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In its sixth issue, *The Journal of Retirement* again features a broad range of articles intended to appeal to analysts and designers of investments for older Americans, economists and policymakers interested in retirement security, and pension plan administrators.

As the article by Gaobo Pang and Syl Schieber in the summer 2014 issue of *The Journal of Retirement* attests, there is a lively ongoing debate over the basic issue of whether older Americans face an insecure retirement. Rusty Olson and Doug Phillips, the authors of the opening article, "Let's Save Retirement: *Repairing America's Broken System of Funding Workers' Retirement*," believe that is indeed so. They argue that a major reform of the institutions of retirement is called for, which would require employers to make available to their employees what they call a trusteed retirement fund (TRF).

Their proposal would simplify the current defined contribution (DC) landscape considerably. Employers would effectively act as conduits funneling workers' contributions to the new plans, and would avoid fiduciary liability. At the distribution end, workers would be encouraged to invest in annuities, and a new government agency would play a key role in developing the market for them. The authors' proposals are controversial, but their comprehensive and broad-brushed effort to address the perceived flaws in the current system is an important contribution to the debate. Readers might wish to compare this article with "Defined Contribution Plans as a Foundation for Retirement Security" by Jeffrey R. Brown and Scott J. Weisbenner in the spring 2014 issue of the JOR.

The Great Recession caused a precipitous drop in the value of the portfolios of many older Americans. Many of them had their retirement plans derailed. In the article "The Great Recession, Decline, and Rebound in Household Wealth for the Near-Retirement Population," Alan Gustman, Thomas Steinmeier, and Nahid Tabatabai provide a comprehensive overview of what happened to the asset holdings of Baby Boomers and other age cohorts over the 2006–2012 period. Their data comes from the Health and Retirement Study (HRS), a longitudinal study that tracks the financial and economic position of a number of different age cohorts (that is, people born in the same period). The HRS data allow them to estimate the value of wealth in the form of future Social Security retirement benefits and defined benefit (DB) pension payments—which they include in their measure of wealth—and to track the position of different deciles of a given cohort by wealth.

The article explains the statistical manipulations needed to exploit the HRS data. The authors find that, perhaps unsurprisingly, the wealth of most deciles recovered after 2010 following a fairly sharp drop in the previous four years. However, they also find that although the wealth of the most affluent Baby Boomers—those in the top two deciles—has not yet recovered totally from the drop in 2006–2010, the wealth of most Boomers has increased, in part because of the cushioning effect of Social Security wealth, which is stable and becomes a more important source of wealth as total wealth declines. This finding illustrates the great importance of Social Security for the less well-off. It also underscores the importance of defining retiree wealth sufficiently broadly to include the present value of future income flows of Social Security and DB pensions.

So-called alternative investments have become an increasingly important asset class in DC plans. "Alternative Investments in Defined-Contribution Plans: *Opportunities and Concerns*," by Stephen Sexauer and Larry Siegel, addresses the pros and cons of these investments. The authors argue that conventional return estimates need to be adjusted downward, and estimates of risk adjusted upward. Alternatives are really best suited for endowments and similar investment vehicles, which can tolerate substantial swings in both value and the degree of liquidity. Their risk and potential illiquidity can make them unsuitable as a significant holding for the typical DC plan, particularly when funds are not pooled. This article deserves a wide readership among fund managers and investors alike.

Variable annuities, which are purchased from insurance companies with a long-term contract and accumulate assets tax-free have been a popular investment, particularly for those investors saving for retirement, and their market exceeds one trillion dollars. In recent years, variable annuities have been combined with another insurance product to form the VA + GLWB, or variable annuity with a guaranteed lifetime withdrawal benefit. The combined product has become very popular with Americans nearing retirement.

In "The Role of Variable Annuities in Addressing Retirement Risks" Nevenka Vrdoljak, David Laster, and Anil Suri explain these complicated instruments to the uninitiated and explore their potential role in the portfolios of retired people. A VA + GLWB provides a lifetime withdrawal benefit, usually in the range of 4% to 5% of the initial value of the underlying assets, depending on the age at which withdrawals begin and on the time that elapses between purchase of the contract and the first withdrawal. In addition, the value of the guaranteed withdrawal can increase with the value of the underlying assets. A guaranteed withdrawal cannot be reduced unless the actual withdrawal exceeds it and continues to be paid even if the underlying assets are exhausted.

A VA + GLWB seems to offer the best of both worlds: guaranteed post-retirement lifetime income with access to capital. It also reduces the risk of a wealth shortfall due to unfavorable returns early in retirement. As the authors explain, the guarantee comes at a price in the form of extra fees, which lower the average bequest of a portfolio that includes them. Rates of return are lower than those of a life annuity, although the loss of control of capital that a life annuity entails, among other factors, has made these instruments unpopular. The guarantee gives the investor an incentive to select the most aggressive asset composition for her investment, because the guarantee gives her protection on the downside and she can enjoy higher returns on the upside.

David Blanchett's contribution to this issue, "Addressing Key Retirement Risks," is well named. The model he presents addresses a broad array of the risks encountered in retirement. A special feature of the model is the explicit way in which it models aversion to asset volatility. In the typical economic model, volatility risk is captured indirectly through the shape of the utility function. People who are particularly averse to volatility risk have a strong preference for a stable steam of consumption in retirement. David includes a separate parameter that is meant to capture the degree of dislike of the investor for asset fluctuations. Also included in the model are parameters representing sensitivity to rising prices, the strength of any bequest motive, and longevity risk (fear of running out of money). The model's assets include stocks and bonds, real assets, and life annuities. Volatility risk has the largest impact on asset allocation. The optimal annuity allocation varies with the strength of the bequest motive, although the allocation to real assets was not particularly sensitive to changes in preferences. It is not possible to capture every aspect of this model in a few words, and interested readers should explore the paper carefully.

Matthew Kenigsberg, Prasenjit Dey Mazumdar, and Steven Feinschreiber, in "Return Sequence and Volatility: *Their Impact on Sustainable Withdrawal Rates,*" provide

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a comprehensive and clear analysis of the way both the sequence of returns and volatility influence sustainable withdrawal rates (SWRs). The article begins with an historical analysis of the behavior of the SWR over 30-year overlapping periods over January 1926 to May 2014, assuming portfolios with asset allocations varying from conservative to aggressive. This exercise yields the interesting result that only the more aggressive asset allocations have a success rate of 100% with a target withdrawal rate of more than 3%. (A simulation analysis yields results that are broadly similar to the historical analysis.) The paper then illustrates the difference that an unfavorable sequence of returns can make. It also shows that a more favorable sequence of returns can offset the effect of high volatility, or to make the same point another way, low volatility does not insure against the effects of unfavorable return sequence. The paper has an enlightening discussion of adaptive withdrawal strategies and an interesting discussion of how it may be able to increase the expected return of a portfolio that is very conservatively invested without lowering the SWR.

Moshe Milevsky, in "Mortality Plateaus and the Pricing of Longevity Insurance," investigates an issue that is likely to grow in importance over time: the way changes in mortality rates at advanced ages might affect the cost of providing advanced life deferred annuities (ALDAs) or deferred annuities. In particular, he considers the consequences of a *plateauing* of mortality rates late in life (which would mean that the death rate, instead of increasing from one year to the next, would stay constant until a very advanced age). Misestimating the mortality at advanced age would be a serious mistake for life insurance companies or pension funds to make, particularly given the currently low level of interest rates. Moshe explains how the date at which the mortality plateau kicks in (for example, at age 93 versus 97), the rate of interest, and the start of the ALDA's payments would affect the ALDA's price, noting that the later the start to payments, the greater the effect of the relative price of a leveling off of mortality rates.

Finally, Jon Kanemasu, Stacie Walker, and Valerie Wong, in "Increasing Defined Contribution Plan Participation: *A California Pilot Project,*" have written an interesting account of an experiment aimed at determining the kind of publicity campaign that might broaden the appeal of the voluntary DC plan provided for employees of the state of California. The Savings Plus Program complements the traditional DB plan, and a recent reform has reduced the benefits that the DB plan will pay to current employees. The pilot project the authors describe was intended to determine what sorts of outreach strategies would be most effective in increasing enrollment in and contributions to the DC plan. Three different strategies were tested on the employees of three state government agencies. The authors acknowledge the comparatively small size of their sample, but conclude that of the three outreach strategies applied, the two entailing the most intervention were successful in achieving a significant increase in membership in the three agencies and in boosting contribution rates of existing members. The authors believe that the pilot project's lessons can be applied in other states.

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Editor

Publisher's Note

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