the journal of retirement

VOLUME 7, NUMBER 4 SPRING 2020



## RETIREMENT IN THE AGE OF CORONAVIRUS

Short-horizon but entirely serious events have, at present, limited our attention to long-horizon goals, of which retirement is a poster child. Yet there is a connection that is worth examining between short-term virus-related policies and pensions for the long term.

One proposal, which may be enacted as part of the massive federal emergency relief bill by the time you read this, is to allow 401(k), 403(b), and IRA account holders to withdraw up to $100,000 without the usual penalties as long as they can claim the withdrawal is related directly or indirectly to medical or economic effects of coronavirus. Individuals could choose to treat the money either as a loan to be paid back over 3 years or as a permanent withdrawal on which ordinary income taxes would be stretched out over 3 years.

Why is this being considered or done? The logic is that the economic effects of the virus and efforts to prevent the spread of the virus are unprecedented in terms of their rapidity and possibly their depth so that individuals who become sick, lose their jobs, or suffer other losses will have few other places to turn for emergency financial support. Tapping a retirement fund will give deeply affected individuals and their families the ability to cover medical bills; buy food and gas; and pay rent, mortgage, and utilities.

Such a retirement fund withdrawal program is both attractive and troubling, depending on what we assume about who uses it and what they do. Let's consider some of these assumptions.

- **Savings Replacement.** First, over time people will be able to replace retirement savings withdrawals or won't need them in the future. As readers of *The Journal of Retirement* are aware, in the US retirement income coverage is, again, far from universal. A significant portion of the workforce has no retirement savings and will depend only on Social Security for retirement income. In this crisis, they can't withdraw what they don't have. Further, for those with savings, models show that over the next few years many people reaching retirement will have accumulations insufficient to replace a large proportion of preretirement income and, unlike previous cohorts, no defined benefit plan. Individuals, especially undersavers, who withdraw retirement savings to support current spending have a huge hill to climb in order to make up for it later, thus further jeopardizing their future financial security.
- **No Other Options.** Second, people taking advantage of the program don't have any other options or those options are inadequate: medical insurance, unemployment insurance, personal savings, other family income, and other provisions in the federal

coronavirus relief bill (direct financial aid, small business loans, etc.). We know that, in the US, the social safety net misses some needs. Medical benefits are not universal and can require significant out-of-pocket expenditures. Unemployment benefits are not available to all, and they run out. Affordable housing is limited in some areas. Beyond the social safety net, most people do not have an emergency fund and families vary in terms of whether, when one person loses his or her income, other earners are available to contribute. As for the relief bill, direct aid and other provisions will help out, but that aid isn't open ended.

In sum, we know some families will suffer financially and need to look for additional resources, but many will receive assistance from some of the listed options. We hope that access to these other backstops will mean that most people won't need to withdraw their retirement savings. Nevertheless, we would note that, in many developed countries, including, but not limited to the UK, Canada, Germany, and France, the social safety net is more substantial, and we are already seeing emergency relief programs that replace a significant portion of income and provides other aid.

- **Deficit Relief.** Third, the federal government will benefit from taxes paid by those who permanently withdraw from their qualified retirement accounts. Any such tax receipts will, of course, reduce the federal deficit. However, although the positive effects of deficit reduction may be attractive, in this case they will be overwhelmed by the fiscal stimulus (spending in tax cuts) contained in the rest of the emergency relief bill, as well as the 2017 federal tax cuts. Moreover, increased taxes now will mean reductions in future tax receipts because those savings will have already been withdrawn. (We are aware that official budget analysis may not see it that way, but that is an artifact of federal budget scoring, not the long-term reality.) Taxes on withdrawals will help the federal deficit, but this does not seem like a strong argument for the program.

Other points, pro and con, will no doubt occur to readers of the journal. The point here is that a retirement savings withdrawal program may serve to help desperate individuals and families in the short run but at the cost of long-term financial security. In addition, those in need, but without retirement savings, cannot take advantage of such a program. It is not a universal cure, and people should be advised to consider the long-term ramifications. Retirement savings withdrawals should be a last step, not a first one.

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In this issue, we continue the journal's interest in better understanding retirement income with three articles that take different approaches to understanding income solutions.

In "Securing Replacement Income with Goal-Based Retirement Investing Strategies," Lionel Martellini, Vincent Milhau, and John Mulvey use goal-based investing principles to create "flexicure" retirement solutions where a goal-hedging bond portfolio is constructed that matches a stream of replacement income for a period of time (e.g., 20 years) and offers a probability of upside potential. They show that this approach offers an attractive alternative to existing retirement products such as annuities or target date funds.

In a similar vein, but with a different model, Javier Estrada, in "Managing to Target (II): *Dynamic Adjustments for Retirement Strategies*," builds on several previous publications in the journal to compare two dynamic withdrawal strategies—withdrawal adjustments and asset allocation adjustments—with static withdrawal rates. In modeling these approaches, he finds that both dynamic strategies are "superior" to a static strategy and that adjusting withdrawals works better than adjusting allocations. This article addresses a growing recognition by journal contributors that we are not doing enough to assist people with withdrawal management and is particularly appropriate in a time when some companies known for managing retirement investments have eliminated products offering dynamic management.

The third article on retirement income design looks at TIAA's Traditional Annuity design, which is more than 100 years old and *sui generis*, in that it is a participating fixed annuity where the crediting rate before retirement and income after annuitization can both be adjusted for changes in investment experience and (after annuitization) for mortality changes. Moreover, reserves are returned to participants in the form of increases in retirement income. It does provide for withdrawals, but over a several-year period. Gabriel A. Lozada, in "Fixed Income for Retirement Saving: *TIAA Traditional's Lessons on Quality, Duration, Risk, and Gradual Withdrawals*," uses long-term measures of risk and return rather than short-term volatility to evaluate the TIAA Traditional Annuity and compare it with carefully constructed alternative portfolios. In historical backtests, he finds that alternative portfolios dominate TIAA's returns but that it may be appropriate for investors who cannot or do not wish to manage more complex holdings.

The shift toward passive investing is more than evident in the data on fund flows over the past 10 years, although we will be interested in how the current stock market downturn will treat active versus passive funds. In "Active Management in Defined Contribution Plans," Gerald W. Buetow, Jr., Bernd Hanke, and Maxim Zagonov compare the use of active and passive funds with target asset allocations in retirement investments. They find that, because active funds as a group are inconsistent in their relative return performance and because those active funds that do outperform tend to have relatively high tracking error, portfolios with identical allocations are likely to do better by using passive funds rather than active funds. We do know that a subset of active funds has consistently done better than comparable passive funds. In addition to being willing to absorb the effects of higher tracking error, the challenge is to spot such funds—those with lower fees and better downside protection from organizations with stable fund lineups.

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