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RETIREMENT SAVINGS FOR LOW-INCOME WORKERS

HEARING

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY, PENSIONS, AND FAMILY POLICY

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

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SECOND SESSION

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RETIREMENT SAVINGS FOR LOW-INCOME WORKERS

WEDNESDAY, FEBRUARY 26, 2014

U.S. SENATE,
SUBCOMMITTEE ON SOCIAL SECURITY,
PENSIONS, AND FAMILY POLICY,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Sherrod Brown (chairman of the subcommittee) presiding.

Present: Senators Cardin and Isakson.

Also present: Democratic Staff: Kara Getz, Senior Tax Counsel; and Tom Klouda, Professional Staff Member, Social Security. Republican Staff: Jeff Wrase, Chief Economist; and Preston Rutledge, Tax Counsel.

OPENING STATEMENT OF HON. SHERROD BROWN, A U.S. SENATOR FROM OHIO, CHAIRMAN, SUBCOMMITTEE ON SOCIAL SECURITY, PENSIONS, AND FAMILY POLICY, COMMITTEE ON FINANCE

Senator BROWN. The subcommittee will come to order. Thanks to Senator Isakson for joining us, and the four panel members. I really appreciate your being here for an issue of increasing importance in our country. We know that there is a growing retirement crisis in the United States.

For many Americans, the traditional 3-legged retirement system—that we have all talked about pretty much all our lives—of pensions, personal savings, and Social Security seems to no longer work for so many. That 3-legged stool lacks stability for too many people.

The annuitized income of Social Security remains a safeguard of retirement security for working-class families. Social Security provides the overwhelming amount of retirement income for more than half the population. For a large number of people, it is essentially their entire income.

For too many, it is the private retirement system that is not working. Fewer than half of American workers, nearly 75 million, have employer-provided retirement plans or other opportunities to save for retirement through workplace contributions. Even more so, the half who do have some kind of retirement plan, in many cases have little in retirement assets. The median retirement account balance is $3,000 for all working-aged households, including those

that have none. But the median is $3,000 and $12,000 for households nearing retirement.

While tax-preferenced retirement accounts have helped spur a great deal of savings, the dollars in these private retirement accounts are typically concentrated among the top quartile or the wealthiest among those who have savings. Households in the top fifth of the income distribution account for 72 percent of IRA and 401(k) assets. The average disbursement among all seniors is just under $1,500. Only 19 percent of senior households receive any disbursements at all.

So, what do we do? Today we will discuss the dimensions of this crisis and a number of policy responses to it. These policies are specifically targeted towards low- and moderate-income workers. They all follow the same theme: doing more of what works.

We know Social Security works for low-income workers; the only question is whether the benefit is adequate. A great deal of evidence suggests that, because of the state of the other two legs of the stool, that income is not sufficient.

Sixty-plus percent of low-income families are at risk of having insufficient income to maintain their standard of living in retirement. For them, we are talking about the difference between a modest retirement and living in poverty.

The Employee Benefit Research Institute has developed a model to predict whether retirees will have sufficient income to cover their expenses, and, in general, retirees in the bottom income quartile do not have enough money to cover those expenses in retirement. We will explore what those levels could, and should, be later in the hearing. The model predicts that just 16.8 percent of low-income retirees will have enough money for any kind of a decent retirement.

The President's decision to withdraw what I believe is the ill-conceived policy of chained CPI should put an end to treating Social Security as another trading piece in budget negotiations. Now we can have the thoughtful debate we need: not Social Security as a budget issue, but Social Security as part of retirement security and what we can do in a more comprehensive way.

We need to debate how to expand the kind of guaranteed annuitized income that Social Security provides. My colleague, Senator Harkin, has proposed a way to do this, his USA Retirement Accounts. It is legislation, I believe, with great merit. I am proud to be a co-sponsor.

The bottom line is that access to tax-preferenced retirement accounts must not be something workers receive when they cross the threshold into the middle class, but a tool that helps them start that journey to get into the middle class. The proposal from Treasury to introduce the myRA program is a step in the right direction. In particular, the myRA plan addresses the gap in access to tax-preferenced savings.

Mr. Iwry, I know, will talk in some detail about that. Fifty percent of full-time workers participate in an employer-sponsored plan, but only 13 percent of workers at companies with fewer than 10 employees participate in an employer-sponsored retirement plan.

There are no easy answers, but, in a system where we primarily administer programs to encourage private retirement savings through the tax code, we need to make sure the incentives align to the need better than they have.

The tax incentives do not much affect low-income people, and they only marginally and unevenly affect moderate-income people, those incentives we provide through the tax code. Those are some of the questions we need to explore.

I appreciate Senator Isakson being here, and Senator Cardin also, who has been a leader in pension issues throughout his time in the other House on the Ways and Means Committee. Thank you for being here, Senator Isakson.

OPENING STATEMENT OF HON. JOHNNY ISAKSON, A U.S. SENATOR FROM GEORGIA

Senator ISAKSON. Well, thank you very much, Chairman Brown. I appreciate your calling this hearing on an important issue for all Americans.

The recent recession left a glaring reminder to many that Americans simply are not saving enough, if any at all. We have made some progress over the years, but I argue that we can do more. Creating an environment for sound retirement is not only good for participants, it is good for America. The more we can empower individuals to save and plan for themselves, the less they have to rely on the government to take care of them in their latter years.

Both in this committee and in the HELP Committee, we have been examining retirement issues. We have been presented with evidence that is clear that the most important factor in determining whether or not an individual is saving for retirement is whether or not their employer offers them a plan.

If our goal is to increase the number of Americans saving for retirement, we should be expanding the options available to employers through existing structures rather than creating a new mandate or a new program which seems overly complicated for such a simple goal.

I applaud Senator Orrin Hatch, the ranking member of this committee and a senior member of the Senate, for introducing last year a series of reforms for American workers and employers which would create stronger tools and options for providing pensions and more security in retirement.

According to the Small Business Administration, small business makes up a substantial majority of the U.S. employer firms. We can certainly find ways to make it easier for these businesses and their employees to participate in savings vehicles and retirement vehicles by reducing unnecessary administrative and testing burdens. Further, at a time when we are trying to encourage higher retirement saving participation rates, we should certainly not be limiting individuals' investment education and advice as the Department of Labor is proposing. With this proposal to redefine the term "fiduciary," Department of Labor is unilaterally seeking to over-regulate 401(k) plans and IRAs, both critical tools for Americans investing in their own retirement.

As we continue to examine the issue of retirement savings, I would continue to urge the Secretary of Labor and the Department

of Labor to revisit the Department's approach to this issue and preserve access to professional advice for low- and moderate-income investors.

I am pleased that the committee is continuing to explore ways to increase retirement savings for all Americans. I hope that we work together to find ways to simplify and improve access for business, to improve plans, as well as create an environment that continues to encourage the American people to save for their retirement and their future.

Thank you, Mr. Chairman.

Senator BROWN. Thank you, Senator Isakson.

Senator Cardin, your opening statement, please?

OPENING STATEMENT OF HON. BENJAMIN L. CARDIN, A U.S. SENATOR FROM MARYLAND

Senator CARDIN. Well, thank you, Mr. Chairman. I very much appreciate you calling this hearing. Senator Isakson, thank you for your leadership on this. I regret that I am going to have to leave shortly to chair a hearing in the Foreign Relations Committee, because this is a subject of great interest to me, and you have an incredible panel of experts who can really help us.

Now, Mr. Chairman, you correctly have identified the huge problem we have in this country, and that is retirement security. We have made progress with some legislation that has been passed over the last decade, but we need to do more.

The 3-legged stool that you mentioned is absolutely accurate. We have to, first, protect Social Security, make sure it is strong and remains strong. It is critically important. For many Americans, it is their primary or sole source of retirement security.

We need to build on what has worked. The Saver's Credit has worked. Millions of Americans today have retirement accounts who would not have retirement accounts but for the Saver's Credit, so let us look at ways that we can strengthen the Saver's Credit. I think there have been some suggestions that have been made that would make that more available.

We need to continue to work on providing appropriate incentives for employers to sponsor retirement accounts. Your observation is absolutely correct, Mr. Chairman, that the tax-deferral incentive, particularly for low-income families, in and of itself has not been effective in getting them to participate in retirement accounts.

The Saver's Credit puts money on the table, therefore they are likely to want to take advantage of the money being on the table. If an employer sponsors a plan and puts money on the table, workers are more likely to participate.

With the Federal Government's Thrift Savings Plan, we see high participation rates. We have also found that automatic enrollment is an effective way to get people to participate in retirement savings. Americans make decisions by inaction, and therefore the automatic enrollment feature where you have to opt out has also been effective.

I would just identify another problem that we have, and that is, it is too easy to take out retirement funds for things other than retirement. They are all well worthwhile, we understand that: to buy a home, or health care, or similar needs. But retirement accounts

should be for your retirement. It is also easy to take out funds in lump sums rather than in annuities, and I think we need to look at the realities that people do not predict well how long they are going to live, and we should offer incentives so that people have income throughout their life.

Many people start their retirement years with a healthy 3-legged stool for retirement security, only to find that the only leg that remains is Social Security, because they spend their retirement savings prematurely.

So I think there are things that we can work on. There are bipartisan proposals that have been made, and I think this hearing will be very helpful to us to work our way through to find ways that we can really help Americans save for their retirement.

Thank you.

Senator BROWN. Thank you for your insight, Senator Cardin.

The first witness will be Mark Iwry, Senior Advisor to the Secretary and Deputy Assistant Secretary for Retirement and Health Policy at the U.S Treasury Department. Mr. Iwry is the architect of the myRA program being launched by the Treasury and has extensive knowledge of all issues related to retirement and savings policy.

Diane Oakley is executive director of the National Institute on Retirement Security. Before joining the NIRS, she served as Senior Policy Advisor to Congressman Earl Pomeroy from North Dakota. Welcome to you.

Stephen Utkus is principal and director of Vanguard Center for Retirement Research in Philadelphia. Mr. Utkus is responsible for conducting the Center's extensive research on retirement savings in the United States.

Judy Miller is the director of retirement policy of the American Society of Pension Professionals and Actuaries. She served on the Finance Committee staff here from 2003 to 2007. We are glad to welcome her back.

Mr. Iwry, if you would begin. Thank you.

STATEMENT OF J. MARK IWRY, SENIOR ADVISOR TO THE SECRETARY AND DEPUTY ASSISTANT SECRETARY FOR RETIREMENT AND HEALTH POLICY, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. IWRY. Thank you, Mr. Chairman. Chairman Brown, Senator Isakson, Senator Cardin, thank you for the opportunity to appear before you today to discuss retirement savings for low-income Americans.

The administration and Treasury remain committed to working with Congress to help secure a dignified retirement for all workers, and, first and foremost, Social Security is and must remain a rock-solid, guaranteed, and progressive benefit on which every American can rely.

To supplement Social Security, as you have said, Mr. Chairman, as well as you, Senator Isakson, Senator Cardin, most secure retirement planning traditionally has included employer-sponsored retirement plans as well as individual savings. But too many of us are not on a path to be sufficiently prepared for retirement. Tens of millions of workers lack access to employer-sponsored plans or

retirement savings, and this puts the onus on the individuals to set up individual retirement accounts and save for retirement on their own.

Fewer than one out of 10 workers eligible to contribute to an IRA actually does so. By contrast, roughly seven or eight out of 10 who are eligible to participate in an employer plan actually participate, and up to nine out of 10, to your point, Senator Cardin, in a plan with automatic enrollment. The risk of an insecure retirement is especially acute for women, for minorities, and for lower-income Americans.

A number of factors are at work here. In addition to lack of access to employer-sponsored plans, those who are not currently saving may encounter minimum balance requirements and administrative- or investment-related expenses that make it difficult to sustain very small accounts. Also, many potential new savers may be hampered by concerns about investment risk and volatility, the challenge of making decisions regarding investment options and other financial choices, and the need to take initiative to establish an account.

To help address these concerns and fill a gap in retirement saving, the President announced in his recent State of the Union address that Treasury would make available a new, specially designed savings bond to be held in a Roth IRA to provide an investment for deposits that may be too small to be of interest to most commercial financial institutions that offer IRAs.

Called myRA, which stands for My Retirement Account, this vehicle will be targeted especially to moderate- and lower-income workers, especially to those who are first-time savers or potential first-time savers and those who are not eligible to participate in employer-sponsored plans, to give them a simple, safe, and affordable way to start saving.

Contributions to be made by payroll deposit at the workplace could be as small as $5 each, with a minimum investment as little as $25. The bond will have an add-on feature so that additional contributions will increase the value of the bond instead of requiring the individual to purchase additional bonds in order to add to their saving.

As a starter account, the myRA will be limited to $15,000 as a cumulative balance—obviously not a target for saving, but only a transition point at which people who have not already rolled over from their myRA account to a private-sector Roth IRA would then shift to a private-sector IRA.

While it is obviously not nearly enough for a secure retirement, $15,000 may be enough to prime the pump to instill a habit of saving to make a new Saver's Account viable in the private sector. These accounts could therefore serve as incubators for small accumulations of savings whose administrative costs might otherwise exceed their earnings. After savers graduate to private-sector Roth IRAs, they will be able to continue saving and accumulating balances greater than $15,000 that could be invested in diversified investment portfolios that have more growth potential.

Employees who are eligible for employer plans will not be the target audience for the myRAs. They will have many good reasons to continue participating in those plans instead of myRAs, which

will complement and not compete with 401(k)s or other employer plans.

The administration and Treasury are committed to expanding and enhancing retirement security and retirement saving, especially for lower- and moderate-income workers. To that end, much remains to be done, including, among other things: promoting more lifetime income in defined benefit and defined contribution plans; facilitating portability and consolidation of savings; encouraging employers to make 401(k)s more available, more automatic, and more effective; and extending coverage to tens of millions of workers not currently in the system.

The President emphasized, in his State of the Union address, the administration's continued support for legislation to provide for automatic enrollment in workplace IRAs for employees of firms that do not sponsor any 401(k) or other retirement plan. But until Congress acts, meaningful steps can be taken administratively and by plan sponsors to give workers better access to retirement saving, and we view the myRA initiative as one such step. We welcome the opportunity to work with the committee to achieve these important objectives.

Senator BROWN. Thank you, Mr. Iwry.

[The prepared statement of Mr. Iwry appears in the appendix.]

Senator BROWN. Ms. Oakley, thank you for joining us.

STATEMENT OF DIANE OAKLEY, EXECUTIVE DIRECTOR, NATIONAL INSTITUTE ON RETIREMENT SECURITY, WASHINGTON, DC

Ms. OAKLEY. Thank you, Chairman Brown, Senator Isakson, Senator Cardin.

From the survey work that my organization, NIRS, has done, we found out that Americans are worried about retirement. In fact, 55 percent of Americans told us they were very concerned about their prospects for retirement, and six out of 10 Americans strongly agreed that Washington needed to give retirement security a higher priority, so I am sure they are going to be very interested in the findings of today's hearing.

When NIRS also went and looked at the readiness of all working households for retirement, one of the things we realized was that the concerns Americans were expressing in their opinions were well-founded, especially when we looked at the levels of coverage, ownership, and savings as a percent of income.

Clearly, the data shows that employer-sponsored plans are the most important source of retirement income after Social Security, but large shares of the American workforce lack access to a pension or a retirement plan, and increasingly individuals are relying on assets accumulated in defined contribution plans and have less access to a predictable income from a defined benefit pension.

Those areas of the economy without access for workers typically tend to be small employers. Two-thirds of the employees who work for small employers lack access to a pension plan, mostly because the employer feels it is too costly or complicated to offer a plan, and yet both large and small employers in low-wage industries are also less likely to offer a plan.

The net impact, when we looked at data from the Federal Reserve Survey of Consumer Finances, showed us that 45 percent of households had neither the head of the household nor the spouse of the head of the household having a retirement account, and that actually translates into about 38 million households that have no dedicated retirement account assets.

The other thing we found is that ownership of an account was very highly correlated with income and assets, and that households that owned retirement accounts had twice the level of income as households that did not own accounts and had five times the level of non-retirement assets as those individuals who did not have accounts.

We also noted that account ownership was highly concentrated with regard to income. When you look at the top quartile of the income scale, nine out of 10 households had a retirement account in their financial package. When you looked at the bottom quartile of households by income, three-quarters of the households had no retirement account, so there really is this polarization in terms of that.

When we looked at it, particularly in another study with regard to race, it was even more stark. Sixty-two percent of white workers have access to a retirement plan, 54 percent of black Americans and Asian Americans have access, but strikingly only 38 percent of Latino individuals have access to a retirement plan through their work.

We also looked at account balances, and what we found there was, again, that same starkness. We often hear higher numbers because people just look at people who have retirement accounts and do not include in those numbers the number of households that have nothing saved. What we found there was that the median account balance for all households across the country between ages 25 and 64 was $3,000. For those within 10 years of retirement, it was $12,000.

When we looked at that as it relates to people's income, because ultimately the purpose of a retirement plan is to replace your paycheck when you retire—and interestingly, we recently did some survey work, and people rated a paycheck, a monthly paycheck, equally important with the concept of portability in a pension plan. When we looked at retirement assets, eight out of 10 households across the whole age spectrum had less than 1 times their current salary put aside in retirement accounts.

That is fine for people at the lowest level where they are probably on track, but when you get to individuals who are, again, between 55 and 64, what we found there was six out of 10 households had less than 1 times their salary put aside in retirement accounts. Another three of 10 had somewhere between 1 and 3 times their salary, and less than one out of 10 households had 4 times their salary or more, and at that age they really should have 5 times their salary, according to some financial sources.

What we need to do, in our mind, or things that we should be looking at, are strengthening Social Security, as has been said, expanding access to low-cost and quality plans, such as the myRA, and I think we are seeing some action in a number of States where they are looking at what might be done.

Maryland is one State that has been looking at this, Senator Cardin and others, and also, I think there are other bills that are targeted at expanding access. And you are absolutely right, the Saver's Credit is a very valuable tool. Six million workers today are getting a benefit. The benefit is extremely modest. It is less than $170, on average. I think there is some room to make that more attractive, more appealing, and make it a real viable option and a way to get people to save.

Senator BROWN. Thank you for your insight, Ms. Oakley.

[The prepared statement of Ms. Oakley appears in the appendix.]

Senator BROWN. Mr. Utkus, thank you for joining us.

STATEMENT OF STEPHEN P. UTKUS, PRINCIPAL AND DIRECTOR, VANGUARD CENTER FOR RETIREMENT RESEARCH, MALVERN, PA

Mr. UTKUS. Thank you very much, Chairman Brown, Senator Isakson, and Senator Cardin. Thanks for the opportunity to address you today on this topic of low-income workers and retirement.

At Vanguard, we manage over $2 trillion on behalf of tens of millions of investors, Americans, most of whom are saving those assets for retirement. Our mission at Vanguard is to take a stand for all investors, to treat them fairly, and to give them the best chance for investment success.

We are particularly known for our efforts to drive down the cost of investing. All other things being equal, lowering the cost of investing is one of the critical levers that individuals and institutions do have to improve retirement outcomes. So we applaud the subcommittee's attention to this issue today. Having a low lifetime income is one of the important risk factors for lack of preparation for retirement.

Now as we consider this issue, I think it is particularly important to think about low-income workers in two categories. First, there are those who will remain at the lowest economic rungs for their working career. For these workers, Social Security does remain the bedrock of financial security. One critical way, of course, to strengthen retirement security for these workers is to ensure that Social Security is placed on a fiscally sustainable footing in the long run.

Now, in addition, many Social Security reform proposals in recent years, while trimming benefits for the better-off, have expanded benefits for low-income workers and their surviving spouses. So Social Security is a particularly targeted and efficient way to help those with low lifetime incomes, and it also recognizes that many of these households lack the discretionary income to generate private savings.

There is also a second group of low-income workers to consider: those who have low income today but who have rising income prospects in the future. For these workers, as their incomes grow, Social Security benefits will represent a smaller fraction of their retirement resources, and they will need more in private savings.

Now, several developments in the private defined contribution system have emerged to improve retirement outcomes. As we have discussed already, one is automatic enrollment. Today, the majority of new hires into the private sector DC plan system are automati-

cally enrolled, and automatic enrollment substantially increases plan participation among groups we have talked about: low-income workers, young workers, and among minorities.

Now, a second important development has been the growing use of automatic investment solutions or programs. Defined contribution programs in the past have been criticized because they place the burden of investment decision-making on often unsophisticated workers. However, the landscape has changed considerably, so much so that we at Vanguard estimate that, within 5 years, the majority of American participants will be leaving investment decision-making in their retirement accounts to professionals chosen by their employers. This is particularly due to the expanded use of target-date funds, though not exclusively. So in effect, the pendulum has swung, and fewer workers are being asked to undertake the complex portfolio construction decisions that did occur within the retirement accounts.

A third development I would highlight is the increased price competition that has been fostered by plan sponsor fee disclosure regulations from the Department of Labor. At Vanguard, we strongly believe that costs, as I said, are the important third lever for influencing retirement outcomes. As a result of these new Department of Labor rules, combined with intensive market competition, retirement plan costs are declining.

Just as one illustration of this point, we now estimate that nearly 45 percent of target-date assets in defined contribution plans are passively invested, or index-invested, for lowest possible cost. Now part of this is, admittedly, what we call a Vanguard effect. By our estimate, we are now the leading provider of target-date funds and defined contribution plans. But it is also due to our competitors, who offer index offerings and, above all, to employers' attention to the issue of costs.

I would like to conclude my comments today by making a broader statement about retirement security in the U.S. Now, some have suggested a sort of glass half full/glass half empty view of retirement security based on a wide number of published studies, yet there are other studies suggesting that 70 to 75 percent of Americans may be prepared for retirement.

Now, because of these different findings, there is actually, as you can see, a robust disagreement over a very basic policy question: is there a retirement crisis in America or not? As you consider this debate, I would recommend thinking of retirement security using a 3-part model.

First, there is a group of Americans who are clearly on track, accounting for half or more of the population. For this group, maintaining current programs and incentives makes sense.

There is also clearly a group of at-risk Americans, no doubt about that, often including many with low lifetime incomes. Strengthening Social Security is a critical policy lever.

And then finally, there is this third group about which we disagree, an intermediate group. I call them the partially prepared, they who have taken the first steps but need to do more, either by saving more or working longer. Many of the automatic programs that I discussed today are designed to help improve outcomes among this particular group.

Thank you for your attention this morning.

Senator BROWN. Well said, thank you.

[The prepared statement of Mr. Utkus appears in the appendix.]

Senator BROWN. Ms. Miller, welcome back. Thank you for joining us.

STATEMENT OF JUDY A. MILLER, MSPA, FSA, MAAA, DIRECTOR OF RETIREMENT POLICY, AMERICAN SOCIETY OF PENSION PROFESSIONALS AND ACTUARIES (ASPPA), AND EXECUTIVE DIRECTOR, ASPPA COLLEGE OF PENSION ACTUARIES, ARLINGTON, VA

Ms. MILLER. Thank you. Thank you, Chairman Brown and Senator Isakson, for the opportunity to talk with you about retirement savings for low-income workers.

Our retirement system today is working for tens of millions of Americans, many of whom are low-income. The system is not perfect, though, and more needs to be done to build on the success of this system and make workplace retirement savings available to more of those who currently do not have access, whether that is 20 percent or 40 percent.

There are a number of existing legislative proposals that would expand coverage while preserving existing plans. For example, the Starter 401(k) proposal in the Hatch SAFE Act* would be a big step in the right direction, as would a number of other proposals in that bill that would simplify the operation of current plans, encouraging small business owners to keep current plans and to establish new ones.

ASPPA also supports auto-IRA proposals that would expand access to workplace savings and, like Starter 401(k), encourage employers to later step up to a more robust arrangement. Of course, there are proposals which will do the exact opposite, like proposals to slash contribution limits or turn the current year's exclusion into a credit. These proposals would discourage employers, especially small business owners, from setting up or continuing to operate a retirement program.

Why do these proposals exist? I think they buy into what I have called myths that distort an honest retirement policy discussion. In September of 2011, I testified before the full committee about these myths. I now think "myth" might be too mild a word because it sounds benign, and I do think these are potentially dangerous, but I will still call them myths anyway for lack of a better term.

The first myth is that less than half of workers have access to retirement savings at work. Now, this is dangerous, because it gives the impression current incentives that have been targeted at substantially full-time workers have failed, when in fact the opposite is true. Bureau of Labor Statistics data shows 78 percent of full-time workers have access to a workplace plan, with 84 percent participating.

The second myth is that only rich people save in 401(k)s. Now, this is absolutely false. In fact, 80 percent of 401(k) plan participants are middle-income Americans from households making less

*The Secure Annuities for Employee (SAFE) Retirement Act of 2013.

than $100,000, and 43 percent of those households make less than $50,000 a year.

The third myth is that the current tax incentive is upside-down. Now, this reflects a failure to understand that the incentives for workplace retirement plans are different than just about any other tax incentive in the code. First, it is a deferral, not a permanent exclusion, so every dollar excluded from income now will be included in a future year. But even if you just look at current-year benefits, this incentive is different. It is different because employer retirement plans are subject to non-discrimination rules that make sure contributions do not discriminate in favor of the highly paid.

The result is, the current tax incentive for employer-sponsored defined contribution plans is actually more progressive than the current income tax system. Taxpayers making less than $50,000 pay only 9 percent of Federal income taxes, but they get 28 percent of the tax incentives for defined contribution plans. By contrast, households making more than $200,000 pay 48 percent of income tax, but only receive 17 percent of retirement plan tax incentives.

Compare this to capital gains. Nearly 90 percent of the capital gains tax benefit goes to those earning over $200,000, and about 1 percent goes to those earning under $50,000. Now, that is upside-down. A retirement tax incentive that provides 28 percent of the tax benefit to those paying 9 percent of taxes, I think, is actually very right-side up.

Another myth is that small businesses will sponsor retirement plans without an appropriate tax incentive. I personally spent over 20 years talking to small business owners about why they should set up or keep operating their plan, and with very rare exceptions the tax incentive was a very key factor, and in most cases really the factor, that supported the decision to put in the plan.

Now, small business owners are really wonderful people with very, very rare exceptions, and it is not that they do not want to help their employees save for retirement. It is just that most small business owners do not have much cash. You need the cash savings generated from the tax incentive to help make contributions that are required by the non-discrimination rules.

So it is a trade-off there, and reducing the incentive literally would have reduced available cash and allowed them to do less. So, there is no doubt in my mind that a reduced incentive is going to reduce coverage or lower contributions for those plans that are left over.

The last myth is that it does not matter if employers terminate their plans because of reduced incentive because, if we re-engineer the incentive, make it a refundable credit, it will lead more employees to save on their own. The fact is, as Mark said earlier, 70 percent of workers in the $30,000 to $50,000 range will participate in an employer-sponsored plan, but less than 5 percent will save on their own in an IRA when there is no plan at work.

So, changing the exclusion to a credit would have to inspire 15 times more people to go out and take action on their own to make up less ground, and that is not considering what is so often forgotten in this discussion: the employer contributions that are going into these people's accounts, which do not show up when you are analyzing strictly the tax benefit. If they have no tax liability, they

have no supposed tax benefit, but they are getting an employer contribution.

In summary, the key to promoting retirement security is expanded workplace savings. Proposals like Starter 401(k) and auto-IRA would expand access by building on the successes of the current system. Some other modest changes could also be made to make it easier for employers, particularly small businesses, to sponsor retirement plans. I think that these small changes would make a huge difference.

Again, thank you for inviting me. I would be pleased to discuss these issues further.

Senator BROWN. Thank you very much, Ms. Miller, for your insight.

[The prepared statement of Ms. Miller appears in the appendix.]

Senator BROWN. Senator Isakson is going to have to leave, so he is going to do the first question, or questions, if you need to.

Senator ISAKSON. Just a couple of short ones. Thank you very much for your courtesy, Mr. Chairman.

Mr. Iwry, let me ask you a question. Mr. Utkus made the statement that the cost of retirement accounts or the cost of setting up savings for retirement was somewhat of a deterrent—I think that was the comment that you made—or had an effect on people saving for their retirement. Does the myRA program have costs associated with it that the saver would have to pay for custodial fees or administrative fees?

Mr. IWRY. Senator, the myRA program is designed so that there would be no fees or costs that the saver would have to pay. It is a very simple arrangement. The saver would be able to contribute as modest an amount as they would like, down to as little as $5 each time, and have no fees involved in this account.

Senator ISAKSON. And I suppose, like a regular IRA, the benefit would ultimately be taxable when they withdrew it, is that correct?

Mr. IWRY. Senator Isakson, it is like a regular Roth IRA.

Senator ISAKSON. All right.

Mr. IWRY. You are correct. In fact, the bond would be held in a Roth IRA that could then roll over to the private sector, would indeed roll over to the private-sector Roth IRAs.

Senator ISAKSON. Ms. Miller, I had a question pop up in my mind when you were talking about small business people. I was a small business person in my other life, and many small businesses do not have employees—they have independent contractors.

One of the tests on independent contractors to qualify for that status is, you cannot offer a benefit program like a retirement plan. Would it be of interest to pursue IRS rethinking their position in terms of the independent contractor test so that small business people would be encouraged to offer plans for their employees to save for their retirement?

Ms. MILLER. I am not that familiar with the independent contractor rules, but, if what you say is true, then that certainly should be considered, yes.

Senator ISAKSON. It was not a trap, I promise.

Ms. MILLER. No, I know. I know.

Senator ISAKSON. It just popped into my mind.

Ms. MILLER. I did not mean to say "if what you say is true." I should not have said that.

Senator ISAKSON. No, no.

Ms. MILLER. But, no. If that is the case, then yes, they should.

Senator ISAKSON. Senators are always subject to being questioned. Do not worry about it. [Laughter.]

And one last question. Are you familiar with the proposal Ms. Solis made on the fiduciary rule when she was Secretary of Labor?

Ms. MILLER. Generally, yes.

Senator ISAKSON. And I understand that that is surfacing again under Secretary Perez.

Ms. MILLER. Yes.

Senator ISAKSON. Would you have any comments on what would happen if we changed the fiduciary rule as they tried to do it?

Ms. MILLER. We are very concerned about that, particularly in the small business context. We think that some significant changes have to be made to the re-proposed rule or else it will be a disaster.

Senator ISAKSON. I think if we prohibit investment advice for savers, we are going to have even fewer savers than we had before, right?

Ms. MILLER. I believe that is true, yes.

Senator ISAKSON. Thank you very much for your courtesy, Mr. Chairman.

Senator BROWN. Thank you. Thank you, Senator Isakson.

Thank you all for your testimony, and those are all good insights. I appreciate that.

I want to start with Ms. Oakley. We are starting to see some kind of cross-currents in the discussion, from what some might call retirement crisis deniers who think that there is some claim that the retirement crisis is based on a pretty fairly selective reading of data.

I would like you to walk us through the data. What are the key numbers we should be paying attention to? Why do experts interpret the status so differently?

Ms. OAKLEY. You know, there are a lot of different sources of data. The source, for example, that we used is the Survey of Consumer Finances, which is a comprehensive analysis done once every 3 years by the Federal Reserve. That is based on a survey.

A number of other survey instruments exist, such as the consumer population survey done by the Bureau of Labor Statistics, BLS, and others. There are other, various surveys. There is also some data that becomes available via tax information as well, and there are different cuts of that.

Now, each one of those has pluses and minuses. Some of the tax data might be missing. As you know, there are a large number of households where their income is so low that they do not pay taxes.

But one of the things is, if you look at the survey data, even though people may understate the values of their accounts, there still are pretty consistent responses across a various range of survey data that lead you to understand that the data is fairly accurate, or as accurate as we have in terms of a picture. The triennial update from the Consumer Finance Study is only done once every 3 years, so the data we have is based on 2010.

The 2013 data in the survey just finished being out in the field, and that data will probably be released by the Fed sometime later this year. So, there are a lot of different sources. But if you just look at people, just saying the amount in an account, that is very helpful for people who have accounts. But one of the real data pieces that is missing is this large group of Americans who have nothing saved.

If we are concerned about low-income individuals, those are really those same individuals in many cases, and so you have to get to databases that are broader than just looking at account balances and mutual fund accounts.

Mr. UTKUS. Senator, could I add something to that?

Senator BROWN. Yes. Certainly, Mr. Utkus. Then the next question is for you. But go ahead.

Mr. UTKUS. So I was going to say, though, that there is actually a quite varied set of studies about the sort of extent of the vulnerable population. So I think there is a general agreement that there is a vulnerable population in the United States. The question is its size and the degree of vulnerability.

So I would encourage you—in my formal testimony, I did actually cite some of the papers from Rand, University of Michigan, the Federal Reserve, Williams College, and others, where independent economists have arrived at sort of different estimates of what constitutes a vulnerable population.

So there is a robust debate, like there is about the weather in Washington, I guess, about these long-term forecasts, and they range in this area from half of households to three-quarters of households being prepared. So I think there is an actual debate about that.

Senator BROWN. Each of you, if you would—and thank you for the lead-in to that. I mean, fundamentally we know a few things. We know, first of all, the fundamental question, the challenge for all of us as we work on pension and retirement issues, is how do you build retirement security for whatever the number is of people who have inadequate retirement savings. I mean, it is fundamentally a problem of wages and all that comes with that.

But give me your read, each of you, and start if you would, Mr. Iwry, on how do you gauge retirement adequacy? I mean, how do we define that in your mind as people sort of strive for enough security to have a decent kind of lifestyle after their retirement? How do we define that to start with? And I will ask each of you that.

Mr. IWRY. Mr. Chairman, it is a matter, I think, of looking at the financial risks that individuals face after their working years or after their full-time work starts to phase down, how they can protect themselves against the risk of not having enough assets to maintain a reasonable standard of living for the rest of their life as a supplement to the bedrock Social Security guarantee.

There is the longevity risk that is so hard for individuals to estimate. There is the financial risk of losses in their assets; there is inflation risk. People need to think of their retirement preparedness in terms of probabilities, not just a flat amount that they need to save and have as a nest egg when they start into retirement.

Circumstances differ. The income replacement, the degree to which one needs to maintain a standard of living that they had

while they were working, is the way to start defining it, what income do you need for your life, and then look back into present values and strategies for achieving that. We have been trying to help people—and I think many of my co-panelists have been very much involved in this—to think about that question on an individual household basis.

The Department of Labor has put out guidance to ask 401(k) plans to state the amount someone has accumulated as an income flow in retirement, not just as a lump sum. We know that the lump sum characterization or the account balance is something that most folks find difficult to translate into a pension paycheck. How much of my monthly income can I supplement?

Senator BROWN. And the amount suggests more security to many people than it really is.

Mr. IWRY. Of course, yes. And, Mr. Chairman, just to wrap up, I would encourage all of us—and I know you are very much focused on this too—to keep our eyes on the prize here. We know the data are important, the debates over how to view the data are important, but the most important thing is what we are doing about the problem.

Proposals such as the President's automatic IRA proposal provide a breakthrough in coverage. Initiatives like the myRA—and I am proud to be a part of the team that developed it at Treasury under Secretary Lew, and under the President—will do what we can without legislation to get more people saving, more people covered. I think we can all agree very much on the direction in which we need to move and on the serious need to take action in that direction.

Senator BROWN. Thank you.

Ms. Oakley, how do you gauge retirement adequacy? You talked about 4 times, 5 times income upon retirement in savings, 4 to 5 times of income in savings. Give me as precise a definition as you can.

Ms. OAKLEY. Well, let me start with a little story, Senator, if I could, just to give you some sense of how complicated this is. I was giving a speech, and I went and Googled, "how much do I need to retire," and in 37 seconds I got 3.8 million answers coming up on Google in my search. So it is not an easy question to answer, and everybody has a different answer to it.

But there seems to be a growing consensus. There has been this thing of, do you need 70 percent, do you need 80 percent to replace your income to maintain your standard of living? You could also look at, what do you need for bare expenses? There has actually been a study done. What does someone need, bare living expenses? My eyes popped open when I looked at it.

They would say a household, a couple, needs about $20,000 a year for basic living expenses. But that might mean rent of only $500. I live in the DC area, and I am trying to think of where I could get an apartment for $500. So I think there are different levels of that for each household.

If we also care in this country about our economy, one of the things we know is that retirees spend their money, and it is a really powerful part of our economy. It generates a trillion dollars of economic output in the GDP.

So, if we have a large generation of individuals who have to cut their standard of living dramatically because they do not have the resources, what I will also say is, we found interesting studies that were done by Fidelity and another group called Aon Hewitt, done with the University of Georgia, where they looked at and tried to simplify this for Americans so that they could say, well, when you are 50 years old, you need 5 times your salary put away for retirement.

The Fidelity numbers came up, when you are 67, you need 8 times your salary. That is in addition to Social Security. When we look at the numbers where most of the households are in our work from the Federal Reserve data, we are so far beyond that. We have nine out of 10 households that are not on those sort of graded benchmarks that Fidelity has put out there. So I think we do have people who are falling behind. Some people can make up the difference, but we also have a lot of people who just are not in the game, and getting them in the game and what has been proposed with the myRA, I think, will make some differences.

Senator BROWN. Mr. Utkus?

Mr. UTKUS. So again, maybe I will answer this slightly differently. I think Ms. Oakley pointed out properly that there are various measures of adequacy. I think from a policy point of view, there are measures of, is it about creating minimum standards or optimal replacement rates for households? Those are the questions in front of the committee.

But I come back to this model of, we have three really distinct audiences. We have a group of audiences who appear to be well-prepared. It is half of Americans, possibly more. Then there is a group of Americans who have very low lifetime income, for whom, by the way, additional discretionary savings is not an appropriate policy lever. You have to figure out where to draw the line of where that threshold is where Social Security will be the principal and sole retirement income support.

And then really the debate is, what is the extent of the problem we are trying to solve for this remaining quarter of Americans who earn higher than the sort of lowest possible income group, yet on the other hand are not doing enough with the available tools? I think that sort of crystallizes the question in front of policymakers. There are three very different audiences.

Senator BROWN. Thank you.

Ms. Miller, let me phrase it a bit differently with you——

Ms. MILLER. Sure.

Senator BROWN [continuing]. Partly because you have said some things that the others seem not to agree with in some cases. The Census Bureau's Survey of Income and Program Participation—slightly different numbers from yours but not significantly different, maybe—indicate 70 percent of workers had access to a retirement plan, and 80 percent of those with access made contributions. That would mean 56 percent of workers—if 70 × 80 equals 56, which I think it does [laughter]—participate in a retirement plan, understanding that participation does not necessarily suggest adequate dollars, obviously.

Ms. MILLER. Absolutely.

Senator BROWN. So how much money do workers need so they are ready? I mean, how many near-retirees are on track to be ready for retirement? Your thoughts on that—how many are there?

Ms. MILLER. I have to build on what everybody is saying, which is, it is unfortunately not a simple answer. I would add one other, what I think is an incredibly important piece to this puzzle, which is: what happens with Medicare, and what have we done to help people with things like nursing home expenses or medical assisted living? Because one of the differences with some of these models is what they assume about medical expenses in retirement, and how that is going to interact.

So you have to assume status quo and kind of go from there, and I think that what makes for a secure retirement is absolutely individual. In my hometown of Greensburg, PA, I think you can get by on a pretty modest amount of income, whereas, if one were to stay here, it is very different. Many of us who live here—myself included—in order to retire comfortably, intend to sell our home and move to a place where we can buy one a lot less expensively and have something else to add to it.

So when we are looking at—and I am not trying to avoid the question, it is just that I think that we have to look at the bare expenses as an absolute minimum. I think, as others have said, for people who are at an income level where they do not have discretionary income to build up a substantial retirement, Social Security is obviously where that is largely going to come from.

Then having some discretionary funds available for unusual expenses, whether it is a car repair or some other kind of lump sum need, I think is important. Like many of us, I think of this in very personal terms. It has been 20 years since my mother retired, but when she did, she basically was able to live on Social Security in Greensburg, and she had her IRA and she did cash out her DB plan, in spite of whatever advice.

Senator BROWN. In spite of her expert daughter's advice.

Ms. MILLER. But her monthly income was fine for that environment. Having that pot of money to use to occasionally get a new car or occasionally to go out to dinner with her friends made her pretty comfortable. Well, I would not want to live like that. My measurement is a different measurement.

So, unfortunately, I am not giving you a good answer, because there really just is no easy answer to this, and it really depends on where you live, what your medical needs are, what other assets you have to deal with that.

Senator BROWN. And it is interesting that—well, let me go somewhere else here. You were the first person, I think, on the panel to mention housing. I think Ms. Oakley mentioned the cost of an apartment.

Ms. MILLER. Yes.

Senator BROWN. But the whole issue of equity in a home. If your mother was like many of her generation in small towns, she maybe had her home paid off by then.

Ms. MILLER. She had an apartment.

Senator BROWN. She had an apartment?

Ms. MILLER. Yes.

Senator BROWN. All right. But what do we include? I said to Senator Isakson before he left that one of the tragedies of this whole discussion is that the equity people had in their homes 5 years ago or 10 years ago has largely evaporated, or worse.

Ms. MILLER. Exactly.

Senator BROWN. Does it make sense to include home equity in measurements of retirement preparedness, do you think, Ms. Oakley?

Ms. OAKLEY. No. I think your home equity or even your cost of housing is just another important piece. A lot of retirees—we are seeing more and more people go into retirement with mortgages. In my organization, we are just in the midst of really preparing for another study to be released.

On a preliminary basis, we are looking at the cost of housing for seniors, and we are finding that, compared to before the recession, when there were about 14 States where 30 percent of retirees were at the level of having more than 30 percent of their income being paid towards housing costs, we are now at double that amount in terms of States where there is a large majority of individuals having more and more of their total income going toward housing costs.

So housing costs are important. I think the housing value is something you have to look at as well. A lot of people do not want to sell their house that they have grown up in and lived in, even though they have equity in it.

I think if you want to talk about stories of my mother, when my mother went into the nursing home, I found this yellow sheet on which she was calculating how much money she could spend each year—or how little money she could spend each year—so that she could stay in her house before she would have to sell her home. I mean, that is the type of debate that is going on around kitchen tables all over America.

Mr. UTKUS. Just on the housing issue, you have to, in any calculation of retirement adequacy, include it because, if you live in your home—let us say you live in a home in an expensive area—that is $1,000 worth, if you will, of rental income you do not have to pay a month. That is $12,000 a year.

Senator BROWN. That is your Social Security check for many people.

Mr. UTKUS. So if you take out, of course, the cost of maintenance and utilities and so forth, still, the whole point is, economists are pretty clear that at least part of that is a substantial resource. It is rental costs avoided. That is why, for example, some of these numbers that we talk about on retirement adequacy always do look better. So I think that is the important issue on housing.

Senator BROWN. Mr. Utkus, what are these reverse mortgages that Senator Thompson and others hawk on TV to this question, without judging what he is doing?

Mr. UTKUS. Well, Senator, I have to plead relative ignorance about the reverse mortgage market. What we do know about home equity in retirement is this—we know two things: (1) it is used first and foremost as a way to save on the cost of living while in the early phases of retirement, and (2) we know from economics research that it is used at the time of either the death of a spouse

or your own illness for paying costs for nursing home care. As you know, before you qualify for Medicaid for nursing home care, you want to deplete assets and use those private resources to pay for private nursing care.

So it does seem that a house is a really interesting resource in the first sense, in that it helps you save on rental costs while you are sort of in the active stage of retirement, but later in life it is a critical resource used to pay for private nursing home care before Medicaid kicks in.

Senator BROWN. All right. I think this is probably for you, Ms. Oakley and Mr. Utkus, but any of the four of you can respond to it. You talked about the distributions in private retirement accounts. Andrew Biggs, who testified here on another couple of retirement issues a while ago, and Sylvester Schieber write that seniors are doing better than we think because Census data does not include lump sum distributions to IRAs and 401(k) accounts.

The question is not whether these distributions exist, obviously, or their size. We know they exist. We are talking about a great deal of retirement wealth. You know a lot about that, Mr. Utkus, at Vanguard, as your competitors do. Talk to me if you could about who is receiving the distribution from these private retirement accounts. I mean, obviously people who made more money have more in their accounts, but give me some information about, who is the beneficiary of these distributions? Ms. Oakley, you want to start?

Ms. OAKLEY. We do not have data on that, but we actually did a study looking at the income sources of seniors in retirement. Again, looking at the data, not so much the survey, what we generally found was that the data with regard to distributions coming from 401(k) accounts was negligible in terms of an impact in keeping people out of poverty.

But we did notice, in contrast to that, that for individuals who were receiving distributions, predictable DB plan payments, monthly checks in retirement, we found that there was a real important role that those accounts were playing, such that someone who had a defined benefit plan payment was 9 times less likely to fall into poverty than someone who did not have a defined benefit type of payment. So we think the idea of making sure that there is some type of lifetime payment does have a really big difference in terms of senior poverty levels and maintaining——

Senator BROWN. Well, we kind of know that. But the question is not, is it desirable, because they are disappearing——

Ms. OAKLEY. Right. But we found that the defined contribution plans, really, right now on the data that is out there, just do not show up as a significant force.

Senator BROWN. Mr. Iwry, do you want to speak on that?

Mr. IWRY. Mr. Chairman, I would add to what Diane Oakley has said. I think you are focusing on a key issue. The nature of the distribution matters. When there is guaranteed lifetime income, such as the Social Security program provides, such as defined benefit pensions have traditionally provided but increasingly less so, such as even 401(k)s and IRAs can provide, we make it much easier for the individual to make sure they do not run out of savings during their retirement.

It is easier for the individual to manage their assets and figure out how much they can prudently spend consistent with retirement security. Treasury and the Labor Department have been working for the past several years to emphasize the importance of keeping the pension, the regular monthly payment for life, in our private pension system.

We have been issuing guidance designed to encourage individuals to consider seriously these lifetime income options, to encourage plan sponsors to consider seriously putting lifetime income into their plans or making them a more salient choice for the individuals in those plans, whether they are 401(k)s, IRAs, or defined benefit pensions, which so often pay lump sums instead of lifetime income.

Senator BROWN. Mr. Utkus?

Mr. UTKUS. I was going to add—if I could use Judy's mother as an example—so when Judy's mother went to her IRA and used money from her IRA to support her standard of living in retirement, economists doing the work in Census decided that that was not income because it was an aperiodic or an ad hoc withdrawal. So if I, for example——

Senator BROWN. It would have been income if she had annuitized it.

Ms. MILLER. Right.

Mr. UTKUS. Or if she had set it up as a monthly withdrawal plan. But because she took the money and spent it—so for example, if I take money from an IRA or a 401(k) plan on the advice of a financial planner once a year and put it in my checking account and use it for income, that does not count as income from my IRA because I took it once and it was not scheduled. So there is just an empirical problem that——

Senator BROWN. But either way, the distribution is going to a relatively small number of people, and the tax code incents any of us who can to take advantage of that, and people who set up——

Mr. UTKUS. Well, this gets back to your earlier question, I think, which is that today, among older households, about half of households have what you would call tax-deferred retirement accounts. The benefits of those accounts obviously accrue to those households. As I think Diane pointed out, the median balance of those owning those accounts today at retirement age is $100,000, but the median balance of those, of course, not owning accounts is zero. So I think you have to think about two different elements of this. One is that the median balance of people who have these savings vehicles is $100,000——

Senator BROWN. And that $100,000, the group you are talking about is all ages or those above 55?

Mr. UTKUS. I was talking about pre-retirees.

Senator BROWN. Any period—so a 40-year-old with $60,000 is part of that average of a 60-year-old with $120,000, correct?

Mr. UTKUS. No, no. I was just saying for people, say pre-retirement age, say 60 to 65——

Senator BROWN. Oh, 60 to 65, it is $100,000.

Mr. UTKUS. It is actually about the same number——

Senator BROWN. So, even if the universe is only those who have savings, retirement savings, excluding those who have zero, that

number is inadequate, clearly, depending on if they have a defined pension benefit and all that, obviously.

Let me ask you the question this way. Is the reason that baby boomers—well, first of all, I assume that baby boomers are less prepared for their retirement than those who have more recently retired, are slightly older, correct?

Is the reason for that incomes, or is the reason for that the decline of savings, or is the reason for that decline of defined pension benefits? Or is it all three, the reason that baby boomers are less prepared for retirement than those who have retired in the last 10 years?

Are we as baby boomers—which I think the four of you and I are; I do not want to judge the age of anybody, but I think so—less prepared because we have fewer defined pension benefits, or we save less, or our incomes have stagnated, or is it all three? Do you want to answer that, Ms. Oakley?

Ms. OAKLEY. It is really a combination of all three. We have looked again at the data from the Federal Reserve about who has a DB plan. So the baby boomers, the early baby boomers—because they go over, like, 20 years, the baby boomers——

Senator BROWN. Right.

Ms. OAKLEY. So the people between 55 and 64, about 60 percent of those households have someone, either the spouse or the household head, who has a defined benefit plan either on its own or as part of their retirement account mix. When you look at the second——

Senator BROWN. That could be a 401(k) with annuitized planned payment payout.

Ms. OAKLEY. It could be an IRA or something like that. Right. If you look at the younger level of the baby boomers, those people between 45 and 54, the level drops precipitously so that now the majority of people are really going to rely only on a defined contribution-type of an account in retirement at that level. So there is a difference among the baby boomers themselves, besides what has happened in the past. Then when you start to look at those account values again, people in or out of——

Senator BROWN. So let me interrupt. So the baby boomers born in the 1940s are better off, taking into account age, than baby boomers born in 1958 or 1959?

Ms. OAKLEY. Yes.

Mr. UTKUS. I do not know that that is the case.

Ms. OAKLEY. Well, they have——

Senator BROWN. They have a higher percentage of defined benefit, DB, plans.

Ms. OAKLEY. They will have a higher percentage of those households having some type of defined benefit income.

Mr. UTKUS. I just want to be clear, though. So there is the median American versus people in defined benefit plans. It is a very different group. We know that defined benefit plans were typically held by affluent, long-tenured men, college-educated, in major corporations in the United States. Those are where the most generous benefits accrued. That was not the typical American.

I think the estimate is that boomers' resources, in terms of Social Security, Medicare, Medicaid, 401(k)s, DB plans that are still in ex-

istence, and so forth, the resources that they command compared to their parents, will purchase more in income, and they will have an absolutely higher standard of living.

But because baby boomers were richer than their parents in terms of income and did not save as much, whether through DB plans or through 401(k)s or through personal savings, they in fact will have somewhat lower replacement rates.

So I think it is very clear in the data that boomers will be richer than their parents but relatively less well-off on a replacement basis. You just have to look at the real value going from Social Security to Medicare, but it would be substantially greater to the boomer generation.

Ms. MILLER. I would like to add that one of the things that happened with boomers is, those who did have a defined benefit plan and had it frozen and then had their 401(k) plan that they probably had not had for their whole working lifetime, lost accruals in DB plans when they were most valuable—because the accruals are worth more as you get older—and instead are saving in their 401(k) plan when there is less time for it to accrue.

I know that Steve has said—and I wish I had it in front of me, but I do not—EBRI has done some work that I think shows boomers as being probably not the group as a whole that we should be most worried about; rather, it is a little further down the line.

Ms. OAKLEY. Although there are some other studies from the Urban Institute where they looked at those late boomers, the second half. Senator, what they found was that, of middle-income boomers, four out of 10 are at risk of falling into low-income levels when they retire just because of not having saved enough, not having enough time to recover, for example, from the last Great Recession and what that did to their levels of savings as they get ready to retire.

Mr. UTKUS. And I think that is right. All I observe is that, look at older retirees today. The old-age retirement income is $30,000 a year, most of which is coming from 2-earner Social Security.

So that is typical, and I think that gets back to this question of, who is the focal point? The low-income worker, I think, is quite different from the median-income worker, who is different from sort of the upper-income worker. That is why they get——

Senator BROWN. Let us talk about that. The lowest-income worker is—I mean, some significant number of them have a negative net worth, some significant number of them, so just by definition they cannot save unless they have had some myRA exposure opportunities. The second quartile, the second-lowest quartile, if you will, has an average net worth of $35,000. For that group, there can be some retirement savings. Let me back up on the low end.

The lowest quartile, I mean, a minimum-wage worker, particularly if we can raise it to—this is more commentary on the low minimum wage in my mind. But if we raise the minimum wage to $10, or to $10.10 as the President suggests and our legislation does, that is not a lot more income than Social Security.

The average Social Security check in Ohio is $1,300 a month. Is that right? Something like that. So that is not a lot less than the minimum wage. But put that group aside for a minute. The second quartile—what does their retirement picture look like, Mr. Utkus?

I mean, you have talked about, the lowest earners are not going to be able—I mean, we just have not addressed their savings. How about the second quartile, second to the lowest?

Mr. UTKUS. Well, this is where I definitely agree with Ms. Oakley that, as you go up the income level, retirement preparation improves. So, when you go into that second quartile group, you are going to see some people—you are still going to see people at risk, but you are going to see some improvement in the number of people who are partially prepared and maybe a few who are adequately prepared.

So I think it does get to the heart of the question of, of this group, where private savings is possible, as opposed to the lower group, where I think we all agree that if you are earning less than—the bottom quartile, I think, is $24,000. I looked that up before our discussion today. So, for households earning less than $24,000——

Senator BROWN. This is the $24,000 for pre-retirement earners?

Mr. UTKUS. Yes. Yes. Or working-age households.

Senator BROWN. Yes.

Mr. UTKUS. Yes. That is sort of the bottom, I think, quartile. That is a group that is very unlikely to accumulate private savings, and, when they do—I think I had this conversation with one of your staff members—when they do, they are more likely to apply it to debt reduction, emergency savings, even purchase of a home.

So that is where the savings among the very lowest-income households go. When they do in fact save, they are going to do it mostly for emergency savings. I think the debate then is what to do about this second quartile of income in terms of plan offering and plan participation.

Senator BROWN. Thank you.

What does your company, Mr. Utkus, say about the importance of Social Security? You do not obviously make a lot of money off the lowest quartile—even the two lowest quartiles, but especially the lowest quartile. What do you say about Social Security, as a company, about its importance, its changes, suggested changes? Have you addressed the issue or taken a position on the issue, or should we find a way to increase payout to low-income workers, to the lowest-income workers? What does Vanguard say, as a company?

Mr. UTKUS. Senator, we actually have not developed a fully fledged proposal on Social Security reform. However, what I observed in my testimony is that every proposal, from the ones that create private accounts to the one that maintains its defined benefit character, every proposal that I am aware of over the past 15 years always included provisions to increase minimum payments for low-income workers and their surviving spouses to deal with some of the issues I think Ms. Oakley raised.

So there really is this seemingly unanimous agreement that, for the lowest-income households, that is going to be the critical policy lever. The current minimum benefit in Social Security, which really no one really qualifies for because it is so low, is really an ineffective policy instrument. So I think that has been the uniform recommendation from all those studies.

Ms. OAKLEY. Senator, if I could add, when we did some of our survey work, one of the questions we asked Americans was, what were some of the barriers to using saving for retirement, or to you getting a secure retirement? Most of the lower-income individuals, people with incomes under $35,000, said their salary was one, an important one, but there was also a really interesting thing about Social Security.

We asked about raising the Social Security normal retirement age to 67, and there was a big divergence in opinion on that between households at an income level of $35,000 and below, where 69 percent of them said that that was a major challenge to their retirement security. And I think the one thing we all know is, when we raise the retirement age—and that is one of these proposals often in reforms—that really translates into a benefit cut, especially if individuals retire earlier. That means they get less income from Social Security.

So we clearly see at the low-income level a concern about that. That is, when we ask the same question of people from households with $75,000 of income, it was a concern of only 40 percent of the individuals who responded to the survey. So I think, at the low-income level, there is a real difference in terms of, what do you do and how do you change Social Security?

Senator BROWN. Pope Francis said not too long ago that he exhorted his parish priests to go out and smell like the flock. When I hear talk of raising the retirement age or raising the Medicare eligibility age, I think that all of us who do this for a living should be doing what the Pope has suggested and actually listening to people in situations like that.

I will never forget, I was in Youngstown 2, 3 years ago at a town hall in a poor area of the city. A woman—this is not a Social Security issue but it is a retirement issue more or less—said, "I am 63 years old." She was working two jobs. She had never made much money. She said, "I am 63 years old. I just have to stay alive another year and a half so I can get health insurance, so I can get Medicare."

To think that you define your life that way: I have to stay alive so I can get health insurance, not stay alive so I can raise my grandchildren or do something, I mean that is—when I hear talk of retirement age and people like us saying it, dressing like this and living like this—anyway.

Mr. Iwry, talk to me more about the myRA. Whom were you thinking of when the myRA was conceived? I mean, talk to me about the kind of person you were thinking of and describe that person to me.

Mr. IWRY. Mr. Chairman, we were thinking of the kind of person you just referred to. We were thinking of ordinary Americans, people who do not have savings now, people particularly who do not have the good fortune to be in a defined benefit pension or have eligibility for a 401(k) or another employer-sponsored plan, people who are moderate- and lower-income.

Those groups, moderate- and lower-income, people not now saving, people who could be saving if it was made easy and convenient enough for them, those are the target audience. Because this program has virtually no minimum investment—$25—has a $5 min-

imum contribution, has payroll deduction, has the convenient way to help people get past the barriers of having to open up their own IRA and decide what type and at which institution and how to invest their funds and so forth, it is done for them to a very great extent.

Senator BROWN. Well, let me ask it this way. Thank you for that. Let me ask it this way. The challenges are many, of course. One of them is, people become aware of these things. I stopped at a fast food restaurant between Dayton and Cincinnati a few months ago, right before the health care roll-out. This was September. There was a lull, nobody at the counter at that time.

I walked up to the counter, and I was talking. There were five or six workers there, mostly in their 30s, probably late 20s, 30s. None of them made more than $10 an hour, except maybe the supervisor. I asked them if they had health insurance. One did because his wife had it—or her husband, I cannot remember—so only one had health insurance.

I asked them about—this was September. I asked them, were they looking forward to the Affordable Care Act, or were they going to sign up? None of them knew about it. These were not 17-year-olds, these were people in their late 20s, early 30s. None of them knew about the Affordable Care Act, so they had no idea how to sign up.

So my question is this: how are those fast food workers who are not—I mean, one reason I want to raise the minimum wage is because I do not really buy that every one of those fast food workers is going to graduate to a better, and better, and better job and make $50,000 a year, $40,000. Many of them are not going to do a lot better than they are doing now because of the economic situation, because of their education, because of their opportunities, whatever it is.

So what do these workers lives' look like in 20 years? If myRA is implemented the way you want, this now 32-year-old fast food worker in Dayton, OH, who in 20 years will probably not be working there but probably not be in anything approaching a middle-class job—mostly high school graduates, probably not Sinclair Community College, probably not University of Dayton, whatever, but wherever they are going—where do these myRA people end up? What do they look like? What do their lives look like in 20 years in your concept of this? So, two questions. How do you get it so they know about this, and, second, what do their lives look like in 20 years?

Mr. IWRY. Mr. Chairman, for them to——

Senator BROWN. What do their savings lives look like in 20 years?

Mr. IWRY. Right. Understood. First of all, how do we get them to know about this? The President started out by highlighting the need for more retirement security, for more retirement saving, especially among ordinary Americans such as the people you are describing, in his State of the Union address just a few weeks ago.

This program, myRA, is intended to start them down a path where, 20 years from now, they will be saving regularly on their own in a private-sector retirement saving arrangement, ideally with employer plans. But whether or not they are fortunate enough

to be covered by an employer plan, something that we want to focus on and expand at the same time is, they will have been started into the habit of lifelong saving.

Senator BROWN. Let me interrupt and continue on that.

Mr. IWRY. Sure.

Senator BROWN. Is implicit in that that they will no longer—I mean, is part of this the whole issue of the unbanked, that they will not go to the payday lender, that they will be at some kind of——

I assume that—I mean I kind of know what your answer is going to be, but include that in the answer too, how that translates into changing that pattern of having to go to a payday lender and then instead going to some financial institution if their myRAs encourage them to do that.

Mr. IWRY. The process of starting to save and watching one's self accumulate a nest egg is something that has worked wonders for a lot of people, including people in the lower ranges of the income distribution. We know, Mr. Chairman—and this is very much a bipartisan point—that saving on one's own, saving with the benefit of convenient aides for saving, such as a myRA or automatic enrollment in a 401(k) or automatic enrollment in IRAs, as the President has proposed, helps people gain a sense of greater independence, of financial security, of hope that they can keep going, keep saving, keep accumulating, reduce their debt, avoid financial practices that are not good for them, increase their financial capability, their financial literacy.

It is an occasion for people to learn more and to grow and to particulate in the system more actively. There are all sorts of benefits, tangible and intangible, once we get people into a lifelong habit of saving. The two critical elements to that are: get them to start, get them to continue. The myRA is intended to get people to start, to encourage them to do so. It is voluntary with employers, it is voluntary with individuals. But the idea is that it is not only that these people do not earn so much and do not have a lot of disposable income that keeps them from saving now, it is also that the saving arrangements are not easy or convenient enough.

That is the importance of employer plans, or lacking an employer plan, payroll deposit saving, the automatic nature of it, Mr. Chairman—that once it starts it just continues, and it can continue for those whole 20 years and longer. That is what we would hope, that 20 years from now millions more of those people you are talking about will have actually had their lives transformed for the better by having gotten into the saving habit this year. By the end of this year, we are hoping that the myRA program will be ready to be implemented.

Through that, plus more sweeping measures that Congress can enact—such as automatic enrollment of tens of millions of people in payroll-deduction IRAs—we can have those folks in a much better place in terms of financial security and a sense of independence and full participation in our system.

Senator BROWN. Thank you.

Mr. Utkus, so with this fast food worker who puts $20 a paycheck, if they can do that much, into their myRA, and then they reach the $15,000 level, and then they get to experience the Van-

guard effect, if I can bring that up—talk to me. I understand your fees, or what I have been given is a ratio—the average expense ratio for Vanguard funds is slightly less than two-tenths of 1 percent, one-fifth what is average for the mutual fund industry. That is the number I have been given.

Two things. One is, how do we make sure that those myRA managers charge the bare minimum when workers get to the $15,000, if they come to you, if they come to Fidelity, to whomever they go? Second, how do we educate those who hold these myRAs in sophisticated issues of investment? I know you said that it is good news.

I understand it also would be good for your company, but it is good news, and I agree with that, that more and more people are turning those investment decisions over to professionals chosen by their employer. This will be a different situation.

So this fast food worker who now has the $15,000 and comes to Vanguard, how can we be assured that it is going to be done right, and how do you advise that person when there is not a lot of money to be made from that person's account? Where does that go then when they get to that number 4 years from now, or whatever?

Mr. UTKUS. Well, interestingly enough, what happens today if you show up with a $15,000 IRA is, overwhelmingly, people at Vanguard choose target-date funds as their IRA choice because of the simplicity of choice.

It used to be, by the way, that when individuals would show up with their IRA contributions, they might make decisions based on recent fund performance, funds that were doing particularly well, which is actually not always a good way to structure these decisions. But the innovation of a target-date fund really has eliminated this focus on accumulating different types of assets for your portfolio and focusing instead on the date you expect to retire, the risk of the portfolio you are taking on, and of course the cost you are paying. So I think that is, in fact, what would happen in this kind of arrangement.

In fact, I know Mark has discussed the whole question of how these arrangements will leave the Treasury platform and move into the private sector. That is an open area of discussion, exactly how that might happen. But certainly our thought would be that a simple solution would be a target-date series solution with low cost.

Senator BROWN. Are you concerned that these myRAs would crowd out, compete with, or replace private retirement accounts? Are you concerned about any competition from them for your company?

Mr. UTKUS. No, we do not think of it in those terms, because this is a group of employers that does not offer retirement plans today. We actually have a fairly robust and growing relatively new offering serving small employers, but those of course are the employers that do offer plans, sort of Judy's natural clientele. But in fact, we think it is a useful addition to the savings landscape.

I think Mark characterized it very well. It is a bit of what we would call a sandbox, or an experiment to sort of work through the mechanics of serving the millions of small employers who may be interested in it. But the real question, the real lever in influencing retirement savings, comes with automatic enrollment, not the voluntary nature as it is structured today.

Senator BROWN. I want to talk at some point, Mr. Iwry, but I want to move to other things. We have about half an hour. On the whole financial literacy question, I just hope that—I assume you are, but I hope—you are doing a lot of thinking about that and how to engage with people who have myRAs on financial literacy questions, but I cannot imagine you are not thinking about them already.

Let me talk about the Saver's Credit. Any of you certainly can respond to this. How do you reform the Saver's Credit to make it a stronger incentive for, I guess, the bottom two quartiles or quartiles we are talking about today, the bottom half or bottom 40 percent? Who wants to start on that? Do you want to start? Just, how do we do this better?

Everybody on this panel, and the other two Senators, seemed to like the Saver's Credit. I think it generally gets good reviews, but it is obviously a bit inadequate still, or more so. So talk that through, if you would. Each of you, if you have an opinion, I would like to hear it.

Mr. IWRY. Mr. Chairman, the Saver's Credit was originally designed in the late 1990s–2000 to be much more robust than the Saver's Credit as enacted. It had a 50-percent credit rate instead of the 10-percent, 20-percent, and for a few eligible people 50-percent, credit rates that it now has.

The 50-percent rate was much more robust, applied across the board. It would be available to a larger portion of the middle class in America. The income limits right now go up to $30,000 individual, unmarried, and $60,000 married filing jointly. It could usefully be extended to more of the middle-income group beyond those maximums. It could be made refundable.

Right now the Saver's Credit is not refundable, yet the way it was originally designed and proposed, it would have been available to the 50 million or so families who pay their Social Security taxes and participate as working households in our economy but do not owe Federal income tax because their income is not high enough or because they have an Earned Income Tax Credit.

So the refundability of the Saver's Credit, having a single 50-percent credit rate instead of the three rates that it now has—which are much less of a playing field leveler for the lower- and moderate-income people who are eligible for the Saver's Credit—and having it extend to more of the middle class, middle-income people, would be fundamental reforms.

Many have also suggested that the credit be deposited in the account in which the person is saving, so, if you are saving in a 401(k) or an IRA, that the credit go into that account. That is another possible improvement. It would have to be administratively feasible before that is done.

But right now, that is why the myRA has been designed to be encased in an IRA account, a bond with the full faith and credit of the United States backing it in a Roth IRA so that the individual who is contributing to this retirement savings bond would get a Saver's Credit under current law, and hopefully, if we can expand the Saver's Credit, a more robust one in the future.

Senator BROWN. You wanted to comment too, Ms. Oakley?

Ms. OAKLEY. I guess, Senator, the one thing I would add is, having worked for Congressman Pomeroy, he actually introduced a bill to do almost everything Mark talked about when he was in the House, which was expanding the credit, making it refundable, enabling that credit to perhaps go back into the account and perhaps even giving the employer, if it was an IRA or a 401(k) account, some of that credit as something to help them meet some of the non-discrimination tests as a way to encourage employers to want to accept that money.

I think the Saver's Credit really can be a very valuable tool. It could be a much more substantial benefit for some of the individuals. As I mentioned, right now the average benefit in that Saver's Credit going to the households who elect it is only $170. For many people, if you are putting in $1,000, that is not much. But what we used to describe as the Uncle Sam match can be a really powerful tool for people who may not have an employer match.

Senator BROWN. All right. Thank you.

Ms. Miller, do you want to talk about that?

Ms. MILLER. Yes. I would agree with, number one, simplifying it. If you look at it now, it looks way too confusing. I think just having the 50-percent credit as it was originally intended would make it a lot easier to talk about.

That gets to my second point, which is communicating it. I found in practice that there were an awful lot of people who had no clue that it was out there. They may never know. If they file an EZ form, they may not even claim it. So I think there was a letter in the Collins-Nelson bill directing IRS to make it so that you could claim it on the 1040EZ, which is something about which I think letters have gone out from the committee before. But I understand it is hard to change a form, but many of the people who are eligible for it file the EZ and do not even know it is there.

With regard to depositing it into the account, I think that can be a great idea. I have some concerns in that, for people who are really low-income to the point where they have a hard timing coming up with money to save, being able to tell them, you are getting some of it back, can be helpful because it does not disrupt their cash flow as much.

I kind of liked an approach that was in a bill that Mr. Neal did on the House side, and others, where you got more of a credit if you had it deposited than if you just took it back, so there was more of an incentive than a mandate. Again, if somebody needs the cash, let them make that judgment. I worry that if cash is really a problem, that maybe being able to get cash back is helpful.

Senator BROWN. All right. Thank you.

Mr. Iwry, I know the President's automatic IRA proposal was developed by you and then by some people at the Heritage Foundation, a gentleman named David John, so there has been a broader ideological spectrum than on some issues. Walk us through that. One criticism I hear is that it is a potential burden on small businesses. How do you address that? Give us some information on that, if you would.

Mr. IWRY. I will be happy to, Mr. Chairman. The President has proposed automatic enrollment in IRAs now in each of the budgets that he has put forward since he was elected, and the idea is really

to strengthen the building blocks that we know work in our current system, and there is a heck of a lot about our current system that works well: employer workplace-based saving, payroll deposit as a method of automatically continuing saving once it starts, automatic enrollment as a method of starting saving so that it can continue then automatically. We have seen how dramatically these measures work to increase the fewer than one out of 10 who will contribute to an individual retirement account on their own without the benefit of payroll deduction or automatic enrollment, to raise that one out of 10 to seven, eight, nine out of 10 or more in a workplace payroll-deposit, automatically enrolled environment. Small employers would not be burdened at all by this. The idea would be to simply have an employer that does not already sponsor a plan and that we have not successfully encouraged to sponsor a plan to at least let their workers use their payroll system as a conduit for the worker to save their own wages, whatever portion they would like, in a tax-favored account.

The private-sector employer would not have any outlay, would not make a penny of contribution, would not have out-of-pocket costs. They would be asked simply to add to the payroll withholdings that they now have to do for income tax withholding—Federal and State, for unemployment insurance, for other purposes, including the direct deposit of paychecks that so many workers enjoy today—one other payroll deposit that would go to, instead of the place where the employee sends their paycheck in general, a different routing number, a different account number, an IRA, perhaps at that same institution, perhaps at a different institution. That would mean that the small business simply has to add to its to-do list another payroll withholding opportunity using standard forms that would be downloaded from a national source, a website, not to have fiduciary liability or to make investment decisions or to hold assets for individuals. These are small employers that we would love to persuade to adopt a 401(k) or another retirement plan.

But if, and as long as we cannot do that, the least they could do is take on what is essentially a costless—other than adding another item on the to-do list and a certain amount of attention that the small business owner would have to pay to this, but not much—a virtually costless step to help their employees save easily. The Saver's Credit would apply to these contributions as well.

Senator BROWN. You have a different view of that, I understand.

Mr. UTKUS. I think our view has been that the myRA—so one of the main issues with an automatic IRA program is—I will put it this way. There are 700,000 401(k) plans in the United States. There are 10 million establishments for work.

So one of the big questions has been, what are the administrative costs from helping millions of small employers to establish the service? That is why we are very interested in the myRA experiment, or sandbox, if you will, to see exactly what it would take to serve such a large constituency of small employers and what the administrative costs would be.

Although Mark talked about there being no fees, of course there are costs to the program, and they will be paid in one way or another. The question is what those costs will be at scale, and that

is one of the reasons why we find myRA encouraging. It would be an interesting experiment to understand that better.

Senator BROWN. All right.

Ms. Miller?

Ms. MILLER. Yes. We are strongly supportive of the auto-IRA proposal. As I mentioned in the written testimony, to me an ideal world would be auto-IRA coupled with the Hatch Starter(k), because, if you are dealing with the small employer market, small business owners are so tied up with trying to just make their business work that one of the challenges is getting them to even think about a retirement plan.

So, if you had payroll-deduction savings—I mean, you cannot have payroll deduction without an employer—that is going to be very little effort for that individual, and the proposals have a small credit to help defray any start-up costs. Then they are at least thinking about retirement, they are thinking about having an arrangement for their employees and themselves, because many of them will actually qualify for the Saver's Credit. But we feel very strongly that, in that environment, not everybody is going to be going to myRA. We have a lot of folks who would love to be competing in that market for the auto-IRA accounts.

In many cases, they probably would step into a Starter(k) right off the bat and have a little higher contribution and that kind of thing, having an ERISA arrangement. So, there are a lot of private entities that are very interested in serving the auto-IRA market as well. Like Diane's organization, we are involved in various States in those efforts too.

Senator BROWN. All right. Thank you.

A couple more questions. I read recently an article by Shlomo Benartzi where he talks about the illusion of wealth, that a significant lump sum of money, $100,000 in a savings account or any kind of a retirement account, seems like far more money than it actually is, especially if you have to live on that amount, obviously, for some period of time.

The concern is that workers might think they are saving enough for retirement when in reality they are falling far short, back to Ms. Oakley's 4 or 5 times what your income has been. He suggests that with respect to DC plans, defined contribution plans, that there be an escalating kind of clause in this, that we combine automatic enrollment with automatic escalation that increases savings over time.

My understanding is, Vanguard has done a lot of research on sort of the behavioral issues there. Would you kind of share that with us?

Mr. UTKUS. Yes. In fact, we did the original pilot with Shlomo Benartzi at UCLA and Dick Thaler in Chicago on the auto-escalation feature. Actually, about two-thirds of the employers that we have who have adopted automatic enrollment today combine this auto-escalation feature. It is a really interesting question, and it pertains to this issue of low-income versus middle-income versus higher-income, depending on your workforce.

If tomorrow we auto-enrolled lots of people into 3-percent savings accounts, for the vast majority of Americans that would be inad-

equate. But for low-income workers, that might be just an additional supplement that would be useful on top of Social Security.

So employers, following actually regulations from the IRS, from Treasury, tended to emphasize this 3-percent automatic enrollment rate. Realistically, we now realize that that is way too low. So, many employers are introducing these auto-escalation features, and they are targeting more higher savings rates, more appropriate for someone, say, at the middle income in the category of employees that they employ. So, for some firms, the cap on savings might be 10 percent a year, for others it might be 15 percent a year depending on how affluent their particular workforces are.

Senator BROWN. Mr. Iwry? Each of you, if you would like. Yes?

Mr. IWRY. Mr. Chairman, if I may just add to what Mr. Utkus was saying. The President, several years ago, and the Treasury Department called attention to the power of automatic escalation. Professors Thaler and Benartzi have done great work in that area, and Treasury regulations and rulings have illustrated and effectively promoted the idea that automatic enrollment ought to continue at increasing levels, that it ought to start not just at 3 percent of pay—which is what our original rulings illustrated back in 1998 when we were trying to get automatic features on the map for the first time—but that 5, 6 percent of pay, for example, ought to be a reasonable place for many employers, if they see fit, to start automatic enrollment, then escalate it over time as employees stay with the employer to the point where people get into double digits of saving, in addition to that employer match.

What we are really trying to do is encourage the private sector to build on the success that it has already had in the private pension system, 401(k)s in particular, by taking the automatic enrollment to a whole new level, starting higher, auto-enrolling not just newly hired employees but people who have been with the company who have not been saving in the past, escalating, as Steve Utkus has described, over time, not stopping that escalation at 10 percent, but continuing as high as the employee wants to go with the choice on the part of the employee at all times to hop off the escalator, to level out at whatever level they are willing to do.

Also, we need to encourage employers to keep their skin in this game, to make robust matching contributions, to make even nonmatching contributions to retirement security, so that we are not only looking at the individual to use increasing salary reduction, but we are keeping that incentive there in the form of an employer match.

Senator BROWN. Thank you.

Ms. Oakley?

Ms. OAKLEY. Senator, I just want to add to that. I think Mark's comment about the employers keeping skin in the game is important. When you look at some of these projections, the assumption is the employer will make a 3-percent matching contribution and stop, and then the worker, to get to an adequate retirement income, might then have to be contributing up to 12 percent of their pay for every year throughout their career if they are going to try to get an 85-percent target replacement.

I have also seen a recent paper published by Jeff Brown at the University of Illinois, and he was making a suggestion that I would

find troubling if it was something that people were going to do, especially for the low-income individuals. Mark's comment about making sure that people are at least going in so they get the full employer match in the auto-enrollment, I think is important to many people: go in at 3 percent, if their employer matches 50 percent, they get 1.5 percent.

But, if they do not contribute at that 3-percent rate, then they are leaving that other 1.5 percent on the table, and we want to make sure they get the full employer benefit. One of the things that some people have been suggesting is this idea of stretching out the employer match and, instead of matching 50 percent up to 6 percent of pay, match 25 percent up to 12 percent of pay.

The one thing I would caution about something like that is, it would have a particular impact on the low-income individuals who are going to be the most likely to contribute. And I think some of the Vanguard studies show that your lower-income people have a much lower contribution into these types of plans, even when there is automatic enrollment. So to make sure that they still get a vibrant contribution, I think that is going to be an important concern to think about.

Senator BROWN. All right. Thank you.

The last point I want to make is not really a question, but for Mr. Iwry is that, I know you are thinking about this, and I want to hear more about it later, that is, the rules governing myRAs to ensure that managers, once they reach the $15,000 threshold, charge the bare minimum in fees. So I just want to implore you to work on that too.

Thank you all. A special thanks to Senator Toomey, the ranking member of this subcommittee, who could not be here but represents your State, Mr. Utkus, for his cooperation on this issue and this hearing. Also, thanks to Chairman Wyden and Ranking Member Hatch for their support of this discussion. There may be some written questions to you from members of the Finance Committee, and please follow up with those within 7 days, if you can. Thanks for the insight you all showed. This was a really good discussion, and I think we all learned from each other, and I particularly learned a lot from the four of you.

The subcommittee is adjourned. Thanks.

[Whereupon, at 11:55 a.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Written Testimony of J. Mark Iwry
Senior Advisor to the Secretary
and Deputy Assistant Secretary for Retirement and Health Policy
United States Department of the Treasury
Before the Senate Finance Committee
Subcommittee on Social Security, Pensions and Family Policy

February 26, 2014

Chairman Brown, Ranking Member Toomey, and distinguished members of the subcommittee, thank you for the opportunity to appear before you today to discuss retirement savings for low-income Americans. We appreciate this subcommittee's interest in this topic, and applaud your highlighting retirement security issues at your recent hearing on December 18, 2013, titled "Social Security & the Retirement Crisis."

Background

At that hearing, Mr. Chairman, you noted that "retirement security in America has traditionally been thought of as a three-legged stool, consisting of Social Security, employer-provided pensions, and personal savings and investment," enabling Americans to maintain the standard of living they enjoyed while they were working, and "to buy homes, start families, and pay for education." However, as you also observed, "for far too many Americans, Social Security is the only leg left standing," as only about half of the U.S. workforce is covered by an employer-sponsored retirement plan.

The Administration and the Department of the Treasury remain committed to working with Congress to help secure a dignified retirement for all Americans. First and foremost, Social Security is and must remain a rock-solid, guaranteed, progressive benefit on which every American can rely. To supplement Social Security, the most secure retirement traditionally has included employer-sponsored retirement plans and individual savings. Yet too many Americans are not on a path to be sufficiently prepared for retirement. Tens of millions of American workers lack access to employer-sponsored pensions or retirement savings plans. This puts the onus on these individuals to set up and save for retirement in IRAs (individual retirement accounts and individual retirement annuities) on their own. However, fewer than one out of ten workers eligible to contribute to an IRA do so. By contrast, roughly seven or eight out of ten workers who are eligible to participate in an employer plan choose to do so (and up to nine out of ten of those who are automatically enrolled in a 401(k) plan participate).

The risk of an insecure retirement is especially acute for women, minorities, and lower-income Americans. Women continue to be less prepared for retirement than men. White households have six times the wealth, including retirement savings, of African American or Hispanic households. And low-wage and part-time workers are only one third as likely as high-wage and full-time workers to participate in an employer-based retirement plan.

A number of factors are at work here. In addition to lack of access to employer-sponsored plans, those who are not currently saving may encounter minimum balance requirements and

administrative- or investment-related expenses that make it difficult to sustain very small accounts. Also, many potential new savers may be hampered by concerns about investment risk and volatility, the challenge of making decisions regarding investment options and other financial choices, and the need to take initiative to establish an account.

The *my*RA Retirement Savings Initiative[1]

In his State of the Union address on January 28, 2014, the President announced "a new way for working Americans to start their own retirement savings . . . a new savings bond that encourages folks to build a nest egg." This Treasury security, to be held in a Roth IRA, will be designed to help fill a niche in retirement saving by providing a vehicle for deposits, largely by new savers, that may be too small to be of interest to most commercial financial institutions that offer IRAs. This vehicle, called "*my*RA" (My Retirement Account), is targeted especially to moderate- and lower-income workers, potential first-time savers who are not eligible to participate in employer-sponsored plans and are looking for a simple, safe, and affordable way to start saving. At the same time, the President emphasized his continuing support for legislation to provide for automatic enrollment in workplace IRAs ("auto-IRAs") for employees of firms that do not sponsor any retirement plan – a proposal he has included in every Administration budget since he took office.

Under the *my*RA program, workers looking to start saving will be able to purchase a specially-designed Treasury retirement savings bond held in a Roth IRA. The bond will have an add-on feature, meaning that additional contributions will increase the value of a single security, instead of requiring the purchase of multiple securities. The Roth IRA that holds the retirement savings bond will be subject to the same tax treatment and other rules applicable to all Roth IRAs. Accordingly, the *my*RA saving opportunity will be available to households who are eligible to contribute to Roth IRAs – those earning up to $191,000 a year (married filing jointly; up to $129,000 for individuals) – and 2014 annual contribution limits of $5,500 ($6,500 if age 50 or older). All of these dollar amounts are adjusted for cost-of-living changes.

Other key features of the *my*RA program, which Treasury intends to begin phasing in by the end of 2014, include the following:

- Starter Vehicle – Making It Easier to Begin Saving for Retirement. As noted, this new product will be targeted to those who lack access to a workplace retirement savings plan (usually the most effective way to save for retirement). Starting to save is only the first step toward a secure retirement, and Treasury and the Administration want to help more Americans save for their future. Initial investments could be as low as $25, and contributions that are as low as $5 could be made through payroll deduction. As starter accounts, *my*RAs will be limited to a cumulative $15,000 each – not a target for saving but rather a transition point at which the individual's savings would shift to a private-

[1] Significant portions of this written statement incorporate language from statements and other informational documents previously issued by the Department of the Treasury or the Administration, including General Explanations of the Administration's revenue proposals that accompany the Administration's annual budgets.

sector Roth IRA. If a saver's myRA never accumulates to $15,000, it will be shifted to a private sector Roth IRA after 30 years.

- Incubator of Small Accounts. While obviously not nearly enough to fund a secure retirement, $15,000 may be enough to "prime the pump" and instill a lifelong habit of continued saving, and should be enough to make a saver's account viable in the private sector. In other words, *my*RA accounts could serve as incubators for accumulations of savings small enough that their administrative costs could exceed their earnings. After successful savers "graduate" to private-sector Roth IRAs, they will be able to continue saving and accumulating balances greater than $15,000 that could be invested in diversified investment portfolios with greater growth potential.

- Available Through Payroll Deduction at the Workplace. During an initial phase, *my*RAs will be offered, only by payroll deduction, to employees of employers that choose to participate. Employees will sign up for *my*RA accounts online and will not be charged administrative or investment fees. The accounts will be easy for employers to offer, as employers will neither administer the accounts nor contribute to them. As is currently the case for Roth IRAs generally, the account owner – not the employer – is responsible for complying with limits on Roth IRA eligibility based on compensation as well as annual IRA contribution limits. As noted, *my*RA is intended to help working Americans who lack access to an employer-sponsored retirement plan. Employees who are eligible for employer-sponsored plans will continue to have many good reasons to participate in those plans rather than in *my*RAs. As a result, *my*RAs will complement, not compete with, employer-sponsored plans. Additional contribution channels, such as direct participation by the self-employed, will be explored over time, and could be added as feasible.

  There is reason to expect that linking saving to an employment-based payroll deduction system could be an important step in boosting participation. For example, millions of employees bought U.S. savings bonds annually through Treasury's former payroll deposit savings bond program, which for decades allowed employees to buy savings bonds through workplace-based payroll deduction.

- Safe and Secure. As noted, the retirement savings security will be held in a familiar Roth IRA account and will constitute the only investment in the IRA. Savers will benefit from principal protection, because the value of the bond, and therefore the IRA account balance, will never decline. In addition, the security, like other U.S. savings bonds issued under 31 U.S.C. 3105, will be backed by the full faith and credit of the United States.

  Savers will earn interest at the same variable interest rate as the federal employees' Thrift Savings Plan Government Securities Investment Fund (G Fund). The G Fund interest rate calculation is based on the weighted average yield of all outstanding Treasury notes and bonds with four or more years to maturity. Over the last ten years, the G Fund has earned annual compounded interest ranging from 1.47 percent to 4.93 percent (3.39 percent compounded over those ten years).

- Roth IRA Tax Benefits. Because the IRA holding the bond will be a Roth IRA, the contributions an individual makes can be withdrawn tax free at any time. In addition, earnings that are withdrawn will be free from tax or early withdrawal penalty if they are withdrawn after age 59½ (or on account of death, disability, or to pay certain home purchase expenses) following a five-year holding period in the Roth IRA.

- Portable Account with Voluntary Contributions. Savers will have the option of keeping the same account when they change jobs and can directly transfer or roll over the balance into a private-sector Roth IRA at any time. In addition, savers working for more than one participating employer at the same time will be able to contribute to the same account by payroll deduction from each employer.

- Eligible for Saver's Credit. Savers with income below certain levels – currently $60,000 for couples and $30,000 for individuals – will be eligible to claim a saver's tax credit for their *my*RA contributions because the saver's credit applies to contributions to IRAs. The saver's credit, which ranges in amount from 10 percent to 50 percent of a saver's first $2,000 of contributions each year, provides an added incentive for lower- and moderate-income individuals to save through *my*RAs. (This incentive could be strengthened by making the saver's credit fully refundable and raising the eligibility income threshold to cover millions of additional moderate-income taxpayers, as well as by raising the credit rate to a uniform 50 percent and simplifying the current three-tier credit structure.)

- Promoting Financial Capability. The *my*RA initiative can complement financial education and counseling to help workers plan and save for their futures. As Treasury develops and implements *my*RAs, we will look for opportunities to use them to promote financial education and capability.

Continued Commitment to Automatic IRA Proposal

The Administration remains committed to its proposal for automatic IRAs and encourages Congress to enact it. (A description of that proposal from the Department of the Treasury's April 2013 General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals is attached as an appendix to this written statement.) Until Congress acts, we believe that meaningful steps can be taken administratively and by plan sponsors to give workers better access to easy and convenient retirement saving opportunities. The *my*RA initiative is such a step.[2]

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[2] Proposed automatic IRA legislation provides for a Treasury retirement bond to serve as a kind of fallback destination to which employers could, if they wished, send employee salary reduction contributions (For example, some employers might prefer a retirement bond to avoid choosing among private sector IRA providers.) Treasury's experience in developing a new retirement savings bond under the *my*RA program will be useful in developing and implementing this kind of option under automatic IRA legislation. See Automatic IRA Act of 2013, H.R. 2035 (sponsored by Rep. Richard Neal (D-MA)).

Conclusion

The Administration and the Department of the Treasury are committed to expanding and enhancing retirement security and retirement saving, particularly for lower- and moderate-income American workers. To that end, much remains to be done, including, among other things, promoting more lifetime income in both defined benefit and defined contribution plans, facilitating portability and consolidation of retirement savings, encouraging employers to employ behavioral strategies to make 401(k) plans more automatic and effective, and extending coverage to the tens of millions of workers not currently in the system. We believe that the *my*RA initiative is one meaningful step in that direction. It is designed to help more lower- and moderate-income households save for retirement, providing a simple, safe, and affordable way to begin a lifelong habit of saving.[3] In addition, we continue to encourage Congress to enact an automatic payroll deduction IRA program that will open a route to even more significant improvement in retirement security for American workers, helping to promote a culture of saving and a nation of savers.

We welcome the opportunity to work with the Committee to achieve these important objectives. Thank you, and I look forward to answering your questions.

[3] Individuals and employers are invited to visit www.treasurydirect.gov/readysavegrow or call (800) 553-2663 for more information about *my*RAs.

PROVIDE FOR AUTOMATIC ENROLLMENT IN INDIVIDUAL RETIREMENT ACCOUNTS OR ANNUITIES (IRAS), INCLUDING A SMALL EMPLOYER TAX CREDIT, AND DOUBLE THE TAX CREDIT FOR SMALL EMPLOYER PLAN START-UP COSTS

Current Law

A number of tax-preferred, employer-sponsored retirement savings programs exist under current law. These include section 401(k) cash or deferred arrangements, section 403(b) programs for public schools and charitable organizations, section 457 plans for governments and nonprofit organizations, and simplified employee pensions (SEPs) and SIMPLE plans for small employers.

Small employers (those with no more than 100 employees) that adopt a new qualified retirement, SEP or SIMPLE plan are entitled to a temporary business tax credit equal to 50 percent of the employer's plan "start-up costs," which are the expenses of establishing or administering the plan, including expenses of retirement-related employee education with respect to the plan. The credit is limited to a maximum of $500 per year for three years.

Individuals who do not have access to an employer-sponsored retirement savings arrangement may be eligible to make smaller tax-favored contributions to IRAs.

In 2013, IRA contributions are limited to $5,500 a year (plus $1,000 for those age 50 or older). Section 401(k) plans permit contributions (employee plus employer contributions) of up to $51,000 a year (of which $17,500 can be pre-tax employee contributions) plus $5,500 of additional pre-tax employee contributions for those age 50 or older.

Reasons for Change

For many years, until the economic downturn in 2008, the personal saving rate in the United States has been exceedingly low. Tens of millions of U.S. households have not placed themselves on a path to become financially prepared for retirement. In addition, the proportion of U.S. workers participating in employer-sponsored plans has remained stagnant for decades at no more than about half the total work force, notwithstanding repeated private- and public-sector efforts to expand coverage. Among employees eligible to participate in an employer-sponsored retirement savings plan such as a 401(k) plan, participation rates typically have ranged from two-thirds to three-quarters of eligible employees, but making saving easier by making it automatic has been shown to be remarkably effective at boosting participation well above these levels.

Beginning in 1998, Treasury and the Internal Revenue Service (IRS) issued a series of rulings and other guidance defining, permitting, and encouraging automatic enrollment in 401(k) and other plans (i.e., enrolling employees by default unless they opt out). Automatic enrollment was further facilitated by the Pension Protection Act of 2006. In 401(k) plans, automatic enrollment has tended to increase participation rates to more than nine out of ten eligible employees. In contrast, for workers who lack access to a retirement plan at their workplace and are eligible to engage in tax-favored retirement saving by taking the initiative and making the decisions

required to establish and contribute to an IRA, the IRA participation rate tends to be less than one out of ten.

Numerous employers, especially those with smaller or lower-wage work forces, have been reluctant to adopt a retirement plan for their employees, in part out of concern about their ability to afford the cost of making employer contributions or the per-capita cost of complying with tax-qualification and ERISA (Employee Retirement Income Security Act) requirements. These employers could help their employees save -- without employer contributions or plan qualification or ERISA compliance -- simply by making their payroll systems available as a conduit for regularly transmitting employee contributions to an employee's IRA. Such "payroll deduction IRAs" could build on the success of workplace-based payroll-deduction saving by using the capacity to promote saving that is inherent in employer payroll systems, and the effort to help employees save would be especially effective if automatic enrollment were used. However, despite efforts more than a decade ago by the Department of the Treasury, the IRS, and the Department of Labor to approve and promote the option of payroll deduction IRAs, few employers have adopted them or even are aware that this option exists.

Accordingly, requiring employers that do not sponsor any retirement plan (and meet other criteria such as being above a certain size) to make their payroll systems available to employees and automatically enroll them in IRAs could achieve a major breakthrough in retirement savings coverage. In addition, requiring automatic IRAs may lead many employers to take the next step and adopt an employer plan, thereby permitting much greater tax-favored employee contributions than an IRA, plus the option of employer contributions. The potential for the use of automatic IRAs to lead to the adoption of 401(k)s, SIMPLEs, and other employer plans would be enhanced by raising the existing small employer tax credit for the start-up costs of adopting a new retirement plan to an amount significantly higher than both its current level and the level of the proposed new automatic IRA tax credit for employers.

In addition, the process of saving and choosing investments in automatic IRAs could be simplified for employees, and costs minimized, through a standard default investment as well as electronic information and fund transfers. Workplace retirement savings arrangements made accessible to most workers also could be used as a platform to provide and promote retirement distributions over the worker's lifetime.

Proposal

The proposal would require employers in business for at least two years that have more than ten employees to offer an automatic IRA option to employees, under which regular contributions would be made to an IRA on a payroll-deduction basis. If the employer sponsored a qualified retirement plan, SEP, or SIMPLE for its employees, it would not be required to provide an automatic IRA option for its employees. Thus, for example, a qualified plan sponsor would not have to offer automatic IRAs to employees it excludes from qualified plan eligibility because they are covered by a collective bargaining agreement, are under age eighteen, are nonresident aliens, or have not completed the plan's eligibility waiting period. However, if the qualified plan excluded from eligibility a portion of the employer's work force or a class of employees such as

all employees of a subsidiary or division, the employer would be required to offer the automatic IRA option to those excluded employees.

The employer offering automatic IRAs would give employees a standard notice and election form informing them of the automatic IRA option and allowing them to elect to participate or opt out. Any employee who did not provide a written participation election would be enrolled at a default rate of three percent of the employee's compensation in an IRA. Employees could opt out or opt for a lower or higher contribution rate up to the IRA dollar limits. Employees could choose either a traditional IRA or a Roth IRA, with Roth being the default. For most employees, the payroll deductions would be made by direct deposit similar to the direct deposit of employees' paychecks to their accounts at financial institutions.

Payroll-deduction contributions from all participating employees could be transferred, at the employer's option, to a single private-sector IRA trustee or custodian designated by the employer. Alternatively, the employer, if it preferred, could allow each participating employee to designate the IRA provider for that employee's contributions or could designate that all contributions would be forwarded to a savings vehicle specified by statute or regulation.

Employers making payroll deduction IRAs available would not have to choose or arrange default investments. Instead, a low-cost, standard type of default investment and a handful of standard, low-cost investment alternatives would be prescribed by statute or regulation. In addition, this approach would involve no employer contributions, no employer compliance with qualified plan requirements, and no employer liability or responsibility for determining employee eligibility to make tax-favored IRA contributions or for opening IRAs for employees. A national web site would provide information and basic educational material regarding saving and investing for retirement, including IRA eligibility, but, as under current law, individuals (not employers) would bear ultimate responsibility for determining their IRA eligibility.

Contributions by employees to automatic IRAs would qualify for the saver's credit to the extent the contributor and the contributions otherwise qualified.

Small employers (those that have no more than 100 employees) that offer an automatic IRA arrangement could claim a temporary non-refundable tax credit for the employer's expenses associated with the arrangement up to $500 for the first year and $250 for the second year. Furthermore, these employers would be entitled to an additional non-refundable credit of $25 per enrolled employee up to $250 for six years. The credit would be available both to employers required to offer automatic IRAs and employers not required to do so (for example, because they have ten or fewer employees).

In conjunction with the automatic IRA proposal, to encourage employers not currently sponsoring a qualified retirement plan, SEP, or SIMPLE to do so, the non-refundable "start-up costs" tax credit for a small employer that adopts a new qualified retirement, SEP, or SIMPLE would be doubled from the current maximum of $500 per year for three years to a maximum of $1,000 per year for three years and extended to four years (rather than three) for any employer that adopts a new qualified retirement plan, SEP, or SIMPLE during the three years beginning when it first offers (or first is required to offer) an automatic IRA arrangement. This expanded

"start-up costs" credit for small employers, like the current "start-up costs" credit, would not apply to automatic or other payroll deduction IRAs. The expanded credit would encourage small employers that would otherwise adopt an automatic IRA to adopt a new 401(k), SIMPLE, or other employer plan instead, while also encouraging other small employers to adopt a new employer plan.

The proposal would become effective after December 31, 2014.

Senate Committee on Finance
Subcommittee on Social Security, Pensions, and Family Policy
Hearing on Retirement Savings for Low-Income Workers
February 26, 2014
QUESTIONS FOR THE RECORD FOR J. MARK IWRY

Senator Ben Cardin

I applaud Treasury's effort to promote long-term retirement savings, especially for low-income workers. The "qualified longevity annuity contract" or "QLAC" is one example of how people with modest means can protect against outliving their lifetime savings by purchasing a QLAC with a portion of their retirement savings.

Question 1:

Can you tell me when you plan on promulgating final regulations?

Answer:
Treasury and the IRS are actively working on a final regulation package with respect to QLACs. Although we are not in a position to predict the date of release, we are hoping to complete work and release the final rules soon.

Question 2:

Are you considering certain provisions or annuity designs that will offer more flexibility and increase consumer interest in QLACs, such as the ability to provide a refund of premium option, or additional, valuable investment options that guarantee lifetime income, such as including fixed-indexed annuities as eligible investments?

Answer:
Treasury and the IRS received extensive comments in response to our proposed regulations with respect to QLACs. Suggestions to provide additional flexibility by permitting refund of premium and fixed-indexed annuity features were among a variety of questions, issues, and requests that stakeholders have raised in their comments. Treasury and the IRS are carefully reviewing each of these comments.

Senator Bill Nelson

In general, for low-income Americans, financial services can be expensive and difficult to access, and there are few good options for those seeking safe and affordable wealth-building products. One product offered by the Treasury Department, tax-time savings bonds, has been particularly effective at helping low-income workers and new savers build assets. Because tax-time savings bonds are available on the federal tax form and at a time when many low-income workers and often receive a lump sum of money, they have had demonstrated appeal and reach. Since 2009, when savings bonds were first offered on the tax form, more than 100,000 taxpayers, most of whom are low- and moderate-income workers, have saved more than $60 million for themselves and their families. Many of these individuals and families are new to saving, and tax-time savings bonds are an invaluable "first step" savings product that helps people start on the road to long-term financial security, including retirement security.

Question 1:

We understand that Treasury is offering savings bonds on the tax form through 2015. Can you provide specific plans for the tax-time savings bonds program for 2016 and beyond? What are the plans for the program if paper savings bonds will not be offered as an option?

Answer:
Treasury and the IRS understand that certain individuals who purchase savings bonds through tax-time savings may prefer to purchase the bonds in paper form. We also recognize that there are significant cost savings in providing savings bonds electronically. We are taking into account all of these considerations in making plans for the tax-time savings bond program after 2015. No decisions have yet been made.

Question 2:

Has Treasury considered upgrades to Treasury Direct to make both tax-time savings bonds and savings bonds in general more accessible?

Answer:
Treasury recognizes that Americans will be more inclined to save by purchasing savings bonds (including through the tax-time savings bond program) if the mechanism for saving is easy and transparent. We recognize that TreasuryDirect's underlying technology is aging and does not provide the best possible experience for potential savers. To that end, Treasury plans to undertake a new initiative to replace TreasuryDirect with a new, more intuitive user interface for savers to buy retail products from the Treasury.

Question 3:

Has Treasury considered electronic options for tax-time savings bonds? Is there a plan to integrate electronic savings bonds onto the tax form that would allow people without an existing Treasury Direct account to save?

Answer:
As computers, cell phones, and other electronic media become more and more prevalent among potential savers, opening up new electronic ways to save may help more Americans enhance their financial security. Currently, savers have an option to purchase savings bonds directly with tax refunds by buying electronic savings bonds through a TreasuryDirect account and an option to buy paper savings bonds with tax refunds without a TreasuryDirect account. Treasury is evaluating other options to buy electronic savings bonds with tax refunds.

Question 4:

Has Treasury considered making myRA, the new savings bond-based retirement vehicle, available on the tax form?

Answer:
Initially, savers will contribute to *my*RA accounts with direct deposit contributions from their paychecks. Treasury recognizes, however, that opening additional channels for contributions to *my*RA accounts, including through tax-time contributions, could potentially broaden participation in the *my*RA program and increase starter savings through *my*RA accounts. Treasury will consider additional funding options in the future.

Testimony Submitted by Judy A. Miller
on behalf of the
American Society of Pension Professionals and Actuaries

Subcommittee on Social Security, Pensions, and Family Policy of the Senate Finance Committee Hearing

Retirement Savings for Low-Income Workers

February 26, 2014

Thank you Chairman Brown, Ranking Member Toomey and members of the Subcommittee for the opportunity to speak with you about retirement savings for low income workers. I am Judy Miller, Director of Retirement Policy for the American Society of Pension Professionals and Actuaries ("ASPPA"). Before working for ASPPA, I had the honor of serving as Senior Benefits Advisor on the Committee staff from mid-2003 through November of 2007.

ASPPA is a national organization of more than 16,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines including consultants, administrators, actuaries, accountants, attorneys and investment advisors. ASPPA is particularly focused on the issues faced by small- to medium-sized employers. ASPPA's membership is diverse but united by a common dedication to the employer-based retirement plan system.

The single most important factor in determining whether or not workers across the income spectrum save for retirement is whether or not there is a workplace retirement plan. If increasing retirement and financial security is the goal, increasing the availability of workplace savings is the way to get there. Over 60 million working Americans already participate in a workplace retirement plan. Workplace savings opportunities should be expanded to tens of millions more, many of whom are low income, while preserving and enhancing the current structure of tax incentives that have motivated employers to voluntarily sponsor retirement plans, and both employers and employees to contribute to these plans.

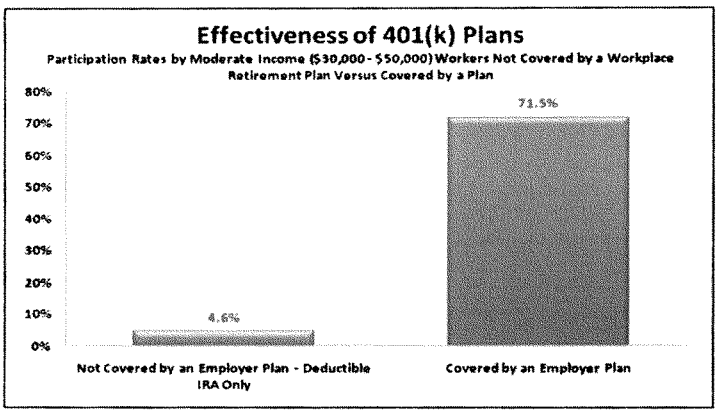
Background

The past 20 years has seen a gradual shift in employer-sponsored arrangements from defined benefit plans to defined contribution plans. The number of participants (active, retired and deferred vested) reported as covered by defined benefit plans has been fairly stable - about 40 million in 1986, and 42 million in 2007, but an increasing proportion of those are retired participants. Over the same period, the reported number of participants in defined contribution plans increased from 37 million to 80 million.[1] In 2012, over 61 million *active* workers participated in employer-sponsored retirement plans.[2]

Data shows that 401(k) and similar plans (such as 403(b) and 457(b) arrangements) have been very successful in getting workers to save for retirement. Contrary to the common assertion that only half of working Americans are covered by a retirement plan, a recent study from the Social Security Administration ("SSA") shows that about 70 percent of private sector workers have access to a retirement plan at work, and 80 percent of eligible workers with access to a plan participate in that plan.[3]

The success of saving through an employer-sponsored plan extends to low to moderate income workers. The chart below, based on data prepared by the Employee Benefit Research Institute (EBRI) updated to 2010, shows that over 70% of workers earning from $30,000 to $50,000 participated in employer-sponsored plans when a plan was available, whereas less than 5% of those without an employer plan contributed to an IRA.

Figure 1



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[1] *EBRI Databook on Employee Benefits: Chapter 10: Aggregate Trends in Defined Benefit and Defined Contribution Retirement Plan Sponsorship, Participation, and Vesting*, Employee Benefit Research Institute, available at http://www.ebri.org/pdf/publications/books/databook/DB.Chapter%2010.pdf

2 *Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2012*, Employee Benefit Research Institute, available at http://www.ebri.org/pdf/briefspdf/EBRI_IB_011-13.No392.Particip.pdf

[3] Irena Dushi, Howard M. Iams, and Jules Lichtenstein, *Assessment of Retirement Plan Coverage by Firm Size, Using W-2 Records*, Social Security Bulletin (2011), available at http://www.ssa.gov/policy/docs/ssb/v71n2/v71n2p53.pdf

Source: Employee Benefit Research Institute (EBRI) (2010) estimate using 2008 Panel of SIPP (Covered by an Employer Plan) and EBRI estimate (Not Covered by an Employer Plan-IRA only)

Sixty-eight percent of U.S. households now have an IRA or an employer-sponsored retirement plan. At the end of 2012, private employer-sponsored defined contribution plans held about $5.1 trillion in assets, private employer-sponsored defined benefit plans held $2.6 trillion and state and local retirement plans held $3.2 trillion. There was another $5.4 trillion held in IRA accounts. Although IRAs include contributions made by individuals to the IRA on their own behalf, a substantial portion of IRA assets are attributable to rollovers from employer-sponsored plans and direct employer contributions. Of the 49 million households that own IRAs, 51% report that their IRA accounts include a rollover from another retirement plan, and over 9 million of the IRAs are employer-sponsored retirement savings arrangements such as SEPs and SIMPLE IRA plans.[4]

Current Tax Incentives

In ERISA, Congress decided to direct tax incentives for employer-sponsored plans toward coverage of substantially full-time employees. Nearly 80% of full time civilian workers now have access to workplace savings, so the incentives have been effective in providing coverage for the targeted group. The incentives are also very efficient at providing coverage to all income groups. This efficiency is derived in large part from two features that set the retirement savings incentives apart from other individual tax incentives:

- The retirement savings incentive is income *deferral*, not a permanent exclusion. Every dollar that is excluded from income this year will be included in income in a future year. Unfortunately, that is not reflected in the cash basis measurement of the retirement savings "tax expenditure". In fact, the current methodology overstates the true cost by over 50%.[5]
- Nondiscrimination rules for employer-sponsored plans assure the plans do not discriminated in favor of highly compensated employees, and limit the amount of compensation that can be included in determining benefits and testing for nondiscrimination. As a result, this tax incentive is *more progressive* than the current progressive tax code.

What are the incentives?

Employer contributions made to qualified retirement plans are deductible to the employer when made. Income tax on investment earnings on those contributions is deferred until amounts are distributed from the plan. When a distribution is made to a plan participant, all amounts are subject to ordinary income tax. Employer contributions made on a participant's behalf are not subject to FICA. In addition, individuals with adjusted gross income ("AGI") of less than $27,750, and married couples with AGI of less than $55,500, may qualify for a Saver's Credit

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[4] *2013 Investment Company Fact Book: A Review of Trends and Activities in the U.S. Investment Company Industry*, Investment Company Institute, available at http://www.ici.org/pdf/2013_factbook.pdf.

[5] Judy Xanthopoulos and Mary Schmidt, *Retirement Savings and Tax Expenditure Estimates* (April 2012), available at http://www.asppa.org/Main-Menu/govtaffairs/RET2012.aspx

ranging from 10% to 50% of the first $2,000 the individual contributes to an IRA or employer-sponsored defined contribution plan.

Limits are placed on contributions to defined contribution plans, and on benefits payable from defined benefit plans:

- Certain defined contribution plans permit employees to contribute on their own behalf by electing to have a certain dollar amount or percentage of compensation withheld from pay and deposited to the plan. These "elective deferrals" are excludable from income for income tax purposes, but FICA is paid on the amounts by both the employer and the employee. For 2014, the maximum elective deferral to a 401(k) or similar plan is $17,500. Employees age 50 or over can also make a "catch-up contribution" of up to $5,500. Elective deferrals to a SIMPLE plan are limited to $11,500, plus a $2,500 catch-up contribution for those age 50 or over.
- If the employer also contributes to a defined contribution plan (such as a 401(k) plan), the maximum contribution for any employee is $52,000. This limit includes any elective deferrals other than catch-up contributions. This means a participant that is age 50 or over, and who makes the full $5,500 catch-up contribution, would have a total limit of $57,500.
- The maximum annual benefit payable from a defined benefit plan cannot exceed the lesser of the average of three year's pay or $210,000. If retirement is before age 62, the dollar limit is reduced. Employers can deduct the amount required to fund promised benefits.
- Annual IRA contributions are limited to $5,500, plus "catch-up" contributions of $1,000 for those age 50 or over.

Compensation in excess of $260,000 cannot be considered in calculating contributions or in applying nondiscrimination rules under either defined benefit or defined contribution plans. For example, if a business owner makes $400,000, and the plan provides a dollar for dollar match on the first 3% of pay the participant elects to contribute to the plan, the match for the owner is 3% of $260,000, not 3% of $400,000.

The higher contribution limits for qualified retirement plans – both defined contribution and defined benefit plans – come with coverage and non-discrimination requirements. For example, a small business owner with several employees cannot simply put in a defined contribution plan and only contribute $50,000 to his or her account. Other employees who have attained age 21 and completed 1 year of service with at least 1000 hours of work must be taken into consideration, and the employer must be able to demonstrate that benefits provided under the plan do not discriminate in favor of "Highly Compensated Employees" ("HCEs"), which would include the owner.

Safe harbors are available. For example, if all employees covered by a 401(k) plan are provided with a contribution of 3% of pay that is fully vested, the HCE can make the maximum elective deferral, regardless of how much other employees choose to contribute on their own behalf.

Age can also be considered when determining the amount of contributions that can be made on a participant's behalf. A larger contribution (as a percentage of pay) can be made for

older employees because the contribution will have less time to earn investment income before the worker reaches retirement age (usually age 65).

How do retirement savings tax incentives differ from other incentives?

Unlike many tax incentives, the income tax incentives for retirement savings are not permanent deductions or exclusions from income. Taxes are *deferred* as long as the savings remains in the plan, but tax must be paid in later years when distributions are made from the plan. Furthermore, the distributions are subject to tax at *ordinary income* tax rates, even though lower capital gains and dividends rates may have applied if the investments had been made outside of the plan.

The tax incentives for qualified employer-sponsored retirement plans also come with stringent non-discrimination rules. These rules, coupled with the limit on compensation that can be considered under these arrangements, are designed to insure that qualified employer-sponsored retirement plans do not discriminate in favor of HCEs. Non-discrimination rules do not apply to other forms of tax-favored retirement savings. For example:

- IRAs share the incentive of tax deferral. However, if a small business owner makes a personal contribution to an IRA, there is no corresponding obligation to contribute to other employees' IRAs. However, under the current rules, the contribution limit for IRAs is set low enough (and the limit for employer-sponsored plans high enough) to make a qualified retirement plan attractive to a business owner who can afford it.
- Annuities purchased outside of a qualified plan share the benefit of "inside buildup" - the deferral of income tax on investment earnings until distributed from the arrangement – but have *no limit on contributions or benefits, and no non-discrimination requirements.*
- Distributions from qualified retirement plans are subject to ordinary income tax, so investment income earned during the accumulation phase is taxed at a higher rate that if it had been invested outside the qualified plan and taxed at the lower rate for capital gains and dividends.

Because of the available alternatives, the attraction of a qualified retirement plan for a small business owner is heavily dependent on the interaction of non-discrimination rules and the contribution limits for a qualified retirement plan.

How does tax deferral work to incent coverage?

The tax incentive for a small employer to sponsor a qualified retirement plan is a critical component to the establishment of a 401(k), defined benefit or other qualified retirement plan. The tax savings for the company's owner (or owners) can generate all or part of the cash flow needed to pay required contributions for other employees, which substantially reduces the cost of the plan to the owner (and transfers much of the apparent tax benefit to covered employees). Consider the following situation:

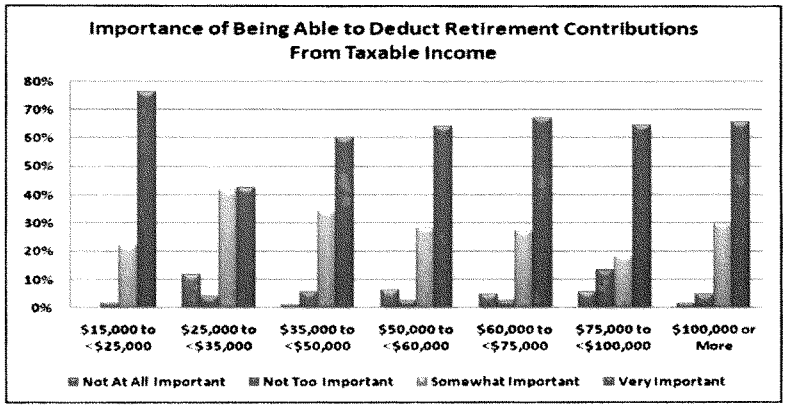
ABC Company has been in operation for 5 years. The owner has some retirement savings in an IRA, but has never taken time to think about retirement. The business has other employees earning from $35,000 to $70,000. The owner takes compensation of $10,000 per month during the year, then takes a year-end bonus of the amount of company profits. The owner pays individual income taxes on the full amount of the profits at a marginal rate of 28%.

The owner meets with a retirement plan consultant. The owner is older than most of the other workers, so the consultant recommends a safe harbor 401(k) plan with an additional "cross-tested" contribution. Thanks to the nondiscrimination rules that apply to qualified retirement plans, putting $50,000 of the profits into the 401(k) plan for the owner means the owner must contribute at least 5% of pay for the employees. However, tax savings on the $50,000 will substantially cover that 5% contribution, and the tax credit for the cost of setting up and operating a new plan helps defray any startup and initial operating costs. Setting up the plan becomes a simple question of "Do you want to give that money to your employees? Or add it to the check you are sending to IRS?"

The current tax incentives transform what would have been a bonus to the business owner, subject to income taxes, into a retirement savings contribution for the owner *and the employees.* Not only will the employees receive an employer contribution of 5% of pay, most will also make additional contributions on their own behalf. This incentive for the business owner to contribute for other employees results in a distribution of tax benefit that is *more progressive* than the current income tax structure. Just how progressive is illustrated in Figure 3 (on page 8), showing the share of this tax benefit going to households earning under $50,000 is more than *three times* the share of income taxes paid by these households. (And that is just the tax benefit, not the full amount of employer contributions received that would otherwise have never been made on the employees' behalf.)

The tax incentives are also used to encourage employees to join 401(k) plans and similar plans. Educational materials encouraging participants to enroll in, and contribute to, plans typically show the worker how tax savings will help them save more than they could through another savings arrangement. For example, materials will show how contributing $100 to your 401(k) account will only cost $85 (or $72 for higher income workers). As shown in the chart below, over 80% of workers in all income categories find this incentive somewhat or very important.

Figure 2



Source: Jack VanDerhei, *The Impact of Modifying the Exclusion of Employee Contributions for Retirement Savings Plans From Taxable Income: Results From the 2011 Retirement Confidence Survey*, ebri.org Notes (Mar. 2011), available at http://ebri.org/publications/notes/index.cfm?fa=notesDisp&content_id=4785.

The importance of the tax deferral on retirement contributions was also born out in a recent Investment Company Institute (ICI) survey in which more than 80% of households owning DC plan accounts said the immediate tax savings from their retirement plans were a big incentive to contribute.[6]

How is the tax benefit distributed?

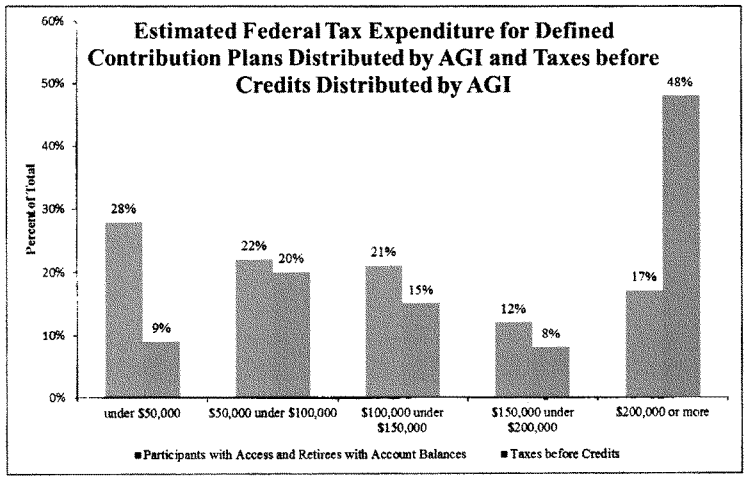
Distribution of the tax benefit is typically analyzed by applying the marginal tax rate to contributions allocated to an individual's account multiplied by the marginal tax rate.[7] Because the U.S. income tax system is progressive, the value of the tax incentive on a dollar of retirement savings *in the year of deferral* increases as the marginal tax rate increases. This progressive income tax structure, coupled with the assumption that the more income a worker has, the more he or she can afford to save, would lead one to expect the tax benefit for retirement savings would be more skewed than the incidence of income tax. However, the non-discrimination rules that apply to employer-sponsored retirement plans, coupled with the limit on compensation that may be considered for purposes of determining contribution allocations, leads to a very different result. The distribution of the tax incentive for retirement savings is *more progressive* than the current progressive income tax system. As the following chart shows, households with incomes of less than $50,000 pay only about 9% of all income taxes, but receive 28% of the defined contribution plan tax incentives. Households with less than $100,000 in AGI pay about 29% of income taxes, but receive about 50% of the defined contribution plan tax incentives. Contrast this

[6] Investment Company Institute, *America's Commitment to Retirement Security: Investor Attitudes and Actions January 2012* available at http://www.ici.org/pdf/ppr_12_retir_sec_update.pdf

[7] For example, see Table 1 of the Hamilton Project paper "Improving Opportunities for Savings and Incentives for Middle- and Low-Income Households" by William Gale, Jonathan Gruber and Peter Orszag.

distribution to the distribution of tax benefit for capital gains, where about 90% of the benefit goes to households earning over $200,000. (In fact, one estimate of the distribution of the capital gains tax benefit for 2015 shows over 68% of the tax benefit going to households with more than $1 million in income.)[8]

Figure 3



Source: Internal Revenue Service (IRS) Statistics of Income Division (SOI) and ASPPA, "Distributional Analysis and Pension Tax Provisions", April 2013 (http://www.asppa.org/Main-Menu/govtaffairs/Distributional-Analysis-and-Pension-Tax-Provisions.aspx)

What this clearly shows is that, contrary to one common myth, the tax incentives for retirement are *not* upside down at all. Thanks to the balance imposed by the current law contribution limits and stringent nondiscrimination rules, these tax incentives are *right side up* – even before properly considering other components of this incentive.

The standard methodology for measuring the benefit of the tax incentive (multiplying marginal rate times income deferred) shows that the tax incentives for employer-sponsored retirement savings are more progressive than the current income tax code. However, because of the unique nature of this tax incentive, this methodology actually *understates* how progressive the current tax incentives are:

- First, as illustrated in the "ABC Company" example beginning on page 5, this measurement fails to consider that much, if not all, of this apparent tax savings to a

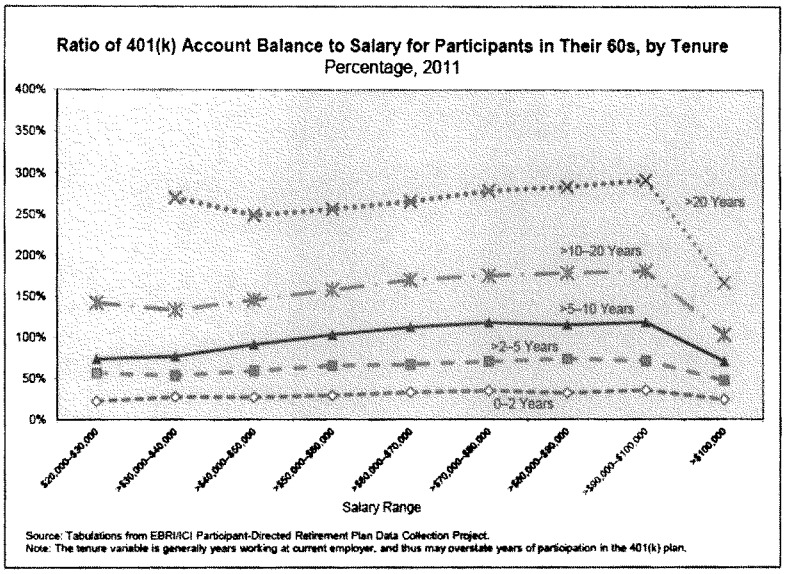
[8] Tax Policy Center, *T13-0258 - Tax Benefit of the Preferential Rates on Long-Term Capital Gains and Qualified Dividends; Baseline: Current Law; Distribution of Federal Tax Change by Expanded Cash Income Level, 2015* (Dec 18, 2013), available at http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=4035&topic2ID=40&topic3ID=41&DocTypeID=1

small business owner is transferred to employees in the form of employer contributions. The standard methodology credits the small business owner contributing $50,000 on her own behalf with $14,000 "tax savings" (28% marginal rate times $50,000). If payroll for other covered employees is $200,000, the nondiscrimination rules require the employer to contribute at least 5% of pay, or $10,000, to the accounts of these other employees. Assuming for the sake of simplicity that the business tax rate is the same as the owner's rate of 28%, the net cost of the $10,000 contribution is $7,200. The small business owner's net benefit for the current tax year is therefore only $6,800 ($14,000 - $7,200). Assume the average marginal rate for the other employees is 15%. The rate times contribution method results in an apparent tax benefit of $1,500 (15% of $10,000). In fact the benefit is the full $10,000. So, although standard methodology would measure the tax incentive in the current year as $14,000 for the owner and $1,500 for the other employees, the true allocation is $6,800 for the owner and $10,000 for employees.

- Part of the cost of the retirement savings tax incentive is the deferral of income taxes on investment income. However, if a small business owner elected not to set up a qualified plan, and had simply paid income taxes instead of making retirement contributions for herself and the other employees, she could have gained identical deferral of income tax on investment earnings by investing the $50,000 in an individual annuity, or benefitted from lower capital gains and dividend tax rates on investment income by purchasing investments outside of a retirement savings vehicle. Therefore, the cost of the qualified retirement plan tax incentive should only reflect the cost of excluding the deferral in the year the contribution is made, plus deferral of tax on investment income on contributions in excess of an after-tax contribution amount, *less* the difference between ordinary income tax and capital gains and dividend taxes on investment income. (Note that for this small business owner, the after-tax value of the *employee* contributions would be available for investment outside of the qualified retirement plan, not just the after-tax value of the $50,000 contribution for the owner.)
- Analyzing the benefit for any given year during an accumulation period also fails to recognize the deferral nature of the savings tax incentive. When an individual saving $50,000 per year reaches retirement and distributions begin, the marginal income tax rate of those distributions will be substantially higher than for those with a history of lower contributions. (The fact that the amount of Social Security benefits includible in income, if any, depends on the amount of other retirement income received during a year increases the rate differential for retirees). As a result, this failure to consider taxes to be paid at a later date tends to overstate the relative benefits offered by the current system to those who make higher levels of contributions to these plans.

The impact of the nondiscrimination rules in distributing the benefit of the tax incentives is shown in Figure 4 below, which shows the ratio of account balance to salary for participants in their 60's with differing years of service with their current employer. The ratio is fairly level across the salary range for workers with similar tenure until the ratio drops dramatically at the top income level, presumably due to the impact of the dollar limits on contributions and the limits on the amount of compensation that is allowed to be considered in determining benefits. This shows the current rules clearly produce a very fair result among all income classes.

Figure 4

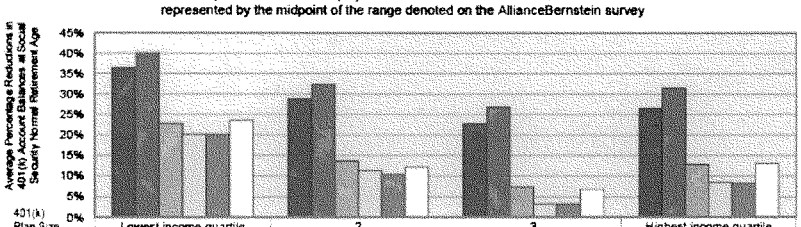


The fact that the current incentive structure works well for lower income workers is further borne out by the projected impact of converting the current incentives to a refundable credit. The following chart shows the *decline* in projected account balances for participants considering both changes in employee behavior and employer behavior, including the termination of plans, if the current year's exclusion from income were modified to an 18% refundable credit. As expected, participants in smaller plans would suffer most, but note that the lowest income quartile shows the largest reduction for all plan sizes.

Figure 5

Simulated Impact of Proposal to Modify the Federal Tax Treatment of Employer and Employee Contributions for 401(k) Plans in Exchange for an 18% Match From the Federal Government for Employees Currently 26–35, by Plan Size and Age-specific Salary Quartiles: Midpoint Estimates

Assumption for this run: Employer increases or decreases to contributions are represented by the midpoint of the range denoted on the AllianceBernstein survey



401(k) Plan Size	Lowest income quartile	2	3	Highest income quartile
<1M	36.4%	28.8%	22.8%	26.5%
1–10M	40.1%	32.4%	26.9%	31.5%
10–50M	22.9%	13.7%	7.4%	12.8%
50–250M	20.2%	11.4%	3.3%	8.5%
250–500M	20.2%	10.4%	3.2%	8.3%
>500M	23.5%	12.2%	6.8%	13.1%

Source: Author's calculations based on results from EBRI Retirement Security Projection Model Version 1472, and responses to AllianceBernstein (2011) and Employee Benefit Research Institute and Mathew Greenwald & Associates, Inc., 2012 Retirement Confidence Survey.
Note: This simulation models only the financial impact of the expected reduction in 401(k) account balances for employees who are not automatically enrolled by modifying the behavior of plan sponsors and participants and does not attempt to assess behavioral modifications on the part of eligible nonparticipants. The simulated rates of return are the same as in VanDerhei and Copeland (July 2010). This version of the analysis assumes no job turnover, withdrawals or loan defaults. The full stochastic nature of the model will be included in a future analysis. Plan sponsor and participant reactions to the proposal are explained in the text. Employer increases or decreases to contributions are represented by the midpoint of the range denoted on the AllianceBernstein survey.

From EBRI Notes March 2012 available at http://www.ebri.org/publications/notes/index.cfm?fa=notesDisp&content_id=5019

Adequacy of Benefits

The availability of a defined contribution plan at work is a key determinant in the likelihood for having a secure retirement. This is true regardless of the level of income. EBRI projections based on voluntary enrollment in 401(k) plans show a 76% success rate of achieving income replacement of 70% for the lowest income quartile with more than 30 years of eligibility ion a 401(k) plan. If automatic enrollment and auto-escalation are added to the projection, that success rate increases to 90%. The success rates for the top quartile are 73% and 81% respectively.[9] In other words, the 401(k) structure with auto-enrollment and auto-escalation produces a higher success rate for the lowest quartile.

The success of lower income workers with access to workplace savings relative to higher income workers is due in part to the higher income replacement Social Security provides for lower income workers, and in part to the non-discrimination rules and the limits on contributions that affect primarily higher income workers. Because Social Security is very progressive, lower income workers need to replace less income through retirement savings than do workers at

[9] VanderHei, Jack; *Statement for the Record, Testimony before the Subcommittee on Social Security, Pensions, and Family Policy Hearing on The Role of Social Security, Defined Benefits, and Private Retirement Accounts in the Face of the Retirement Crisis*, December 18, 2013

higher income levels. For example, for an individual retiring in 2014 with "Average Indexed Monthly Earnings" of $1,500 ($18,000 per year), the Primary Insurance Amount (PIA) would provide about 63% of the AIME. For someone with an AIME of $4,000 ($48,000 per year), the PIA would replace about 44% of AIME. For an individual with the maximum AIME of $8,890 ($106,680 per year), the PIA would replace about 30% of AIME.

The current employer-based system, combined with Social Security, provides the structure for successful outcomes for workers of low and moderate levels. The key is to expand access to workplace savings for those who do not currently have access.

Who Benefits

Who is participating?

The Bureau of Labor Statistics ("BLS") found that 78 percent of all full time civilian workers had access to retirement benefits at work, with 84 percent of those workers participating in these arrangements. For private sector workers, BLS found the access and participation rates are 73 percent and 80 percent respectively. Availability and take up rates are substantially lower for part-time workers, so if part time workers are included, BLS found that 68 percent of civilian workers had access to retirement plans, and 80 percent of those actually participate in the offering. For the private sector only, the access and participation rates for all workers are 64 percent and 76 percent respectively.[10]However, alternative research suggests these estimates are less than what is actually happening in the workplace.

A report from SSA shows that 72 percent of *all* employees who worked at private companies in 2006 had the ability to participate in a retirement plan, and 80 percent of those participated.[11] The SSA used data from a Census survey merged with W-2 tax records to correct for respondents' reporting errors. SSA found "among private-sector wage and salary workers, both employer offer rates and employee participation rates in *any* type of pension plan considerably increase when W-2 records are used, an indication of substantial reporting error." [12] The SSA results indicate the BLS statistics on availability are likely understated.

Part-time workers are far less likely to have a retirement plan available at work, and less likely to participate in a plan when it is available. BLS data shows only 37% of part-time private sector workers have a retirement plan available at work, and 54% of those participate in the plan. Similarly, employees that work for smaller employers are less likely to have a plan available. BLS data shows 49 percent of private sector employees who work for employers with less than 100 employees have a plan available at work. Sixty-nine percent of those workers do participate

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[10] Bureau of Labor Statistics, *Employee Benefits Survey: Retirement Benefits, March 2011: Retirement benefits: access, participation, and take-up rates: National Compensation Survey March 2011* available at http://www.bls.gov/ncs/ebs/sp/ebnr0017.pdf (hereinafter "BLS Survey").

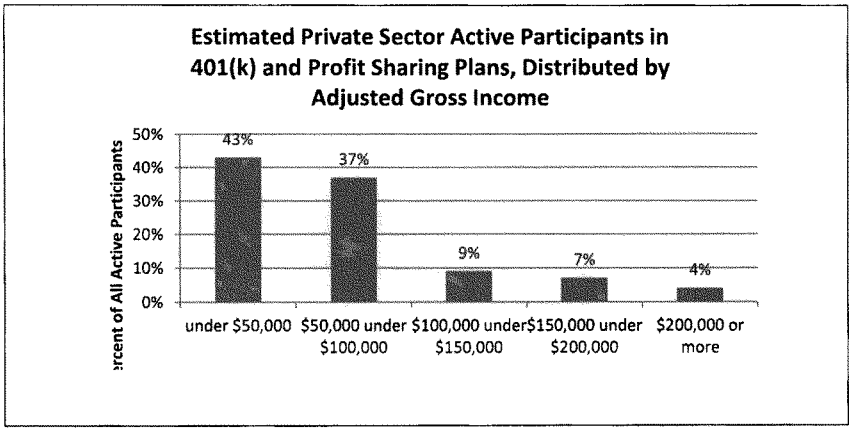
[11] Irena Dushi, Howard M. Iams, and Jules Lichtenstein, *Assessment of Retirement Plan Coverage by Firm Size, Using W-2 Records*, Social Security Bulletin (2011), available at http://www.ssa.gov/policy/docs/ssb/v71n2/v71n2p53.pdf

[12] *Id.* at 1 (noting "We find substantial reporting error with respect to both offer and participation rates in a retirement plan. About 14 percent of workers who self-reported nonparticipation in a defined contribution (DC) plan had contributed as indicated by W-2 records, whereas 9 percent of workers self-reported participation in a DC plan when W-2 records indicated no contributions.").

when a plan is offered, though. Employer surveys indicate business concerns are the primary driver of this low rate of sponsorship among smaller employers.

Participation in employer-sponsored defined contribution plans is heavily weighted toward middle class Americans. As the chart below shows, over 40% of participants in defined contribution plans make less than $50,000 per year. About 80% make less than $100,000.

Figure 6



Source: Internal Revenue Service (IRS) Statistics of Income Division (SOI)

What Should Be Done?

The current system is working very well for millions of working Americans. Expanding *availability* of workplace savings is the key to improving the system. There is no need for dramatic changes, but measures should definitely be considered to make it easier for employers, particularly small businesses, to offer a workplace savings plan to their employees.

There are a number of other proposals that we believe would expand coverage, including the Starter 401(k) Plan proposed in S.1270. This proposal would allow employers who cannot afford to make contributions for employees put their toes in the water with a 401(k) plan that could easily be amended to a full blown plan when the business becomes more stable. ASPPA is also supportive of the auto-IRA proposal developed by the Retirement Security Project, and proposed by Rep. Neal (D-MA) in H.R. 2035. This proposal does not require employers to contribute to a retirement plan, or impose fiduciary responsibilities on business owners. It does give employees an opportunity to contribute to an IRA on their own behalf through payroll deduction. Both Starter K and auto-IRA recognize that not only are many lower income workers employed by small business, but many small business owners have very modest incomes themselves and cannot be burdened with contribution requirements in order to offer a retirement savings arrangement.

I have heard calls for "simplification" as a means of expanding coverage. Any proposal that would reduce options available to employers under the guise of simplification definitely are *not* the road to expanded coverage. I spent over 20 years working with small businesses that were considering whether or not to set up a retirement plan. I can assure the Subcommittee that "complicated" testing does *not* discourage employers from establishing plans, and employers would be *less* likely to establish plans that include employer contributions if the employer had less flexibility in plan design. The truth is, it is that flexibility that creates sufficient tax savings for the small business owner to fund the contributions for employees, and the availability of general nondiscrimination testing is key to this flexibility.

Complexities that discourage small business owners from taking advantage of the tax incentives for maintaining a plan, or incorporating features that would make the plan more effective as a savings vehicle for all employees, are not plan design, but the significant red tape, fines and penalties that can accompany even the most basic of these arrangements.

Some complications are statutory and some are regulatory. For example, multiple employer plans (MEPs) are one approach that has gained favor in the marketplace. However, DOL has concluded that the employers must have a relationship other than joint sponsorship of the plan to participate in a "multiple employer plan". There have been a number of legislative proposals to permit these so-called "open" MEPs. We think the provision in Senator Hatch's SAFE Act (S. 1270) would be a good approach that permits open MEPs, while providing safeguards for adopting employers through a designated service provider.

There are numerous other examples of how the framework for operating a small qualified plan could be simplified, but here are a few suggestions:

- Eliminate mandatory "interim amendments"[13] which increase the cost and burden of maintaining a plan without any corresponding benefit. The current process is incredibly complicated, with different amendment deadlines that vary based upon the type of amendment and the plan's fiscal year. This leads to mistakes being made by well-meaning plan sponsors (who are voluntarily providing this benefit). Small plan sponsors in particular are shocked and surprised when asked to pay thousands of dollars in sanctions when an inadvertent amendment mistake is uncovered during an IRS audit. Amendment deadlines co-ordinated with the plan's 5 or 6 year review cycle would be user friendly and cost-effective. (Included in S.1270.)
- Don't penalize small employers for allowing employees to start contributing to a 401(k) plan immediately upon employment. This could easily be accomplished by excluding employees the statute would have allowed to be excluded from

[13] Qualified retirement plans are governed by written documents that must meet certain requirements under the Internal Revenue Code to maintain tax-favored status. Revenue Procedure 2007-44, as modified by Rev. Proc. 2008-56 and Rev. Proc. 2012-50, provides staggered dates for plan documents to be submitted to IRS for review as to a plan's qualified status. Individually designed plans are on five-year cycles, and pre-approved documents are on six-year cycles. During these five or six-year cycles, plans must adopt amendments to reflect legislative and regulatory changes to the qualification requirements. Except as provided by law or other guidance, these "interim amendments" must generally be adopted by the due date (including extensions) for filing the income tax return for the taxable year the change is effective. There is no coordination of the due dates of these required "interim amendments" with the cycle for submission of documents to IRS.

participation in the plan[14] from the 3% minimum "top heavy"[15] contribution requirement. (S.1270 goes further and eliminates the top heavy rules.)

- Make it less "dangerous" for small employers to use automatic enrollment by making it less expensive when the plan inadvertently fails to automatically enroll an employee. Small employers shy away from automatic enrollment, often because a mistake can cost the employer 3% of the employee's pay for the year, in addition to any matching contribution the employer would have made if the employee had been enrolled and contributed the default amount. It is reasonable to require the employer to make any matching contributions that would have been due if the employee had contributed the default amount, but to impose an additional cost because the employer voluntarily adopts automatic enrollment simply discourages adoption of automatic enrollment.
- Eliminate unnecessary notices, such as the notice requirements for the 3% safe harbor. The safe harbor information is already provided to participants in the Summary Plan Description, and since employees receive the contribution whether or not they contribute to the plan, it does not cause participants to change their behavior. (Included in S.1270.)
- Simplification should not be limited to defined contribution plans. Enactment of the proposal to eliminate reduction of assets by credit balances in applying the benefit restrictions of Internal Revenue Code section 436 would not only make sense from a policy standpoint, but would dramatically simplify the operation of that provision. (This proposal is included in S.1979 sponsored by Senators Harkin and Brown.)

In addition to these plan simplifications, the Saver's Credit for individuals should be streamlined. For example, replacing the current tiered formula with a simple formula such as 50% of a fixed amount of contributions would make it much easier to explain and communicate.

ASPPA looks forward to working with the Committee to enhance the current employer-based retirement savings system, and to help more American workers, especially small business owners and their employees, take advantage of workplace savings.

I would be pleased to discuss these issues further with the Committee or answer any questions that you may have.

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[14] Employees who have not attained age 21 or who have not completed a year of employment with at least 1000 hours of service may be excluded from plan participation.

[15] A plan is considered top heavy if over 60% of the accrued benefits are for "key employees". Many small business plans are top heavy and, as a result, must provide all participants in a defined contribution plan with a contribution of at least 3% compensation. For a defined benefit, the requirement is a minimum accrued benefit of 2% of pay per year of service, with a 20% maximum. Special rules apply to participants covered under both types of plans.

Statement before the United States Senate
Committee on Finance
Subcommittee on Social Security, Pensions, and Family Policy

For a Hearing on

"Retirement Savings for Low-income Workers"

on

February 26, 2014

Diane Oakley
Executive Director

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Thank you Chairman Brown, Ranking Member Toomey, and Members of the Committee on Finance for the opportunity to testify today. I am Diane Oakley, executive director of the National Institute on Retirement Security (NIRS). NIRS is a non-profit, non-partisan research and education organization committed to fostering a deep understanding of the value of retirement security to employees, employers and the economy.

For today's hearing, I will focus on two recent NIRS research studies, which are available at www.nirsonline.org:

- *The Retirement Savings Crisis: Is It Worse Than We Think*?; and
- *Race and Retirement Insecurity in the United States.*

In *Pensions & Retirement Security 2013*, we surveyed Americans on retirement security issues. We found that Americans are very worried about their retirement outlook despite stabilization of the financial markets, declining unemployment and increased consumer confidence. An overwhelming majority of Americans (85 percent) report concern about their retirement prospects, with more than half (55 percent) very concerned. We also found that 86 percent of Americans believe that that leaders in Washington need to give retirement a higher priority, with 62 percent strongly agreeing.

To perhaps explain this sentiment, I would like to share NIRS findings on retirement savings. This may shed light on why Americans want and need help from leaders in Washington if their dream of retiring with dignity and independence can come true.

NIRS examined the readiness of all working-age households for retirement by analyzing the 2010 Survey of Consumer Finances (SCF) from the U.S. Federal Reserve. Our analysis looked at workplace retirement plan coverage, retirement account ownership, and household retirement savings as a percentage of income, for all working families. We also looked more closely at the retirement readiness of people of color. Overall, we found that retirement readiness is dangerously low – even lower than we expected. Below are the key findings of our analyses.

1. Retirement Plan Access and Coverage

Employer-sponsored retirement plans remain the most important vehicle for ultimately providing retirement income among working households after Social Security. However, a large share of American workers lacks access to a retirement plan through their employer. Those workers who do participate in a retirement plan will be much more likely to rely on assets from individual retirement accounts in a 401(k) or other defined contribution (DC) plan rather than on a predictable monthly income from a group defined benefit (DB) pension.

Historical retirement participation data from both the U.S. Bureau of Labor Statistics' Current Population Survey (CPS) and the SCF indicate that gradual changes over past decades resulted in participation in retirement plans peaking around the year 2000 and then declining over the last decade. According to CPS data, by 2011, only 52 percent of private sector employees age 25-64 had access to a retirement plan on the job—the lowest rate since 1979. The SCF illustrates a similar trend on a household level. The share of working families in which neither the head of household nor the spouse participated in a retirement plan through their job increased from 42.7

percent in 2001 up to 44.6 percent in 2010. That 45 percent nonparticipation level contributes to more than 38 million working-age households with no retirement account assets, whether in an employer sponsored 401(k) type plans or in an IRA.[1]

Workers who lack access to an employer sponsored retirement plan tend to work for smaller firms, and to be low- to middle-wage employees.[2] Large firms generally offer more generous benefits, and a significant number continue to sponsor DB pensions.[3] Small businesses—which account for approximately two-thirds of workers that lack access to a retirement plan—often find it too expensive and complicated set up a plan. Earnings levels make a difference, as small and large employers in low-wage industries are less likely to offer a retirement plan. On the other hand, higher-income workers are more likely to work for employers that provide generous matches and have more disposable income.[4]

Retirement account ownership rates are closely correlated with income and wealth. Households that do own retirement accounts have a significantly higher income and wealth—more than double the income and five times the non-retirement assets—compared to households that do not own a retirement account.[5] Also, an analysis of the ownership of savings in retirement accounts by the Economic Policy Institute found that the top one fifth of households by income accounted for 72 percent of the total savings in retirement accounts in 2010.[6]

The SCF shows that ownership of retirement accounts is sharply concentrated in the top half of the income distribution. **Figure 1** shows the retirement account asset ownership status of households in each income quartile ranked by income. The nearly 9 of 10 households (89 percent) in the top income quartile own retirement account assets, as do 72 percent of the third income quartile. In comparison, slightly more than one half of the second income quartile and one quarter of households in the bottom income quartile own retirement account assets.[7]

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[1] N. Rhee, 2013 (Jun.), "The Retirement Savings Crisis: Is It Worse Than We Think?" National Institute on Retirement Security, Washington, DC.

[2] S. Allegretto, N. Rhee, J. Saad-Lessler, and L. Schmidt, 2011 (Oct.), "California Worker's Retirement Prospects," pp. 22-41 in N. Rhee, Ed., *Meeting California's Retirement Security Challenge*, UC Berkeley Center for Labor Research and Education, Berkeley, CA.

[3] Towers Watson, 2011 (Nov.), "Pension Freezes Among the Fortune 1000 in 2011," Insider, Towers Watson; PBGC Data Tables 2011, Table S-30 "PBGC-Insured Plan Participants (1980-2011) Single-Employer Program," http://www.pbgc.gov/documents/pension-insurance-data-tables-2011.pdf.

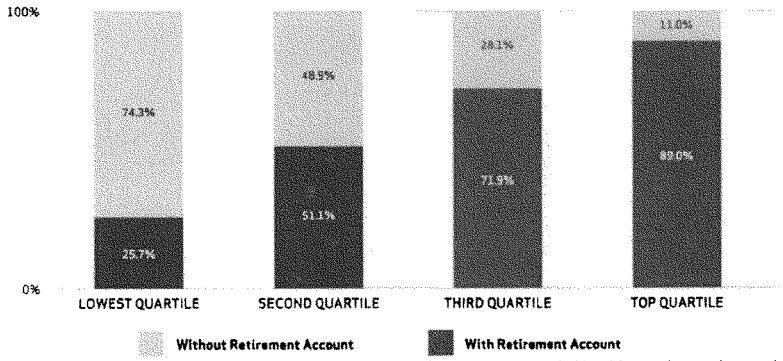
[4] Congressional Budget Office (CBO), 2013, *The Distribution of Major Tax Expenditures in the Individual Income Tax System*, CBO Publication No. 4308, CBO, Washington, DC; M. Morrissey, 2009, *Toward a Universal, Secure, and Adequate Retirement System,* Economic Policy Institute. Washington, DC.

[5] N. Rhee, 2013 (Dec.), "Race and Retirement Insecurity in the United States," National Institute on Retirement Security, Washington, DC.

[6] M. Morrissey and N. Sabadish, 2013 (Sep.), "Retirement Inequality Chartbook," Economic Policy Institute, Washington, DC.

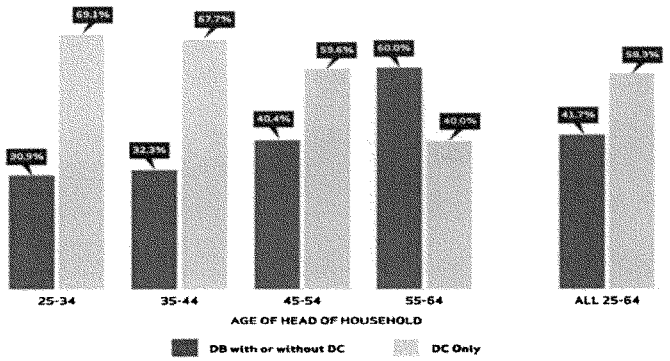
[7] Rhee, 2013 (Jun.).

Figure 1. Retirement account ownership status by household income quartile, 2010



Source: NIRS analysis of 2010 SCF using households with heads age 25-64. Households with negative earnings excluded.

Figure 2. DB and DC plan participation among households covered by an employer-sponsored retirement plan, by age of head of household



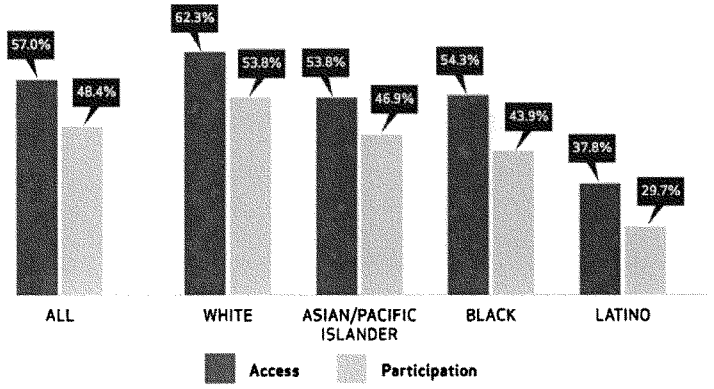
Source: NIRS analysis of 2010 SCF using households with heads age 25-64. Households with negative earnings excluded.

As workers' access to workplace retirement plans has declined over the past decade, the income security provided by such plans has also eroded. Among working-age households in which the head or spouse participated in an employer sponsored retirement plan through a current job, the share that had a DB pension—whether alone or with a DC account—dropped precipitously from 73 percent in 1989 to 42 percent in 2010 with much of that decline occurring prior to 2001. Conversely, the share of participating households that only had a DC plan grew from 23 percent to 58 percent during the same period.

Households currently near retirement represent the last generation of workers to enjoy widespread DB pension coverage. Among households covered by workplace retirement benefits, **Figure 2** illustrates that while 60 percent of older households (age 55-64) are covered by a DB pension, younger households are half as likely to have a DB pension—31 percent for age 25-34 and 32 percent for age 35-44.[8]

Figure 3. Retirement Plan Access and Participation among Workers of Color

Employer-sponsored retirement plan coverage among wage and salary employees by race, 2012



Source: NIRS analysis of CPS ASEC microdata from IPUMS. Universe is public and private wage and salary employees age 25-64. Racial categories are single-race.

NIRS also explored the racial differences in workplace retirement plan coverage. **Figure 3** breaks down the overall 57 percent of employees age 25-64 with an employer that sponsors a retirement plan, based on an analysis of CPS data. Some 62 percent of white workers have access to employer-provided retirement plans, while only 54 percent of Black and Asian employees have access. Latinos fare even worse, with only 38 percent employed in firms that offer a retirement plan. Workplace retirement plan *participation* rates generally follow access levels, with 44 percent of Blacks and with 30 percent of Latinos participating in a plan.[9]

2. Retirement Account Balances

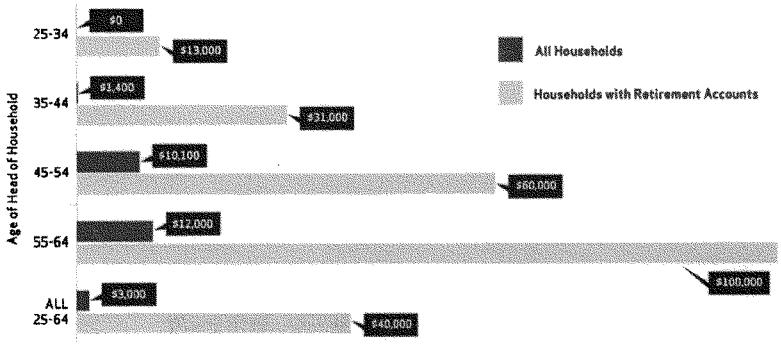
[8] N. Rhee, 2013 (June)

[9] Rhee, 2013 (Dec.).

To maintain their standard of living in retirement, the average household needs to replace roughly 85 percent of their pre-retirement income.[10] Social Security, assuming no further benefit cuts, provides a replacement rate of roughly 35 percent for a typical household, leaving a gap of 50 percent of pre-retirement earnings. The magnitude of this challenge facing working families is considerably bigger than many realize.

The shift away from DB pensions leaves most covered workers needing to rely only on assets accumulated in DC accounts to supplement their Social Security income. This trend has had profound consequences for American workers and families in terms of the risks and costs they now bear in saving and investing to fund their own retirement. Unfortunately, the typical household—even one near retirement—has only a few thousand dollars in retirement account assets, nowhere near the $100,000-plus average balances often quoted in the news media. A large majority of working-age households have little savings in relation to their income, and fall a long way short of recommended benchmarks for their age.

Figure 4. Median retirement account balance, households with retirement accounts vs. all households, 2010



Source: NIRS analysis of 2010 SCF. Universe is households with heads age 25-46 and those with negative earning excluded.

Given that 45 percent of households do not own retirement accounts, there is large disparity between median (50th percentile) retirement asset balances counting only working-age

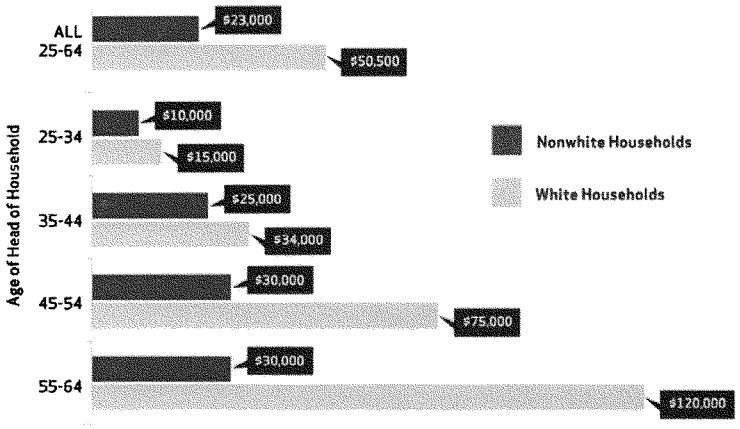
[10] Income replacement estimates vary by source, and by income level. HR consulting firm Aon Hewitt and financial services firm Fidelity Investments both estimate that a typical worker will need to replace 85 percent of income to maintain their standard of living in retirement. Aon Hewitt, 2012, "The Real Deal: 2012 Retirement Income Adequacy at Large Companies"; Fidelity, 2012 (Feb. 27), "How much do you need to retire?," https://www.fidelity.com/viewpoints/personal-finance/8X-retirement-savings. The Center for Retirement Research at Boston College estimates that a middle-income two-earner couple born 1960-1962 will need to replace 76 percent of their income excluding health care and long term care costs, and 98 percent including these costs.

households that own retirement accounts, versus all working-age households **(Figure 4).** The median retirement account balance for households with retirement assets was $40,000 in 2010 compared to $3,000 for all households age 25-64. Even more significant, among households approaching retirement (age 55-64), the median balance was $100,000 for account owning households and only $12,000 for all households in that age group. In other words, half of working-age households in the U.S. have virtually no retirement savings—just a few thousand dollars, or perhaps a little more due to recent stock market growth, but still not enough to provide meaningful retirement income.

While the median value of retirement accounts for the typical American working-age household is only $3,000 for age 25-64 and $12,000 for age 55-64, the NIRS analysis of the SCF reveals that ***the typical Black or Latino household has no dedicated retirement savings.*** In fact, 62 percent of Black and 69 percent of Latino households having no retirement accounts. We also analyzed mean balances—calculated as aggregate retirement savings divided by the number of households—as an indication of the race gap in retirement wealth. The $31,600 mean retirement account balance of working-age households of color is *less than one-third* of the $111,700 of white households. Worse still, average retirement account balances for Black ($20,100) and Latino households ($17,600) are less than one-fifth that of white households.[11]

Figure 5. Typical Household of Color with Retirement Accounts Has Much Less in Account than Typical White Household with Retirement Accounts

Median retirement savings among households with retirement accounts, by race status, 2010



Source: NIRS analysis of 2010 SCF. Universe is households with heads age 25-46 and those with negative earning excluded.

[11] N. Rhee. 2013 (December)

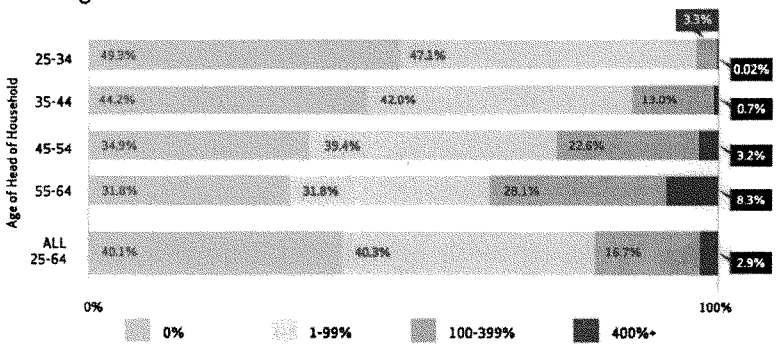
Even when only households that own a retirement account are counted, the racial gap in retirement savings is stark (**Figure 5**). The typical retirement-account owning household of color has a balance of $23,000, less than half of $50,500 median balance of white households with retirement accounts. Also, the racial disparity in retirement wealth among households that own retirement accounts is much larger for older households than for younger households. For example, among households with retirement accounts, the ratio of the median balance of households of color to the median balance of white households approximately 3 to 4 ($25,000 vs. $34,000) in the 35-44 age group and exactly 1 to 4 ($30,000 vs. $120,000) among near-retirement households age 55-64.

3. Retirement Account Values and Relationship To Income

Most people do not have a clear idea of how much they need to save in order to have enough income—including Social Security—to maintain their standard of living in retirement. For instance, a $200,000 retirement account balance may seem high, but will it be enough to maintain the standard of living for a couple with combined annual income of $60,000?

So NIRS looked at retirement savings as a multiple of annual income. **Figure 6** illustrates ratios of retirement account balances to household income among working-age households with at least one earner. Overall, over 40 percent have no retirement savings. Another 40 percent have retirement savings less than 100 percent of income. Among working households age 55-64, nearly 32 percent have no retirement savings; and another 32 percent have retirement savings less than 100 percent of their income. Overall, 80 percent of all working households age 25-64 and 60 percent of working households approaching retirement do not have retirement savings worth even 100 percent of their annual income. This reflects a huge shortfall compared to the amount they will need.

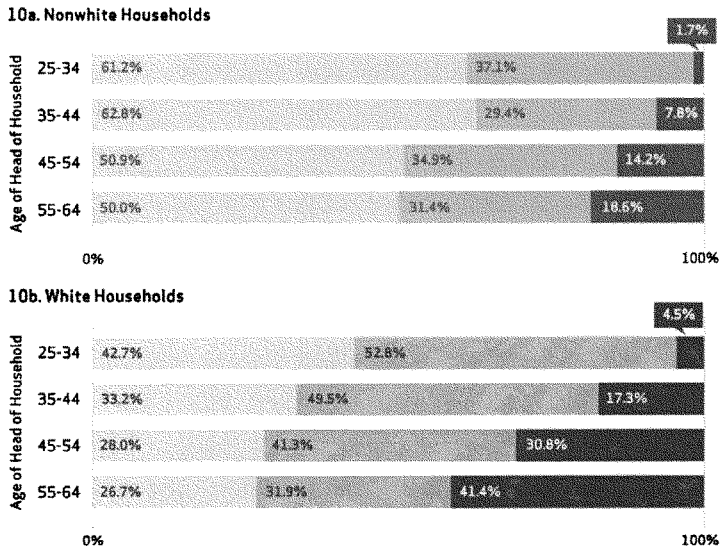
Figure 6. Retirement Account Balances As a Percentage of Income Among Working Households



Source: NIRS analysis of 2010 SCF. Universe is households with heads age 25-64, with total earnings ≥ $5,000 and < $500,000 and total income < $1M.

While the above chart provides SCF retirement savings data for the general population using several categories above 100 percent of earnings, households of color comprise a smaller sample in the SCF and relatively few have high retirement account balances, so for the purposes of analyzing differences by race, NIRS grouped households into just three categories: 1) those with retirement assets, 2) those with retirement assets greater than zero and less than 100 percent of earnings, and 3) those with retirement assets equal to or greater than 100 percent of earnings. The results are shown in **Figure 7**.

Figure 7. Households of Color Are Less than Half as Likely As White Households to Have Retirement Savings of at Least Annual Income



Source: NIRS analysis of 2010 SCF microdata. Universe is households with total earnings > $5,000 and < $500,000 and total income < $1M. Values may not add up to 100% due to rounding.

Working households of color have markedly less savings in relation to their income than do white working households. For example, in the 55-64 age group, only 19 percent of households of color had retirement savings equal to or greater than their annual earned income, compared to 42 percent of white households. Across age groups, households of color are about half as likely as white households to have this level of retirement savings.

The financial services provider Fidelity Investments recommends accumulating a minimum of 8 times income in retirement savings for retirement at age 67 and provides benchmarks in 5-year age intervals that start at half of a year's salary at age 30 and then move up to reach 8 times

earnings by ager 67.[12] Another organization, Aon Hewitt estimates that 11 times salary is needed in retirement assets in order to retire at age 65. [13] Both models include a target replacement rate of 85 percent of pre-retirement income. And the models are in line with recommendations from financial experts who have begun to recommend a total contribution of 15 percent of pay since the financial crash —rather than the previous 10—over a 40 year career in order to meet this goal.[14] NIRS used the Fidelity benchmarks to gage the percentage of households that were on track and when we looked at all retirement assets including the value of defined benefit plans, we noted that 9 out of 10 households had a savings gap.

Conclusion

With the disappearance of secure pensions and declining workplace retirement plan coverage, Americans face a retirement savings burden that is heavier than ever.

More than 38 million U.S. working-age households do not have retirement accounts, most are in the bottom half of the income distribution. The typical working-age household has only $3,000 in retirement savings. Among households with at least one earner, 4 out 5 have retirement savings less than their annual income.

While our analysis finds that every racial group faces significant risks, but people of color face particularly severe challenges in preparing for retirement. For example, a large majority of black and Latino working age households—62 percent and 69 percent, respectively—do not own assets in a retirement account, compared 37 percent of White households. Three out of four black households and four out of five Latino households age 25-64 have less than $10,000 in retirement savings, compared to one out of two White households.

While experts recommend that people build a nest egg that is at least 8 to 11 times income in order to maintain their standard of living in retirement, a large majority of working households fail to meet conservative benchmarks that assume a retirement age of 67.

Significant retirement security challenges face baby boomers and the upcoming generations of working families. A sustained increase in retirement savings is needed to put all Americans on a path toward financial security. No doubt households need to find ways to sharpen their budgets and save more of their pay for retirement each year. Many individuals, who can, will likely delay retirement or plan for earnings from work to be part of their income in retirement. The

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[12] Fidelity Investments, 2012 (Sep. 12), "Fidelity Outlines Age-Based Savings Guidelines to Help Workers Stay on Track for Retirement," http://www.fidelity.com/inside-fidelity/employer-services/age-based-savings-guidelines; Ann Carns, 2012 (Sep. 12), "Suggested Retirement Savings Goals, by Age," http://bucks.blogs.nytimes.com/2012/09/12/suggested-retirement-savings-goals-by-age/. Fidelity assumes 5.5 percent lifetime rate of return on retirement resources, 2.3 percent inflation, and 1.5 percent real (after-inflation) income growth.

[13] Aon Hewitt 2012, op cit., p. 10. Assumptions include career start at age 25; 50th percentile life expectancy; 7.0 percent rate of return on assets before retirement and 5.5 percent after retirement; 3 percent inflation; and 4 percent wage growth.

[14] Aon Hewitt, op cit.; Fidelity 2012, op cit.

nation also needs its employers, especially small businesses, to be come more engaged in assuring greater access to retirement plans in the workplace.

Given the low level of readiness for retirement, strengthening the Social Security safety net, expanding access to low-cost, high quality retirement plans such as the recently-announced my RA proposal and other proposals designed to expand workplace retirement coverage both at state and federal levels, and expanding incentives like the Saver's credit that already helps over 6 million low-income families save for retirement are important policy considerations.

Americans are highly concerned about their retirement prospects; among individuals with incomes less than $35,000, two thirds are very concerned. Americans in this income group told us the barriers they face when saving for retirement include: not having enough income to save (28%); not having enough money to support their family (21%); and not having steady employment (20%). While those individuals earning more than $75,000 cited these situations as barriers about one-third less often. Another striking difference in their views was raising the Social Security normal retirement age to 67, which over two-thirds of those with incomes under $35,000 classified a major factor in marking it more difficult to retire, but only 37 percent of high income respondents felt that same way.

I thank you for holding this hearing today to examine retirement security for working families. I am happy to respond to your questions.

Testimony of Stephen P. Utkus, Principal, Vanguard

Before a hearing of the

Senate Committee on Finance, Subcommittee on Social Security, Pensions and Family Policy

February 26, 2014

* * *

Chairman Brown, Ranking Member Toomey and members of the subcommittee—thank you for the opportunity to address you today on the topic of low-income workers and saving for retirement.

My name is Stephen Utkus, and I am director of the Vanguard Center for Retirement Research and a member of the leadership team of Vanguard's institutional retirement services business. At Vanguard, we manage more than $2 trillion in assets for tens of millions of U.S. investors—both for employees in workplace retirement plans and for individuals managing their savings on their own or with financial advisers. Our mission is "to take a stand for all investors, treat them fairly and give them the best chance for investment success." We are in particular known for our efforts to drive down the cost of retirement saving and investing. All other things equal, lowering the cost of investing is one of the critical levers that individuals and institutions have in order to improve retirement security.

We applaud the subcommittee for its focus on today's topic, the particular challenges facing low-income workers preparing for retirement. As you may know, having low lifetime earnings is a risk factor for being financially unprepared for retirement. To paraphrase one team of researchers in the field of retirement security, those who are financially vulnerable in their

working years are more likely to be financially vulnerable in their retirement years.[1] So dedicating more attention to understanding this at-risk group is a particularly worthwhile goal.

The broader question of retirement security

Before considering the case of low-income workers, I believe a useful first step is to establish some perspective on a broader question—retirement security for the entire U.S. population. As you may know, there are varied estimates of retirement preparation in the U.S. One group of studies emphasizes that about half of Americans are "on track" for a financially secure retirement, while the other half are not. This is a "glass half full, glass half empty" view. Other studies suggest that 70 to 75 percent of Americans are likely to have the resources they need to maintain their standard of living in retirement. In light of this body of research, it is possible to maintain that anywhere from half to three-quarters of Americans are "retirement ready." The reason for these differences is that retirement security estimates are long-term forecasts based on varying assumptions and methodologies. These differences help explain why there is an ongoing and active debate on a fundamental policy question, Is there a retirement crisis in America—or not?[2]

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[1] See Brigitte Madrian, Olivia S. Mitchell and Beth J. Soldo, *Redefining Retirement: How Will the Boomers Fare?*, Oxford University Press, 2007, for a selection of papers on retirement preparation. This citation is to Robert Haveman, Karen Holden, Barbara L. Wolfe and Andrei Romanov, "The Sufficiency of Retirement Savings: Comparing Cohorts at the Time of Retirement," in that same volume, pp. 36-69.

[2] Alicia Munnell, Anthony Webb, and Francesca Golub-Sass, "The National Retirement Risk Index: An Update," Boston College Center for Retirement Research, Issue Brief 12-20, 2012. Jack VanDerhei, "All or Nothing? An Expanded Perspective on Retirement Readiness," EBRI Notes, Employee Benefit Research Institute, Washington, DC, 33:11, 2012. David A. Love, Paul A. Smith and Lucy C. McNair, "A New Look at the Wealth Adequacy of Older U.S. Households," *Review of Income and Wealth,* 54(4): 616-642, 2008. Michael Hurd and Susan Rohwedder, "Economic Preparation for Retirement," in David Wise, editor, *Investigations in the Economics of Aging,* University of Chicago Press, 2012. William Gale, John Karl Scholz, and Ananth Seshadri, "Are All Americans Saving Optimally for Retirement?," working paper, 2009, and John Karl Scholz, Ananth Seshadri, and Surachai Khitatrakun, "Are Americans Saving Optimally for Retirement?," *Journal of Political Economy,* 114(4): 607-643, 2006.

Having assessed studies like these over many years, I would encourage policymakers to avoid a simple, two-part "glass half full, glass half empty" view of retirement, and instead think about a three-part model. First, there is clearly a population, at least half of all Americans, and possibly larger, who are "on track" in their retirement planning. Second, there is also a group, probably at least a quarter of Americans, who are clearly "at risk" for retirement security. Many of the "at risk" workers have low incomes and lack the ability to accumulate meaningful private retirement savings. And third, there is an intermediate group, as a rough rule of thumb a quarter of Americans, who are "partially prepared." They have made some effort to accumulate private assets and savings for retirement, yet they will need to do more to close retirement shortfalls—whether that means saving more of their income while working or working for a longer period.[3]

Two types of low-income workers

A starting point for the conversation on low-income workers is to establish some baseline or terms of reference. The Census Bureau reports that in 2012, median income for households under age 65 was just over $57,000, meaning that half of working-age households earned above this amount and half below. About one-fifth of working-age households earned less than $24,000 per year in 2012, a narrow definition of "low-income worker," and one-third earned less than $40,000 per year in 2012, a more expansive definition of the group.[4]

Low-income workers likely fall within each of the three retirement readiness groups I described. Some will be "retirement ready," some will be "at risk," and others "partly ready."

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[3] See James M. Poterba, "Retirement Security in an Aging Population," NBER Working Paper 19930, National Bureau of Economic Research, Cambridge, MA, 2014, for a discussion of heterogeneity of retirement preparation. Jack VanDerhei, 2012, cited above, also discusses relative degrees of preparation.

[4] Carmen DeNavas-Walt, Bernadette D. Proctor, and Jessica C. Smith, "Income, Poverty and Health Insurance Coverage in the United States: 2012," U.S. Census Bureau, Washington, D.C., 2013. Quintile and bottom-third working age incomes were interpolated from working-age distributions.

Yet as I mentioned at the outset of this testimony, the empirical evidence does suggest that the lower a worker's earnings, the greater the likelihood that the work will be "at risk" or "partially prepared" for retirement.

As we consider the prospects for low-income workers, I believe it is helpful to think about low-income workers in terms of two groups. First there are those workers who will remain at the lowest economic rungs for their working career, whom I will call "low lifetime earnings" workers, and who have the greatest chance of being in the "at risk" category. Then there are workers who, while having a low income today, are likely to see earnings rise over time. I'll refer to this latter group as "low current income" workers. These workers, as their earnings grow, will have greater chances for private retirement savings to supplement Social Security and reduce their chances of being "at risk."

Workers with low lifetime earnings

For workers with low lifetime earnings, Social Security remains the bedrock of financial security in retirement. Social Security's benefit structure is progressive, meaning that lower income workers receive a higher replacement income (as a fraction of their wages during their working years) than do better-paid workers. Thus one critical way to strengthen retirement security for low-income workers is to ensure that Social Security is on a fiscally sustainable footing for the long run.

In addition, many Social Security reform proposals advanced in recent years, while often trimming benefits for better-off retirees, include reforms to expand benefits for low-income workers. Acting through Social Security has several advantages. It will directly reduce retirement risks for workers with low lifetime earnings and their surviving spouses. It recognizes that many

of these households lack the discretionary income to generate private resources for retirement—and when they do save for the future, any savings they accumulate are likely to be devoted to emergency needs, home purchase, or debt reduction, not retirement. And it also acknowledges that the existing Social Security system is an efficient and targeted way to improve outcomes among these households.

Workers with low current incomes

A second group of low-income workers are those with low current incomes today but with rising income prospects for the future. For individuals in this group, as their incomes grow, Social Security benefits will come to represent a smaller fraction of their retirement resources, and the need for private retirement savings increases.

Several important developments in the defined contribution (DC) system have emerged in recent years designed to improve retirement outcomes among these workers. Our annual statistical publication *How America Saves* and our other research studies can be helpful in understanding these developments. Today, the majority of new hires into private-sector DC plans are automatically enrolled. The striking benefit of automatic enrollment is that it encourages substantially higher plan participation rates among young and low-income workers and among minorities—traditional low- or non-saver groups. Automatic enrollment, often combined with an automatic savings escalation feature, continues to disseminate in the private DC system as a result of the reforms enacted by Congress.[5]

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[5]"How America Saves 2013: A Report on Vanguard 2012 Defined Contribution Data," Vanguard Center for Retirement Research, Malvern, PA, 2013. Cynthia A. Pagliaro and Stephen P. Utkus, "Diversity and defined contribution plans: The role of automatic plan features," Vanguard Center for Retirement Research, Malvern, PA, 2011. William E. Nessmith, Stephen P. Utkus, and Jean A. Young, "Measuring the effectiveness of automatic enrollment," Vanguard Center for Retirement Research, Malvern, PA, 2007.

One concern about automatic savings programs is that they are only available to those workers who are offered a DC plan at work. On this front, there have been encouraging new findings from researchers at the Social Security Administration and Small Business Administration, who estimate that now 7 out of 10 private-sector workers are covered by a retirement plan at work. This is higher than previous estimates because it relies not on worker surveys, but on a more accurate, data source: workers' own W-2 forms submitted to the IRS. Plan coverage remains lowest among the smallest firms—those with fewer than 50 employees.[6]

A second important development within DC plans has been the rising importance of automatic investment programs. Participant-directed DC plans have been traditionally criticized because they placed the burden of investment decision-making on often inexperienced or unsophisticated workers. However, the landscape has changed considerably—so much so that within five years, we estimate that the majority of 401(k) and other DC plan participants will be leaving investment decision-making to professional money managers chosen by their employer. In effect, the pendulum on investment decision-making has swung, and fewer workers are being called upon to undertake complex portfolio decisions within their retirement accounts.

A major reason for this development is the growing use of target-date funds within DC plans. Target-date funds are evolving within DC plans in two ways. First, plan sponsors, when implementing automatic enrollment, are overwhelmingly selecting target-date funds as their preferred default investment. Most sponsors have expressed a strong interest in a default investment program that reduces risk-taking as the participant approaches retirement. Second, in plans where participants are not automatically enrolled but instead make their own investment choices, sponsors are also introducing target-date funds as a way to streamline investment

[6] Irena Dushi, Howard M. Iams and Jules Lichtenstein, "Assessment of Retirement Plan Coverage by Firm Size, Using W-2 Tax Records," *Social Security Bulletin,* 71(2): 53-65, 2011.

decision-making by workers. Target-date funds simplify investment choices because they reorient decision-making away from detailed fund selection to the choice of a portfolio based on the year of retirement. Participants can thus focus on understanding the risks and costs of the investments they own at a very high level, and not concern themselves with complex portfolio construction questions. The old view of DC plans—that workers had to be their own money managers—is gradually receding from the landscape.[7]

The Importance of Costs

So far I have addressed both savings rates and investment decisions in DC plans. Yet at Vanguard we strongly believe that all employers and workers have a third lever for influencing retirement outcomes, both when accumulating savings and in the drawdown or retirement phase—namely, costs. All other things equal, the lower the costs that workers bear in their retirement programs, the larger the nest egg they will accumulate during their working years, and the longer the money will last when it is spent in retirement.

For retirement programs, costs come in two forms: recordkeeping costs, which include all expenses associated with operating a retirement plan, communicating it, and serving plan sponsors and participants; and investment costs, which include all expenses associated with money management for the plan. As a result of the plan sponsor fee disclosure regulations issued by the Department of Labor (DOL), combined with intense competition in the marketplace, both recordkeeping costs and investment costs are declining. On the administrative side, we are seeing substantial downward pressure on recordkeeping fees due to DOL disclosure regulations and competitive re-pricing efforts. On the investment side, we are experiencing a resurgence of

[7] Jean A. Young, "Target date fund adoption in 2013," Vanguard Center for Retirement Research, Malvern, PA, 2014.

interest in low-cost indexing strategies as sponsors look to ways to reduce DC plan investment costs and improve relative investment performance.

As one illustration of this latter point, among fast-growing target-date funds within DC plans, we now estimate that nearly 45 percent of target-date assets are passively invested (compared to 20 percent for the overall private DC system). An important part of this is the "Vanguard effect," where our emphasis on low-cost investing contributes to positive change in the marketplace. According to our internal calculations, we recently became the largest target-date investment manager for U.S. DC plans because of the growth of our low-cost, indexed target-date strategies.[8] But it is also a testament to our competitors who also provide index services to the DC marketplace. And it is of course directly due to the growing attention to plan investment costs among employers.

On the cost front, one worry has been that while mid- and large-sized companies can obtain investment management costs at competitive prices, small-company plans are at a disadvantage. In this vein we are excited about the recent launch of Vanguard Retirement Plan Access—where, with our partner Ascensus, we are bringing low-cost investing to small company retirement plans. As the marketplace continues to respond to regulatory reform and fee disclosure requirements, we anticipate ongoing scrutiny of plan costs, and in particular increased demand among small employers to obtain lower fees for their participants.

Conclusion

The U.S. retirement system can best be characterized as a hybrid, public-private partnership. From the public sector, Social Security, a mandatory and universal system, is used to

[8] These Vanguard estimates, derived from market sources, include target-date strategies in mutual funds, commingled trusts and other investment vehicles used within DC plans.

provide a floor of income for most workers. It is augmented by Medicare, which pays for the majority of in-retirement medical costs, and Medicaid, which pays for a substantial proportion of long-term care costs. In the private sphere, government policy has encouraged the development of a robust system of supplemental, voluntary retirement plans that today cover about 7 in 10 private sector workers. Improvements in Social Security could be one way to address the concerns of workers with low lifetime earnings. For low-income workers with rising income prospects, automatic enrollment in the DC system is gradually expanding the benefits of these plans to workers who are covered by but not currently participating in their employer's plan.

As the subcommittee considers the issue of low-income workers, efforts to improve retirement outcomes should be evaluated from this holistic perspective. We would also encourage policymakers to consider a three-part model of retirement security, distinguishing among those who are likely to be "on track," "at risk," or "partially ready," and weighing policy prescriptions in terms of these distinct groups.

COMMUNICATIONS

AARP STATEMENT FOR THE RECORD
ON
"Retirement Savings for Low-Income Workers"

U.S. Senate Committee on Finance

February 26, 2014

On behalf of our members and all Americans age 50 and over, AARP would like to thank Chairman Brown and Ranking Member Toomey for convening today's hearing on "Retirement Savings for Low-Income Workers". We appreciate the opportunity to submit written comments on proposals to help low income earners accumulate sufficient assets for retirement as well as improve the retirement security of all American workers and their families.

A major priority for AARP has long been to assist all Americans in accumulating and effectively managing the resources they need to supplement Social Security and maintain an adequate standard of living throughout their retirement years. Social Security has long been the primary source of retirement income for most retirees, but it was intended as the guaranteed base of income to be supplemented by employer provided pensions and personal savings (the so-called three legged stool). Unfortunately, both economic and social trends over recent decades, and notably developments affecting employer-provided pensions, have made achieving and maintaining an adequate income in retirement more challenging than ever before.

Low and moderate wage-earners and retirees in particular are struggling to make ends meet. Wages for most Americans have not kept pace with inflation since the 1970's, and the 2008 financial crisis further set American families backward. As the economy slowly strengthens, it is an appropriate time to consider the adequacy of American retirement policies and programs for all groups, but especially the most vulnerable, low income families. We hope the Committee will move expeditiously to advance legislative initiatives that will enhance retirement security for those who are struggling and in ways that will be effective now and for decades into the future.

Social Security is the Primary Retirement Income Source for Most Americans and Needs to be Preserved and Strengthened

For the overwhelming number of Americans, Social Security is the most important source of retirement income today and in the foreseeable future. Social Security benefits are financed through payroll contributions from employees and their employers, throughout an individual's working life. Social Security has demonstrated its effectiveness over its 75 year life, and the program is likely to be as or more important in the future. Social Security is perhaps our most

successful social program. It has almost near universal coverage (96% of seniors), low administrative costs, low incidence of fraud, and high public approval. Social Security also fills a critical void – as evidenced by our voluntary private pension and savings programs -- since too few save enough voluntarily and adequately. Most other countries also have adopted universal systems similar to Social Security and the countries that do not have universal systems have serious problems with economic growth due to insufficient consumer demand and high rates of senior poverty.

For fiscal year 2015, the Social Security Administration says it will pay benefits to almost 59.5 million beneficiaries. The majority of these beneficiaries were 36.7 million retired workers. Social Security is the principal source of income for nearly two-thirds of older American households receiving benefits, and roughly one third of those households depend on Social Security benefits for nearly all (90 percent or more) of their income.

Despite its critical importance, Social Security's earned benefits are modest, averaging only about $1,225 per month for all retired workers in December 2013. Today, half of those 65 and older have annual incomes below $20,000, and many older Americans have experienced recent and significant losses in retirement savings, pensions, and home values. Every dollar of the average Social Security retirement benefit of a little over $15,000 is absolutely critical to the typical beneficiary.

Social Security also provides critical income protection for workers and the families of those who become disabled or deceased. Social Security's cost of living adjustment keeps seniors from falling behind, including falling into poverty, after they have retired. These lifetime based payments keep millions of older Americans out of poverty and allow tens of millions of Americans to live their retirement years independently, without fear of outliving their retirement income.

Social Security benefits are particularly important for women, who, on average, live longer and earn less than men. Women also spend more time out of the labor force or work part-time to care for children and other family members. Fifty two percent of all women aged 65 and older depend on Social Security benefits for 50 percent or more of their family income. Moreover, in 2012, older minorities relied on Social Security for a significant share of their family income. Thirty-four percent of African Americans and 35 percent of Hispanics who are 65 and older depended on Social Security for 90 percent or more of their family income. Finally, the poor and near-poor also rely on Social Security for a significant share of their income; in 2012, over 60 percent of older Americans who were poor near-poor relied on Social Security for 90 percent of more of their family income.

According to its trustees, the Social Security program has sufficient income from payroll contributions and assets in Treasury notes to pay 100 percent of promised benefits for the next 20 years, and even with no changes, can continue to pay approximately 75 percent of promised benefits thereafter. Social Security is therefore not in crisis. AARP believes that the current projected shortfall should be addressed sooner rather than later so that the fundamental structure of the program can be retained and the protections it offers to almost all workers and their families can be preserved and even enhanced.

In recent years, proposals have been made to reduce Social Security benefits in order to shrink the federal budget deficit. AARP believes that reducing the nation's deficit and restoring confidence in our budget is important, but Social Security's long term adequacy and solvency should be addressed separately from the budget shortfall. Social Security benefits are vital to the economic security of older Americans, surviving spouses and children, and the disabled. Social Security is a separate, off-budget and self-financed program with its own dedicated funding source and it is not the cause of our federal deficits. AARP strongly opposes cuts to Social Security, including reductions to cost of living adjustments, in order to reduce the federal deficit.

Finally, it is important to understand that Social Security benefits play a critical role in the economy. A recent report published by AARP, "Social Security's Impact on the National Economy," examined the economic impact of the $774 billion in benefits paid by Social Security in 2012. The report shows that every dollar of Social Security benefits generates about $2 of economic output. Social Security benefit payments help people keep or find over 9.2 million jobs that generate more than $370 billion in salaries, wages and other compensation. Benefit payments add almost $1.4 trillion in economic output (goods and services) to the overall American economy. Perhaps most surprisingly, Social Security benefits result in tax revenues for local, state, and federal governments exceeding $222 billion, including $78.9 billion in local and state taxes and $143.3 billion in federal taxes.

Employer Retirement Plan Changes Have Reduced Retirement Security for All Workers including Low and Moderate Earners

AARP strongly believes that all workers need access to a workplace retirement plan that supplements Social Security's strong foundation for retirement income. Unfortunately, employer-provided retirement plan coverage in the U.S. private-sector has generally hovered around a modest 50 percent for decades, with larger employers more likely than smaller ones to offer retirement plans. Overall, roughly 78 million American workers (both public and private) do not have access to a workplace retirement plan, such as a pension or 401(k) plan. Further, according to the Center for Retirement Research, 57 percent of workers in 2013 reported that the total value of their entire household's savings and investments (not just for retirement), was less than $25,000, and 28% had less than $1,000. Low and moderate earners largely comprise the ranks of the uncovered and non-savers.

In addition to coverage issues, the actual participation rate of workers in private-sector pension plans varies with age, income, education, ethnicity, size of employer and type of employment. Many plans exclude shorter service workers or tie employer contributions to employee contributions. Thus, older, better-educated, full-time, better-paid workers are more likely to participate than younger, less educated, part-time, lower-paid workers. As a result, more lower wage Americans do not accumulate sufficient retirement savings, and too many who are currently retired, or will retire, have less than enough money to meet their basic needs, relying on Social Security as their sole source of income in retirement.

For those workers who are fortunate to work for employers who offer a workplace retirement vehicle, the type of plan provided has changed dramatically over time. Today, only about 18

percent of public and private sector workers have defined benefit pension coverage on their current job (down from over 40%), 41 percent have defined contribution plan coverage with 10 percent of workers having both.

AARP strongly believes that Congress should protect the defined benefit system and consider ways to improve and expand it. Defined benefit plans generally automatically cover all workers who meet minimum eligibility requirements, have automatic employer contributions, professional investment management and better market performance, lower administrative fees, spousal protection, and provide benefits in the form of a lifetime annuity. Ideas for protecting the existing system that have been suggested include reducing short term volatility costs for employers (*e.g.*, modifications to the Pension Protection Act enacted funding rules) and strengthening the Pension Benefit Guaranty Corporation's (PBGC) premium base. AARP submits that it would also be beneficial to explore other innovative ways to offer defined benefit features through pooled arrangements, so as to better balance the respective risks and rewards of longevity and investment concepts.

The importance of a guaranteed lifetime monthly annuity benefit historically offered by defined benefit plans cannot be underestimated – not only for the income that such plans provide, but also for the peace of mind that the individual will not outlive his or her money. However, even traditional defined benefit plans are now offering lump-sum distribution options in increased numbers. They do so, in part, because plan sponsors are thereby able to shed longevity risk and pension costs by increasing the take-up of lump-sum distributions by plan members, and because many workers have expressed a preference for them. Thus, many retirees are opting for lump sum distributions – even if it is not in their best financial interest – including some retirees who are in pay status where the plan sponsors have decided to transfer risk to the retirees (a/k/a "de-risking"). Both the Administration and the Government Accountability Office (GAO) are examining the effects of these practices, and we urge the Congress to do so as well.

While defined contribution plans, such as 401(k) plans, can be valuable to many, they transfer investment, longevity, inflation, and interest rate risks entirely to the individual, and could make it more likely that an individual would outlive his or her retirement nest egg. The shift away from defined benefit to defined contribution plans places significant responsibility on individuals to make smart decisions concerning their contributions, investments and how they will manage their money once they retire so that they will have adequate income to fund their retirement years.

Unfortunately, the technical demands of investment management and the associated risks and costs are more than many individuals are able or willing to handle. While defined contribution-type plans can be an effective savings vehicle for retirement – especially if individuals take all the right actions and markets achieve historical rates of return – in practice these conditions will not all be met. Many people fail to make optimal choices at every step along the way, as evidenced by generally less than adequate individual account balances. The Center for Retirement Research and Towers Perrin consultants regularly report that typical defined contribution plans underperform defined benefit plans by 1-2% a year. Fidelity mutual funds reports also show that average 401(k) account balances of their clients were only $89,300 at the end of 2013 with over 1/3 of workers cashing out their accounts when changing jobs. Moreover,

even if defined contribution plan members make all the right decisions, if they happen to retire in a down market, much like the recent economic downturn, their account balances may be woefully inadequate for retirement.

Both the Department of Labor (DOL) and the GAO have documented how high fees in defined contribution plans make adequate savings difficult for typical investors. GAO estimated that $20,000 left in a 401(k) account that had a 1 percentage point higher fee for 20 years would result in an over 17 percent reduction – over $10,000 – in the account balance. We estimate that over a 30-year period, the account balance would be about 25 percent less. Even a difference of only half a percentage point, or 50 basis points, would reduce the value of the account by 13 percent over 30 years. In short, employers – as well as employees – need to be aware that fees and expenses can have a huge impact on retirement income security levels. Employers and plan participants need to receive timely, accurate, and informative fee disclosures from their 401(k) and similar defined contribution plans to help them better prepare for a financially secure retirement.

AARP is concerned that – unlike the case with Social Security benefits – many Americans will outlive the retirement assets they have accumulated in defined contribution plans due to the combined effects of longer life expectancies and the overly optimistic assumptions many individuals make when spending down these assets. Effectively managing this de-cumulation phase of retirement can be especially complicated, but it is essential for the long term economic security of millions of American workers who can no longer count on the guaranteed lifetime income stream once overwhelmingly provided by workplace defined benefit plans. The Employee Benefit Research Institute (EBRI) recently reported that steps such as annuitization could substantially increase the likelihood of not running out of money during retirement.

In response, AARP is pleased to support S. 1145 and HR 2171, the bipartisan Lifetime Income Disclosure Act – legislation sponsored by Senators Isakson and Murphy and Reps. Holt and Petri that would provide individuals with a better understanding of the lifetime value of their 401(k) plan assets by including in a yearly benefit statement a conversion of their total accrued benefits into a monthly dollar amount as if they had opted to receive a lifetime annuity. This conversion would help provide a more meaningful long term perspective to 401(k) plan participants than is generally presented under current practices by giving them a more accurate picture of the lifetime value of their plan and helping them make better decisions about how much they may need to save and how best to manage their retirement assets. DOL also is considering how best to provide lifetime income disclosures to participants.

Make the Savers' Credit an Effective Savings Incentive for Low and Moderate income Families

Many low and moderate-income households cannot benefit from the current tax incentives that Congress has provided to individuals because they do not earn enough income. Even for those moderate-income people that do save, the benefits provided through tax incentives are often minimal. Congress and others had high hopes for rectifying some of the lack of adequate incentives for lower wage earners when it created the Savers' Credit as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). The Savers' Credit provides in

essence, a government matching contribution in the form of a tax credit to taxpayers who make voluntary contributions to 401(k) plans, individual retirement accounts (IRAs), and similar retirement plans. The credit is designed to provide a greater credit to the lowest earners (the opposite of the general retirement savings tax structure) and support employer based retirement plans. However, the Savers' Credit is limited to taxpayers with tax liability and is not refundable for those who do not owe any federal income taxes. In addition, the credit is not tiered with the child tax credit so the half of eligible taxpayers who have children benefit little if at all from the Savers' Credit.

According to the Aspen Institute Initiative on Financial Security and the Tax Policy Center, over 40% of Americans have no net federal income tax liability and receive no benefit from non-refundable tax credits. In 2007, the latest year for which data have been publicly released, 69 million taxpayers had incomes eligible for the credit, but 45 million had no tax liability and thus, could not benefit. Still, over 5 million households each year have been able to claim some level of the credit. Also, because the credit has strict cliffs for eligibility a family earning $34,500 is eligible for a $1,000 credit but an identical family earning $34,501 can claim a maximum credit of only $400.

The Savers' Credit should be enhanced to better fill a critical gap in our current retirement savings tax structure. Currently, tax preferences generally are worth the least and provide the smallest incentive to save to households with the lowest incomes who need the most help to accumulate savings for retirement. An effective Savers' Credit flips the incentives in favor of lower income households. A stronger Savers' Credit would reward efforts to save and provide assistance to those who need it the most.

Accordingly, AARP supports improving and expanding the current Saver's Credit to provide a more robust benefit to those who are less likely to save (particularly those with low to moderate incomes). Improvements could include coordination with the child tax credit, expanding the income limitations, eliminating the phase-out "cliffs" in the credit, making it refundable, and directly depositing the credit into a retirement account. Congress also could direct or work with the Treasury Department and Internal Revenue Service (IRS) to better provide public education about the availability of the credit. The Savers' Credit has great potential to effectively target retirement savings tax incentives to low and moderate income earners, including those age 50 and over.

The Next Step – Automatic Savings for All Workers including Low and Moderate Earners

Saving is the gateway to both self-reliance and economic mobility, and has allowed millions of Americans to own their own home, enable children to receive better educations than their parents, and allowed families to both start businesses and protect themselves against sudden economic reverses. Studies show that when individuals start to save, their attitudes change and they become both more focused on the future and more connected to their neighborhoods.

It is not that Americans do not want to save. It is just that they need a little help. Americans of all ages have expressed support for programs that automatically help them to save. According to

findings of the Association for Financial Counseling and Planning Education, sixty percent of low-income earners believe they can save some amounts.

Keeping and improving incentives to offer workplace plans are crucial to this effort because savings through the workplace has proven to be the most efficient and effective method to increase savings. Encouraging retirement savings through payroll deductions is an optimal system that helps to maximize the number of workers with access to retirement savings accounts. Low and moderate income savers in particular prefer to have amounts automatically withheld from their paychecks.
We need to keep and create incentives to save for all income levels while targeting in particular those low- and moderate-income earners who have fewer opportunities to save. Increasing private savings overall is critical to economic growth and our policies should recognize that low- and moderate-income Americans have a more difficult time setting money aside for their retirement.

AARP supported the successful auto-enrollment provisions in the bipartisan Pension Protection Act. A May 2011 Aon Hewitt consultants study found that "(t)hree in five employers automatically enrolled employees into their defined contribution plans in 2010, up from 24 percent in 2006. For employees who were subject to automatic enrollment, Aon Hewitt's analysis found that 85.3 percent participated in their defined contribution plan, 18 percentage points higher than those that were not subject to automatic enrollment." Similarly, Vanguard's 2013 "How America Saves" report of its clients found that large employer adoption of auto-enrollment increased from 40-50% from 2007-2012, and over half of all participants and 80% of new hires were auto-enrolled in 2012. It should be noted however, that some recent studies have found a decline in new employers adopting automatic enrollment, presumably in part due to the cost of employer matching contributions.

The automatic enrollment, automatic escalation of contribution amounts, and default investment selection for 401(k)'s and similar retirement plans provisions adopted in the Pension Protection Act of 2006 have demonstrated that individuals can benefit from these positive default incentives. These enhancements have resulted in millions of new retirement accounts, millions of new savers and millions more dollars being saved. This success demonstrates both the effectiveness and the importance of well-constructed tax and pension policies to make it easy for Americans to save. It is time for Congress to take the next step and establish automatic savings into a diversified low cost default investment (with a right to opt out) that will benefit all workers, primarily low and moderate earners.

Individuals Also Need Independent Advice and Fiduciary Conflict of Interest Protection

Because the burden of saving adequately and managing assets has largely has been shifted to individuals, the impact of conflicted or inappropriate advice on individuals' private retirement savings can be devastating. Accordingly, the importance of strong fiduciary standards cannot be overstated and such measures are essential to protect the security of individuals' hard earned retirement assets both now and in the future.

Because the growth in 401(k) and similar type plans places significant responsibility on individuals to make appropriate investment choices so that they have adequate income to fund their retirement, AARP supports the goal of increasing access to investment advice so individual account plan participants may be better empowered to achieve their retirement savings objectives. To that end, we have consistently asserted that such advice must be subject to the Employee Retirement Income Security Act's (ERISA) fiduciary rules, based on sound investment principles and protected from conflicts of interest. The recent financial turmoil and scandals on Wall Street underscore the imperative that such advice be independent and non-conflicted.

AARP supports regulations to ensure that participants are provided with objective, non-conflicted investment advice. Consistent with a recent AARP poll, Americans believe that advice should be based on their needs, objectives and risk tolerance. AARP supports the DOL's review of the definition of fiduciary regulation given that the current manner in which employee benefits are provided is significantly different from the situation in 1975, as is evident with the shift from defined benefit plans to defined contribution plans. Not only has the financial industry's emphasis shifted to accommodate the demand for individual investment advice in 401(k) plans, but the variety and complexity of investments has radically changed. Consequently, AARP believes that a revision of this regulation to reflect the practices in the current market place would better protect the interests of plans and their participants and beneficiaries.

Protect Older Workers from Age Discrimination

AARP also believes that Congress should ensure equal opportunity for those older workers who want or need to work longer. Since the economic downturn in 2008, older Americans have experienced record levels of unemployment, and unprecedented levels of long-term unemployment. Age discrimination remains a significant barrier to older workers who are unemployed and seeking work, and is also of great concern to employed older workers who wish to remain in the workforce. According to a recent AARP survey, nearly half of workers age 50 and older who had recently experienced unemployment cited age discrimination as a significant barrier in finding a new job.[1] Although age discrimination is a serious and growing problem, recent decisions by the U.S. Supreme Court have departed from decades of precedent and significantly narrowed the scope of legal protections for older workers who have experienced discrimination. This is why AARP is urging Congress to enact the bipartisan Protecting Older Workers Against Discrimination Act (S. 1391, H.R. 2852), which would restore and reaffirm the law so that older workers are on the same legal footing as other workers in challenging discrimination.

Conclusion

AARP strongly believes that the trends and factors discussed herein, as well as the recent economic crisis, highlight the importance of Social Security's guaranteed benefit as the foundation of retirement income for all Americans. In the face of declining traditional pensions

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[1] *Boomers and the Great Recession: Struggling to Recover* 28 (Sept. 2012), *available at* http://www.aarp.org/content/dam/aarp/research/public_policy_institute/econ_sec/2012/boomers-and-the-great-recession-struggling-to-recover-v2-AARP-ppi-econ-sec.pdf.

or the outright lack of pension coverage, low personal savings rates, diminished home values, longer life expectancies and higher healthcare costs, the guaranteed benefit of Social Security will be increasingly important to future generations of Americans.

In addition, we need to refocus our efforts on the critical need for all American workers and their families to supplement Social Security and accumulate the resources they require to achieve an adequate standard of living throughout their retirement years. Ample evidence has demonstrated that automatic savings and targeted tax credits such as the Savers' Credit would greatly enhance the retirement income of the workers most in need of assistance, low and moderate earners.

Once again, AARP would like to thank Chairman Brown and Ranking Member Toomey for holding today's important hearing. We look forward to working with you and the other Members of this Committee to help ensure that as many Americans as possible are able to achieve a secure and adequate retirement.

United States Senate Committee on Finance
Subcommittee on Social Security, Pensions, and Family Policy

Hearing on:

Retirement Savings for Low-Income Workers

Wednesday, February 26, 2014, 10:00 AM
215 Dirksen Senate Office Building

Statement for the Record

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Retirement Savings for Low-Income Workers

By Jack VanDerhei, Ph.D.
Research Director, Employee Benefit Research Institute (EBRI)

1 Introduction

Measuring retirement savings and retirement income adequacy for low-income workers is an extremely important and complex topic, and EBRI started to provide this type of measurement in the late 1990s with the development of the EBRI Retirement Security Projection Model® (RSPM).[1] When we most recently modeled the projected outcomes for Baby Boomers and Gen Xers in 2014, we found that between 57 percent and 59 percent were expected to have adequate retirement income to fund 100 percent of simulated basic retirement expenses (housing, food, etc.—plus uninsured health care costs, using EBRI's Retirement Readiness Ratings™ (RRRs) as the gauge). Some retirement planners suggest that many households are able to successfully cut expenditures below the average expenses when financially constrained. Therefore, we also computed thresholds of 80 and 90 percent of simulated expenses and on that basis found that the RRRs for Baby Boomers and GenXers at a 90 percent threshold was between 67 and 70 percent. When the threshold was further relaxed to an 80 percent threshold, the RRRs increased to 81–84 percent.[2]

Who is most at risk of not having adequate retirement income? Not surprisingly, lower-income households have much lower RRRs: The 2014 baseline RRRs range from 17 percent for the lowest-income[3] households to 86 percent for the highest-income households with a 100 percent of simulated expenses threshold. At a 90 percent threshold, the RRR for the lowest-income households increases to 30 percent (indicating that 3 in 10 of those households would have sufficient financial resources to cover 90 percent of simulated basic retirement expenses, as detailed above). At an 80 percent threshold, 55 percent of the lowest-income households are predicted to have sufficient retirement income.

However, it should be noted that these probabilities will depend to a large extent on whether future years of employment take place with employers sponsoring defined contribution retirement plans or not. Previous EBRI analysis[4] shows the positive impact of future years of eligibility for a defined contribution plan. For GenXers[5] in the lowest-income quartile with no future years of eligibility in a defined contribution plan, the RRR value when measured with a 100 percent of simulated expense threshold is only 17.2 percent—indicating that more than 8 in 10 of this cohort are projected to run short of money in retirement. This value increases almost 10 percentage points, to 27.1 percent for those in the lowest-income quartile with one to nine future years of eligibility in a defined contribution plan. The RRR value increases further to 35.6 percent for those in this category who have 10–19 future years of eligibility in a defined contribution plan, and reaches a maximum value of 35.9 percent for those with 20 or more future years of eligibility in a defined contribution plan. When the threshold for a successful retirement is measured at a 90 percent of simulated expense threshold, the RRRs range from 28.6 percent for those with no future years of eligibility to 51.7 percent for those with 20 or more years. At an 80 percent of simulated expense threshold, the RRRs range from 51.7 for those with no future years of eligibility to 70.4 percent for those with 20 or more years.

2 The Potential of 401(k) Plans to Produce Adequate Income Replacement for Low-Income Workers

At least part of the concern with respect to retirement savings for low-income workers appears to stem from, among other things, a desire to increase the perceived fairness of the current retirement savings system. This "lack of fairness" hypothesis is often mentioned in conjunction with the so-called "upside-down incentives" provided by the current tax system with respect to the tax treatment of contributions in the 401(k) system.

From a purely financial economics perspective, the current federal tax treatment for 401(k) plans has advantages for workers with higher marginal tax rates (those who pay taxes at higher rates are seen as receiving a greater benefit from the deferral of those taxes), if other elements of the tax code are ignored.[6] However (and as several EBRI publications have explained), the constraints contained in IRC Secs. 402(g) and 415(c), combined with nondiscrimination requirements for the actual deferral percentage (ADP) and actual compensation percentage (ACP) have been shown to serve their intended purpose: restricting contributions made by more highly compensated workers relative to those made by non-highly compensated workers—resulting in a relatively flat multiple of final earnings at retirement as a function of salary across the income range. Figure 9 of VanDerhei, Holden, Alonso and Bass (2013) shows the ratio of 401(k) account-balance-to-salary for participants in their 60s for the year-end 2012 version of the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project, the largest, most representative repository of information of individual 401(k) plan participant accounts in the world. For those with 20 or more years of tenure, these ratios are highest for those with the lowest salary ranges. For those with shorter tenures, the ratios for the lowest-income quartile are nearly as large as those in any other income category.

While this information is certainly useful to evaluate assertions (and anecdotal claims) with respect to 401(k) plans, it needs to be supplemented with simulation modeling for a proper assessment of the potential of 401(k) plans to produce "adequate" income replacement for several reasons:

- The EBRI/ICI 401(k) database does not contain information on individual retirement account (IRA) rollovers, many of which may have originated as a 401(k) balance at an individual's prior employer(s), and therefore may only provide information on a fraction of the participant's retirement accumulations if there have been one or more job changes in their careers.
- Even if one looks only at 401(k) participants who are on the verge of retirement and have had significant tenure with the current employer, there is a significant likelihood that they would not have been eligible to participate in a 401(k) plan during their entire career with the current employer.[7]
- Since the passage of the Pension Protection Act of 2006, many of the 401(k) plans that had previously allowed eligible employees to voluntarily enroll have been modified to automatically enroll eligible employees. Although these employees will have the ability to opt out of such participation, it is clear that these plans have had a substantial impact on participation rates, especially for lower-income employees.[8]
- An analysis based solely on current balances will, of necessity, not be able to assess the impact of future employee activity (such as potential cash-out behavior at job change) nor the impact of future financial market returns.

In an attempt to assist the Subcommittee in its evaluation of the role of 401(k) plans, in December of 2013, EBRI's RSPM was used to analyze the potential of 401(k) plans to produce "adequate" income replacement for retirement.[9] That undertaking found that, assuming current Social Security benefits are not reduced, 86 percent of workers in the lowest-income quartile with more than 30 years of eligibility in a voluntary enrollment 401(k) plan are simulated to have sufficient 401(k) accumulations that, when combined with Social Security retirement benefits, would be able to replace at least 60 percent of their age 64 wages and salary on an inflation-adjusted basis. When the threshold for a successful retirement financing is increased to 70 percent replacement, 76 percent of these workers will still meet the threshold, based solely on the combination of projected 401(k) savings and Social Security combined. At an 80 percent replacement rate, 69 percent of the lowest-income quartile will still meet the threshold. It should be noted, however, that the percentage of those in the highest-income quartile deemed to be "successful" from just these two retirement components drops to 59 percent from 83 percent when measured against the 60 percent threshold.

When the same analysis is conducted for automatic enrollment 401(k) plans (with an annual 1 percent automatic escalation provision and empirically derived opt-outs), the probability of success for workers in the lowest-income quartile with more than 30 years of eligibility increases substantially: 94 percent at a 60 percent threshold; 90 percent at a 70 percent replacement and 85 percent at an 80 percent threshold are assumed to have sufficient resources at those levels.

Note, however, that the analysis of automatic enrollment plans mentioned above used the actual plan-specific default contribution rates (typically 3 percent of compensation). Many have questioned the wisdom of continuing to set the rates at this relatively low level in view of recent empirical evidence suggesting that higher default contribution rates may not result in a substantial increase in opt-out rates. A 2012 EBRI publication[10] simulated the impact of increasing the current plan-specific default rates to 6 percent. Under a set of specified behavioral assumptions, more

than a quarter of those in the lowest-income quartile who had previously NOT been projected to have a financially successful retirement under actual default contribution rates were found to be successful as a result of the increase in default deferral percentage.

3 What are the Primary Risks for Low-Income Workers After Retirement?

While the probabilities of not running short of money in retirement for a low-income Baby Boomer or Gen Xer is 17 percent when a threshold of 100 percent of simulated expenses is used, 30 percent with a 90 percent threshold, and 55 percent with an 80 percent threshold, it should be noted that these are averages for households in these cohorts, and the actual results may differ markedly, depending on how various risk contingencies play out after retirement. In 2006, EBRI provided a detailed analysis of the replacement-rate levels required to provide retirees with various probabilities of having "sufficient" retirement income.[11] As part of the analysis, a "building block" approach was adopted where the risks of investment, longevity and long-term health care costs were added in incremental layers. The impact of two of these risks are analyzed below.[12]

3.1 Longevity Risk

In an attempt to assess the impact of longevity on retirement income adequacy, relative longevity quartiles were established based on family status, gender, and age cohort. It should be noted that the impact would not be as severe if all retirement income was taken in the form of an annuity (either as a real annuity such as Social Security, or a nominal annuity such as that offered by private-sector defined benefit plans); however, given that only a very small percentage of defined contribution and IRA balances are currently annuitized (and that an increasing percentage of defined benefit accruals are taken as lump-sum distributions when the option is available), the prospect of "out-living" their retirement wealth is a very real risk for many low-income Baby Boomers and Gen Xers.

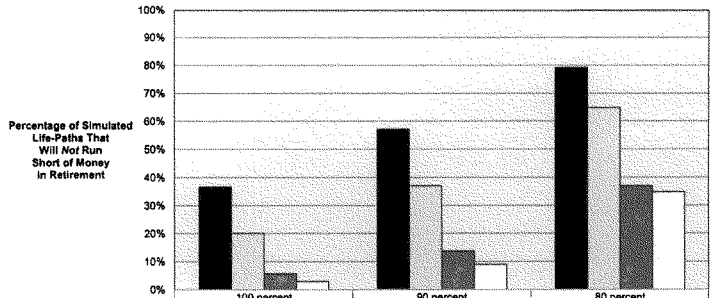
Figure 1 shows the impact of relative longevity quartiles on 2014 RRRs by preretirement income quartile. For the lowest-income quartile simulated to die in the earliest relative longevity quartile, the RRR with a 100 percent expenditure threshold is 36.7 percent. This is 19.9 percentage points larger than the overall average for this income cohort. This value decreases slightly to 20.1 percent in the second relative longevity quartile and 5.6 percent in the third relative longevity quartile. For the lowest-income quartile with the longest relative longevity, the RRR falls all the way to 2.8 percent. Similar influences are found when less rigorous thresholds are used. With a 90 percent of simulated expense threshold, the RRR for the earliest relative longevity quartile is 57.2 percent decreasing to only 9.0 percent for those with the longest relative longevity. The gap between the earliest and latest quartile is approximately the same at the 80 percent threshold, with 79.2 percent of those in the earliest quartile having sufficient retirement income decreasing to only 34.8 percent of those in the latest (longest-living) quartile.

3.2 Long-Term Care Risk

One of the primary findings of a 2012 EBRI publication on retirement income adequacy[13] was the significant impact of stochastic health care costs on overall retirement income adequacy. These include health care costs in retirement that are not likely to occur every year (in fact they may never occur for many households), but when they do they may have a catastrophic financial impact, due to their relatively high daily cost and/or potentially long duration. Unlike many other retirement projection models, RSPM has explicitly included the costs of nursing home and home health care costs in its decumulation model since its initial release in 2003 to account for these contingencies.

Figure 2 filters out those simulated life-paths with no stochastic health care costs in retirement and categorizes those costs into quartiles (based on the present value at age 65 of the per capita stochastic health care costs in 2014 dollars). Assuming a threshold of 100 percent coverage of simulated expenses, the results for the lowest-income quartile show that for this group of families unfortunate enough to experience the highest quartile of stochastic health care costs, the probability of not running short of money in retirement is virtually zero (an RRR value of 0.1 percent).[14] Not surprisingly, those in the lowest-income quartile who experience the lowest quartile of stochastic health care costs have a much higher probability of having enough money, with an RRR value of 30.0 percent. At a 90 percent expense threshold, 59.3 percent of the households in the bottom quartile of stochastic health care costs have adequate retirement income, but those in the top quartile are still virtually certain to run short of money (an

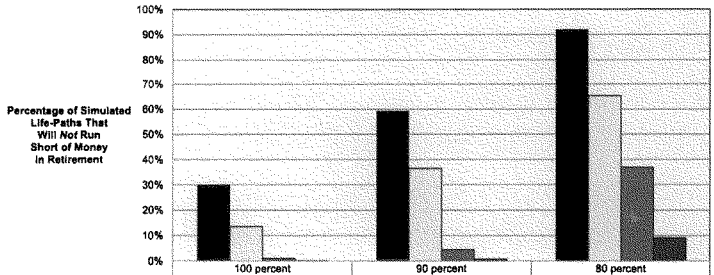
Figure 1
Impact of Relative Longevity Quartile* on 2014 Retirement Readiness Ratings,™ for Lowest Income Quartile



	100 percent	90 percent	80 percent
Earliest Quartile	36.7%	57.2%	79.2%
Second	20.1%	37.1%	64.9%
Third	5.6%	13.7%	37.0%
Latest Quartile	2.8%	9.0%	34.8%

Source: EBRI Retirement Security Projection Model® Version 1995.
Note: The values in this figure represent the percentages of simulated life-paths that will not run short of money in retirement assuming that 100 percent of simulated retirement expenses are paid.
* The longevity quartile is established relative to family status, gender, and age cohort.

Figure 2
Impact of Stochastic Health Care Costs on 2014 Retirement Readiness Ratings,™ by Preretirement Wage Quartile: Only Those Simulated Retirement Paths With Stochastic Health Care Costs Greater Than Zero



	100 percent	90 percent	80 percent
Bottom Quartile*	30.0%	59.3%	91.9%
Second	13.6%	36.5%	65.4%
Third	1.1%	4.5%	36.9%
Top Quartile	0.1%	0.8%	9.0%

Source: EBRI Retirement Security Projection Model® Version 1995.
Note: The values in this figure represent the percentages of simulated life-paths that will not run short of money in retirement assuming that 100 percent of simulated retirement expenses are paid.
* Measured as quartile of present value at age 65 per capita stochastic health care costs in 2014 dollars.

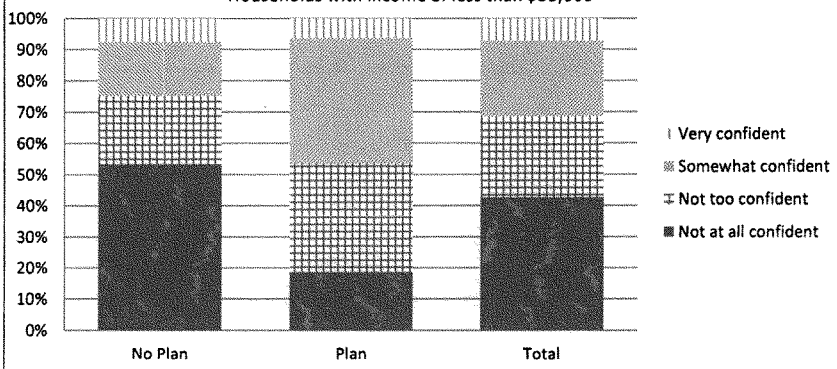
RRR of just 0.8 percent). At an 80 percent expense threshold, the RRR for households in the bottom quartile of stochastic health care costs jumps to 91.9 percent while those in the top quartile increase only to 9 percent.

4 Retirement Confidence for Low-Income Workers

While individual confidence of achieving a financially comfortable retirement is not dispositive of the reality of that goal, it can be instructive in crafting educational and policy goals. Drawing results from the 24th annual Retirement Confidence Survey, Figure 3 shows the distribution of confidence in 2014 that, for households with income of less than $35,000, the respondent (and spouse) will have enough money to live comfortably throughout retirement years. Although a total of 42 percent of these low-income households were not at all confident they would have enough money for this definition of retirement income adequacy, the numbers diverged substantially when the sample was bifurcated into those with a retirement plan[15] and those without. Only 18 percent of those with a plan were not at all confident, but this lack of confidence increased to more than half (52 percent) for those without a plan.

Figure 3

Distribution of confidence in 2014 that respondent (and spouse) will have enough money to live comfortably throughout retirement years by whether the household has a retirement plan:*
Households with income of less than $35,000



Source: Employee Benefit Research Institute and Greenwald & Associates, 2014 Retirement Confidence Survey
*Has a retirement plan is defined as any household that currently has at least one of the following: an IRA, money in an employer-sponsored retirement savings plan, or a defined benefit plan

Additional analysis was conducted with respect to confidence in having enough money to pay for long-term care (should it be needed) during retirement. Respondents with household incomes less than $35,000 appear to be quite cognizant of the risks shown in Figure 2, as 52 percent were not at all confident about this aspect of their retirement costs.[16] This compares with 30 percent of respondents with household income between $35,000 and $75,000 and 13 percent for those with household incomes above $75,000.

5 Summary

Since 2003, EBRI research has analyzed the retirement savings and retirement income adequacy of low-income Baby Boomers and Gen Xers in the United States. This statement highlights those previous results and provides new evidence on the importance of proper risk management techniques as a growing number of low-income workers approach retirement age. It would appear that while RRR values depend to a large degree on a household's future years of eligibility in a defined contribution plan (as well as whether future Social Security retirement benefits are reduced[17]), a great deal of the variability in these values could be mitigated by appropriate risk-management techniques at or near retirement age.

For example, the annuitization of a portion of the defined contribution and IRA balances may substantially increase the probability of not running short of money throughout retirement (VanDerhei, September 2006 and Park, 2011). Moreover, a well-functioning market in long-term care insurance would appear to provide an extremely useful technique to help limit the financial volatility from the stochastic, long-term health care risk.

EBRI looks forward to assisting the members of the Subcommittee as they continue their investigations into this extremely important public policy topic.

Appendix A: Brief Chronology of the EBRI Retirement Security Projection Model®

- The Retirement Security Projection Model® (RSPM) grew out of a multi-year project to analyze the future economic well-being of the retired population at the state level. The Employee Benefit Research Institute (EBRI) and the Milbank Memorial Fund, working with the office of the governor of Oregon, set out in the late 1990s to see if this situation could be evaluated for the state. The resulting analysis (VanDerhei and Copeland, September 2001) focused primarily on simulated retirement wealth with a comparison to ad hoc thresholds for retirement expenditures.
- The April 2001 *EBRI Issue Brief* (VanDerhei and Copeland, April 2001) highlighted the changes in private pension plan participation for defined benefit (DB) and defined contribution (DC) plans and used the model to quantify how much the importance of individual-account plans was expected to increase because of these changes.
- With the assistance of the Kansas Insurance Department, EBRI was able to create the EBRI Retirement Readiness Rating™ (RRR) based on a full stochastic decumulation model that took into account the household's longevity risk, post-retirement investment risk, and exposure to long-term nursing-home and home-health-care risks. The first state-level RSPM results were presented to the Kansas' Long-Term Care Services Task Force on July 11, 2002 (VanDerhei and Copeland, July 2002), and the results of the Massachusetts study were presented on Dec. 1, 2002 (VanDerhei and Copeland, December 2002).
- RSPM was expanded to a national model—the first national, micro-simulation, retirement-income-adequacy model, built in part from administrative 401(k) data. The initial results were presented at the EBRI December 2003 policy forum (VanDerhei and Copeland, 2003).
- The basic model was subsequently modified for testimony for the Senate Special Committee on Aging to quantify the beneficial impact of a mandatory contribution of 5 percent of compensation. (VanDerhei, January 2004).
- The model was enhanced to allow an analysis of the impact of annuitizing defined contribution and individual retirement account (IRA) balances at retirement age (VanDerhei and Copeland, 2004).
- Additional refinements were introduced to evaluate the impact of purchasing long-term care insurance on retirement income adequacy (VanDerhei, 2005).
- The model was used to evaluate the impact of defined benefit freezes on participants by simulating the minimum employer-contribution rate that would be needed to financially indemnify the employees for the reduction in their expected retirement income under various rate-of-return assumptions (VanDerhei, March 2006).
- Later that year, an updated version of the model was developed to enhance the EBRI interactive Ballpark E$timate® by providing Monte Carlo simulations of the replacement rates needed for specific probabilities of retirement income adequacy under alternative-risk-management treatments (VanDerhei, September 2006).

- RSPM was significantly enhanced for the May 2008 EBRI policy forum by allowing automatic enrollment of 401(k) participants with the potential for automatic escalation of contributions to be included (VanDerhei and Copeland, 2008).
- Additional modifications were added for a Pension Research Council presentation that involved a "winners/losers" analysis of defined benefit freezes and the enhanced employer contributions provided to defined contribution plans at the time the defined benefit plans were frozen (Copeland and VanDerhei, 2010).
- Also in 2009, a new subroutine was added to allow simulations of various styles of target-date funds for a comparison with participant-directed investments (VanDerhei, June 2009).
- In April 2010, the model was completely re-parameterized with 401(k)-plan design parameters for sponsors that had adopted automatic-enrollment provisions (VanDerhei, April 2010).
- A completely updated version of the national model was produced for the May 2010 EBRI Policy Forum and used in the July 2010 *EBRI Issue Brief* (VanDerhei and Copeland, 2010).
- The new model was used to analyze how eligibility for participation in a defined contribution plan impacts retirement income adequacy in September 2010 (VanDerhei, September 2010), and was later used to compute Retirement Savings Shortfalls (RSS) for Baby Boomers and Generation Xers in October 2010 (VanDerhei, October 2010a).
- In October testimony before the Senate Health, Education, Labor and Pensions Committee on "The Wobbly Stool: Retirement (In)security in America," the model was used to analyze the relative importance of employer-provided retirement benefits and Social Security (VanDerhei, October 2010b).
- The November 2010 *EBRI Issue Brief* expanded upon earlier work by EBRI to provide the first results of a new simulation model that estimated the impact of changing 401(k) plan design variables and assumptions on retirement income adequacy. Until recently however, there was extremely limited evidence on the impact of automatic contribution escalation (VanDerhei and Lucas, 2010).
- In February 2011, the model was used to analyze the impact of the 2008–2009 crisis in the financial and real estate markets on retirement income adequacy (VanDerhei, February 2011).
- An April 2011 article introduced a new method of analyzing the results from RSPM (VanDerhei, April 2011). Rather than simply computing an overall percentage of the simulated life-paths in a particular cohort that would not have sufficient retirement income to pay for the simulated expenses, the new method computed the percentage of households that would meet that requirement more than a specified percentage of times in the simulation.
- As explored in the June 2011 *EBRI Issue Brief*, RSPM allowed retirement income adequacy to be assessed at retirement ages later than 65 (VanDerhei and Copeland, June 2011).
- In a July 2011 *EBRI Notes* article (VanDerhei, July 2011), RSPM was used to provide preliminary evidence of the impact of the "20/20 caps" on projected retirement accumulations proposed by the National Commission on Fiscal Responsibility and Reform.
- The August 2011 *EBRI Notes* article (VanDerhei, August 2011) used RSPM to analyze the impact of defined benefit plans in achieving retirement income adequacy for Baby Boomers and Gen Xers.
- In September, it was used to support testimony before the Senate Finance Committee (VanDerhei, September 2011) in analyzing the potential impact of various types of tax-reform options on retirement income. This was expanded in the November 2011 *EBRI Issue Brief* (VanDerhei, November 2011).
- A March 2012 *EBRI Notes* article (VanDerhei, March 2012) used new survey results to update the analysis of the potential impact of various types of tax-reform options on retirement income.
- The May 2012 *EBRI Notes* article (VanDerhei, May 2012) provided 2012 updates for the previously published RRRs as well as the RSS.
- The June 2012 *EBRI Notes* article (VanDerhei, June 2012) introduced severity categories in the RSS projections for Gen Xers.
- The August 2012 *EBRI Notes* article (VanDerhei, August 2012) provided additional evidence on whether deferring retirement to age 70 would provide retirement income adequacy for the vast majority of Baby Boomers and Gen Xers.
- The September 2012 *EBRI Notes* article (VanDerhei, September 2012) analyzed the impact of increasing the default-contribution rate for automatic enrollment 401(k) plans with automatic escalation of contributions.
- The November 2012 *EBRI Notes* article (VanDerhei, November 2012) reclassified the RRRs to provide additional information on those substantially above the threshold; close to the threshold; and substantially below the threshold.

- The March 2013 *EBRI Notes* article (VanDerhei and Adams, March 2013) used a modified version of RSPM to assess the probability that respondent households would not run short of money in retirement if they did, in fact, accumulate the amount they said would be required in the 2013 Retirement Confidence Survey.
- The June 2013 *EBRI Issue Brief* (VanDerhei, June 2013a) used RSPM to provide a direct comparison of the likely benefits under specific types of DC and DB retirement plans.
- The June 2013 *EBRI Notes* article (VanDerhei, June 2013b) used RSPM to show that 25–27 percent of Baby Boomers and Gen Xers who would have had adequate retirement income under return assumptions based on historical averages were simulated to end up running short of money in retirement if today's historically low interest rates were assumed to be a permanent condition.
- The August 2013 *EBRI Issue Brief* (VanDerhei, August 2013) used RSPM to analyze the Obama administration's fiscal year (FY) 2014 budget proposal to include a cap on tax-deferred retirement savings that would limit the amounts accumulated in specified retirement accounts to that necessary to provide the maximum annuity permitted for a tax-qualified defined benefit plan under current law.
- The December 2013 *EBRI Notes* article (VanDerhei, December 2013) used RSPM to expand the analysis in the June 2013 *Issue Brief.* Rather than trying to reflect the real-world variation in DB accruals, the baseline analysis in the previous analysis used the median accrual rate in the sample (1.5 percent of final compensation per year of participation) as the stylized value for the baseline counterfactual simulations. The new research computed the actual final-average DB accrual that would be required to provide an equal amount of retirement income at age 65 as would be produced by the annuitized value of the projected sum of the 401(k) and IRA rollover balances.
- The January 2014 *EBRI Notes* article (VanDerhei, January 2014) used RSPM to model the likelihood that 401(k) participants currently ages 25–29 would have sufficient 401(k) accumulations that, when combined with Social Security benefits, could replace 60, 70 or 80 percent of their preretirement income on an inflation-adjusted basis.

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Endnotes

[1] See Appendix A for a brief chronology of the model.
[2] VanDerhei (February 2014).
[3] Preretirement income in RSPM is determined in a manner similar to the average-indexed-monthly-earnings computation for Social Security with the following modifications:

- All earned income is included up to the age of retirement (i.e., there is no maximum taxable wage base constraint, and the calculation terminates at retirement age).
- Instead of indexing for changes in average national wages, the model indexes based on assumed, after-tax rate of return based on asset allocations that are a function of the individual's age in each year.

Percentile distributions are then established based on population statistics for each five-year age cohort.
[4] Figure 3 of VanDerhei (February 2014).
[5] Only Gen Xers are shown in this portion of the analysis given their longer future working careers until age 65.
[6] See VanDerhei (March 2011) for more detail.
[7] The proposed regulations for 401(k) plans were first introduced in November of 1981 and it took several years for many sponsors to introduce the plans. Moreover, many plans that were originally introduced as supplemental plans to existing defined benefit plans have been modified to provide more generous employer contributions at the time the defined benefit plans were frozen (VanDerhei, April 2010).
[8] See Figure 23 of Utkus and Young (2013) for recent evidence.
[9] Additional details on RSPM and the assumptions used in 2013 can be found in VanDerhei (June 2013). The financial market results are generated from stochastic annual returns with a log-normal distribution and an arithmetic mean of 8.6-percent real return for stocks and 2.6 percent real return for bonds.
[10] VanDerhei (September 2012).
[11] VanDerhei (September 2006).
[12] EBRI is currently working on a separate study to model sequence of return risk that will need to be completed before investment risk in the decumulation period can be appropriately analyzed in RSPM.
[13] VanDerhei (August 2012).
[14] Note that even though Medicaid eligibility is factored into RSPM, an extended stay in a nursing home is still likely to leave those alive at the end of the nursing home stay (or the surviving spouse) in a financially depleted condition.
[15] Defined as any household that currently has at least one of the following: an IRA, money in an employer-sponsored retirement savings plan, or a defined benefit plan.
[16] Another 21 percent of respondents in this group were not too confident.
[17] See VanDerhei (February 2014) for details.

Senate Finance Subcommittee on Social Security, Pensions, and Family Policy
Hearing on Retirement Savings for Low-Income Workers
February 26, 2014

Submission for the Record
M. Cindy Hounsell, President
Women's Institute for a Secure Retirement (WISER)

Introduction

WISER is a nonprofit organization that works to help women, policymakers, the media and industry understand the important issues surrounding women's retirement income security. Our primary mission is financial education and capability — providing women with the crucial skills and information they need to avoid poverty in retirement.

WISER's efforts include direct outreach to millions of women through publications, financial education workshops and our renowned website; partnerships; research; and outreach to policymakers and the media. WISER also operates the U.S. Administration on Aging's National Resource Center on Women and Retirement Planning.

WISER is pleased to submit written testimony for the record on the topic of retirement income savings for low-income workers. This issue is particularly relevant for women, who are more likely than men to be among the working poor.[1] WISER strongly supports President Obama's MyRA proposal and will work to promote adoption by employers and the opportunity for American workers, particularly women to have access to this savings plan.

Women and Retirement Income Insecurity

What WISER knows firsthand, and what surveys confirm, is that women across all income groups fear becoming bag ladies in their old age. A 2013 Allianz Life survey found that 49 percent of women fear ending up broke and homeless. This includes 27 percent whose household incomes are $200,000 or more.[2] Perhaps this concern is so pervasive because so many women know of others who have ended up poor who never struggled before. Often, these women's financial lives are turned upside down following the death of a spouse or a divorce or a job loss.

Women face a host of unique issues that put them at risk of poverty in retirement. They earn less than men and therefore have less to save. They tend to work where retirement benefits aren't offered. As primary caregivers, women are more likely to work part-time or take long stretches of time out of the workforce, giving them

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[1] BLS. A Profile of the Working Poor, 2011. April 2013.
[2] Allianz Life. *Women, Money, and Power Study*. 2013.

lower lifetime earnings. This affects their Social Security benefits and their ability to save. Also, women live longer than men on average, which means their money has to last longer. Because women live longer, they are more likely to end up alone in their older years. One in five women age 65 or over who live alone are poor.

Despite needing more retirement assets, women end up having less. In the case of single women over 65 today, fully half receive less than $750 a year in income from assets.[3] The result of the unique issues women face? A report by GAO identified that women age 65 and over have 25 percent less retirement income and twice the poverty rate of men.[4] When widowhood or divorce occurs, the effects are even more pernicious. The same report found that the income of women near or in retirement dropped 37 percent as a result of widowhood, while men's fell 22 percent. Divorce or separation reduced women's income by 41 percent – almost twice the decline of men's income.[5]

Today, the rate of poverty for women age 65 and over is 10.7 percent, compared to 6.2 percent for men.[6] When looking at single women over age 65, the poverty rate jumps to 17.4 percent.[7] In this mix is a poverty rate for white single women of 15.3 percent, 32.5 percent for single African American women, and 43.7 percent for single Hispanic women.[8]

Women need guidance about how to plan and save, and how to avoid poverty in old age. But women feel shortchanged by the financial services industry, according to the Allianz Life study referenced earlier. They believe the industry is more oriented to men, and 62 percent do not have a financial professional.

Help From MyRA

In his State of the Union Address, President Obama committed to establishing MyRAs – "starter" retirement savings accounts – to help millions of people save. MyRAs will not solve most of the problems in our wobbly system of retirement security, but they can begin to solve some of them.

The retirement income security 'system,' as it is, leaves behind millions of American workers. Whether they're self-employed, work part-time, or work for small businesses that don't offer 401(k)-type plans, these Americans, and in particular women, don't have the tools to save for retirement.

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[3] Women's Institute for a Secure Retirement. *Fact Sheet: Single Older African American Women and Poverty.*
[4] GAO. Retirement Security: Women Still Face Challenges. GAO-12-699. July 19, 2012.
[5] GAO. Retirement Security: Women Still Face Challenges. GAO-12-699. July 19, 2012.
[6] Current Population Reports. Income, Poverty and Health Insurance Coverage in the United States, 2011. September 2012.
[7] WISER. Fact Sheet: Single Older African American Women and Poverty.
[8] Ibid.

It could be argued that these workers could open an IRA. But the reality is that they don't. Why? To start, 17 million Americans don't have an IRA because they don't even have a bank account.[9] And for those who do have bank accounts, perhaps they couldn't imagine coming up with $1,000+ to open an IRA. Then, there's the reality that nearly 25 million Americans are simply invisible to financial institutions because they lack a credit score.[10]

Even though the vehicle for MyRAs is a Roth IRA, there's not much else in common between the two accounts. For example, a MyRA will let a worker open an account with as little as $25 initially and a $5 per pay period contribution. The investment will be government bonds – a safe, albeit low-interest, product that the American people trust.

You can look at MyRAs as eventually giving entry into the IRA space to small savers. MyRAs are capped at $15,000, after which they have to get rolled into a private Roth IRA (or a 401(k) if the worker has access to one at some future point in time). Once in a private IRA, workers will have a range of retirement investment options.

For the uninitiated, investing is overwhelmingly complicated. The MyRA gives workers a chance to start simple with a small payroll deduction into principal-preserved government savings bonds. Yes, once these workers reach the cap they will have to wade into the waters of investing. But initially, keeping it simple paves the way to action.

MyRAs may represent an important tie-in to the federal Saver's Tax Credit. If MyRA contributions are introduced hand-in-hand with the credit, we could see a significant uptake by low- and moderate-income earners.

National Education and Resource Center on Women and Retirement Planning

One of WISER's key initiatives is the **National Education and Resource Center on Women and Retirement Planning**. WISER administers the program in cooperation with the U.S. Administration on Aging, which funds the Center. The Center's primary goal is to educate moderate- and low-income women with actionable information that can help them avoid poverty in retirement.

WISER's approach is to bring financial planning back to the basics. Our goal is to help women make the best decisions they can with the limited resources they may have. We educate them on the risks of longevity, inflation, and lifestyle changes. We train trainers who assist women in their own communities.

Through the Center, we have directly reached tens of thousands of women with our workshops, and millions of women with our publications and website. The Center

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[9] FDIC. *2011 FDIC National Survey of Unbanked and Underbanked Households.* September 2012.
[10] Forbes.com. *Banking the Unbanked: A How-To.* June 14, 2013.

has a Business Advisory Council and receives help in disseminating education and information through the Financial Services Roundtable website, as well as the American Council of Life Insurers and several individual companies. Many other partners—employers, business and trade organizations, aging and women's organizations and community-based groups help spread our message and disseminate our materials. We also work with other federal agencies, including the Department of Agriculture's Cooperative Extension Service, the Department of Labor, and the Social Security Administration.

Conclusion

Thank you for accepting WISER's testimony for the record. Women are at a particularly high risk for poverty in retirement. WISER has learned first-hand that women without financial knowledge are eager to gain and apply it, and to take greater control of their financial lives. MyRAs represent an important opportunity to make savers out of non-savers and to ultimately open a wider universe of retirement saving and investing options to lower-income women. WISER will do everything in its power to promote adoption and use of MyRAs.

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