

## **Goldman Sachs Exchanges**

### **The missing link to retirement security**

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**Allison Nathan:** The US economy has been remarkably resilient. Inflation is falling, unemployment remains low, and markets are rising. So is this environment putting Americans on track to meet their retirement goals, or are they still falling short?

**Mike Moran:** When we think about the current economic environment, the current market environment, there's some good news in there but there are also some challenges as well, both for current workers as well as retirees.

**Allison Nathan:** I'm Allison Nathan, and this is Goldman Sachs Exchanges.

For today's episode, I'm speaking with Mike Moran, a pension strategist in Goldman Sachs's Asset Management business, to discuss how the current macro environment is changing the retirement picture for both savers and retirees. Mike and his team are out with a new report that describes what they see as a missing link to retirement security. Mike, welcome back to the program.

**Mike Moran:** Thanks for having me, Allison.

**Allison Nathan:** Mike, as I just mentioned, inflation is moderating. The Fed recently cut interest rates for the first time since embarking on an extended period of raising rates, and it was an aggressive cut at that, 50 basis points. What does this mean for retirement savers?

**Mike Moran:** So I think, Allison, when we look at the current economic environment, the current financial market environment, it's a bit of a mixed bag. So inflation is coming down, but when we look at the cumulative effect of inflation over the last couple of years, we see it having an impact on individuals and that's impeding at times their ability to save for retirement.

So in our retirement survey, we asked working respondents: What was the biggest change in your personal financial situation over the past year? And the most popular answer was just an increase in everyday expenses. And so you're seeing that cumulative impact of inflation really stretching consumers. And we see this in economic data as well, right? Credit card balances are increasing. Delinquencies on both credit cards as well as auto loans is increasing. So the consumer is being stretched, in particular the low-end consumer.

Now, there is some good news. So within our survey, we track every year what we call the financial vortex. It's a term we use to discuss those competing financial priorities that potentially get in the way of saving for retirement. And these are things like paying off credit card bills and saving for a college education and dealing with emergency expenses. So the good news is, in our survey, that for the first time in the four years we've been tracking this, the impact of the financial vortex diminished a little bit. That's good.

The bad news is that it's still elevated. And when we look at working respondents to our survey, two thirds of them

are saving for multiple goals at the same time. They're saving for retirement, but they may also be saving for a home purchase, child's college education, and so forth. And as a result, 60% of those people feel like they're going to have to delay their retirement because of competing financial priorities.

Now when we think about looking forward, we're entering a new phase of the economic cycle here. As you point out, the Fed recently cut interest rates. When we think about retirees, lower interest rates, retirees who are on a fixed income, is not necessarily their friend, right? We've all enjoyed the last few years, robust yields on money market funds, short-term treasuries. Well, those days may be behind us, so that could be a headwind for current retirees. Certainly lower interest rates can be supportive to equity prices. Equity markets here in the US, close to all-time highs.

The problem, though, for many current workers is they can't save for retirement because of the financial vortex. So when we think about the current economic environment, the current market environment, there's some good news in there but there are also some

challenges as well, both for current workers as well as retirees.

**Allison Nathan:** Right. Because even though inflation is coming down, obviously price levels are still quite high, so we are hearing a lot about this affordability crisis in some respects in the US. There's a lot of debate it seems to be about whether that's actually bringing on a retirement crisis. What's your view of that? And what does the survey reveal about that?

**Mike Moran:** So I think, Allison, when we talk about the retirement system, we can't talk about it as just one group of people, right? There's a distribution. And I think what we find is that the current retirement system works well for some; it doesn't work as well for others. So there's some data from the survey of consumer finances that would say those at the upper income level, the top quintile of income, when you look at their retirement balances, their savings balances, they've grown quite dramatically over the last several decades. Lower income levels, not so much.

And I just want to point out, I didn't say "low income levels." I said "lower income levels."

**Allison Nathan:** Right.

**Mike Moran:** So if you're just not in that top 20%, the growth of retirement assets has been a lot more muted. And this comes back to, again, you know, for higher income people, the ability to save, the ability to invest, the system works well. For everyone else, maybe not so much. And we see this also in the data from our survey. When we look under the hood and look at people who have the ability to have a plan for retirement, they tend to be much more prepared for retirement. They feel better about their retirement balances, their ability to meet their retirement goals. They feel more comfortable, less stressed when they get to retirement. So there's a dispersion underneath the hood as to: Is there a retirement crisis or not?

Now, I think some people look at it and say, well, wait a minute, the equity markets are at all-time highs, right? How could there be a retirement crisis? A lot of that comes back to some people can't save for retirement, so they're not benefiting from the high equity prices that we're seeing in the market today.

**Allison Nathan:** That's actually very striking. So when you say "lower," that's anyone but the top 20%.

**Mike Moran:** Correct. And that's not to say that their retirement balances haven't grown. They've just grown at a much more muted level. And certainly when you get to the really low income levels, there's where you see almost no growth at all.

**Allison Nathan:** And so what can be done at this point to help this 80% that might be struggling a bit more to save for retirement?

**Mike Moran:** Well, I think one of the most popular things we see people say is, well, people should just save more money, right?

**Allison Nathan:** Right.

**Mike Moran:** Well, that doesn't always work so well, right? Partially because, number one, as we talked about earlier, the financial vortex, maybe I can't save for retirement because I have these competing financial priorities. But the other issue becomes: Do I have the tools to actually

save for retirement? And that's why the title of our survey this year talks about that planning is the missing link to retirement security because many retirement plans don't provide a plan, but employers can help with that, especially as we develop more digital tools to provide employees the ability to think about how much I need to save for retirement.

Individuals who had a plan for retirement were much better prepared in terms of their retirement balance, their ability to generate income in retirement, their confidence that they'll be able to meet their retirement needs.

Now I just want to be clear here. When I say "a plan for retirement," I'm not talking about some, like, 20-page, you know, analysis here. Our survey really basically just asks: Have you thought about how much you need for retirement? And have you then thought about how much you need to save and how you need to invest in order to achieve those goals? So it's nothing tremendously complicated.

**Allison Nathan:** Right. But if I'm hearing you correctly, the plan essentially is a plan for savings, so it really does



get back to, no, there's no way to get around this besides saving more or is there? I mean, can you invest more aggressively, for instance, if you have less savings but need to hit higher returns to meet your savings goals?

**Mike Moran:** So I want to answer that a couple of different ways. So first of all, save more for retirement. Yes, we want people to save more for retirement. As we've discussed, some people can't save for retirement. We would also argue that at times you have to think about this holistically, right? We talk about that financial vortex. At times, an individual may have excess cash in a certain month or a certain year, and we may argue saving for retirement maybe is not the highest and best use of that. Think about someone carrying a credit card balance, paying 20% interest on credit card debt. Maybe using that money to pay off that debt first is the right answer before saving for retirement.

So we have to think about this holistically, and that's where the plan helps. So the question of: Can we just invest more aggressively? I'm going to answer that two different ways. One way, again, is some people haven't saved for retirement; they can't save for retirement. So

developing a plan to invest more aggressively doesn't help them. But the other way I would answer that is say, yes, we as an industry need to make sure that defined contribution participants have access to the type of investments that will allow them to achieve the returns they need to have the retirement lifestyle that they aspire to.

When we look at institutional investors, defined benefit pension plans, endowments and foundations, sovereign wealth funds, they have successfully used alternative asset classes for decades. And when I talk about alternative asset classes here, I'm talking about private equity, private credit, private real estate.

In the United States, defined contribution plans have historically not included those asset classes in a defined contribution line-up or in the different menu items. So in many ways, individuals here in the US have been disadvantaged because they don't have access to some of those asset classes that can generate higher returns, especially when you consider here in the United States there are more private companies today than public companies. And even the ones that ultimately do become

public, they're staying private for longer. So that value creation a lot of times is happening outside the public markets. Individuals are being disadvantaged by not having access to that.

Are there challenges to bringing private markets and alternative investments into defined contribution plans? Absolutely. But we as in industry need to figure that out so that way individuals can save and invest appropriately to meet their retirement goals.

**Allison Nathan:** And has that historical omission for individual retirement plans been because those assets are perceived to be riskier? Or are they just more difficult and therefore more expensive to manage? What has held back that type of exposure from individuals?

**Mike Moran:** There are some operational challenges. We think about defined contribution plans needing to have daily liquidity. We can move our balances around, you know, on a daily basis. We also think about fees, which many plan sponsors are very fee-sensitive about what's the type of assets they want to put on their investment line-up. And obviously alternative asset classes, private markets,

tend to have higher fees than more public markets.

**Allison Nathan:** So it would be more expensive for companies to have that option in their plans?

**Mike Moran:** It could be a more expensive option for the participant, especially if we include it within a broader multi-asset class type of option. It may increase the expense there. Again, as investors, we would always say if we're trying to get better risk-adjusted returns, it may be worth it. So there are challenges to doing this, but I think it's something that the industry is probably going to evolve in over the next couple of years.

**Allison Nathan:** And so what else are companies or plan sponsors doing to help individuals through this?

**Mike Moran:** I think one of the big things that they're doing, and a lot of this has been spurred on by regulatory change, are automatic features. So for example, automatic enrollment has been a great way to increase participation in retirement plans.

So let me just make sure I'm clear here when I talk about

automatic enrollment. Let's say an individual joins a company. That individual decides not to sign up for the defined contribution plan, the 401(k) plan. That sponsor can automatically enroll the individual in the plan. Now, the individual always has the right to say, "No, don't do that. I'm opting out of that." But just looking at behavior, we know that, if we automatically enroll individuals, it's likely that they're going to stay in the plan, which ultimately is good for the individual because it puts them on a path to saving for retirement and investing for retirement.

Another automatic feature is the ability of plan sponsors to default a participant into a QDIA, a qualified default investment alternative. And again, a lot of this was spurred on by regulatory change. Let's say that individual doesn't sign up for the plan. We as the sponsor automatically enroll them. Or maybe that individual does sign up, but they don't choose which investments they want to have. That sponsor can default that participant into a QDIA, which is oftentimes a professionally managed target date fund or multi-asset type of solution, which is going to be a better investment alternative for them than defaulting them into a low-yielding money market fund or

short-duration bond fund.

So automatic features have helped to increase participation, increase savings rates, giving individuals access to better investment alternatives. Now, if I look forward and say what do we think are some of the automatic changes we could see in the future? I think one thing we want to look at is potentially what we call a hybrid QDIA. Somebody comes into the plan. Let's say they're 35 years old. They join the company from another company. We default them into the plan. We default them into a QDIA, which is a target day fund, which for many individuals at a younger age is probably the right answer.

But what happens when that individual gets older and their savings become larger and their life becomes more complicated because now maybe they have a spouse or a partner, they have assets outside the 401(k) plan? They have children? Their financial situation gets a lot more complicated. Do we need to give them something a little bit more customized to them? And then maybe the QDIA is you're now out of the target day fund into something like a managed account, which will provide a more personalized experience for the individual. That's where we could say,

again, automatic features helping later career workers as they get closer to retirement and come up with a more personalized plan for them specifically.

**Allison Nathan:** So there could be, for example, an age trigger where you would revisit the plan you've been in, and there would be some automatic function to kind of reassess where you should be?

**Mike Moran:** 100%. And we can debate as an industry what is that age? Is it 45? Is it 50? Is it 53? But it's something later in life when your life has become more complicated.

**Allison Nathan:** Right.

**Mike Moran:** You got married. You got divorced. You had kids. You have assets outside the 401(k) plan. There's a point where you sort of cross over and say just being in a target day fund probably doesn't make sense for you.

**Allison Nathan:** Understood. So we've been mostly talking about the US here, but obviously other countries do things differently. And when I think about that and what

I've heard, Australia, UK are taking a different approach. Are there any lessons that we can learn here in the US from those different approaches?

**Mike Moran:** I think there's a couple of lessons. And one of them is one we've already touched on, and that is what are the range of investment options available in a DC plan? So if we look at some countries -- and Australia and the UK are perfect examples here -- they have been using alternative investments within their plans for a long time now. And so giving participants the ability to have exposure to private equity, private credit, private real estate, and so forth. In many ways, the United States is behind the rest of the world because it's not just --

**Allison Nathan:** That's interesting.

**Mike Moran:** -- Australia and the UK. There's other countries that are far ahead on this as well. So again, I think that's something that we as a DC business here in the US are going to evolve to start including more of those.

The other thing that some other countries do -- and Australia with their superannuation funds is a poster child



example -- is more use of pooled vehicles. And what I mean by that is employers or employees participating in a plan that includes a number of different employers and employees, right?

So in the United States here, according to the department of labor, there are over 700,000 defined contribution plans. That doesn't seem like the most efficient way to deliver retirement benefits. And so other countries -- again, the superannuation funds are a great example -- basically allowing employers or employees to pool their assets together and gain economies of scale. That's something that we're seeing other countries do. We could see more of that here in the US, especially given some regulatory change. We have greater ability for plan sponsors to buy in together and participate into what we call a pool employer plan, or a PEP.

**Allison Nathan:** In the report, your team talks about something called financial grit and that that might be one of the keys to success in your retirement planning. What do you mean by that?

**Mike Moran:** So one of the things, Allison, we really want

to do in this survey was understand for retirement planners that had successfully saved for retirement, what were their characteristics? What were their attributes? What made them good retirement planners and retirement savers? And when we looked at the data, what we found is that a lot of them share similar characteristics. They tend to delay gratification for some future achievement down the line. They like to engage in advice. They like to search out different sources of advice about retirement saving and investing. They like to plan. They like to learn. They like to grow. They persevere when faced with financial challenges, not just saving for retirement but other financial challenges.

And so when you look at these together, all these different attributes, this is what we call financial grit, the ability to save, learn, grow, persevere when faced with financial challenges. With many things in life, people are looking for the magic bullet. What's the one thing I need to do to be a better retirement saver? Be a better retirement planner? And I think what our work would say is, looking at these attributes, it's not one thing. It's a collection of items that allow people to overcome the challenges they have, to keep going.

When they have an emergency expense, I'm going to get through that, but I'm going to continue to save for retirement. So financial grit is that collection of attributes and characteristics that make a good retirement planner.

**Allison Nathan:** Seems like those characteristics could serve us all well in other aspects of our life, too, if you think about discipline and perseverance of course.

**Mike Moran:** And delaying gratification, right? I'm going to save more today. I'm not going to consume as much today because I'm going to save it and invest it, and that's going to benefit me in the future.

**Allison Nathan:** Right. Okay. We talked a lot about regulation in the course of this conversation. Obviously we're having an election this year. What should we be on the lookout for future regulatory changes that could have an impact here?

**Mike Moran:** Retirement is one of those few bipartisan issues in Washington. That doesn't mean the devil isn't in the detail and each side of the aisle has maybe things they

want to see happen, but we've seen a lot of activity the last couple of years in terms of retirement legislation. Back in 2019, Congress passed Secure Act 1.0 and followed up with that in 2022, Secure Act 2.0. And a lot of these provisions were intended to try to increase employee coverage, getting more people covered by an employee sponsored retirement plan, include annuities in defined contribution plans.

The last couple of years, Washington has really been focused on implementing a lot of those changes that came out of Secure Act 1.0 and Secure Act 2.0. We're already starting to hear about, well, what could a Secure Act 3.0 look like? And I'd say one of the biggest retirement challenges in this country is lack of coverage. And what I mean by that is about 25% of private sector workers are not covered by any employer sponsored retirement program, defined benefit or defined contribution. And some of those changes in Secure Act were intended to kind of increase coverage, and one of them is the creation of these PEPs, these pooled employer plans.

But when I think about Secure Act 3.0, one of the other things that I think Washington is probably going to try to

take a look at is gig workers, right? Especially as you think about the changing nature of work in this country, more individuals in the gig economy. Well, how do they get coverage? How are they covered by a retirement plan?

So when we look ahead, I think that's going to be one of the other things that Washington looks at is how do we start covering some of these other workers who aren't attached to an employer? Coming back to your question on the election, in some ways, I don't think it matters what comes out of the election. I think retirement is a bipartisan issue. Washington very clearly understands, when you look at Secure Act 1.0 and Secure Act 2.0, that we are transitioning in this country away from a defined benefit system to more of a defined contribution system. We need to make some changes to that to get more people into defined contribution programs, make it easier for them to save, make it easier for them to decumulate assets.

Again, the devil's in the details. Each side of the aisle has their own wish list of how they want to see that, but I think retirement is one of those few bipartisan issues in Washington. We'll continue to see them focus on that in the next four years.

**Allison Nathan:** In fact, the Employment Retirement Income Security Act of 1974, otherwise known as ERISA, recently just passed its 50th anniversary. A lot has changed, as we've been discussing, in the US retirement system over the past 50 years, some of which were influenced by ERISA. But if you look into a crystal ball, what changes do you think will transpire over the next 50 years?

**Mike Moran:** So Allison, I've taken enough management communication classes through the years to know that you're supposed to just say three things because people can focus on three things, but I'm going to do six, right? It's 50 years.

**Allison Nathan:** Wow, okay.

**Mike Moran:** It's a long runway, Allison. You got to give me more leeway here. I'm going to do six, although some of them kind of cross over a bit, okay? So the first one -- and this is the one that I have the most conviction in and that's probably why I'm putting it first -- is that the future of retirement is going to be much more personalized. We

think about most of us today are only covered by a defined contribution plan. Our employer gives us a line-up of options. Really, the only personalization on that option tends to be a target day fund. When do you think you're going to retire? That's the only personalization option. It doesn't take into account what other assets I have, my spousal assets, what kind of lifestyle I want in retirement.

You think about so many industries today are able to deliver a personalized experience to their consumers through the use of technology. Netflix knows what we like to watch, and they make recommendations based on that. Amazon knows what we like to buy, and they make recommendations based on that. The retirement industry needs to get more personalized, and I think technology and digital tools are going to make that happen.

The second thing that I think is going to change is that planning is going to be available to everyone. And we talked about our survey showed the importance of having a plan, but many individuals don't even know where to start. And that's, again, coming back to employees are looking to their employers for help with this. As digital tools become more pervasive, I think it's going to open up planning to

everybody. Everybody will have access or the ability to create a plan for retirement.

The number three item is going to be that we will figure out the decumulation issue. Most of us are in a defined contribution plan, which is a great way to save assets for retirement. They weren't necessarily built to provide a steady stream of assets to a retiree, just like a defined benefit plan would. And certainly again, coming back to Secure Act 1.0 and 2.0, it's made it easier for sponsors to include things like annuities in plans. There is some other product development that's going on. Like many things in development, some of these ideas will end up on the cutting room floor, but I think we've figured out as an industry this is super important, especially since more individuals are retiring without a defined benefit plan. We need to provide a way for individuals to draw steady stream in retirement from their defined contribution plan.

**Allison Nathan:** Right. So, just to clarify, we're talking about plans to actually take out the savings that you have saved.

**Mike Moran:** Correct. So maybe --



**Allison Nathan:** And then spend it.

**Mike Moran:** -- I've done the right things. I've saved. I've invested. I've developed a large balance in my 401(k) plan, but now I've got to live on that the rest of my life. And one of the huge variables there is, well, how long am I going to live? And what's my lifestyle going to be like in retirement?

And so that also comes back to the personalization side because what you may need in retirement from a retirement income stream may be different than mine. But defined contribution plans have been great at savings, but now how do we give employees and retirees, really, a mechanism to draw a steady stream of income in retirement from those assets?

**Allison Nathan:** Okay, number four. Sorry, I think we're on number four.

**Mike Moran:** Number four, the range of investments available to defined contribution will expand and will include alternative investments. We've talked about this before. Many defined contribution plans in this country do

not include those asset classes as part of their investment line-up. In many ways, the United States is behind other countries that have already successfully done this. Many individual investors here in the US are disadvantaged by not having access to that.

There are operational issues. We will get past that I think in the next few number of years, not just the next 50. We will see more alternatives included in defined contribution plans.

The fifth is going to come back to sort of those pooled employer plans. And I think what you're likely to see over the next 50 years is more plan sponsors say, "I'd rather be part of a pooled plan than have my own plan." Certainly, the creation of pooled employer plans, one of the incentives was for plan sponsors that are not offering a plan, this is a way for you to offer a plan that takes some of the financial burden, the administrative burden off of you.

But I think over time, what you're going to see is some smaller employers say, "You know what? Even though I have a plan today, I think I'd rather join that pooled employer plan. It's probably better for me." An open

question is going to be: Does that start to move up market over time? We're talking about 50 years, Allison. That's a long time. Over time, would we see even larger employers say, "Maybe I'm better off being in a pooled employer plan than having my own plan"? I think the answer to that may be yes. It's not going to be tomorrow, but again 50 years is a long time. But I think we're going to see more plan sponsors saying, "I want to be part of a pooled vehicle."

And then the sixth and final one, which isn't really a prediction, it's more of a question. And the question really is: Is the retirement plan of the future something that doesn't even exist today? You think about the transition in this country from a defined benefit system to a defined contribution system, but yet what are we trying to do with defined contribution plans today? We're trying to make them look more like defined benefit plans by including alternative asset classes, by providing a decumulation vehicle where that retiree would get a steady stream of income in retirement.

Is there a retirement plan of the future that marries both the best of both worlds of DB and DC, especially again as we think about the future of work changes and how our

kids and our grandkids are going to work and change different jobs and have different careers? Is there something different in the future that we haven't even thought about today? I think there's a really strong possibility of that.

**Allison Nathan:** That is a very long list, Mike, and -- I mean, correct me if I'm wrong, but the industry is pretty slow moving. So you sound pretty optimistic that that can change.

**Mike Moran:** Yes. Well, we did say 50 years, right? So 50 years is a long time. But I do think over time things are going to change, and you've already started to see that a little bit, right? Again, we've started to see some development of annuities within 401(k) plans. We've seen the creation of some pooled employer plans. Will a lot of this happen overnight? Absolutely not. But 50 years is a long time, and so I think some of these are things that, over the next several decades, we're probably going to see the defined contribution industry innovate and change and come up with new solutions.

**Allison Nathan:** Thanks so much, Mike.

**Mike Moran:** Thanks for having me, Allison.

**Allison Nathan:** This episode of Goldman Sachs Exchanges was recorded on Thursday, September 26th, 2024. I'm your host Allison Nathan. And if you want to hear more from Goldman Sachs, listen to The Markets. Every Friday, we break down what's going on in the markets and what could come next. Check it out on your podcast platform of choice. Thank you for listening.

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