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ARTICLE ONE IN A MERCER AND STANFORD CENTER ON LONGEVITY SERIES

IT'S TIME TO RISE TO THE RETIREMENT INCOME CHALLENGE

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The retirement world today looks a lot different from that of our parents. In the era when defined benefit (DB) plans dominated, many employees could look forward to a steady retirement income in the form of a pension. Their employers took care of everything. However, since the mid-eighties, the prevalence of DB plans has fallen by 70%.[1] Now we look to the 401(k) plan as the primary retirement vehicle — but this was conceived as a simple, supplemental savings plan. These defined contribution (DC) plans place significant responsibility and challenges on employees and retirees, as they were not designed with the goal of transforming savings into adequate lifetime retirement income.

The simple DB past has been replaced by a kaleidoscope of complex options that are leaving employees confused and ill-prepared. Mercer clients and their employees are starting to recognize the consequences of this seismic shift in retirement provision. We are witnessing many older employees delaying their retirement. This is causing significant challenges with workforce renewals as well as with unexpected costs in the form of the additional incentives needed to bridge the gap in retirement income. At a social level, the increasing numbers of Americans who cannot retire gracefully is a growing concern.

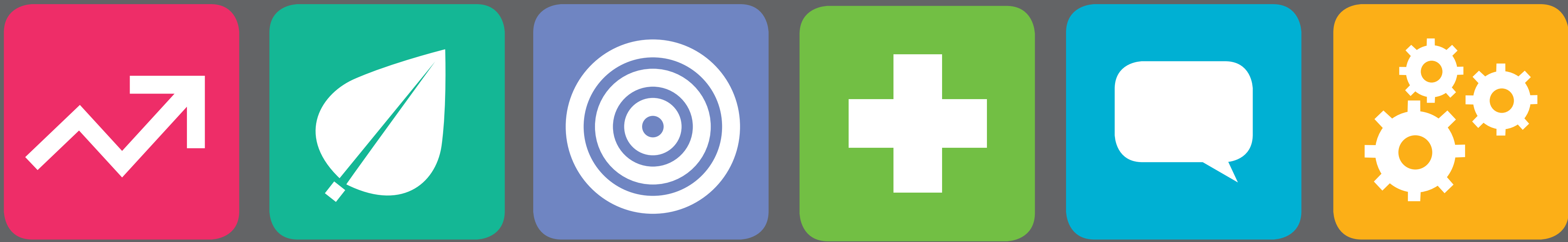
We believe it is time to rise to the retirement income challenge. For most plan sponsors, this represents a change from current practice. According to one study, 91% of plan sponsors view DC plans as savings plans, while only 9% see them as vehicles for providing retirement income.[2] However, emerging retirement products and innovative approaches present excellent opportunities for employers to do their part in delivering an adequate and sustainable retirement income to their employees. The commercial and social reasons for doing so are compelling.

In this first article in the Mercer-Stanford series, we take a close look at the complex choices facing employees and employers in generating sufficient retirement income.

[1] Pension Benefit Guarantee Corporation. "PBGC-insured Plans (1980–2011) Single-employer Program" (Insured Plans with 25 Participants or More), 2011, available at http://www.pbgc.gov/, accessed October 4, 2013.
[2] MetLife. Retirement Income Practices Study: Perspectives of Plan Sponsors and Recordkeepers for Qualified Plans, 2012.

WHEN OUR PARENTS RETIRED THEY GOT A PENSION. TODAY, YOU GET A LUMP SUM …

RETIRING EMPLOYEES FACE NUMEROUS RISKS:



- MARKET
- LONGEVITY
- INFLATION
- POOR HEALTH
- POOR ADVICE
- POOR DECISION-MAKING possibly due to cognitive decline.

UNDERSTANDING YOUR EMPLOYEES' NEEDS

Employees face a number of daunting challenges and planning tasks.

SAVINGS HAVE TO GO A VERY LONG WAY:

Given improvements in life expectancy, the money that employees set aside for retirement may need to last a long time — potentially 20 years or more. Indeed, for a married couple retiring at age 65, there's a 25% chance that one will still be alive 30 years later. If this eventuality is not recognized and planned for, then retirement funds will run out. One study found that drawdown rates as high as 8% are common among recent retirees[3] — many experts would argue for less than 4%. When planning for the long term, taking account of Social Security benefits, leveraging other assets to enhance retirement security, and the option of phased retirement are just some of the important considerations that are often missed.

SAVINGS HAVE TO SURVIVE MARKET VOLATILITY:

Market volatility complicates the challenge of managing savings. Since 1987, there have been four major market meltdowns. With retirements potentially lasting 20 years or more, retirees have to expect and plan for more meltdowns in their future.

SAVINGS LEVELS ARE TOO LOW:

Many employees don't know how to calculate the amount of savings needed to generate lifetime retirement income; they often guess and usually the guess is too low. As a result, many people retire sooner than is financially prudent. Furthermore, there are competing demands for these savings, such as health care provision, that need to be accounted for.

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[3] National Bureau of Economic Research. The Drawdown of Personal Retirement Assets, January 2011.

UNDERSTANDING THE RATIONALE FOR EMPLOYER ENGAGEMENT

There are many reasons an employer may want to take advantage of the trust their employees place in them when it comes to the challenge of generating an adequate retirement income.

- As discussed in Mercer's "Securing Retirement Outcomes for the Employee" point-of-view article, employers are uniquely positioned to bring clarity to complexity. A crisp, easy-to-implement set of retirement income principles will help minimize the confusion that employees experience in planning for retirement. Employers taking this step stand to differentiate themselves and reap a material employee-engagement dividend.
- The workforce renewal and management issues caused by inadequate retirement readiness are both real and current for many employers. Forward-thinking employers have an opportunity to sidestep these complex legal, human, and cost issues by partnering with their employees in "taking on" the retirement income challenge.
- Employer costs associated with retirement plans are material. Conventional wisdom dictates that those costs should be channeled to do what they were intended to do — that is, improve retirement security.
- Retaining assets in the plan in the retirement phase instead of encouraging lump-sum distributions at retirement can help drive down per-capita administrative costs.
- Institutional buying power can make a real difference to a retiree's paycheck. Watch out for the next article in the series, in which we will discuss this topic.

Some employers may find the prospect of rising to the retirement income challenge daunting. We see it differently. In our view, it is not a question of building new capabilities from scratch, but rather leveraging existing infrastructure in new ways. Part of the challenge relates to changing employee saving behaviors. In subsequent articles, we will present some new ideas on how to engage your workforce.

SOME EMPLOYERS MAY FIND THE PROSPECT OF RISING TO THE RETIREMENT INCOME CHALLENGE DAUNTING. WE SEE IT DIFFERENTLY.

CONCLUSION

In summary, helping your employees address these significant challenges can help you manage an aging workforce while enhancing your employer brand as a desirable place to work. Also, it's the right thing to do for your employees. In this series, we look forward to sharing our views on how to make that happen.

For more information on how we are rising to the retirement income challenge, visit www.mercer.com/dc

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