



Testimony of Aaron Friedman
Before the Connecticut Retirement Security Board
November 19, 2014 – 4 PM

INTRODUCTION

Good Afternoon. My name is Aaron Friedman, and I am an Assistant Vice President at Principal Financial Group, where, among other things, I serve as the National Practice Leader for retirement plans for tax-exempt organizations. I have lived in Trumbull, Connecticut for the last 23 years, and I work in Shelton. My background and experience includes 28 years in industry with expertise as an actuary, a consultant around retirement plan design and operation consistent with the tax code and ERISA, as well as product and investment design and compliance. I am here on behalf of the Securities Industry and Financial Markets Association (SIFMA), a national trade association which represents hundreds of securities firms, banks and asset managers, including Principal Financial Group.

I appreciate the opportunity to appear before you today. I hope you have had a chance to review SIFMA's fairly detailed written response to your request for public comment. I would like to highlight a couple key points in that document and then spend the rest of my allotted time speaking specifically about investments.

We would all agree that there is a retirement savings challenge in this country today. Individuals need to save more for retirement and need to better understand the benefits of compounding interest, diversification, and not accessing retirement savings accounts for other purposes. Where we might disagree is how best to meet that challenge.

SIFMA strongly feels that the existing private market is well suited to address the retirement needs of investors. And we are all aware of and support the new federal retirement program created by President Obama known as myRA (My Retirement Account). This payroll deduction program, which will be rolled out in late 2014, is described as a "simple, safe, affordable" way to save for retirement. It is backed by the U.S. Government, has Roth IRA tax advantages, and is portable for employees. Information can be found on the U.S. Treasury website at www.treasurydirect.gov/readysavegrow/readysavegrow.htm. We would encourage you to fully evaluate this new federal program before creating an expensive state alternative. Furthermore, SIFMA supports additional tax incentives to encourage more employers to provide retirement savings plans as well as possible public/private partnerships to highlight existing low-cost retirement savings options.

INVESTMENTS - ACCESS

The market for retirement savings alternatives in Connecticut is robust and highly competitive. There are currently 25,833 individuals in Connecticut working in the securities industry and a total of 114,325 people in the State employed by entities falling within the broader category of finance and insurance. These industries all provide numerous fairly priced retirement savings options, including 401(k), 403(b), 401(a), and 457(b) plans as well as SIMPLE, SEP and traditional and Roth IRAs. In fact, earlier this year, ThinkAdvisor rated Connecticut as the #1 state for 401k(s) in the country based on its concentration of strong plans, with plans measured on their design, management and performance. In addition, for those without an employer option, IRAs are also readily available on-line and at most financial institutions in the State.

With plenty of low cost savings options available, access is not the problem. The question then becomes, what factors other than access may be preventing workers from saving for retirement? Certainly, educating people about the importance of saving for retirement would encourage those who have the resources but haven't prioritized the issue. A study from the Investment Company Institute, however, shows the primary reason that people don't save is competing financial needs. (*ICI Research Perspective Volume 17, No 7., October 2011*) If lack of resources is the fundamental issue, then a new retirement system with an employee opt-out capability, however well-intentioned, will not address the problem.

It is also critically important that any proposal does not encourage employers with strong existing plans to switch over to the State provided alternative. The State is looking to enhance, not reduce, retirement savings. Offering options that encourage employers that are already providing retirement plans to re-evaluate their offerings does not satisfy that objective.

INVESTMENTS – OBJECTIVES AND OTHER CONSIDERATIONS

In order to discuss investments, it is first important that we start with a context. Investments and investment products do not exist in a vacuum, but serve to meet specific needs and achieve particular objectives. The fact of the matter is that different people with different levels of income, financial sophistication, and different time horizons will all have different objectives and different needs from their investments.

The question of retirement adequacy and savings rates:

As we look to identify the needs that have to be satisfied, it is paramount that we acknowledge the tremendous cost of retirement savings. The RFI asks for recommendations on default contribution rates, but that avoids the critical questions of what level of retirement income is the Board trying to achieve and over what time frame? Some examples might help the discussion.

Examples:

<u>Annual Contribution Rate</u>	<u>Annual Return</u>	<u>Income Replacement Ratio for a Person in the system 40 years</u>	<u>Income Replacement Ratio for a Person in the system 20 years</u>
3%	3%	approx. 10%	< 5%
6%	3%	approx. 20%	<9%
6%	6%	approx. 40%	11-12%

These projections are done assuming 1.5% average wage increase and individual annuity purchase rates. Assumptions could be changed, but they will not significantly change the magnitude of the results.

I note that the Center for Retirement Research at Boston College has gone as far as to say the savings rate should be 14% of income over a career. Contribution rate is important over a career, but even more important is the effect of compounding higher returns over a career. This is essential to getting to successful income replacement rates. An important thing to note – to generate higher returns you must take on higher market risks.

Challenges

1. It may not be appropriate to take on those levels of risk for individuals with shorter time horizons. They might not have the time to recover from inevitable market downturns.
2. Not everyone has the same level of risk tolerance. Even those with longer time horizons may have different risk tolerances and needs.

In the world of investing, investments must be suitable to individuals' needs and risk tolerances. There are significant regulations to ensure that investments are suitable to the investor's needs, objectives and risk tolerance. **One size does NOT fit all.**

Variations in the market

There is a great deal of variation in product structure to satisfy the needs, objectives and risks tolerances in a diverse population. They range from insurance company guarantees to balanced target date funds that become more conservative over time to aggressive portfolios that allow individuals to balance their own risk tolerances against potential returns. Investment styles can be active or passive, or a combination. Because of this variation and diversity, it is essential that there are resources to help. The resources include:

- Online tools
- Telephonic support
- Access to financial professionals that can help navigate the options.

INVESTMENT - PRODUCTS

To a large extent, specific products and product types are tied to the legal structure of the plan. For example, there are different products that can be offered to plans qualified under section 401(a) of the internal revenue code that cannot be offered to IRAs.

SIFMA believes the only way to address the diverse needs, objectives and risk tolerances of a diverse population is to provide a diverse set of options for individuals which would be suitable to their needs. There must also be resources available to help individuals navigate the complexity. There are several categories that should be taken into account.

1. Stable Value. A typical stable value fund is a conservative bond portfolio that seeks conservation of principal that is complemented with insurance contracts that allow market fluctuations to be smoothed out over time. A stable value fund is only available to 401(a) plans and government 457 plans. Due to rules under the Securities Act of 1933, they are not available to IRAs. These tend to be used by those with short investment timelines or those that are risk averse.
2. Insurance Company Guaranteed Contracts/Annuities. These are also used by those with short investment time horizons or those that are risk averse. In these products, the insurance company guarantees principal and a rate of interest and takes on all of the risk. Individuals do not see any market fluctuation. These products can be used with IRAs.
3. Indexed Annuities. These are technically fixed annuities that buy options on the stock market so have the potential for gain above the minimum guarantee. It is important to understand that these do not “insure” the stock market. Although these are suitable in some cases, they tend to be expensive and securities regulators have paid a great deal of attention to ensuring they are not misused.
4. Target Date Funds. These are balanced portfolios of both stocks and bonds that are managed with a higher allocation to stocks in early years and gradually introduce more conservative bonds over time as it gets closer to the targeted “retirement date”.
5. Target Risk Funds. These are a mix of stocks and bonds that are targeted to an individual’s tolerance for risk. They do not change the allocation over time.
6. A general mix of funds with different investment objectives. This is necessary for individuals that want to customize their investment portfolio by themselves or in conjunction with a financial professional.
7. Active versus Passive strategies. It is appropriate to include both active and passive strategies. While this is a topic that has been debated for many years, the fact is that both strategies have advantages and disadvantages, and options need to be available to meet the preferences of individuals.

LEGAL CONSIDERATIONS

ERISA considerations

1. It is extremely important that the ERISA applicability question be addressed early in the Board's review process. The US Department of Labor is the regulator responsible for enforcement. The SIFMA comment letter provides the appropriate questions to ask formally of the Department of Labor. We would encourage you to look closely at a 2012 Advisory Opinion to Governor Malloy which found that an ERISA exemption for governmental plans does not apply when the plan participants are not government employees. The ERISA decision, of course, has a significant impact on cost and liability.
2. In addition, with respect to risk management, ERISA has played a positive role in protecting plan participants in ERISA-covered plans. ERISA sets forth many requirements regarding prudence and risk management, including making timely contributions, mapping and defaulting investment options, analyzing and understanding plan expenses, reporting, and more. We would suggest the Board adopt a risk management structure consistent with ERISA regardless of DOL's determination on ERISA applicability. Liability and risk - for the state and for participants - do not disappear in the event that the plan is deemed ERISA exempt.

Securities considerations

1. In the event that the Board is considering that the state will manage investments, SIFMA recommends that this Board vet the requirements for registration under the Federal Securities Act of 1933 and the Investment Company Act of 1940. Any discussion of the cost of investment management would change significantly with the addition of registration and compliance costs.
2. Whether the plan's investments are managed by the state or existing market products are used, the Board should vet the requirements of the Federal Securities Exchange Act of 1934 which applies rules to those acting as a broker/dealer, including the suitability requirements mentioned earlier.
3. The Board should also vet the state securities laws of neighboring states to ensure there will be no violations on behalf of commuters from those states.

This Board has a very important task ahead of it. I'm confident when you review the facts, the real hurdles to savings and the robust offerings that already exist in the marketplace, that the Board will make responsible recommendations. I appreciate the opportunity to provide feedback, and I look forward to your questions.

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Peter Brady, ICI Senior Economist, and Michael Bogdan, ICI Associate Economist, prepared this report.

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This paper is an update to "Who Gets Retirement Plans and Why," originally published in September 2008 and updated in March 2011.

Who Gets Retirement Plans and Why, 2010

KEY FINDINGS

- » **Most workers who are likely to have the ability to save and to be focused primarily on saving for retirement are covered by an employer-provided retirement plan.** Of those most likely to desire to save for retirement in the current year, three-quarters had access to a pension plan through their own employer or their spouse's employer, and 93 percent of those with access participated.
- » **Younger and lower-income households are more likely to report that they save primarily for reasons other than retirement—for example, to fund education, to purchase a house, to fund other purchases, or to have cash on hand in case of an unexpected need.** Economic analysis suggests that these preferences are rational. Older and higher-earning workers are more likely to save primarily for retirement, and thus are more likely to prefer having a portion of their compensation in the form of retirement benefits rather than fully in cash.
- » **Access to retirement plans at work is not randomly distributed throughout the workforce.** The probability that an employee works for a firm that sponsors a plan is highly related to the employee's characteristics. In particular, employees who work for firms that sponsor plans are more likely to be older, have higher earnings, and work full-time for a full year.
- » **Workers at small employers that sponsor retirement plans are as likely to participate as workers at large employers sponsoring retirement plans.** Although only 18 percent of workers at firms with fewer than 10 employees have an employer that sponsors a plan—compared with 69 percent of workers at firms with 1,000 employees or more—if a firm sponsors a plan, approximately 80 percent of employees participate, regardless of firm size.
- » **Differences in workforce composition appear to be a primary cause for the lower rate at which small employers sponsor retirement plans.** As a group, the characteristics of small-firm employees differ substantially from the characteristics of large-firm employees. Nevertheless, workers at small firms that sponsor plans are very similar to workers at large firms that sponsor plans, and workers at small firms that do not sponsor plans are very similar to workers at large firms that do not sponsor plans.

Key findings continued on the next page

- » **It is of vital importance to maintain a Social Security system that provides adequate benefits to workers with low lifetime earnings.** Even the best-designed voluntary private-sector retirement system is unlikely to provide adequate resources to fund retirement consumption for workers who find they have inadequate resources to fund consumption in years when they are working.

Introduction

There is considerable interest in developing public policies to increase the number of employers that sponsor workplace retirement plans and to increase employee participation at firms that currently offer plans. As the retirement industry and policymakers try to increase coverage, it is important to understand the motives at play, including why more employers do not currently sponsor plans. To that end, it is necessary to understand which workers currently have access to and participate in employer-sponsored retirement plans, and why certain employees desire, and certain employers offer, compensation in the form of retirement benefits.

Which Workers Want Retirement Benefits?

Workers search for jobs that offer them the most valuable compensation packages. Individuals who wish to save for retirement value pension benefits because the benefits offer favorable tax treatment and other advantages such as the pooling of investments. However, because of the restrictions and tax penalties placed on accessing retirement benefits

prior to retirement, some individuals who are not focused on saving for retirement would prefer to have compensation that consists only of cash to an otherwise equivalent compensation package that includes both cash and pension benefits.

Why Do Firms Sponsor Retirement Plans?

Because employers compete with one another to hire workers, they create compensation packages that will help them attract and retain qualified workers. In structuring compensation, employers can compensate their workers with cash or noncash benefits, such as retirement plans. However, the amount of compensation they can offer their employees is limited by the need to keep the products and services that they sell competitively priced. Therefore, employers are more likely to offer retirement benefits as part of their compensation packages if their workforces value such benefits. It is reasonable to predict that the likelihood of a firm offering retirement benefits is greater if a higher proportion of its workforce has the ability to save and is focused on saving for retirement.

This paper is an update to “Who Gets Retirement Plans and Why,” first published in September 2008 (available at www.ici.org/pdf/per14-02.pdf) and first updated in March 2011. This update is a summarized version of the original paper. For the most recent detailed analysis, see “Who Gets Retirement Plans and Why: An Update” (available at www.ici.org/pdf/per17-03.pdf).

As part of this update, additional tabulations that provide the detailed data needed to replicate the figures contained in the March 2011 report for the years 1979 to 2010 are available in the supplemental tables (available at www.ici.org/info/per17-07_data.xls).

More formally, a firm sponsors a retirement plan if the associated reduction in the firm's direct compensation costs (cash compensation plus retirement benefits) is sufficient to cover the costs incurred by the firm to set up and administer the plan. A firm would not offer retirement benefits if doing so would increase their total compensation costs. Total compensation costs would increase if the costs incurred by the firm to set up and administer a retirement plan were greater than the associated reduction in the firm's direct

compensation costs (cash compensation plus retirement benefits that accrue to employees). This would be the case if a firm's employees valued retirement benefits no more highly than cash compensation. It also would be the case if a firm's employees valued retirement benefits more highly than cash compensation, but the costs incurred by the firm to set up and administer a retirement plan would be greater than the associated reduction in the firm's direct compensation costs.

How the Terms Pension Plan and Retirement Plan Are Used in This Report

Often the term *pension* is used to refer to a traditional defined benefit (DB) plan, and *retirement plan* is used to refer to a defined contribution (DC) plan. In this *ICI Research Perspective*, the two terms are used interchangeably. Specifically, the term *pension* or *pension plan* refers to both DB plans and DC plans, including 401(k) plans.*

The Department of Labor has stated:

"The Employee Retirement Income Security Act (ERISA) covers two types of pension plans: defined benefit plans and defined contribution plans....Examples of defined contribution plans include 401(k) plans, 403(b) plans, employee stock ownership plans, and profit-sharing plans."[†]

The Current Population Survey (CPS), the primary source of data on pension coverage that are used in this *ICI Research Perspective*, also does not distinguish between DB plans and DC plans when asking whether a worker's employer offers a plan.

The question for pension coverage in the March CPS is:

Other than Social Security, did [any] employer or union that (name/you) worked for in [the past year] have a pension or other type of retirement plan for any of its employees?

* The Internal Revenue Code makes distinctions among pension, profit-sharing, and stock bonus plans. And, because most 401(k) plans are profit-sharing plans, they would be distinguished from pension plans under tax law. However, the distinction between the plans is not because one type is a DB plan and one is a DC plan. Rather, under tax law, the primary difference between pension plans and profit-sharing plans is that employer contributions to DC pension plans cannot be based on company profits, whereas employer contributions to profit-sharing plans may be based on company profits—although they are not required to be. (See 26 C.F.R. § 1.401-1 "Qualified pension, profit-sharing, and stock bonus plans.") For example, money purchase plans are a type of DC plan and they are classified as pension plans under tax law. In general, pension, profit-sharing, and stock bonus plans are governed by many of the same sections of the Internal Revenue Code.

[†] See www.dol.gov/dol/topic/retirement/typesofplans.htm.

Why Do Households Save?

Analysis of survey data shows that younger and lower-income households were less likely to cite retirement as the primary reason they save. These households were more likely to be primarily focused on saving to fund education, to purchase a house, to fund other purchases, or to have cash on hand for an unexpected need.

The tendency of younger workers to focus less on retirement savings is consistent with economic models of life-cycle consumption, which predict that most workers will delay saving for retirement until later in their working careers.

The structure of government transfer programs is consistent with lower-income households focusing less on retirement savings. For example, most government programs aimed at lower-income households attempt to supplement income and increase these households' current consumption; it is unlikely that these same households wish to reduce current consumption to save for retirement. Moreover, Social Security benefits replace a higher percentage of pre-retirement earnings for individuals with low lifetime earnings, making lower earners less likely to desire to save for retirement at any given age.

In addition to age and income, part-time and part-year workers are unlikely to desire to save for retirement in the current year. To some degree, this is because the bulk of these workers has low earnings and likely will receive a high earnings replacement rate from Social Security. But, in part, this also is because many workers who are currently working part-time or part-year typically may work full-time or for a full year. If earnings in the current year are below typical earnings, individuals are unlikely to want to reduce current consumption further by saving—either for retirement or for other reasons.

Are Certain Types of Workers More Likely to Work for Firms with Retirement Plans?

In 2010, 50 percent of private-sector wage and salary workers aged 21 to 64 reported that their employers sponsored retirement plans (Figure 1). However, access to employer-sponsored retirement plans is not distributed randomly throughout the workforce. Consistent with the focus of households on saving for retirement, younger workers, lower-earning workers, part-time workers, and part-year workers are less likely to work for firms that sponsor retirement plans.

Thirty-nine percent of workers aged 21 to 29 worked for employers that sponsored retirement plans in 2010, compared with 57 percent of workers aged 55 to 64 (top panel, Figure 1). Twenty-three percent of workers in the lowest quintile of annual earnings (\$14,000 or less) worked for employers with retirement plans, compared with 74 percent of workers in the highest quintile (\$60,000 or more) (middle panel, Figure 1). Employees also were more likely to report that they worked for an employer that sponsored a plan if they were more fully engaged in the workforce: 58 percent of employees who worked full-time for a full year reported that their employer sponsored a plan in 2010, compared with 24 percent of employees who worked part-time for part of the year (bottom panel, Figure 1).

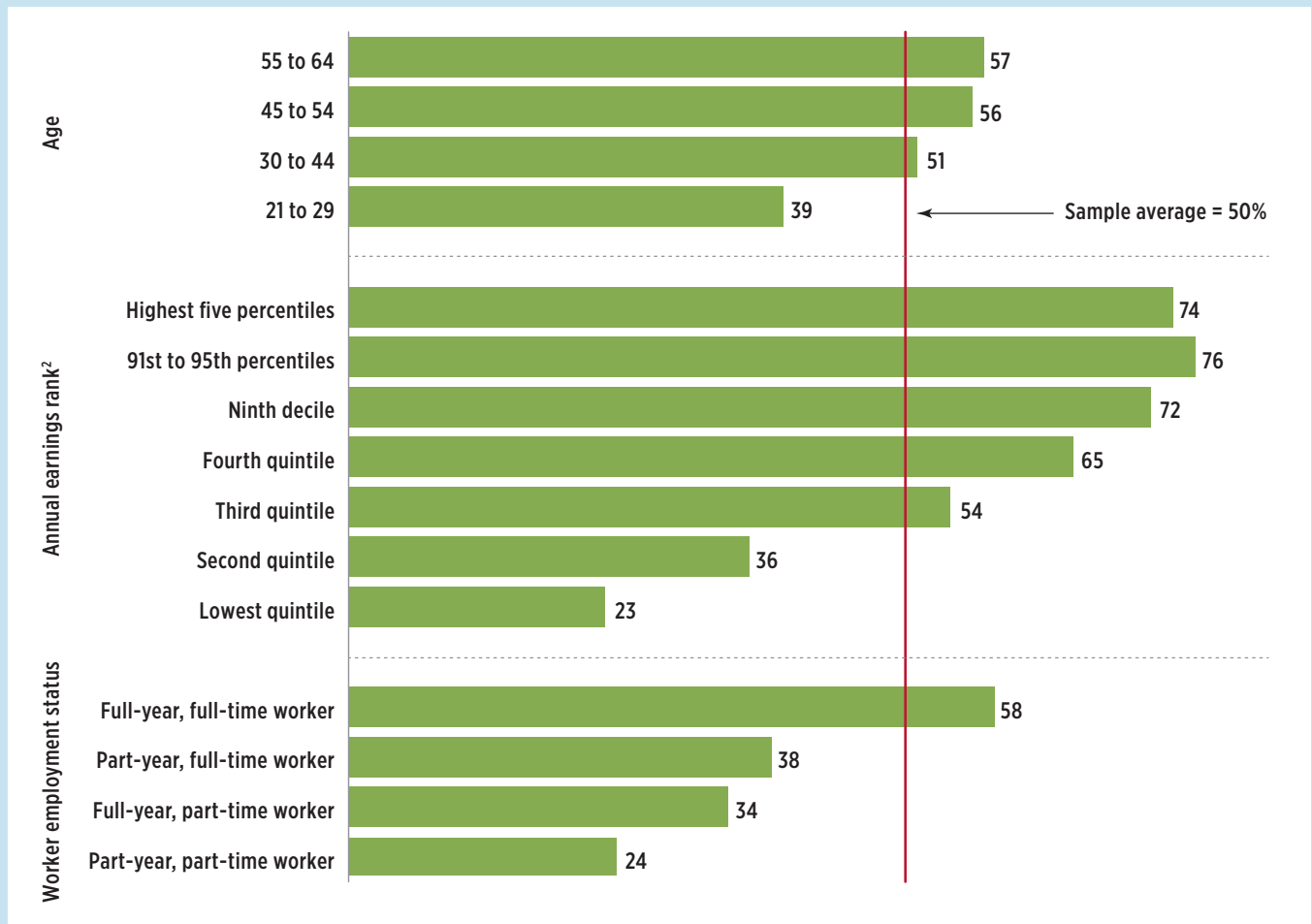
The fact that worker characteristics are related to the employer's decision to sponsor a plan suggests that worker demand* for retirement benefits plays a key role in determining which employers sponsor retirement plans.

* In this paper, the term *demand* is used in accordance with its meaning in economic theory. An individual worker is said to “demand” pension benefits if he or she would prefer a compensation package that combines cash and pension benefits to a package with an equal amount of total compensation but consisting of cash alone. If an individual demands a pension, that in no way implies that the worker communicates this preference in any direct manner to his or her employer or that the individual will be offered a pension by an employer.

FIGURE 1

Probability That Employers Sponsor Retirement Plans by Various Employee Characteristics

Percentage of private-sector wage and salary workers aged 21 to 64 whose employers sponsor plans,¹ 2010



¹ Survey respondents are asked whether any worker at their employer is eligible to participate in a retirement plan. The figure plots the percentage of employees answering affirmatively.

² The lowest earnings quintile includes individuals with \$14,000 of earnings or less; the second quintile includes those with earnings from \$14,000 to \$25,000; the middle quintile includes those with earnings from \$25,000 to \$39,000; the fourth quintile includes those with earnings from \$39,000 to \$60,000; the ninth decile includes those with earnings from \$60,000 to \$85,000; the 91st to 95th percentiles include those with earnings from \$85,000 to \$112,000; the highest five percentiles include those with earnings from \$112,000 or more.

Note: For more detailed information on the earnings rank calculations, see the notes page in the supplemental tables (available at www.ici.org/info/per17-07_data.xls).

Source: Investment Company Institute tabulations of March 2011 Current Population Survey

The starkest difference in sponsorship across groups of workers, however, is not related to a worker characteristic, but rather to a characteristic of the employer—namely, employer size as measured by the number of employees. Only 18 percent of workers at firms with fewer than 10 employees reported that their employer sponsored a retirement plan in 2010, compared with 69 percent at firms with 1,000 or more workers (left panel, Figure 2). Why sponsorship rates vary so markedly by firm size is examined below.

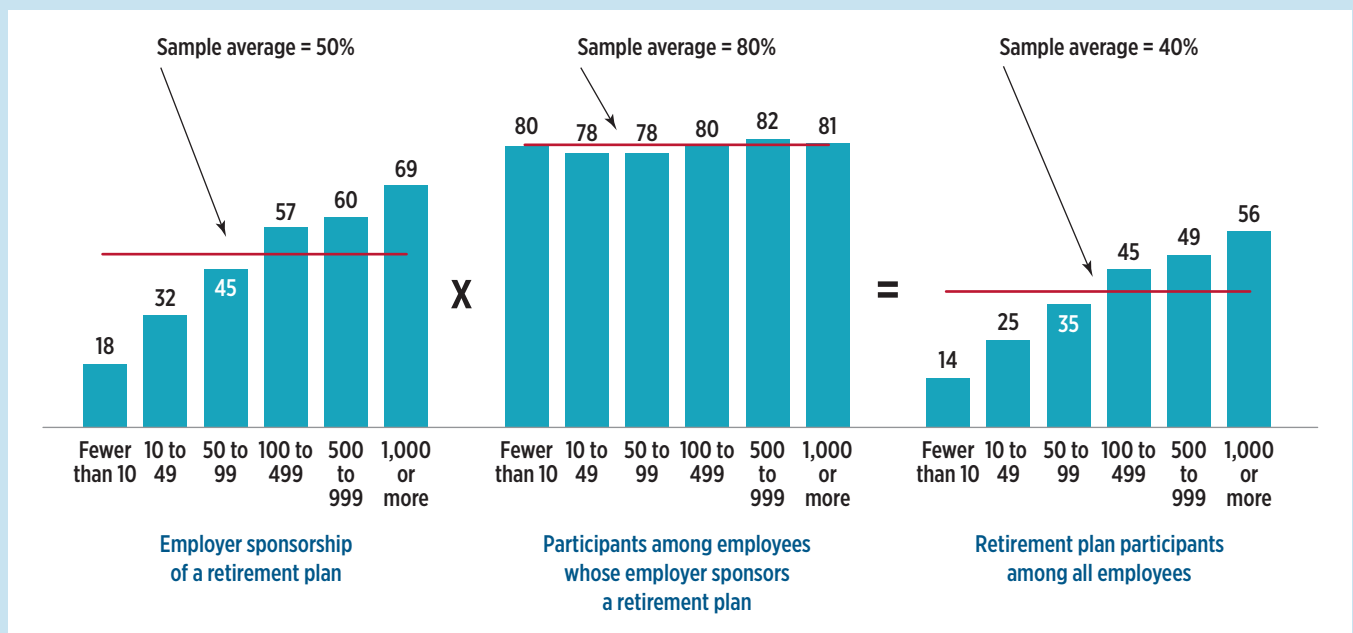
Are Certain Types of Workers More Likely to Participate in Retirement Plans?

As with employer sponsorship, there are significant differences between groups of workers in the proportion that participate in a retirement plan. For most characteristics used to classify workers, these differences are primarily driven not by the employee’s decision to participate in a plan if one was offered, but by his or her employer’s decision to offer a plan. For example, the percentage of workers participating in a plan ranged from 14 percent for workers at firms with fewer than 10 employees to 56 percent for workers at firms with 1,000 or more employees (right panel, Figure 2). However, this pattern primarily is driven by differences in sponsorship rates. Of those working for a firm that sponsored a plan, participation rates averaged 80 percent and varied little by firm size, ranging from 78 percent to 82 percent (middle panel, Figure 2).

FIGURE 2

Retirement Plan Sponsorship and Participation Rates by Firm Size

Percentage of private-sector wage and salary workers aged 21 to 64 by firm size (number of employees), 2010



Note: Survey respondents are asked whether any worker at their employer is eligible to participate in a retirement plan. The first panel plots the percentage of employees answering affirmatively. Survey respondents who say their employer offers a plan are then asked if they participate in the plan. The second panel plots the percentage of individuals whose employer sponsors a plan and who answers the second question affirmatively. The third panel reports all respondents who participate in a plan as a percentage of all workers, including those who said that their employer does not sponsor a plan.

Source: Investment Company Institute tabulations of March 2011 Current Population Survey

Alternative Explanations for Why Retirement Plan Sponsorship Rates Differ by Firm Size

Given the importance of the employer's decision to sponsor a plan and the focus of public policy on increasing sponsorship by small firms, this section examines differences in sponsorship rates by firm size in more detail.

There are two potential explanations for why small firms are less likely to sponsor retirement plans: (1) small firms incur higher per-employee administrative costs than large firms and (2) small-firm employees do not value retirement benefits as highly as do large-firm employees.

If the costs of setting up and administering a plan have a significant fixed component that does not vary with the number of employees covered, then small firms will have much higher per-employee costs associated with a plan than large firms. In this case, even if employees at a small firm value retirement benefits as much as employees at larger firms that sponsor plans, smaller firms will be less likely to sponsor a plan because of higher per-employee administrative expenses.

Alternatively, small firms may have lower sponsorship rates because small-firm employees are systematically different from large-firm employees. Specifically, they are less likely to desire to save for retirement in the current year and thus place less value on employer-provided retirement benefits. In fact, many may prefer cash wages to retirement benefits. On net, if total compensation costs, including administrative costs, are higher with retirement benefits, employers will choose not to offer plans.

In particular, for firms with few employees who desire to save for retirement, complying with nondiscrimination rules, rather than administrative costs, may be the largest barrier to adopting a plan. Nondiscrimination rules are designed to ensure that pension benefits do not disproportionately accrue to highly compensated employees. This is accomplished by linking the benefits received by high-paid workers to the benefits received by low-paid workers within a given firm. However, if few of a firm's low-paid workers choose to contribute to a 401(k) plan, the consequence of this linkage is that high-paid employees at that firm have the amount that they can contribute severely restricted. For these firms, the end result is that offering a 401(k) plan would provide little benefit to any employee.

Although both high fixed costs and differences in workforce composition could explain the observation that smaller firms are less likely to sponsor a retirement plan, the two alternative explanations generate other predictions that differ. If the fixed costs associated with starting up and administering retirement plans are the primary barrier to small firms adopting a plan, then noticeable differences should exist in sponsorship rates by firm size even if firms are similar in other observable characteristics. In contrast, if the primary reason small firms are less likely to sponsor a plan is that small-firm employees place a lower value on benefits relative to cash compensation compared to larger-firm employees, the workforce composition of small firms should be noticeably different from that of large firms, and these differences should be consistent with small-firm employees having less desire to save for retirement in the current year.

Employees with Retirement Plans at Firms of All Sizes Have Similar Characteristics

For ease of exposition, this section will refer to firms with fewer than 100 employees as “small firms” and firms with 100 employees or more as “large firms.”*

Despite substantial differences in worker characteristics by firm size in the aggregate, small firms that sponsor retirement plans have workers who are similar to workers at large firms that sponsor plans. Similarly, large firms that do not sponsor plans have workers who are similar to workers at small firms that do not sponsor plans.

For example, controlling for whether or not employers sponsor retirement plans, there is very little difference in the age distribution of employees between small firms and large firms (top panel, Figure 3). However, across all firm sizes, workers at firms that do not sponsor a plan are younger: 29 percent of workers at firms without plans are 21 to 29 years of age, compared with 19 percent of workers at firms that offer plans.

Twenty-five percent of employees at small firms that sponsor plans are in the lowest two quintiles of annual earnings (\$25,000 or less), compared with 23 percent of employees at large firms that sponsor plans (middle panel, Figure 3). Regardless of firm size, employees at firms that do not sponsor plans earn substantially less: 60 percent of employees at small firms that do not sponsor plans and 53 percent of employees at large firms that do not sponsor plans are in the lowest two quintiles of annual earnings.

Firms that do not sponsor retirement plans also have higher proportions of part-time or part-year employees (bottom panel, Figure 3). Of firms that sponsor plans, 74 percent of employees at firms with fewer than 50 employees are full-time, full-year workers, compared with around 80 percent of workers at other firms. Regardless of firm size, firms that do not offer a plan have fewer full-time, full-year workers. Of firms that do not sponsor plans, the smallest and largest firms have the lowest percentage of full-time, full-year workers: 56 percent of workers at firms with fewer than 50 employees; 61 percent of workers at firms with 50 to 99 employees; 62 percent of workers at firms with 100 to 999 employees; and 57 percent of workers at firms with 1,000 or more employees.

Although both administrative costs and workforce composition are likely to influence an employer’s decision to sponsor a retirement plan, the data suggest that the low sponsorship rate at small firms is more likely due to differences in demand for retirement benefits by the firms’ employees than to the fixed costs associated with starting up and administering a plan.

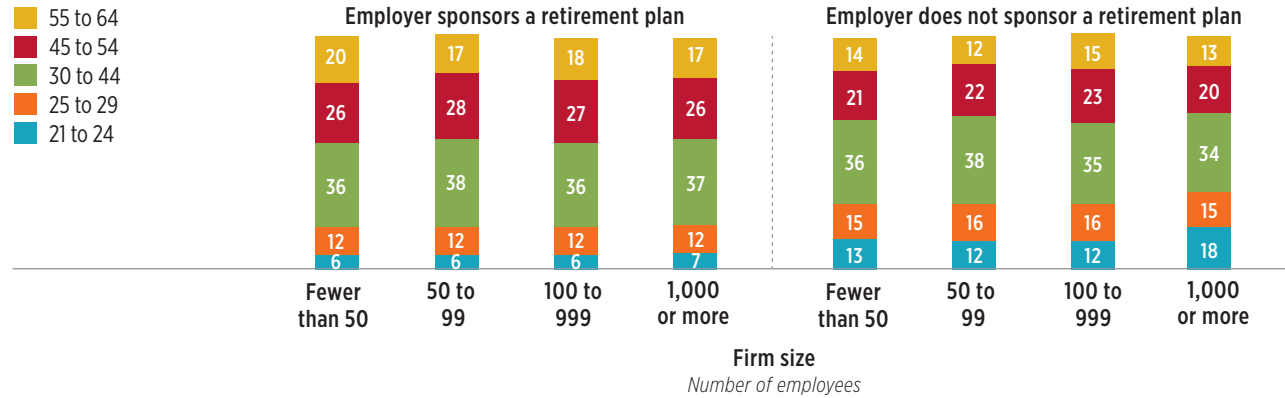
* For this reason, the numbers reported in the text are not reported directly on the figures because they are an average of the categories presented.

FIGURE 3

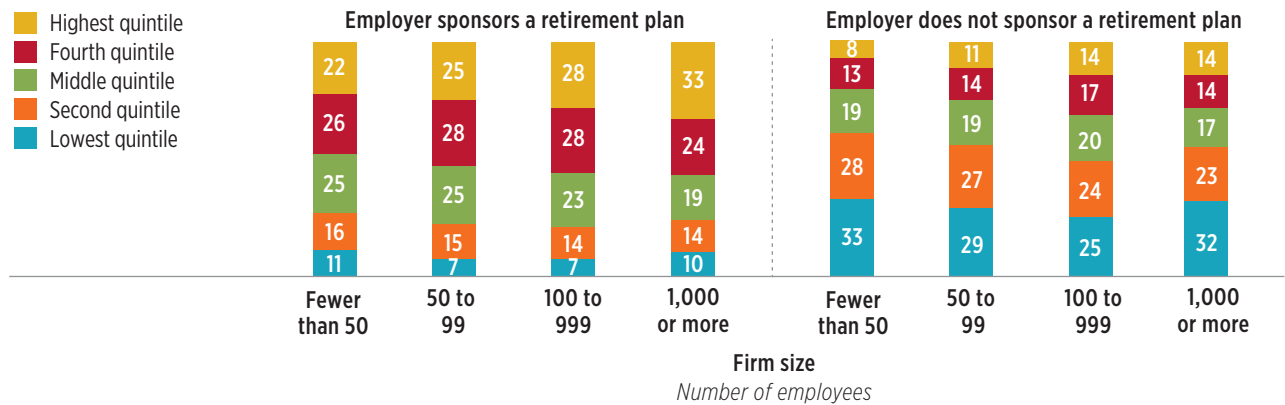
Many Employee Characteristics Are More Associated with Employer Retirement Plan Sponsorship Than Firm Size

Percentage of private-sector wage and salary workers aged 21 to 64 by various characteristics, 2010

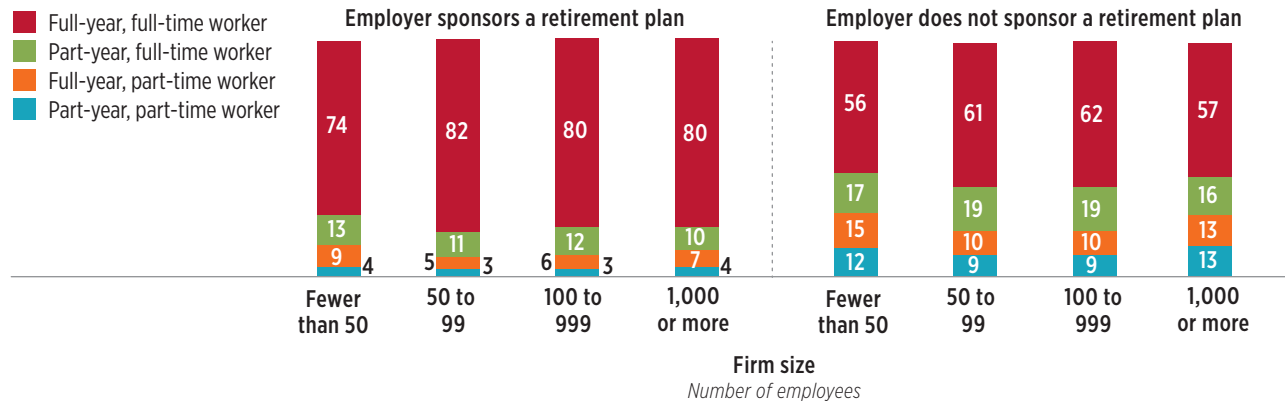
Employee age by employer size and employer retirement plan sponsorship



Employee annual earnings rank* by employer size and employer retirement plan sponsorship



Worker employment status by employer size and employer retirement plan sponsorship



*The lowest earnings quintile includes individuals with \$14,000 of earnings or less; the second quintile includes those with earnings from \$14,000 to \$25,000; the middle quintile includes those with earnings from \$25,000 to \$39,000; the fourth quintile includes those with earnings from \$39,000 to \$60,000; the highest quintile includes those with earnings from \$60,000 or more.

Note: Components may not add to 100 percent because of rounding. For more detailed information on the earnings rank calculations, see the notes page in the supplemental tables (available at www.ici.org/info/per17-07_data.xls).

Source: Investment Company Institute tabulations of March 2011 Current Population Survey

Reexamining Which Workers Are at Firms That Do Not Sponsor Plans

Figure 4 examines the data underlying the often-cited statistic that more than 70 million American workers do not have access to employer-sponsored retirement plans. In 2010, 77.7 million workers reported that their employers did not sponsor retirement plans. However, not all of these workers were private-sector wage and salary workers. Among government workers, 1.1 million federal government workers and 4.0 million state and local government workers reported that their employers did not sponsor retirement plans. Another 12.8 million workers without an employer-sponsored retirement plan were self-employed and approximately 117,000 reported that they worked without compensation of any type. Of the 77.7 million without a work-based retirement plan, 59.8 million were private-

sector wage and salary workers. This study focuses on private-sector wage and salary workers between the ages of 21 to 64. Within this group, 51.0 million reported that they worked for employers that did not sponsor retirement plans.

Figure 5 categorizes these 51.0 million workers based on the likelihood that they would be focused on saving for retirement. Among this group, 21.6 million (or 42 percent) were part-time or part-year workers. As noted, this group is unlikely to be focused on saving for retirement in the current year, particularly if they typically work full-time or for a full year. Another 7.0 million (or 14 percent) were full-time, full-year workers aged 21 to 29. Few in this age group save primarily for retirement; this group saves primarily for education, the purchase of a home, or for precautionary reasons.

FIGURE 4

Distribution of Workers Without Retirement Plan Coverage

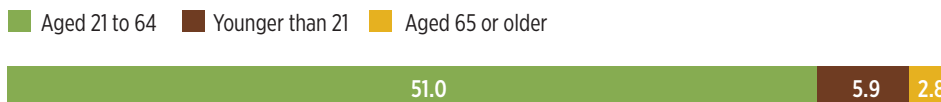
Workers reporting that employer does not sponsor a retirement plan, millions of workers, 2010

Workers reporting that their employer does not sponsor a retirement plan



Total: 77.7 million

Private-sector wage and salary workers reporting that their employer does not sponsor a retirement plan



Total: 59.8 million

Private-sector wage and salary workers aged 21 to 64 reporting that their employer does not sponsor a retirement plan



Total: 51.0 million

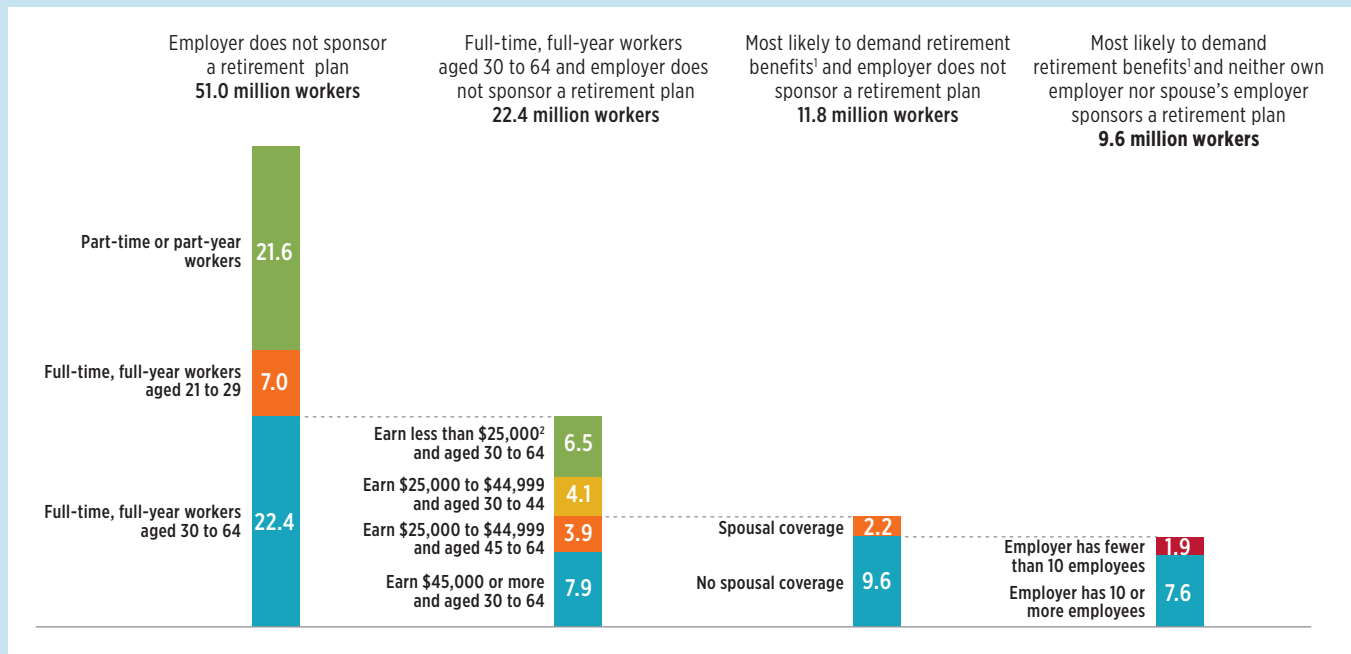
Note: Components may not add to the total because of rounding.

Source: Investment Company Institute tabulations of March 2011 Current Population Survey

FIGURE 5

A Closer Look at Workers Whose Employer Does Not Sponsor a Retirement Plan

Millions of private-sector wage and salary workers aged 21 to 64, 2010



¹ Full-time, full-year workers who earn \$45,000 or more and are aged 30 to 64 or earn \$25,000 to \$44,999 and are aged 45 to 64.

² Among full-time, full-year workers aged 35 to 44, \$25,000 represents the top earnings of the 20th percentile of annual earnings and \$45,000 represents the top earnings for the 50th percentile of annual earnings.

Note: Components may not add to the total because of rounding.

Source: Investment Company Institute tabulations of March 2011 Current Population Survey

Among the 22.4 million full-time, full-year employees aged 30 to 64, 6.5 million earned less than \$25,000 a year. These workers are unlikely to have the capacity or desire to save for retirement. Another 4.1 million earned \$25,000 to \$44,999 in 2010 and were aged 30 to 44. Full-year, full-time workers earning \$25,000 to \$44,999 may have the ability to save, but because they have other saving priorities, they are likely to delay saving for retirement until after age 44. This leaves 11.8 million workers—or 23 percent of all 21- to 64-year-old private-sector wage and salary workers at firms that did not sponsor plans—who were the most likely to be focused on saving for retirement: 3.9 million who earned \$25,000 to \$44,999 in 2010 and were aged 45 to 64, and 7.9 million who earned \$45,000 a year or more and were aged 30 to 64.

To some extent, the percentage of workers at firms that sponsor retirement plans underestimates access of individuals to employer-sponsored retirement benefits. Some individuals who do not have access to plans through their own employers have spouses who work for firms that sponsor plans. On net, of the 51.0 million employees who worked for firms that did not sponsor retirement plans, 9.6 million, or 19 percent, were both likely to demand retirement benefits from their employer and were without access to an employer plan through a spouse.

Indeed, limiting the sample to those workers likely to demand retirement benefits, 69 percent worked for a firm that sponsored a plan, and 75 percent had access to a plan either through their own employer or through their spouse's employer. Additionally, of those workers in this group whose own employer sponsored a plan or whose spouse's employer sponsored a plan, 93 percent participated in either their own employer's plan or their spouse's employer plan.

Conclusion

The private-sector pension system often is criticized because it is said that too small a fraction of the private-sector workforce has access to employer-provided retirement plans. However, employer-sponsored retirement plans should not be analyzed in a vacuum; the U.S. retirement system includes both tax incentives to encourage employers to offer pension benefits and a social safety net of programs to help the elderly. Social Security is structured so that the portion of earnings replaced is much higher for workers with lower lifetime earnings; those with higher lifetime earnings rely more heavily on employer-sponsored retirement plans and private savings. This is not unintentional; from the inception of Social Security, policymakers understood that Social Security alone would be insufficient for those with higher lifetime earnings and intended for Social Security and employer-provided pensions to work together.*

The success of private-sector plans should be judged in light of these factors. Of those most likely to need to supplement Social Security benefits in retirement and to desire to save for retirement in the current year, three-quarters have access to a plan through their own employer or their spouse's employer, and 93 percent of those with access participate.

The analysis in this paper supports the proposition that the private-sector pension system can and should be improved. However, the analysis also suggests caution when proposing reforms to a system that already provides retirement benefits to most of the workers who are likely to value retirement benefits more highly than cash compensation. The incentives faced by both employees and employers should be taken into account when crafting pension reforms, and realistic goals should be set for increasing employer-based retirement plan coverage.

Some workers do not have the resources to fund current consumption, much less the ability to set aside resources to fund consumption in retirement. Other workers may have the ability to save and will likely desire to save for retirement at some point in their careers, but have more important savings priorities in the current year. It is unlikely that either group of these workers will seek to work for a firm that offers a pension plan, or choose to participate in such a plan if offered.

More significantly, some households face a lifetime of low earnings. Even the best-designed voluntary private-sector retirement system is unlikely to provide adequate resources to fund retirement consumption for workers who have inadequate resources to fund consumption in their working years. Because of this, it is vitally important to maintain a Social Security system that provides adequate benefits to workers with low lifetime earnings.

* Since the enactment of Social Security, Congress has allowed private-sector employers to account for Social Security in their pension plans. This process—known as integration—permits a higher benefit formula or a higher employer contribution rate on earnings not covered by Social Security. Permitted disparity—the provision in the tax code that allows Social Security integration—is defined in Section 401(I) of the Internal Revenue Code.



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