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Report

The retirement revolution: Regulatory reform to enable behavioral change

Martin Neil Baily and Benjamin H. Harris Friday, June 8, 2018

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The American retirement landscape is constantly in flux. American retirement went from an experience dominated by short retirements and pensions for some to one financed increasingly by 401(k)s with decades-long retirements for many.

While this evolution has advantaged some workers, it has also resulted in serious challenges that have been exacerbated by both inadequate and poorly designed saving incentives, as well as a private insurance market that is insufficient to meet the needs of millions of retirees wanting to achieve a secure retirement. Fixing this system is a complicated endeavor, requiring widespread changes across the landscape.

Unfortunately, many households of retirement age, even those with no pension income, have very low levels of financial assets and are therefore reliant on Social Security and are compelled to work beyond the age at which they hoped to retire. Americans, in aggregate, have accumulated nearly $15 trillion in 401(k)s, IRAs and related retirement vehicles, but these savings have not translated into retirement security. The *de facto* retirement paradigm has become to save as much as possible and hope you don't live too long.

In the brief "The Retirement Revolution: Regulatory Reform to Enable Behavioral Change" (PDF), Martin Neil Baily, the Bernard L. Schwartz Chair in Economic Policy Development at Brookings, and Benjamin H. Harris of the Kellogg School of Management lay out some of the challenges involved for households as they save for retirement and draw down their assets after they've left the workforce.

Despite these challenges, the authors argue that several targeted regulatory reforms can improve the experience of saving for retirement for millions of middle-class households.

Managing Retirement Assets

Families not only have to save a lot for many years, they also have to manage their holdings wisely in order to build up enough assets to ensure a comfortable retirement, especially to allow for end-of-life care. There are many advantages to having a financial advisor who can help families make the right saving and investment decisions, including navigating tax rules. Unfortunately, finding good advice at an affordable price can prove difficult.

At a minimum, consumers should know the size of the fees they are paying and whether or not the person advising them has a financial interest in the investment choices they make.

From a consumer perspective, there is a pressing need to resolve the uncertainty with fiduciary safeguards and provide widespread access to advice that is as unconflicted as can be reasonably achieved. At a minimum, consumers should know the size of the fees they are paying and whether or not the person advising them has a financial interest in the investment choices they make.

To help achieve this second goal, another potential reform is better benchmarking for advisory fees and better transparency more generally. On benchmarking, or knowing how fees compare to others in the market, there is a stark asymmetry between advisory fees charged to individuals and expenses charged by mutual funds to shareholders.

Reverse Mortgages

Reverse mortgages are products that allow families to turn their housing wealth into cash, in the form of regular, periodic, or lump-sum payments. . In effect, reverse mortgages allow older Americans to borrow against their home, with interest, and repay the balance when they leave their house.

The reverse mortgage market, currently dominated by the Department of Housing and Urban Development's Home Equity Conversion Mortgage (HECM) program, could be substantially revised to better account for low-risk borrowers subject to high fees.

Under the current structure, even retirees who borrow only a small share of their housing equity are required to pay exceptionally high fees to account for the potential of default. This program should be revised, as was tried under the HECM "Saver" program, so that low-risk borrowers with low relative borrowing do not have to pay higher fees to subsidize higher-risk borrowers.

Long-Term Care

The option of subsidized long-term care through Medicaid discourages people from buying long-term care insurance. Low- and moderate-wealth retirees are incented to draw down their assets if they need care and, once these are exhausted, accept Medicaid benefits—avoiding private insurance altogether.

The private market for long-term care will never reach its full potential as long as Medicaid beneficiaries pay a large implicit tax on their private long-term care insurance distributions. While this reform is a difficult one given the potential for its negative impact on low-income seniors, strengthening anti-abuse provisions for asset runoff and lowering the implicit tax on private policyholders is essential to the long-term care market.

Conclusion

Private-sector employers are eliminating or shrinking the scope of traditional defined benefit pension plans, transforming the retirement landscape. Most employers realize their employees need help in managing their assets in both the accumulation and decumulation phases of their lives but they are reluctant to take a more active role in helping current or former employees because of concerns about legal liability and regulations that make it difficult to include a full range of retirement options.

When it comes to supporting the retirement revolution, financial regulation has not yet caught up. Regulation must be enabling, designed to make markets work better while providing consumers with both protection and access to the products that will bring them a more secure retirement. Barriers to the availability of insurance products should be removed, while regulators must make sure that retirees are protected against fraud, misunderstandings, and excessive fees.

Read the full paper here.

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