

Statement of the Investment Company Institute
“Pension Savings: Are Workers Saving Enough for Retirement?”
Hearing of the Committee on Health, Education, Labor and Pensions
United States Senate

January 31, 2013

The Investment Company Institute¹ is pleased to provide this written statement in connection with the hearing on January 31, 2013, in the U.S. Senate Committee on Health, Education, Labor and Pensions titled “Pension Savings: Are Workers Saving Enough for Retirement?” The Institute strongly supports efforts to promote retirement security for American workers and welcomes an examination of retirement savings adequacy in the United States. Reflecting Congress’ strong support for promoting retirement savings, Americans currently have \$19.4 trillion earmarked for retirement, with more than half of that amount in defined contribution (DC) plans and individual retirement accounts (IRAs).² About half of DC plan and IRA assets is invested in mutual funds, which makes the mutual fund community especially attuned to the needs of retirement savers.

Academic research indicates that Americans, on average, are able to maintain their standard of living when they retire.³ Most households accumulate enough retirement resources to maintain their consumption in retirement.⁴ Other than those who retired because of poor health, household consumption levels are maintained, on average, as workers enter retirement.⁵ Households typically are

¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$13.9 trillion and serve over 90 million shareholders.

² At the end of the third quarter of 2012, U.S. retirement assets totaled \$19.4 trillion. See Investment Company Institute, “The U.S. Retirement Market, Third Quarter 2012” (December 2012), available at www.ici.org/info/ret_12_q3_data.xls.

³ For a brief summary of the relevant research on assessing retirement saving adequacy, see Brady, Burham, and Holden, *The Success of the U.S. Retirement System*, Investment Company Institute (December 2012), pp. 14–17, available at www.ici.org/pdf/ppr_12_success_retirement.pdf.

⁴ See Scholz, Seshadri, and Khitatrakun, “Are Americans Saving ‘Optimally’ for Retirement?” *Journal of Political Economy* 114 (August 2006): 607–643, available at ssrn.com/abstract=941137; and see Scholz and Seshadri, “Are All Americans Saving ‘Optimally’ for Retirement?” *Michigan Retirement Research Center Working Paper* 2008-189 (September 2008), available at www.mrrc.isr.umich.edu/publications/papers/pdf/wp189.pdf.

⁵ See Hurd and Rohwedder, “The Retirement-Consumption Puzzle: Actual Spending Change in Panel Data,” *RAND Labor and Population Working Paper*, no. 563 (April 2008), available at www.rand.org/pubs/working_papers/WR563.html.

able to maintain sufficient wealth to generate as much income as they could when they first retired.⁶ Other analysis and data show that retirement resources have increased over time. Successive generations have reached retirement wealthier than the last.⁷ The amount of assets earmarked for use during retirement has increased over time.⁸ Furthermore, poverty rates for people aged 65 or older have fallen over time. In 1966, for example, the elderly poverty rate was nearly 30 percent. In 2011, it was 9 percent—and the elderly had the lowest poverty rate among all age groups.⁹

With more than 80 million U.S. households accumulating retirement savings under employment-based retirement plans and IRAs,¹⁰ this Committee should be mindful that the first, and most important, principle to follow in the context of its activities is: do no harm. Consistent with the views of the overwhelming majority of Americans,¹¹ we urge this Committee to avoid any actions that would impair the ability of the voluntary employer-provided retirement system to provide Americans with retirement resources, and put at risk the success the system has achieved to date.

⁶ See Haveman, Holden, Wolfe, and Romanov, “Assessing the Maintenance of Savings Sufficiency over the First Decade of Retirement,” *CESIFO Working Paper*, no. 1567 (October 2005), available at www.cesifo-group.de/portal/pls/portal/docs/1/1188496.pdf; Love, Palumbo, and Smith, “The Trajectory of Wealth in Retirement,” *Center for Retirement Research at Boston College Working Paper*, no. 2008-7 (February 2008), available at crr.bc.edu/wp-content/uploads/2008/02/wp_2008-7-508.pdf; and Poterba, Venti, and Wise, “Were They Prepared for Retirement? Financial Status at Advanced Ages in the HRS and AHEAD Cohorts,” *NBER Working Paper*, no. 17824, Cambridge, MA: National Bureau of Economic Research (February 2012), available at www.nber.org/papers/w17824.

⁷ See Haveman, Holden, Wolfe, and Romanov, “The Sufficiency of Retirement Savings: Comparing Cohorts at the Time of Retirement,” *Redefining Retirement: How Will Boomers Fare?* Edited by Madrian, Mitchell, and Soldo: 36–69, New York: Oxford University Press (2007); and Gustman, Steinmeier, and Tabatabai, “How Do Pension Changes Affect Retirement Preparedness? The Trend to Defined Contribution Plans and the Vulnerability of the Retirement Age Population to the Stock Market Decline of 2008–2009,” *Michigan Retirement Research Center Working Paper 2009-206* (October 2009), available at www.mrrc.isr.umich.edu/publications/papers/pdf/wp206.pdf.

⁸ See Brady, Burham, and Holden, *The Success of the U.S. Retirement System*, Investment Company Institute (December 2012), Figure 4, p.11.

⁹ See U.S. Census Bureau, *Current Population Survey, 1967 to 2012, Annual Social and Economic Supplements*. In 2011, the poverty rate for individuals age 18 to 64 was 14 percent, while it was 22 percent for those younger than 18. See Brady, Burham, and Holden, *The Success of the U.S. Retirement System*, Investment Company Institute (December 2012), Figure 6, p. 14.

¹⁰ In May 2012, 49 million U.S. households reported ownership of IRAs (traditional, Roth, or employer-sponsored IRAs); about 73 million U.S. households reported they had employer-sponsored retirement plans— defined contribution (DC) plans or defined benefit (DB) plans; with about 39 million households reporting they had both employer-sponsored plans and IRAs. See Holden and Schrass, “The Role of IRAs in U.S. Households’ Saving for Retirement, 2012,” *ICI Research Perspective* 18, no 8 (December 2012), Figure 1, p. 3, available at www.ici.org/pdf/per18-08.pdf.

¹¹ See Holden and Bass, *America’s Commitment to Retirement Security: Investor Attitudes and Actions*, Investment Company Institute (January 2012), Figures 6 and 7, pp. 8 and 11, available at www.ici.org/pdf/ppr_12_retir_sec_update.pdf and discussed later in this statement.

THE COMPOSITION OF RESOURCES RELIED UPON IN RETIREMENT WILL DIFFER FROM HOUSEHOLD TO HOUSEHOLD

Assessing whether or not workers are saving enough for retirement requires a standard by which to judge savings adequacy. Retirement savings adequacy is typically defined as a relative, rather than an absolute, standard: savings would be judged to be adequate if the savings allowed retired households to maintain the standard of living they enjoyed while working. Another complicating factor in judging adequacy is that the focus on formal retirement savings typically occurs later in a working career. Younger households typically invest in other ways, such as funding education, purchasing a home, and raising children. Importantly, this life-cycle pattern of savings observed in the data is consistent with rational economic behavior. Because of this change in focus over the life cycle, it is difficult to assess retirement preparedness for households that are not in or near retirement.

In assessing whether American workers are saving enough for retirement, it is also important to understand the different resources that most people will draw from in retirement and the role that each resource plays. The traditional analogy is that retirement resources are like a three-legged stool. This analogy implies that everyone should have resources divided equally among Social Security, employer-sponsored pension plans, and private savings. This is not, nor has it ever been, an accurate picture of Americans' retirement resources. A pyramid is a better representation of retirement resources. The retirement resource pyramid has five basic components: Social Security; homeownership; employer-sponsored retirement plans (both private-sector employer and government employer plans, as well as both DB and DC plans); IRAs (including rollovers); and other assets.¹² The composition of the retirement pyramid—that is, the extent to which a household relies on any given resource—will differ from household to household.

Social Security

Although often ignored in retirement policy discussions, the United States already has a mandatory retirement plan: Social Security. Social Security stands at the base of the retirement resource pyramid, providing households across all levels of earnings with inflation-indexed income for life. For most households, Social Security is one of their most valuable resources.

When Social Security was signed into law in 1935, it was intended to replace a modest portion of income. Changes to the system since its inception—in particular, two periods of expansion, first in

¹² These assets can be financial assets—including bank deposits and stocks, bonds, and mutual funds owned outside of employer-sponsored retirement plans and IRAs; and nonfinancial assets—including business equity, nonresidential property, second homes, vehicles, and consumer durables (long-lived goods such as household appliances and furniture). Assets in this category tend to be owned more frequently by higher-income households. For a more complete discussion of the retirement resource pyramid—as well as estimates for components of the pyramid across households from Gustman, Steinmeier, and Tabatabai, “How Do Pension Changes Affect Retirement Preparedness? The Trend to Defined Contribution Plans and the Vulnerability of the Retirement Age Population to the Stock Market Decline of 2008–2009,” *Michigan Retirement Research Center Working Paper 2009-206* (October 2009)—see Brady, Burham, and Holden, *The Success of the U.S. Retirement System*, Investment Company Institute (December 2012), Figure 16, p. 35.

the 1950s and then again in the 1970s—increased benefits substantially, especially for those with low lifetime earnings. Described as a “cornerstone” for U.S. retirement security at its beginning, Social Security has transformed into a comprehensive government-provided pension for workers with lower lifetime earnings and a strong foundation for retirement security for those with higher lifetime earnings.

The expansion of benefits has not come without costs. In 1937, the OASDI tax rate was 2.0 percent on up to \$3,000 of wages and salary (equivalent to about \$48,000 in constant 2012 dollars). Today, Social Security mandates contributions from every American worker of 12.4 percent of wages and salary from the first dollar they earn up to the maximum annual earnings covered by the system, *i.e.*, \$113,700 in 2013.¹³

Social Security benefits are designed to be progressive; that is, the benefits represent a higher proportion of pre-retirement earnings for workers with lower lifetime earnings than for workers with higher lifetime earnings. For example, for the cohort of individuals born in the 1940s, the Congressional Budget Office analysis shows that Social Security benefits are projected to replace 70 percent of average earnings for the typical individual in the bottom 20 percent of individuals ranked by lifetime earnings.¹⁴ The replacement rate drops to 47 percent for the second quintile, and then declines more slowly as lifetime earnings increase. Social Security benefits are projected to replace a considerable fraction of covered earnings—29 percent—for even the top 20 percent of earners.

Because of the progressive benefit formula, Social Security benefits comprise a higher share of lower-earning households’ retirement income. In addition, although this resource typically is not included in measures of household wealth, if it were to be counted as an asset, the value of future Social Security benefits would comprise a higher share of assets in such an augmented balance sheet for those households. In contrast, to maintain their standard of living in retirement, higher-earning households have a greater need to supplement Social Security benefits.

Homeownership

A second resource available to the vast majority of retired households is the home in which they live.¹⁵ Homeownership increases with age and is high across all income groups among near-retiree households. Households who own homes often have no or low mortgage debt by the time they reach

¹³ See Social Security Administration, “Contribution and Benefit Base Determination” (October 16, 2012), available at www.ssa.gov/oact/cola/cbbdet.html. For historical tax rates, see www.ssa.gov/oact/progdata/taxRates.html. For the historical earnings base, see www.ssa.gov/oact/cola/cbb.html#S. OASDI taxes as a percentage of earnings increased to 3.0 percent by 1950, to 6.0 percent by 1960, to 8.4 percent by 1970, to 10.16 percent by 1980, and reached the current 12.4 percent rate in 1990.

¹⁴ See Congressional Budget Office, *The 2012 Long-Term Projections for Social Security: Additional Information* (October 2012), available at www.cbo.gov/publication/43648. Also see Brady, Burham, and Holden, *The Success of the U.S. Retirement System*, Investment Company Institute (December 2012), Figure 9, p. 19.

¹⁵ See Brady, Burham, and Holden, *The Success of the U.S. Retirement System*, Investment Company Institute (December 2012), pp. 22–26.

retirement age. Households do not have to sell their homes to benefit from them in retirement; they simply have to live in them. Homeownership is like having an annuity that provides rent, as the home provides a place to live that otherwise would have to be rented.

Employer-Sponsored Plans and IRAs

The next two layers of the retirement resource pyramid consist of accumulations in employer-sponsored retirement plans (both private-sector employer and government employer plans, as well as both DB and DC plans) and IRAs (both contributory and those resulting from rollovers from employer-sponsored plans). In 2010, data from the Survey of Consumer Finances (SCF), conducted by the U.S. Federal Reserve Board, showed that accrued benefits and asset accumulations in employer-sponsored retirement plans and IRAs constituted a resource for about 80 percent of near-retiree households.¹⁶ Near-retiree households across all income groups have these retirement benefits, but employer-sponsored retirement plans and IRAs typically provide a larger share of resources for higher-income households, for whom Social Security benefits provide a smaller share. Furthermore, assets specifically earmarked for retirement have increased significantly over time. In 1975, they represented \$27,300 per household in constant 2012 dollars. By mid-2012 they stood at \$153,100 – 5.6 times higher than in 1975.¹⁷

Although, as noted above, benefits from employer-sponsored plans and IRAs are a resource for about 80 percent of near-retiree households, there is still a perceived “coverage gap,” with a commonly referenced statistic that half of all American workers do not have access to employer-sponsored retirement plans. Looking at the percentage of all workers who have access to retirement plans at their employers at any single point in time understates the share of the population who will reach retirement with work-related retirement benefits. Many young workers, low-wage workers, or part-time workers are more concerned with saving for a rainy day, to purchase homes, or to fund education than they are with saving for retirement. However, young workers do not remain young throughout their working careers, and many low-wage and part-time workers do not remain low-wage and part-time throughout their careers. Many workers who do not have access to employer-sponsored retirement plans today will have access to a plan—either through their own employers or their spouses’ employers—prior to retirement.¹⁸ In other words, distinct snapshots of coverage rates in any given year do not offer meaningful information for purposes of assessing the retirement system as a whole.

¹⁶ See Brady, Burham, and Holden, *The Success of the U.S. Retirement System*, Investment Company Institute (December 2012), Figure 14, p. 31.

¹⁷ See Brady, Burham, and Holden, *The Success of the U.S. Retirement System*, Investment Company Institute (December 2012), Figure 4, p. 11.

¹⁸ See Brady and Bogdan, “Who Gets Retirement Plans and Why, 2011,” *ICI Research Perspective* 18, no. 4 (September 2012), available at www.ici.org/pdf/per18-04.pdf. Current Population Survey (CPS) data for 2011 indicate that 50 percent of private-sector wage and salary workers were employed by firms that sponsored retirement plans (including both DB and DC plans). However, access to retirement plans is not random. Limiting the analysis to full-time, full-year workers aged 30 to 64, access to retirement plans increases to 60 percent. If the analysis is narrowed further to the groups of workers most likely to be focused on saving for retirement—workers aged 30 or older with at least moderate levels of earnings and all but

THE SHIFT IN PRIVATE-SECTOR RETIREMENT PLANS FROM PREDOMINANTLY DEFINED BENEFIT (DB) PLANS TO PREDOMINANTLY DEFINED CONTRIBUTION (DC) PLANS IS UNLIKELY TO REDUCE RETIREMENT PREPAREDNESS

Retirement policy discussions often start from the premise that the transition of private-sector pensions from primarily DB plans to primarily DC plans has led—or will lead in the near future—to a substantial drop in retiree income from retirement plans. In addition, there is skepticism as to the ability of DC pensions to fill the void.¹⁹ In fact, neither the premise that the shift to DC plans has already caused a drop in retiree income nor the premise that it will lead to a drop in retirement income in the near future is correct. Looking over all the available data from 1975 to 2011, it is clear that income from private-sector pension plans has become more—not less—prevalent over time. Further, there is reason to believe that the data understate the trend in pension income, as the household survey data used to measure retiree pension income does not appear to capture a large portion of the distributions paid to retirees from DC plans and IRAs.²⁰ As to future generations, research suggests that many can expect to receive more benefits from DC plans than they would have accumulated in DB plans.

the lowest earning workers aged 45 or older—then 69 percent work for employers that sponsor retirement plans. In addition, some in this group without access to plans at their own employers have access to plans through their spouses' employers. Taking into account access through spouses, 74 percent of workers who are likely to be focused on saving for retirement have access to employer-provided retirement plans, and 93 percent participate in the plans offered.

¹⁹ For example, see Munnell and Sundén, *Coming Up Short: The Challenge of 401(k) Plans*, Washington, DC: Brookings Institution Press (2004); Munnell and Sundén, "401(k) Plans Are Still Coming Up Short," *Center for Retirement Research at Boston College Issue Brief*, no. 43 (March 2006), available at crr.bc.edu/wp-content/uploads/2006/03/ib_43.pdf; U.S. Government Accountability Office, *Private Pensions: Low Defined Contribution Plan Savings May Pose Challenges to Retirement Security, Especially for Many Low-Income Workers*, GAO-08-8 (November 2007), Washington, DC: U.S. Government Printing Office, available at www.gao.gov/assets/280/270253.pdf; U.S. Government Accountability Office, *Private Pensions: Alternative Approaches Could Address Retirement Risks Faced by Workers but Pose Trade-offs*, GAO-09-642 (July 2009), Washington, DC: U.S. Government Printing Office, available at www.gao.gov/new.items/d09642.pdf; and Purcell, "Retirement Savings and Household Wealth in 2007," *CRS Report for Congress*, RL30922 (April 2009), available at assets.opencrs.com/rpts/RL30922_20090408.pdf.

²⁰ It is difficult to measure the role of employer-sponsored pension income among retirees because of difficulties with the surveys that collect such information. CPS data understate the amounts that individuals withdraw from IRAs; see Sabelhaus and Schrass, "The Evolving Role of IRAs in U.S. Retirement Planning," *Investment Company Institute Research Perspective* 15, no. 3 (November 2009), available at www.ici.org/pdf/per15-03.pdf. The CPS data underreport income from employer-sponsored retirement plans relative to surveys that collect data from firms and administrative data. Comparing data from multiple surveys, research suggests that pension income, specifically from DC pension plans, is underreported in the CPS; see Anguelov, Iams, and Purcell, "Shifting Income Sources of the Aged," *Social Security Bulletin* 72, no. 3 (2012), available at www.ssa.gov/policy/docs/ssb/v72n3/v72n3p59.pdf. Administrative tax data also indicate that income from pensions, annuities, and IRAs is underreported in the CPS; see Brady and Pierce, "The Promise and Potential Pitfalls of Using Administrative Tax Data: A Case Study," Working Paper (April 2012). The tax return data show that 17 percent more individuals aged 65 or older receive income from pensions, annuities, and IRA distributions than is estimated in the CPS, and the median amount they receive is nearly 50 percent higher than reported in the CPS. Because not all individuals with income from employer-sponsored retirement plans file a tax return, the administrative tax data likely provide a conservative estimate of underreporting when compared with the CPS.

Historical Trends in Retiree Income from Employer-Sponsored Retirement Plans and IRAs

Overall, the share of the workforce covered by DB or DC retirement plans has remained fairly steady over the past few decades.²¹ The primary difference has not been the share of workers with retirement plans, but rather the growth of DC plans relative to DB plans. Furthermore, the extent to which previous generations received income from private-sector DB plans cannot be gleaned simply by looking at data on pension coverage. Not all workers covered by DB pension plans would have received benefits from the plans, and the amounts received would likely be less than what would be implied by simple calculations that use a typical DB plan benefit formula and assume workers retire from their employer after a lengthy period of employment. Private-sector workers change jobs frequently. In order to receive any benefits, workers must participate in a plan long enough to become vested.²² Even so, vesting alone does not ensure benefits will be of great value: the accrual of benefits in a traditional DB plan is typically back loaded, which puts a premium on having long tenure at a single employer and separating from service close to the retirement age designated by the plan.

To date, the shift of employer-provided retirement plans in the private sector from predominantly DB plans to predominantly DC plans has not led to a reduction in the amount of income retirees receive from private-sector pensions. Rather, private-sector pension income (including both DB and DC plan benefits) has become more prevalent. The share of retirees receiving private-sector pension income increased by more than 50 percent between 1975 and 1991, and has remained fairly stable since.²³ In addition, among those receiving income from private-sector pensions, the median amount of inflation-adjusted income—which had remained fairly flat between 1975 and 1991—has increased nearly 40 percent since 1991.

Some of the increase in income from private-sector retirement plans may be attributable to the growth of DC pension plans and IRAs. Indeed, because the CPS data on retiree pension income do not fully capture distributions from DC plans and IRAs, the growth in the importance of income from private-sector pensions is likely understated.²⁴ Some of this increase may be, counter to conventional wisdom, attributable to an increase in the amount of retiree income generated by private-sector DB

²¹ For example, analysis of CPS data shows that the share of private-sector workers whose employers sponsored retirement plans (inclusive of both DB and DC plans) has averaged 54 percent since 1979, ranging from 50 percent to 60 percent; see Brady and Bogdan, “A Look at Private-Sector Retirement Plan Income After ERISA, 2011,” *ICI Research Perspective* 18, no. 5 (October 2012), Figure 1, p. 3.

²² For a discussion of tenure of U.S. workers and changes in vesting rules over time, see Brady and Bogdan, “A Look at Private-Sector Retirement Plan Income After ERISA,” *Investment Company Institute Research Perspective* 16, no. 2 (November 2010), available at www.ici.org/pdf/per16-02.pdf.

²³ See Brady and Bogdan, “A Look at Private-Sector Retirement Plan Income After ERISA, 2011,” *ICI Research Perspective* 18, no. 5 (October 2012), available at www.ici.org/pdf/per18-05.pdf.

²⁴ See note 20, *supra*.

pensions: although fewer private-sector workers are covered by DB pensions, changes to pension vesting rules since 1974 have increased the share of covered workers who are vested.²⁵

Regardless of the cause of the increase, the typical amount of private-sector pension income observed in the data historically can be generated by relatively modest accumulations in DC plans or IRAs. For example, even though few workers have worked an entire career with DC plans as their primary employer-provided retirement plans, a Congressional Research Service report estimates that median retirement account balances for pre-retiree households in 2007 could have generated annual pension income in excess of the median pension income received by retired households historically.²⁶

Projecting Future Retiree Income from DC Plans and IRAs

In the future, individuals who have access only to employer-provided DC plans during their working careers can expect to accumulate enough assets to maintain their standard of living in retirement. In addition, many individuals will have more resources in retirement than they would have had if they had been covered by traditional DB plans during their working careers.

DC plans have the potential to replace a significant share of income in retirement. Median 401(k) account balance statistics are often cited as evidence of inadequacy, but these statistics are misleading because they tend to ignore other accounts that an individual may have, including other 401(k) plan accounts and IRAs. A research collaboration between ICI and the Employee Benefit Research Institute (EBRI), the EBRI/ICI 401(k) Accumulation Projection Model, forecasts what 401(k) plan participants could accumulate across a full career.²⁷ The model used in the study to project accumulations moves 401(k) participants through their careers, with decisions as they age that reflect actual participant behavior on contributions, asset allocations, job changes, rollovers, withdrawals, and loans. The study focuses on 401(k) participants who will turn 65 between 2030 and 2039 (now aged 38 to 47). For more than 60 percent of this cohort, their 401(k) accumulations are projected to replace more than half their salaries. Accounting for Social Security, the majority of the lowest income quartile of this cohort of 401(k) plan participants is projected to have their salaries fully replaced.

More recent research illustrates that most workers can accumulate adequate retirement resources by making moderate contributions to 401(k) plans, assuming that the only resources available

²⁵ *Ibid.*

²⁶ See Purcell, "Retirement Savings and Household Wealth in 2007," *CRS Report for Congress*, RL30922 (April 2009), available at assets.opencrs.com/rpts/RL30922_20090408.pdf. "For example, if the median retirement account balance of \$100,000 among households headed by persons 55 to 64 years old in 2007 were converted to an annuity, it would provide a monthly income of \$700 per month (\$8,400 annually) to a man retiring at age 65 in 2009." (Purcell 2009, p. 15) ICI analysis of CPS data finds that between 1975 and 2011 the median annual private-sector pension income received by retiree households with such income, expressed in constant 2007 dollars, averaged \$6,700 and ranged from \$5,155 (in 1982) to \$8,341 (in 2011); see Brady and Bogdan, "A Look at Private-Sector Retirement Plan Income After ERISA, 2011," *ICI Research Perspective* 18, no. 5 (October 2012), available at www.ici.org/pdf/per18-05.pdf.

²⁷ See Holden and VanDerhei, "Can 401(k) Accumulations Generate Significant Income for Future Retirees?" *Investment Company Institute Perspective* 8, no. 3, and *EBRI Issue Brief*, no. 251 (November 2002), available at www.ici.org/pdf/per08-03.pdf and www.ebri.org/pdf/briefspdf/1102ib.pdf.

to workers in retirement are Social Security benefits, financial assets accumulated in 401(k) plans, and (in the case of homeowners) housing.²⁸ Importantly, the results do not rely on 401(k) plan investments earning a higher rate of return by investing in risky assets. This research illustrates the importance of accounting for Social Security benefits when assessing savings adequacy. The study examines single individuals and married couples with various levels of earnings. Savings rates vary substantially depending on each household's circumstance. For example, some are assumed to contribute to a 401(k) plan as early as age 32, while others do not begin doing so until age 52. Despite the differences in savings rates, all the workers have retirement income, net of taxes, that replaces most, if not all, of the net income they had while working.

For many workers, the shift from DB plans to DC plans likely will mean that they will be better off in retirement. As noted earlier, traditional DB plans place a premium on both having long tenure at a single employer and separating from service close to the retirement age. However, only a minority of private-sector workers approaching retirement have had a work history that would have maximized benefits under a traditional DB plan. The U.S. labor force is—and has always been—highly mobile. CPS data show that among private-sector workers aged 55 to 64 in 2012, 49 percent had been at their current job for nine years or less, whereas only 26 percent had tenure of 20 years or more; in 1983, the comparable statistics were 42 percent and 33 percent, respectively.²⁹ In contrast, 401(k) plans are well suited to a mobile workforce, allowing workers to accumulate retirement assets steadily, paycheck by paycheck, and allowing workers to retain those assets when they separate from an employer.

Taking into account the risks faced by retirement plan participants—for example, the investment risk faced by workers in DC plans and the job turnover risk faced by workers in DB plans—several studies have concluded that the majority of workers who have access only to DC plans during their working careers will be better off than if they had access only to DB plans. For example, comparing typical DB plans with typical 401(k) plans in the SCF data, under a variety of possible labor market and investment return scenarios, a Dartmouth study concluded that “generally, 401(k) plans ... are as good or better than DB plans in providing for retirement.”³⁰ Another study comparing DC plans and DB plans that are of equal cost to the employer, concluded that, by the 1990s, DC plans were preferred by most workers, taking into account uncertainty in wage growth, job turnover, asset returns, and life expectancy.³¹ Finally, in an analysis of HRS data using both detailed descriptions of retirement plans and the actual work histories of individuals, economists from MIT, University of Chicago, Dartmouth,

²⁸ See Brady, “Can 401(k) Plans Provide Adequate Retirement Resources?” *Public Finance Review* 40, no. 2 (March 2012): 177–206.

²⁹ See Brady and Bogdan, “A Look at Private-Sector Retirement Plan Income After ERISA, 2011,” *ICI Research Perspective* 18, no. 5 (October 2012); Table 24 in data supplementing the report available at www.ici.org/info/per18-05_data.xls.

³⁰ See Samwick and Skinner, “How Will 401(k) Pension Plans Affect Retirement Income?” *The American Economic Review* 94, no. 1 (March 2004): 329–343.

³¹ See Schragger, “The Decline of Defined Benefit Plans and Job Tenure,” *Journal of Pension Economics and Finance* 8, no. 3 (July 2009): 259–290.

and Harvard projected that retirement resources will be higher on average with private-sector DC plans than they would be with private-sector DB plans.³²

THE VOLUNTARY EMPLOYER-PROVIDED RETIREMENT SYSTEM IS CHARACTERIZED BY INNOVATION AND FLEXIBILITY

A strength of the voluntary employer-provided retirement system is the flexibility allowed in its design. This flexibility has allowed a tremendous amount of innovation to take place over the past few decades, due to the combined efforts of employers, employees, and plan service providers. The convenience and stability of making contributions through regular payroll deduction is one such innovation. Employer matching contribution arrangements designed to further incentivize employee participation is another innovation many take for granted today. There is good reason to believe that outcomes under a system dominated by DC plans will improve even more after recent innovations have time to reach their full impact. One of those important improvements has been automatic enrollment to increase plan participation.³³ Another change, auto-escalation, gradually increases the share of pay contributed each pay period until it reaches a desired goal. Further, target date funds have also become increasingly popular both as a default and as an employee choice and have been successful in ensuring that investors have a diversified portfolio that rebalances to be more focused on income and less focused on growth over time.³⁴

AMERICAN WORKERS SHOW STRONG SUPPORT FOR THE DEFINED CONTRIBUTION SYSTEM

Given the foregoing, it is no surprise that Americans highly value their DC plans and the features typically associated with them. A 2011 household survey demonstrated American households' strong support for key features of DC plans, including their tax benefit, and their appreciation for the investment opportunity these plans provide.³⁵

³² See Poterba, Rauh, Venti, and Wise, "Defined Contribution Plans, Defined Benefit Plans, and the Accumulation of Retirement Wealth," *Journal of Public Economics* 91, no. 10 (November 2007): 2062–2086.

³³ The EBRI/ICI 401(k) Accumulation Projection Model demonstrates the increases in retirement income that can result from automatic enrollment. Replacement rates, modeled after adding automatic enrollment and investing contributions in a target date fund, increase significantly. See Holden and VanDerhei, "The Influence of Automatic-Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement," *Investment Company Institute Perspective* 11, no. 2, and *EBRI Issue Brief*, no. 283 (July 2005), available at www.ici.org/pdf/per11-02.pdf and www.cbri.org/pdf/briefspdf/EBRI_IB_07-20054.pdf. Furthermore, studies find that adopting an automatic enrollment feature has a particular impact on improving participation rates among low-income and younger workers. See, e.g., Nessmith, Utkus, and Young, *Measuring the Effectiveness of Automatic Enrollment*, Vanguard Center for Retirement Research (December 2007), available at <https://institutional.vanguard.com/iam/pdf>.

³⁴ See Charlson, "Diversification Pays Off for Target-Date Funds," *Morningstar Advisor* (January 17, 2013).

³⁵ See Holden and Bass, *America's Commitment to Retirement Security: Investor Attitudes and Actions*, Investment Company Institute (January 2012), available at www.ici.org/pdf/ppr_12_retir_sec_update.pdf.

- **Overwhelming support for preserving the tax incentives for retirement saving.** Eighty-five percent of all U.S. households disagreed when asked whether the tax advantages of DC accounts should be eliminated. Eighty-three percent opposed any reduction in employee contribution limits.³⁶
- **Many oppose altering key features of DC plans.** Nearly ninety percent of all U.S. households disagreed with the idea that individuals should not be permitted to make investment decisions in their DC accounts. Nearly eight in 10 disagreed with the idea of replacing all retirement accounts with a government bond.³⁷
- **Investors like choice and control of investments.** Ninety-seven percent of all DC account-owning households agreed that it was important to have choice in, and control of, the investment options in their DC plans. Seventy-nine percent said their plan offers a good lineup of investment options.³⁸
- **Most households continue to have positive attitudes toward the 401(k) system.** Sixty-five percent of all U.S. households in 2011 had favorable impressions of 401(k) and similar plan accounts, similar to 2010.³⁹ Nearly three-quarters of households expressed confidence DC plan accounts that could help participants reach their retirement goals.⁴⁰

ICI's household surveys during the past five years find that even in the depths of a bear market and despite a broad economic downturn, Americans continue to be committed to saving for retirement and value the characteristics, such as the tax benefits and individual choice and control that come with DC plans.

CHANGES IN RETIREMENT POLICY SHOULD BUILD ON EXISTING SYSTEM—NOT PUT IT AT RISK

As this Committee considers the issue of retirement savings adequacy, the Institute urges you to focus on the following policy objectives and improvements to ensure that as many American workers as possible are successful in retirement:

- **Recognize the importance of Social Security.** Social Security provides the foundation of retirement security for almost all American workers—and for the majority, it may be the largest single income source in retirement. Yet, the Social Security system faces a projected long-term

³⁶ *Ibid* (Figure 7).

³⁷ *Ibid* (Figure 7).

³⁸ *Ibid* (Figure 6).

³⁹ *Ibid* (Figure 4).

⁴⁰ *Ibid* (Figure 8).

imbalance.⁴¹ It is absolutely imperative to preserve Social Security as a universal, employment-based, progressive safety net for all Americans.⁴²

- **Foster innovation and growth in the voluntary retirement savings system.** Policymakers, plan sponsors, and service providers strive to improve the ability of American workers to make sound decisions about retirement savings and investing. This Committee was instrumental in encouraging rules that improved disclosure of 401(k) plan fees and associated investment information. Now, this Committee is urged to go further by promoting electronic delivery of plan information, interactive educational tools, and materials to help American workers understand their savings options. Employers should be encouraged to use automatic enrollment if appropriate for their employee base; employers may want to enroll their workers at higher levels of savings and escalate the savings more substantially than is perceived appropriate under current law. As noted above, studies show that automatic enrollment has a particularly notable impact on the participation rates of lower-income and younger workers because these groups are typically less likely to participate in a DC plan where affirmative elections are required.⁴³
- **Offer simpler plan features for small employers.** Small businesses often face particular challenges in establishing and maintaining retirement plans. Special attention should be given to address how legal requirements may create obstacles to plan sponsorship among smaller employers. Creating a new type of SIMPLE plan for small employers would encourage coverage in smaller workplaces. The new plan would be modeled on existing SIMPLE plans, but would

⁴¹ For projections related to these programs, see The Board of Trustees, Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, *The 2012 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds* (April 2012), Washington, DC: U.S. Government Printing Office, available at www.ssa.gov/OACT/tr/2012/tr2012.pdf; The Boards of Trustees, Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, *2012 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds* (April 2012). Washington, DC: Centers for Medicare and Medicaid Services, available at www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/ReportsTrustFunds/Downloads/TR2012.pdf; Congressional Budget Office, *The 2012 Long-Term Budget Outlook* (June 2012), available at www.cbo.gov/sites/default/files/cbofiles/attachments/06-05-Long-Term_Budget_Outlook_2.pdf; and Social Security Administration, “Detailed reports on the financial outlook for Social Security’s Old-Age, Survivors, and Disability Insurance (OASDI) Trust Funds,” (2012), available at www.ssa.gov/OACT/tr/index.html.

⁴² Bringing the Social Security system into balance requires benefit cuts, tax increases, or some combination of the two. Regardless of the form they take, these changes will increase the burden on employer-sponsored retirement plans and IRAs. If Social Security benefits are cut, future retirees will need to accumulate more retirement resources. If taxes are raised on workers, net earnings will fall, but the amount of earnings that would need to be set aside to supplement Social Security benefits in retirement would remain largely unchanged. To the extent that either the benefit cuts or tax increases are structured to exempt workers with low lifetime earnings, it would place an even heavier burden on those already most dependent on employer-sponsored retirement plans and IRAs. For a discussion of how different methods of cutting Social Security benefits would impact workers with different levels of lifetime income, see Brady, “Measuring Retirement Resource Adequacy,” *Journal of Pension Economics and Finance* 9, no. 2 (April 2010): 235–262.

⁴³ See note 33, *supra*.

not require or allow employer contributions. It would have contribution limits above traditional and Roth IRA limits, but below existing SIMPLE plan limits.

- **Support flexible approaches to retirement saving.** Employers have a number of options for savings plans today,⁴⁴ but it is important for this Committee to recognize that mandating a particular plan or contribution level would not work for workplaces where the majority of workers are focused on saving for goals other than retirement—such as education, a home, or an emergency fund.⁴⁵ The voluntary employer-provided retirement system recognizes that employers need the flexibility to design benefit packages that meet the unique needs of their particular workforce in the business’ specific competitive environment.

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The U.S. retirement system is more successfully providing retirement resources to American workers now than in the past. Adjusted for inflation and the number of U.S. households, assets earmarked for retirement were nearly three times larger in mid-2012 than in 1985. More recent generations of retirees have had higher levels of wealth, on average, upon entering retirement than those in previous generations. Research also suggests that the shift of private-sector retirement plans from DB plans to DC plans is unlikely to reduce income, on average, for future retirees; on the contrary, especially for those who have frequent job changes during their working careers, income likely will increase. That said, there are still areas for improvement. In particular, policymakers should focus on helping participants get the information and education needed to manage their retirement assets and income; easing the burdens of plan sponsorship for small businesses; and ensuring that Social Security remains the strong foundation for retirement security that it is today.

We urge this Committee to continue its leadership in pursuing policies to improve the successful U.S. retirement system. Any changes that are made should build upon our existing and successful system so that it works even more effectively to facilitate retirement preparedness for American workers and their families. The Institute stands ready to assist the members of this Committee in continuing its long history of promoting retirement savings opportunities for American workers.

⁴⁴ DC plans, traditional DB plans, hybrid plans, and SIMPLE IRAs all are available to meet the varying needs of employers.

⁴⁵ See discussion on page 5, *supra*, noting that households are more likely to focus on saving for retirement as they get older and as their income increases, and that younger and lower-income households, which are already contributing 12.4 percent of income to Social Security, tend to earmark the balance of their additional saving for liquidity, education, future large purchases, or to purchase homes.