



US SENATE  
COMMITTEE ON

HEALTH  
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PENSIONS

# The Retirement Crisis and a Plan to Solve It



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## LETTER FROM THE CHAIRMAN

After a lifetime of hard work, people deserve the opportunity to live out their golden years with dignity and financial independence. But for most of the middle class, the dream of a secure retirement is slipping out of reach. We are facing a retirement crisis. Consider the following:

- The retirement income deficit – *i.e.*, the difference between what people have saved for retirement and what they should have at this point – is \$6.6 trillion;
- Only one in five people in the private sector workforce has a defined benefit pension plan; and
- Half of Americans have less than \$10,000 in savings.

The retirement crisis will have significant repercussions. As older Americans transition out of the workforce, either voluntarily or involuntarily, many will find that they cannot afford basic living expenses. They will be forced to make the difficult choice between putting food on the table and buying their medication. The retirement crisis will put an enormous strain on our families, our communities, and our social safety net.

The retirement crisis is directly attributable to the breakdown of the traditional “three-legged stool” of retirement security – pensions, savings, and Social Security. Defined benefit pension plans used to play an enormous role in providing a reliable source of retirement income, but the pension system has been in decline for decades. At the same time, stagnant wages and rising costs are making it harder and harder to build up a nest egg through a retirement savings plan (*e.g.*, a 401(k) or IRA) or otherwise. Fortunately, Social Security is still strong, but it was always intended to be supplemented by other sources of retirement income.

I am committed to ensuring that middle class families have a secure retirement. That is why I have been holding a series of hearings in the Senate Committee on Health, Education, Labor, and Pensions to highlight the state of retirement security and better understand how we can improve the system. This report summarizes the key findings from those hearings and includes two bold proposals to address the retirement crisis. Specifically, I propose providing universal access to a new type of retirement plan – Universal, Secure, and Adaptable (“USA”) Retirement Funds – that can deliver real retirement security for all working Americans. I have also proposed improvements to Social Security that will increase benefits and make the program stronger for future generations.

I intend for this report to be the starting place in an evolving discussion about retirement security. Over the coming months, I plan to bring together business and labor leaders, policy experts, advocates, and my fellow lawmakers to implement necessary reforms. The retirement crisis is simply too big to ignore, and it is time for us to roll up our sleeves and get to work.

Sincerely,



Senator Tom Harkin  
Chairman

# THE RETIREMENT CRISIS

“Retirement.” The word used to conjure up images of travelling, pursuing new hobbies, or spending time with the grandkids. But these days, when people think about retirement, all they do is worry. Not having enough savings for retirement is one of people’s biggest economic fears, and a recent survey found that 92% of people think there is a retirement crisis in America.<sup>1</sup>

## Retirement (In)security

As a country, we are woefully unprepared for retirement. Half of all Americans have less than \$10,000 in savings, and nearly half of the oldest Baby Boomers are at risk of not having sufficient retirement resources to pay for basic retirement expenses and healthcare costs.<sup>2</sup> The Center for Retirement Research at Boston College estimates that our “retirement income deficit” is \$6.6 trillion.<sup>3</sup> That number represents the gap between the pension and retirement savings that American households have today and what they should have today to maintain

*“I, like millions of people in this country, have worked all my life, and I have worked very hard. And I have no retirement savings at all. None.”*



Karen O'Quinn

their standard of living in retirement. That is enough dollars that, if lined up end to end, they would stretch to the moon and back 1,000 times and still leave enough left over to pay NASA’s budget for the next eight decades.

The public is becoming increasingly concerned about the lack of retirement security. Only 14% of people say they are very confident they will have enough money to live comfortably in retirement.<sup>4</sup> That is down 9% since 2002.<sup>5</sup> And 69% of people believe they could save until age 65 and still not have enough.<sup>6</sup> Employers are even more

pessimistic; only 4% are “very confident” their employees will retire with sufficient assets. That is down from 30% in 2011.<sup>7</sup>

## Breakdown of the Three-legged Stool

The retirement crisis is directly attributable to the failure of the “three-legged stool” of retirement security. Traditionally, defined benefit pension plans (“pensions”), personal savings, and Social Security were seen as the three pillars creating a solid foundation for our retirement system. Each should play an important role in supporting people in old age. However, the stool, never sturdy, has become increasingly wobbly as pensions have disappeared and the middle class is finding it harder and harder to save.

### *Disappearing Pensions*

Defined benefit pensions – which provide people with a lifetime benefit based on a formula that usually takes into account a person’s years of service and salary – used to play an enormous role in providing a safe and secure retirement for many in the middle class. Although coverage has never been universal, pensions have successfully helped millions of people prepare for retirement by providing a secure, guaranteed benefit for life. Pensions are regulated to protect participants against mismanagement, and they shield people from the risk of market downturns and the possibility of living longer than expected. However, the pension system has been in a steady decline for decades, and now, only one out of every five people working in the private sector has a pension.<sup>8</sup>

These days, employers have largely stopped offering pensions at all. Those that choose to offer their employees a retirement plan tend to provide defined contribution plans (“DC Plans”), such as 401(k) plans. DC Plans allow people to save for retirement on a tax-advantaged basis and are more attractive to many employers because they shift virtually all of the risks associated with the plan to employees. Employers typically are not responsible for investment losses in a DC Plan, and they are not required to make contributions for their employees. DC Plans can be an effective way to help people save for retirement, but they are not a substitute for pensions because they do not provide people with the same level of protection from

financial risk and do not provide a guaranteed stream of income for life.

The decline of the traditional pension is going to have real consequences for individuals and families. Pensions are one of the simplest, most cost-effective means of securing a source of retirement income and an important source of protection for families against economic risk. They are also an extremely effective means of keeping older Americans out of poverty. Research indicates that the poverty rate in 2010 for older households lacking pension income was nine times greater when compared to households with pension income.<sup>9</sup>

In addition to providing economic security to individuals, pensions provide enormous benefits to our economy and play an instrumental role in job creation.<sup>10</sup> Every dollar that goes into a pension plan is held in trust for a benefit that may not need to be paid for 40 years or more. Consequently, pensions are able to invest those dollars over long time horizons. That means they are able to provide critical sources of financing for long-term projects like technology and infrastructure development.<sup>11</sup> Pensions are also able to make investments in good times and bad, so they are an important source of liquidity during economic downturns, such as the Great Recession, when banks and other financial institutions slow or stop their lending. In short, pensions make the kinds of consistent, long-term investments in our economy that spur innovation and create jobs. As pensions disappear, we are losing a key source of investment capital and a driving force behind our economy.

### *Retirement Savings & the Middle Class Squeeze*

At the same time as middle class families have seen their pensions disappear, economic conditions are making it tougher and tougher for people to save through DC Plans or on their own.<sup>12</sup> People are working longer and harder than ever before, and productivity has steadily increased. However, worker compensation has been flat or negative over the past four decades, and costs of living have been increasing. The middle class is being squeezed, and we are at a point where half of households would not

even be able come up with \$2,000 in 30 days if faced with an emergency.<sup>13</sup> For many years, families were able to mask the effects of stagnant wages and rising costs by becoming two-income households, working more, and relying on credit. But the Great Recession exhausted those coping mechanisms and exposed the underlying economic challenges facing the middle class.<sup>14</sup> Now, the middle class is struggling just to keep its head above water.

With the significant economic challenges facing families, it should be no surprise that the middle class finds it difficult to save. As noted above, half of Americans have less than \$10,000 in savings, and 60% of the population has less than \$25,000. There have been many positive developments to help people save by expanding access to DC Plans and facilitating automatic savings. However, despite all of those efforts, savings rates are still too low, and people are less likely to report that they are saving for retirement than just a decade ago.<sup>15</sup>

### *Social Security: Strong but Not Enough*

Fortunately, Social Security continues to provide families with a basic level of income security. It prevents millions of Americans from slipping into poverty when their working years are over because, like a pension, Social Security provides Americans with an income stream that they cannot outlive. However, Social Security was never meant to be people's sole source of retirement income. The program replaces only about 40% of the average person's income after retiring, but people typically need 65-85% percent of pre-retirement earnings to maintain their standard of living.<sup>16</sup> Thus, a robust private retirement system is absolutely essential to give ordinary people an opportunity to retire.

### *Cost of the Crisis*

The breakdown of the three-legged stool of retirement security and the resulting retirement crisis are going to have very real costs. In 2010, nearly 6 million Americans aged 65 and over were living in poverty or near-poverty.<sup>17</sup> By 2020,

*“Pensions are vitally important for keeping older Americans out of poverty. The poverty rate in 2010 for older US households lacking pension income was nine times greater as compared to households with pension income.”*

Diane Oakley  
National Institute on Retirement Security

that number is expected to increase by 33%. Given that an increasing number of older people are reaching retirement age without income to supplement Social Security, we could see even higher poverty rates in the future. This trend will place enormous new burdens on families, and it will strain our social safety net, which is already facing significant financial constraints.

Older people without adequate retirement savings will have trouble just making ends meet. Many will need long-term care, but few seniors will be able to afford it. As a result, they will have to rely on their families for support. This will put a strain on working families, who are already struggling to cope with stagnant wages, rising living costs, and the lingering effects of the Great Recession. It will also make it more difficult for younger family members to save for their own retirement.

In addition to the strain on families, the retirement crisis will have a significant impact on government programs that provide assistance to poor or near-poor retirees. As people are unable to afford basic living expenses in retirement, they will rely more and more on programs like housing assistance, home heating aid, and food assistance. Elder poverty will

*“I have paid into Social Security. That’s one benefit to look at down the road. But in today’s economy... Social Security is not going to be enough.”*



David Muse

*“We don’t make enough to save and have no pension coming... Retirement is supposed to be a time when you cherish your family... For me, retirement will be the time to pick up a second, low-paying career.”*



Teresa Law

also increase Medicare and Medicaid costs because seniors living in or near poverty often have higher incidences of chronic and acute health problems and are also less able to afford private long-term care services. The increased costs will undoubtedly strain our social safety net.

The retirement crisis will have a significant human cost as well. Life will be extraordinarily difficult for seniors without adequate income in retirement. After a lifetime of hard work, many seniors will find themselves forced to choose between putting food on the table and buying their medication. And many people simply will not be able to leave the workforce. They will have to work well into advanced age, eliminating job opportunities for younger workers.

Most Americans do not expect a lavish lifestyle in retirement, but they do want to live out their golden years with dignity and financial independence. We need a retirement system that gives them the opportunity to do that.

# PRINCIPLES FOR REFORM

Over the past two years, the Senate Committee on Health, Education, Labor and Pensions has held a series of hearings on the retirement system.<sup>18</sup> The hearings have taken a hard look at key aspects of the retirement system, and they have provided a clear picture of the kinds of changes we need to ensure the system can work for everyone. Those changes can be boiled down into the following four basic principles:

## **1. The retirement system should be universal and automatic.**

Most people realize that they should be preparing for retirement, but it is often difficult because they have more immediate concerns, like paying the bills and putting food on the table. And people are frequently overwhelmed by the complexity of the financial decisions they have to make.<sup>19</sup> However, when saving is easy and automatic, people are much more likely to put money aside.<sup>20</sup> By ensuring that every American has access to a retirement plan at work and making participation automatic, we can drastically reduce the retirement income deficit and promote retirement security.

## **2. The retirement system should give people certainty.**

The retirement system should give people certainty that they will have a reliable source of income in retirement. It needs to provide people with the opportunity not just to save for retirement but also to secure a predictable stream of retirement income that they cannot outlive.

## **3. Retirement is a shared responsibility.**

Individuals, employers, and the government all have a role to play in ensuring that every American has the opportunity to retire with dignity and financial independence. It is unfair for any one party to shoulder the burden alone.

## **4. Retirement assets should be pooled and professionally managed.**

The retirement system should not force people to become investment experts. Most people simply do not have the background, interest, or time to manage their retirement funds effectively. Instead, it should give everyone access to prudent, professional asset management and allow people to pool their assets with others to reduce costs and risk, including the risk of living longer than expected.

These four principles should form the framework for developing comprehensive solutions to the retirement crisis. With a retirement income deficit of \$6.6 trillion, the crisis is simply too big to ignore. We cannot continue to stand idly by as average Americans struggle to save for retirement and our seniors continue to slip into poverty.

# SOLUTIONS

This section lays out a two-part plan to solve the retirement crisis by making some bold changes to the private retirement system and Social Security. The first proposal would rebuild the private pension system by providing universal access to Universal, Secure, and Adaptable (“USA”) Retirement Funds, a new type of private pension plan that would give people the opportunity to earn a secure benefit and would be easy for employers to offer. The second proposal will improve Social Security by increasing benefits while strengthening the long-term finances of the trust fund. Together, those two reforms would go a long way toward rebuilding the three-legged stool of retirement security and helping people retire with dignity and financial independence.

## Part One

### Rebuilding Pensions

A strong and vibrant pension system is a core component of a secure retirement. However, the pension system has been in decline for decades, and businesses are reluctant to provide new pension benefits to their employees. Existing pension models are simply not attractive to many employers. It is time for a new approach – USA Retirement Funds.

USA Retirement Funds are innovative, privately-run, hybrid pension plans that incorporate many of the benefits of traditional pensions while substantially reducing the burden on employers. Under this proposal, there would be universal access to USA Retirement Funds through the existing payroll withholding systems for those that do not already have access to a retirement plan, and anyone participating would have the opportunity to earn a cost-effective and portable source of retirement income. USA Retirement Funds would have professional asset management and give people an easy way to pool their risk

*“Risk sharing and professional money management help make USA Retirement Funds an efficient and secure way to prepare for retirement.”*

David Madland  
Center for American Progress

with other active employees and retirees. Importantly, USA Retirement Funds would also allow employers to offer a secure retirement benefit without taking on management responsibility or financial risk. That is especially important for small businesses, which often do not have the resources to manage a retirement plan.

#### *Professional Management*

USA Retirement Funds would be privately-run, licensed, and regulated retirement plans. Each USA Retirement Fund would be overseen by a board of trustees consisting of qualified employee, retiree, and employer representatives. The trustees would act as fiduciaries and be required to act prudently and in the best interests of plan participants and beneficiaries. The assets held by each USA Retirement Fund would be pooled and professionally managed.

#### *Lifetime Income Benefit*

People participating in a USA Retirement Fund would earn a benefit paid out over the course of their retirement, with survivor benefits, like a pension. The amount of a person’s monthly benefit would be determined based on the total amount of contributions made by, or on behalf of, the participant and investment performance over time. Because it is

nearly impossible for low-wage workers to save enough for retirement, they would be eligible for refundable retirement savings credits that would be contributed directly to a USA Retirement Fund.

#### *Risk Sharing*

Pension plans have traditionally placed all of the risk, primarily investment and longevity risk, on employers. Those risks have discouraged employers from offering a pension. USA Retirement Funds would make offering a pension benefit more attractive by eliminating virtually all risk to employers. Instead, USA Retirement Funds would spread the risks inherent in running a pension across large

groups of employees and retirees. That kind of broad risk pooling would provide significant protection to individuals and would reduce overall costs.

The risk sharing component of the USA Retirement Funds would mean that benefit levels are responsive to long-term market conditions. For example, USA Retirement Funds would be conservatively managed, but if there were a severe and long-term economic downturn, the trustees could, under specified procedures, gradually adjust benefits to reflect market realities while still providing a steady income stream to retirees. Conversely, if a USA Retirement Fund had better-than-expected returns, those returns would be conservatively allocated as increased benefits for employees and retirees. This type of risk sharing is beneficial to participants and gives them an opportunity to earn a cost-effective source of retirement income.

### *Universal Coverage*

USA Retirement Funds would ensure that every working person in America has access to a retirement plan through an automatic payroll deduction.<sup>21</sup> Employers that do not offer a workplace retirement plan with automatic enrollment and a minimum level of employer contributions would have to automatically withhold a portion of their employees' pay and send such amounts to a USA Retirement Fund. The employer could either choose a USA Retirement Fund or simply use the "default" fund identified for the region, industry, or through collective bargaining. Employees would be automatically enrolled in the USA Retirement Fund at a specified contribution level, but they could increase their contributions, decrease their contributions, or opt out of automatic enrollment at any time. Enrolling employees in a USA Retirement Fund would utilize existing payroll withholding systems, so it would involve little, if any, additional administrative burden, and employers would receive a credit to help off-set the cost. Importantly, employers that already have pension plans or DC Plans with automatic enrollment and a match would not have to change anything.

### *Employer Responsibility*

Because USA Retirement Funds would be licensed and overseen by a board of trustees, employers would not have any fiduciary responsibilities in selecting, administering, or managing the funds. Employers' only obligation with regard to the USA Retirement Funds would be to automatically enroll employees, ensure that employee contributions are processed, and make modest contributions. Importantly, employers would not "guarantee" the USA Retirement Funds or have any residual responsibility to provide additional funding or make up shortfalls.

### *Encouraging Competition*

Competition among USA Retirement Funds will keep costs low and ensure optimal performance. To facilitate competition, USA Retirement Funds would be subject

to stringent transparency requirements and would be required to regularly provide information on investment performance, funding levels, and the projected level of retirement benefits based on contribution levels. Benefits would also be entirely portable so that participants could move from one USA Retirement Fund to another.

*"The USA Retirement Funds and comprehensive Social Security proposals are bold, innovative initiatives that will help lead our nation toward the safe and sufficient retirement income system that working Americans need and deserve."*

Karen W. Ferguson  
Director, Pension Rights Center

### *Coordination with Other Retirement Plans*

There are many people for whom the current system is working, and it is important that systemic reforms not compromise their retirement security. Thus, USA Retirement Funds are not intended to replace existing pensions. Many employers and employees have developed excellent pension arrangements that benefit everyone involved, and those arrangements should be allowed to continue to flourish. Additionally, individual retirement savings are a critical component of retirement security, so USA Retirement Funds are intended to supplement, not supplant, DC Plans. Employers could certainly offer both a USA Retirement Fund and a DC Plan for their employees.



## Part Two

### Strengthening Social Security

Social Security has proven to be an incredibly efficient means of delivering retirement security to millions of Americans. Therefore, one of the most effective ways to address the retirement crisis and reduce the retirement income deficit is to improve Social Security by enhancing benefits in a fiscally responsible way. The Rebuild America Act (the “Act”), introduced in March 2012, contains a comprehensive plan to improve Social Security.<sup>22</sup> That plan would improve benefits to help reduce the retirement income deficit, ensure the cost of living adjustment (“COLA”) better corresponds to the typical expenses for seniors, and improve the long-term financial condition of the trust fund by gradually lifting the cap on wages subject to payroll taxes.

#### *Improved Benefits*

To improve benefits for current and future Social Security beneficiaries, the Act changes the method by which the Social Security Administration calculates Social Security benefits. Social Security benefits are based on a progressive formula that replaces a set percentage of income – called a replacement factor – at three different income levels. The replacement factor for a person’s first \$767 of Average Indexed Monthly Earnings (“AIME”) is 90%. The replacement factor drops to 32% for AIME between \$767 and \$4,624 and 15% for AIME between \$4,624 and \$8,532.

The Act improves Social Security benefits by expanding by 15% over a 10 year period the amount of earnings covered under the first replacement factor. In other words, it would increase the amount of AIME that receives the 90% replacement rate. That change will boost benefits for most beneficiaries by approximately \$60 a month. Although the increase is modest, it will have an especially

profound effect for those in the middle and at the bottom of the income distribution for whom Social Security has become an ever greater share of their retirement income.

#### *Improved COLA*

The Act changes the way the Social Security Administration calculates the COLA so that it more accurately reflects the change in seniors’ cost of living. Currently, the annual adjustment is tied to the Consumer Price Index for all Urban Wage Earners (“CPI-W”) for the purposes of calculating inflation. The CPI-W is based on a basket of goods that does not adequately track the purchases of seniors such as medical care. The Act moves from using the CPI-W to the Consumer Price Index for the Elderly (“CPI-E”), an index that is specifically tailored to more closely track costs for seniors. Making this change ensures that Social Security benefits keep pace with the rising costs of essential items for seniors, including health care.

#### *Improved Financing*

Social Security is not in crisis, but it does face a long-term deficit. According to the most recent Social Security Trustees report, the trust fund will be able to pay full benefits through 2033.<sup>23</sup> In order to improve benefits and improve the solvency of the trust fund, the Act would phase out the cap on wages subject to the payroll tax, which is currently \$110,100. In other words, income above \$110,100 would be subject to the payroll tax, bringing more revenue into the Social Security system. The change would be phased in over a 10 year period to minimize the burden on employers and employees. Moreover, to ensure that people receive a benefit for every dollar they pay into the system, the Act creates a new replacement factor of 5% for income over the current wage cap. Together with the benefit increases in the Act, these steps will significantly extend the life of the Trust Fund.<sup>24</sup>

*“By expanding Social Security benefits and improving the long-term solvency of the program, the Rebuild America Act demonstrates a renewed commitment to seniors and hard-working Americans in these turbulent times.”*

Social Security Works

# CONCLUSION

We are facing a retirement crisis, and at \$6.6 trillion, it is simply too big to ignore. This report provides concrete solutions to the retirement crisis. They are intended to be a starting place in an evolving discussion, and over the coming months, the discussion will continue on Capitol Hill, in Iowa, and across the country.

Public input on this issue is critically important, so people with ideas or stories they want to share can contact Chairman Harkin by:

**Sending emails to:** Retirement\_Security@help.senate.gov

**Sending letters to:** Retirement Security Project  
Senate Committee on Health, Education, Labor, and Pensions  
428 Senate Dirksen Office Building  
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