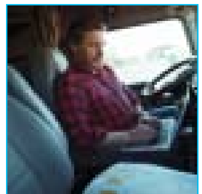


saving for our future

chapter nine

Introduction

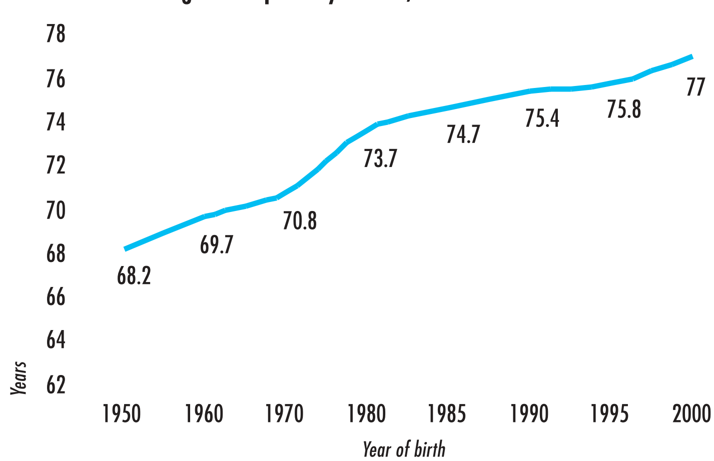
As Secretary Elaine L. Chao noted at the 2002 National Summit on Retirement Savings, the retirement landscape has been transformed by an "earthquake of change."[i] For Americans born today, average life expectancy is 77 years — more than a decade longer than the life expectancy for their grandparents' generation. (See Chart 9.1.) Of particular note is the rise in life expectancy for those over age 65. By 2000, the life expectancy of someone at age 65 had risen to 83.[ii] An aging and retiring workforce pose a number of demographic challenges.

The demographics are revealing. Between today and the year 2050, the U.S. population is expected to grow from 282 million today to 420 million. The percentage of the U.S. population that will be 65 and older will grow from 12 percent in 2000 to 21 percent in 2050. The percentage of Americans 85 and older will also increase substantially—from 1.5 percent of the population to 5 percent.[iii]

Because it is rare for someone to work their entire lifetime for a single employer, it is more critical than ever to assure that workers can take ownership over their pension and other retirement savings accounts. Workers have more control over their own retirement accounts, through Individual Retirement Accounts (IRAs) and 401(k) plans, and they are less likely to expect a fixed pension from a single employer upon retirement.

Retirement security must be a national priority. Because we have the advantage of living

Chart 9.1 **Average Life Expectancy at Birth, 1950 - 2000**



Source: Centers for Disease Control and Prevention

Expanding Ownership of Retirement Assets

The tax relief legislation signed into law by the President provided almost $50 billion dollars of tax relief over the next ten years to strengthen retirement security. This landmark legislation raised the contribution limits for IRA and 401(k) accounts, allowed for additional "catch up" contributions for workers aged 50 and over, and speeded up the vesting process for employer contributions to 401(k) accounts.

New Savings Opportunities: The President has proposed to expand savings opportunities through the creation of Retirement Savings Accounts (RSAs) and Lifetime Savings Accounts (LSAs). RSAs would provide all Americans with an easy, tax-preferred way to prepare for retirement. LSAs would give all Americans the opportunity to save tax free to pay for job training, college tuition, the down-payment on a first home, a car to drive to work, or their retirement.

Ensuring Freedom of Choice: The President's proposal would ensure that workers who have participated in 401(k) plans for three years are given the freedom to choose where to invest their retirement savings. The President has also proposed that choice be a feature of Social Security itself, allowing individuals to voluntarily invest a portion of their Social Security taxes in personal retirement accounts.

longer after retirement – often 15, 25, even 30 years in retirement – successful and active retirement requires better planning. Today individuals are bearing increasing responsibility for their retirement savings as employers turn from the traditional defined benefit pension plan to 401(k) and other defined contribution plans.

While some Americans still believe that Social Security will pay for all or most of their retirement needs, a comfortable retirement requires a combination of savings accounts, including Social Security, retirement plan benefits, and personal savings and investments. However, Social Security is not expected to meet its planned obligations after 2042. Often, retirees wish to continue to spend at high levels, requiring between 74 percent and 83 percent of their pre-retirement income in order to maintain their standard of living. Studies indicate, however, that only 56 percent of households are adequately prepared for such a lifestyle.[i]

The landscape of retirement is also changing as workers no longer view retirement as a complete end to work and a transition to leisure but rather as a new phase of life. According to the *2003 Retirement Study* conducted by Towers Perrin, almost four out of five workers plan to continue working after reaching retirement age. More than half of these individuals plan on working in order to stay involved and active, while the remainder cite financial reasons for staying on the job.[iv] (See Chart 9.2.)

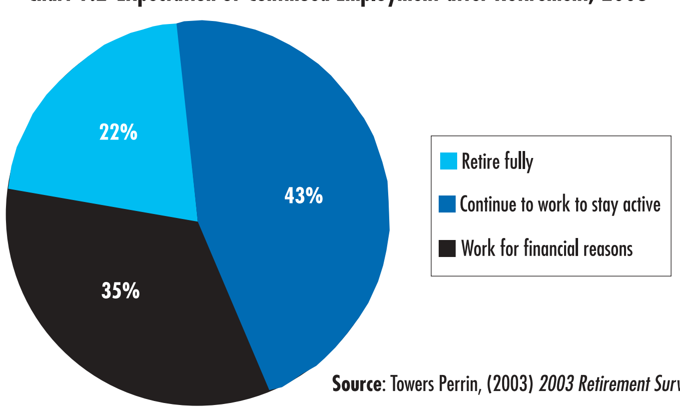
Similar results were reported by AARP in their *The AARP Working into Retirement Study* (2003).[v] A number of factors will influence future retirees' decisions to continue working. The Social Security earnings test has been eliminated for those who retire at normal retirement age, and the eligibility for full benefits is increasing to 67; people are living longer; and they want to maintain their employment-based health care coverage.

Today consensus is emerging among Congress, the Executive Branch, and private sector organizations on two major policy goals — first, we need to educate American workers on the importance of saving for a secure retirement; and second, we need to educate American employers about the advantages of a workplace savings plan.

Employment-Based Retirement Plans

Half of private full-time workers and 14 percent of private part-time workers participate in employment–based retirement plans. Sixty-four percent of private and public employees worked for employers that sponsored a retirement plan in 1999. This represents 90 percent of public workers but only 58 percent of private workers. Out of covered private sector workers, 51 percent of full-time workers and 14 percent of part-time workers participated in a retirement plan.

Chart 9.2 **Expectation of Continued Employment after Retirement, 2003**



Source: Towers Perrin, (2003) *2003 Retirement Survey*

A greater percentage of public-sector than private-sector workers participate in employment-based retirement plans. In a similar breakdown of public sector worker coverage, 85 percent of full-time workers and 32 percent of part-time workers participated in a retirement plan. These coverage rates have not changed substantially over the past 30 years.

Many workers who do not have a workplace retirement plan work for small employers, who often do not sponsor a plan. In 2003, just 35 percent of workers at private establishments with fewer than 100 employees participated in a retirement plan, compared with 65 percent of workers at larger establishments.[vi]

A defined benefit plan – the traditional pension plan – promises a specified monthly benefit at retirement. The plan may state this promised benefit as an exact dollar amount or calculate the benefit through a formula that considers such factors as salary and service (for example, 1 percent of your average salary for the last five years of employment for every year of service with your employer).

A defined contribution plan, on the other hand, does not promise a specified benefit at retirement. In these plans, employees and/or the employer contribute to an employee's individual account in the plan, sometimes at a set rate, such as 5 percent of annual earnings. The contributions are invested, with most participants making the investment decisions for their own accounts. The participants will receive their account balance as their retirement benefit. The value of the account will fluctuate due to changes in the investments. Examples of defined contribution plans include 401(k) plans, 403(b) plans, employee stock ownership plans, and profit-sharing plans.

Defined contribution plans, such as 401(k) plans and profit-sharing plans, have proliferated over the past 20 years. They have more than doubled in number from 1978 to 1999, from 315,000 to 683,000 plans. (See Chart 9.3.) At the same time, the number of traditional defined benefit pension plans decreased by more than 60 percent, from 128,000 to 50,000 plans. Some companies offer both types of plans.

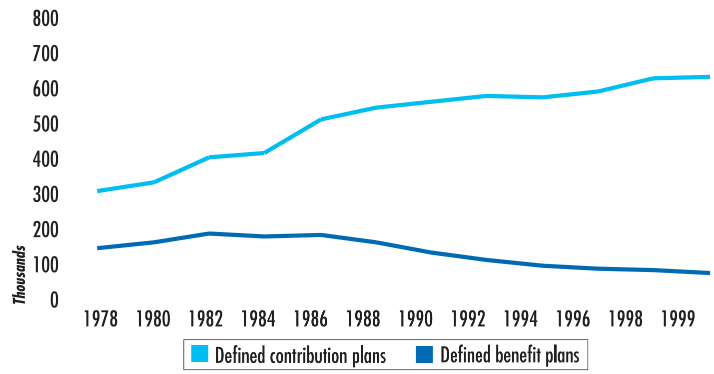
In terms of individuals covered by the plans, the number of people covered by defined contribution plans rose from 16 million in 1978 to 60 million in 1999. (See Chart 9.4.) Over the same period the number of people covered by defined benefit plans rose from 36 to 41 million.

The popularity of 401(k) plans has been largely responsible for the shift from traditional defined benefit pension plans to defined contribution plans. Of 730,000 total retirement plans, 93 percent are defined contribution plans covering 69 percent of total active participants.[vii]

The shift toward defined contribution plans has major implications for retirement. Unlike traditional defined benefit pension plans, which employers solely fund and manage, employees contribute to defined contribution plans and generally direct where and how their account balances are invested and allocated. Employees can also tap into their vested accounts before retirement, for example, by taking a loan or leaving an employer.

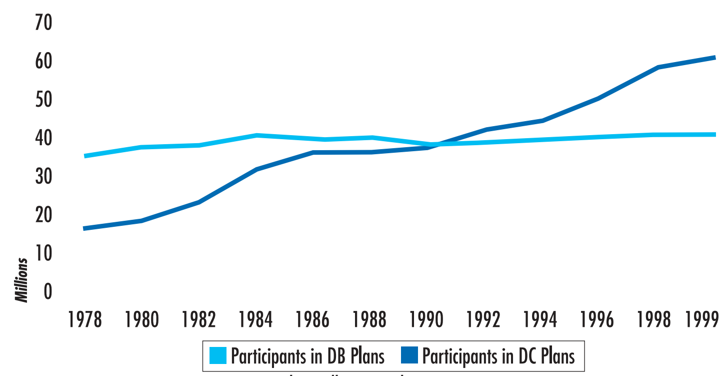
The popularity of self-directed defined contribution plans has brought with it a need for

Chart 9.3 **Number of Plans, 1978 - 1999**



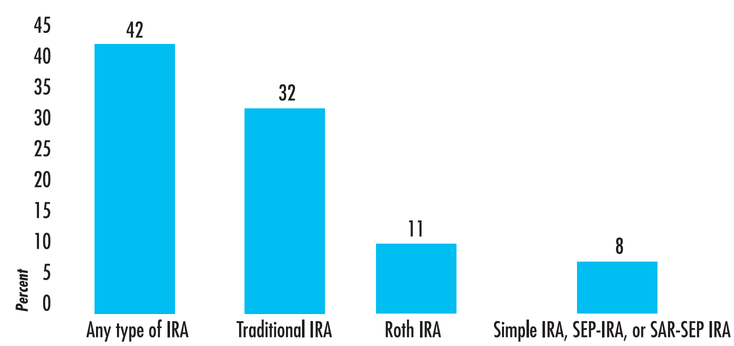
Source: EBSA, *Private Pension Plan Bulletin*, Number 12

Chart 9.4 **Number of Participants in DB and DC Plans, 1978 - 1999**

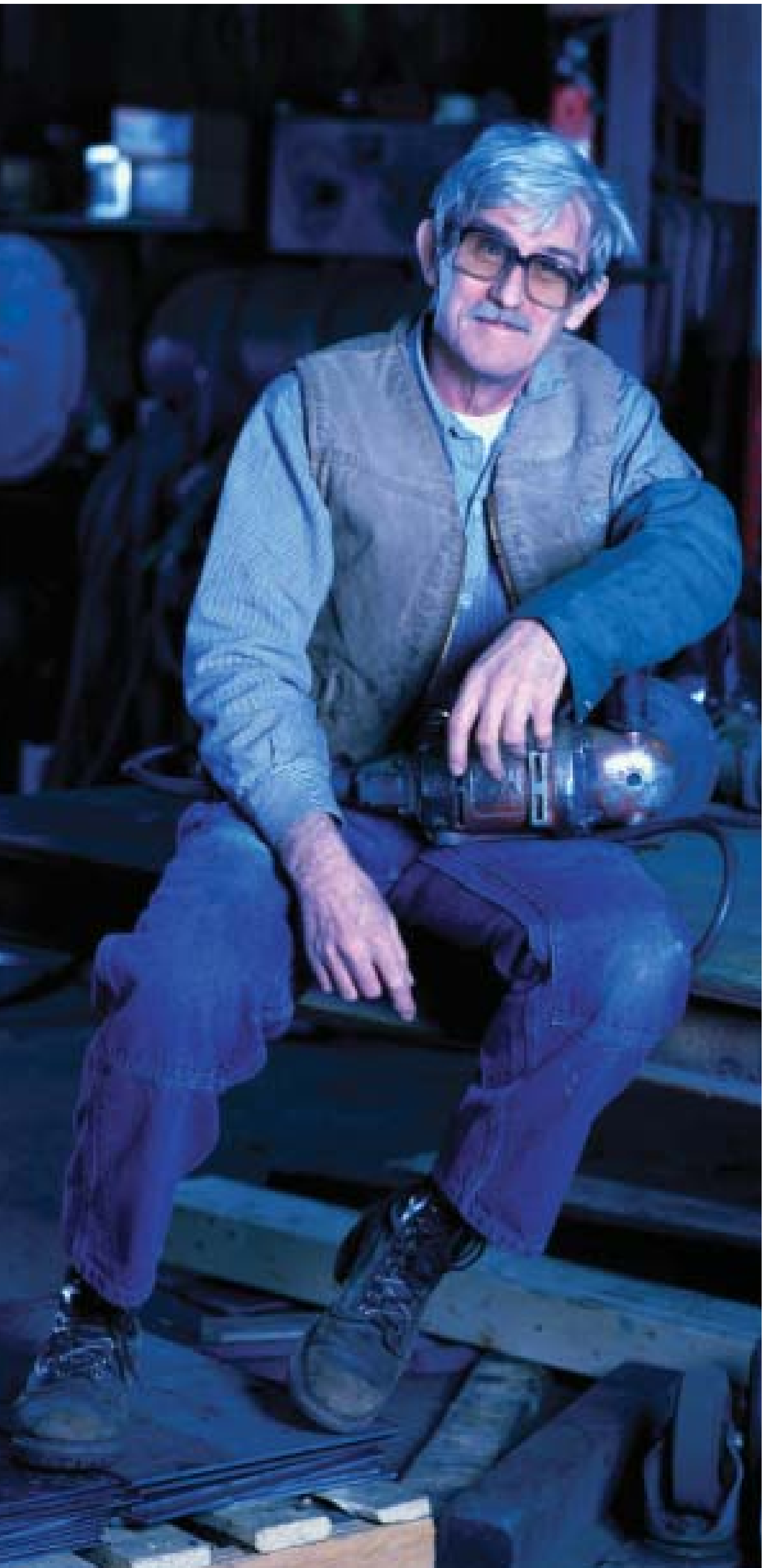


Source: EBSA, *Private Pension Plan Bulletin*, Number 12

Chart 9.5 **Ownership of IRA, Percent of All U.S. Households, 2001**



Source: *Fundamentals*, Investment Company Institute Research in Brief, September 2001



financial literacy to help employees understand the specifics of their plan, the importance of participating and contributing, and how to choose appropriate investments and diversify those investments.

Individual Retirement Accounts

Two-fifths (42 percent) of the U.S. households tracked by the Investment Company Institute in 2001 own IRAs. (See Chart 9.5.) Further, IRA assets are growing substantially. In 1999, for the first time, EBRI found assets in IRAs ($2.47 trillion) exceeded those in defined contribution plans ($2.45 trillion) and defined benefit plans ($2.21 trillion).[viii]

Most IRA growth, though, is not from new contributions but from rollovers of employment-based plan distributions and investment gains. Today IRAs are used primarily as a vehicle to store retirement wealth that has been accumulated elsewhere in the retirement system, and not as a vehicle through which current retirement savings occur.

Misperceptions about retirement and investments may be discouraging people from contributing more to IRAs. Common mistakes include overestimating investment returns, and consequently running out of funds in retirement; underestimating the needed income to preserve an active lifestyle; expecting too much from Social Security; depending on an inheritance or a spouse's pension; and underestimating longevity.

Social Security

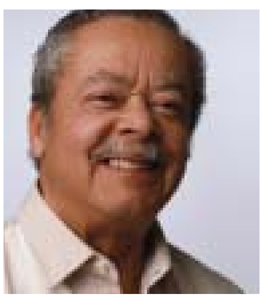
Social Security is the mainstay of most people's retirement income. Nine in ten households aged 65 and older receive Social Security benefits.[ix] Thirty-eight percent of the

Strenghtening America's Retirement Future and Strengthening Social Security

Social Security was designed in 1935 for an America that was very different in many ways. In order for Social Security to withstand the conditions of the 21st Century, retirees in 2035 must have a system that reflects the realities of the nation in which they live.

Fifty years ago, there were 16 workers paying into Social Security for every 1 collecting benefits from it. Today, there are 3.3 workers paying into Social Security for every 1 collecting benefits. By the time today's young workers retire, there will be only 2 workers paying into Social Security for every 1 collecting benefits.

The current Social Security system is effectively a "pay as you go" system. The benefits of today's seniors are not paid from personally-owned Social Security accounts, but from the payroll taxes of today's workers. Under current Social Security law, even surplus payroll taxes paid by workers are not saved in personal accounts, but finance the current operations of the federal government. Because Social Security is a "pay as you go" system rather than a savings system, a sharp drop in the worker-collector ratio must mean a sharp increase in the tax burdens borne by workers.



President Bush favors allowing younger workers the opportunity to save a portion of their payroll taxes in a personal account. These accounts would enable the worker to build a nest egg for retirement, which could eventually be passed on to the worker's heirs.

In May 2001, the President convened a bipartisan Commission to Strengthen Social Security, co-chaired by the late Senator Daniel Patrick Moynihan and Richard Parsons. That Commission was charged with making recommendations to make Social Security fiscally sustainable, subject to reform principles prescribed by the President. The President's reform principles, in addition to creating voluntary personal accounts, also include making no changes to the benefits of those now in or near retirement, and opposing any increases in the Social Security payroll tax.

The President's Social Security Commission issued a unanimous report of options to permanently strengthen Social Security, while protecting the benefits of current and near-term retirees, and establishing voluntary personal accounts for younger workers. With its report, the Commission invited others to discuss and to expand upon their proposals. Many Members of Congress have answered the call, and stepped forward with plans. Since the Commission report, six fully detailed, comprehensive proposals have been introduced by Members of Congress.

Fixing Social Security will require choices, bipartisanship, and public education. The President wants to work with Congress to produce a consensus on the best elements of the many proposals that have been put forward. Working together, we can build a Social Security system that improves the lives of Americans in the 21st Century, in the same way that the original Social Security system improved the lives of 20th century Americans.

total income of retirees comes from Social Security. Social Security supplies 50 percent or more of the income for two-thirds of households aged 65 and older; it is the only source of income for 18 percent of beneficiary households.

The eligibility age for unreduced Social Security benefits is increasing from 65 to 67. Over a period of 22 years, beginning in 2000, the normal retirement age increases gradually from age 65 to age 67 for people born in 1938 and after. For those born in 1960 and after, normal retirement age is 67.

The later normal retirement age of 67 may accelerate a reversal of the decline in the average age at retirement experienced up to the 1990s. Some workers may even choose to work beyond normal retirement age because delayed retirement increases Social Security benefits for each year after normal retirement age, reaching 8 percent per year of delay in 2010.

Earnings

People are increasingly transitioning to retirement through bridge jobs or phased retirement. A 1999 AARP survey confirmed that most Baby Boomers (80 percent) plan to work at least part time in retirement.[iv]

Continuing to work after retirement makes sense in light of increasing lifespans. On average a child born in 1998 can expect to live to almost 77. As mentioned above, a 65-year-old female retiree in 1998 can expect to live until 84. With people living longer and retiring earlier, earnings could become a more significant source of retirement income. Also, as the workforce ages and there are fewer younger people in the workforce, labor shortages may encourage people to retire later.

Another reason people transition to or delay retirement is to maintain or pay for health care coverage. Not only do retirees have to bridge gaps between early retirement and the Medicare eligibility age of 65, but most want to supplement Medicare coverage. The percentage of employers with retiree health benefits, once a more common benefit, is declining.

Helping Americans to Save

There is plenty of evidence of the need for Americans to save – and, as noted above, there is consensus among those leading efforts to help Americans take on this important responsibility for a secure future. The Retirement Savings Education Campaign implements a statutory mandate under the Savings Are Vital to Everyone’s Retirement (SAVER) Act of 1997. It advances the public’s understanding of the importance of saving for retirement, often working with many public and private sector partners.

Further, pursuant to this Act, Secretary Chao convened the 2002 National Summit on Retirement Savings. Under the theme “Savings for Lifetime: Advancing Generational Prosperity,” Secretary Chao welcomed the President, members of Congress, and 200 other leaders in this field as they spoke to the importance of understanding the differences between generations – focusing on their attitudes toward finances and saving for retirement. The Summit produced a report, recommendations, and action steps specific to each generation of savers.

Adding new and expanded incentives to motivate Americans to save, President Bush signed into law the Economic Growth and Tax Relief and Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA). Both bills encouraged saving by reducing taxes on income from capital, thereby increasing returns to savers.

EGTRRA is particularly important to many of the Baby Boom generation approaching retirement with the addition of catch-up contributions to retirement savings plans for those over 50. In addition, EGTRRA encourages higher salary deferrals by increasing the limits for retirement plan contributions. It also encourages Americans to keep savings and not spend them by facilitating rollovers opportunities from retirement plan accounts into IRAs when employees change jobs.

The Department's work to help small businesses consider the various retirement plan options available was also expanded to work with the Internal Revenue Service and highlight the new incentives added as part of EGTRRA. By encouraging more small businesses to set up plans, more workers can be covered by plans and save for the future.

In May 2004, the U.S. Department of Labor launched a new education campaign designed to assist plan officials, especially small businesses, in meeting their fiduciary responsibilities. The campaign is part of a retirement plan compliance assistance program that includes a number of new publications, live outreach

> **"The more ownership there is in America, the more vitality there is in America, and the more people have a vital stake in the future of this country."**
>
> -President George W. Bush,
> June 17, 2004

seminars conducted with the IRS and many other partners including the Small Business Administration, the U.S. Chamber of Commerce, the Society for Human Resource Management, the National Federation of Independent Businesses, and the American Institute of Certified Public Accountants.

Wise Up is a Women's Bureau e-mentoring financial security and retirement savings demonstration project that is accessible via the web and at institutions in six regions. The project is designed to teach Generation X women ages 22 to 35 the basics of managing money, saving, investing, using credit wisely, buying insurance and retirement planning. The curriculum is available online and in participating institutions.

As part of its continuing e-gov educational efforts, this campaign also features a dedicated web page. The Department continues to expand its compliance assistance efforts to assist retirement plan officials in operating their plans and keeping the plans secure to provide promised benefits to their workers.

e-gov

Efforts to educate workers and employers about the importance of saving for a secure retirement include a number of e-gov initiatives. In 2003, EBSA worked with its partners, the U.S. Chamber of Commerce and the Small Business Administration, to update an interactive web site developed by the three organizations, selecta-retirementplan.org, for small businesses. The site now draws more than 50,000 visitors per month.

Four additional web sites provide information to motivate employees and employers and help them make wise decisions about retirement. One such site, www.dol.gov/ebsa, features publications and web-only information to help all of the agency's target audiences. The interactive elaws Small Business Retirement Savings Advisor (at www.dol.gov) links small business owners with timely information and the requirements and benefits of the various types of retirement plans. And the Retirement Savings Education Campaign and the National Summit on Retirement Savings both have web sites with helpful and interesting information for workers and employers.

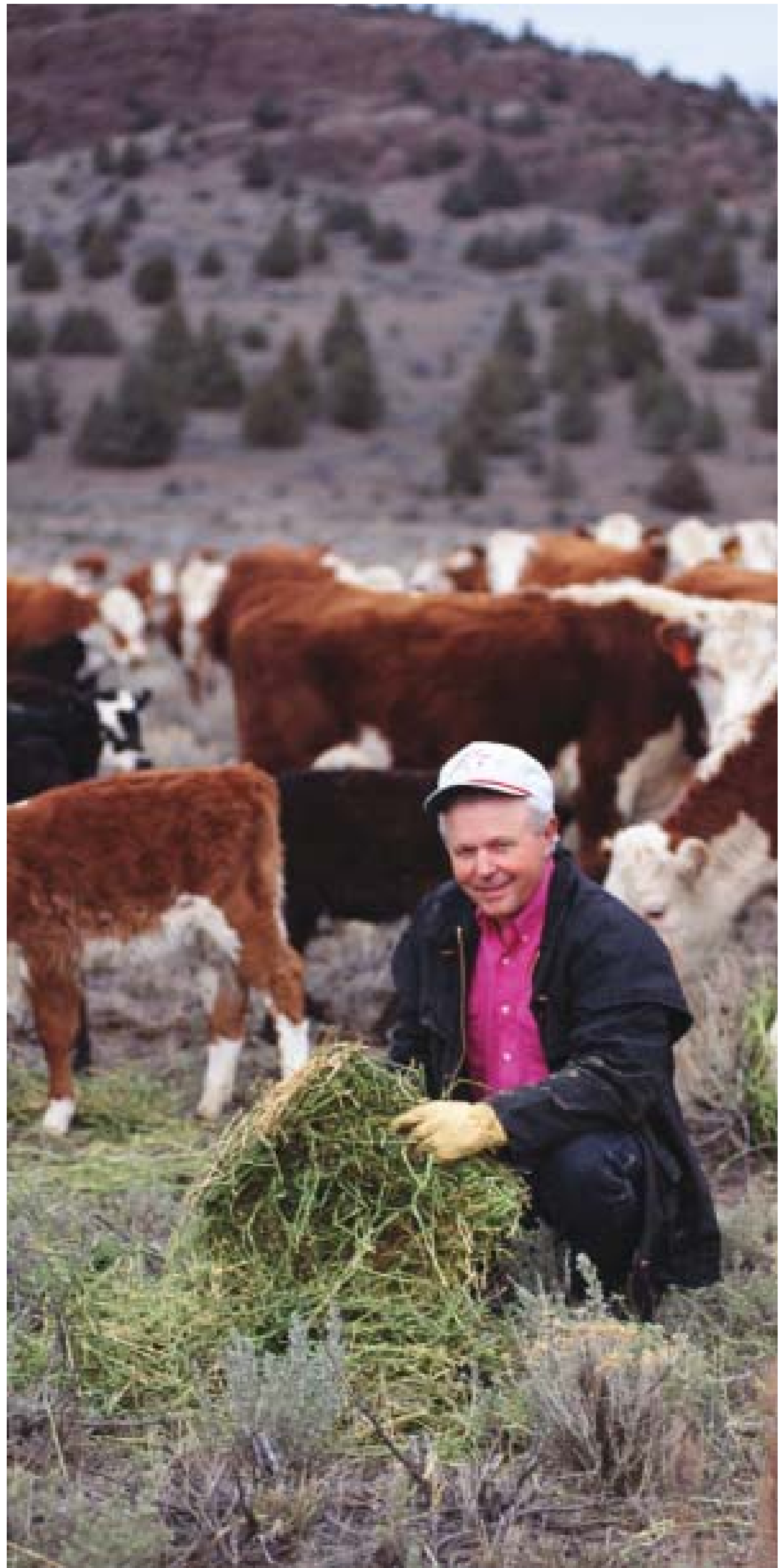
Partnerships

Partnerships are an important component of the Retirement Savings Education Campaign's efforts to educate workers and employers about retirement savings and retirement plans. EBSA has multiplied its outreach by working with many private- and public-sector partners. From the IRS to the Consumer Federation of America, these partnerships have resulted in greater exposure for the retirement savings message.

As one example, the EBSA's partnership with the IRS has resulted in information on the tax advantages of saving for retirement being added to several publications for employers. A partnership with the Consumer Federation of America gives consumers at the grass-roots level basic information and tools to increase their savings rate.

EBSA's partnership with the Federal Citizen Information Center (FCIC) has resulted in increased exposure for the agency's publications. Through the efforts of the FCIC, *Savings Fitness, Top 10 Ways to Prepare for Retirement, and Women and Retirement Savings* have been promoted in the pages of *Parade* magazine, through the syndicated column "Hints from Heloise," and highlighted on information accompanying federal income tax refunds.

The Retirement Savings Education Campaign has worked with a wide range of partners to draw from varied expertise and to reach a wide range of the American public. These partners, in addition to those noted above, include the Small Business Administration, the U.S. Chamber of Commerce, the Certified Financial Planner Board of Standards, the



Social Security Administration, the National Association of Women Business Owners, and many others. The Campaign continues to expand its partnerships and looks forward to working on future collaborative efforts.

Reaching Non-English Speaking Americans

During 2002, EBSA increased the number of publications available to Spanish-speaking populations. *Pension and Health Care Coverage…Questions and Answers for Dislocated Workers*, was translated and disseminated. The publication answers questions about the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) and other health and retirement benefits after job loss.

Las Mujeres y el Dinero (Women and Money) is a series of financial education conferences held across the country. The Women's Bureau initiated these events with partners from the Hispanic business community especially for Hispanic women who face unique challenges when it comes to financial security. The web site address is http://www.dol.gov/wb/hisp.htm.

Conclusions

Retirement security has become a national priority. Today, people are bearing more responsibility for their retirement savings as more employers turn from traditionally defined benefit pension plans to 401(k) and other defined contribution plans.

By preparing for retirement and taking advantage of tax benefits, Americans will be ready for the future.

Changing Jobs, a poster offering regional office assistance with retirement and health questions, was also translated into Spanish and distributed by EBSA's 15 field offices. This builds upon EBSA's continuing efforts to expand its retirement and health benefits educational materials available to non-English speaking Americans. EBSA, working with a translation service, can also assist callers speaking over 140 languages.

The Department of Labor assists Americans as they plan for an active retirement. Through programs and partnerships, the Department of Labor encourages Americans to take advantage of the tax-favored opportunities proposed by President Bush and passed by Congress. By preparing for retirement and taking advantage of tax benefits, Americans will be ready for the future.

Notes

[i] U.S. Department of Labor (2002a). *Saving for a Lifetime: Advancing Generational Prosperity: The 2002 National Summit of Retirement Savings*, U.S. Department of Labor, Washington, DC.

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[iii] U.S. Census Bureau (2004). *U.S. Interim Projections by Age, Sex, Race, and Hispanic Origin*, http://www.census.gov/ipc/www/usinterim-proj/, Internet Release Date: March 18, 2004.

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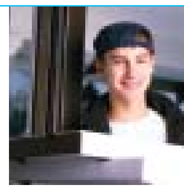
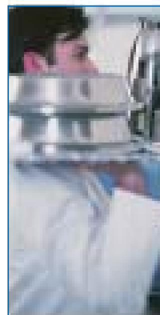
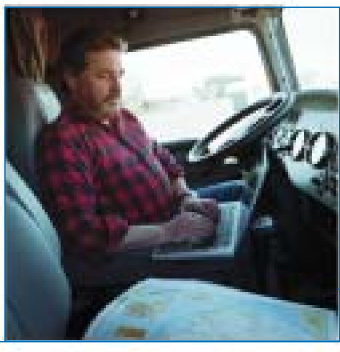
Detailed industry	2002 number	2012 number	Percent change	Numeric change
Software publishers				
Internet service providers and web search portals				
Other residential care facilities				
Home health care services				
Management, scientific, and technical consulting serv				
Computer systems design and related services				
Employment services				
Community care facilities for the elderly	530,100	815,300	53.8	285,200
Wireless telecommunications carriers (except satellite)	195,900	294,800	50.5	98,900
Vocational rehabilitation services	376,300	562,500	49.5	186,200







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