401(k) Reform:

A Secure Retirement Plan for Life for "The 99%"

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Introduction: How We Became So Pension Poor

Mention the word Australia and the images that come to mind are "shrimps on the barbie," Koala bears and kangaroos. We'd like to add another image: people who can actually afford to retire. Australians between the ages of 30 and 34 are projected to have more than $540,000 in today's dollars in their version of our 401(k) accounts, known as Superannuation, by the time they are ready to retire; those between 20 and 24 will have nearly $700,000.[i]

How do those six-digit projected nest eggs for the typical Australian compared with of a typical American approaching retirement?

Australians are scheduled to retire with nest eggs of $500,000 to $700,000--more than five times that of their American counterparts. The reason? Employers are required to contribute three times as much to Australian retirement accounts.

Here's the bad news: according to the Federal Reserve Board's Survey of Consumer Finances, the median amount saved in account and rollover balance for those age 55 to 64 was around a measly $86,600 in 2009 when the median wage for that age group is about $65,000. But even before the market slump in 2007 when the median balance was $103,600, that low six-figure number is less than twice the median Boomer salary when it needs to be 10-13 times that amount. [ii] In other words, if you're 65 and earning $65,000 $650,000 in retirement savings isn't a windfall--it's the goal.

Here are our findings--corroborated by leading pension actuaries--about 34 million people can't retire. Unless they work in the public sector or are the tiny percentage of the private sector workforce that has long job tenure at a company that still offers an old-fashioned pension or in academia, most of those 38 million Boomers born between 1946 and 1956 who are scheduled to turn 65 between 2011 and 2020 will have to stay on the job another eight to 10 years to achieve adequate 401(k) savings. **And that's if reform takes place.** This means that a big chunk of nearly 40 million young adults born between 1989 and 1998--a larger Baby Boom--who are graduating during that period will very likely not be able to find jobs. If reform DOESN'T place those nearing retirement age will have to work another 20 years. To make matters worse, 53% of the population in the private sector isn't covered by any plan.

The reason why Australians' nest eggs are fuller than those of their American counterparts? Very simply: Australian employers are REQUIRED to contribute to their version of a 401(k) account—the current contribution rate is 9% of salary up to a salary ceiling of $137,880 up to age 75.[iii] In addition, the employer contribution is made regardless of whether the employee contributes--it's not simply a "matching contribution." One in four Americans whose employers offer a plan don't contribute to a 401(k) account and therefore ends up with nothing. While the Obama Administration has supported "automatic enrollment" to get non-participants saving in these plans, the typical "default" employee contribution is only 3%, less than one-third of what is needed. The reform that's needed is not to get non-savers to participate in their employer's plan at an insufficient savings rate but rather to require employers to contribute more generously to employee accounts.

Baby Boomers are also faced with greater financial burdens than their parents in the Greatest Generation--from mortgages to college costs for their kids.

While some retirement reformers might instead want to consider requiring all employers to offer conventional pensions, a more generous 401(k) plan is the right plan for a mobile 21st century workforce because portability is crucial. Employees reap absolutely no benefit from a generous defined benefit plan if they don't work at a company long enough to be vested in it.

My prediction is that most Boomers will run out of money in less than five years. Why? They have more expenses than their parents, the post-World War II “Greatest Generation.” Whether it’s because they postponed buying their first home or because they “traded up” to McMansions, more than 50% of Boomers between the ages of 55 and 65 were still making mortgage payments in 2007 -- on average owing more than $140,000, according to the Federal Reserve Board’s Survey of Consumer Finances. That amount is nearly three times what was owed by that age group in 1989, when only 34% were still making mortgage payments.[iv] Boomers are also likely to be paying off college loans for their kids. According to a 2007 Ameriprise survey of 1,000 affluent boomers, 74% said they were helping adult children with college loans.[v] Again, this financial burden was not as great a generation ago. While federal grants subsidized 70% of the cost of a degree 30 years ago, loans are now needed to cover 64% of the cost.[vi]

What follows are proposed reforms that would increase benefits, improve coverage and portability and lower fees and “leakage,” or tapping into savings for retirement.

Action plan: the 401k Security Act:

Retirement Plan for Life

Part I: Boost Employer Contributions to Accounts

1. **Mandate employer contributions to 401(k) accounts equaling 9% of pay for Fortune 500 companies.** While some may claim this mandate would be too burdensome in these recessionary times, America's largest corporations are doing just fine. In 2011 the Fortune 500 saw an 81% jump in profits--the third largest gain in the group's history; Apple boasted a 145% jump in profits and moved up 21 places to number 35.[vii] The nation's high unemployment rate is driven by the fact that rich companies are offshoring or outsourcing jobs. Take Apple, which is sitting on $80 billion in cash: for every Apple worker in America there are 10 in China.[viii]

Only six member nations of the Organization for Economic Cooperation and Development have lower pension wealth than the U.S.

2. **Non Fortune 500 companies with 10 or more employees that have been in business for five years or more must contribute the equivalent of 6% of pay.** Those employers who contend that a 6% contribution rate is too burdensome should consider that the U.S. has one of the least generous pension systems in the advanced world; only six member countries of the OECD have lower pension wealth. What's more, seven of the eight OECD countries that have a mandatory 401(k) style system feature employer contribution rates that are more generous than ours. Denmark's is 11.8%, Hungary's is 8%, Mexico's is 6.5%, Poland's is 7.3% and the Slovak Republic's is 9%.[ix]

3. **Any company that currently offers only a regular pension--known as a defined benefit plan--must convert to a generous 401(k) plan by first freezing the pension and using any assets to contribute more generously to an existing or new 401(k) plan.** Why? While defined benefit plans have traditionally been more generous than 401(k) plans, their vesting rules--typically requiring that employees work for the employer for at least five years to be eligible for a benefit--make it impossible for the majority of American job-hoppers to end up with a sufficient retirement assets. (Employers are free to offer a supplementary defined benefit plan in conjunction with a 401(k) plan if they wish.)

A more generous 401(k) plan is better than a regular pension because it usually takes five years to "own" benefits in a pension.

4. **Employees working in companies with fewer than ten employees in business less than five years would be enrolled in a Universal 401(k) featuring a government matching contribution equivalent to 6% of pay**. A new entity, a clearinghouse akin to the Federal Thrift Savings Plan (TSP), which manages very low-cost 401(k)-style accounts invested in index funds for three million federal military and civilian personnel, would receive all deposits.

Part II: Turn 401(k) Plans Into One-Stop Retirement Plans for Life

1. **Retirement Plans for Life: Along with requiring more generous employer contributions to 401(k) accounts, we want to improve investment performance and lower costs AND "leakage" by pooling the assets of multiple employees at a mutual fund company. This will also make it possible to keep track of retirement assets--and therefore adequacy--throughout an individual's career, which is currently impossible for most Americans.**

Employees should be able to choose a "mutual fund for life" that employers are required to contribute to--lowering the risk of constantly having to replace an underperforming fund.

Pick a fund for your entire life that outperforms the others: While employers can continue to offer a "menu" of options in their plans, typically resulting in employees selecting three or more funds--employees must be given the option of choosing a "mutual fund for life," so that they don't have to select new investments each time they change jobs, which will lower the risk of making bad investment decisions.

Not only will a high-performing plan-for-life help frequent job-changers, it will help the minority of Americans who stay at the same employer throughout their careers because their employers often select inferior funds that they wind up replacing--forcing employees to sell their shares and invest in new funds--which likely will be replaced again. According to Deloitte's 2009 401(k) Benchmarking Survey, 62% of employers replaced an underperforming fund within the previous two years and 39% did so within the previous year.

More than likely this Plan for Life will be an index fund, because years of research have demonstrated that actively managed funds underperform benchmark index funds. For the 20-year period ending in December 2010, 72% of managed funds underperformed index funds.[x] What's more, this Plan for Life fund must include international stocks as a reflection of the fact that "the world is flat" when it comes to investing. Not only are two thirds of the world's largest publicly held companies based overseas but that's been the case since *Fortune* magazine launched its Global 500 ranking 22 years ago. My preference is to choose an index fund that replicates Fortune magazine's Global 500--the closest match would be the Vanguard Global Equity Fund (VGEF), comprised of 854 securities from 22 countries; 40% of them U.S.-based. While Americans who only invested in the S&P 500 during the last decade--also known as the "lost decade"-- saw near-inflation-rate returns of 2.71%, the 10-year return for the VGEF fund was 6.89%. Unfortunately, while most of Vanguard's clients offer international funds, only 30% of participants invest in them.[xi] What's more, international investing is typically viewed as a currency hedge, as opposed to an investment strategy that reflects the 21st century economy

Offering employees a one-stop-savings vehicle isn't a radical change from recent investing trends in 401(k) plans; in the last few years virtually all mutual fund companies have started to offer one-stop investing funds known as target date funds, which automatically decrease exposure to equities as participants approach retirement age. However, the pooled asset approach would outperform target-date funds because such a shift away from stocks wouldn't be necessary (although the funds would need to keep 5-10% of assets in cash to meet redemptions, which for the most part would only occur when individuals retire.)

By continuing to receive employer contributions at the same fund (unless they choose a different one), it will also make it easier for workers to keep track of retirement assets and to see if they are on track to a secure retirement, which very few Americans have the tools to figure out and most of them desperately need. Why is this necessary? Americans are job-changers; the average Americans born in the latter years of the baby boom worked for more than 10 employers between the ages of 23 and 44 alone, according to the Bureau of Labor Statistics.[xvi]

Unfortunately, when I asked selected mutual fund companies whether they offer software that enables participants to “aggregate” 401(k) assets at rollover accounts and at previous employers spokespeople for Vanguard Group and Principal Financial said they did not. And while Fidelity Investments, the industry leader, does offer this software, only about 6% of its participants use it and based on my own experience

Americans are job-changers; the average American born in the latter years of the baby boom worked for more than 10 employers between the age of 23 and 44 alone, according to the Bureau of Labor Statistics.

it’s very likely that users frequently encounter error messages when they attempt to enter account data.

2. **Even those employees who choose not to select a fund-for-life would be encouraged to roll over existing account balances either to the new employer or to single rollover account at a mutual fund rather than having multiple rollover accounts, making it difficult to keep track of their assets.**

Part III: Employer Contributions Must Be Immediate, Consistent and in Cash

More than half of employers make employees wait up to six years until they "own employer contributions," depriving the majority of Americans--who are job changers--of retirement benefits.

1. **Employer matching contributions must start when the employee is hired, not after one year.** As of 2010 25% of employers surveyed by the Vanguard Group require employees to have one year of service before the match starts in order to "minimize compensation costs."[xiv] However, this practice results in "minimizing nest eggs" since it could deprive someone who changed jobs every 4 years of a total of 11 years of employer contributions and investment returns.

2. **Employee "ownership" of employer contributions--otherwise known as "vesting"--must be immediate.** According to How America Saves 2011, 54% of Vanguard's clients make their employees wait between one to six years before they are completely vested in employer contributions.[xiii]

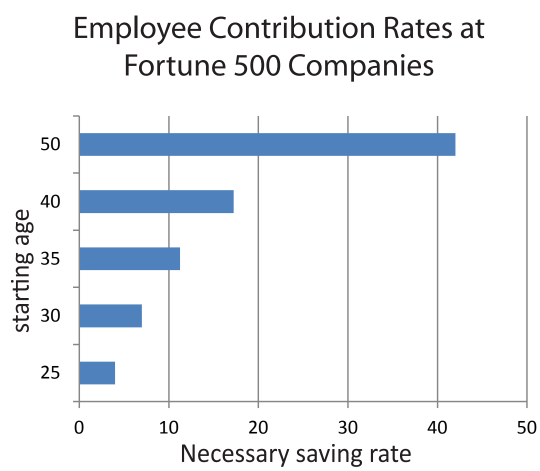
3. **Employers would not be permitted to "suspend" contributions during economic downturns as many of them did in 2002-3 and 2008-9.** This practice both deprives employees of retirement assets but frequently results in not being fully invested in the stock market once it rebounds, so employers wind up buying fewer shares of stock once they resume contributing.

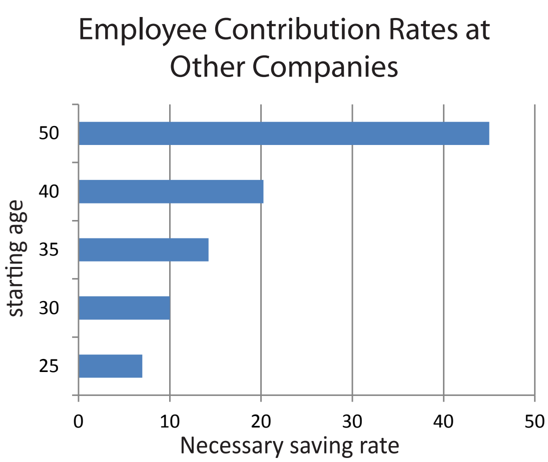
4. **All employer contributions must be in cash, not company stock.** As was the case with Enron employees, a stock match carries the risk that the contribution will be worthless if the company goes out of business. While the Pension Protection Act has resulted in employees being able to divest out of employer stock, 11 million of the nation's more than 52 million 401(k) participants have more than 20% of their balances in company stock, revealing a lack of understanding of the risks of not diversifying. [xv] (Either that or employees figure that a stock match is better than no match.) Unlike a traditional defined benefit plan, or pension, in which no more than 10% of plan assets can be in company stock the Pension Protection Act doesn't place any restrictions on company stock in 401(k) plans. The law only requires that employers send employees a warning that their savings "may not be diversified" once more than 20% of their assets are in company stock.[xvi]

Despite the destruction of Enron employee's 401(k) savings, which were exclusively in company stock, it's still "legal" for employers to match in company stock--more than one in five Americans have more than 20% of their 401(k) assets in it.

Part IV: Boost Retirement Savings By Defining the Contribution Rate, Removing Contribution Limits, etc.

1. **Mutual fund managers must communicate the necessary employee contribution, or "co-pay," depending on participant's investment time horizon, to achieve at least "10 times final" in their accounts.** Based on calculations by pension actuary James Turpin, even with the implementation of the contribution equivalent to 9% of salary by Fortune 500 employers, 401(k) participants need to sock away 4% of pay if they start contributing to their accounts at age 25, 7% of pay if they wait until age 30, 11.25% at age 35, 17.25% at age 40, and 42% at age 50 to achieve a minimum next egg of 10 times their final pay. Employees at smaller companies with the less generous 6% employer contribution rate would have to cough up even more: 7% if starting at age 25, 10% at age 30, 14.25% at age 35, 20.25% at age 40 and 45% at age 50.





Employees must be given the most important investment advice they're currently not getting--how much to save in their accounts based on when they started participating in the plan.

2. **Unfortunately the necessary employee contribution rates aren't "legal" under the current system because of counterintuitive "ceilings." We need to remove the low ceiling on employee contributions along with the ceiling on "catch-up" contributions for those over 50, which currently don't enable a single American to catch up--a fact that apparently hasn't registered with any of the companies advising these plans.** The limits in 2011 were $16,500 for those under 50 and $22,000 for those over 50 and they only increase by a measly $500 in 2012--as a result, most employees aren't allowed to contribute enough to afford to retire. On the other hand, baby boomer Australians can sell a home or another asset and add the proceeds to their accounts; workers over age 60 can make after-tax superannuation contributions of $150,000 a year, or $450,000 over three years.[xvii]

All employees must be offered the Roth option--because otherwise they're paying income taxes when they can least afford them, at retirement.

3. **Get rid of "non-discrimination testing."** If highly paid people have waited too long to start saving, they should have the opportunity to save. (What's more, testing would no longer be necessary because employer contributions would no longer be voluntary.)

4. **Remove the tax deductibility feature from the plans--or at least give every employee the option of investing in a Roth, which forces you to "get taxes over with." Otherwise, people don't have an accurate picture of how much they've accumulated.** Rather than "incentivizing" participants to participate, the ability to deduct contributions from taxes results in deferring tax obligations to retirement, when people can least afford to pay them. While a 30-year old who contributes $5,200 a year to a Roth 401(k) could accumulate $870,000 by age 67, all tax free, in a "deductible" account that person would owe more than $261,000 to Uncle Sam at retirement, assuming a 25% tax rate and a 5% state income tax. What's more, tax deductions are an overrated tactic to "incentivize" Americans to save, as opposed to doing so to avoid pension poverty; fewer than 5% of Americans contribute to a deductible IRA. Finally, switching to a "get taxes over with" approach would also put a dent in our federal deficit.

5. **There should be no loans, hardship withdrawals, or ability to "cash out" of account balances when changing jobs.** (The temptation to do so will also be lowered because the money will likely stay at the same mutual fund when changing jobs.) Currently nearly half of job changers surveyed by Hewitt Associates cashed out of at least part of their account balances rather than leaving money in the plan or "rolling it over" to an IRA or new plan. Not only is it self-destructive to spend your nest egg, but half of the proceeds could be owed to Uncle Sam; someone in the 25% tax bracket living in a state with a 5% income tax who cashes out a $20,000 account balance is left with $12,000.

Part V: Ensure That Workers Don't Retire too Early, Help Protect Their Nest Eggs

1. **Fund managers must communicate to workers that unless they have other sources of retirement savings they most likely cannot afford to retire unless they have accumulated AT LEAST 10 times their salary--13 times for those with six-figure salaries--because they should only spend 4% of their assets each year in retirement.**

2. **Workers who have accumulated enough that they can afford to retire--at most 10% of the private sector population-- should be encouraged to invest in a managed payout account or an annuity. However, while annuities offered at the workplace are likely to be fixed-rate commission-free products, buyers should be warned that once they leave the workplace they should avoid retirement seminars in which they may be convinced to buy a new (most likely variable) annuity, an example of "churning", in which a broker attempts to sell annuity holders a new product in order to generate commissions.**

All employees must be advised that they cannot afford to retire until they've accumulated AT LEAST "10 times final pay" in their accounts and rollover accounts.

Here are just a few of the examples of questionable practices by annuity sellers. A federal judge ruled in 2009 that Allianz Life Insurance used deceptive practices in selling an equity-indexed annuity to about 340,000 people nationwide. In 2008 Allianz Life paid $10 million to settle charges it had sold unsuitable annuities in California.[xviii] In Texas AARP criticized then-Governor Rick Perry for vetoing a bill that would establish new safeguards for buying annuities.[xix]

In 2008, Florida Governor Charlie Crist signed a law increasing penalties on annuity salespeople who pressure clients to buy annuities. In 2006, then- New York Attorney General Eliot Spitzer announced an agreement in which the Hartford Financial Services Group would pay $20 million in fines for improper annuity sales. In 2005, New Jersey enacted a law that limits how long annuity sellers can impose surrender charges in the event the annuity owner wants to sell the product.[xx] Finally, the fact that the Dodd-Frank financial reform legislation did not include language that permitted the SEC to have oversight over annuities was regarded as one of the "battles that we lost" by Barbara Roper, director of investor protection for the Consumer Federation of America.[xxi]

3. **The Department of Labor should include tips on its website that guide workers on issues they should consider while contemplating retirement.** These might include: how much do people need to save if they have a working spouse versus a non-working spouse or what is the impact of divorce, disability, etc. The website also should include information about annuities.

Employees must be warned of the risks of buying an annuity--that they will likely be sold a new one in order to generate commissions for a broker.

About Retirement Solutions

Retirement Solutions LLC is an advocacy and educational organization dedicated to the retirement adequacy of 401(k) participants. Retirement Solutions president and founder Jane White is a regular blogger on retirement and other personal finance issue for the Huffington Post and has appeared on Fox Business News, CNN and CNBC, and is the author of "America, Welcome to the Poorhouse," (FT Press, 2009), which has been favorably reviewed by the *New York Times, Newsday* and other publications.

With the input of pension actuary James E. Turpin of the Turpin Consulting Group, White developed formulas for contribution rates required based on the current typical employer match of 3%. At the invitation of the US Department of Labor's (DOL) ERISA Advisory Council White offered recommended contribution rates based on participant starting ages to the in the fall of 2007. As a result, the Working Group recommended to the DOL that employers communicate to employees how much 401(k) participants need to contribute to achieve a multiple of their salary nearing retirement.

A Congressionally appointed delegate to the 2002 National Summit on Retirement Savings, White first observed the 401(k) crisis in 1993 as the associate editor of Standard & Poor's "Your Financial Future," distributed to half a million 401(k) participants at Fortune 500 firms. Previously she was a syndicated personal finance columnist for *Gannett News Service* and her articles have appeared in *The New York Times, Barron's, Working Woman, Newsday, Employee Benefit News, Contingencies and The ASPPA Journal.*

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Footnotes

i	Australians between narrative is from “The AMP Superannuation Adequacy Index Report,” Access Economics Pty Limited, 2008
ii	Survey of Consumer Finance, Federal Reserve Board, 2007 and 2009 is from conversation with Ken McDonnell of EBRI, 10/14/2011
iii	Australian employers are required narrative is from “A Super Guide,” National Information Centre on Retirement Investments Inc., 2007
iv	Boomers with a mortgage narrative is from http://www.money-zine.com/Financial-Planning/Retirement/Retiring-With-a-Mortgage/
v	Helping adult children with college loans narrative is from The Ameriprise` Financial Money Across Generations Study,” Ameriprise Financial, September, 2007
vi	The 70% of a cost of degree narrative is from “Going Broke by Degree/Why College Costs So Much, The AEI Press, Washington, D.C. 2004, p. 8
vii	81% jump in profits, Apple narrative is from “Fortune 500,” by John Berman, Nightline, May 4, 2011
viii	For every worker narrative is from “Make it in America” by Andrew Liveris”, Kindle Edition, Location 468
ix	Narrative on U.S. pension generosity versus other countries is from “Pensions at a Glance: Public Policies Across OECD Countries,” Paris, France, OECD, 2007.
x	72% of managed funds is from “Why 401(k)’s Should Offer Index Funds,” by Ron Lieber, New York Times, May 13, 2011
xi	Only 30% of participants invest is from “How America Saves 2011, Vanguard Group.
xii	Americans are Job Changers are From NUMBER OF JOBS HELD, LABOR MARKET ACTIVITY, AND EARNINGS GROWTH AMONG THE YOUNGEST BABY BOOMERS: RESULTS FROM A LONGITUDINAL SURVEY,” Bureau of Labor Statistics, September 10, 2010
xiii	Vesting practices are from Ibid, page 13
xiv	Vanguard narrative on employer matching contributions is from “How America Saves 2011,” page 8.
xv	Percentage of participants with company stock is from, “Remove exemption for company stock, 4 academics urge.” by Phyllis Feinberg, Pensions & Investments, February 21, 2005
xvi	Invest more than 20% of their assets narrative is from “Some plans company-stock heavy,” by Robert Steyer, Ibid, July 12, 2010
xvii	Baby Boomer Australians is from A Super Guide, Ibid, page 16.
xviii	Allianz narrative re federal jury and California example is from “A split decision in Allianz Life annuity lawsuit,” by Chris Serres, Star Tribune, October 14, 2009
xix	Texas annuity narrative is from “AARP blasts Texas Gov. Rick Perry’s veto..” by Terrence Stutz, Dallas Morning News, June 24, 2009
xx	Narrative on reforms in Florida, New York and New Jersey is from, “America, Welcome to the Poorhouse,” (FT Press 2009), pages 29, 30
xxi	Barbara Roper quote re financial services reform is from “For consumers, federal protection with some teeth,” by Tomoeh Tse, Washington Post, June 26, 2010