RETIREMENT SECURITY WORSE ON ERISA'S 40TH ANNIVERSARY

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In just nine years, from 2011 to 2020, the number of people over age sixty-five will have increased by more than 14 million, from 41.4 million to 56 million; in twenty years it will increase to 79.7 million.[1] Between 2011 and 2030, approximately 10,000 Americans will turn sixty-five every day.[2]

For older workers near retirement who lost significant portions of their assets in the financial crisis of 2008, the subsequent increase in the equities market did not bring accounts back to target levels.[3] An account with an expected return of 6% annually that loses 25% of its value in one year will need to achieve 41% growth in the following year to meet expected goals.

Older workers are nearing their retirement years with record levels of debt—mortgages, credit cards, student loans—and with lower-than-anticipated levels of income. Their ability to save has diminished, and their predicted ability to retire comfortably is worse now than it was in 1974 when pension coverage was increasing.[4]

The U.S. Census Bureau's Survey of Income and Program Participation forecasts that when current workers between the ages of fifty and sixty-four reach age sixty-five, over 48% will be poor or near-poor.[5]

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1. *A Profile of Older Americans: 2012*, ADMIN. ON AGING, http://www.aoa.gov/AoAroot/Aging_Statistics/Profile/2012/4.aspx (last visited May 29, 2014).

2. *See* D'Vera Cohn & Paul Taylor, *Baby Boomers Approach 65 – Glumly*, PEW RES. CENTER (Dec. 20, 2010), http://www.pewsocialtrends.org/2010/12/20/baby-boomers-approach-65-glumly/.

3. *See* Barbara A. Butrica, *Fact Sheet on Retirement Policy*, 2012 URB. INST. 1, *available at* http://www.urban.org/UploadedPDF/411976_retirement_account_balances.pdf (noting that the average 401(k) plan lost 31% in 2009 from 2007 levels).

4. *See generally* Daniel Cooper, *Changes in U.S. Household Balance Sheet Behavior After the Housing Bust and Great Recession: Evidence from Panel Data*, 13-6 PUB. POL'Y DISCUSSION PAPERS 1, 1–2 (Sept. 6, 2013), *available at* http://www.bostonfed.org/economic/ppdp/2013/ppdp1306.pdf.

5. *See* JOELLE SAAD-LESSLER & TERESA GHILARDUCCI, SCHWARTZ CTR. FOR ECON. POLICY ANALYSIS, NEW RETIREES HAVE INADEQUATE RETIREMENT ACCOUNT BALANCES: ANALYSIS OF THE 2010 SURVEY OF INCOME AND PROGRAM PARTICIPATION (SIPP), WAVE 10, (Aug. 2013), http://www.economicpolicyresearch.org/images/docs/research/retirement_security/Fact_Sheet_Retirement_Balances_using_wave_10.pdf [hereinafter *Analysis*].

Further, although many public-sector workers are seeing employers cut their pensions,[6] about half of private-sector workers have no pension at all.[7] Tens of thousands of older workers are taking Social Security early—foregoing a substantial portion of their maximum benefit—because they have lost their jobs and cannot find employment.[8]

The net result of all this is a budget problem for state and local governments, both because of the decline in tax revenue resulting from lower aggregate incomes, and because people who lose their jobs (or their ability to work full-time) put far more demands on local and state government services than the non-poor. In addition, the creation of a vast new class of formerly middle-class (now poor) elderly individuals will bring with it significant political and social instability.

The blame should not lie with the victim. Without traditional pensions, people are asked to save almost 17% of their income from age twenty-five to sixty-six to maintain their same standard of living.[9] The problems Americans face in planning for their retirement is not a lack of financial education and financial literacy,[10] despite what

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6. *See* Robert Powell, *Public Pension Funds Face Vast Shortfall*, MARKETWATCH (Nov. 13, 2012, 7:01 PM), http://www.marketwatch.com/story/public-pension-funds-face-vast-shortfall-2012-11-13; *see also* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-332, STATE AND LOCAL GOVERNMENT PENSION PLANS: ECONOMIC DOWNTURN SPURS EFFORTS TO ADDRESS COSTS AND SUSTAINABILITY 7 (2012), *available at* http://www.gao.gov/assets/590/589043.pdf ("State and local governments experienced declining revenues and growing expenses on other fronts, and growing budget pressures will continue to challenge their ability to provide adequate contributions to help sustain their pension funds.").

7. Joelle Saad-Lessler & Teresa Ghilarducci, *Explaining the Decline in the Offer Rate of Employer Retirement Plans Between 2001–2012* (Schwartz Ctr. for Econ. Policy Analysis & Research, Working Paper No. 2014-2, 2014) [hereinafter *Explaining the Decline*], *available at* http://www.economicpolicyresearch.org/images/docs/research/retirement_security/Ghilarducci%20Lessler%202014-2%20Final.pdf; *see also* Keith Brainard, *Public Fund Survey Summary of Findings for FY 2008*, 2009 NAT'L ASSOC. ST. RETIREMENT ADMINISTRATORS 3–9.

8. *See* Joyce Manchester, Congressional Budget Office, The Short- and Long-Term Effect of Job Displacement on Social Security Claiming and Work at Older Ages, Panel Paper presented at the Association for Public Policy Analysis & Management Annual Fall Research Conference: Power of the Past – Force for the Future (Nov. 8, 2013, 1:35 PM), *available at* https://appam.confex.com/appam/2013/webprogram/Paper6254.html.

9. *See* MASSI DE SANTIS, MARLENA LEE & DIMENSIONAL FUND ADVISORS LP, HOW MUCH SHOULD I SAVE FOR RETIREMENT? 3 (June 2013), *available at* http://us.dimensional.com/media/50824/How_Much_Should_I_Save.pdf.

10. *See* RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS 11–13, 108 (2008); *see also* Shlomo Benartzi & Richard H. Thaler, *Heuristics and Biases in Retirement Savings Behavior*, 21 J. ECON. PERSP. 81, 99–102 (2007) (arguing that retirement plan design provides better participation rates than educational efforts).

some scholars assert,[11] but of pension design. Human nature has not changed in forty years. In 1974, the psychological tendencies and behaviors of human beings were the same as they are in 2014: people suffer from inertia and shortsightedness—which cause them to emphasize current events over future ones. Humans want to spend more than they have, both then and now. People in 1974 were charmingly overconfident about their ability to work as they aged. Young people in the 1970s also believed Social Security would not be there for them when they retired.[12] People today share the same traits and beliefs as those held in 1974, but in 1974, retirement account coverage at work was growing and retirement savings rates were higher.[13]

What has changed are the institutions that enable workers to save for retirement. A 2003 *New Yorker* cartoon of an older couple talking elicits a worried and wry giggle. The caption reads, "If we take a late retirement and an early death, we'll just squeak by."[14] To succeed under the current American retirement system—the one developed after 1980 by policy makers and the mutual fund industry to replace defined benefit plans with commercial, individual-directed, and voluntary 401(k) plans—it seems you need to know exactly when you are going to retire (or when your employer will lay you off or force you to retire) and when you are going to die. Of course, one rarely knows when those two key retirement planning events will occur.

A system designed for people to rely on voluntary, commercial, and individual-directed retirement accounts has fatal flaws and built-in limitations.[15] People, on their own and with extraordinary luck, have to get their retirement income flow right.[16] The 401(k) individual-account pension design requires that American workers have a good handle on future rates of financial returns, medical care

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11. Annamaria Lusardi & Olivia S. Mitchell, *Financial Literacy and Retirement Preparedness: Evidence and Implications for Financial Education* 14–16 (Univ. of Mich. Ret. Research Ctr., Working Paper No. 144, 2006), *available at* http://www.mrrc.isr.umich.edu/publications/papers/pdf/wp144.pdf.

12. *See* Sally R. Sherman, *Public Attitudes Toward Social Security*, 52 SOC. SEC. BULL. 12, 4–6 (1989).

13. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-01-591SP, NATIONAL SAVING: ANSWERS TO KEY QUESTIONS 21–22 (2001).

14. Barbara Smaller, *Cartoon*, NEW YORKER, July 7, 2003, at 40, *available at* http://archives.newyorker.com/?i=2003-07-07#folio=040; *see also* Jeff Schlegel, *Time & Money*, FIN. ADVISOR MAG. (Mar. 1, 2005), *available at* http://www.fa-mag.com/news/article-1086.html.

15. Teresa Ghilarducci, *Unprepared: Our Flawed Retirement System*, YALE REFLECTIONS (Fall 2013) [hereinafter *Unprepared*], http://reflections.yale.edu/article/test-time-art-aging/unprepared-our-flawed-retirement-system.

16. *Id.*

cost inflation, future costs of home health care and assisted living, and all other factors that will affect future wages, financial returns, and health until they die.[17]

The current American way of retiring requires, in other words, "superhuman" effort.[18] It is a system built for robots with Excel spreadsheets and crystal balls, not real people who live with uncertain labor markets, volatile housing prices, family members with money problems, and a for-profit money management industry that promises to manage your retirement savings but whose top loyalty is to its Wall Street employers.[19]

The United States is the only industrial country that depends on untrained individuals to supplement their own basic Social Security within a system of voluntary contributions and retail-based investment products in order to fund long-term savings.[20] It is like requiring everyone to fix their own car or provide their own workers' compensation insurance. Since the 1980s, the 401(k) and the Individual Retirement Account (IRA) systems have dominated workplace pensions, but still only half the workforce has such a pension.[21] In theory, 401(k) and IRA plans were meant to be convenient for employees, a way to supplement their basic pension and Social Security. In practice, 401(k)s and IRAs (most of the money in IRAs are from 401(k) plans)[22] shifted complex decisions and a great deal of risk from employers to workers. There has been no improvement in workplace retirement account coverage in thirty years.[23]

For workers trying to save for retirement, their ability to do so has never been worse. Using the current population survey, I found that from 2001 through 2012, there was a dramatic drop in employer sponsorship of retirement plans, from 61% down to 53%.[24] Retirement plan coverage rates fell 13% between 2001 and 2012.[25] This is a reversal of recent optimistic trends; between 1950 and 1979, retirement account sponsorship rates doubled from 25% to 50% and leveled

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17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.; see generally* Lusardi & Mitchell, *supra* note 11 (comparing international examples of the impact of financial literacy and the impact of the United States's dependence on saving on retirement security).

21. *See Analysis*, *supra* note 5.

22. *See* Craig Copeland, *Individual Retirement Account Balances, Contributions, and Rollovers, 2011: The EBRI IRA Database*, 386 EMP. BENEFIT RES. INST. ISSUE BRIEF 1, 4 (2013).

23. *Unprepared*, *supra* note 15.

24. *Explaining the Decline*, *supra* note 7, at 3.

25. *Id.* at 4.

off.[26] ERISA was passed in 1974 and set into law funding and vesting practices that were already in place by many of the largest firms. In 2001, coverage rates began to fall steadily.[27] A larger share of employees are not covered by any type of retirement account, neither a defined contribution nor defined benefit plan; this diminishes their ability to save consistently for retirement and their ability to adequately supplement their Social Security benefits.[28]

Although a sixty-five-year-old man has a one in five chance—and a sixty-five-year-old woman has a one in three chance—of living until ninety,[29] everyone is advised to save as if they will in fact reach their ninth decade because no one wants to run out of money.[30] That means, to plan properly under the American system is to hoard a lot of cash.[31] And, because the system requires individuals to save in individual retirement accounts that can be tapped at any time, people are forced to invest for the short term in liquid, high-priced retail mutual funds.[32] The rates of return are much lower than they could be because 401(k) plans and IRAs are retail products managed by for-profit firms with large sales forces.[33]

Also, the system is highly subsidized with taxpayer money. Policymakers exempted regular pension, 401(k), and IRA contributions from being taxed, hoping to ensure that all workers would have enough savings for retirement.[34] But because those tax advantages are tax deductions rather than refundable tax credits, the highest paid employees with the highest contributions and highest tax rates get the most subsidies. Eighty percent of the tax breaks for retirement accounts go to the wealthiest 20% of taxpayers.[35]

But the problem for most Americans is not too much cash in retirement accounts. As seventy million Americans between the ages

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26. *Id.* at 3.

27. *Id.*

28. *Id.*

29. *Census Bureau Releases Comprehensive Analysis of Fast-Growing 90-and-Older Population*, U.S. CENSUS BUREAU (Nov. 17, 2011), http://www.census.gov/newsroom/releases/archives/aging_population/cb11-194.html.

30. *Unprepared*, *supra* note 15.

31. *Id.*

32. *Id.*

33. *See Analysis*, *supra* note 5.

34. *Id.*

35. *See* ERIC J. TODER, BENJAMIN H. HARRIS, KATHERINE LIM & URBAN-BROOKINGS TAX POLICY CTR., DISTRIBUTIONAL EFFECTS OF TAX EXPENDITURES (July 21, 2009), *available at* http://www.taxpolicycenter.org/UploadedPDF/411922_expenditures.pdf (examining the distributional effects of three of the largest groups of tax expenditures—those that subsidize owner-occupied housing, medical care, and retirement savings).

of fifty and sixty-four head into their retirement years, we need to stop pretending that the American system works. Seventy-five percent of Americans nearing retirement age in 2010 had less than $30,000 in their accounts.[36] If required to stretch that money over twenty years, an older person would need to be able to live on $4 per day, not adjusted for inflation. "Nothing" is a better description of what most people have in their retirement accounts.

The average national balance is low because many American households have no retirement accounts at all.[37] Because of the tax break, the richer someone is, the more likely he or she is to have a retirement account. Less than 30% of older lower-middle class individuals—those who earn less than $20,000 per year—have any kind of retirement account.[38] A large portion—more than one in five (23%)—of older Americans earning in the top quarter of the income distribution have no retirement savings.[39] Using simple algebra and making reasonable assumptions about interest rates, employment rates, and mortality tables, most people at age fifty or so should have ten times their annual salary in a retirement account. The average person between fifty and sixty-four has $30,000 in her account when she should have half a million.[40]

Who or what is to blame for the lack of retirement savings? It is impossible to believe that the lack of knowledge about saving is responsible. A large industry that advertises the need for retirement savings is growing. Media gurus, including Suze Orman and David Ramsey, among others, abound.

Is it that average Americans spend too much and do not care about retirement? Lots of pundits will blame the victim. Financial planner David Bach made a splash when he suggested that the root cause of the retirement crisis was a "daily latte factor"—flawed humanity's need for small luxuries and resistance to delaying consumer gratification and to saving for a secure retirement.[41] To make the point that lack of planning and budgeting is the reason people do not have savings—and not low wages or an inadequately designed national retirement savings structure—the McDonald's Corporation

36. *Analysis*, *supra* note 5.

37. NARI RHEE & NAT'L INST. ON RET. SEC., THE RETIREMENT SAVINGS CRISIS: IS IT WORSE THAN WE THINK? 1 (June 2013), *available at* http://www.nirsonline.org/storage/nirs/documents/Retirement%20Savings%20Crisis/retirementsavingscrisis_final.pdf.

38. *Analysis*, *supra* note 5.

39. *Id.*

40. *See id.*

41. *See* David Bach, *Back to the Basics with the Latte Factor®*, DAVID BACH BLOG (Oct. 3, 2011), http://www.finishrich.com/blog/back-to-the-basics-with-the-latte-factor%C2%AE/.

and Visa created a "Practical Money Skills" website that shows how saving for retirement is in reach for a fast food worker.[42] (Critics pounced because the budget allows nothing for children or for extra heat in the winter and it budgets $20 per month for health care).[43]

But wages are the only source of savings for most people. Over the past year, hourly earnings have risen only 1.9% and the minimum wage—last raised in 2009—is now $7.25 an hour, which, adjusted for inflation, is 20% less than in 1968.[44]

Continuing the argument that modern behavior is the reason the system is faulty, the Investment Company Institute (the lobbying arm of the mutual fund industry) shows that a human can attain retirement comfort if she acts in ways that humans do not act.[45] The Institute's spreadsheets show that if one starts saving early, earns 5% adjusted for inflation over a thirty-five-year time span, and never uses the money for thirty-five years, a worker can have enough saved to maintain a good standard of living in retirement.[46] Yes, a robot with a spreadsheet could save 5% of every paycheck for its entire career, but human beings are embedded in social and familial relationships, where a pile of money just sitting there would be immoral to keep if a loved one needed education, health care, or bailing out of jail.

We have become convinced that the jam we are in is all our fault. But it is not. This is not just a personal problem. It is a pension-design problem that will quickly become a national problem, affecting large numbers of poor and near-poor Americans facing retirement and old age.

What is an individual to do with the system we have? First, do not give up on changing the system; vote for Social Security and Medicare strength and expansion, and support politicians who will regu-

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42. *See* Press Release, McDonald's USA and Visa Inc., McDonald's® USA and Visa Inc. Launch America's Largest Employer-Based Financial Literacy Initiative, (Dec. 4, 2008), *available at* http://www.practicalmoneyskills.com/about/press/releases/120408.php.

43. *See, e.g.*, Amy Langfield, *McDonald's Finance Guide 'Insulting' to Low-Wage Workers*, CNBC (July 16, 2013, 10:06 AM), http://www.cnbc.com/id/100889874; Leslie Patton, *McDonald's Employee Budget Planner Assumes 2 Jobs at $13 an Hour*, BLOOMBERG (July 15, 2013, 3:42 PM), http://www.bloomberg.com/news/2013-07-15/mcdonald-s-employee-budget-planner-assumes-2-jobs-at-13-an-hour.html; Martha C. White, *The Dollar Menu for Rent and Gas: McDonald's Budget Advice for Employees Falls Short*, TIME (July 18, 2013), http://business.time.com/2013/07/18/the-dollar-menu-for-rent-and-gas-mcdonalds-budget-advice-for-employees-falls-short/.

44. *Analysis*, *supra* note 5.

45. *See* Teresa Ghilarducci & Joelle Saad-Lessler, *401(k) Industry Report Debunked*, SCHWARTZ CENTER FOR ECON. POL'Y ANALYSIS BLOG, http://www.economicpolicyresearch.org/index.php/guaranteeing-retirement-income/580-industry-report-debunked-sp-479474577 (last visited May 29, 2014).

46. *Id.*

late and reform the system. One key area of reform is fees. No fund manager will likely "beat the market" for long enough to justify his or her fees. Most everyone is better off eliminating all active funds and switching to index or to passive funds.[47] Index or passive management can be done very cheaply, by virtue of its hands-off approach. This savings is passed on to the investor. Active management, by nature, costs more. A sophisticated review of the economics literature published in 2013 concluded that from 1980 to 2006, financial services almost doubled: from 4.9% to 8.3% of GDP, partly due to increases in the fees for asset management paid by individuals and by pension funds.[48] Investors did not get better returns from these fees.[49] Actively managed equity and bond funds underperform index funds net of fees.[50]

Here is how fees reduce rate of return. Index funds charge one-tenth of 1% of the assets under management.[51] Over ten years, your $100,000, earning the stock market average of 5%, gives you a return of 4.9% after fees, leaving you with $161,300. But the actively managed fund is likely to charge twenty times more, or 2%.[52] That means it earns, functionally, 3%, leaving the investor with only $134,300.[53] That is a whopping 44% less.[54] Over ten years, you have lost $27,000—not to market performance, but just to fees.[55] That is the math of compounding interest: every 1% drop in the rate of return leads to a 20% drop in total return.[56]

If, forty years after ERISA, a person turning sixty-five is inadequately prepared for retirement, it is very likely not his or her fault.

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47. Passive investing is more profitable than active investing because of high fees charged by actively invested fund managers. *See, e.g.*, U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-325, 401(K) PLANS: INCREASED EDUCATIONAL OUTREACH AND BROADER OVERSIGHT MAY HELP REDUCE PLAN FEES 36 (2012), *available at* http://www.gao.gov/assets/600/590359.pdf; Burton G. Malkiel, *Asset Management Fees and the Growth of Finance*, 27 J. ECON. PERSP. 97, 105 (2013); Emily Brandon, *Hidden 401(k) Fees You're Probably Paying*, U.S. NEWS MONEY (May 25, 2012), http://money.usnews.com/money/blogs/planning-to-retire/2012/05/25/hidden-401k-fees-youre-probably-paying; Michael A. Fletcher, *GAO: 401(k) Companies Often Mislead Account Holders*, WASHINGTON POST (Apr. 2, 2013), http://www.washingtonpost.com/business/economy/gao-401k-companies-often-mislead-account-holders/2013/04/02/71683d3e-9bc1-11e2-9a79-eb5280c81c63_story.html.

48. Robin Greenwood & David Scharfstein, *The Growth of Finance*, 27 J. ECON. PERSP. 3, 3 (2013).

49. *Id.* at 14.

50. *Id.* at 13 n.8.

51. *Unprepared*, *supra* note 15.

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.*

The money management industry is not on the side of its clients. The voluntary, individual account business is one of the most profitable but most lightly regulated aspects of the financial industry, and it has a lot of money for lobbyists who are paid to oppose tighter regulations.

Our society has made a commitment to its citizens' retirements in deliberate and meaningful ways since the sensible construction of Social Security. All workers need a guaranteed pension to supplement their Social Security for the rest of their lives. All workers, rich or poor, need to have some time to themselves, on their own terms, at the end of their working lives.