United States Senate Committee on Banking, Housing, and Urban Affairs
Subcommittee on Economic Policy

Hearing on, "The Current State of Retirement Security in the United States"
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Testimony of Senator Kent Conrad
Co-Chair of the Bipartisan Policy Center's Commission on
Retirement Security and Personal Savings

Good afternoon, Chairman Cotton, Ranking Member Heitkamp, and members of the subcommittee. Thank you for inviting me here to discuss the state of retirement security in America.

Millions of Americans are financially unprepared for their retirement. Too many lack adequate savings, having set aside money at insufficient levels. Even those who do accumulate sufficient savings for retirement run the risk of outliving those funds, and others are forced to raid their retirement accounts early due to a shortage of short-term, emergency savings. Compounding these challenges is the fact that Americans often lack the financial capability to take actions that are in their own best interests. Meanwhile, the Social Security system—the bedrock of retirement security in America—is facing a serious shortfall, with its trust funds set to be exhausted by 2035.

The lack of retirement savings is eye-opening. According to research from the Urban Institute's DYNASIM model, the median amount of retirement assets held by Americans aged 62-69 stood at just $32,000 in 2015. More than one-quarter of households in this group had *zero* in retirement savings.[1] But this problem is not limited to older Americans. Research from the Employee Benefits Research Institute (EBRI) has found that more than four in ten Gen-Xers are projected to run short of money in retirement.[2]

Part of this problem can be attributed to a lack of access and contributions to employer-sponsored retirement plans. Modeling from EBRI has found that 31 percent of civilian workers lack access to an employer-sponsored retirement plan. Among those with access, many choose

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[1] The Urban Institute. 2016. DYNASIM3.

[2] VanDerhei, Jack. 2014. "What Causes EBRI Retirement Readiness Ratings to Vary: Results from the 2014 Retirement Security Projection Model." Employee Benefit Research Institute Issue Brief, no. 396. Pp. 6-19. http://www.ebri.org/pdf/briefspdf/EBRI_IB_396_Feb14.RRRs2.pdf.

not to contribute. In total, just over half of civilian workers contribute to an employer sponsored-plan.[3]

Given these disturbing statistics, it is little wonder that Americans are concerned about their retirement. A 2016 Gallup poll found that 64 percent of Americans are either very worried or moderately worried about not having enough money for retirement, making it their top financial concern in the survey.[4] A recent study by the Federal Reserve found that around half of adults say they would be unable to come up with even $400 in an emergency without borrowing or selling possessions.[5]

The Bipartisan Policy Center's Commission on Retirement Security and Personal Savings, which I had the privilege of co-chairing with the Honorable James B. Lockhart III, former Principal Deputy Commissioner of the Social Security Administration, identified six key challenges associated with retirement security in America today:

1) **Too few workers participate in a workplace retirement savings plan**. As described previously, just around half of private-sector workers contribute to an employer-sponsored retirement plan. One primary cause of this lack of access is that some businesses find it too expensive and complex to sponsor either a traditional "defined benefit" pension or a 401(k)-style "defined contribution" plan. Small businesses, in particular, are often unprepared to take on what can be large administrative, financial, and fiduciary burdens. In a recent survey by the Pew Charitable Trusts, 59 percent of small- to medium-sized businesses not offering a plan attributed that decision to either the associated expense or the firm's resource constraints.[6] As a consequence, 53 percent of workers at businesses with fewer than 50 employees do not have access to a plan, compared to only 10 percent among companies with more than 500 employees. Simply put, workers without these plans are less likely to enjoy retirement security. According to projections from EBRI, 56 percent of those without ongoing access to a DC retirement plan will run short of money in retirement.[7]

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[3] EBRI, Policy Forum #79. Basic Facts: Retirement, December 15, 2016.
[4] McCarthy, Justin. 2016. "Americans' Financial Worries Edge Up in 2016." Gallup. http://www.gallup.com/poll/191174/americans-financial-worriesedge-2016.aspx.http://www.gallup.com/poll/191174/americans-financial-worriesedge-2016.aspx.
[5] Federal Reserve. "Report on the Economic Well-Being of U.S. Households in 2015." May 2016. P. 1. http://www.federalreserve.gov/2015-report-economic-well-being-us-households-201605.pdf.
[6] The Pew Charitable Trusts. "Small Business Views on retirement Savings Plans." January 2017. http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2017/01/small-business-views-on-retirement-savings-plans.
[7] This result is for Gen-Xers (born between 1965 and 1974) who are in the second income quartile (i.e., between the 25th percentile and the median of the income distribution). For more information, please refer to: VanDerhei, Jack. "What Causes EBRI Retirement Readiness Ratings to Vary." Employee Benefits Research Institute. Issue Brief #396. February 2014. P. 7. https://www.ebri.org/pdf/briefspdf/EBRI_IB_396_Feb14.RRRs2.pdf.

2) **Many Americans lack the income or resources to save for short-term needs, forcing them to raid their retirement accounts for unexpected expenses.** Usually called "leakage," pre-retirement withdrawals occur when savers withdraw their DC plan or IRA assets before retirement. Research suggests that between 1 and 1.5 percent of 401(k)-plan and IRA assets are lost to leakage *each year*.[8,9] Individuals who pull savings out early tend to withdraw a high percentage of their retirement assets, averaging around 20 percent.[10,11] Leakage can not only lead to high fees and penalties, but it also directly translates to a reduction in retirement assets.

3) **Americans are living longer and are increasingly at risk of outliving their savings**, but despite rising life expectancy, the average retirement age has stagnated. Between 1962 and 1996, the average retirement age among men actually declined from 65 to 63. Though the average retirement age increased for women — along with workforce participation — it remains relatively low, at 62 in 2013.[12] To make matters worse, most Social Security beneficiaries claim their benefits well before the full retirement age (FRA). In 2014, roughly three-fourths of individuals claiming Old-Age and Survivors Insurance (OASI) benefits did so at an age below the FRA.[13] Early claimers in 2016 saw their monthly payment reduced by up to 25 percent from what it would have been if they claimed at the current FRA of 66. A diminished stream of income from Social Security compounds the problem of having fewer years in the workforce to save for retirement. This is especially concerning for the large number of older Americans who depend on Social Security for the overwhelming majority of their income.

4) **Home equity is an under-utilized source of retirement savings.** For many retirees, home equity represents a significant portion of their assets. Americans own more than $13.3 trillion in home equity—a sum that rivals the $14.9 trillion that Americans hold in retirement savings.[14,15] Just

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[8] Munnell, Alicia and Anthony Webb. 2015. "The Impact of Leakages From 401(k)s and IRAs." The Center for Retirement Research at Boston College. P. 1. http://crr.bc.edu/wp-content/uploads/2015/02/wp_2015-2.pdf.
[9] Butrica, Barbara A., Sheila R. Zedlewski, and Philip Issa. 2010. "Understanding Early Withdrawals from Retirement Accounts." The Urban Institute. P. 23. http://www.urban.org/sites/default/files/alfresco/publication-pdfs/412107-Understanding-Early-Withdrawals-from-Retirement-Accounts.PDF.
[10] Ibid.
[11] Argento, Robert, Victoria Bryant, and John Sabelhaus. 2015. "Early Withdrawals from Retirement Accounts During the Great Recession." Contemporary Economic Policy. Vol. 33. No. 1. (January). P. 14. http://onlinelibrary.wiley.com/doi/10.1111/coep.12064/epdf.
[12] Munnell, Alicia H. 2015. "The Average Retirement Age – An Update. Center for Retirement Research at Boston College." Pp. 3-4. http://crr.bc.edu/briefs/the-average-retirement-age-an-update/.
[13] Social Security Administration. 2015. Annual Statistical Supplement, 2015. Table 6. B5.1. https://www.ssa.gov/policy/docs/statcomps/supplement/2015/6b.html.
[14] See, Board of Governors of the Federal Reserve System. Financial Accounts of the United States: Fourth Quarter 2016. P. 138. March 9, 2017. http://www.federalreserve.gov/releases/z1/Current/z1.pdf. Home equity is equal to total household real estate less total home mortgages, as calculated by the Board of Governors of the Federal Reserve System.
[15] See, Investment Company Institute. 2016. Report: The U.S. Retirement Market, Fourth Quarter 2016 (xls). Table 1. March 22, 2017. https://www.ici.org/research/stats/retirement. Retirement savings include assets in DC plans and IRAs.

like retirement savings, housing assets are built slowly over most people's working life, making home equity a crucial stock of wealth for many older Americans. Unfortunately, the past several decades have seen increasing indebtedness among older Americans—driven by increases in mortgage debt—which poses a unique threat to retirement security. The share of older households holding any form of housing-related debt has more than doubled since 1989, from 15 to 32 percent.[16] Federal tax policy worsens this problem by promoting mortgage debt. Mortgage interest payments are usually deductible for taxpayers who itemize. Ultimately, holding mortgage debt in retirement limits retirees' ability to tap home equity and is among the many considerations that Americans need to understand as they make decisions about their own savings and retirement.

5) **Many Americans lack financial capability**. Financial capability is defined as the knowledge, ability, and opportunity of all individuals to manage their personal finances**.** It is more important now than ever, as workers are increasingly responsible for their own retirement security. Unfortunately, too many Americans struggle in this area. A 2014 study found that 23 percent of Millennials and 19 percent of Gen-Xers spend more than they earn, and only about one-third of each group has set up a rainy-day fund.[17] In addition, Americans fare poorly on assessments of financial literacy.

6) **Social Security is facing a significant financial shortfall and needs modernization.** Social Security is the foundation upon which Americans across the economic spectrum build their retirement. While the program continues to serve as an essential safety net for nearly all American workers, its financial troubles put that position at risk. Under current projections by the program's trustees, the OASI Trust Fund – which pays benefits to older Americans, their dependents, and their survivors – is projected to be exhausted by 2035.[18] At that point, beneficiaries would face an across-the-board benefit cut of 23 percent.[19] While that may seem far off, Social Security is already paying out more in annual benefits than it collects in taxes. Waiting to address this shortfall increases uncertainty for beneficiaries and makes the policy fixes more difficult.

Though these challenges are indeed daunting, our commission put forth a comprehensive package of recommendations to improve retirement security for all Americans, focusing on the six broad challenges described above.

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[16] Board of Governors of the Federal Reserve System. 2014. 2013 Survey of Consumer Finances. http://www.federalreserve.gov/econresdata/scf/scfindex.htm. Housing-related debt is defined as debt secured by one's primary residence.

[17] Mottola, Gary R. 2014. "The Financial Capability of Young Adults – A Generational View." FINRA Investor Education Foundation. http://www.usfinancialcapability.org/downloads/FinancialCapabilityofYoungAdults.pdf.

[18] The Congressional Budget Office expects the OASI Trust Fund to be exhausted in 2029 – six years sooner than the projection of the trustees.

[19] Committee on Ways and Means. 2016. "The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds." United States House of Representatives. 114th Congress. H. Rep. 114-145, P. 6. https://www.ssa.gov/OACT/TR/2016/tr2016.pdf.

To expand access and make it easier for individuals to save for retirement, we propose several solutions. Generally, our strategy is to reduce the burden on small businesses and simplify the process of providing retirement benefits to employees, incentivize enrollment in workplace retirement savings plans, and create a national minimum-coverage standard that would require all businesses with at least 50 employees to offer their workers some form of workplace retirement savings option. Our modeling shows that such changes would increase savings among middle class Americans by 50 percent once fully phased in.

Enhancing retirement saving opportunities is critical, but planning for retirement should never be considered in a vacuum. Retirement security is inextricably linked to everyday financial security decisions during one's working years. Americans need to increase their personal savings so that they are better positioned to handle emergencies and major expenses, and when appropriate, purchase insurance against the vicissitudes of life. Insufficient short-term savings can lead workers to draw down their retirement accounts, incurring taxes and (often) penalties. This "leakage" of retirement savings—while it might address an immediate financial squeeze—jeopardizes many Americans' long-term retirement security. To address this issue, we recommend allowing employees to be automatically enrolled in multiple savings accounts—a standard checking account for short-term savings and a tax-preferred retirement account. We would also reform the regulations surrounding retirement accounts to further deter pre-retirement withdrawals.

Once workers reach retirement, they face the daunting prospect of making their savings last for the rest of their lives. With Americans increasingly living into their 80s and 90s, this challenge has only become more difficult. By clearing regulatory barriers to lifetime-income options for retirees and encouraging Americans to claim Social Security benefits later to maximize their incomes, our recommendations would ensure that fewer retirees outlive their savings.

To diversify Americans' options for retirement income, our proposals would make home equity more readily available for retirement needs. We discourage the use of home equity for pre-retirement consumption by removing the deduction for interest on second mortgages and other lines of credit that reduce home equity before retirement. We also recommend expanding awareness of Federal Housing Administration (FHA)-insured reverse mortgages and establishing a low-dollar reverse-mortgage pool, allowing retirees to tap into a smaller portion of their home equity without incurring the large fees that accompany larger loans.[20]

Increased use of IRAs, 401(k)s, and other defined-contribution accounts means that today's workers have more responsibility for managing their personal finances than previous generations. To improve Americans' financial knowledge and better equip them to manage their own finances, we recommend expanding personal financial education at all ages and

[20] Please see page 69 of our report for our full recommendations on facilitating the use of home equity for retirement consumption.

stress the importance of "just-in-time" interventions, in which individuals are provided with important information at the moment that they are making major financial decisions.

Finally, no discussion of retirement policy would be complete without addressing the significant challenges that face Social Security. Our package would avoid the 23-percent cut that is set to take effect and give Americans certainty about what to expect in benefits from the program as they prepare for retirement. The Chief Actuary of Social Security found that our plan would achieve "sustainable solvency," meaning that the program's reserves would be increasing even after 75 years. We achieved this outcome through a balanced package of revenue increases and benefit savings. Our policies include gradually increasing the payroll-tax rate, raising the amount of income subject to Social Security taxes, very gradually raising the full retirement age, and using a more-accurate measure of inflation for Social Security's annual cost-of-living adjustments. But what I am most proud of is the enhancements that we were also able to make for the most vulnerable beneficiaries, including surviving spouses and low-income workers. These groups would see dramatic increases in benefits, which is why the Urban Institute found that our package would reduce elderly poverty by 30 percent in just 20 years.[21]

To achieve agreement, the commission voted on these recommendations as a package, not as individual policies. My fellow commissioners and I continue to believe that, taken as a whole, these policies represent the most comprehensive, bipartisan proposal to reform U.S. retirement policy for the benefit of all Americans.

Based on the interests of this committee, there are a few policies I would like to highlight that might be particularly ripe for near-term action:

Establish simplified Retirement Security Plans for small businesses. To expand access and make it easier for individuals to save for retirement, the commission recommends creating new Retirement Security Plans that would dramatically simplify the process of offering automatic-enrollment plans for small businesses.[22] These plans would allow employers with fewer than 500 workers to band together and form well-run, low-cost retirement plans that defuse administrative expenses. Responsibility for operating and overseeing these plans would fall to a third-party administrator that would be certified by a new oversight board designed to protect consumers from bad actors. A similar proposal (entitled "pooled plans") was included in the Retirement Enhancement and Savings Act of 2016, which was unanimously reported out of the Senate Finance Committee on a bipartisan basis.

Allow employers to enroll employees in multiple savings accounts. To help ensure that retirement savings last until retirement, we believe that employers should be able to

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[21] Please see page 78 of our report for our full recommendations on strengthening Social Security's finances and modernizing the program.
[22] Please see page 39 of our report for more information about Retirement Security Plans.

automatically enroll their employees into two accounts—one meant for retirement savings, another for short-term savings. By building up these rainy-day savings, individuals might be less likely to raid their retirement savings in the event of an unexpected emergency.

Incentivize retirement savings for young workers. To help build a culture of savings and improve the financial resilience of American families, we propose a new Starter Saver's Match, which would replace the existing Saver's Credit for individuals under the age of 35. The current Saver's Credit reduces the income-tax burden for lower-income individuals who contribute to retirement accounts, but the credit is not refundable, meaning that individuals with no income-tax liability cannot benefit from it. The Starter Saver's Match would instead be a refundable credit of up to $500 deposited directly into the claimant's retirement account. This change would better encourage younger workers with lower wages (those who are least likely to save on their own) to start saving for retirement. It would also maximize the government's "bang-for-the-buck" by allowing the invested match more years to grow.[23]

Facilitate the establishment of a Retirement Security Clearinghouse to improve portability. Many savers face the problem of having several retirement accounts scattered among their previous employers. For this reason, we recommend the creation of a Retirement Security Clearinghouse to ease the process of consolidating accounts.

Encourage plan sponsors to integrate easy-to-use, sophisticated lifetime-income features. Including lifetime-income options can be a complex endeavor that entails concerns about fiduciary liability; in addition, businesses often have to invest significant time and resources to develop lifetime-income features. We recommend providing limited protection for fiduciary liability, modifying regulations, and giving additional guidance to plan sponsors that wish to incorporate lifetime-income options within a DC plan.[24] These developments could have a similar effect for lifetime-income solutions as the Pension Protection Act of 2006 had for retirement plan auto-features. Removing barriers to auto-enrollment and auto-escalation, as well as providing limited protection from fiduciary liability for the use of qualified default investment alternatives, increased substantially the number of plan sponsors that implemented auto-features. The lifetime-income field is ripe for comparable changes.

Accurately reflect retirement tax policy changes in the budget process. Last but certainly not least is an issue that I know well from my years chairing the Senate Budget Committee. As tax reform discussions progress, the tax treatment of retirement savings accounts appears to be on the table. In particular, some have proposed moving all traditional tax-deferred retirement plans (such as 401(k)s and IRAs) to an after-tax Roth system in order to create "budget savings" in the 10-year window. However, the current scoring system significantly overstates the costs of tax-deferred accounts and understates the cost of Roth accounts. We recommend changing

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[23] Please see page 53 of our report for more information about our Starter Saver's Match.
[24] Please see page 61 of our report for our full recommendations on Lifetime-Income Options.

the scoring of these tax provisions to a system that would score both types of accounts on an equal basis.[25] I would encourage caution among policymakers when considering dramatic changes to retirement policy for tax policy purposes. Hundreds of billions of dollars are saved in these retirement accounts every year and the tax incentives play a significant role in this system. While debating the merits and structure of retirement tax preferences is certainly appropriate, hastily overhauling them without due consideration for the impact on American savers could serve to worsen the retirement security predicament about which we are all concerned.

Conclusion

I am encouraged that the issues of savings and retirement security have attracted bipartisan interest among not only members of Congress, but also business leaders, the media, the administration, and the states, as well as from candidates seeking public office. I hope that the work of our commission can inform these efforts and can contribute to meaningful action by individuals, businesses, and governments to improve the economic well-being of all Americans.

Thank you for inviting me to be here today, and I look forward to answering your questions.

[25] Please see page 51 of our report for more information about our recommendation on changing congressional budget-estimation rules for retirement tax expenditures.