



MEDIA SUMMARY

Nov 3, 2017

We Have the Tools to Fix Retirement: Merton

The shortfall in global retirement savings is an engineering problem, not a scientific one, but the world already has the tools at its disposal to meet the challenge, Nobel laureate and finance professor Robert Merton said today.

In an interview with business television network CNBC in Singapore, Professor Merton also said while artificial intelligence would create huge efficiencies in some areas of finance, it would come up against obstacles in the area of financial advice.

The network framed the interview in the context of [news](#) from Washington that the amended Republican tax reform bill had left off proposals to place an annual cap on how much people could put into their tax-deferred 401 (k) retirement savings accounts.

Asked how he would define the problem in retirement savings, Merton cited the issue of demographics and longevity.

“We’re all aging. So there are more of us old folk to be looked after and fewer young ones to do it,” he said. “But the good news is the younger generation will live longer. The big issue is how are you going to pay for all that extra time? So that’s the challenge.”

“There are essentially three ways to improve your chances of a good retirement – work longer, save more, which means consume less, or take more risk but be prepared to deal with it if the risk is realised. Those are all designed to get you more assets.”

Professor Merton said a fourth solution, which would be important for the core of working and middle class people in almost every country, was in generating more benefits from their existing assets. These solutions include annuities and reverse mortgages.

Asked which country had the retirement system right, Professor Merton said there were issues in even the best systems such as the Netherlands and Singapore.

“No country gets a free pass and says ‘we’re secure’,” he said. “The answer is no-one has it right now. So best practice in how it’s done now is still not good enough. That means we have to do new things but not experimental things.”

Professor Merton said counting on strong equity markets to fill the funding ratio for retirement was not a viable long-term strategy.

“We can’t build a retirement system on good luck. So yes, it’s good that equities have been strong. Interest rates may be coming up a bit. That will help too. But fundamentally retirement systems have very long horizons. It isn’t about what people are going to be able to do next year. It’s too late anyway but rather how the system is going to survive.”

Professor Merton noted that governments and the private sector were trying to address these challenges with a move away from defined benefit to defined contribution systems, but these also complicated things by requiring people to make decisions outside their expertise.

“The top line is that this is not a science problem, meaning we don’t know how to do it. It’s an engineering problem. We know how to make the system sustainable and give people a good chance for a good retirement. But it’s a huge task. There are politics attached to it, so it’s complex. But the good news is we can do it.”

Asked about the growth of robo advice and artificial intelligence, Professor Merton saw technology delivering great efficiency gains in verifiable areas such as processing, calculations and payments systems. But financial advice was different.

“You cannot just simply pick up your mobile phone and ask it what to do with your money. You have no idea what the motivation behind that advice was or what model was used and they all use models. And I’ve been building and using models for four decades. Technology doesn’t create trust on its own.”

“Technology is a great enhancer, but it can’t do it by itself. The issue is if you have a bad model in finance, you don’t know it till it’s too late. You still need a human to trust even if we use technology more. It’s not that simple.”
