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Committee on Finance
Subcommittee on Social Security, Pensions, and Family Policy

For a Hearing on

"Retirement Savings for Low-income Workers"

on

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Thank you Chairman Brown, Ranking Member Toomey, and Members of the Committee on Finance for the opportunity to testify today. I am Diane Oakley, executive director of the National Institute on Retirement Security (NIRS). NIRS is a non-profit, non-partisan research and education organization committed to fostering a deep understanding of the value of retirement security to employees, employers and the economy.

For today's hearing, I will focus on two recent NIRS research studies, which are available at www.nirsonline.org:

- *The Retirement Savings Crisis: Is It Worse Than We Think*?; and
- *Race and Retirement Insecurity in the United States*.

In *Pensions & Retirement Security 2013*, we surveyed Americans on retirement security issues. We found that Americans are very worried about their retirement outlook despite stabilization of the financial markets, declining unemployment and increased consumer confidence. An overwhelming majority of Americans (85 percent) report concern about their retirement prospects, with more than half (55 percent) very concerned. We also found that 86 percent of Americans believe that that leaders in Washington need to give retirement a higher priority, with 62 percent strongly agreeing.

To perhaps explain this sentiment, I would like to share NIRS findings on retirement savings. This may shed light on why Americans want and need help from leaders in Washington if their dream of retiring with dignity and independence can come true.

NIRS examined the readiness of all working-age households for retirement by analyzing the 2010 Survey of Consumer Finances (SCF) from the U.S. Federal Reserve. Our analysis looked at workplace retirement plan coverage, retirement account ownership, and household retirement savings as a percentage of income, for all working families. We also looked more closely at the retirement readiness of people of color. Overall, we found that retirement readiness is dangerously low – even lower than we expected. Below are the key findings of our analyses.

1. Retirement Plan Access and Coverage

Employer-sponsored retirement plans remain the most important vehicle for ultimately providing retirement income among working households after Social Security. However, a large share of American workers lacks access to a retirement plan through their employer. Those workers who do participate in a retirement plan will be much more likely to rely on assets from individual retirement accounts in a 401(k) or other defined contribution (DC) plan rather than on a predictable monthly income from a group defined benefit (DB) pension.

Historical retirement participation data from both the U.S. Bureau of Labor Statistics' Current Population Survey (CPS) and the SCF indicate that gradual changes over past decades resulted in participation in retirement plans peaking around the year 2000 and then declining over the last decade. According to CPS data, by 2011, only 52 percent of private sector employees age 25-64 had access to a retirement plan on the job—the lowest rate since 1979. The SCF illustrates a similar trend on a household level. The share of working families in which neither the head of household nor the spouse participated in a retirement plan through their job increased from 42.7

percent in 2001 up to 44.6 percent in 2010. That 45 percent nonparticipation level contributes to more than 38 million working-age households with no retirement account assets, whether in an employer sponsored 401(k) type plans or in an IRA.[1]

Workers who lack access to an employer sponsored retirement plan tend to work for smaller firms, and to be low- to middle-wage employees.[2] Large firms generally offer more generous benefits, and a significant number continue to sponsor DB pensions.[3] Small businesses—which account for approximately two-thirds of workers that lack access to a retirement plan—often find it too expensive and complicated set up a plan. Earnings levels make a difference, as small and large employers in low-wage industries are less likely to offer a retirement plan. On the other hand, higher-income workers are more likely to work for employers that provide generous matches and have more disposable income.[4]

Retirement account ownership rates are closely correlated with income and wealth. Households that do own retirement accounts have a significantly higher income and wealth—more than double the income and five times the non-retirement assets—compared to households that do not own a retirement account.[5] Also, an analysis of the ownership of savings in retirement accounts by the Economic Policy Institute found that the top one fifth of households by income accounted for 72 percent of the total savings in retirement accounts in 2010.[6]

The SCF shows that ownership of retirement accounts is sharply concentrated in the top half of the income distribution. **Figure 1** shows the retirement account asset ownership status of households in each income quartile ranked by income. The nearly 9 of 10 households (89 percent) in the top income quartile own retirement account assets, as do 72 percent of the third income quartile. In comparison, slightly more than one half of the second income quartile and one quarter of households in the bottom income quartile own retirement account assets.[7]

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[1] N. Rhee, 2013 (Jun.), "The Retirement Savings Crisis: Is It Worse Than We Think?" National Institute on Retirement Security, Washington, DC.

[2] S. Allegretto, N. Rhee, J. Saad-Lessler, and L. Schmidt, 2011 (Oct.), "California Worker's Retirement Prospects," pp. 22-41 in N. Rhee, Ed., *Meeting California's Retirement Security Challenge*, UC Berkeley Center for Labor Research and Education, Berkeley, CA.

[3] Towers Watson, 2011 (Nov.), "Pension Freezes Among the Fortune 1000 in 2011," Insider, Towers Watson; PBGC Data Tables 2011, Table S-30 "PBGC-Insured Plan Participants (1980-2011) Single-Employer Program," http://www.pbgc.gov/documents/pension-insurance-data-tables-2011.pdf.

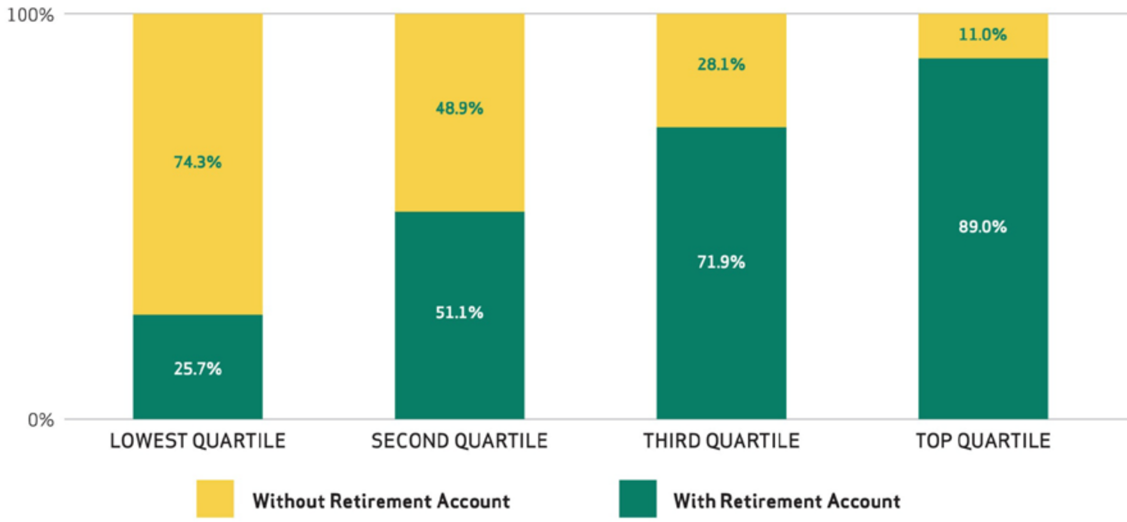
[4] Congressional Budget Office (CBO), 2013, *The Distribution of Major Tax Expenditures in the Individual Income Tax System*, CBO Publication No. 4308, CBO, Washington, DC; M. Morrissey, 2009, *Toward a Universal, Secure, and Adequate Retirement System,* Economic Policy Institute. Washington, DC.

[5] N. Rhee, 2013 (Dec.), "Race and Retirement Insecurity in the United States," National Institute on Retirement Security, Washington, DC.

[6] M. Morrissey and N. Sabadish, 2013 (Sep.), "Retirement Inequality Chartbook," Economic Policy Institute, Washington, DC.

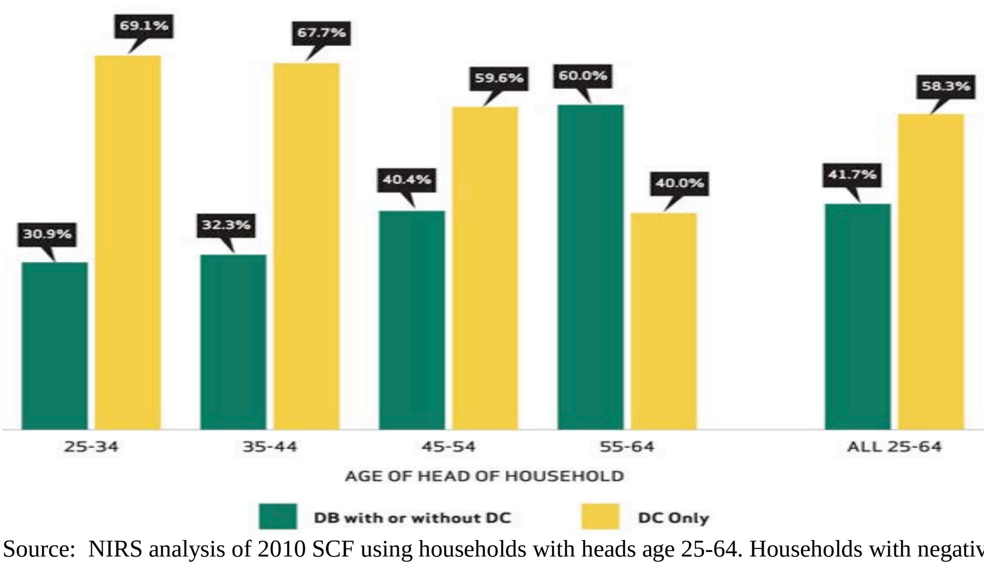
[7] Rhee, 2013 (Jun.).

Figure 1. Retirement account ownership status by household income quartile, 2010



Source: NIRS analysis of 2010 SCF using households with heads age 25-64. Households with negative earnings excluded.

Figure 2. DB and DC plan participation among households covered by an employer-sponsored retirement plan, by age of head of household

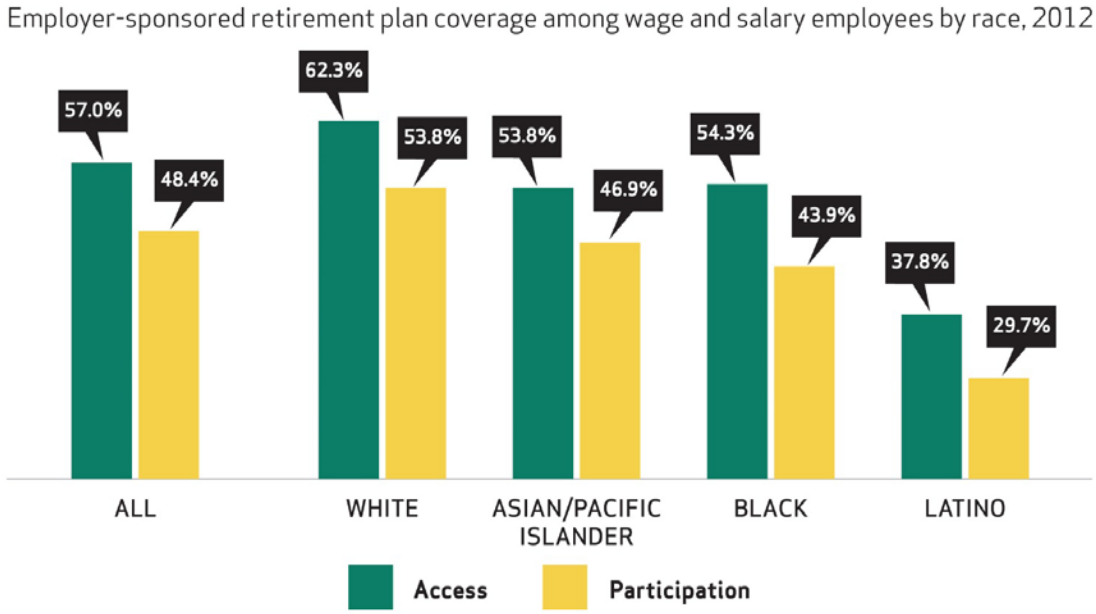


Source: NIRS analysis of 2010 SCF using households with heads age 25-64. Households with negative earnings excluded.

As workers' access to workplace retirement plans has declined over the past decade, the income security provided by such plans has also eroded. Among working-age households in which the head or spouse participated in an employer sponsored retirement plan through a current job, the share that had a DB pension—whether alone or with a DC account—dropped precipitously from 73 percent in 1989 to 42 percent in 2010 with much of that decline occurring prior to 2001. Conversely, the share of participating households that only had a DC plan grew from 23 percent to 58 percent during the same period.

Households currently near retirement represent the last generation of workers to enjoy widespread DB pension coverage. Among households covered by workplace retirement benefits, **Figure 2** illustrates that while 60 percent of older households (age 55-64) are covered by a DB pension, younger households are half as likely to have a DB pension—31 percent for age 25-34 and 32 percent for age 35-44.[8]

Figure 3. Retirement Plan Access and Participation among Workers of Color



Source: NIRS analysis of CPS ASEC microdata from IPUMS. Universe is public and private wage and salary employees age 25-64. Racial categories are single-race.

NIRS also explored the racial differences in workplace retirement plan coverage. **Figure 3** breaks down the overall 57 percent of employees age 25-64 with an employer that sponsors a retirement plan, based on an analysis of CPS data. Some 62 percent of white workers have access to employer-provided retirement plans, while only 54 percent of Black and Asian employees have access. Latinos fare even worse, with only 38 percent employed in firms that offer a retirement plan. Workplace retirement plan *participation* rates generally follow access levels, with 44 percent of Blacks and with 30 percent of Latinos participating in a plan.[9]

<u>2. Retirement Account Balances</u>

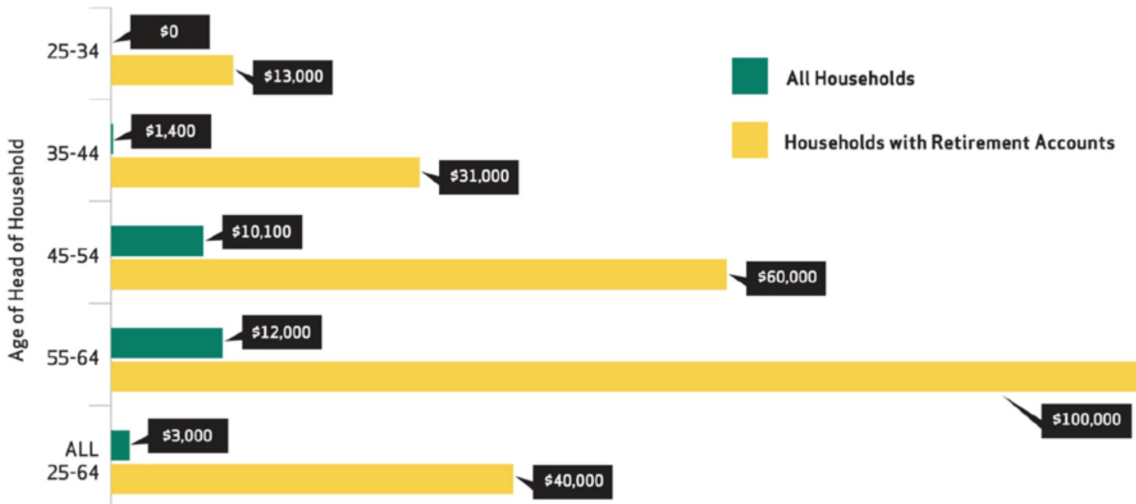
[8] N. Rhee, 2013 (June)

[9] Rhee, 2013 (Dec.).

To maintain their standard of living in retirement, the average household needs to replace roughly 85 percent of their pre-retirement income.[10] Social Security, assuming no further benefit cuts, provides a replacement rate of roughly 35 percent for a typical household, leaving a gap of 50 percent of pre-retirement earnings. The magnitude of this challenge facing working families is considerably bigger than many realize.

The shift away from DB pensions leaves most covered workers needing to rely only on assets accumulated in DC accounts to supplement their Social Security income. This trend has had profound consequences for American workers and families in terms of the risks and costs they now bear in saving and investing to fund their own retirement. Unfortunately, the typical household—even one near retirement—has only a few thousand dollars in retirement account assets, nowhere near the $100,000-plus average balances often quoted in the news media. A large majority of working-age households have little savings in relation to their income, and fall a long way short of recommended benchmarks for their age.

Figure 4. Median retirement account balance, households with retirement accounts vs. all households, 2010



Source: NIRS analysis of 2010 SCF. Universe is households with heads age 25-46 and those with negative earning excluded.

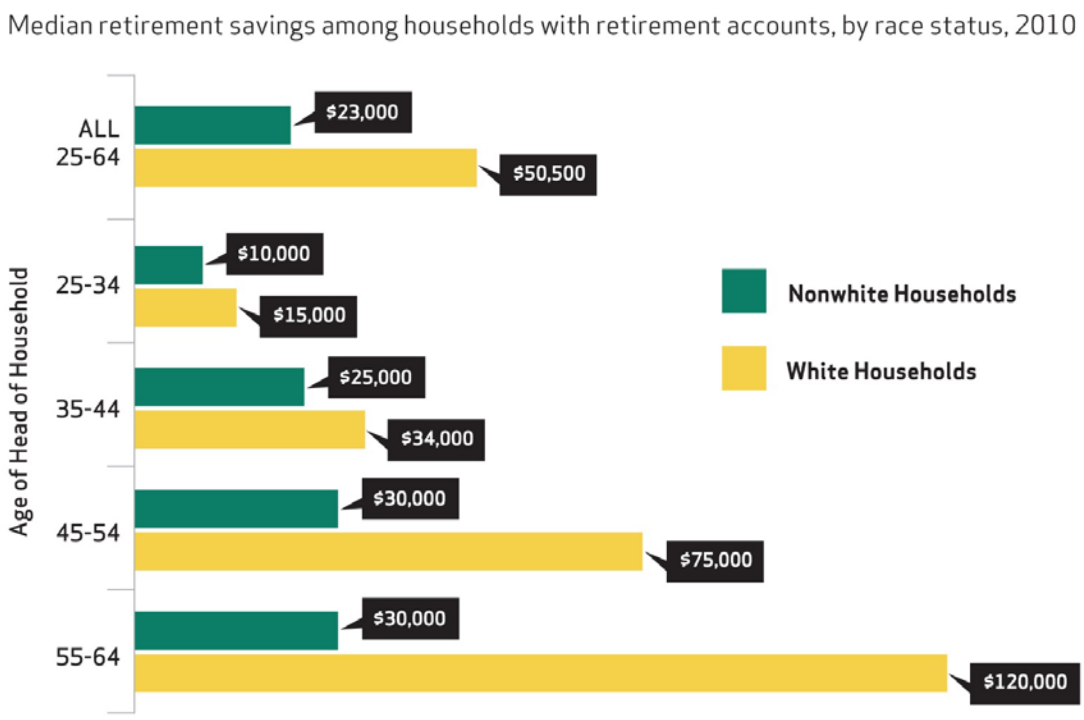
Given that 45 percent of households do not own retirement accounts, there is large disparity between median (50th percentile) retirement asset balances counting only working-age

[10] Income replacement estimates vary by source, and by income level. HR consulting firm Aon Hewitt and financial services firm Fidelity Investments both estimate that a typical worker will need to replace 85 percent of income to maintain their standard of living in retirement. Aon Hewitt, 2012, "The Real Deal: 2012 Retirement Income Adequacy at Large Companies"; Fidelity, 2012 (Feb. 27), "How much do you need to retire?," https://www.fidelity.com/viewpoints/personal-finance/8X-retirement-savings. The Center for Retirement Research at Boston College estimates that a middle-income two-earner couple born 1960-1962 will need to replace 76 percent of their income excluding health care and long term care costs, and 98 percent including these costs.

households that own retirement accounts, versus all working-age households **(Figure 4).** The median retirement account balance for households with retirement assets was $40,000 in 2010 compared to $3,000 for all households age 25-64. Even more significant, among households approaching retirement (age 55-64), the median balance was $100,000 for account owning households and only $12,000 for all households in that age group. In other words, half of working-age households in the U.S. have virtually no retirement savings—just a few thousand dollars, or perhaps a little more due to recent stock market growth, but still not enough to provide meaningful retirement income.

While the median value of retirement accounts for the typical American working-age household is only $3,000 for age 25-64 and $12,000 for age 55-64, the NIRS analysis of the SCF reveals that ***the typical Black or Latino household has no dedicated retirement savings.*** In fact, 62 percent of Black and 69 percent of Latino households having no retirement accounts. We also analyzed mean balances—calculated as aggregate retirement savings divided by the number of households—as an indication of the race gap in retirement wealth. The $31,600 mean retirement account balance of working-age households of color is *less than one-third* of the $111,700 of white households. Worse still, average retirement account balances for Black ($20,100) and Latino households ($17,600) are less than one-fifth that of white households.[11]

Figure 5. Typical Household of Color with Retirement Accounts Has Much Less in Account than Typical White Household with Retirement Accounts



Source: NIRS analysis of 2010 SCF. Universe is households with heads age 25-46 and those with negative earning excluded.

[11] N. Rhee. 2013 (December)

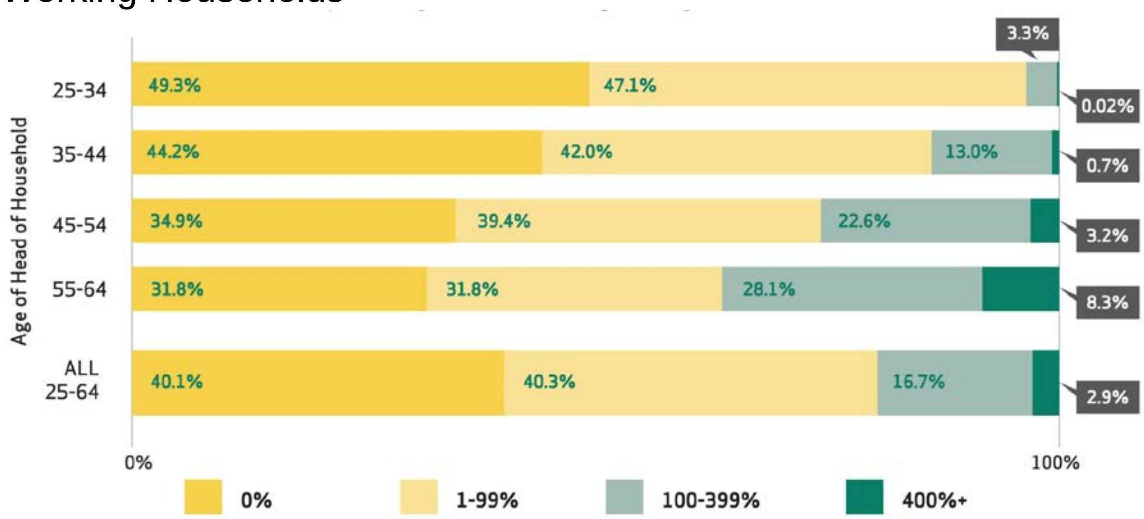
Even when only households that own a retirement account are counted, the racial gap in retirement savings is stark (**Figure 5**). The typical retirement-account owning household of color has a balance of $23,000, less than half of $50,500 median balance of white households with retirement accounts. Also, the racial disparity in retirement wealth among households that own retirement accounts is much larger for older households than for younger households. For example, among households with retirement accounts, the ratio of the median balance of households of color to the median balance of white households approximately 3 to 4 ($25,000 vs. $34,000) in the 35-44 age group and exactly 1 to 4 ($30,000 vs. $120,000) among near-retirement households age 55-64.

3. Retirement Account Values and Relationship To Income

Most people do not have a clear idea of how much they need to save in order to have enough income—including Social Security—to maintain their standard of living in retirement. For instance, a $200,000 retirement account balance may seem high, but will it be enough to maintain the standard of living for a couple with combined annual income of $60,000?

So NIRS looked at retirement savings as a multiple of annual income. **Figure 6** illustrates ratios of retirement account balances to household income among working-age households with at least one earner. Overall, over 40 percent have no retirement savings. Another 40 percent have retirement savings less than 100 percent of income. Among working households age 55-64, nearly 32 percent have no retirement savings; and another 32 percent have retirement savings less than 100 percent of their income. Overall, 80 percent of all working households age 25-64 and 60 percent of working households approaching retirement do not have retirement savings worth even 100 percent of their annual income. This reflects a huge shortfall compared to the amount they will need.

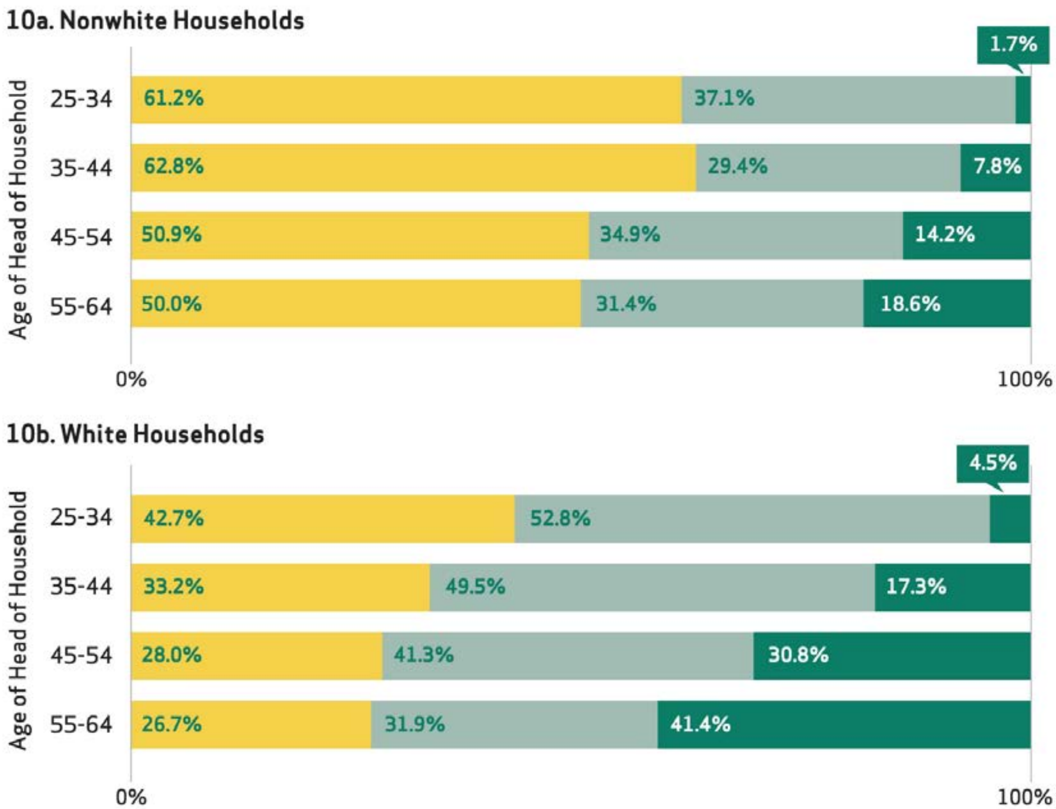
Figure 6. Retirement Account Balances As a Percentage of Income Among Working Households



Source: NIRS analysis of 2010 SCF. Universe is households with heads age 25-64, with total earnings ≥ $5,000 and < $500,000 and total income < $1M.

While the above chart provides SCF retirement savings data for the general population using several categories above 100 percent of earnings, households of color comprise a smaller sample in the SCF and relatively few have high retirement account balances, so for the purposes of analyzing differences by race, NIRS grouped households into just three categories: 1) those with retirement assets, 2) those with retirement assets greater than zero and less than 100 percent of earnings, and 3) those with retirement assets equal to or greater than 100 percent of earnings. The results are shown in **Figure 7**.

Figure 7. Households of Color Are Less than Half as Likely As White Households to Have Retirement Savings of at Least Annual Income



Source: NIRS analysis of 2010 SCF microdata. Universe is households with total earnings > $5,000 and < $500,000 and total income < $1M. Values may not add up to 100% due to rounding.

Working households of color have markedly less savings in relation to their income than do white working households. For example, in the 55-64 age group, only 19 percent of households of color had retirement savings equal to or greater than their annual earned income, compared to 42 percent of white households. Across age groups, households of color are about half as likely as white households to have this level of retirement savings.

The financial services provider Fidelity Investments recommends accumulating a minimum of 8 times income in retirement savings for retirement at age 67 and provides benchmarks in 5-year age intervals that start at half of a year's salary at age 30 and then move up to reach 8 times earnings by ager 67.[12] Another organization, Aon Hewitt estimates that 11 times salary is needed in retirement assets in order to retire at age 65.[13] Both models include a target replacement rate of 85 percent of pre-retirement income. And the models are in line with recommendations from financial experts who have begun to recommend a total contribution of 15 percent of pay since the financial crash —rather than the previous 10—over a 40 year career in order to meet this goal.[14] NIRS used the Fidelity benchmarks to gage the percentage of households that were on track and when we looked at all retirement assets including the value of defined benefit plans, we noted that 9 out of 10 households had a savings gap.

Conclusion

With the disappearance of secure pensions and declining workplace retirement plan coverage, Americans face a retirement savings burden that is heavier than ever.

More than 38 million U.S. working-age households do not have retirement accounts, most are in the bottom half of the income distribution. The typical working-age household has only $3,000 in retirement savings. Among households with at least one earner, 4 out 5 have retirement savings less than their annual income.

While our analysis finds that every racial group faces significant risks, but people of color face particularly severe challenges in preparing for retirement. For example, a large majority of black and Latino working age households—62 percent and 69 percent, respectively—do not own assets in a retirement account, compared 37 percent of White households. Three out of four black households and four out of five Latino households age 25-64 have less than $10,000 in retirement savings, compared to one out of two White households.

While experts recommend that people build a nest egg that is at least 8 to 11 times income in order to maintain their standard of living in retirement, a large majority of working households fail to meet conservative benchmarks that assume a retirement age of 67.

Significant retirement security challenges face baby boomers and the upcoming generations of working families. A sustained increase in retirement savings is needed to put all Americans on a path toward financial security. No doubt households need to find ways to sharpen their budgets and save more of their pay for retirement each year. Many individuals, who can, will likely delay retirement or plan for earnings from work to be part of their income in retirement. The

[12] Fidelity Investments, 2012 (Sep. 12), "Fidelity Outlines Age-Based Savings Guidelines to Help Workers Stay on Track for Retirement," http://www.fidelity.com/inside-fidelity/employer-services/age-based-savings-guidelines; Ann Carns, 2012 (Sep. 12), "Suggested Retirement Savings Goals, by Age," http://bucks.blogs.nytimes.com/2012/09/12/suggested-retirement-savings-goals-by-age/. Fidelity assumes 5.5 percent lifetime rate of return on retirement resources, 2.3 percent inflation, and 1.5 percent real (after-inflation) income growth.
[13] Aon Hewitt 2012, op cit., p. 10. Assumptions include career start at age 25; 50th percentile life expectancy; 7.0 percent rate of return on assets before retirement and 5.5 percent after retirement; 3 percent inflation; and 4 percent wage growth.
[14] Aon Hewitt, op cit.; Fidelity 2012, op cit.

nation also needs its employers, especially small businesses, to be come more engaged in assuring greater access to retirement plans in the workplace.

Given the low level of readiness for retirement, strengthening the Social Security safety net, expanding access to low-cost, high quality retirement plans such as the recently-announced my RA proposal and other proposals designed to expand workplace retirement coverage both at state and federal levels, and expanding incentives like the Saver's credit that already helps over 6 million low-income families save for retirement are important policy considerations.

Americans are highly concerned about their retirement prospects; among individuals with incomes less than $35,000, two thirds are very concerned. Americans in this income group told us the barriers they face when saving for retirement include: not having enough income to save (28%); not having enough money to support their family (21%); and not having steady employment (20%). While those individuals earning more than $75,000 cited these situations as barriers about one-third less often. Another striking difference in their views was raising the Social Security normal retirement age to 67, which over two-thirds of those with incomes under $35,000 classified a major factor in marking it more difficult to retire, but only 37 percent of high income respondents felt that same way.

I thank you for holding this hearing today to examine retirement security for working families. I am happy to respond to your questions.