Baby Boomers, the Financial Crisis and the Recession

By Randy Myers

Many are not going to have enough money.

That was the discouraging but hardly surprising retirement-income message that Sara Rix, senior strategic policy advisor for the AARP Public Policy Institute, delivered at the 2013 SVIA Spring Seminar when talking about America’s Baby Boom generation.

Rix’s forecast was informed in part by an October 2010 AARP Public Policy Institute survey of nearly 4,000 Boomers between the ages of 50 and 64. All were in the labor force at that time or had been at some point since the start of the last recession, which encompassed all of 2008 and the first half of 2009. Among those surveyed, 59 percent had remained steadily employed throughout the recession and up to the survey date. Another 13 percent had been involuntarily unemployed before finding a new job, while 17 percent were unemployed and the remainder—about 11 percent—had already left the work force.

Not surprisingly, the recession altered retirement plans and expectations for the Boomers. Many cut back on saving, including retirement saving, and tapped into monies they had already set aside. Twenty-seven percent said they had exhausted their savings, and more than 20 percent said they had fallen behind on credit card payments. Many also delayed medical and dental care. A majority said they now lack confidence that they will have an adequate nest egg for retirement, with women even more concerned than men.

Boomers said they are taking steps to create a more secure retirement, though, and some indicated they might be willing to accept a lower standard of living. In fact, 48 percent said they expect their standard of living in retirement to be less than what their parents enjoyed. Only 22 percent expect it to be better.

When they do retire, Rix said, many Boomers will find Social Security a critical source of income. An AARP study projects that for people who were between the ages of 25 and 54 last year, Social Security will make up about 51 percent of their total income, on average, at age 70.

To supplement Social Security, more Boomers now expect to work even after they have reached the traditional retirement age of 65. In 2007, about 70 percent of workers between the ages of 45 and 54 said they expected to work “in retirement.” In a 2011 survey, 80 percent said they were planning to do so.

Working longer can be a prudent way to enhance financial security in retirement, Rix noted. Each year someone continues to work is one less year of retirement they need to fund, and one more year of collecting wages and perhaps saving for retirement. Still, it’s far from foolproof. “The best laid plans often go awry,” Rix said, noting that people often are forced out of the workforce due to job loss, disability or ill health. A survey by the Employee Benefit Research Institute (EBRI) found that only 14 percent of the respondents expected to retire between the ages of 60 and 64, although real-world experience shows 32 percent have retired by that age.

Rix encouraged those who plan to work in retirement not to quit their current job until they have a new one in hand, since it is easier for older workers to keep a job than it is to find one. She also suggested postponing Social Security benefits as long as possible, since each year of postponement yields a 7 percent to 8 percent benefit increase.

Among the 54 percent of surveyed Boomers who have already taken steps to prepare for a more secure retirement, the most common decisions they made—beyond planning to do some work in retirement—include paying down non-mortgage debt, saving more, retiring later than originally planned, investing their savings more conservatively, and deciding to pay off their mortgage.

Boomers’ biggest concerns about retirement include not having enough money for long-term care or healthcare, having their income fail to keep pace with inflation, depleting all of their savings, maintaining a reasonable standard of living, being able to stay in their homes, and, lastly, not being able to leave money to their children.

Boomers are right to be concerned about healthcare, Rix said, noting that estimates from organizations like EBRI indicate that they may need nearly $270,000 each to cover planned and unplanned healthcare needs.

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The Evolving Definition of Competing Funds
By Randy Myers

There was a time in the stable value industry when the term “competing fund” almost always referred to one thing: a money market fund.

No longer. Over the past decade or so, the financial services industry has rolled out a slew of new investment products for defined contribution plans, from inflation-protected bond funds to target-date funds and self-directed brokerage accounts. Stable value issuers—particularly stable value wrap issuers—have had to think carefully about how plan participants might use these new products during periods of rising interest rates, and whether they should be classified as competing funds subject to the same trading restrictions typically imposed on money market funds.

Those restrictions are aimed, of course, at discouraging plan participants from trying to arbitrage stable value funds and competing funds when interest rates are rising sharply. The most common restriction is an equity wash rule that requires money moving from a stable value fund to a competing fund to first go into an equity fund for a fixed period of time—usually 90 days.

During a panel discussion at the 2013 SVIA Spring Seminar, executives from four firms—two portfolio managers and two wrap issuers—talked about how their definition of competing funds has evolved, how it continues to evolve, and how the industry can make competing-fund restrictions less objectionable to plan sponsors.

Anthony Luna, vice president and portfolio manager for T. Rowe Price Associates, said his firm generally defines competing funds as fixed-income products with a duration of three years or less. However, he noted, some wrap providers also put certain asset-allocation products under the competing-fund umbrella. These can include target-date funds and balanced funds, but typically only when they have a large allocation to fixed-income assets—perhaps 75 or 80 percent of the portfolio—and when the duration of that part of the portfolio is less than three years.

“Most of our contracts also view self-directed brokerage accounts as a competing fund,” he added.

Jennifer Gilmore, head of stable value portfolio management for Invesco Advisors Inc., said her firm’s definition of a competing fund is similar to the one Luna spelled out. She added that self-directed brokerage accounts are the investment option that most often prompts discussions with wrap providers over whether they should be placed in the competing-fund category.

“We have to look at the specifics over every plan’s self-directed brokerage window,” she said, explaining that her firm typically allows no more than 25 percent of plan assets to be allocated to that investment option.

Christopher Pellegrino, a portfolio analyst for Transamerica Stable Value Solutions, and Tim Grove, vice president of markets-product risk for Prudential Financial, said their definitions of competing funds are similar to those used by T. Rowe Price and Invesco, too. Grove noted, though, that his firm sometimes classifies Treasury Inflation-Protected Securities, or TIPS, funds as competing funds, too, assuming they have a short duration. Most do not, he conceded, although he said duration is not the only factor his firm considers.

“When we think about TIPS funds, we also think about how it’s communicated to plan participants,” he said. “What does the fact sheet say? How does it describe the fund’s objective? Will it be a safe alternative to stable value, even if there might be some underlying characteristics that could cause fluctuation? How is the participant going to view it? We’ve seen similar funds described differently, and how participants see it can be important.”

Grove also conceded that the stable value industry has not reached a consensus on whether to treat self-directed brokerage windows as competing funds. His firm does. “It’s the access they have to money market funds underneath that’s the issue,” he said.

Gilmore said the arbitrage risk embedded in brokerage windows should be a concern to every plan sponsor as they seek to protect the interests of their plan participants, particularly those invested in stable value. Often, she said, it is the most sophisticated plan participants who are most likely to use brokerage windows and who are, perhaps, most likely to spot and act on arbitrage opportunities. “Overall, plan sponsors understand,” she said. “They just want (any restrictions on the use of competing funds) to be workable. They have to be restrictions their record-keeper can implement, and that they can communicate clearly to participants.”

Luna added that as a stable value manager, it’s easier for him to justify competing-fund restrictions to plan sponsors when those restrictions are workable. “If I don’t believe in what continued on page 8

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To promote better retirement outcomes, Rix encourages Boomers to take advantage of training programs offered by their employers, not only to enhance their value in their current positions but also to make them better qualified for other jobs. From a public policy perspective, she added, training programs should be made more widely available.

Rix also suggested that policymakers and employers do more to promote saving, to monitor and enforce age-discrimination laws, to provide more flexible work arrangements, and to provide advice and support for entrepreneurship among Boomers.

Finally, Rix said, policymakers in Washington must take measures to preserve the financial integrity of the Social Security system. “We need to recognize that Social Security is, and will likely remain, the bedrock of retirement security in the U.S.,” she said. “It is important—critically important—that we encourage savings and provide people with opportunities to save more readily than many of them are doing now. But those savings should be on top of, not in place of, Social Security.”