



# A New Era in Retirement Savings

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Robert C. Pozen  
Chairman  
MFS Investment Management®

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# Agenda

Decline of DB Plans

Expanding Coverage

Accumulation Phase

Distribution Phase

Re-Thinking Retirement

# Corporate DB Plans

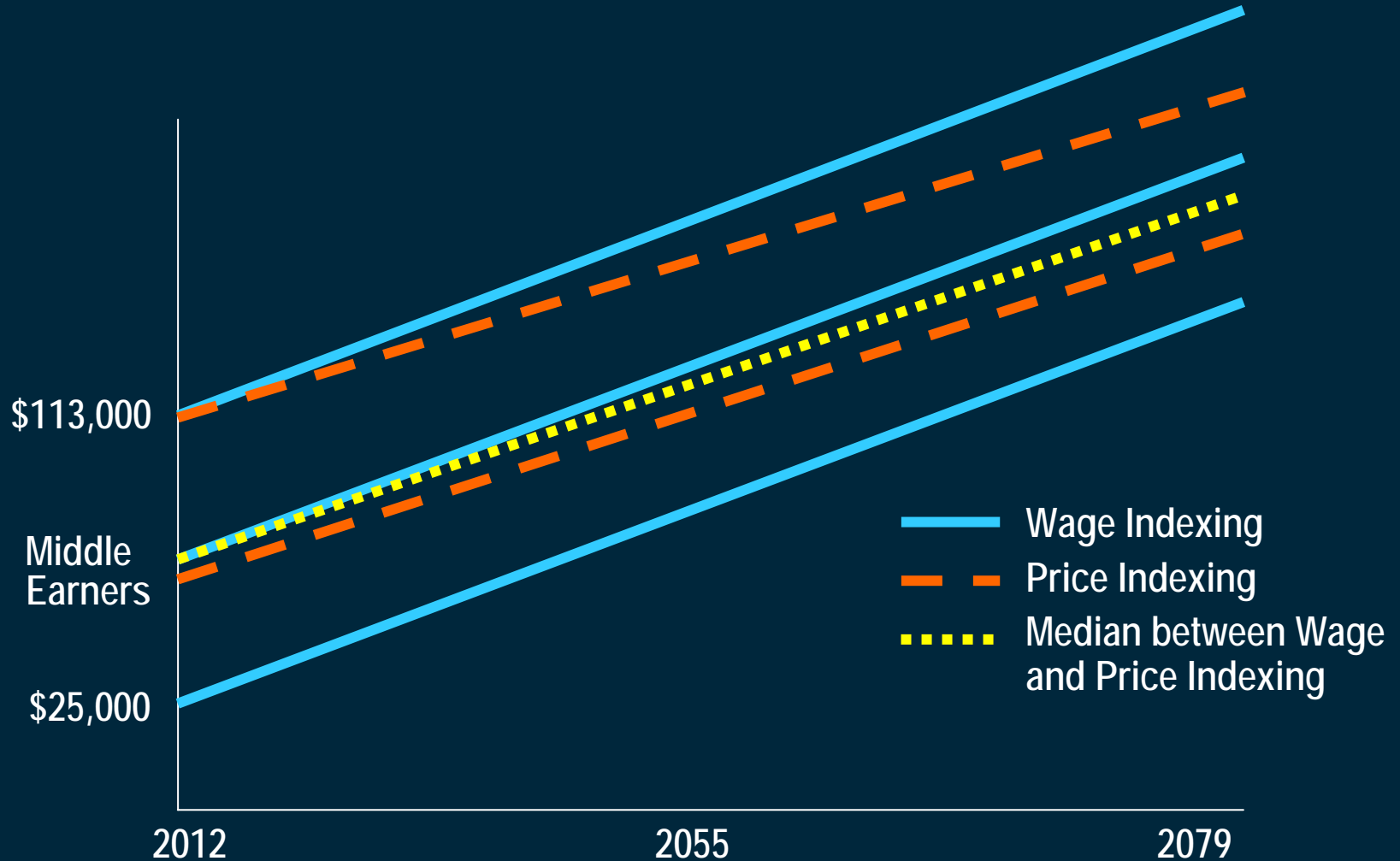
- Recent Legislation
  - Increase minimum funding contributions
  - Obligations calculated according to new interest rate assumptions
  - Special rules for at-risk DB plans (less than 70-80% funded)
- Accounting Reforms
  - Unfunded pension obligations: moved from footnotes to balance sheet
  - Putting both pension assets and liabilities on balance sheet would reduce total equity of S&P "370" by 5%

# State and Local DB Plans

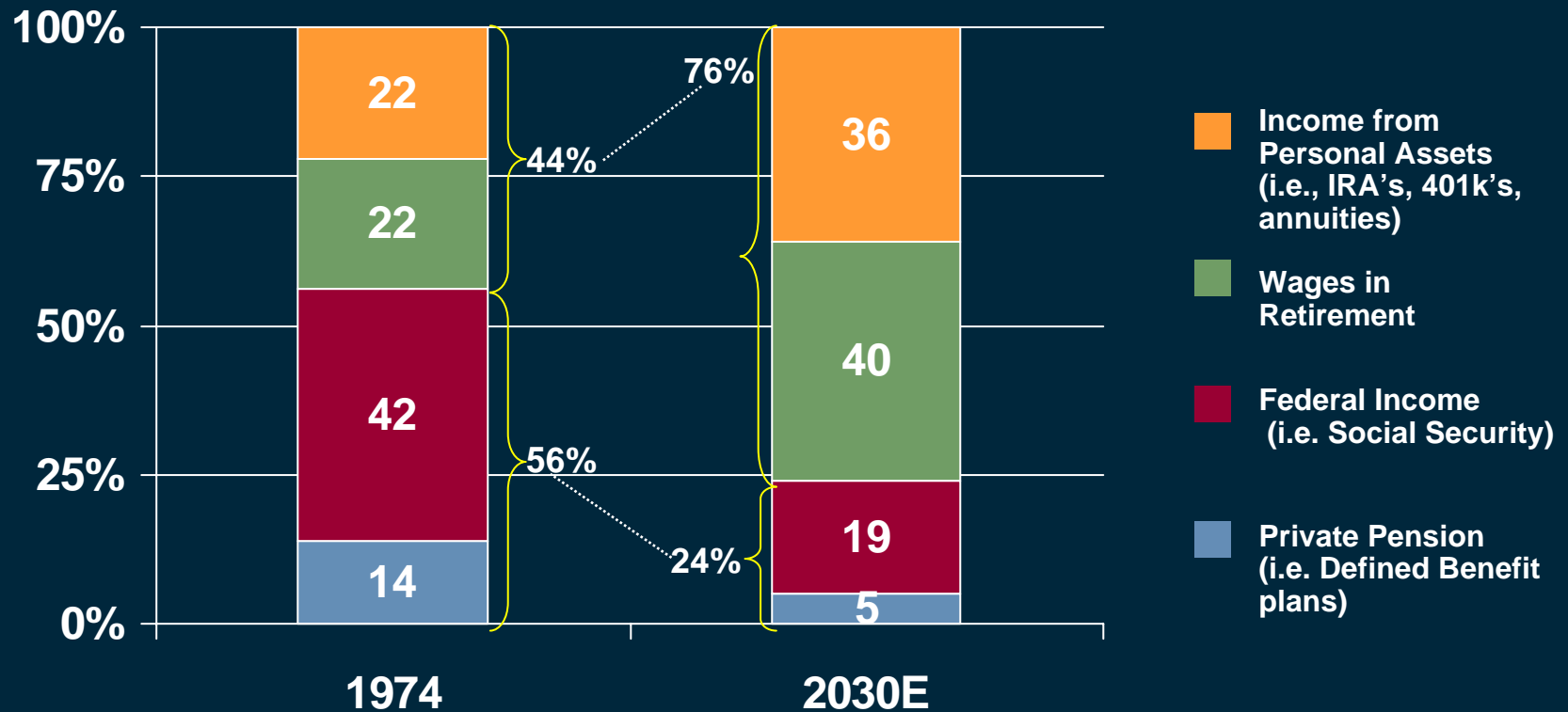
- Inconsistent rules for pension accounting
  - San Diego
  - New York City
- Unfunded health care benefits
  - State and local governments required to report unfunded retiree healthcare benefits beginning in 2007
  - Study estimates average obligation of \$135,000 per worker; total unfunded obligations of \$1.4 trillion

# Progressive Indexing for Social Security

Slower benefit growth for middle and high earners



# Shifting Responsibility for Retirement Income



## Not Covered by Pension Plans at Work

- 30 million full-time workers are uncovered (25% of 120 million full-time workers)
  - Small employers (less than 100) represent 75% of total uncovered
  - Large employers (100 or more) account for 25% of total uncovered

# Check-off IRA (CIRA) Proposal

- Employers not offering plans deduct a minimum percentage (e.g., 3%) of an employee's wages, tax-deductible in year of contribution
  - Employee granted 60-day period to raise contribute rate or opt out
  - Employer protected from legal liability by safe harbor
- Deductions invested in a balanced fund (50% diversified stock, 50% high quality bond)
  - Employees granted 60-day period to opt out of balanced fund and choose alternative investments (diversified stock, high-quality bond, money market, bank deposit)
  - If CIRA offers these four choices, its sponsor would be legally protected by another safe harbor

## CIRA as a Solution for Small Employers

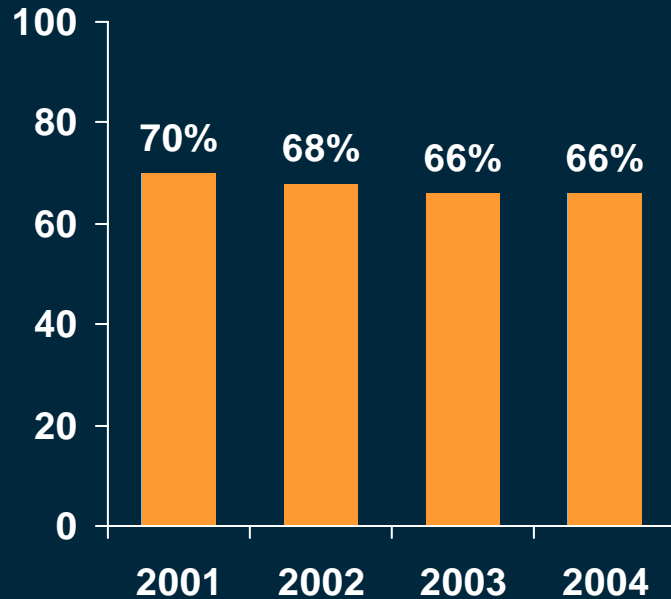
- Smaller employers would not be required to:
  - Make contributions to CIRA
  - Satisfy IRS tests for anti-discrimination
- They would only be required to connect their payroll system to a qualifying financial institution offering a CIRA
- Congress could exempt employers with fewer than 5 or 10 employees, since many do not have an outside payroll service or computerized payroll program

# CIRA as a Solution for Large Employers

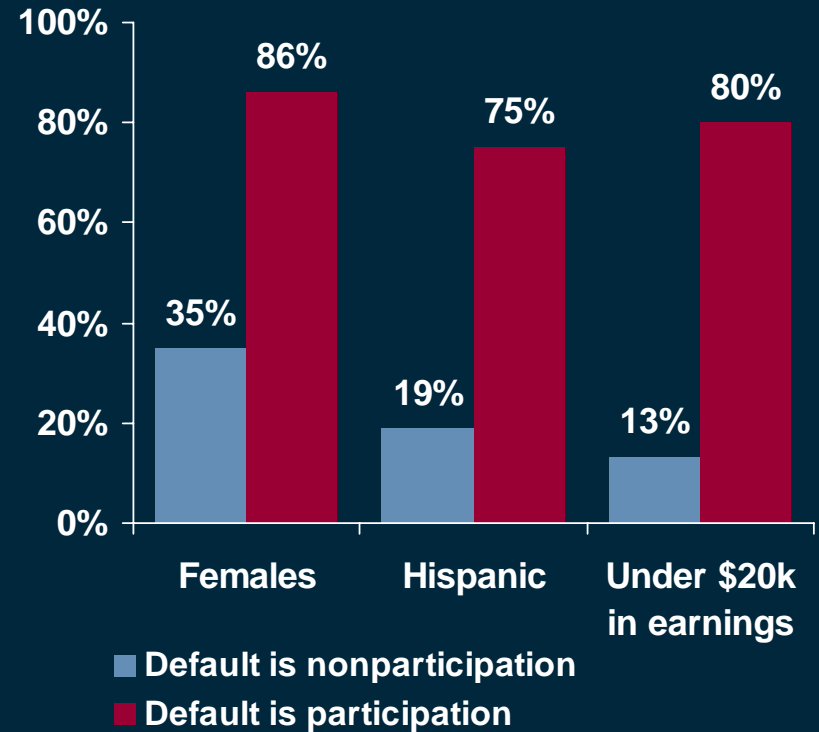
- Large employers should be required to make a reasonable contribution to an employee's CIRA account, e.g.:
  - 50% match of annual contributions by full-time employees up to 6% of wages (maximum match of 3%)
  - Large employers contributing such matches should be deemed to have met antidiscrimination tests
- Growing companies exempted from matching requirement until they have 100 full-time employees for three consecutive years

# Participation Rates and Auto-Enrollment

All Plans



The Benefits of Auto-Enrollment

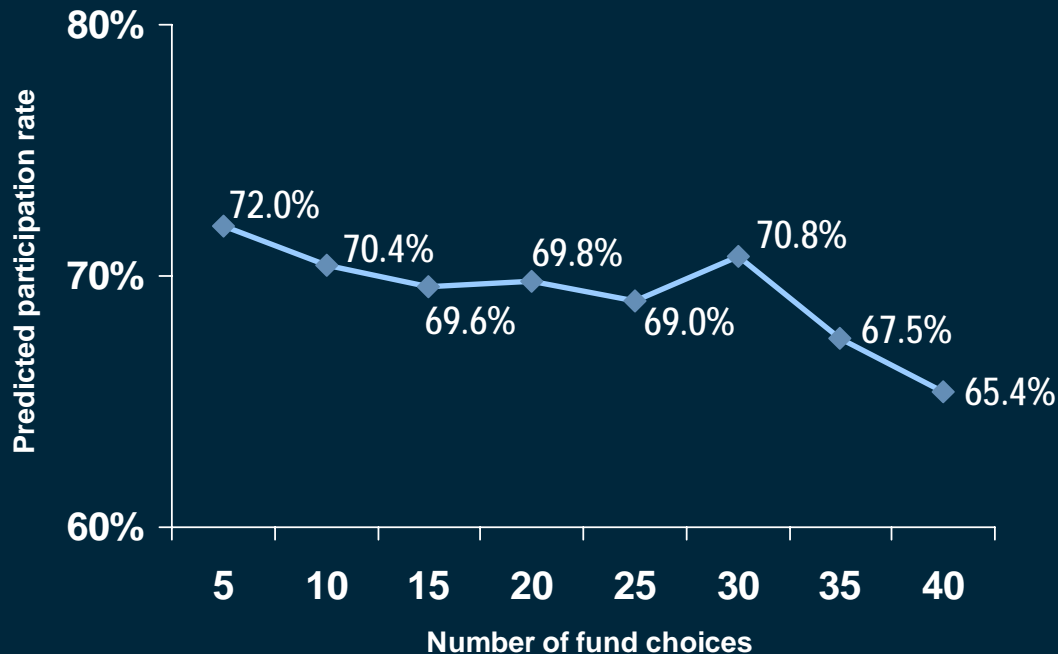


Fidelity Investments, *Building Futures VI*, 2006

The Brookings Institution. Actual results for employees with between 3 and 15 months tenure.

# Choice Overload and Response

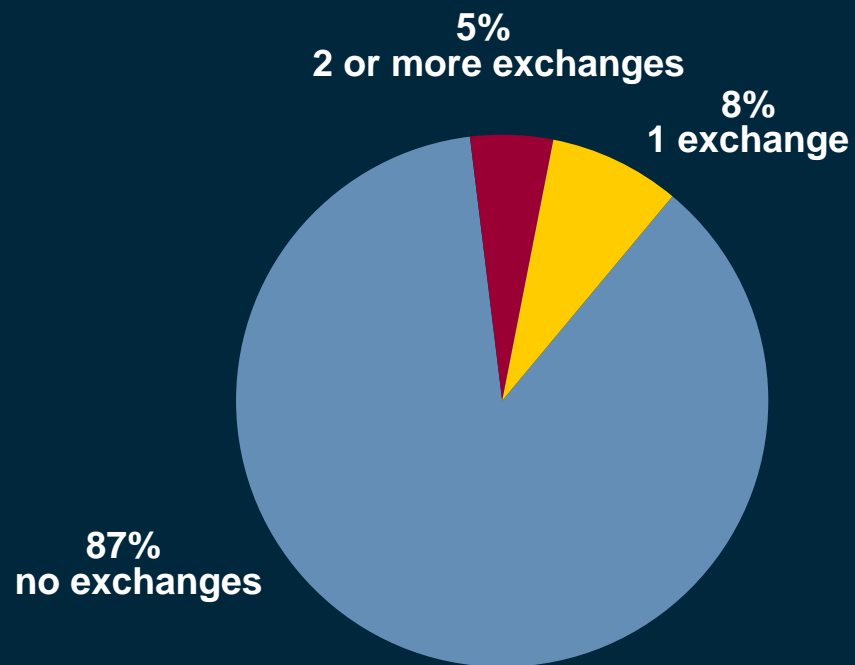
Predicted participation rates in relation to number of investment choices



% of 401(k) Plans Offering Lifestyle Funds

2000	28%
2002	30%
2004	39%
2005E	48%

# Rebalancing... or Lack Thereof

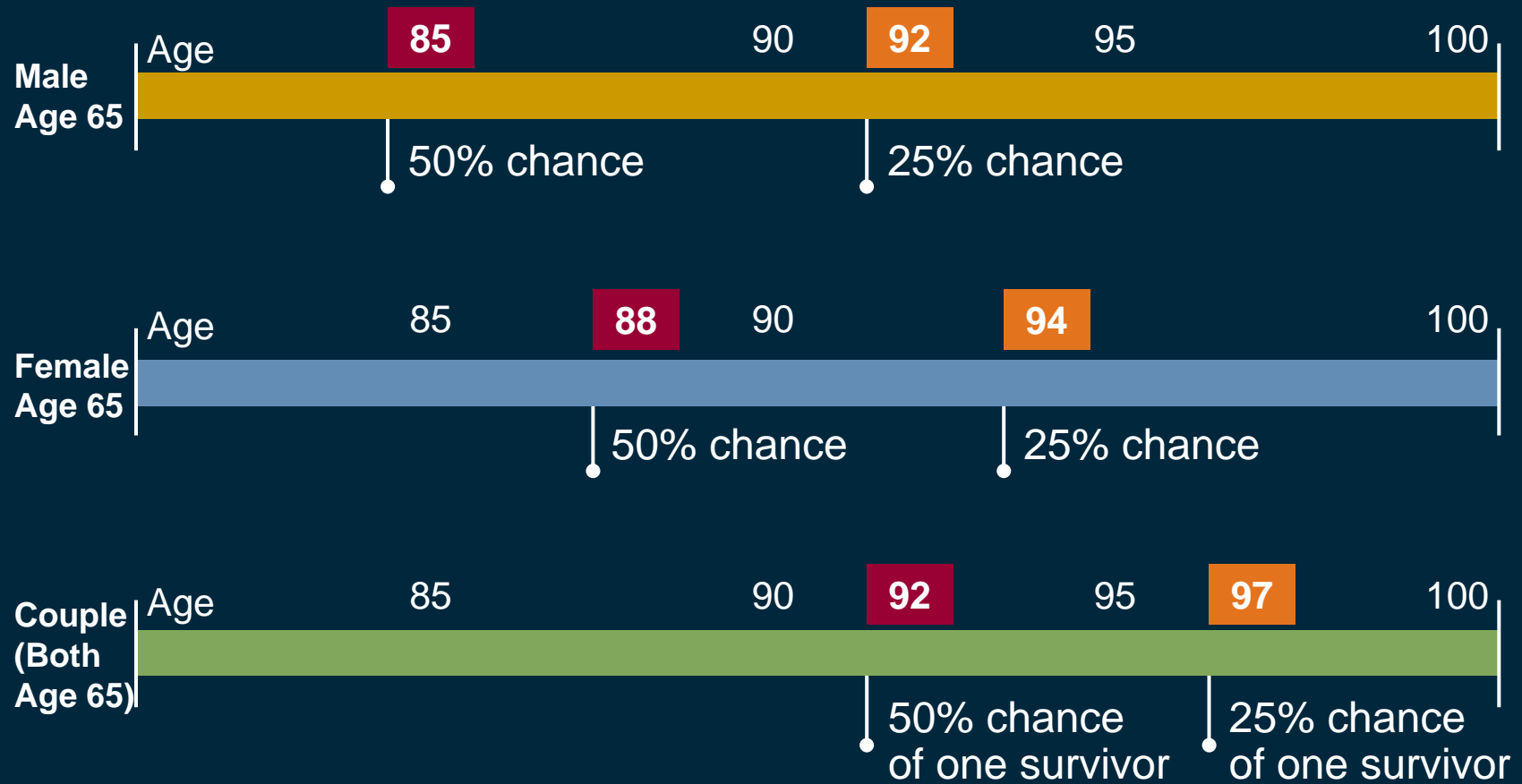


# Safe Harbor for Investment Advice

- New pension bill provides framework for fiduciaries to avoid entering into a prohibited transaction when providing advice for a fee
- Rules put in place to limit the possibility of abuse:
  1. Fee must not vary depending on investment choices made by participants, or
  2. Recommendations must be based on a computer model certified by an independent third party
- Advice on IRA investments from plan fiduciaries must comply with #2

# Increased Life Expectancy

## Lifespans



Annuity 2000 Mortality Table; Society of Actuaries; Fidelity Investments. Figures assume a person is in good health.

# Investment Products for Longer Distribution Phase

- Equities
  - Consider investing in equities after retirement
  - Bonds carry significant inflation risk
- Treasury Inflation Protected Securities (TIPS)
  - Fixed interest rate, but principal rises gradually to keep pace with inflation
  - Imputed income unless in tax-sheltered vehicle

# Variable Annuities – Attractive Features

- Savings/Accumulation phase:
  - Guaranteed Minimum Death Benefits
  - Guaranteed Minimum Living Benefits
  - Long Term Care
- Income/Distribution phase:
  - Lump sum
  - Systematic withdrawal plans
  - Annuitization

Note: Guarantees are based on the claims-paying ability of the issuing insurance company.

## Withdrawal Risks

- Unrealistic expectations: Two-thirds of Americans expect their standard of living to remain the same in retirement, but less than 42% have tried to calculate retirement needs\*
- Many expect to withdraw between 8%-10% during early years of retirement
- Reality: If you withdraw 8%-10%, you could run out of money between the ages of 77 and 81 ½\*\*
- May be best to start slow: 4% - 5% per year

\*EBRI Retirement Confidence Survey, 2005. \*\* MFS quantitative analysis – assumes portfolio size of \$500K, 6% yearly investment return, and 10% volatility. Rates of return are hypothetical in nature and are not meant to represent the future performance of any MFS product.

# The Traditional Definition of Retirement

- "...withdrawal from one's position or from active working life"
- Past generations had greater flexibility to retire early – male labor force participation at age 62\*
  - 1960: 79.8%
  - 1995: 51.3%
- Baby Boom generation is not following suit
  - Expected to live longer in retirement
  - Fewer employer pensions to fund retirement
  - 75% of people age 40 and older have 401(k) balances of only \$50K
    - Average net worth of \$400K including house

Merriam-Webster Dictionary

\*Professor John F. Quinn, "Changing Retirement Trends and Their Impact on Elderly Entitlement Programs," in *Policies for an Aging Society* (eds. Stuart Altman and David Schactman)

## The New Definition

- 49% of Boomers expect to retire after age 65<sup>1</sup>
  - 72% anticipate working after they retire
    - 39% cite financial necessity
    - 28% want to work in retirement – mostly high income
    - 5% other
- 7 million “retirees” have returned to workforce after average sabbatical of 1 ½ years<sup>2</sup>
  - Working retired represent 10% of US workforce aged 40 and above
  - 54% work part-time; 36% full-time

<sup>1</sup>MassINC, *A Generation in Transition: A Survey of Bay State Baby Boomers*, 2005. Results based on survey of 1,000 Massachusetts adults aged 40 to 58.

<sup>2</sup>Putnam Investments, *The Working Retired*, 2005. Based on national survey of 1,726 respondents.

## Employers Should...

- Offer part-time work and flexible hours
- Offer partial payouts of retirement plans while working part-time
- Provide health care benefits up to age 65 (Medicare)

## Government Should...

- Continue moving normal retirement age back as life expectancy rises
- Offer financial incentives in Social Security for working later
- Address disability issues for those performing physical labor

“The fear of dying too soon made life insurance the largest financial services industry of the 19th century.

But providing financial protection against the new risk of not dying soon enough may well become the 21st century’s leading financial industry.”

— Peter Drucker