



Chapter 7

# Retirement

# Retirement

## The middle-class squeeze on retirement is real

- As of 2013, 31 percent of non-retired Americans reported having no retirement savings and no pension, with persons of color being significantly more likely to report having no such savings.<sup>1</sup>
- As of 2010, 53 percent of American households were estimated to be in danger of having insufficient savings for retirement<sup>2</sup>—a problem that is likely to get worse as younger generations are projected to be even less well prepared than those currently near retirement.<sup>3</sup>
- As of 2010, American workers’ total retirement savings shortfall—in other words, the difference between what they are projected to need in retirement and what they currently have—was estimated to be approximately \$6.6 trillion.<sup>4</sup>

## Understanding how we got here

Among the top concerns of middle-class Americans is whether or not they will be able to afford to retire.<sup>5</sup> While Social Security provides a critical baseline of income for retirees and must be strengthened so it can continue to provide in the future, it was never intended to be workers’ only source of retirement income. To maintain their standard of living, retired Americans also depend on workplace retirement plans such as 401(k)s, pensions, and, to a smaller degree, private savings.

Unfortunately for many, saving for retirement has become much more difficult in recent decades as costs of other elements of middle-class security have risen and as workplace retirement plans have fundamentally changed. As employers have shifted away from pensions to 401(k)-style plans, employees have been forced to shoulder far more risk and to invest in savings vehicles that are often excessively costly.



For an example middle-class family of four, it was harder to save for retirement since the costs of other pillars of middle-class security—such as child care, higher education, health care, and housing—rose by more than \$10,000 in 12 years, while incomes remained stagnant. See figure 1.3



While some workers have managed to put away significant sums in this new system, many others have failed to save enough. The first problem is access: As of 2014, only 65 percent of private-sector workers had access to a workplace retirement plan, and only 48 percent of private-sector workers participated in one.<sup>6</sup> But even among those who do save, savings are often nowhere near adequate. As of 2010, more than 40 percent of households age 55 to 64 did not have any private retirement account, and the median account balance for those who did was only \$100,000<sup>7</sup>—barely enough to provide a few hundred dollars per month in retirement.<sup>8</sup>

Part of the problem is retirement plan features that unnecessarily drive up costs and are often difficult for workers to understand. For example, 401(k) fees—often expressed to savers as a tiny percentage of plan assets and frequently overlooked by many—can eat away between one-quarter and one-third of investment returns.<sup>9</sup>

## Policy recommendations

To secure dignity in retirement for more American families, we need to alleviate other elements of the middle-class squeeze—making it easier for households to save for retirement—and also address the failings in our current retirement system. To shore up our retirement system we should:

- Encourage the adoption of hybrid retirement plans—such as CAP’s Safe, Accessible, Flexible, and Efficient, or SAFE, Retirement Plan—at both the state and national levels.<sup>10</sup>
- Increase access to existing alternative savings options such as the low-cost Thrift Savings Plan.<sup>11</sup>
- Require 401(k) and Individual Retirement Account, or IRA, plans to be more transparent about fees and investment practices.<sup>12</sup>
- Make tax incentives for saving simpler and more fair by replacing existing tax deductions with a Universal Savings Credit and introducing a progressive match for low-income savers’ contributions.<sup>13</sup>



# Retirement

Stagnating incomes and increasing costs have left families with less money to set aside for retirement. At the same time, our private retirement system has failed to provide many retirees with the assets they need to supplement their Social Security benefits. Fortunately, if the appropriate reforms are put in place, saving for retirement can be made significantly easier, cheaper, and more secure for all Americans.

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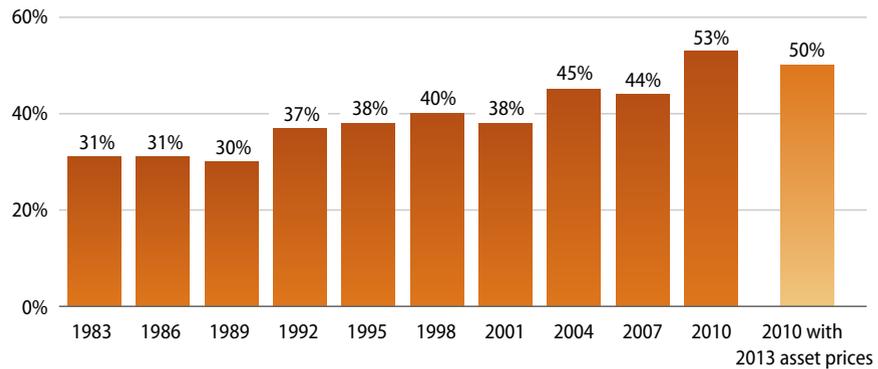
## The nature of the crisis

According to Boston College's Center for Retirement Research, as of 2010—the most recent year for which complete data are available—a full 53 percent of American households were at risk of not being able to maintain their standard of living in retirement.<sup>14</sup> And while recoveries in the stock and housing markets seen since 2010 may have improved this situation slightly, preliminary estimates indicate that the share of households likely to have insufficient savings remains unacceptably high. Center for Retirement Research calculations that incorporate these market gains and estimate what the percentage of households at risk in 2010 would have been if equity and house prices had been at their 2013 levels found the share at risk to still be an alarming 50 percent—significantly higher than it was a generation ago.<sup>15</sup>

FIGURE 7.1

### More Americans are at risk of having a lower standard of living in retirement

Share of households at risk of not having enough money to maintain their standard of living in retirement



Source: Alicia H. Munnell, Anthony Webb, and Francesca Golub-Sass, "The National Retirement Index: An Update" (Chesnut Hill, MA: Center for Retirement Research at Boston College, 2012), available at [http://crr.bc.edu/wp-content/uploads/2012/11/IB\\_12-20-508.pdf](http://crr.bc.edu/wp-content/uploads/2012/11/IB_12-20-508.pdf); Alicia H. Munnell, Anthony Webb, and Rebecca Cannon Fraenkel, "Will the Rebound in Equities and Housing Save Retirees?" (Chesnut Hill, MA: Center for Retirement Research at Boston College, 2013), available at [http://crr.bc.edu/wp-content/uploads/2013/12/IB\\_13-17.pdf](http://crr.bc.edu/wp-content/uploads/2013/12/IB_13-17.pdf). Note that final column represents an estimate produced using household data from the 2010 Survey of Consumer Finances adjusted to reflect changes in equity and house prices that occurred between 2010 and 2013.

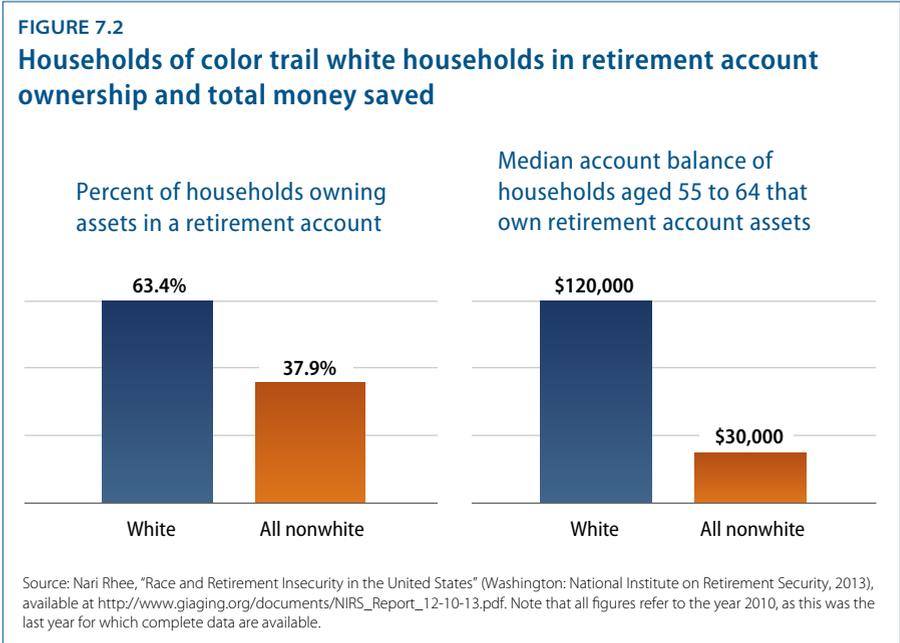
Many households are so unprepared simply because they have not been able to accumulate enough in savings. Partly to blame is the Great Recession, which damaged millions of families' balance sheets. However, even before the market downturn, Americans were falling far short when it came to building up enough assets for retirement. Indeed, many Americans have no money saved at all for retirement, with one 2013 survey finding that 31 percent of non-retired Americans—nearly one out of every three—reported having no retirement savings of any kind and no pension.<sup>16</sup>

Data from the Federal Reserve's comprehensive Survey of Consumer Finances—which also records how much families save—further illustrate the scale of Americans' saving inadequacy, particularly when it comes to the assets families have built up in today's most commonly used savings vehicles: private retirement accounts, such as workplace 401(k)s, Individual Retirement Accounts, or IRAs, and Keogh Plans.<sup>17</sup> As of 2010—the most recent year for which data are available—more than 40 percent of households ages 55 to 64 did not own any such retirement accounts, and the median account balance of all households in that age group was a paltry \$12,000.<sup>18</sup> Even for those who did own assets in such accounts, the median account balance was still only \$100,000—barely enough to provide a household with a few hundred dollars per month in retirement.<sup>19</sup>

Matters only get worse when looking at younger workers. In 2010, roughly 48 percent of households ages 35 to 44 owned zero retirement account assets, and 53 percent of households ages 25 to 34 owned none.<sup>20</sup> Younger workers are also far less likely to have defined-benefit pensions than are older workers, meaning they will be even more reliant on their limited retirement account assets.<sup>21</sup> Consequently, it should come as no surprise that as of 2010, the Center for Retirement Research estimated that 62 percent of households ages 30 to 39 are at risk of not being able to maintain their standard of living in retirement; for households ages 50 to 59, it's 44 percent.<sup>22</sup>

Retirement preparedness not only differs by age, but it also differs greatly by race and income.

First, households of color are significantly less likely to own retirement accounts or to have a defined-benefit pension than are their white counterparts. As of 2010, only 16 percent of non-white working-age households had a defined-benefit pension through their current job and only 38 percent owned a retirement account, compared to 24 percent and 63 percent of white households respectively.<sup>23</sup> And the differences between these groups' retirement preparedness become more apparent when looking at the median account balances of those workers who do own a retirement account. In 2010, near-retirement white households' median savings were \$120,000, while the savings of households of color amounted to only \$30,000.<sup>24</sup>



Other large disparities exist based on income. While it is not surprising that higher-income households are more likely to own retirement accounts, or that they have more in savings,<sup>25</sup> what is surprising is the degree to which retirement savings inequality has grown in recent decades. In 1989, the median retirement account balance of households in the top income quintile was roughly 3.7 times higher than the median account balance of households in the middle quintile.<sup>26</sup> By 2010, it was nearly seven times higher. The wealthy continue to pull further and further away, while the middle is stuck with far less than what is needed to maintain their standard of living in retirement.<sup>27</sup>

The costs of this lack of preparedness will be substantial for whoever picks up the tab. According to the Center for Retirement Research, the estimated combined retirement savings shortfall among all American households—that is the difference between what they have saved and what they are projected to need—was approximately \$6.6 trillion in 2010; other estimates place this figure even higher.<sup>28</sup> To make-up the shortfall, millions of workers will likely be forced to muddle through by lowering their standard of living in retirement, working longer than they had ever envisioned, or relying on assistance from their family or government programs, potentially creating a significant drag on economic growth in the process.<sup>29</sup>

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## How we got here

Social Security has long been the bedrock of American retirement security. But, while Social Security does provide an essential baseline of income for retirees, it was never intended to be workers' sole source of income in retirement. Further strengthening the program and ensuring that it is able to continue to provide full benefits for generations to come—as CAP has previously proposed<sup>30</sup>—will certainly help many workers retire with security. But no matter how strong the Social Security system is, supplemental savings will always play a critical role.

Other forms of saving—such as 401(k)s, pensions, and private savings—have become even more important as national life expectancy has increased and the full retirement age for Social Security benefits has been raised to 67 years old. Together, these changes mean that workers are living longer and have more years of expenses to cover, but they must also wait longer to begin receiving full Society Security benefits.

Unfortunately for many middle-class households, saving for retirement outside of Social Security has become much more difficult in recent decades. The reasons for this are twofold: Simply finding the money to save has gotten harder for financially squeezed middle-class families, and changes to the saving vehicles available to them have made it more difficult to accumulate sufficient assets.

First, finding money to save for anything—including retirement—has become increasingly difficult for middle-class households as their incomes have stagnated and the prices of important goods and services have risen. Since peaking in 1999, the median household income has declined by more than \$5,000 in inflation-adjusted terms and was sitting below its 1989 level as of 2012.<sup>31</sup> In the meantime, as this report also shows, costs of many essential goods and services—from higher education to health care—have increased dramatically. Attempting to cover these increasing costs with stagnating earnings has left many families with less and less to save for retirement.

To make matters worse, current tax incentives designed to make saving for retirement easier disproportionately benefit those at the very top who need them the least, rather than benefitting those working families who are having the hardest time saving. Approximately 70 percent of the benefits of these tax incentives now flow to the top 20 percent of households, while only about 3 percent go to bottom 40 percent.<sup>32</sup> This is largely because these benefits are designed as tax deductions that provide greater tax relief to higher-income earners paying higher marginal tax rates than they do to lower-income earners in lower brackets. The consequence of this design is that the United States is now directing the vast majority of the monetary incentives it provides for saving to individuals who would have likely saved anyway, while not providing enough support to those working families most in need of support.

Even when families do manage to save, however, the changing nature of the savings vehicles available to them has made it increasingly difficult for middle-class households to build up sufficient assets.

The most prominent of these changes has been the movement among private employers away from defined-benefit retirement plans, such as pensions, toward defined-contribution plans, such as 401(k)s. While workplace pensions were considered the norm among workplace retirement plans a generation ago, by 2013, only 19 percent of private-sector workers had access to a defined-benefit plan at work.<sup>33</sup> By comparison, 59 percent of workers had access to a defined-contribution plan in 2013.<sup>34</sup>

While pensions have always had their own shortcomings, and some workers—particularly those prone to changing jobs often—may have benefited from this change, this transition has effectively transferred the majority of the risks associated with saving for retirement away from employers and onto individual savers. Now, instead of the company being responsible for setting aside enough money to provide all of its workers with a promised level of benefits, it is individual savers who must confront the risks—including that their investments may underperform, that a sudden drop in the market right before they retire could force them to work for years longer, or that they could simply outlive their savings.

For individual workers with little-to-no investment experience, successfully navigating the multitude of complex decisions required to manage these risks can become an almost impossible task. If workers postpone saving for too long or save too little, they may find themselves with far less than they need at retirement. If they misallocate their investments—as many inexperienced investors are prone to do<sup>35</sup>—their savings may grow too slowly, leaving them in a similar predicament. And if they draw down their assets too quickly in retirement, they may simply run out of money.

On top of these challenges, several design features of modern 401(k) plans further undermine employee saving. For example, because 401(k) accounts are typically tied to individual employers, workers switching jobs must often go through a complicated process to rollover their savings into a new work plan or IRA—a process that often results in significant savings ‘leakage’ as many workers opt to cash out a portion of their plans instead.<sup>36</sup> Unnecessarily high fees charged to savers by plan providers can also eat away between one-quarter and one-third of investment returns and may force workers to retire years later than planned if they want to hit their savings targets.<sup>37</sup>

It must be remembered, however, that employees encountering all of these obstacles at least have access to workplace retirement plans: a benefit millions of Americans still lack. While the switch from defined-benefit plans to defined-contribution plans should have allowed far more employers to offer retirement plans since the latter is cheaper to provide, this large growth in coverage has unfortunately not occurred. In fact, some worker surveys show retirement plan access has dropped significantly since the late 1990s.<sup>38</sup> Even employer surveys—which tend to report higher coverage rates than worker surveys—only showed 65 percent of private-sector workers having access to a workplace retirement plan as of 2014, with only 48 percent actually participating in one.<sup>39</sup>

In summary, saving for retirement has become significantly more difficult for middle-class families in recent decades as incomes have stagnated, access to retirement benefits has remained limited, and savers have been forced to shoulder more risk and make more complex decisions. Our current retirement system is overly complicated, overly costly, and overly risky, and it should come as no surprise that so many Americans are struggling to save enough to afford a secure retirement.



# Policy recommendations

Fortunately, there is no reason America’s retirement system must remain the way it is and a number of options exist for significantly improving how families save for retirement. These options can be divided into two camps: broader systemic reforms that can be implemented over a longer period of time and more moderate tweaks of the existing system that can help savers immediately.

In the long term, transitioning away from individual defined-contribution plans that are strictly tied to workers’ employers to hybrid plans that incorporate features from both defined-benefit and defined-contribution plans—such as CAP’s proposed SAFE, Retirement Plan—would be the best method for ensuring that all Americans can afford a secure retirement.<sup>40</sup> These plans can help workers save significantly more at a lower cost and with lower risk by combining the best elements of a traditional pension—including regular lifetime payments in retirement, professional management, and pooled investing—with the best elements of a 401(k), such as predictable costs for employers and portability for workers.

## How CAP’s SAFE Retirement Plan works

- Plans would be organized as nonprofit organizations run by independent boards whose sole objective would be to maximize participants’ long-term benefits.
- Plans would be available to all workers regardless of whether their employer previously offered a retirement plan, and benefits would be portable when workers change jobs.
- Each worker would select a plan, and his or her employer would only need to facilitate enrollment and any required payroll deductions.
- Investments would be pooled together and professionally managed to maximize returns, and a financial mechanism called a “collar” would enable the plan to save excess returns from good years to maintain benefits in bad years.
- The risks of a SAFE Plan would be spread among workers and retirees rather than borne solely by employers, as they are in a traditional pensions, or individual workers, as they are in a 401(k).

Indeed, modeling done by CAP has shown that a worker invested in a plan like the SAFE Plan would be nearly 2.3 times more likely to maintain their standard of living in retirement than a worker with a typical 401(k) making identical contributions.<sup>41</sup> Alternatively, a worker in a SAFE Plan could achieve the same likelihood of maintaining their standard of living in retirement as one with a typical 401(k) by contributing half as much of their paycheck.<sup>42</sup>

Despite these advantages of hybrid plans like the SAFE Plan, however, some savers will always have the background knowledge, interest, and time to invest in a 401(k)-style plan and may prefer the greater control over their investments such plans allow. To accommodate these savers and simultaneously expand retirement plan access even further, policymakers should also consider coupling the adoption of hybrid plans with the opening up of the Thrift Savings Plan to all workers.<sup>43</sup>

The Thrift Savings Plan is the 401(k) plan currently available only to federal employees. The Thrift Savings Plan is a model 401(k) plan with very low fees, strong oversight, smart investment options, and an annuity option. All of these features help savers in the Thrift Savings Plan accumulate greater assets and be better prepared for retirement than most people in typical 401(k) plans.<sup>44</sup> Opening up this plan to all workers would not only give many more workers a chance to save through a workplace plan, but also provide them with access to one of the best 401(k) plans available.

While pushing for the adoption of hybrid plans such as the SAFE Plan and working to open up the Thrift Savings Plan, however, policymakers should also do their best in the short term to make the existing retirement system less predatory and more accessible.

Among the first steps should be to require 401(k) and IRA plan providers to be more transparent about the fees they charge for holding and investing savers' assets. As mentioned above, these fees can eat away workers' retirement savings and greatly reduce the returns received by savers on their investments. A recent CAP analysis found that the average fees paid by a typical worker could cost them nearly \$100,000 over their lifetime, compared to if they were invested in a low-fee plan.<sup>45</sup>

To help workers make informed decisions and encourage employers to seek out lower-cost options for their employees, CAP has proposed a simple solution: place a warning label on all retirement plan literature that informs consumers about the high risks of fees and lets them know how the fees in a given plan compare to fees in other plans of the same type.<sup>46</sup> This is one example of how transparency surrounding defined-contribution plans can not only be increased in a low-cost fashion, but also in a way that will help workers save thousands of dollars over the course of their careers.

Finally, immediately addressing the upside-down tax treatment of retirement savings would also go a long way toward helping working families save enough for retirement. Replacing the existing complex web of tax deductions that disproportionately benefit the wealthy with a Universal Savings Credit that would turn all existing deductions into one single, streamlined credit—as CAP has previously proposed<sup>47</sup>—would ensure that middle-class families and those at the bottom of the income distribution are provided the same effective tax benefits as those at the very top. It would also make it easier for all households to understand and access incentives for saving. Matching low-income savers' contributions to their retirement nest eggs via additional progressive tax credits would go even further and could help many families currently struggling just to make ends meet save enough for a secure retirement.<sup>48</sup>



## Conclusion

As saving for retirement becomes increasingly difficult, more and more middle-class families have found themselves facing the very real possibility that they may not have enough saved to maintain their standard of living during retirement. Fortunately, there are a number of steps that policymakers can take to help these families catch up and afford a dignified retirement, starting with making our retirement system less complex, less risky, and less costly to savers.

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## Endnotes

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- 44 Rowland Davis, Nayla Kazzi, and David Madland, "The Promise and Peril of a Model 401(k) Plan: Measuring the Effectiveness of Retirement Savings Plans Offered by Private Companies and the Federal Government" (Washington: Center for American Progress, 2010), available at <http://www.americanprogressaction.org/wp-content/uploads/issues/2010/04/pdf/401k.pdf>.
- 45 Erickson and Madland, "Fixing the Drain on Retirement Savings."
- 46 For more details of this proposal, see Ibid.
- 47 Weller and Ungar, "The Universal Savings Credit."
- 48 Valenti and Weller, "Creating Economic Security"