PRINCIPLES FOR A NEW RETIREMENT SYSTEM

Working Paper

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www.retirement-usa.org
Retirement USA is an initiative developed by organizations representing workers and retirees that are committed to working for a universal, secure, and adequate private retirement system for the future that supplements Social Security. The organizations launching the initiative are the Economic Policy Institute, the National Committee to Preserve Social Security and Medicare, the Pension Rights Center, and the Service Employees International Union.

This working paper documents the need for a new system, details principles that should guide the development of a new system, and provides examples of plans and proposals that incorporate these principles. It was prepared by Robert Stowe England, with invaluable technical contributions and editing by Karen Ferguson, Monique Morrissey, Norman Stein, John Turner, and Robert Walker.

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PREFACE

America’s promise of a secure retirement system is essential to our nation’s ideals. But for far too many Americans that promise has been broken or never fulfilled. While the current system of pensions and retirement savings plans, in combination with Social Security, have provided adequately for many people in retirement, the system has failed to provide a reasonable standard of living for too many others. In what has been the most prosperous nation in the world, millions of retirees are barely scraping by.

There is a growing recognition at all levels – by workers and retirees, by the business community, and by policymakers – that placing all of the risks and responsibilities for retirement savings on individuals to supplement Social Security has proven to be both inefficient and ineffective. At the same time, there has been a quiet acknowledgement by many in the public policy community that a better approach would incorporate key elements of traditional pensions – such as money locked in until retirement, pooled professional investment, and lifetime payouts – while at the same time including other features such as portability and simplicity, which are not characteristic of these plans.

Among the organizations and experts concerned about these issues, there is general agreement that such a system should be designed to supplement a strengthened Social Security system, and should allow for the continuation of existing plans that provide adequate and secure retirement benefits.

Over the past year and a half, the Pension Rights Center, the Economic Policy Institute, the National Committee to Preserve Social Security and Medicare, and the Service Employees International Union have met with pension experts and representatives of worker and retiree organizations to examine a number of plans, systems and proposals that incorporate these core concepts, both in America and abroad, to determine what principles should guide the design of a new visionary system.
A total of seven systems, plans, and proposals were studied. Of particular interest were two existing programs in other countries – the Australian Superannuation System and Collective Defined Contribution Plans in the Netherlands – and two proposed systems for this country: the Guaranteed Retirement Account plan developed by Teresa Ghilarducci for the Economic Policy Institute and the Guaranteed Benefit Plan contained in the proposed Lifetime Security Plan developed by the ERISA Industry Committee. The group also reviewed principles adopted by the Executive Councils of the AFL-CIO and Change to Win that reflect these concepts. (See Appendices B and C)

After studying these proposals, we have identified key principles needed to achieve the broad goals of providing universal, secure and adequate retirement income for future retirees. Now we are committed to educating policymakers and the general public about the need for a new private retirement system, and the importance of these principles. To that end, we have launched the Retirement USA initiative, with the goal of working together to develop a retirement system that, together with Social Security, will be Universal, Secure, and Adequate.

The Retirement USA initiative is not advancing a specific proposal or approach at this time. It is our hope that these principles, once they are understood and embraced, will lead to the formulation of a range of proposals. Indeed, the Retirement USA initiative encourages those employee, retiree, business, consumer, and public policy organizations that support these principles, to draft their own proposals for public consideration. These proposals will be the focus of a conference scheduled tentatively for the fall of 2009 to coincide with the 35th anniversary of the landmark private pension law, the Employee Retirement Income Security Act of 1974.

As important as it is to envision and begin developing a private new retirement system now, this initiative is not intended to diminish in any way ongoing efforts to preserve, strengthen, and improve current pensions, 401(k)s, and other retirement plans, and to expand retirement plan coverage. But even as we shore up and expand existing plans, it is time to begin work on a new, more comprehensive system that, together with Social Security, will
provide universal, secure and adequate retirement income for workers. It will take time to
develop and implement such a system. That work needs to begin now. Delay will only make
it harder to provide true retirement security for all Americans.
SHORTCOMINGS OF THE CURRENT SYSTEM

America’s promise of a secure retirement is central to our nation’s ideals. Yet today, our retirement system does not work for far too many Americans. Although Social Security is the cornerstone of our retirement system—nearly two-thirds of retirees rely on Social Security for more than half of their retirement income— the average Social Security benefit is only slightly above a minimum wage income. In 2007, the median income (from all sources) of individuals aged 65 and older was only $17,382.

Employer-provided pensions and retirement savings are essential in filling the gap. But fewer than half of all workers participate in a retirement plan, and millions of workers who have 401(k) plans have too little in them. Workers who are lucky enough to have defined benefit plans are the most likely to have an adequate income, but employers are pulling back on pension promises.

Retirement experts predict that most Americans working today will have less retirement security than their parents, a historic reversal linked to the decline in employer-provided pensions and exacerbated by steep declines in stock and housing values. Retirement account balances have dropped by roughly a third from their peak, slashing the income of millions of retirees and forcing many older workers to push back their retirement. Meanwhile, unemployment among older workers has spiked and many older Americans have not saved enough to retire nor find a job.

Why has our private retirement system failed so many workers? In large measure, it is because it is a patchwork system without clearly articulated goals. Three key goals should guide the reshaping of our pension system for future generations of workers: universality, security, and adequacy. This chapter describes how the current system fails to meet these goals and also charts the enormous costs and inequities that our current system creates.
The current system does not provide universal coverage.

Only half of full-time workers participate in an employer-sponsored retirement savings or pension plan, even fewer if you include part-time workers. This includes 35% of full-time workers who do not have access to a plan at work, and 15% who have access but decline to participate. iv

Low-income workers are the least likely to participate: over 70% of households in the bottom earnings quintile reach retirement age without acquiring any employer-sponsored retirement coverage over their working lives. v These workers are both less likely to be covered under a plan and less likely to participate if they are covered. This is not surprising, because they have a harder time saving yet receive minimal or no tax incentives to contribute.

The current system does not provide most workers with secure retirement benefits.

Secure retirement benefits are predictable and do not subject workers or retirees to unreasonable risk. In other words, they are benefits a participant can count on. First, the benefits should be predictable enough for workers to plan for retirement and feel a sense of financial security; and second, retirees and their spouses or domestic partners should be able to count on uninterrupted streams of income for life, regardless of market conditions or length of life.

In the current system, many workers and retirees are subjected to unacceptable levels of risk. The two principal risks to which workers and retirees are exposed are financial risk and longevity risk, but there are also other sources of risk, such as the risk that an employer will reduce or freeze benefits, and the risk that inflation will erode retirement income.
Participants in traditional defined benefit pension plans do not generally face financial risk unless their plan becomes underfunded and their earned benefits exceed amounts guaranteed by the Pension Benefit Guaranty Corporation. In defined benefit pension plans, assets are pooled and managed by professional asset managers who invest for the long term. Structurally, defined benefit plans assign immediate financial risk to the employer rather than to individual employees, so a decline in market values does not ordinarily result in a reduction in benefits.

A majority of plan participants, however, are covered by 401(k) plans where they must make investment allocation decisions and bear the risk of adverse investment performance. Participants often lack the financial skills, time, and focus to make good investment decisions and regularly rebalance a portfolio. It has been extensively documented that some participants invest too conservatively, that some fail to optimally diversify, that some assume too much risk, and that some make arbitrary investment decisions. Moreover, participants do not receive adequate disclosure of investment and administrative fees, which further complicates the problem of making sensible investment allocations.

But even those 401(k) participants who make sensible, conservative investment allocation decisions over a long time horizon are subject to unacceptable degrees of market fluctuation. Gary Burtless of the Brookings Institution has estimated that a 401(k) participant who contributed 4% of her wages over 40 years and invested the funds in a conservative portfolio split equally between long-term government bonds and stocks would be able to replace a quarter of her pre-retirement earnings if she retired in 2008. This is only half as much as a similar worker who retired in 1999, but much better than a worker who retired in 1974, who would have a dismal replacement rate of only 18%. Similarly, simulations by Patrick Purcell of the Congressional Research Service indicate that 401(k) participants who adopt a lifecycle approach—gradually reducing their exposure to stocks from 65% to 50% of total assets as they approach retirement—also face a significant risk of not being able to maintain their standard of living in retirement.
Financial risk typically follows the worker into retirement. Most retirees receiving 401(k) plan distributions continue to manage their investments and continue to be subject to market declines. Moreover, even retirees who invest in fixed income securities are subject to both risk of firm failure and declining interest rates as fixed income securities mature.

The plummeting stock market—broad market indices are back down to now at 1996 levels—graphically illustrates the financial risk that workers and retirees bear. The market has lost more than half of its value since its October 2007 peak, draining more than $2 trillion from defined contribution plans. With two-thirds of account balances invested in equities, this means the average participant has seen a third or more of his or her retirement savings evaporate in little over a year.

Employees and their spouses in traditional pension plans are guaranteed the security of a defined lifetime income—an income that they cannot outlive. In contrast, few 401(k) plans or other individual retirement savings plans offer an option to receive benefits as a lifetime annuity. Such individuals must prepare for the possibility that they might live to 90 or even a 100, or run the risk that they will deplete their retirement resources before dying.

Participants in 401(k) plans can enter the market for an individual annuity, converting their lump sum into a lifetime stream of income. But the individual annuity market is expensive, in part because insurance companies assume that only someone with a higher-than-average life expectancy would be interested in purchasing an annuity. This problem is compounded by the fact that the annuities market is difficult for non-experts to navigate, so unsophisticated investors are not well situated to comparison shop or determine whether an annuity represents a good value. Moreover, in many states the individual annuity market is not subject to fiduciary and consumer protections equivalent to those that regulate the behavior of pension fiduciaries under federal law.

While 401(k) plans are risky for workers, traditional defined benefit plans require employers to take on long-term liabilities and to make contributions that can vary significantly from
year to year, depending on the returns earned on pension assets and other factors.\textsuperscript{ xv }
Although benefits are funded in advance, employers who sponsor traditional pensions face the possibility of a sustained market downturn or a faster-than-anticipated increase in group life expectancy. This is a particular challenge for small businesses, who are rarely in a position to promise benefits decades into the future. But even large employers may find themselves in a bind following a market downturn, especially those in shrinking industries or where productivity gains have reduced the ratio of active workers to retirees.

- \textit{The current retirement system did not generate adequate retirement income for most workers even before the economic downturn.}

Social Security covers the vast majority of workers, and nearly two-thirds of retirees rely on it for more than half of their income.\textsuperscript{ xvi }While Social Security is the most efficient and effective poverty-prevention program in the nation, it was never meant to provide more than a basic level of benefits. There was an underlying assumption that retirees would need to have pensions and savings to supplement these benefits. As a result, Social Security retirement benefits replace less than half of most workers’ pre-retirement earnings—39\% for the average worker if he or she retires at 65—and these benefits will continue to decline as scheduled benefit cuts take effect.\textsuperscript{ xvii }

Retirement experts generally believe that employees who participate in a traditional employer-provided defined benefit pension plan for most of their careers will receive sufficient benefits, along with Social Security, to prevent a sharp decline in living standards at retirement. But traditional pension plans cover fewer and fewer workers in the private sector.\textsuperscript{ xviii }In 2007, only 20\% of private-sector workers\textsuperscript{ xix }were in defined benefit plans, compared to 43\% who participated in 401(k)-style defined contribution plans (this includes 12\% with both kinds of plans).\textsuperscript{ xx }A worker who spends only a few years in a defined benefit plan, especially early in his or her career, will often receive only modest retirement benefits.
The situation is generally worse for workers in 401(k) and other types of individual account retirement savings plans. In 2006, the median account balance of defined contribution plan participants was only $25,000, and $40,000 for workers approaching retirement age.\textsuperscript{xxi} Total household savings in retirement accounts are larger, but still grossly inadequate. The Federal Reserve’s Survey of Consumer Finances shows that the median household with at least one retirement account had a total of $45,000 in retirement savings in 2007—$98,000 for a household at or approaching retirement age.\textsuperscript{xxii} All of these figures predate the market’s decline.

This is not nearly enough. Alicia Munnell and Annika Sundén of the Center for Retirement Research have estimated that 401(k) and IRA balances in 2004 were about 20-40\% of what participants should have in their retirement accounts based on age and earnings benchmarks.\textsuperscript{xxiii} Similarly, the Government Accountability Office has projected that based on contribution patterns before the current economic downturn, defined contribution plans would on average replace about 22\% of earnings at retirement, with 37\% of workers reaching retirement age with zero plan savings.\textsuperscript{xxiv}

Part of the problem is that employers and employees can reduce or stop 401(k) contributions at any time. Many companies, for example, have suspended their 401(k) match in the current downturn.\textsuperscript{xxv} But another problem is that the current system permits employees to have access to retirement savings before retirement age. In most plans, employees can take withdrawals to pay for housing, education, and medical expenses while they are still employed, and most 401(k) plans permit employees to borrow against their accounts. Indeed, 18\% of participants who were eligible had loans outstanding from their 401(k) account, with unpaid balances averaging around $7,500.\textsuperscript{xxvi} Perhaps the most significant risk of pre-retirement asset depletion occurs when an employee changes jobs. According to the Center for Retirement Research, 45\% of participants who changed jobs in 2004 cashed out their 401(k) balances, siphoning off approximately 18\% of total 401(k) assets.\textsuperscript{xxvii}
The current retirement system is costly, inefficient, and inequitable.

The current private retirement system not only performs poorly, it also comes at a high cost to taxpayers. Subsidies for retirement plans are one of the three biggest categories of tax expenditures, along with subsidies for health care and homeowners. The Office of Management and Budget estimates that the cost of tax breaks for contributions to defined benefit pensions was $47 billion dollars in 2007, and the cost for 401(k)s, IRAs and other individual accounts was $67 billion. To get a sense of the magnitude, if the total ($114 billion) were instead distributed directly to retirees, every American 65 and over could receive a check worth approximately $3,060 per year, or nearly a quarter of the average Social Security individual retirement benefit. Furthermore, these figures understate the total long-term cost of tax breaks for contributions made to retirement plans that year, which is nearly double that amount ($218 billion) in present-value terms.

The tax benefits to those who participate in both pensions and retirement savings plans are tied to a participant’s income tax rate. As a result, lower and moderate income taxpayers receive modest (or in some cases no) tax subsidy for each dollar put into retirement plans, while more affluent workers—who have the financial resources to save for their retirement even without government subsidy—receive the most generous tax subsidies. This is compounded by the fact that higher-paid workers are more likely to be covered and—in the case of 401(k)s and other savings plans—to participate. As a result, 70% of the tax benefits of 401(k) plans go to the top 20% of households by income, according to an estimate by the Tax Policy Center.

Experts question whether much additional savings are actually generated by tax subsidies for retirement savings plans. There is no way to ensure that these tax breaks generate new saving rather than simply reducing the taxes of people who already save. They also do not prevent individuals from saving in tax-favored accounts and drawing down other savings (or borrowing) elsewhere.
Individual account plans, such as 401(k)s and Individual Retirement Accounts, are generally less efficient than pooled defined-benefit funds, a problem compounded by poor disclosure of 401(k) fees. The Center for Retirement Research estimates that net investment returns were a full percentage point higher (10.7% vs. 9.7%) for defined benefit pension plans than for 401(k)-type defined contribution plans between 1988-2004, despite a lower concentration of funds invested in equities. With compounding, this small-sounding difference can translate into a 30% larger nest egg over 30 years.

One reason for this poorer performance is that most 401(k) participants bear much higher investment costs than those paid by pension plans. A survey of 80 providers found that annual fees could range from about 0.5% to 2.5% of assets for a medium-sized plan. Employers have no incentive to look for low-cost providers since these fees are mostly passed on to participants, and weak disclosure rules mean that most participants are unaware of how much their investment returns are being eroded by fees.

Most 401(k) participants do not have the financial expertise to manage their investments. They tend to have an all-or-nothing approach to risk, with 21 percent holding more than 80 percent of their 401(k) balances in stocks, either directly or through mutual funds, and 38 percent investing none in stocks.

- **Conclusion**

Our retirement system was in trouble even before the economy and the stock market collapsed. Fewer than half of all workers participate in an employer-based retirement plan, and those who do are less and less likely to have secure and adequate benefits as responsibility for retirement has shifted to the individual.

As more and more workers are forced to delay retirement, it is difficult for even 401(k) supporters to argue that the system is working. But this patchwork system was full of holes even before the stock market collapsed, and 401(k)s were never designed to be the primary source of retirement income for most workers. The question is whether we should keep
adding patches, or whether we need a complete overhaul of our employer-based retirement system.

Until recently, the focus has been on incremental reforms, many designed to help individuals make better saving and investment decisions. Though many of these reforms are sensible, the focus on individuals ignores how the system has failed and does not ask why our society shifted the responsibility for retirement to individuals in the first place. It implies that workers are to blame for their predicament, even though those who save diligently and invest carefully are also struggling.

There are three overarching goals that should guide policymakers in designing a new retirement income system: universality, security and adequacy. We need to ensure that any solutions that are proposed will meet these goals in the real world, not in an idealized one. We also need to ensure that taxpayer funds are used to promote retirement security, not to provide tax shelters for wealthy households or lucrative fees for the financial services industry.

We need a comprehensive solution that addresses interrelated problems. For example, a system that places most of the burden for retirement saving on individuals will always have to wrestle with the problem of pre-retirement loans and withdrawals (simply plugging these leaks will not work, because many workers would stop contributing to the system). A system that relies on tax incentives to promote individual retirement savings will necessarily tend to favor high-income workers who can afford to save more and who benefit the most from these tax breaks. Conversely, a truly universal system would need to shield low-income workers from out-of-pocket costs or wage cuts.

Traditional pensions work well for many workers, but they expose employers to long-term risks and cost volatility. Meanwhile, 401(k) plans have failed to provide most workers with adequate and secure retirements. We need a comprehensive solution: a retirement system for the 21st century that combines elements of both defined-benefit and defined-contribution
plans in order to minimize—not simply shift—costs and risks. To do so, retirement will need to be the shared responsibility of employers, employees and the government.
TOWARDS A 21ST CENTURY RETIREMENT SYSTEM

When it comes to retirement security there is no quick fix. It will take years to develop and implement a comprehensive approach to retirement security, one that can provide universal coverage and benefits that are adequate and secure. To those that say “Not now. Now when the economy is in trouble,” we remind them that the Social Security system was enacted and implemented during the worst economic crisis in the history of our country: the Great Depression. Work needs to begin now.

It will also take time to make sure that the millions of current workers fortunate enough to be in good plans are protected, particularly those who are nearing retirement. Employee and retiree organizations, consumer groups and policymakers must redouble their efforts to strengthen Social Security, preserve existing pension plans, improve 401(k)s, and expand retirement plan coverage.

If we fail to undertake this task now – when the shortcomings of the current system are most apparent – we lose this opportunity and we imperil the retirement security of future generations of retirees. The time for a new visionary approach to retirement income security is now.

In designing a system for the benefit for future generations of retirees, we must do what the current system fails to do: provide retirement income security that is universal, secure, and adequate. Our experience with the current system has taught us that such a system will not evolve by accident; it must be by design.

While there are innumerable ways of expanding pension coverage and participation in retirement savings plans, most of those approaches would fall short of one or more of the goals of universality, security and adequacy.

Achieving all three of those goals will require adherence to a core set of principles. Tax incentives, for example, can serve to expand pension coverage and retirement savings, but
tax incentives alone will never yield universal coverage. Universality can only be achieved if we require the participation of all employers and employees not participating in an existing plan. Similarly, retirement income security for most workers cannot be achieved unless benefits are protected from the vagaries of the stock market and paid over the lifetime of retirees. And, just as importantly, the goals of universality, security and adequacy can never be achieved by putting all the responsibility on either employees or employers. A new and comprehensive system will, of necessity, require shared risks and responsibilities; neither employees nor employers alone can do it, and the government has an essential role to play in ensuring the full participation of low-income workers.

As in all areas of public policy, the devil is often in the details. As demonstrated by the experience of other countries, there is no single, commonly accepted formula for achieving universality, security and adequacy, but there are some common features or principles that are essential to success. Identifying those features or principles is the first step toward the design of a viable, high-performing system.

Below are Retirement USA’s Principles for a New Retirement System. The principles are preceded by a preamble, which is designed to place the principles in context.

**PREAMBLE TO PRINCIPLES FOR A NEW RETIREMENT SYSTEM**

The current financial meltdown highlights the inadequacy of America’s retirement system. Social Security is the only reliable and guaranteed benefit for most American retirees. But Social Security pays the average retiree income only the same amount our lowest wage workers receive through the minimum wage. A typical retiree needs nearly twice that amount to preserve a reasonable standard of living. Our retirement system assumes that retirees will have sufficient income from other sources to supplement Social Security. The problem is that most do not. As a result half of all people age 65 and over are trying to make ends meet on income of less than $17,382 a year.
About half of American workers in the private sector do not participate in any private retirement plan, and the majority of those who do participate are in retirement savings arrangements that are dependent on the vagaries of the stock market. Even before the economic collapse most workers had accumulated very little in these plans. Half of all private sector employees contributing to 401(k)-type plans had less than $25,000 in their accounts, and older employees had median account balances of $40,000. Only one-fifth of all private sector workers are covered by secure pension plans. America deserves a retirement system that is Universal, Secure and Adequate. Accordingly, we believe it is imperative to lay out principles that should guide us as we begin an important national dialogue on how we can do better for American workers in the future.

Underlying the principles we are putting forward today are the following shared beliefs:

- Social Security is the cornerstone of American retirement security. The current economic crisis and the resulting decline in individual retirement savings, combined with the continuing disappearance of defined benefit pension plans, are powerful reminders of the importance of Social Security. Social Security must be preserved and strengthened.
- Defined benefit pension plans remain the soundest vehicles for building and safeguarding retirement income security. We must make every effort to stabilize these plans and encourage employers to offer and maintain them.
- We must strengthen worker protections for 401(k) and other defined contribution plans, which help millions of Americans build retirement savings.

While we remain committed to preserving and improving those current pension and 401(k) plans that are providing adequate and secure benefits for workers, we cannot ignore the fact that the current system – regardless of how many changes are made – will remain inaccessible, inadequate and/or insecure for millions of workers. Therefore, we must begin a dialogue now about the type of retirement system we need for the future.
PRINCIPLES FOR A NEW RETIREMENT SYSTEM

We offer the following set of principles as guideposts against which all proposals should be evaluated.

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

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

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

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**Shared Responsibility.** Retirement should be the shared responsibility of employers, employees and the government.

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

**Pooled Assets.** Contributions to the system should be pooled and professionally managed to minimize costs and financial risks.

**Payouts Only at Retirement.** No withdrawals or loans should be permitted before retirement, except for permanent disability.

**Lifetime Payouts.** Benefits should be paid out over the lifetime of retirees, and any surviving spouses, former spouses, or domestic partners.
**Portable Benefits.** Benefits should be portable when workers change jobs.

**Voluntary Savings.** Additional voluntary contributions should be permitted, with reasonable limits for tax-favored contributions.

**Efficient and Transparent Administration.** The system should be administered by a governmental agency or by private, non-profit institutions that are efficient, transparent, and governed by boards of trustees that include employer, employee, and retiree representatives.

**Effective Oversight.** Oversight of the new system should be by a single government regulator dedicated solely to promoting retirement security. xxxvii
EXAMPLES OF ALTERNATIVE APPROACHES

Below are descriptions of four retirement schemes. They were selected because they incorporate the core concepts that formed the starting point for the group’s deliberations. All include employer contributions, pooled professionally invested money that is locked in until retirement age, and, with one exception, lifetime payouts. They differ in other respects. For example, two have a centralized government administered structure; the other two have decentralized administration. Two mandate a specified level of contributions; the others depend on agreements with employers or voluntary contributions. Two have inflation adjusted payments; one guarantees benefits; and another requires employees and employees to collectively assume the risk of investment loss.

The plans and proposals below contain helpful examples of how a new retirement scheme containing many, if not all, of the principles might work in the real world.

The first two approaches are programs currently in existence that are operating in other countries. The second two alternatives are proposals for programs specifically designed to operate in this country.

THE AUSTRALIAN SUPERANNUATION SYSTEM

Superannuation is the term used in Australia for pension funds. Australia uses the term superannuation because traditionally funds have paid out lump sum benefits instead of pension benefits paid out as an annuity. The superannuation system is funded by 9 percent compulsory employer contributions and in early 2008 there were about 1.1 trillion Australian dollars under management.

The superannuation system supplements the Age Pension, which is paid out at age 65 to all Australian residents with assets or income below a certain threshold. It is non-contributory
and paid out from general government revenues. The Age Pension provides a flat payment amount that is pegged at about 25 percent of the median wage.

The superannuation system’s funds fall broadly into two groups. There are about 350 large funds in the mainstream system, each with a billion Australian dollars or more in early 2008.xi

The other part of the Australian superannuation system is made up of 350,000 self-managed funds, which are micro funds with four or fewer funds. They are generally used by high net worth individuals and small business people for their families. The mainstream part of the system – made up of larger funds – is the part that has attracted interest from abroad as a possible model for other countries.

The Australian Superannuation System is premised on trust law principles. There are trustees that hold and manage assets on behalf of a group of beneficiaries. That requirement was part of common law in Australia for a very long period of time and was codified into law in the Superannuation Industry (Supervision) Act of 1993. xli Flowing out of the fiduciary responsibility, there are specific statutory obligations. One of them is the sole purpose test, which is the requirement that investment decisions made by the trustees be for the sole purpose of providing future retirement income.

The meaning and effect of the sole purpose test has been vigorously debated in Australia. For example, there have been debates about whether funds can use assets to promote themselves, and whether the test inhibits socially responsible investing or direct investments. There is, however, general agreement that the sole purpose test generally has kept trustees focused on their primary obligation to act solely in the interests of beneficiaries.

In Australia there are no quantitative minimums or maximums in the allocation of asset classes. There’s no minimum in cash or bonds, example. There are no caps or ceilings in terms of basic holdings. There is a statutory obligation on trustees to develop and implement an investment strategy. And, in developing and implementing this strategy, trustees have to
take into account risk and return, diversification, and liquidity. Quite often the investment strategy is balanced.

About 90 percent of Australia’s workers are enrolled in a defined contribution scheme. There is still a defined benefit scheme, but it is generally restricted to larger private sector employers and older public schemes. In the defined contribution arrangement, the default investment option is about 60 percent in equities and 40 percent in fixed income. Some funds are more aggressive with a 70/30 allocation. A lot of defined contribution funds provide for investment choice between aggressive, standard, and conservative.

When the Superannuation Industry (Supervision) Act was introduced in 1993, one of its primary provisions was the requirement for equal representation on trustee boards. There had to be some accommodation to this requirement because of the diversity within the Australian system. There are the traditional single employer schemes and then there are industry funds, which are often actively supported by trade unions and employer associations. Lastly, there are funds that are offered by commercial financial institutions.

In the employer regime and in the industry funds generally, equal representation is facilitated by the requirement in the law that 50 percent of the board trustees or directors have to be appointed or elected by members. The law is silent about how that is done. In some funds, the trustees are appointed by relevant trade unions in that industry. In some industries, they are elected by the members. In some instances, it is a bit of a mix. In the industry funds, more often than not the trade unions will appoint the trustees. And, in the single employer funds, more often than not, the member representative trustees are elected.

When commercial funds are providing superannuation pension services to a group of employers, the equal representation becomes a challenge. It is difficult to require that the board of directors of an Australian commercial fund manager have 50 percent of the trustees by members of the superannuation system, for example. To accommodate the need for member representation, there is a requirement to have the commercial funds set up a policy
committee when requested by members, which advises the trustees on behalf of members on particular issues.

There was a hue and cry against the notion of equal representation on trustee boards in the early and mid-1990s. It was claimed that trade union officials would use their position as trustees to punish and reward employers. It was also suggested that workers would elect incompetent amateurs to trustee boards. However, equal representation has turned out to be one of the major successful innovations of the Australian system and has been an effective way of managing agency risk. It is, in fact, the most effective way of agency risk because it takes it away. The reason is that you have representatives of the members and beneficiaries there on the board making key investment decisions.

The trustees who are appointed by trade unions or elected by members take their positions seriously. Since 2002, the Australian Prudential Regulatory Authority (APRA) licenses trustees – not individual trustees but trustee boards. As part of the licensing process, there is a requirement that individual trustees be fit and proper. They cannot be bankrupt people or people convicted of a dishonest offense. They need to demonstrate good character. There was a little bit of concern when licensing was first introduced that it would be too restrictive. What eventually emerged was a flexible but stringent licensing system.

The prudential regulator, APRA, supervises banks, insurance companies and pension funds to make sure they have adequate capital, robust governance structures and are appropriately managing their risks. There is also the Australian Securities and Investments Commission (ASIC), which focuses more on consumer protection. They look at disclosure, provision of financial advice, and keep an eye on conflicts of interest. Some critics contend that this institution needs to be strengthened to improve regulatory vigor and oversight.

The Superannuation System allows for voluntary employee contributions above the mandatory employer contributions, but employees generally do not make voluntary contributions, partly because direct contributions from employees are not tax deductible. Some can do salary sacrifice contributions, which occurs when they have the employer put
the contribution in for them and reduce their salary accordingly. Australia has a co-
contributions scheme aimed at middle and low-income earners. If you put in an after-tax
contribution, the government will put in a contribution. This arrangement is income tested
and seems to work well.

Commercial financial institutions are the biggest players in the management of the 350 main
superannuation funds, but they do not dominate the system, since they represent less than
one third of assets.

The fact the traditional payout is a lump sum distinguishes the Australian system from
many others. There simply is no requirement that the benefit be annuitized. There has been
a debate within Australia about whether or not this represents a flaw in the system. One
concern is that people double dip – they take their lump sum, and then spend it down in
order to qualify for the full Age Pension. Research has found that spending down the lump
sum to qualify for the Age Pension is not as much of a problem as it is often portrayed. The
Superannuation System is not yet a mature system and employers have been contributing 9
per cent only since 2002. A lot of people leaving the system now have relatively modest
sums. Research has found that women often leave with a lump sum of A$50,000 while men
have A$100,000 lump sums. The sums are low because the system started out with a 3
percent mandatory contribution in the early 1990s, which was gradually raised to the
current 9 percent as of 2002. Thus, people retiring at age 65 in 2008 have the benefit of a 9
percent contribution only for the last 6 or 7 years of their working life.

The mandatory employer contribution feature of the Australian system is an accident of
history. In the 1980s there were annual negotiations between the peak trade union body and
the Labor government over across-the-board wage increases. Such negotiations are possible
in Australia because of its highly centralized industrial relations system. When inflation
started to increase in 1987, there was an agreement between the Labor government and the
trade unions that instead of taking some of the income as wages and salary, compensation
would be given to the employee as a superannuation contribution instead of salary primarily
as an inflation-control measure. That was the beginning of the compulsory superannuation in Australia.

The superannuation guarantee was introduced in the early 1990s and was a popular measure. Even though a conservative government replaced the Labor government in 1996, the compulsory superannuation contribution was so popular and entrenched; its opponents could not roll it back.

COLLECTIVE DEFINED CONTRIBUTION PLANS IN THE NETHERLANDS

A new type of retirement plan – the collective defined contribution plan – has emerged in the Netherlands in recent years and has gained international attention as a model that may inspire ideas for new retirement plans in other countries. Declines in funding ratios and the rise of fair market accounting of pensions on company balance sheets and income statements are frequently cited as the factors that have led to the creation of this new type of plan. The new plan is a hybrid of the defined benefit plan, which is the prevalent type of retirement benefit in the Netherlands, and the pure defined contribution, which is distinctly unpopular there. The adverse trends in accounting rules and the stock market led many employers in the Netherlands to switch from a final-average pay defined benefit plan to a career-average defined benefit plan, reducing some of the uncertainty on future funding requirements on employers. The collective defined benefit plan, however, takes the process further still by giving employers a fixed contribution rate for a period of time – typically five years – and transfers the risk of market returns to the participants in the plan.

According to the Dutch Central Bank, which regulates the nation’s retirement plans, one can see the trends that are reshaping the landscape for retirement plans in the Netherlands.

In 1998, 66 percent of plans were final-average pay plans. Eight years later 1996, only 10 percent of plans were final average pay, according to the Dutch Central Bank. In contrast,
career-average plans rose from 27 percent of plans in 1998 to 77 percent in 2006. Among the career-average plans, 15 percent are career-average collective defined contribution plans.\textsuperscript{xlv} Most of the final-average pay plans also have indexation based on the funding ratio of the plan. Indexation occurs when there is a sufficient surplus in the plan to allow it.

Most defined contribution plans are collective career-average plans. Under this hybrid plan, the employer has a fixed contribution and no additional obligations should the plan become underfunded. The pension fund uses the contributions to grant a conditional career-average benefit. The risk of market returns and the impact of accounting rules fall on the plan and the employees and pensioners. For example, the employer contribution is not affected by changes in interest rates. After five years, the pension plan can set up a new contribution rate, but it does not seek to “repair anything from the past.” On the other hand, the plan is not made up of individual accounts and employees do not make investment choices among a menu of options. The funds are pooled and professionally managed.

The conditionality of the collective career average benefit is subject to the following:

- The annual accrual of benefits for active participants;
- The annual cost of living adjustment (COLA), and pension indexation of the accrued benefits for both active and inactive participants; and,
- The accrued benefits of both active and inactive participants.

The annual accrual rate for benefits can go down if the premium (contribution) by the employer is not enough to cover the cost. The same applies to the COLAs and pension indexation of accrued benefits. If the normal contribution is 20 percent, and the agreed contribution turns out to be only 15 percent of the pension base, then the accrual will go down that year. The Dutch Central bank looks at the funding arrangements and if the funding levels do not justify the accrual, then the board of the pension plan has to come up with a plan to maintain the benefit level. If they cannot, then they have to lower the benefits. This can also apply to old, accrued benefits.
The employer’s actuarial contribution depends in part on the age profile of the company’s employees. The premium can be higher for older employees. Normally, a risk premium is included in the employer’s contribution for having transferred the risks from the employer to the employees/retirees. Under Netherlands law, strictly enforced by the Dutch Central Bank, pension plans have to maintain 130 percent of funding. The absolute level depends on the asset mix of the pension fund. If the assets in the fund are not sufficient to cover the liabilities and the required solvency margins of 30 percent, then the COLA will be reduced. Secondly, if the funding falls below 105 percent, and there is no short-term recovery plan, the plan will lower accrued benefits of active workers and inactive employees. The category of ‘inactive participant’ includes anyone who has previously been an active worker in the plan, including retirees.

The collective defined contribution plans, as well as employer-sponsored defined benefit plans, are in addition to a benefit from the government-sponsored retirement system, which gives everyone who has worked 40 years and reaches age 65 an amount equal to about €8,500 per year (2008). The typical worker earns about €30,000 a year. The typical pension takes into account the basic government-sponsored benefit of €8,500 and is designed to produce a second pillar private sector benefit of about 80 percent of career average pay. That translates into private sector pension plan benefit of about €15,500 for someone who earned €30,000. Thus, a worker earning €30,000 would receive a combined government/private sector benefit of €24,000, an 80 percent replacement rate.

The amount of the employer’s fixed annual contribution for employees is based on the underlying cost of the career-average plan and the targeted level of pension indexation. The contribution can also include a risk premium, since the risk has been shifted from the employer to the employee. This means that the premium (or contribution) the employer pays is higher than in a contribution for a similar benefit in a defined benefit plan. The risk premium is calculated by performing an asset liability modeling (ALM) study. This exercise calculates the risk to employees in case the employer does not pay anything additional. If a plan’s investments do well, the employer's contribution can go down in the next five-year
fixed contribution cycle. Premiums are calculated by the plan, and the plan determines the assumptions, but must also follow the rules on the discount rate and mortality rates.

Workers receive annual notice from the plan about what benefit they have accrued and what benefit they will get if they continue working until age 65 at the current salary. The central bank reviews the communications made by the plan to employees. The plan is based on solidarity between generations, and the benefit does not depend on interest rates or mortality rates at the time the benefit begins. Lump sums are prohibited. From the individual’s point of view, the collective defined contribution plan has the characteristics of a defined benefit plan. In addition, while the typical pension provides 80 percent of career-average pay, there is also a survivor’s benefit that provides 70 percent of the deceased spouse’s career-average pay.

Given that the Netherlands has a highly unionized work force it should come as no surprise that a collective defined contribution plan (as is the case for a defined benefit plan) is set up jointly by the employer and the employees, who are either represented by a union or a works council. The board of the pension plan is evenly divided between employer and employee representatives. Participants can also form a Participant’s Council of the pension fund to advise the board. Typically, unions represent workers for multi-employer or industry plans, and works council represent workers in a single employer plan.

Contributions in an industry-wide plan are first determined on an industry-wide basis and then adjusted for each employer based on the number of employees and their salaries. Premiums are the same for employers in an industry plan, regardless of the age distribution within a given employer.

The board of the pension plan decides how funds in the plan are to be invested. While the Participant’s Council is typically only advisory, sometimes they are given more rights. Investments must follow the prudent person rule, and investments within one’s own company are limited to 5 percent of the assets. The Dutch Central Bank reviews the investments and may have some remarks for the pension board to consider. The allocation
of funds is fairly conservative, even in defined benefit plans, often with 40 percent in shares and the rest in bonds. If such plans are converted to collective defined contribution plans, however, the share of funds going into bonds is higher, making the investment approach even more conservative.

Plans are further differentiated as being industry-wide multi-employer plans or a single employer plan. In the Netherlands, if there is a plan at a given employer, all full-time and part-time workers are covered by the plan. This is also true for the collective defined contribution plan.

Employers find two things attractive about the collective defined contribution plan: they have stable pension costs for easy budgeting and they also like the fact that the plan has defined benefit characteristics for participants. Further, unions will not accept an individual account defined contribution plan unless it is for the part of pay above the Social Security ceiling for pension income of €45,000. Most importantly for the employer, the collective defined contribution plan avoids the defined-benefit-plan accounting impact on the balance sheet and the profit and loss statement.

In the United States, under generally accepted accounting practices (GAAP), it would not be possible to have collective defined contribution plans without changes in the accounting rules. Under GAAP rules, it is not possible for a collective defined contribution plan to report as a defined benefit plan. Accounting rules in the Netherlands following the fair market standards of the International Financial Reporting Standards Board.

THE ECONOMIC POLICY INSTITUTE’S GUARANTEED RETIREMENT ACCOUNT

The Guaranteed Retirement Account (GRA) proposal was developed by Teresa Ghilarducci for the Economic Policy Institute in 2007 and featured in her book “When I am Sixty-Four: The plot Against Pensions and the Plan to Save Them.”

The plan was designed to reverse
the slide in employer-provided defined-benefit plans with a new type of universal plan that mandates a contribution of 5 percent of earnings for all workers – evenly divided between an employer contribution of 2.5 percent and a participant contribution of 2.5 percent. GRA departs from existing defined benefit plans and defined contribution plans in a number of ways. Importantly, GRA would transfer to the federal government – specifically the Social Security Administration – the burden of running the plan, removing employers of that obligation. The government would also take over the investment of the contributions, relieving employers who sponsor defined benefit plans and individuals in 401(k)-type defined contribution plans of that responsibility. Contributions to Guaranteed Retirement Accounts would be deducted from payroll. The 2.5 percent employee contributions would be offset by a $600 refundable tax credit provided to all participants. Part-time workers and caregivers of children under age six and those collecting unemployment benefits would be eligible for the tax credit. The tax credit ensures that lower-income participants would have a minimal annual deposit of $600.

Mandatory contributions would be made by employer and employee up to the Social Security earnings cap. Employer and employee voluntary contributions could be made on top of the mandatory contributions, but they would not be income tax-deductible, even though this feature is only designed to keep the federal government’s costs reduced and could be revised to feature some tax deductibility. The contributions of husbands and wives would be combined and divided equally between their individual accounts.

The pooled assets would be managed by the Thrift Savings Plan, a retirement savings plan for federal civilian employees, or a similar body. The plan would provide for a guaranteed real 3 percent annual rate of return that is adjusted for inflation. The trustees of the plan could, however, distribute a surplus to individual accounts if actual investment returns are consistently higher than 3 percent inflation adjusted over a number of years. However, a balancing fund would be maintained to ride out periods of low returns.

Account balances would be converted to inflation-adjusted annuities upon retirement, thereby assuring that retirees do not outlive their savings and that inflation does not erode
the retirees’ relative buying power. The plan does, however, provide for a partial lump sum of 10 percent of the account balance or $10,000, whichever is higher. A full-time worker who contributes into the plan for 40 years and retirees at age 65 can be expected to receive income equal to roughly 25 percent of inflation-adjusted pre-retirement income, assuming a 3 percent real rate of return. When the average 45 percent of pre-retirement income provided by Social Security is combined with GRA, an average earner making $40,000 could receive income equal to 71 percent of pre-retirement income.

Participants could begin collecting benefits at the same time as Social Security; that is, no earlier than age 62, which is the early retirement age for Social Security benefits.

The Guaranteed Retirement Account also provides additional protections of the contributions against early death. The plan would provide a death benefit of one-half the account balance for participants who die before retiring. Those who die after retirement can bequeath to their heirs half their final account balance less the total of benefits received.

THE ERISA INDUSTRY COMMITTEE’S GUARANTEED BENEFIT PLAN

The ERISA Industry Committee, which represents employee benefits concerns of large employers, put forward a proposal for a new independent benefit platform in July 2007. Titled the New Benefit Platform for Life Security, it calls for competitive independent benefit administrators to offer to assume the sponsorship of health and retirement benefits, thus relieving employers of administrative and related responsibilities. Each benefits administrator and its affiliates would be liable for contractual and other common-law obligations (similar to existing ERISA fiduciary responsibilities) related to the Lifetime Security Plan – which is a collection of health, retirement and savings plans. Employers would have only limited fiduciary responsibilities. These new programs would be voluntary, that is, they would be available to employers that could elect to have employees participate in such programs or they could continue to operate their existing employer-sponsored plans.
One of the benefits proposed for the new Lifetime Security Plan is a Guaranteed Benefit Plan (GBP), which would provide a single source of retirement income. Employers could retain their existing plans or participate in the new system. The GBP would be a hybrid account-based retirement arrangement, such as a cash balance plan, that would combine some of the elements of defined benefit plans and some elements of defined contribution plans. Hybrids appear easier for employees to understand than traditional defined benefit plans, are more flexible for employers, and raise fewer accounting issues. The Guaranteed Benefit Plan was included in the Life Security Platform in order to provide for a full array of retirement security vehicles.

The GBP would, at a minimum, guarantee the principal that employers and employees contributed to the plan. Thus, no matter how markets performed, workers would not suffer a net loss on the funds in this plan. In addition the GBP could establish a minimum investment credit that would apply to the balance of each individual account. The interest credit could be a fixed guarantee (e.g., three percent) or an index (e.g., composite corporate bond rate).

Under the proposed scheme, employers could make contributions on behalf of employees to a GBP sponsored by the benefit administrator chosen by the employers. Employers could also offer contribution credits or vouchers to their employees, who would then choose their own GBP. Employees could also make contributions on the same basis as those sponsored by their employer. While employers would not be mandated to make contributions, employees would be required to have a retirement plan and to make a minimum contribution each year.

The portability of a GBP would be based on reasonable standards necessary to maintain the viability of the benefit administrators and their affiliates, which would be responsible for asset management. Although employees would have individual accounts, they would not be self-directed, and employees would not have to choose among a selection of investment options.
Distributions from the GBP would be paid out at retirement only as a stream of payments or an annuity form. Further, the GBP would be designed so that it would be guaranteed by the Pension Benefit Guaranty Corporation (PBGC).

The benefits administrators would also offer a separate single-source Retirement Savings Plan, which would be similar to a 401(k), potentially with Roth features. Benefit administrators would also make available Short-Term Security Accounts, to provide a vehicle for non-retirement savings. The existence of the Short-Term Security Accounts, which allow for pre-retirement withdrawals, would mean that there would be no need for cash-outs and no need for hardship withdrawals from the GBP or the Retirement Savings Plans.

The role of the independent benefit administrators would be the key to the success of the proposed new Lifetime Security Plan’s raft of benefits. The administrators could be banks, insurers, mutual fund and/or investment companies, health plan administrators and even new “platform” administrators. The plan envisions regional competing benefit administrators who would compete in the marketplace.

Employers could choose one or more benefit administrators for their employees or the employee could choose an administrator and the employer could provide funding directly to the administrator. It is intended that all benefits would be portable between benefit administrators within a given region.

The Guaranteed Benefit Plan will pay out the benefit only as a stream of payments or in an annuity form, and the assets will be managed by the administrator or a third party selected by the administrator. Because each benefit administrator is expected to enroll very large numbers of employees, this large pool should help bring down the cost of annuities, making them significantly more affordable to retirees.
The employer in the GBP proposal funnels the money into the system, but the financial institution offering the investment product is, in effect, the guarantor. To the extent it is involved in the process, the employer would retain fiduciary responsibility for choosing among benefit administrators.

Each administrator would offer its own set of annuities from a variety of insurance companies and could offer different types of annuities and payouts. It is expected that joint and survivor annuities would be available and that spouses of participants would have equivalent rights and protections that currently exist under ERISA.

As for regulatory oversight, the suggestion (although it is not absolutely essential to the adoption of the proposal) is that there would be a single regulator in order to avoid the possible complexities and confusion of current multi-agency oversight, and the regulation would not involve the current division of regulatory authority among the Treasury Department, the Internal Revenue Service, the Department of Labor, the Securities and Exchange Commission, the Pension Benefit Guaranty Corporation, and the Financial Accounting Standards Board. Whatever the structure turns out to be, it must be federal and nationally uniform across the country and state laws will not apply.

It is worth noting that the Benefit Administrators envisioned by the proposal would also provide health benefits for active workers and other Americans, and the proposal envisions a mechanism for providing for saving for health care coverage in retirement.

CONCLUSION

As the first decade of the new century winds down, one thing is clear. America’s retirement system is increasingly failing to provide retirement security for the vast majority of workers and retirees. It is time to think about an entirely new approach to retirement security, one that, together with Social Security, would provide adequate and secure retirement income for all workers. Let the discussion begin.
APPENDIX A

“+” GROUP PRINCIPLES FOR A NEW RETIREMENT SYSTEM

After a series of 18 meetings that began in July 2007, the pension experts and representatives of worker and retiree organizations participating in what was then known as “+” Group of the DB+ Initiative, agreed, in November 2008, on 34 goals and principles to guide the development of a visionary private retirement system for the future. In subsequent meetings these goals and principles were distilled into the shorter list of 12 principles presented on pages 17 and 18 of this working paper. The longer list below contains additional details and is included with the thought that it may provide helpful information for the deliberations of other groups.

GOALS OF THE NEW SYSTEM

- **Universal Coverage**
  The new system would cover all private sector employees, as well as all self-employed people.

- **Adequate Retirement Income**
  The system would be designed so that it would provide the average full-career worker a supplement to Social Security that, when combined with Social Security, would provide an adequate retirement income.

CORE PRINCIPLES FOR THE NEW SYSTEM

- **Employer Contributions**
  The system would require direct employer contributions and would not be based solely on employee contributions and/or employer matches.

- **Pooled Professional Investments**
  The assets in the system would be pooled and managed by professionals rather than being allocated by employees among a menu of investment options.

- **Money Locked In Until Retirement Age**
No payouts would be permitted until retirement except for disability. Loans, hardship withdrawals, and cash-outs would not be allowed.

- **Lifetime Payouts**
  Distribution of benefits would be paid out over the lifetime of the retiree and/or spouse or domestic partner.

- **Portability**
  The system would provide for portability among employers and across the nation.

**PAY-IN PRINCIPLES**

- **Mandated Employer Contributions**
  All employers, including self-employed persons, would be required to make contributions to the system.

- **Mandated Employee Contributions**
  All employees would be required to make contributions to the system.

- **Government Subsidy for Low Earners**
  There would be a government subsidy to relieve or eliminate the burden on the mandated employee contribution for lower-income workers.

- **Contributions Based on Percentage of Pay**
  The amount of the contributions that employers and employees would be required to make would be based on percentages of pay. There would be a cap or limit on the maximum contribution that could be made on a tax-favored basis.

- **Employer and Employee Contributions Equal for All Income Levels**
  The mandated contributions of employers and employees would be the same percentage of pay across all income levels.

- **Tax-favored contributions.**
  Employer and employee contributions would be tax-favored.

- **Voluntary Employee Contributions above Mandate (With a Cap)**
  Employees would be permitted to contribute additional amounts above the mandated percentage of pay on a tax-favored basis, but there would be a limit on the total amount that could be contributed.

- **Voluntary Employer Contributions above Mandate (With a Cap)**
  Employers would be permitted to make additional contributions above the mandated percentage of pay on a tax-favored basis, but they would have to be the same percentage of pay for all employees and there would be a limit on the total amount that could be contributed.
PAY-OUT PRINCIPLES

- No Pre-Retirement Payouts Other Than Disability
  Employees who become disabled would be able to receive pre-retirement payouts. There would be no loans, hardship withdrawals, or cash-outs before retirement age.

- Lifetime Annuity or Distribution of Payments over Life Expectancy
  Benefits would normally be paid out as annuities provided or purchased by the sponsoring entity or as a stream of payments over the retiree’s life expectancy and the life expectancy of any surviving spouse or domestic partner.

- Limited Lump Sums
  Lump sums would be permitted at retirement in the case of very small balances.

- Spousal Protections
  There would be protections for spouses and domestic partners in the event of death or divorce.

- Guarantee If Feasible (Depends on Structure)
  If feasible, the new system would provide a guarantee. This could be a guaranteed benefit, a guaranteed rate of return, or a guarantee of principal.

- Cost-of-Living or Other Adjustments If Feasible (Depends on Structure)
  If feasible, the new system would provide for cost of living adjustments.

ADMINISTRATION OF A NEW SYSTEM

- Single Purpose Agency or Entities
  The agency or entities charged with administering the new system would have a single purpose: to provide retirement income to current and future retirees and their surviving spouses or domestic partners.

- The new system would be administered by
  - A single government agency; or
  - Multiple private nonprofit entities.

- Trustee-Directed Pooled Investments
  All funds would be pooled, and investment would be overseen by trustees, who could contract out investment of part or all of the funds in the plan.

- Employee Representation on Boards of Trustees
  Employees would be represented on the board of trustees that oversees the government agency or nonprofit entities that administer the plan.
• **Benefit Projections**
  Benefit statements would contain projections of benefits as annuity income payments.

• **Plain-English Benefit Statements**
  Benefit statements would be written in plain English so that they would be easily understood by employees.

• **Low Fees and Full Disclosure of Fees**
  The costs of administering the plan and managing investments would be kept as low as possible, and there would be full disclosure of all fees to employees.

### PRINCIPLES FOR REGULATING THE NEW SYSTEM

• **Centralized Federal Regulatory Scheme**
  There would be a central federal regulatory scheme that would oversee the administration of the system.

• **Dedicated Government Regulatory Agency**
  The government regulator of the system would be dedicated solely to overseeing the entity or entities administering the program; the regulatory authority would not be dispersed among existing regulatory bodies.

• **Licensing of Non-Governmental Entities**
  If the program is administered by a government agency, it does not need to be licensed. If, however, it is administered by non-governmental entities, they will be required to obtain a license from the government regulator.

• **Licensing of Trustees**
  All trustees of the board or boards overseeing the entity or entities administering the program will be licensed, including trustees representing employees.

• **If Nonprofits, Trust Law Principles**
  If the system is administered by nonprofit entities, trust law principles would govern the administration of the program.

### PRINCIPLES RELATING TO PRESERVATION OF CURRENT PLANS

• **Carve-Out of Plans Providing Comparable Benefits**
  Existing plans that provide benefits that would be comparable to those that could be provided by the new plan would continue to operate and employees participating in those plans would not be required to contribute to the new system – nor would employers be required to contribute for those employees.
Ensuring Retirement Security for America’s Workers

August 08, 2006

Chicago, Illinois

Retirement security is fast becoming a goal beyond the reach of most Americans. Our private pension system is fraying, with fewer workers now covered by pension plans. Companies increasingly view bankruptcy as a business strategy to eliminate pensions, and even healthy companies are reneging on decades-old commitments to help provide their employees with a secure retirement.

The bankruptcy code provides little protection for workers’ retirement security. With the law’s emphasis on facilitating reorganization at almost any cost, companies in entire industries are shedding their pension obligations with hardly a look back and workers who lose pensions are unable to pursue a claim for those benefits in court. A buyer looking for assets in bankruptcy knows that employee obligations can be shed with relative ease through the use of the law’s “free and clear” sale provisions; accordingly, companies in bankruptcy shirk their pension obligations by selling their assets to leave companies that are unable to fund workers’ pensions.

A succession of healthy companies with marquee names and well-funded plans are also turning their backs on their pension promises by freezing their plans or closing them to new hires. Many other companies are soon to follow, likely to cite changes in pension funding requirements, prospective new accounting rules, globalization and/or competitive pressures within their industries. Regardless of the validity of these explanations, workers will pay the price because they will be losing sorely needed retirement income.

Although workers’ ability to achieve retirement security has long been premised on a system of mutual responsibility – government-provided Social Security, employer-provided pensions, and personal savings – only Social Security now guarantees a universal benefit. Only one-tenth (11 percent) of private-sector employers now sponsor a defined benefit pension plan, covering one-fifth (21 percent) of private-sector workers (down from nearly two-fifths of workers a quarter century ago). For non-union workers, the situation is even
more dire: only 15 percent of non-union workers have defined benefit pension plans, compared to 72 percent of union workers. And even this limited coverage is on the decline.

Across the country, the retirement security of public employees is also under attack through efforts to replace defined benefit pension plans with riskier defined contribution plans. Both Michigan and Alaska have closed their defined benefit pension plans to new hires. In Maine, Georgia, Illinois, Kansas, Minnesota, New Mexico, South Carolina and Virginia, a similar threat now looms.

These trends portend poorly, not only for the economic health of our retirees, but also for the nation overall. Most of our 76 million baby boomers will face retirement with fewer assets than previous generations, if they are able to retire at all, and many will be forced to remain in the workforce to stave off poverty. These seniors, who will comprise an increasing share of the population, will be without the purchasing power that is needed for a healthy economy.

The facts about how much workers are saving for retirement are sobering and offer no hope that 401(k)s or other defined contribution plans will make up for the loss of traditional pensions without major changes, both in the design of the plans and the level of contributions. The average employer contribution to a defined benefit plan secures an individual worker a lifetime pension benefit worth $400,000. By contrast, half of all American families have no retirement savings whatsoever. Among families close to retirement (those headed by someone aged 55 to 64), nearly two in five have no retirement savings in a 401(k), IRA or other defined contribution account. Among those near-retirement families lucky enough to have some retirement savings, half have less than $83,000 – enough for a monthly retirement income at age 65 of only several hundred dollars.

Moreover, individual savings plans, like 401(k) plans and IRAs, as they exist today, cannot offer all the benefits of real pensions. Well-designed defined benefit pension plans provide benefits for all covered workers, provide lifetime retirement income, deliver valuable survivor and disability protections, and may offer important early retirement benefits and post-retirement benefit increases. By contrast, individual savings plans require workers to bear all the risk, are often insufficiently diversified, suffer from poor returns and typically carry very heavy fees and expenses. (According to a study by the authoritative National Association of State Retirement Administrators, the average expense ratio for defined contribution plans runs as high as 2 percent, compared to 0.25 percent for large defined benefit plans.)
A clear vision and bold action are required to address our retirement security crisis and to secure adequate and guaranteed lifetime retirement income for all American workers. The AFL–CIO calls on the Congress and the President to enact legislation guided by the following principles, and sets out the following policies as meeting those principles:

**Principles to Guide the Delivery of Retirement Income**

- Retirement security should be based on mutual responsibility, with financing and risk allocated equitably among government, employers, and workers;
- Every full-career worker should have the opportunity to retire at 65 with at least 70 percent of his or her pre-retirement income;
- Retirement benefits should be portable;
- Defined contribution plans should be structured to serve the interest of workers, not those of their employers or Wall Street;
- Retirement plan participants should be represented in the governance of their plans.

**Policies to Achieve Retirement Security for American Workers**

- **Strengthen Social Security:** The bedrock of retirement security for America’s working families is Social Security. While we successfully defeated the Bush Administration’s attempt to privatize Social Security in 2005, we must continue to fight all such efforts. Similarly, we must oppose attempts to switch public employee defined benefit pensions to defined contribution plans. Beyond this, we need to work for improvements in Social Security, at least to provide above poverty-level benefits for workers who put in a full career at low-wage jobs and to improve the retirement security of women.

- **Ensure employer responsibility:** All employers should be required to fund retirement benefits on top of Social Security, as an essential part of every worker’s pay. The most effective and efficient way to do this is through a defined benefit pension plan. Private-sector employers who don’t provide such a plan should be required to contribute into either a supplementary Social Security plan or a government-
sponsored annuity plan that builds on existing programs, e.g., state employees’ pension systems.

- Curb corporate abuse of the bankruptcy process: All workers should have a claim in bankruptcy court for lost pensions, just like unpaid wages. Today, only the PBGC can pursue such a claim and regardless of what it realizes, the PBGC will not pay pension beneficiaries more than the PBGC-ensured limits. Companies should be precluded from selling assets to escape their pension obligations. Today, companies in bankruptcy will sell their assets “free and clear,” leaving nothing but shell companies to fund employee benefits.

- Improve defined contribution plans: Employers should be given the flexibility to provide benefits through qualified defined contribution plans, but not as a substitute for their contribution to the defined benefit system. The design of worker savings plans should be improved to make worker contributions to employer-provided defined contribution the default option for workers. Requiring employer contributions to worker savings plans, like defined contribution plans, should also be considered.

- Make all retirement savings vehicles effective and efficient: Many 401(k)’s and IRA’s are not operated in the best interests of Americans straining to save for retirement. Reducing the big fees paid out of workers’ retirement accounts can yield both enormous aggregate savings and meaningful improvements in individual workers’ retirement security. Making sure plans are structured and operated so that saving, investment and distribution decisions are simple also will improve Americans’ retirement security.
APPENDIX C

CHANGE TO WIN PRINCIPLES

A SECURE AND DIGNIFIED RETIREMENT

Change to Win is devoted to achieving a secure and dignified retirement for all workers in America. At retirement, no one should have to face the prospect of working forever to keep their head above water or face a dramatic decline in income that jeopardizes their financial security.

The American labor movement played a leading role in establishing today’s retirement system. It was at the forefront of the effort to create Social Security – the foundation of our retirement that benefits all workers. Through collective bargaining the labor movement led efforts to get private companies and government employers to provide workers with a defined-benefit pension, which guarantees retirees with a steady income for life on top of Social Security.

Unfortunately, the current system benefits too few workers and is under tremendous stress. Social Security is under attack by the White House and Wall Street who want to privatize it, which would do away with a guaranteed income and shift the financial risk to beneficiaries. Many companies have dismantled their defined-benefit pension plans or refuse to provide a plan to their employees. The result – 40 percent of workers had an employer-provided pension plan twenty-five years ago, but today only one half that many have such a plan and most of them are in unions. Many employers have shifted to retirement savings plans such as 401(k)s for their workers, but these typically provide much less income than a pension, shift all of the risk to the worker and often do not include an employer contribution. Worst of all, half of all workers have no retirement security plan other than Social Security.
Change to Win believes we should build on the current public and private systems to ensure all workers in America a dignified retirement before generations of workers are faced with a financial crisis, and the burden that this might create for their children.

These are Change to Win’s principles for an American retirement system:

**Ensure a Guaranteed Income**: All retirees should be guaranteed at least 70 percent of their pre-retirement income for life, depending on the person’s household unit, income history and gender. This minimum amount, which is recommended by retirement experts, would include all sources of retirement income, including Social Security benefits.

**Strengthen Social Security**: Social Security should remain a public insurance program, not be privatized. It should also be adequately and fairly funded to ensure that it provides a minimum floor of protection for all Americans. Currently, the average retiree receives about 36 percent of his pre-retirement income through Social Security, but it is likely to decline in the future. This amount is only half the replacement income needed by a typical beneficiary.

**Preserve and Strengthen Existing Private and Public-sector Guaranteed Pension Plans**: About 20 percent of workers have employer-provided pension plans known as defined-benefit plans, which close the gap between the amount Social Security provides and what a retiree needs to live. By providing a guaranteed income, these plans are far superior to 401(k) plans; they should be preserved and strengthened. In the private sector, despite five years of record corporate profits too many pension plans are still underfunded and many have been eliminated. The federal government needs to hold corporations accountable to the promises they’ve made to their workers. In the public sector, we oppose efforts to convert pension funds to 401(k)-like plans.

**Guarantee All Workers a Secure Retirement**: All workers without a guaranteed pension need to have one to close the gap between how much a retiree needs to live and the amount Social Security provides. Retirement plans should be portable and funded by stable
employer contributions to ensure workers accumulate the benefits they need without creating uncertainty for employers. Investments should be pooled to reduce the costs of professional management, and workers should have a voice in plan governance to ensure accountability.
END NOTES

2 Purcell, 2008.
6 Participants in defined-benefit plans do, however, face the risk of having lower-than-anticipated benefits if they cease to be covered under a plan before retirement. Most traditional defined-benefit pensions are tied to years of service and final pay. Thus, workers who lose their jobs or whose employers freeze their pensions years before retirement will have lower-than-expected pension benefits because these accrued service credits are now tied to a lower (mid-career, not final) salary. This is true even if the worker moves to another job with similar pay and pension benefits.
7 A case in point on diversification and excessive risk is the degree that employees choose to invest in stock of their employer. Despite the lesson of Enron, more than 10% of all 401(k) participants still have funds invested in employer stock, and 8% who have the option invest more than 80% of their savings in employer stock (Sarah Holden, Jack VanDerhei, Luis Alonso and Craig Copeland. 2008. 401(k) plan asset allocation, account balances, and loan activity in 2007. Investment Company Institute Research Perspective, December)
9 Using measures of risk and return derived from historical data, the unluckiest 5% of participants will not have enough to replace even a quarter of their pre-retirement earnings, while the luckiest 5% will end up four times as much—enough to replace all of their pre-retirement earnings even without Social Security. (Source: Patrick Purcell. 2007. “Retirement savings: how much will workers have when they retire?” Congressional Research Service Report for Congress, January 29).
10 The Dow Jones Wilshire 5000, for example, peaked at 15,819 on October 11, 2007 and was at 6,935 as of March 6, 2009, adjusted for dividends and splits.
12 Holden et al., 2008
13 Pension funds insure individual participants against longevity risk—the risk of living a longer-than-average lifespan—by pooling the retirement plans of many workers. If a plan is sufficiently large, it can then simply plan benefits around the average expected lifespan. Otherwise, this can be done through an insurer. However, the employer or insurer retains the risk of an increase in the average lifespan.
14 Moreover, in retirement savings plans that do offer participants the option of taking benefits in annuity form, the size of the annuity is often dependent on interest rates at the time of retirement.
15 This volatility increased after the Pension Protection Act of 2006 reduced the ability of employers to smooth pension contributions over time.
16 Purcell, 2008.
xvii 2008 Social Security Trustees Report, Table VI.F.10. This does not take into account rising Medicare B premiums, which are deducted from Social Security retirement benefits and will further reduce the amount retirees receive.

xviii A major reason for the decline in traditional pensions appears to be cost. While defined benefit pensions are more cost-effective than 401(k) plans due to scale economies and other factors, employers may be able to reduce their costs by shifting responsibility for retirement onto workers. Traditional pensions usually cover all employees and are funded primarily through employer contributions in the private sector. In contrast, 401(k) plan participation is voluntary and the most common arrangement is an employer match equal to half the employee contribution. As a result, workers shoulder nearly two-thirds of the cost of 401(k) plans on average (Purcell 2009), and employers also save because some workers are not covered. Though some economists are skeptical that employers can unilaterally cut retirement benefits without raising wages, cost considerations do appear to be a driving force in the shift toward 401(k) plans, especially in the wake of market downturns and changes in funding rules that have caused spikes in required contributions to defined benefit pension plans (Alicia H. Munnell, Francesca Golub-Sass, Mauricio Soto, and Francis Vitagliano. 2006. “Why are healthy employers freezing their pensions?” Center for Retirement Research Issue in Brief, March.; Alicia H. Munnell and Mauricio Soto. 2007. “Why are companies freezing their pensions?” Center for Retirement Research Working Paper, December.)

xix Defined benefit pensions remain the norm in the public sector.


xxi Purcell, 2009.


xxiii Alicia H. Munnell and Annika Sundén. 2006. “401(k) plans are still coming up short,” Center for Retirement Research Issue in Brief, March.


xxvi Holden et al., 2008

xxvii Munnell and Sundén, 2006.


xxix This is because contributions to these plans are growing and assets generally accrue earnings on a tax deferred basis until the money is withdrawn. Source: OMB, 2008.

xxx For each dollar contributed to a retirement account, a high-income household in the 35% tax bracket gets a tax break more than three times as valuable as a middle-income household in the 10% tax bracket. Meanwhile, low earners who owe payroll but no income tax get no help at all.

xxxi Workers earning $30,000 or more are nearly twice as likely to be covered under an employer plan as workers earning less than $30,000 (Copeland, 2008). Disparities in participation are even greater, in part because lower-income workers who are covered under a plan are likely to have less generous benefits.


xxxiii Tax expenditures for retirement have risen even as overall savings have declined. An analysis by the Urban-Brookings Tax Policy Center found that in 2003, retirement savings incentives actually exceeded
the level of total personal saving by nearly $50 billion (Elizabeth Bell, Adam Carasso, and C. Eugene Steuerle. 2004. Retirement Saving Incentives and Personal Saving, Tax Policy Center Tax Notes, December 20.).

xxxiv Alicia H. Munnell, Mauricio Soto, Jerilyn Libby and John Prinzivalli. 2006. Investment returns: defined benefit vs. 401(k) plans. Center for Retirement Research Issue in Brief, September.


xxxvi Holden et al., 2008.

xxxvii These principles are distilled from a longer list agreed to in November 2008. See Appendix A

xxxviii The groups also heard a presentation on TIAA-CREF, and briefly reviewed two other approaches, a proposal developed by Christian Weller, the Personal Universal Retirement Accounts (PURE) proposal http://www.epi.org/publications/entry/tp265/ and the Pensions 2000 proposal, a proposal developed by a group of policy experts in 1997.

http://www.conversationoncoverage.org/national_policy_forum/stein.html

xxxix Presentation by Brad Pragnell, then Deputy Chief Executive and Director of Policy to the Association of Superannuation Funds of Australia by phone from Sydney on March 20, 2008.

x Consolidation in funds early in this decade reduced the number of funds in this group and made the average fund larger, as Australia went through the process of licensing of trustees. The demands of the licensing system led to a lot of single employer schemes folding and merging into the other arrangements

xli The Superannuation Industry (Supervision) Act of 1993 can be found at this web site: http://law.ato.gov.au/atolaw/view.htm?locid='PAC/19930078/ATOTOC


xliii Presentation by Arnold Jager, Consultant with the Hewitt Associates Amsterdam office by phone February 1, 2008, from Amsterdam.

xliv While hybrids and defined contribution plans represented less than one percent of plans in 1998, by 2006 about 7 percent of plans were hybrid plans, 4 percent defined contribution plans and 2 percent described as miscellaneous.

xlv A works council is an elected group of employees within a company that have the right to advise about various things, including pension funds. Companies with more than 50 employees are required to have a works council.


xlvii The ERISA Industry Committee (ERIC) represents the retirement, health care coverage, deferred compensation and other employee benefit and compensation interests of America’s largest private sector companies before Congress and the Administration. This summary is based on a presentation by Mark Ugoretz, President & CEO of the ERISA Industry Committee, on March 20, 2008.