SOCIETY OF ACTUARIES

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Exploring developments in new products, tools, and strategies designed to help reduce retirement risks.

HOW TO FIX THE RETIREMENT CRISIS TOMORROW

A R O M E R. The world's first fully funded retirement investment strategy.

Abstract

AROMER makes guaranteed retirement a reality for every single American by sanctioning a third-party 401(k) contribution as a mutually beneficial investment vehicle. AROMER introduces a safe solution to help achieve 100 percent retirement plan participation while simultaneously empowering the 99 percent with guaranteed long-term financial security by creating a reciprocal relationship between qualified sponsors seeking alternative investment opportunities and cash-strapped individuals unable to save for retirement.

By Kalon McMahon

The retirement crisis is very real. The median total household retirement savings for American workers is estimated at only $50,000[1], while over one in four Americans say they have no retirement savings or pension benefits whatsoever.[2] Improvements in health care means people are living longer, but that only puts more pressure on the need to save more. While auto-enrollment and auto-escalation have helped increase retirement plan participation, the value of these plan innovations is lost on the majority of American's who neglect their finances on autopilot. The American retirement model has not been comprehensively addressed for decades, and without immediate intervention and policy change, this very solvable problem will continue gaining momentum in the wrong direction and eventually reach a point of no return that will forcibly escalate the retirement crisis into a retirement tragedy.

The good news is we can fix it, literally overnight, with one simple solution: AROMER. Remora spelled backwards, AROMER inverts the traditional symbiotic relationship that exists between the financial services industry and retirement plan participants by allowing financially stressed individuals to establish a risk free, mutually beneficial relationship with external investors seeking to fund additional retirement accounts in exchange for added exposure to the tax advantages and investment incentives privy to retirement plan participants. By sanctioning a third-party 401(k) contribution as a mutually beneficial investment vehicle, AROMER provides a safe solution to help solve the retirement crisis and achieve 100 plan participation while simultaneously empowering the 99 percent with guaranteed long-term financial security.

Before we dissect this common-sense solution, let's explore how we found ourselves in a retirement crisis despite years of market highs and unemployment lows.

The Problem

The retirement crisis is the inadvertent collateral damage of a sound niche investment strategy that was suitable for some, being misappropriated and repackaged as a blanket long-term financial salvation theory for all. In the early 1970's, a group of high-earning individuals from Kodak approached Congress to allow a part of their salary to be invested in the stock market and thus be exempt from income taxes. This resulted in section 401(k) being inserted in the then taxation regulations and was intended to allow taxpayers a break on taxes on deferred income.

The key word in this story being "high-earning." The modern retirement model as we know it is the derivative of a specific investment strategy designed for employees with too much income seeking an additional tax shelter. That investor profile does not sound anything like the modern average American:

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[1] https://transamericacenter.org/docs/default-source/retirement-survey-of-employers/tcrs2019_sr_employer_survey_retirement_security_challenge.pdf

[2] https://www.federalreserve.gov/publications/2019-economic-well-being-of-us-households-in-2018-retirement.htm

- Median American income in 2019 is $63,000[3]
- The average American household with debt owes $137,063[4]
- 27 percent of adults would need to borrow or sell something to pay for an unexpected expense of $400.[4]
- 25 percent of adults have no retirement savings and skipped necessary medical care in 2018 because they were unable to afford the cost.[4]
- 78 percent of Americans live paycheck[5] to paycheck and simply can't afford to contribute to a 401(k).

For anyone with enough financial acumen to grasp the concept and enough financial surplus to fund it, the 401(k) made perfect sense. It reduced taxes, increased wealth, and if the employer made matching contributions it offered "free" money. Thirty-year projections promised employees retirement nest eggs big enough to fund the American dream. To reduce benefit disparity between higher- and lower-wage earners, nondiscrimination rules were adopted in 1984.[5] As such, the tax-deferred benefits of a defined contribution retirement plan were quickly becoming available to the masses. The logic was sound: invest a small percentage of your paycheck every month and you could be a millionaire by the time you retire. It was foolproof. Who couldn't afford to save a few hundred dollars every month?

But while society shifted from guaranteed retirement via defined benefit pension plans to possible retirement via "do it yourself" defined contribution plans, we forgot to educate people on one small detail— how to actually do it yourself. Consequently, it failed.

Fast forward to 2019. Employees who joined the workforce in the dawn of the defined-contribution retirement plan era and theoretically should be enjoying their fully funded retirement, instead find themselves working beyond age 65 as Uber drivers, grocery store clerks, and school teachers. As of February 2019, more than 20 percent of adults aged 65 and older are either working or looking for work, compared to 10 percent in 1985.[6] The Bureau of Labor Statistics (BLS) expects the trend of older people working to continue, estimating that 13 million Americans age 65 and older will be in the labor force by 2024.[7]

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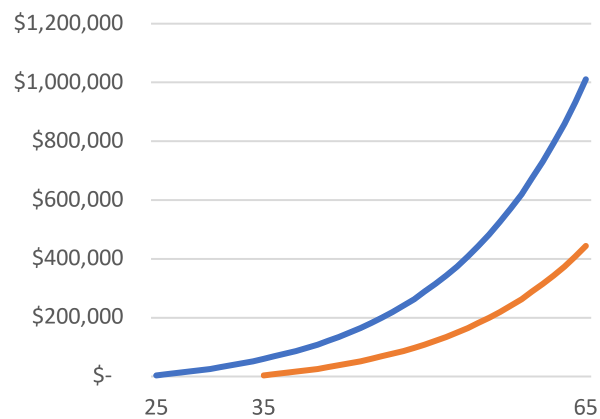
3 https://www.census.gov/newsroom/press-releases/2018/income-poverty.html
4 https://www.federalreserve.gov/publications/files/2018-report-economic-well-being-us-households-201905.pdf
5 http://press.careerbuilder.com/2017-08-24-Living-Paycheck-to-Paycheck-is-a-Way-of-Life-for-Majority-of-U-S-Workers-According-to-New-CareerBuilder-Survey
5 https://www.ebri.org/docs/default-source/fast-facts/ff-318-k-40year-5nov18.pdf
6 https://unitedincome.com/library/older-americans-in-the-workforce/
7 https://www.bls.gov/careeroutlook/2017/article/older-workers.htm

How do we fix it?

The catch-22 of the modern retirement system is that it only works if you start saving when you are 22. The success of the model relies on the power of compound interest over time, but with so many workers living paycheck to paycheck few can afford to save for retirement, especially in their twenties. Consider the following:

- Average student loan debt total per person: $31,172[8]
- Average monthly student loan payment: $393[9]
- Time to pay off student debt: 10 to 30 years[9]

Take the example of a 25-year-old who invests $300 a month in a Roth IRA for 40 years and earns on average 8 percent annually. When they retire at age 65, their investment will be worth just over $1 million. If the same person were to start investing $300 a month at age 35, they'd only have around $450,000 by the time they reached age 65. Those 10 years would cost over $550,000. In other words, it's nearly impossible to catch up if you don't start saving in your twenties.



Currently, one in six Millennials say they have less than $10,000 saved for retirement, and over half say they have nothing saved for retirement.[9] What this suggests is that we are knowingly grooming an entire generation to fail all over again unless we afford some sort of alternative retirement strategy capable of exponentially closing the enormous retirement gap. But what if there were a zero-risk solution to immediately guarantee 100 percent plan participation with 100 percent of employees contributing enough to receive the full employer match starting their first day on the job?

The Solution:

Introducing AROMER, the world's first fully funded retirement investment account option. By sanctioning a third-party retirement plan contribution as a mutually beneficial investment vehicle, we can empower employees to actually utilize and leverage the life-changing benefit already at their disposal—a benefit that would otherwise go untapped without connecting participants with willing investors seeking additional exposure to the employer matching and tax advantages unique to retirement plan participants.

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[8] https://www.credit.com/personal-finance/average-student-loan-debt/
[9] https://www.gobankingrates.com/retirement/planning/why-americans-will-retire-broke/

How It Works:

The idea works like this: a third-party financier offers to contribute to a retirement plan account on behalf of a plan participant, up to the annual contribution limit—at least enough to ensure receipt of the full employer match. In doing so, we create an additional retirement plan participant and convert a non-saver into a saver without requiring them to take any action or make any lifestyle changes. Better than auto-enrollment and auto-escalation, 100 percent of employees would actually be—and stay—enrolled in the plan starting their first day on the job. Yes, the employer's 401(k) contribution expenses will dramatically increase with 100 percent employee participation. However, this additional expense would be offset by the corresponding decrease in FICA and payroll tax liability.

In exchange for funding the participant's retirement account, the financier is entitled to a majority split (60/40) of the retirement plan balance. To be clear, this is not a loan. There is no interest rate applied to the contributions. The participant can stop coverage at any time without penalty. In exchange for their principal investment, the financier gains access to additional investment multipliers via the employer match while retaining all of the tax advantages afforded to direct retirement plan participants. While a majority split may seem drastic, it's still 40 percent more than zero, which is what most American's are on track to have saved for retirement without access to an AROMER account.

Consider this example: a 25-year-old college graduate making $50,000 a year with $30,000 in student loan debt who simply can't afford to make their student loan payments, pay rent, and contribute to their retirement plan at work.

Results Summary	
Current retirement plan balance	$0
Years to invest	40
Annual rate of return	6%
Annual salary	$50,000
Expected annual salary increase	2%
AROMER contribution	$19,000 per year
Employer match	50% up to 6% of salary
Total contributions (including catch-up)	$850,000
Total employer contribution	$90,603
Retirement plan balance @ 65	**$3,383,046**
Share to retirement plan participant	$1,353,218
Share to AROMER investor	$2,029,828

If they allow an AROMER investor to fully fund their retirement account up to the annual contribution limit of $19,000 (2019), at a 6 percent annual rate of return for forty years the participant would earn **$1,353,218 without contributing a single dollar out of pocket**. In exchange for the principal investment of $850,000 over forty years, the AROMER investor would be entitled to the remaining majority share totaling $2,029,828.

What Needs to Change?

Currently, ERISA law does not allow for any third-party besides the employer to contribute to a participants 401(k) retirement account. The American retirement model hasn't been comprehensively addressed for decades. Given the impending crisis, it must be reevaluated through a modern and realistic lens in order to effectively serve the millions of Americans who literally depend on it to survive in retirement.

Let's take some cues from the FinTech industry. Upromise paved the way by helping parents turn everyday purchases into college savings.[10] In the same way, FinTech solutions like EvoShare offer a financial platform that makes it possible for employees to turn everyday purchases into additional retirement plan contributions.[11] What's interesting is that the opportunity to save is not limited to the participant. Imagine a world where family and friends can contribute to your retirement plan as a wedding gift or birthday present.

For their report, *Securing Retirement for New Generations*,[12] POLITICO asked thought leaders and policymakers to address the problems with the current U.S. retirement system and to identify potential solutions. The group put forth several straightforward ideas aimed at revamping the retirement model and helping Americans generate more wealth for retirement, including:

> ***An independent commission could help build political consensus.*** *American retirement hasn't been comprehensively addressed for decades. One way to move forward would be for Congress to establish a high-profile independent commission. Though not a policy change in itself, a commission would bring needed attention to the issue, set an official baseline for the problem and launch the conversation on reforms, from small-scale adjustments to a wide-ranging revamp of the U.S. retirement system.*
>
> ***More Americans need access to retirement savings plans.*** *The retirement system is still highly dependent on employers, and far more dependent on the 401(k) than even its inventor envisioned. A simpler and portable account would give workers more consistent access to tax-advantaged savings and leave them less vulnerable to gaps caused by job changes and financial emergencies.*

Although a seemingly new concept, the strategy AROMER seeks to legitimize is not drastically different from other proven alternative investment strategies such as life settlement transactions whereby a policyholder transfers ownership of their policy to a third party in exchange for relief from future premium payments and an immediate cash payout for less than the mature value of the policy. Similarly, AROMER proposes a safe and effective strategy to help make a sufficiently funded retirement a reality for all by connecting qualified investors with cash-strapped individuals unable to save for the future. Ultimately, by sanctioning a third-party retirement plan contribution as a mutually beneficial investment vehicle, AROMER empowers plan participants to effortlessly profit by simply allowing investors to come along for the ride.

So, the question to the millions of Americans not contributing to their retirement plan becomes: would you rather have 100 percent of $0 or 40 percent of $3,000,000?

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[10] https://www.upromise.com/
[11] https://evoshare.com/AboutUs
[12] https://static.politico.com/dd/46/de2db6744a41957c96c51f84f094/working-group-report.pdf