

ERISA Advisory Council Testimony of Anna M. Rappaport, F.S.A., M.A.A.A.

APPROACHES FOR RETIREMENT SECURITY IN THE UNITED STATES

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My name is Anna Rappaport and I appreciate the opportunity to appear before the ERISA Advisory Council and to provide input on this very important topic. I am very committed to and passionate about retirement security and concerned that as Americans we need to do a better job. I have been a Fellow of the Society of Actuaries since 1963 and a member of the American Academy of Actuaries since its founding. My career included 28 years of experience as an actuary focusing on employer-sponsored pensions while at Mercer, many years before that in the life insurance industry focused on financial products, and since 2005, I have been focusing on retirement security through Anna Rappaport Consulting. I am a phased retiree very committed and passionate about improving the system.

I have been very involved with different organizations supporting the retirement system and have chaired the Society of Actuaries Committee on Post-Retirement Needs and Risks since its inception about ten years ago. I am a Past President of the Society of Actuaries. I am currently on the Board of WISER and the Advisory Board of the Pension Research Council, and a member of several advisory groups related to retirement matters. See my website, www.annarappaport.com.

I want to congratulate the ERISA Advisory Council for focusing on this very difficult topic.

In my testimony I provide responses to the ERISA Advisory Council questions. Then, I provide supplemental information including:

- Context and background, which provides a point of view and information on key trends underlying retirement today.
- Discussion of clear system successes and failures, as well as other results that are viewed as either successes or failures depending on whom you ask.
- Consolidated summary of recommendations organized by topic.

QUESTIONS FROM THE ADVISORY COUNCIL

Does the current voluntary US retirement system need to be redesigned or completely restructured?

I believe that redesign is the best approach. I support building on the successes of the current system and maintaining a good role for the employer in the system. Successes, failures and some

areas that might be viewed as either success or failure are discussed below in the Supplementary Information.

In redesign of the system some of the key things to keep in mind are as follows:

- The system is voluntary and an add-on to Social Security.
- Over the long term, the system worked very well for long-term employees in large employers, but poorly for employees of very small employers and those without stable long-term employment.
- In recent years, there have been problems with the system in the areas where it had historically worked well, and it is important to address those.
- It is equally important to focus on the areas where it historically did not meet population needs and fill in the gaps.
- Individuals' capability to understand risk and deal with it effectively is variable and very limited for some people.
- Social Security represents virtually all of the resources that people at the lower end of the economic spectrum have and virtually all of the income for four out of ten older women living alone. The system needs to work in partnership with Social Security, and Social Security needs to be strong.
- There are a lot of benefits and efficiencies to be obtained from risk pooling, and pools need to be at least a minimum size to be effective.
- While health care and long-term care are not part of the discussion today, providing for both of them is an important part of retirement security.

I do not recommend complete restructuring because I do not know of any existing system worldwide that is ideal and would offer a good U.S. solution. There is a lot of positive to build on and the price of totally discarding the existing system and starting over is too high.

What role should the DOL take in such redesign?

The DOL can play a leadership role in the development of ideas and promotion of legislation. This current effort by the ERISA Advisory Council is a step in that direction. Other ideas for DOL leadership include:

Unify and Rationalize Regulations: at present there are a number of U.S. Federal agencies regulating pensions, and a number of different agencies regulating financial institutions. Insurance is primarily regulated at the state level. When annuities are involved with DC plans, benefit and insurance regulation intersect. Steps are already being taken to unify financial institution regulation. The DOL should play a leadership role in unifying employee benefit regulation.

Encourage Development of National Retirement Policy—The U.S. does not have an integrated National Retirement Policy. Pension legislation over the last 50 years has represented a balancing act between measures designed to implement tax policy and measures designed to enhance retirement policy and protect the participants in plans. The DOL should encourage the development of a National Retirement Policy, and could offer to host its development. Retirement policy development should focus on meeting important goals for retirement security.¹

Serve as an information resource for stakeholders: The DOL can play a significant role in providing information to a range of stakeholder audiences including policy makers, plan sponsors, participants, and advisors.

Encourage better labor force participation: Some of the people who do not fare well in retirement do not have good long-term attachment to the mainstream labor force. Retirement policy should not attempt to address this issue, but the DOL can work to expand the labor force attachment of these groups, thereby increasing retirement security as well as the situation of these people during their working years.

Work with others to get those not in the mainstream financial system into the system: The unbanked are another group who do not fare well in retirement. The DOL should work with other agencies, primarily the Department of the Treasury to help get the unbanked into the main stream financial system.

Can DC plans be redesigned to generate better retirement security outcomes?

Yes. However, before we think about redesign, it should be pointed out that the moves to auto-enrollment, and better default investment options already were big steps forward.

Things to think about include:

- Structuring of the choices during the retirement/distribution period: This was a topic for the 2008 ERISA Advisory Council. If DC plans are to be the primary retirement vehicle they should do a better job of helping people use their plans to maintain regular income and support during retirement.

¹ In my view, examples of key goals are to achieve the following:

- Financial systems, public and private, to support retirement that work without too much individual decision making. Systems that support better work options, later retirement, and retirement security for as many citizens as possible. Systems designed to recognize that many individuals will not do good long-term planning.
- Better work options for “third age” Americans as they move toward full exit from the labor force.
- Later retirement and full exit from the labor force that gradually adjusts to changing life spans, and helps make the idea of retirement more affordable for more people.
- More individuals thinking long-term and doing better personal planning for retirement, with more analysis as part of that planning.

- Using 401(k) funds to purchase a variety of risk protection options, either through the plan or through employer offerings on an advantageous basis would be ideal. Some of the choices should include lifetime income with survivor protection, with or without inflation protection, supplemental health insurance, and long-term care benefits. The 401(k) balance could be an “account” that could be applied in different ways.
- Encouraging long-term thinking and focusing on whether the amount saved will be enough. A key principle is that it is necessary to save enough and important to save early. It will be important to agree on a definition of “enough” for this purpose.
- Maintaining simplified models that work well for small employers and making it easy for small employers to offer these benefits.
- Encouraging thinking about the DC account balance as needing to generate “paycheck replacement.” Signals are very important in encouraging people to think and act in different ways. DC plans should be signalling retirement security and income replacement rather than simply pools of money. It would be desirable for DC plans to communicate the idea that the goal is income in retirement and to get participants to think about the value of their account balance in terms of the income it can produce. Some plans already do this and some do not.
- Considering whether there should be more limits on using the money early (prior to retirement).
- Reviewing spousal rights in primary DC plans and in Individual Retirement Accounts. While there are fewer single earner families, many still have a primary breadwinner and a spouse with a lot of household responsibility. More thought is needed about whether the resources in these plans are family assets and what rights that should convey.
- Revisiting the Required Minimum Distribution as it has become the de facto default distribution for many people and as a result, many people do not focus on lifetime income or the best distribution strategy from the perspective of making money last a lifetime.

Does the variety and quantity of choices offered participants contribute or detract from retirement security?

Choices can do either. Whether choices add to or detract from security depends on the program. A few well-structured choices plus a good default option is optimal. Too many choices are confusing and detract from program success.

One of the challenges is that the best choice for an individual depends on that person’s total portfolio, risk tolerance, and life stage. Use of life-cycle funds that vary by life stage are advantageous to individuals without much other portfolio, but they may not be a good choice for those with significant other assets.

Key points:

- Good defaults are needed regardless of the other choices

- Choices should be limited in number and clearly distinct
- Good education/information is needed to help the participant understand the choices and how they might apply
- Expenses matter—attention should be made to offering choices with low administrative cost.

How does participant education/investment advice help?

Signals and “Nudges” are very important because they influence behavior. Participant education and investment advice can help participants make better choices and help encourage them to pay attention. Staying in the default option and not making a positive election is also a choice, and education can help reinforce that point. With e-mail and electronic communications, education can be tailored to the life stage of the participant.

One of the big challenges is that the planning horizon for retirement security is the rest of life, but many people think short term. Participant education can regularly focus on the longer term and can also encourage modeling. The plan sponsor can offer tools directly, can encourage use of the tools of a vendor, or it can encourage using outside tools such as “Taking the Mystery Out of Retirement Planning” from the Department of Labor. This tool is particularly valuable for mid-life employees who need to think about retirement in more depth.

Some very important messages include:

- Think long term—planning is for the rest of life (and some people live beyond age 100)
- Communicate that the purpose of the retirement plan is to create a “paycheck replacement” in retirement
- Develop a plan and check how you are doing with the plan at least once a year—keeping track is just as important as planning in the first place
- Many decisions involve trade-offs—to understand the trade-offs ...(provide information that is appropriate to the specific trade-off)
- Even if you are in the plan defaults, it is important to pay attention
- Save enough money
- The amount saved will enable you to replace ___% of your income at retirement age ___

And of course there are more...

Can DB plans be redesigned to be more attractive to employers, and ultimately result in broader coverage, as well as better retirement security for participants?

I believe that they can.

Before real progress can be made on longer-term issues, short-term issues need to be addressed first. PPA relief would be the most pressing short-term issue. I believe that other witnesses have addressed this issue.

Here are some of my suggestions for improvements/further study to address longer-term issues:

Employee contributions: Pre- and post-tax employee contributions should be available on a parallel basis in both DB and DC plans. DB plans with employee contributions offer a safety valve and alternative design if employee contributions can be increased under adverse circumstances. This is recommended as an option.

Hybrid plans: Hybrid plans theoretically offer a very good way to respond to a changing labor force, but simpler designs that are explicitly authorized by statute are needed. The statute needs to be structured to preclude potential problems with age discrimination and allow latitude in transitions. Hybrid authorization should include account designed plans (e.g., 5% of pay each year credited to an account with investment income based on formula in plan) with pooled investments and payouts in either lump sums or income. Plan sponsors should have a choice about offering a guaranteed investment income. Hybrids should also include designs that build to a lump sum that is defined as a multiple of expected final earnings or final average earnings.

Adjusting to the new realities of retirement: Many people are gradually moving into retirement, retiring but continuing to work on some basis, or scaling down before full retirement. Plans need to accommodate these realities through more liberal phased retirement provisions, and provisions that allow payment of benefits after a defined age without suspension during part-time work with the employer.

Self adjusting systems: DB designs need to accommodate to self adjusting features, such as the right to gradually move up retirement ages. Ideally they would also include some type of “safety valve” to provide for the potential to reduce benefits somewhat in case of very adverse experience. One model that was used many years ago, but has been out of favor, is worth exploring. Participating deferred annuity contracts guaranteed a modest benefit, but increased the benefits in the event of good experience. Some public plans include cost of living adjustments, but with the potential to reduce them under adverse circumstances. Employee contributions that can be increased under certain circumstances are another form of self adjustment.

Multi-employer and collective models: One of the problems with the current system is that it does not serve the needs of small employers well. In addition, some larger employers would rather outsource their retirement benefits and would like to have good collective options. Within the U.S., Taft Hartley plans offer one model of multi-employer plans, and large public systems such as the Illinois Municipal Retirement Fund offer a different model. Another model for multi-employer nonprofits would be specialized insurance companies devoted to retirement security. TIAA-CREF is an example of such a company. There are collective systems in the Netherlands, and large public systems in Canada that offer different multi-employer models.

New multi-employer models that allow employers to join a larger plan need to be investigated, and new multi-employer options need to be authorized and offered. These should be an option to single employer plans. Governance will be important in structuring these entities. They need knowledgeable governing bodies that represent the interests of all of the stakeholders. Including independent trustees is one approach to consider for governance.

Final average pay plans in the future: Final average pay plans were a good model under employment patterns of the past, but they need patching to fit the employment patterns of the future. The reasons for this include:

- Final average pay plans are not well suited to careers that include moving from organization to organization.
- Portability is difficult with these plans, and unless they include cost of living adjustments, what is portable is generally a frozen benefit.
- Pay and career patterns have changed so that many people no longer end their career with their peak salary.
- Many do not experience a smooth compensation pattern during their careers.
- Final average pay plans do not fit well with gradual retirement.

The designs for these plans should be updated to accommodate gradual retirement and to freeze final average pay if there is a career change where pay goes down below the final average.

A modest final average pay benefit in combination with a 401(k) plan is still a good and efficient way to provide retirement benefits.

Career average pay plans in the future: Career average pay plans continue to be a good model under the employment patterns of today and those expected in the future. The designs for these plans should be updated to accommodate gradual retirement. A modest career average pay plan benefit in combination with a 401(k) plan is still a good and efficient way to provide retirement benefits.

Would the adoption of plan designs in use outside of the US contribute or detract from retirement security in the US?

There are a variety of lessons to be learned from experience outside of the U.S. There is no ideal perfect solution that can be pointed to as the best option for the future.

Here are some examples that the U.S. does not want to follow:

Provident Funds used in several Asian countries provide lessons about mandated DC plans with very high contribution percentages. Saving a lot is vital but not sufficient for good retirement security in DC plans. Unfortunately, Provident Funds have not provided adequate retirement security. Problems in different settings have included (but are not limited to):

- Using funds for non-retirement purposes authorized by the programs
- Inadequate investment returns, in part due to types of investments provided for in the plans
- Early retirement ages
- Lump sums at retirement

This is a DC model where the plans are run by exclusive purpose not-for-profit organizations and adequate retirement security has not been achieved.

Australia has a 9% of pay mandated DC plan with a wide choice of investment options, but not a Social Security system available to all. It has been cited as a good approach, but in fact it also does not offer adequate benefits. Some key points:

- Some of the 9% can be used to provide death and disability benefits
- The 9% is instead of contributions to a Social Security system, not in addition to them
- Expenses are too high with some options
- Not enough is being saved for adequate benefits
- Money is used too quickly after retirement

There is also a means tested Social Security system, and housing is generally not counted in the means test, so individuals end up using their money and then going on Social Security.

The Swedish Social Security system offers so many investment choices that it has led to a significant decrease in resulting investment performance. The Swedish Social Security system on privatisation initially offered 456 funds. Through July 2007, the return on the default option was 21.5% compared to an average return of 5.1% for plan members who chose their own funds.

Other systems offer good learnings.

The Netherlands uses a “hybrid” design in collective plans that includes some self-adjustment. There are features of the Dutch system that are very good and that system would be worth studying closely to see what we could learn in the design of new hybrids.

However, it is not suggested that the Dutch system could simply be transported to the U.S. The circumstances and culture in the Netherlands are different.

Other models

While not international models, some public plans that include many employers offer models worth studying. Public plans in both the U.S. and Canada should be studied.

Has the consolidation of the financial services industry impacted participant retirement security?

No comments are offered on this question

Should plan providers be able to market retail products to plan participants because of their relationships?

One of the valuable roles that an employer can play in helping participants achieve retirement security is to serve as a “purchasing agent” and offer access to participants of good products and services that have been well screened, and where there is an advantage to the participant in group purchase.

Products offered should have been screened to be a good buy, and should have institutional pricing appropriate to the group and a reduced distribution cost.

What is the role of the fiduciary in this marketing effort?

The fiduciary should screen the products to be sure that they are a good deal, should insist on a marketing approach that provides good disclosure and focuses on suitability as well. There should be a requirement that there is no financial incentive paid to the employer for offering the products and services. The fiduciary should not be held to a standard of finding the best deal. “Best” is too high a standard, and it is important not to create unreasonable barriers to employer participation in bringing desirable offerings to employees.

Should the DOL take a position on such marketing practices?

The DOL should offer safe harbors about the screening that should be done on such products and what would conceptually constitute institutional pricing. They should also focus on the disclosures that are needed in connection with such offerings.

Should DC plans be amended to permit sponsors to invest funds contributed by participants to better ensure financial security and can such sponsors receive fiduciary protection?

No comments are offered on this question

Can the Government provide some form of guaranty or insurance for DC plans to protect retirement security?

I do not believe that it is feasible to offer such protection, and this is one of the reasons why it is important to further develop hybrid designs. And it should be noted, that participants who want security of return should choose the fixed investment option in the plan.

SUPPORTING INFORMATION AND COMMENTARY

General perspective and context

My responses to the ERISA Advisory Council's questions are based on my perspectives about the appropriate philosophy for the U.S. retirement system, as well as demographic trends, knowledge about how participants behave and some reaction to the economy.

Appropriate philosophy and the employer: The United States is a democracy and we value our freedom. We believe in individual responsibility. At the same time, we believe that we have social responsibility to provide for the common good, and that there is a minimum social safety net that should be provided, and in addition some benefits should be provided for all. I believe the best system is a voluntary system working in partnership with mandates in the form of a strong Social Security system.

The employer is a valuable part of the retirement security system for people with long-term attachment to the labor force. It is important we not forget that much of the wealth of Americans came through employer plans. Employers should be encouraged to offer plans, and need a range of options to provide security for their employees.

Sources of wealth: Middle Americans nearing retirement age have about 70% of their wealth in non-financial assets, primarily housing wealth. The two biggest retirement planning decisions for many of them as they reach retirement age are when to retire and claim Social Security, and how to use housing wealth in retirement. We need to understand that retirement plans operate in this context, and in our retirement planning, education, and messaging remember these realities.

Demographic trends—who we are: The United States is a diverse country. We can not expect an employer based retirement system to provide coverage for several groups—people without regular labor force attachment (except to the extent that they are family members of those with such benefits), the unbanked, and the underbanked. According to the President's Advisory Council on Financial Literacy, there are about 28 million Americans who are “unbanked” and 44.7 million who are “underbanked.”² Until these Americans are connected to the mainstream financial system, my view is that it is unrealistic to expect that they will be covered adequately by a retirement system.

Those without regular labor force attachment are also a diverse group. Some are homemakers who rely on benefits through their spouses, and it is key that spousal rights, widows benefits, and pension rights on divorce be part of the total picture. There are others in this group as well.

² 2008 Annual Report of the Council, page 29

Demographic trends—how we retire: Increasingly people are exiting the labor force gradually, blending work and retirement over a period of time. See my 2008 ERISA Advisory Council testimony for more detail on this point.

Demographic trends—the aging population: Population aging is a global fact of life. The United Nations Department of Economic and Social Affairs says about the global situation:

- *“Population ageing is unprecedented, without parallel in human history—and the twenty-first century will witness even more rapid ageing than did the century just past.*
- *Population ageing is pervasive, a global phenomenon affecting every man, woman and child—but countries are at very different stages of the process, and the pace of change differs greatly. Countries that started the process later will have less time to adjust.*
- *Population ageing is enduring: we will not return to the young populations that our ancestors knew.*
- *Population ageing has profound implications for many facets of human life.”*

The economic realities: The economic crisis presented major challenges to individuals as they managed their savings and to employers as they managed DB plans. It did not remove any of the challenges present before the crisis, but it presented new ones, and made solving the old ones more difficult and more pressing. And, because so many sectors of the economy were affected, even knowledgeable investors were hurt.

Retirement implications of what we know and how we think: There has been a vast increase in individual responsibility for retirement, with a major shift in pension structure from DB plans to DC plans. It is difficult to describe this as either a success or failure, but lessons have been learned. DC plans generally offer far more choice than DB plans. Choices include whether to enroll, how much to save, and how to invest funds. Both types of plans can offer choice at retirement or plan exit. While it was once expected that choice would be a big plus for DC plans, experience with choice has demonstrated that many people choose default options—they do what happens without having to take positive action. And further, the average citizen is not knowledgeable about investment choices and can be nudged quite easily. The result of this is that DC plans are now structured to work better without individual action, and common defaults include automatic enrollment, increases in savings, and balanced investment options. Under this system, employees must opt-out, otherwise they will be in. Offering a wide range of choice has not worked well.

Successes and Failures

The United States retirement systems overall can be viewed as a mixture of successes and failures. While a lot of progress has been made, there are gaps in the system and problems with the way it is operating. It is important not to focus only on either successes or failures but to understand both, seek to build on the successes and work to resolve the failures, or improve on them. It is also important to recognize that no country has been able to develop a system that is

perfect and transportable to the United States, so that we need to look for improvement, and recognize that perfect is unattainable.

The discussion will review and comment on some key successes and failures, and some areas that can be viewed as a success or failure depending on whom you ask:

Area of success	Comments and discussion
Many Americans have been able to choose to retire and are happy in retirement today.	The financial crisis had reduced the assets of many retirees, but they are not as impacted as the group nearing retirement. ³ The impact will potentially be greater on the group nearing retirement, and this group includes many Americans who were not as well prepared for retirement even before the financial crisis. Different researchers have reached a range of conclusions about how well prepared people are and how many Americans are unprepared to retire.
Poverty rates among elderly couples are around 5%.	In the U.S., the percentage of the 65 and over population in poverty was 35.2% in 1959, 15.7% in 1980, and 9.4% in 2006. ⁴ For the 85 and over population, the percentage in poverty dropped from 21.2% in 1982 to 11.4% in 2006. However, with the present economic crisis, it is unclear how much the number who can retire reasonably will be reduced and how those already retired will be affected. Poverty rates among the elderly are significantly lower than among children. Married couples are better off than single persons, particularly women.
People are living longer in many countries and it is not uncommon for people to be retired for 25 years or more.	Life expectancies at age 65 for men in the U.S. increased from 11.5 years in 1900 to 12.7 years in 1950, and 17.1 years in 2004. For women the corresponding years are 12.2, 15.0, and 20.0. ⁵
Social Security has made major contributions to well being of the elderly, disabled Americans, and survivors.	The economic crisis has again demonstrated the success of this system. At the same time, it needs additional financing or some benefit reductions to be put back into financial balance. The added financing needed is less than 2% of covered payroll. In the absence of any added financing, benefits would ultimately need to be cut about 25%. A range of options are available for meeting this gap with a key option being to increase retirement ages.

³ Pew ResearchCenter Report, Different Age Groups, Different Recessions, May 14, 2009 states “Adults 65 and older – most of whom have already retired and downsized their lifestyles – have escaped its full fury.” P1

⁴ Older Americans, 2008, Tables 7a, Federal Interagency Forum on Age Related Statistics

⁵ Older Americans, 2008, Tables 14a, Federal Interagency Forum on Age Related Statistics

Area of success	Comments and discussion
The employer system has resulted in retirement benefits and savings for millions of Americans who would not have anything beyond Social Security without employer plans.	Employer-provided pensions are important to today's retirees and those nearing retirement. Over three-quarters of households aged 51-56 in 2004 are either currently covered by a pension or enjoyed pension coverage in the past. 60% of pension wealth held by those age 51-56 in 2004 is in the form of a DB plan. Median pension wealth of Early Boomer households in the 2004 HRS was \$108,798. This was \$136,711 for couples, \$52,912 for one member male households and \$49,216 for one member female households. Social Security wealth for couples was \$234,993. ⁶
DB plans have played a valuable role in enhancing retirement security and pay lifetime income for many retirees today	These plans continue to be important for the next wave of retirees, although they have clearly declined within the retirement system.
Default options and efficiencies in 401(k) plans.	Auto-enrollment features, default investment options and auto-increase features have worked to enhance the operation of 401(k) plans and provide good benefits for those who may not take the initiative on their own. In addition, most 401(k) plans allow individuals to save on a more efficient basis than they could if they did it on their own. Many would not do it at all, but for those who would, employer-sponsored plans offer efficiency, lower expense charges in most situations, payroll deduction, and a fiduciary to screen and select investment options.
Individual retirement accounts(IRAs)	IRAs have big balances today, largely due to rollovers from qualified plans at time of distribution or job change. They have an important role to play in system portability. In addition, they offer individuals without plans a method of pre-tax savings. Even if not many people make this choice, it is important that it be available.
DB plans as a workforce management tool	These plans were established to help retirement in an orderly fashion and they succeeded well in that goal.

Area of failure	Comments and discussion
About four out of ten Americans retire before they choose to.	Major reasons are loss of job, poor health, and family members in poor health. Americans nearing retirement age who seek new jobs often find it more difficult to get them than younger persons.

⁶ Gustman, Alan L., Steinmeier, Thomas L., and Tabatabai, Nahid, "How Do Pension Changes Affect Retirement Preparedness?" —paper presented at the August, 2009 Retirement Research Consortium Conference. Presentation covers material from a forthcoming book. "Pensions in the Health and Retirement Study"

Area of failure	Comments and discussion
Many working Americans do not have current pension coverage.	It is important to focus on which groups have coverage and which do not. Full-time workers of larger organizations are very likely to have coverage, whereas individuals working for very small companies are much less likely to have coverage. Issues relating to small companies need to be separately addressed. Part-time workers are also less likely to have coverage.
Many small employers have not adopted retirement plans.	Small employers have low rates of plan sponsorship. However, many newer small businesses will not survive more than a few years.
The advantages of DB plans have been diminished because of employers discontinuing or freezing them, particularly in situations where replacement benefits are not provided.	<p>Many DB plans have been frozen, and while some have been replaced by other plans, some have not. So employees get some benefit from the frozen plan, but not what they had hoped for.</p> <p>Freezing or termination without replacement is more likely when companies/industries are doing poorly and in some cases, going into bankruptcy. However, other companies are choosing to freeze or terminate without severe financial distress. Generally, employees get all benefits earned until the date of freeze or termination, but for those with higher benefits, it will not necessarily be true. The Pension Benefit Guarantee Corporation insures benefits to a certain level, but those with higher benefit amounts may lose some of their benefit in bankruptcy. This was a major issue in the case of some airline benefits.</p>
Poverty rates for older women alone—single, widowed and divorced are in the 15% to 20% range and many more are in near poverty	Older persons alone do less well than older couples, and older women less well than older men. In addition, after widowhood, men are more likely to remarry, so that there are many more women alone.
Choice of guaranteed life income (or payout annuities) at retirement	When given a choice of a guaranteed life income or a lump sum at retirement, most choose the lump sum. Ultimately whether it is a better deal or not depends on investment experience and how long people live. Evidence would indicate that the lump sum is over-valued and the life income under-valued, in part because people underestimate how long they might live and over estimate the amount of return they can get on their assets. Products that are available only for individual purchase are also not viewed as very attractive by many observers.

Success or failure? Depends on who you ask	Comments and Discussion
DB Funding Rules (including the PPA changes)	<p>The DB funding rules were greatly strengthened by PPA. The interaction of these rules with the economic crisis created hardship for companies that had well funded plans prior to the crisis. This was an unintended consequence. Many feel that the rules are too harsh and will contribute to further exodus from the system. There has been some relief but not as much as requested by the plan sponsors.</p>
401(k) plans—Millions of Americans are participating in these plans and saving money for retirement that they would not otherwise save.	<p>Nearly all Americans working for large well-established employers have access to these plans, and individuals with long service in these companies have very good account balances. However, small employers are much less likely to sponsor plans, and people in very small organizations may not have anything. There is controversy surrounding a number of 401(k) issues including the ability to manage investments as an individual, how to get those who are not saving enough to save more, leakage, and method of benefit payment.</p> <p>Expenses and expense disclosure are another controversial issue. Some large employers offer plans at very low cost, whereas other plans have quite high expenses. Employees often do not know what expenses are embedded in the plans. The most important information of course is the net result after expenses and getting the best result. There is lack of agreement about what details are most important. And providing extensive information does not necessarily enhance understanding.</p>
Level of participation in employer-sponsored plans	<p>Depending on the universe you choose, there are various estimates of how many people/families are covered by employer-sponsored plans.</p> <p>Most people believe that coverage should be increased, but there are differences of opinion as to whether the best approach is to identify the weak spots and fill them in, to start over, or to add a new layer on top. A new layer might be either a mandated auto-IRA for employers who do not offer coverage at all or a mandated additional benefit for all. Another approach is to strengthen the minimum benefits in Social Security.</p>

Success or failure? Depends on who you ask	Comments and Discussion
Cash balance and hybrid plans	<p>DB plans that used account balances as their base or plans that were based on lump sums as a multiple of pay at retirement appeared at first to offer very promising designs that responded well to changing business conditions and workforce patterns. They ended up mired in regulatory hassle and did not work out well, in part because they were not explicitly authorized.</p> <p>New hybrid designs appeal to me very much, particularly if they pool longevity and investment risk, without total risk transfer. Such designs with some self adjustment seem to me to be a very good idea.</p>
Failure to raise the retirement age to track increases in life spans	<p>Retirement periods have gotten longer and longer. At the point when retirement plans started, the mid-60s were first provided as the age of retirement, and life spans were much shorter. Retirement ages dropped for many years and have risen somewhat in the last decade, but more increases in retirement ages including the normal retirement age are important.</p>
Company stock in retirement portfolios	<p>Research shows that many employees think their company's stock is less risky than a diversified portfolio. Historically, company stock has played a major role in some company's retirement portfolios. Where a company match is in stock, and there is also a DB plan, then from a minimum benefit and portfolio approach, the employee is largely protected. In other plans, the employee takes on huge risk if there is too much investment in company stock. This issue has already been addressed to a significant extent.</p>
Lump sum options in employer-sponsored plans	<p>Some experts view lump sums as a very good option in plans, and others view them as a problem. My view is that whether they make sense or not depends on whether a plan is a primary or a supplemental retirement plan. Where they are offered, most individuals elect lump sums. There is concern that retirement funds are used too fast.</p>
Plan provisions that allow withdrawal and spending of retirement funds before time of retirement	<p>This matter deals with the issue of the purpose of the plans and it is intermixed with portability.</p>
Degree and type of portability in retirement plans	<p>Portability is very important in light of today's employment patterns.</p>

Success or failure? Depends on who you ask	Comments and Discussion
Public employee pensions	<p>These plans are typically contributory DB plans. These plans have helped public entities attract and retain the talent they need. They have helped employees in an environment where there is no opportunity for stock ownership and main forms of incentive payments. There is concern that they are too costly to taxpayers and that the benefits in some of these plans are larger than warranted.</p> <p>These plans are not subject to Federal regulation. While many of them are very well managed, not all are. Dealing with public plan issues is outside of the scope of the ERISA Advisory council. However, these plans can offer some lessons that can be transferred back to the private sector, and can be of interest for the future structure of the system.</p>
Equity investments in pension funds	<p>Half a century ago, pension funds didn't invest much in common stocks, and they often used insured group annuities. Investment gains and losses were no problem, but costs were higher. Then employers seeking to reduce costs searched for higher yields and found equities, using asset gains and greater discount of liabilities to justify richer benefits based on final pay. But occasional heavy losses have posed financial problems for employers and losses for the PBGC as plan terminations increase when the market is down. Today, equity investments are criticized as a mismatch of assets and liabilities.</p>
Retiree health benefits	<p>These benefits have helped many employees achieve security in retirement and retire early. They may have encouraged retirement at too early an age. The benefits are largely unfunded and represent a problem to many organizations. The burden of these benefits was not anticipated when they were implemented. Disclosure requirements have forced plan sponsors to at least understand their costs. These benefits are an important part of total retirement security and need to be considered as part of national retirement policy.</p>
Flat dollar negotiated plans	<p>These plans provided secure benefits to union members and enabled the union to get credit for negotiated benefit increases. But the structure of the funding rules with common practices often led to underfunded plans because increases could be funded prospectively only.</p>

Summary of recommendations

Recommendations regarding broad policy and overall system management:

My view is that it is important to build on successes and work to fill in the gaps in the current system. Some ideas for doing this include:

- National retirement policy—Develop a national retirement policy and keep it updated. Recognize that an integrated retirement system is important to the fabric of the nation, and that it needs an underlying rationale with stability and which makes sense. Include in the policy a minimum age for receipt of benefits from tax qualified plans (except for disability) as retirement should focus on old age security.
- Role of the employer—Support a strong employer role in the retirement security system while at the same time recognizing that employers should have a choice of what role they wish to play. Recognize that employees are much more likely to save through employer affiliated plans.
- Small employers—Understand special issues of small employers, and work to develop plan structures that will be more attractive to them.
- Stand-alone multiple employer entities—Study the range of multi-employer approaches in use in the U.S. and other industrial countries to look for new and better multiple employer approaches.
- Unbanked and underbanked—Work with appropriate entities to get as many of these people as possible into the mainstream financial system.
- Family benefits and spousal rights—Recognize that there are still many families where there is one spouse who accounts for the greatest part of the family lifetime earnings, and that the other spouse counts on retirement resources based on the other spouse's work history.
- Unify and Rationalize Employee Benefit Regulations—At present there are a number of U.S. Federal agencies regulating pensions, and a number of different agencies regulating financial institutions. Insurance is primarily regulated at the state level. Where annuities are involved with DC plans, benefit and insurance regulation intersect. Steps are already being taken to unify financial institution regulation.
- Integrate housing wealth into thinking about retirement security—Housing wealth is a very important part of the assets for middle Americans. There is a need to develop approaches to help Americans focus on whether it is better to invest more in housing or save more directly for retirement. From a policy perspective, public policy encourages putting much of one's assets into housing, and this should be re-evaluated as well. DOL should encourage the appropriate groups to look at this issue.

Recommendations regarding DB plans

- Short term—Enact legislation necessary to resolve short-term PPA issues.

- Hybrid plan designs—Explicitly authorize new hybrid plan designs. The statute needs to be structured to preclude potential problems with age discrimination and allow latitude in transitions. Hybrid authorization should include account designed plans with pooled investments and payouts in either lump sums or income. Plan sponsors should have a choice about offering a guaranteed investment income. Hybrids should also include designs that build to a lump sum.
- Self-adjusting systems—DB designs should be allowed to include self adjusting features, such as the right to gradually move up retirement ages. Ideally they would also include some type of “safety valve” to provide for the potential to reduce benefits somewhat in case of very adverse experience. A range of self adjustments should be allowed.
- Alignment and modernization of employee contribution requirements—Employee contributions should be allowed on a pre-tax and post-tax basis on a comparable basis in both DB and DC plans. In contributory DB plans, the plan sponsor should be allowed to pass along some part of cost increases through adjustments to employee contributions in times of adverse experience. Some public plans include such a feature.

Recommendations to respond to new patterns of retirement

- Recognize emerging patterns of retirement—Discuss retirement as a time when wages and earnings are replaced or supplemented by Social Security, pensions (if any), and/or the use of retirement assets. Focus thought about retirement in terms of sources of financial support.
- Regularly update retirement ages—Index Social Security and private plan retirement ages or at least increase them. Retirement ages that change gradually with changes in life spans would create very different expectations. Note that the American Academy of Actuaries issued a statement on Aug. 4, 2008 calling for an increase in Social Security retirement ages.
- Remove and reduce barriers to phased retirement—in the United States, there are a range of barriers to phased retirement. They include complexities in pension laws and uncertainties about and barriers to the rehire of retirees. These barriers should be addressed so that phased retirement can become an accepted option.

Effective messaging and “nudges”

- Effective messaging and signals: Use “Nudges” to promote retirement security—Show information about Social Security benefits by starting with the age where the monthly benefit is the largest rather than the earliest age at retirement.
- Change the terminology about retirement ages—while it does not seem practical to get an entirely new term, it is suggested that the terms “normal” and “early” retirement are not helpful in working toward a different world.
- Financial and health literacy—Try to build a culture of analysis and improve financial and health literacy. Encourage individuals to do more analytical work in retirement planning. Create situations where peers talk about this and where peer groups encourage it. Many tools are already available, and more are coming on the market regularly.

- Encourage long-term and balanced planning—Balance messages about leisure, working in retirement, new retirement with messages about risk, long life, and the need for retirement income. Focus on longer-term thinking.
- Respond to gaps in individual knowledge—Recognize the limitations surrounding financial literacy and include appropriate defaults in programs.
- Trade-offs—Identify tradeoffs and the pros and cons of various positions.
- Housing and retirement wealth—Provide tools to help people understand the options with regard to housing and evaluate strategies.
- Role of the DOL—Use “Taking the Mystery Out of Retirement Planning” as a platform to build on and expand.

Recommendations regarding the payout period

- Rethink default distribution options in DB and DC plans—While DB plans pay income, today lump sums are the common default in DC plans, and life income options are often not available. While there has been a great deal of innovation in plan design over past decades, there has not been much innovation in payout management. Open up new possibilities for options and defaults. Public discussion is needed to reach consensus on what should be allowed, what should be required, and what should be protected in a safe harbor.
- Enable use of DC funds for risk protection—Change DC regulatory structure so that 401(k) funds could be a retirement risk protection account, and after retirement, balances could be used to purchase a variety of risk protection options, either through the plan or through employer offerings on an advantageous basis. Some of the choices should include lifetime income with survivor protection, with or without inflation protection, supplemental health insurance, and long-term care benefits.
- Restructure or eliminate RMD requirements—as they exist today, RMD requirements often become the DC distribution default, and they can be a barrier to guaranteed life income and other desirable distribution options.
- Explaining trade-offs—It is clear that many individuals do not make well-informed choices about their retirements and the management of money post-retirement. The trade-offs involved in the choice of a strategy are extremely important, and not easy to understand. Better information is needed for all concerned about the range of options available and the trade-offs implied by choices. It should also be remembered that some choices are irrevocable when made, while others can be changed later.