Adequacy

<table>
<thead>
<tr>
<th>Organization (year of study)</th>
<th>Retirement adequacy benchmark (replacement rate, unless otherwise specified)</th>
<th>Percentage of sample projected to be below benchmark</th>
<th>Other notes and statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aon Hewitt (2012)</td>
<td>85%, or 11 times pay at the age of 65</td>
<td>85% of sample, including 71% of employees with potential to participate in employer plan for 30 years</td>
<td>Estimates that savings shortfall relative to target for full-career contributing employee is 2.2 times pay</td>
</tr>
<tr>
<td>Biggs-Schieber (2014)</td>
<td>Able to maintain standard of living in retirement, but no specific target stated</td>
<td>N/A</td>
<td>For those who work to full retirement age, Social Security typically replaces 62% of final average earnings; income from 401(k)s and IRAs underreported by SSA.</td>
</tr>
<tr>
<td>Center for Retirement Research at Boston College (2014)</td>
<td>69% for highest one-third income level, 72% for middle, 79% for lowest</td>
<td>52% overall; 60% of low-income and 43% of high-income households</td>
<td>Projects retirement income at the age of 65; assumes annuitization of wealth, including housing equity</td>
</tr>
<tr>
<td>Employee Benefit Research Institute (2012)</td>
<td>Sufficient to meet basic expenses, including health expenses, throughout retirement</td>
<td>44% of 1948-1954 birth cohorts; 87% of lowest income quartile; 13% of highest income</td>
<td>Assumes retirement at the age of 65; assumes housing equity converted to savings only when other resources are exhausted</td>
</tr>
<tr>
<td>Hurd-Rohwedder (2012)</td>
<td>Enough resources to maintain pre-retirement consumption and die with bequeathable assets</td>
<td>30% of 66-69-year-olds; 23% of married households; 51% of single persons</td>
<td>Estimates consumption trajectories based on pre-retirement consumption; assumes housing wealth not depleted until other forms of wealth are; lowest rates of preparedness for people with shortest financial planning horizons and with least education</td>
</tr>
<tr>
<td>National Institute on Retirement Security (2015)</td>
<td>85%, or eight times income at the age of 67</td>
<td>66% of working households aged 25-64; 70% of aged 55-64 households</td>
<td>Estimates that 62.4% of households aged 55-64 fall short of target, using a 25% lower savings goal</td>
</tr>
<tr>
<td>Investment Company Institute (2012)</td>
<td>Able to maintain standard of living in retirement, but no specific target stated</td>
<td>N/A</td>
<td>Declining poverty rates of 65-and-older population, with smaller percentage of 65-and-older in poverty than those aged 18-64; Social Security and housing equity comprise key components for lower wealth workers; most 55- to 64-year-olds covered by some pension wealth</td>
</tr>
</tbody>
</table>
researchers conclude that "the 4% rule cannot be treated as a safe initial withdrawal rate in today’s low-interest-rate environment."6

Further complicating things are cognitive errors people experience in estimating how long they are likely to live in retirement and in drawing down assets. Research by Heimer et al. found that, on average, younger individuals substantially underestimate their survival chances relative to actuarial statistics from the Social Security Administration, whereas older individuals substantially overestimate their survival chances. Specifically, both men and women aged 58 and younger underestimate their expected longevity, while 78-year-olds overestimate how long they will live. These distortions, the researchers found, cause the young to save less and those beyond retirement age to consume their savings at a slower pace than necessary.7

The SOA focus groups found that retirees often respond to financial uncertainty by reducing their lifestyle.

“I think our needs are a lot less than our wants, and we all have way too much stuff that we can live without.”

“There is no longer a fixed income, from investments to Social Security to my pension. Well, when you are the average housewife—I’m speaking for myself and a lot of my neighbors—you can have a couple pair of jeans and T-shirts and you get along just fine. You don’t have to go out and spend a lot of money.”

“When I was working and making a considerable amount of money every year, I didn’t shop. If I needed something, I would buy it. I never thought about shopping. I will tell you something: My wife and I have made shopping and coupon clipping, and of course using the Internet, a hobby.”

The bottom line of financial planning for retirement is that it is an equation with several missing variables: What should retirement look like? How long will retirement last? Simply providing employees with retirement calculators is clearly not sufficient, given how few workers use such calculators and how challenging it can be for people to incorporate realistic inputs around required income and expected time in retirement into their calculations.

Managing Money in Retirement Only Gets Harder

Another hurdle in retirement decision making is the relationship between age and cognitive decline. In another study, Finke et al. found that financial literacy scores over an individual’s life span decline each year after the age of 60. Even more concerning, they found that confidence in financial decision making does not—in fact, it increases slightly with age.8

Other research suggests retirement may even be a source of such decline. Dave et al. found that over a six-year period after retirement, complete retirement led to a 5% to 16% increase in difficulties associated with mobility and daily activities, a 5% to 6% increase in illness and a 6% to 9% decline in mental health. The adverse health effects were reportedly mitigated if the individual was married and had social support, engaged in physical activity postretirement or continued to work part-time. However, there was also some evidence that the adverse health effects were larger in the event of involuntary retirement.9

Finke et al. conclude: “A decline in financial skills may not lead to poor financial outcomes if individuals recognize and anticipate the decline. For example, recognition of diminished investment skills may increase demand for annuitization or the delegation of important financial decisions to a trusted advisor.” The researchers encouraged helping retirees to perceive their decline in abilities so they would seek support. For example, they noted that while older drivers generally do not perceive a decline in their driving skills, those who took an objective test that provided evidence of a decline changed their driving behavior to reduce the chances of an accident.

It Takes a Village

With nearly a third of assets residing in 401(k) accounts of people in the preretirement cohort (ages 55 to 65),10 it behooves the financial industry, regulators and plan sponsors to come together to help workers—and mitigate the Thelma & Louise retirement scenario. Yet finding the silver bullet that will help employees navigate retirement has proven challenging.

Consider annuities. The Departments of Labor and the U.S. Treasury and members of Congress have supported annuities over the years by issuing regulations, introducing legislation and holding hearings on the important
role of lifetime income solutions in DC plans. Research has shown the value of immediate annuities, and DC participants have expressed interest in guaranteed income solutions. However, the DC industry has struggled to provide viable options.

Longevity insurance, for example, has languished despite a 2014 Treasury regulation excluding longevity insurance premiums from 401(k) plan account balances used to determine required minimum distributions should have been a watershed event. However, three years later, according to the Callan survey 2017 Defined Contribution Trends, only 1.9% of plans offer longevity insurance (Figure 1).

The required coordination between insurance providers, recordkeepers, regulators and plan sponsors has proven daunting. Recordkeepers say they cannot support in-plan qualified longevity annuity contracts because there are too many unanswered questions about flow of information, paperwork, money flow and tax reporting. The Department of Labor has declined to create an annuity safe harbor for plan sponsors. As a result, plan sponsors remain unenthusiastic about taking on the fiduciary liability that comes with adding guaranteed options to the DC plan. Further, they point to extremely low utilization by plan participants when annuity options are made available. Seeing little demand, insurance providers have been slow to develop the product.

Other solutions such as in-plan guaranteed minimum withdrawal benefit options and annuity placement services fare little better in the survey (Figure 1). More sobering still, the survey finds that nearly half of plan sponsors

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**Figure 1**

**Retirement Income Solutions Offered in DC Plans**

<table>
<thead>
<tr>
<th>Solution</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>50.0%</td>
</tr>
<tr>
<td>Access to defined benefit plan</td>
<td>27.4%</td>
</tr>
<tr>
<td>Managed accounts/income drawdown modeling services (e.g., Financial Engines)</td>
<td>14.2%</td>
</tr>
<tr>
<td>Annuity as a form of distribution payment</td>
<td>12.3%</td>
</tr>
<tr>
<td>Annuity placement services (e.g., Hueler Income Solutions)</td>
<td>3.8%</td>
</tr>
<tr>
<td>Longevity Insurance/QLAC</td>
<td>1.9%</td>
</tr>
</tbody>
</table>

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**Figure 2**

**Plan Sponsor Policy on Retaining Retiree/Terminated Employees’ Assets Within the DC Plan**

<table>
<thead>
<tr>
<th>Policy</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>No policy</td>
<td>48.7%</td>
</tr>
<tr>
<td>Seek to retain retiree assets</td>
<td>28.3%</td>
</tr>
<tr>
<td>Seek to retain assets of terminated participants</td>
<td>25.7%</td>
</tr>
<tr>
<td>Do not seek to retain assets of terminated participants</td>
<td>17.7%</td>
</tr>
<tr>
<td>Do not seek to retain retiree assets</td>
<td>15.0%</td>
</tr>
<tr>
<td>Other/don’t know</td>
<td>2.7%</td>
</tr>
</tbody>
</table>
currently don’t even have a policy with respect to retaining retiree/terminated assets within their plan (Figure 2).

Realistically, plan sponsors are left not with a single silver bullet for helping workers plan for retirement but an array of investments, tools, solutions and communication approaches that can facilitate better outcomes. And by harnessing plan demographic data, they can navigate retirement decision solutions to create better outcomes for participants. Many recordkeepers can tell plan sponsors not only how many workers in the plan are near retirement but also how well they are doing in saving within the plan. Armed with that information, plan sponsors can consider which solutions best fill the needs of workers.

First, however, the plan sponsor should establish a plan policy for retention of retiree assets (Figure 3). On the positive side, retaining assets can afford the entire plan—including retirees—greater economies of scale when it comes to things like investment funds. Conversely, retired participants can be more expensive for plan administration (e.g., tracking down changes of address) and potentially more litigious.

If a plan sponsor embraces asset retention, the next step is to ensure that plan design and delivery can support participants staying in the plan. Are there any plan design elements that make it challenging for workers to leave money in place, such as force-out provisions? Conversely, do design elements make it easy to leave money in the plan, such as by providing participants the option to take a partial distribution or installment payments (as opposed to only a lump sum)? It might even make sense to provide options to consolidate money within the plan by allowing individual retirement account (IRA) roll-ins, for example.

Next, the plan sponsor can turn to plan investments. It may be as simple as highlighting to those close to retirement the value of investments such as the stable-value fund. Plan sponsors also may consider options that can be particularly attractive to retirees, such as brokerage windows, which will increase investment flexibility. In-plan annuities also may be on the table. Even if plan sponsors do not provide guaranteed options, managed account providers are increasingly making available drawdown solutions that help retirees determine how much to extract from their DC plan and then developing portfolios consistent with the desired income amount.

In the age of the Department of Labor fiduciary rule, plan sponsors will wish to pay special attention to what their recordkeeper is comfortable supporting when it comes to retirement decision-making conversations. In addition, they likely will want to work with their own Employee Retirement Income Security Act attorney to ensure that any plan sponsor-provided communication does not fall under the rubric of advice. Because the retirement decision is such a complex and emotional one, thought should be given to high-touch communication such as preretirement workshops that tackle sources of income in retirement, expense planning, tax rules for distributions and payout options. Providing one-on-one advice through a third-party fiduciary should also be considered.

Regardless of whether the goal is to keep assets in the plan or not, plan
sponsors should consider auditing the participant experience of the recordkeeper when it comes to retirement decision making. As a result of the fiduciary rule, many recordkeepers now offer a soft hand-off to licensed representatives when participants call into the benefit center for distribution advice. Are the interactions between the representatives and participants driving assets into proprietary rollover products or third-party IRAs (from which the recordkeeper may or may not receive fees) or resulting in assets remaining in the plan? Plan sponsors should ask for distribution reports to gain an understanding of where retiree assets are flowing. It also can be helpful to have the recordkeeper demonstrate the retirement tools that are being made available on the website or that are being used by representatives to see how they help participants assess whether and how to roll over their money or keep it in the plan.

Conclusion
When Thelma and Louise’s convertible soared off the cliff at the end of the movie, for a moment the audience could almost be convinced that a miracle would happen and the women would make it all the way to the other side of the Grand Canyon. Of course, that was impossible, and their fate was sealed. Likewise, participants who have simply not saved enough cannot expect any available solutions to magically create a cushy retirement income stream out of nothing. However, plan sponsors can be proactive in working with participants to counter magical thinking, help them set reasonable goals and develop a coherent path to and through retirement.

Endnotes
2. The focus groups were conducted in the United States and Canada with people who had retired voluntarily 15 years earlier.
6. “The 4% Rule is Not Safe in a Low-Yield World,” Michael Finke, Texas Tech University; Wade Pau, American College; David Blanchett, Morningstar Investment Management.
10. EBRI.
11. The 2014 regulations generally exempted qualified longevity annuity contracts (QLACs) from the required minimum distribution rules until payments commence for premiums of the lesser of (1) $125,000 or (2) 25% of the individual’s account balance under the plan or IRA.

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