The Freedom of Choice

T. ROWE PRICE LOOKS AHEAD TO A NEW TYPE OF RETIREMENT

As the nation ages, the focus of plan sponsors and participants alike increasingly turns to retirement and on being able to provide a secure and steady flow of income to fund that retirement. However, tomorrow’s retirement may well be different, and successful retirement-income solutions will have to take those changes into account. To discuss those trends and the implications for a new kind of retirement, PLANSPONSOR recently spoke with Carol Waddell, Director of Product Development in the Retirement Plan Services division of T. Rowe Price.

PS: Clearly, there is a renewed and heightened interest in retirement income and retirement-income product designs. How are people dealing with retirement income today?

Waddell: The financial industry has been dedicating significant resources to research and development of products and services intended to help people manage their income through retirement. We’re seeing more insurance-based solutions and advisory services, improved education, and new tools. This can be viewed as progress from an industry perspective but, if you look at what’s happening among participants, it seems that, behaviorally, they’re not necessarily progressing to where they need to be. Very few people are saving enough for retirement, very few people are investing or benefiting from enough equity exposure, and most participants are withdrawing too quickly. One of the biggest changes we’ve seen is how the Baby Boomer generation is approaching retirement. Retirement used to mean that you stopped working, but it is being redefined by this generation. Now, retirement means having flexibility. We see things like people phasing retirement, so they might phase in and do part-time work; they might take three years off and then go back to work. Also, the Social Security Administration reports the average remaining life expectancy for those surviving to age 65 has increased an average of 5 years since 1940—to 15.3 years for men and 19.6 years for women—so people will need to make their retirement assets last longer.

PS: Don’t those variances make it hard to develop a one-size-fits-all solution for retirement income?

Waddell: There’s certainly no one silver bullet to solving this complex issue. These days, it seems more like we need a silver buckshot approach. Solutions that combine process and product to simplify the experience are ideal for assisting participants in this critical decision.

PS: There have been a lot of new products coming to market, but plan sponsors seem hesitant to embrace them.

Waddell: Product design is still evolving, and plan sponsors have a lot to consider. There’s a lot of noise out there, and plan sponsors are not seeing a path to a simple solution. With insurance-based products, for example, some of the reasons plan sponsors have hesitated are due to cost and complexity, and once you’re in, you’re in. To most, the current insurance offerings feel like a “forever” choice, and one without a lot of federal regulatory guidelines.

PS: What about participant hesitancy?

Waddell: The complexity of the decisions for people heading into retirement can cause paralysis among participants. They’re not really sure how the products work or what is best for them, and, of course, the best course of action varies by individual. For some, insurance-based products are a good option; for others, that isn’t the case. In our focus groups, we hear from participants that they really like the concept of a guarantee—but they don’t like the expense, the notion of losing control over managing their assets, or losing the flexibility to tap into those assets over time, if needed. There are a lot of layers to look at when you’re trying to evaluate not only the product, but also the provider of those
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benefits, so people are wary of the single-insurer model. That’s an issue for plan sponsors as well. We also know from our experience in the 401(k) accumulation space that simplicity is a key to strong enrollment participation, and it stands to reason from that same experience that ensuring products are easy to understand and adopt will be a key to retirement-income product adoption.

PS: What kinds of things will affect those trends going forward?
Waddell: Regulatory guidelines will be very important. You can see the impact of the Pension Protection Act on paving the way for a widespread adoption of automatic plan designs, and I think similar guidelines for retirement-income products may play a role. Additionally, creation of a government backstop and clarity around the strength of the guarantee could reduce concerns over the financial stability of private guarantors. Of course, helping plan sponsors and participants better understand retirement income through innovative programs will enable them to make more confident decisions. One example is Plan Meter, a T. Rowe Price tool that enables plan sponsors to analyze their participants’ retirement income progress and determine how implementing plan design changes and/or programs might improve those outcomes.

PS: What about the impact of behavioral finance?
Waddell: If we leverage automated solutions on the accumulation side, we’ll see “best practices” evolving around automated solutions for the distribution side as well. We have found that many participants think they have saved enough, even when they haven’t, and we’ve focused on how to better frame their accounts in a way that would be more meaningful and help to improve participant behavior. At T. Rowe Price, we have been putting monthly income projections on participant statements for more than four years and find that framing participants’ accounts in terms of potential income, either monthly or annually, in today’s dollars is a very effective way to improve participant behavior.

PS: How might this changing view of retirement influence product design?
Waddell: The concept of phased and partial retirement will be one of the driving factors to changes in product design. Again, if you look at the insurance-based solutions or even installment payments from a 401(k) plan, they really were designed to be continuous once they started. However, if people return to work, or pursue some kind of phased or partial retirement, they might want to stop drawing from their savings, at least periodically. So, as the market evolves, we’ll see tools, education, advisory solutions, and even insurance products that respond to those changes in terms of letting people modify their income strategy over time. We’ve also seen some people spend more conservatively up front because they’re concerned about what they will need later on—being able to respond to those types of personal preferences also will be important.

PS: What is T. Rowe Price responding to these trends?
Waddell: First and foremost, we are spending a lot of time with plan sponsors and participants on this topic so everyone can fully understand the issues. Just getting that concept of retirement income down—shifting views from thinking about asset accumulation to thinking about retirement-income generation—is an area of focus for us. We continue to approach retirement income from both ends of the continuum: first, making sure people are saving enough and investing appropriately to avoid a potential shortfall; then, once they are ready to start spending in retirement, making sure participants have choices and understand how to optimize their income—to make sure they don’t outlive their assets and that they can make educated decisions around the trade-offs between lifestyle and longevity. Also front and center for us is finding simple, flexible solutions to meet the plan sponsors’ needs within the benefit plan, as well as the participants’ needs over their lifetime. Recognizing that the retirement industry is in the midst of an evolutionary transformation, and with guaranteed solutions likely to play an important role in the retirement-income landscape, we are continuing to evaluate investment products, insurance solutions, and other programs that might appropriately and prudently address these needs. Our ultimate goal is to make sure that plan sponsors and participants recognize what they need—and what can help them meet those needs—and feel confident enough to make thoughtful and informed decisions about retirement income.