RETIREMENT

Americans Haven't Saved Enough for Retirement. What Are We Going to Do About It?

by Teresa Ghilarducci and Tony James

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Each year, BlackRock, the world's largest asset manager, sends a much-anticipated letter to leading CEOs. This year, chief executive Larry Fink's focus was on why it is imperative for business to contribute to society. One of the first big issues he highlighted was retirement:

> *“Many [individuals across the world] don’t have the financial capacity, the resources, or the tools to save effectively; those who are invested are too often over-allocated to cash. For millions, the prospect of a secure retirement is slipping further and further away — especially among workers with less education, whose job security is increasingly tenuous. I believe these trends are a major source of the anxiety and polarization that we see across the world today.”*

We agree: Over the last four decades, changes across corporate America have put workers and the broader U.S. society at risk. We’ll talk more about the risks in a bit, but first it’s worth outlining how we got here.

The Road to the Retirement Crisis

Ultimately, the shift from defined benefit pension plans to employee-directed defined contribution 401(k)s is the major driver of the impending retirement crisis. Beginning in the 1980s, this move helped companies reduce their retirement liabilities and better meet their quarterly financial targets, but put an unmanageable burden on employees. For 401(k)s to be effective, for example, contributions must be made consistently throughout a worker’s career. In practice, people tend to make contributions sporadically. They also struggle in choosing contribution levels and investment options, and avoiding the temptation of using their savings for other needs.

Even when contributions *are* made, 401(k)s tend to earn subpar returns on average due to limited investment strategies and high administrative expenses. Employees in defined contribution plans often do not have significant investing expertise and earn rates of return that are substantially below professionally managed pension plans. When workers near retirement have to decide how to withdraw funds, determine a spending rate, and map out an investment strategy, many lack the expertise to do so effectively.

The result is that many workers are left with insufficient nest eggs for retirement and won’t be able to maintain the economic position they achieved while working. Among Americans between 40 and 45 years of age, for example, the median retirement account balance is just $14,500 — *less than 4%* of what the median-income worker will require in savings to meet his retirement needs. What’s worse, Social Security currently provides a declining percentage of the required retirement income. For a median income worker, Social Security minus Medicare premiums today covers about 29% of

their pre-retirement income, down from 40% two decades ago. In addition, less than four years from now, Social Security costs are projected to begin exceeding revenues until that program's Trust Fund is fully depleted in 2034. This will put further pressure on Social Security benefits.

Based on these trends, we predict the U.S. will soon be facing rates of elder poverty unseen since the Great Depression; in fact, one study shows that more than one in three retiring Americans will find themselves in or near poverty in the next 10 years. This wave of older poor Americans will strain our social safety net programs and budgets as the country copes with providing low-income elder shelter, food, and health care.

This will likely not just have an impact on state and federal governments; it could also tear at the social fabric of America in fundamental and destructive ways. It's bad enough that incomes have stagnated for all but the richest Americans; what happens when an entire generation, many of whose members have worked hard all their lives, suddenly have little to show for it? Polls showing that large majorities of the population worry about retirement security should be a warning sign to business leaders and politicians alike.

One Potential Solution

The good news is that fixing the coming retirement crisis is possible. It won't involve reinstituting traditional pensions, however. Why? The first reason is the current nature of competition. If an individual company tries to ensure their workers have a secure retirement, it burdens them with an added cost not shared by their competitors. This will make broad adoption much harder than if a level competitive playing field can be established.

More importantly, a company-by-company approach is ill-suited to today's increasingly mobile workforce. Employees are increasingly likely to move from job to job rather than make their career at a single organization, and are generally cashed out of existing 401(k)s by their old employers and have to start all over again. This doesn't even begin to tackle the issue of freelancers, contractors, and gig workers who now, more than ever, need a portable pension-type benefit that does not burden employers or taxpayers with unfunded liabilities. We need a holistic solution.

In our book, *Rescuing Retirement,* we put forward such a plan. It requires no new taxes, does not increase the deficit, and actually reduces the administrative burden on companies that sponsor plans.

Under our proposal, every worker will receive a personal Guaranteed Retirement Account (GRA). Workers maintain ownership of this account as they move from job to job, automatically contributing at least 1.5% of every paycheck to the GRA until they retire. A matching 1.5% is provided by each employer. To offset the required employee contribution, the plan gives every worker up to a $600 tax credit. This almost fully pays for the contribution for people earning below median income — our most vulnerable workers. We accomplish this in a deficit neutral way by redeploying the existing tax deductions for 401(k) contributions. Those deductions disproportionately benefit high income employees who are not at risk in retirement.

To achieve higher returns with lower risk, savings in the GRAs are pooled and invested. Workers select a professional pension overseer, which could include government entities such as state pension funds or private sector pension managers. Pooling GRAs in this way reduces administrative costs and gives GRA holders access to higher returning investment products and the best asset managers. Upon retirement, the GRA is automatically converted into a government guaranteed annuity based on their GRA balance which provides consistent, life-long income for the employee and his or her spouse. This way, retirees can never outlive their savings.

Why It's a Good Deal for Companies

We believe businesses will find the 1.5% contribution rate affordable and attractive for several reasons:

- The cost of employer contributions is substantially offset by relief from the burdensome administration and regulatory burden of existing plans (determining investment options, managing early redemptions and departing employees, negotiating fees, etc.) Many employers will be able to reduce expenses as compared to traditional pension plans or 401(k)s.
- A modest, one-time price increase of less than 1% on their goods or services will fund the entire plan for most employers.
- Aging workers will be better able to retire, making room for younger workers. A 2017 study by Prudential and the University of Connecticut estimates that a one year delay in retirement age by one employee could cost an employer $50,000.

Our approach is even beneficial for small businesses not currently offering any retirement plans. Small businesses are like families, where owners know personally and care deeply about their employees. And yet, in 2016, less than 20% of companies with fewer than 24 employees sponsored any kind of retirement plan. This doesn't mean they don't want to help; a 2016 Pew survey found that small firms would welcome an easy solution to their employees' retirement problems. The simple to administer GRA model would enable many small employers to do what they have wanted to do all along: take care of their workers in retirement without the cost, complexity, or liability associated with the other alternatives.

Most executives care about their people. They understand the basic idea that employees are the foundation of their company's success, and deserve dignity and financial security in their old age. No leader wants to see someone who loyally dedicated his or her career to a company ending up in poverty. And yet due to the current set of short-term pressures placed on today's business world — where a CEO is only as good as the last quarter's results — executives have offloaded volatile retirement liabilities onto workers who are ill-equipped to bear that burden.

To be sure, the solution doesn't rest entirely on the shoulders of executives; public policy plays a huge role. But business leaders should be coming up with ways to help address the burden created in large part by pension changes they helped usher in. We've offered one potential approach; what will be yours?

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This article is about RETIREMENT

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Abhishek Pal a year ago

What you're suggesting is a combination of EPF (equal contribution by employee & employer) & NPS (professional management of retirement funds) plan existing in India!

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