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Time for Congress to Step Up

Bob Reynolds says the right public policy can fix the retirement gap.

10-06-15 | Scott Cooley

Bob Reynolds is a man on the go. In the 1980s, he took over Fidelity's modest 401(k) business and built it into an industry heavyweight. By the turn of this century, he had ascended to chief operating officer at Fidelity. In 2006, while still at Fidelity, Reynolds reportedly finished second in the contest to become the next commissioner of the National Football League. When it became clear that the Fidelity CEO job would stay in the family—founder Ned Johnson's daughter, Abigail, later took the company's top role— Reynolds looked for a new challenge and took on the responsibility in 2008 of turning around Putnam Investments, which had fallen on hard times in the early 2000s. In 2014, Reynolds also became CEO of Great-West Financial, which shares a common owner with Putnam. Great-West Financial owns a substantial insurance business and operates one of the nation's largest recordkeeping operations, Empower Retirement.

Reynolds has long campaigned to remake the nation's retirement system. It is no secret that Americans have inadequate retirement savings— the Employee Benefit Research Institute, or EBRI, puts the "retirement gap" at $4 trillion—but Reynolds is optimistic that, with the right public policy framework, that gap will shrink. Reynolds has proposed a number of policy changes that would help people save more—and that would make workplace retirement plans available to the 50% of private-sector employees who currently lack them. I talked with Reynolds in August about his ideas to reshape the U.S. retirement system. What follows is an edited transcript of our Q&A.

Scott Cooley: Bob, you're a very well-known player in the investment-management industry and in Washington, DC, but I think even some people in the industry may be surprised at the breadth of your business now. Can you provide a few key stats for Putnam, Great-West Financial, and Empower?

Bob Reynolds: Putnam's a money-management firm, and we manage about $150 billion, predominantly in the U.S., but we have clients around the world. In the U.S., we provide product solutions and services for the retail mutual fund, retirement, and institutional markets, and outside the U.S., our work is predominantly on the institutional side, but we do have a joint venture in Japan with Nippon Life. Putnam has a 78- year history; it's a great firm. When I was across the street [at Fidelity], I knew the organization well.

Empower, part of Great-West Financial, is a retirement company with more than 7 million participants, serving over 22,000 corporations or entities. The firm also has a large government market practice.

Great-West Financial is also an insurance company—a very large player in what I would call niche markets. In particular, this part of our company focuses on executive benefits, as well as providing life insurance and annuities through banks and financial intermediaries. I think being a large-scale 401(k) or defined-contribution service provider with insurance capabilities positions our firm to address the broader retirement income challenge, which the industry and public are facing.

Getting People to Save

Cooley: How would you characterize the state of retirement security in America? Are some of these estimates of a retirement gap of $4 trillion or $8 trillion at least somewhat accurate?

Reynolds: Yes, I think you have to get behind the numbers and see what that means. In defined contribution, the younger you are, the greater your retirement gap is—but also your chances are greater of closing that gap over time.

I'm bullish on the industry itself, because through the Pension Protection Act of 2006, we as an industry figured out how to get people to save at the right level. The law gave protection for the plan sponsor to do automatic enrollment and automatic escalation, and they made target-date or balanced funds default options. Prior to that, for most plans, the default option was the most conservative option they had. But having participants default more to an appropriate asset allocation is very beneficial. I think this changed defined contribution as we know it.

The other challenge, as you mentioned, is that right now defined-contribution workplace savings covers just over half of working Americans. How do we get that other half participating in the retirement system? Because clearly it makes a huge difference. The EBRI study you mentioned was interesting. They looked at middle- to lower-income workers, and if they have access to workplace savings, 70% of them were saving for retirement. That exact same demographic group, without workplace savings, under 10% were saving for retirement.

I would put this in two buckets. In existing plans, the automatic features have really driven up participation and savings rates. On the other side, again, we have to figure out a way to get coverage to these workers who do not have workplace savings available to them.

Cooley: That probably brings us to some of the proposals around the auto IRA approaches, whether at the federal level or the state level. What are your thoughts on those?

Reynolds: I would rather see federal legislation, so you have common rules nationwide. If you change jobs or move out of state, you'd be in the same system. But as you know, because they haven't gotten traction there, President Obama recently instructed the Department of Labor to come up with a set of rules where states could establish these plans. But I would still like to see a federal solution to it.

Cooley: You've talked about the successes of autoenrollment and auto-escalation, but one problem is not every plan sponsor offers auto-enrollment, and even among those that do, not everyone offers auto-escalation. Do you foresee an additional government role in promoting these?

Reynolds: I'd like to see more guidance and encouragement from government for adopting "full-auto" plan designs—because they work. We have figured out the accumulation phase. If you have auto-enrollment, autoescalation, and obviously the right default options, people participate at higher levels, they save more, and their retirement readiness level goes up significantly. I would like to see it as part of the system. I just think that for a defined-contribution system to work, you need this type of plan design. Clearly, the results are in, and they're dramatic.

Also, to have more than 100% income replacement at retirement, you have to be saving at the 10% to 15% level. That should be the goal—every company, every plan, how do we get people saving at that level? This includes a company match, if the company has one in place.

Cooley: In terms of supporting these sorts of mandates, you're out there advocating for them, but much of the industry has not gotten behind them. Why is that? Is it because the industry views this segment of the population as too expensive to serve profitably, or is there some other reason?

Reynolds: With companies that have established plans, why haven't they done these things? It is optional at the plan-sponsor level. Some of them choose one but not the other. Some of them decide to offer auto-enrollment just for new employees. Some offer auto-enrollment one time, rather than every year like your health plan. To me, it should be annually, especially for people who aren't participants. You're enrolled unless you tell us not to.

I think it needs to be carefully phrased. It's not a mandate. A mandate leaves you no option. It always comes down to participant choice. Even though the plan sponsor offers automatic enrollment, a participant can opt out. If they offer automatic escalation, a participant can opt out. And participants always have choices on investments. So, to me, it's not a mandate. It's just a structure for the system that has proven to work. Why not do it?

Cooley: So, in terms of other countries that have tackled these issues, what you envision is something a little bit more like the U.K.'s approach or New Zealand's, but not the kind of mandate like they have in Australia.

Reynolds: The Australia system is a great system, because everyone participates at a 9.5% level now, which clearly provides them with retirement readiness. As you know, Australia has a much different Social Security system, so it's hard to compare the two.1 But I do think plans that institute these automatic features are well on the way to setting up the right system for their employees.

Cooley: That raises another interesting point that you have made. Some arcane federal budget rules actually are an impediment to expanding retirement savings.

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Reynolds: Yes. We would like to see dynamic scoring, so you look at things in the real world, rather than a false measurement. The budget office just looks at everything in a 10-year window. If you're 54, they say what you save in retirement is lost to the Treasury forever. In reality, it is a tax-deferral, not a tax expenditure. The government's going to get tax on all that money, plus it's all taxed as ordinary income. But if you do true dynamic scoring—and take account of those tax flow-backs—then the cost of retirement deferrals is 50% less than the way they score them today.

The Medical Burden

Cooley: Shifting gears a bit, you have called for allowing people to make tax-free withdrawals from qualified retirement plans to pay for health insurance and medical care. What's your thinking there?

Reynolds: We have a tool that we provide for Empower clients that helps participants project their medical costs in retirement, depending upon where they live in the United States and their health condition. People are very surprised when they see the amount of money that needs to be earmarked for medical care in retirement. One potential solution to help address this big problem is to allow individuals to pull money tax-free from their qualified retirement account to pay for health care.

Cooley: Would you be in favor of simplifying a lot of these tax-advantaged accounts so that they're more unified, so maybe you just have one tax-advantaged bucket instead of having these separate ones, like health savings accounts? Or would you retain the existing structure?

Reynolds: I would retain the existing structure. I do think health savings accounts are a good way to help fund post-retirement health care.

Cooley: There's been bipartisan interest in expanding access to workplace retirement plans. One proposal came from Florida Sen. Marco Rubio, who at one point anyway called for the government to make the Thrift Savings Plan open to all Americans. Is that viable from your perspective?

Reynolds: No.

Cooley: Why?

Reynolds: The plan doesn't offer the type of investment and service options that are made available to plan sponsors and participants through the larger, more mainstream retirement providers in our industry.

Cooley: It seems like it would be a pretty dramatic departure from the current framework under ERISA, where the plan sponsor has a lot of responsibility to make good investment choices.

Reynolds: Companies structure plans that meet the needs of their employees and whom they're trying to attract. They have different matches and different options. They provide different services. I think having business involved in this solution is beneficial to not only the corporations but to all the participants in it.

Cooley: You've also mentioned having some tax preferences for people who annuitize at least a portion of their retirement money. Can you explain a little bit more what your thoughts are there?

Reynolds: The use of deferred income annuities, where you can take a portion of your retirement account to provide guaranteed income for the rest of your life when you reach a designated age, addresses the longevity risk that defined contribution retirement plans have not addressed in the past. This provides a safety net for the future and allows individuals to plan how best to deploy the non-annuitized portion of their retirement savings.

If you invest a portion of your retirement savings in an annuity, the government does not require that a minimum withdrawal be taken at any particular age. That's a good change.

The Fiduciary Rule

Cooley: I wanted to ask you about the Department of Labor's proposed fiduciary rule, which has attracted a lot of attention. You've been critical of the rule, as have a lot of people in the industry. What changes does the labor department need to make to its proposal? Would you prefer to see the SEC making this sort of rule? And how do you see the process playing out?

Reynolds: Any time you have a rule that's 650 pages, there's some complexity to it.

Clients and advisors should not have different rules for different buckets of their assets. It creates complexity and confusion, and it's not workable.

My biggest concern is that it will drive up the cost of advice. There's no question that participants that get advice are saving at much higher levels, have better investment returns, and their retirement readiness is significantly ahead of people who do not have advice. So, to do any rule that would make advice less attractive to the people that need it most, to me, really needs to be looked at hard.

Another issue is that the proposed rule does not have a carve-out for small companies. Advisors play a key role at companies with less than 100 employees, many of which do not have big HR departments. Typically, an advisor will help these companies structure a plan that works best for them. Without access to advice, I think small companies will be discouraged from establishing plans.

As discussed earlier, our goal should be to encourage more of these plans and greater retirement savings coverage across the U.S., not less.

And then you have to have a contract before you can talk to anyone. If you came to me and said, "I have a question about an investment," I would have to give you a piece of paper and say, "Would you sign this contract? We have to contract with each other so I can give you the advice you need." People aren't going to do that. They're going to say, "I'm not signing anything just to ask you a question."

Then, I think there's a lot of confusion. If you're a service provider, what can the phone reps do? Do you have to have individual contracts? Can a company have a contract with a company? I just think it's very, very complex now. They received 2,500 letters, and I believe 500 were supportive and over 2,000 offered suggestions to make it work.

Everyone I know is for doing what's right for the participant. Quite frankly, if you don't do a good job for clients, you're not going to be in business. It's just not feasible. So, I understand the intention and trying to protect people, and that their best interests should always be followed, but I think the complexity of this proposal could actually reduce overall retirement savings, raise costs, stymie advice, and worsen the coverage gap.

I do think this should be under the purview of the SEC. They monitor asset management and people that give advice.

Cooley: Do you think they'll be receptive to some of these suggestions to improve the regulation?

Reynolds: They say they're going to be. The proof is in the pudding. We sat down with the Department of Labor, and they said they're receptive to ideas. Time will tell.

Cooley: How optimistic are you that the government will make the necessary policy changes to help more Americans achieve secure retirements?

Reynolds: I'm an optimist, a born optimist. I think there are compelling arguments why things need to be changed, and I do think the government wants greater coverage, and they really want to help the smaller-balance customers to get the help they need to make the right choices. I think that's their intent, and I'm hopeful that we'll get to a good place.

Cooley: One final question. You were a star football player in the past. Which is rougher, football or Washington, D.C., politics related to retirement security?

Reynolds: One's a game, and one's life. I think that in dealing with Washington on anything, the key is patience. Things don't happen overnight, and they never happen as quickly as you want. Again, one's a game, and one's life. Obviously, life is more important.