



Retirement USA

EARN Conference
September 23, 2009
Detroit, Michigan



Retirement USA Launched March 2009

- EPI
- National Committee to Preserve Social Security and Medicare
- Pension Rights Center
- SEIU

Coalition is growing...



Goal:

- **Universal, secure, and adequate** retirement income for future retirees

Retirement USA principles

- **Universal Coverage**
- **Secure Retirement**
- **Adequate Income**
- Shared Responsibility
- Required Contributions
- Pooled Assets
- Payouts Only at Retirement
- Lifetime Payouts
- Portable Benefits
- Voluntary Savings
- Efficient and Transparent Administration
- Effective Oversight



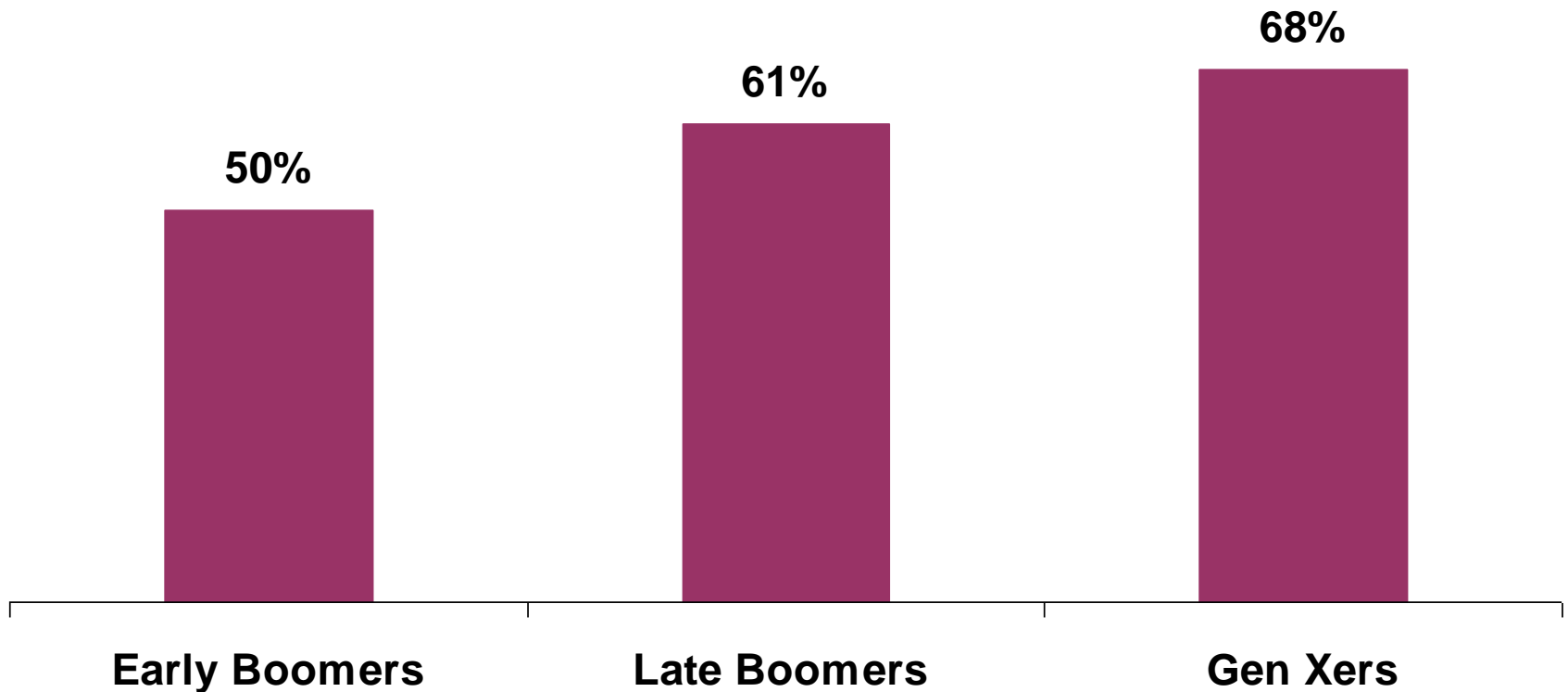
EPI's Plan

- Guaranteed Retirement Accounts
- Prof. Teresa Ghilarducci, New School University
- Meets Retirement USA principles

Historic Reversal

- Most Americans working today will have less retirement security than their parents
- Downturn exacerbated existing problems
 - Retirement account balances down by a quarter from their peak
 - High unemployment among older workers as many can neither retire nor find a job

Share at Risk of Not Maintaining Standard of Living in Retirement

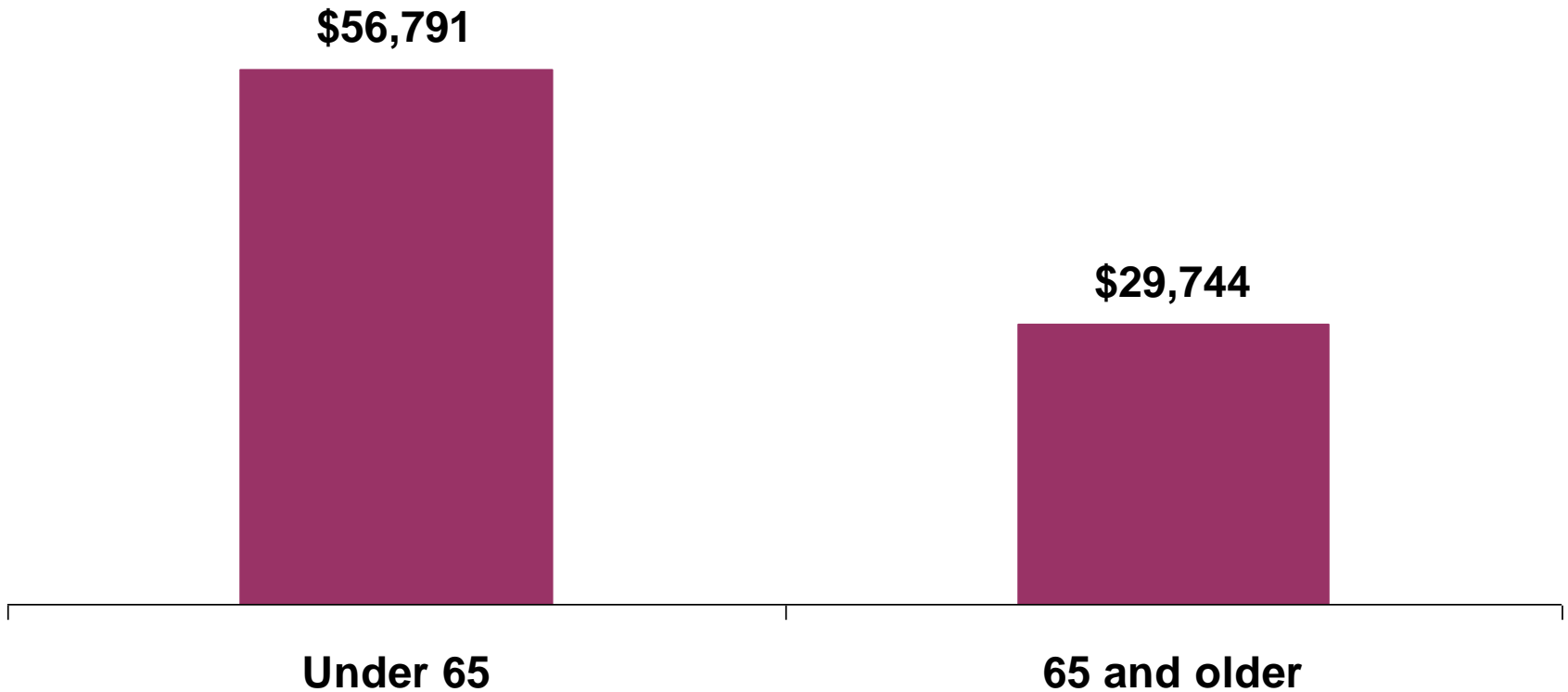


Center for Retirement Research, National Retirement Risk Index, including health care expenses.

All Workers Need a Pension

- Social Security guarantees a universal benefit, but not sufficient to maintain pre-retirement standard of living
- Average Social Security retiree benefit is under \$14,000 (less than a minimum-wage income) and replaces less than 40% of pre-retirement income

Median Household Income, 2008



Source: Census Bureau (CPS)



▶ Principle: Universal Coverage

- Every worker should be covered by a retirement plan in addition to Social Security. A new retirement system should include all workers unless they are in plans that provide equally secure and adequate benefits.

Coverage

- Fewer than half (45%) of private-sector workers in U.S. participate in an employer-sponsored plan, and most of these are in 401(k)-style plans that are neither secure nor adequate

Coverage

- U.S. relies on tax incentives and employer HR concerns
- Countries that have achieved retirement security either mandate coverage or achieve it through collective bargaining (Netherlands)
- Of 10 OECD countries with highest senior poverty rates, 8 (including U.S.) also among those with lowest replacement rates from universal retirement systems



High Cost to Taxpayers

- Cost of tax breaks for DB pensions (2008): \$46 billion
- Cost for 401(k)s, IRAs and other individual accounts: \$72 billion

Upside-Down Subsidies

- Proportional to marginal tax rate
- Low-income workers receive modest or no tax subsidies for each dollar saved, while highest paid workers receive most generous subsidies
- 70% of tax breaks for 401(k) plans go to top income quintile

Incentives or Tax Shelters?

- Experts question whether “incentives” generate new saving, since subsidies grew as savings rate declined
- People can save in tax-favored accounts while drawing down other savings
- Tax breaks reduce taxes of people who already save, primarily the wealthy

Shift from Pensions to 401(k)s

- 1978 change in IRS code allowed deferral of Wall Street bonuses
- Workers bear most of the cost and all of the risk of 401(k)s
- Traditional pensions more cost-effective, but employers can reduce costs with 401(k)s by shifting responsibility for retirement onto workers



401(k)s Risky for Workers

- Retirement income dependent on investment returns
- Retirees can outlive retirement savings



▶ **Principle: Secure Retirement**

- Retirement shouldn't be a gamble. Workers should be able to count on a steady lifetime stream of retirement income to supplement Social Security.



Pooling Spreads Risks Across Generations

- DB pensions pool funds of workers who retire during bull and bear markets
- Benefits based on earnings and years of service rather than market performance



▶ **Principle: Pooled Assets**

- Contributions to the system should be pooled and professionally managed to minimize costs and financial risks



Pooling Insures Against Longevity Risks

- 401(k) participants need to prepare for possibility that they might live to 90 or 100
- Pension funds need only set aside enough to cover average life-spans
- Adverse selection problem in individual annuity market is compounded by complexity



▶ Principle: Lifetime Payouts

- Benefits should be paid out over the lifetime of retirees, and to any surviving spouses, former spouses, or domestic partners.

A nation of financial analysts?

- Most 401(k) participants have an all-or-nothing approach to risk, with 21% holding more than 80% of balances in stocks, and 38% investing none in stocks
- Despite Enron, many workers still heavily invested in employer's stock

Even Cautious Investors Face Risks

- A 401(k) participant who contributes 4% over 40 years, split equally between government bonds and stocks, would replace a quarter of pre-retirement earnings in 2008
- This is only half as much as a worker who retired in 1999, but much better than one who retired in 1974 (Source: Gary Burtless, Brookings)
- Similar research by Patrick Purcell of CRS shows lifecycle approach isn't much help

401(k) Balances Very Low

- In 2007, half of households approaching retirement (ages 55-64) had <\$98,000 in their account—*if they had an account**
- Enough to buy \$5,400 joint & survivor annuity, replacing 10% of earnings

* Median account balance for *all* households 55-64 was less than one fifth of that amount, i.e., <\$20K



▶ Principle: Adequate Income

- Everyone should be able to have an adequate retirement income after a lifetime of work. The average worker should have sufficient income, together with Social Security, to maintain a reasonable standard of living in retirement.

Spotty Contributions

- Employers and employees can reduce or stop 401(k) contributions at any time, and many companies have suspended their match in current downturn

Low Returns and High Fees

- Net investment returns a full point higher for DB pensions than 401(k) plans, despite a lower concentration in equities (CRR)
- With compounding, can translate into a 30% larger nest egg at retirement
- One reason for poor performance is 401(k) participants bear higher investment costs



Government Should Offset Cost for Low-Income Workers

- The total amount currently devoted to subsidizing private retirement plans, if equally distributed among workers, would be more than enough to make or offset a 5% contribution for low-income workers



▶ **Principle: Required Contributions**

- Employers and employees should be required to contribute a specified percentage of pay, and the government should subsidize the contributions of lower-income workers.

Loans and Withdrawals

- In a voluntary system, attempts to discourage workers from tapping into funds before retirement must be balanced against need to encourage them to contribute in the first place



▶ **Principle: Payouts Only at Retirement**

- No withdrawals or loans should be permitted before retirement, except for permanent disability.

Broadening the Debate

- Until now, focus has been on helping individuals make better saving and investment decisions
- Ignores how system has failed and blames workers for their predicament
- Accepts that employer role reduced to facilitating employee saving in tax-favored accounts



Where do we go from here?

- No single formula for success, but some features essential...

Essential features...

1. All jobs must come with benefits that provide a retirement income for life.

Social Security isn't enough.

Relying on tax incentives to encourage employers to provide benefits or individuals to save is ineffective & helps those who least need it.

Essential features...

2. Responsibility must be shared.

A DIY system doesn't work; neither does one that places entire burden on employers.

Government must also be involved, especially to offset costs for lower-income workers.



Essential features...

3. Risks must be spread, not just shifted from employers to workers.

Here too, government can play a role, and so can multi-employer plans.



Essential features...

4. Key to achieving adequacy is steady contributions and preserving funds for retirement.

Need to limit pre-retirement leakages in form of loans, withdrawals, and high fees.



Employers Want Predictability

- While 401(k) plans are risky for workers, traditional pensions require employers to take on long-term liabilities
- Risk of sustained market downturn or faster-than-anticipated increase in group life expectancy

Hybrid Solutions

- DB pensions work well for workers but expose employers to long-term risks and cost volatility.
- 401(k) plans fail to provide workers with adequate and secure retirements.
- Can combine elements of both DB and DC plans to minimize—not just shift—costs and risks.

Expanding Social Security

- Another alternative is to expand the existing Social Security system
- Political difficulties aside, would be preferred approach
- Nevertheless, can be advantages to having a multi-tiered retirement system.



President Obama's Auto IRA

- Proposes requiring employers who don't offer retirement plans to set up automatic payroll deductions into IRAs
- Uses inertia to boost participation by having workers opt out rather than opt in

Doesn't Address Problems

- Increases coverage, but not enough
- Workers still shoulder all the risks
- High fees erode retirement savings
- Tax subsidies remain upside-down
(though administration proposes enlarging Saver's Credit and making it refundable)

“Nudge” Approach

- Are tax breaks less heavy-handed than one-size-fits-all solutions like expanding Social Security or mandating pension coverage?
- One person’s tax break is another’s higher tax

Homo Economicus?

- Idea that individuals are rational optimizers is argument for no government intervention, not taxpayer-subsidized savings schemes
- Sophisticated investors who want to tailor risk-return profile can achieve similar results with strategies pursued outside retirement system



Healthcare Debate Parallels

- Healthcare system relies on employers to provide benefits, yet leaves it up to the employer to decide
- Adverse selection problem



Healthcare Debate More Advanced

- In some ways retirement is a step ahead of healthcare, because Social Security covers most workers, not just targeted populations
- But most employers who offer health benefits shield workers from risks in group plans, whereas risky individual accounts have become the norm among retirement plans
- May explain why retirement debate is narrower, with focus on individual accounts