

“Will Individuals be able to Afford to Retire in an Ownership Society?”



Dallas Salisbury
EBRI.org

The President's “Ownership Society”

2003

This administration is working hard to promote an ownership society in America. We want more people owning their own home. ... We want people owning and managing their own retirement accounts, owning and controlling their own health care accounts.

2004

We stand for a culture of responsibility in America. We're changing the culture of our country from one that has said, if it feels good, do it, and if you've got a problem, blame somebody else, to a culture in which each of us understands we are responsible for the decisions we make in life.....The culture of responsibility is growing.

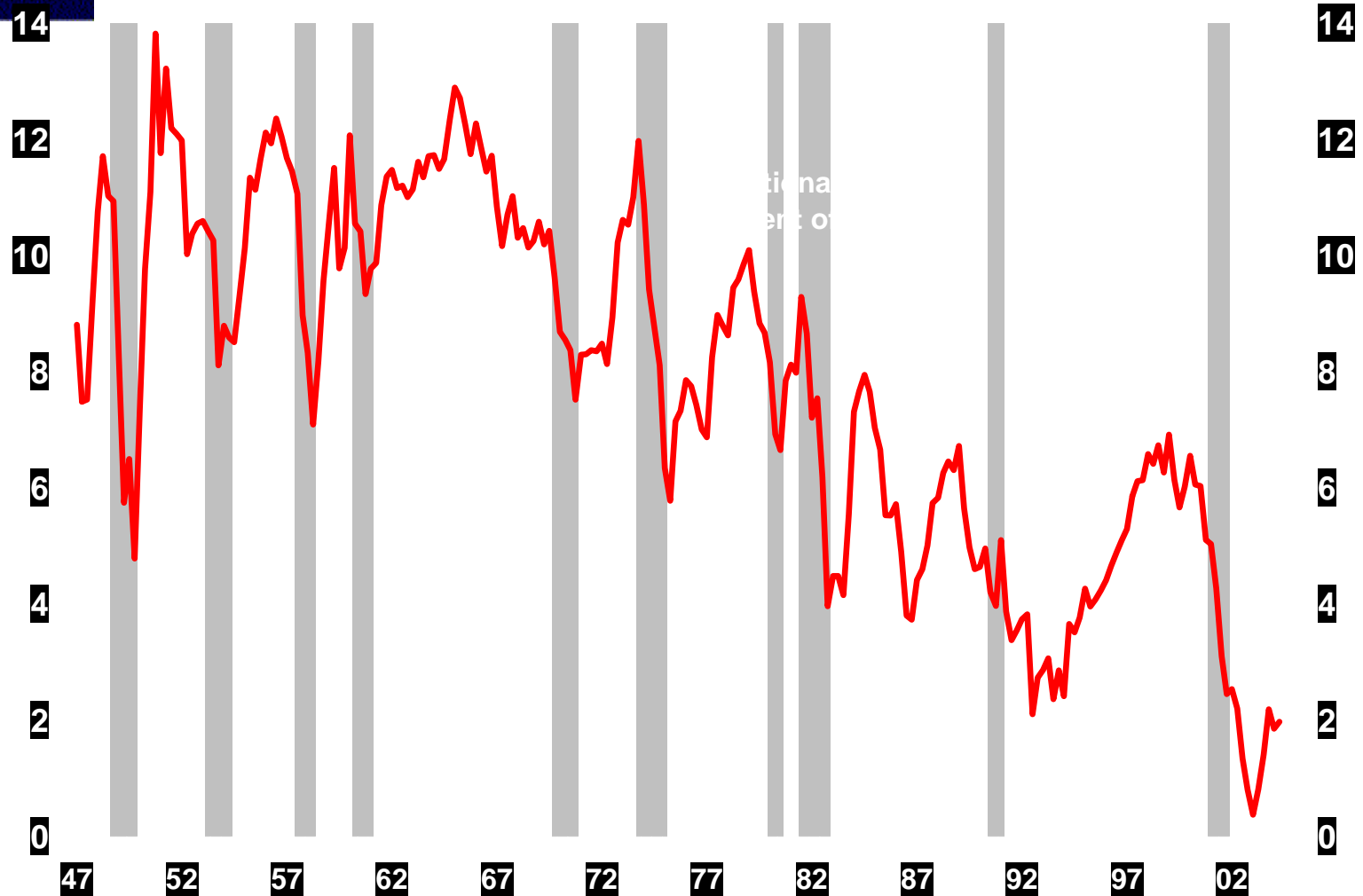
Accelerating Transition

- The “age wave” moves towards retirement
- Medical advances leading to longer lives.
- Competition driving employers to average down benefits offerings paid by them.
- Union decline and demographics reinforce averaging down.
- “Ownership society” focus leads to social, economic, benefit, distribution, tax change.
- Global reality drives all, including investments.

The Agenda

- The Savings Need
- Retirement Policy Challenges
- Demographic Drivers
- Federal Fiscal Drivers
- Retirement Trends
- Opportunities

Net Saving: Driven Down By Deficits

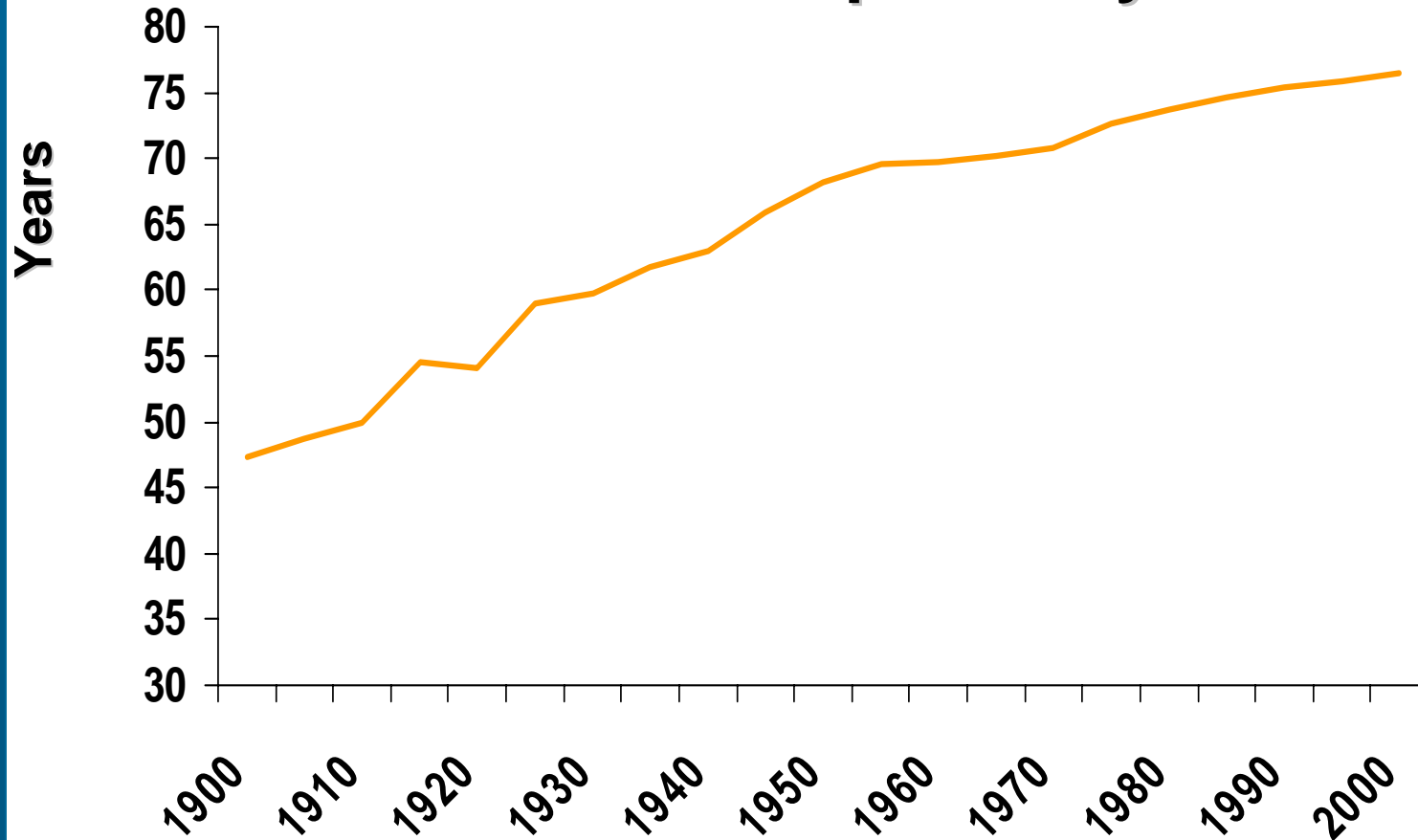


Source: Bureau of Economic Analysis

Demographic Drivers

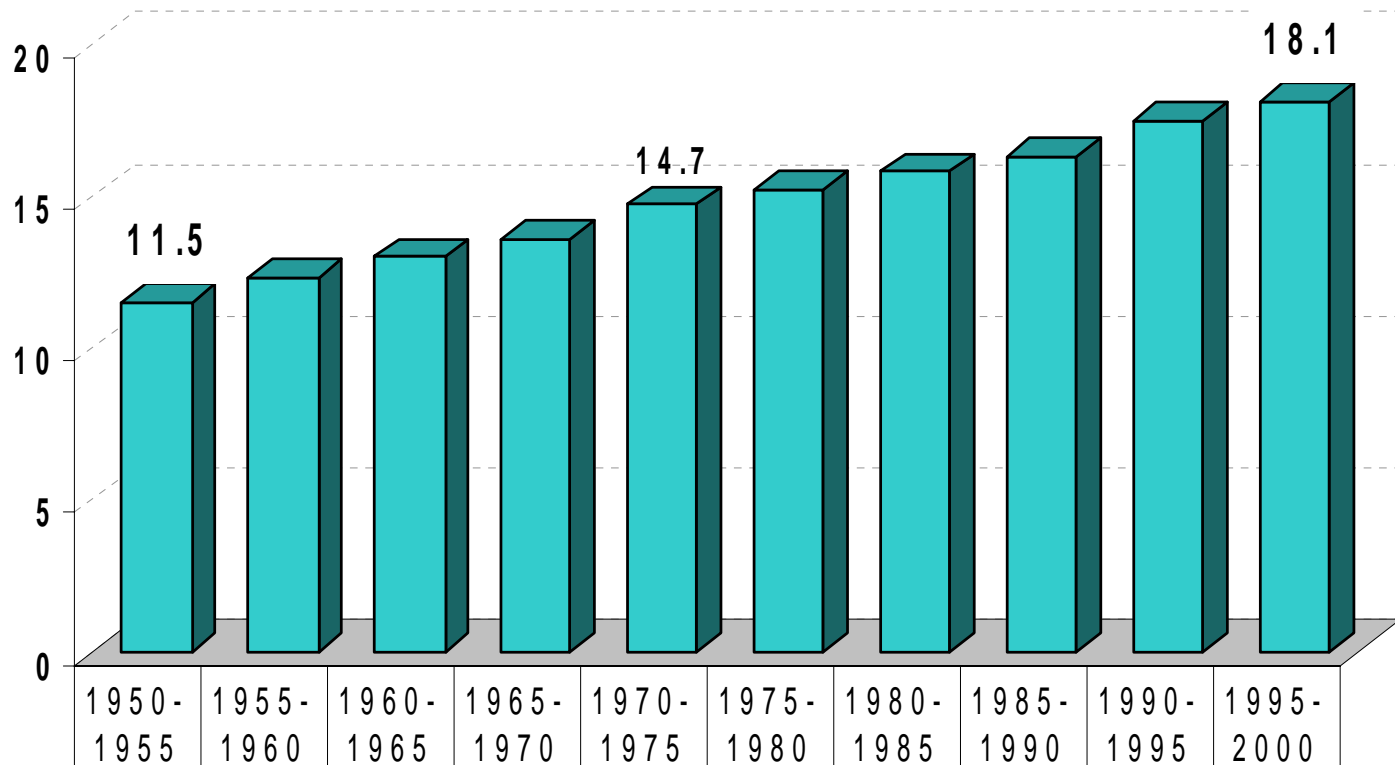
As Life Extends

Life Expectancy



Source: National Center for Health Statistics

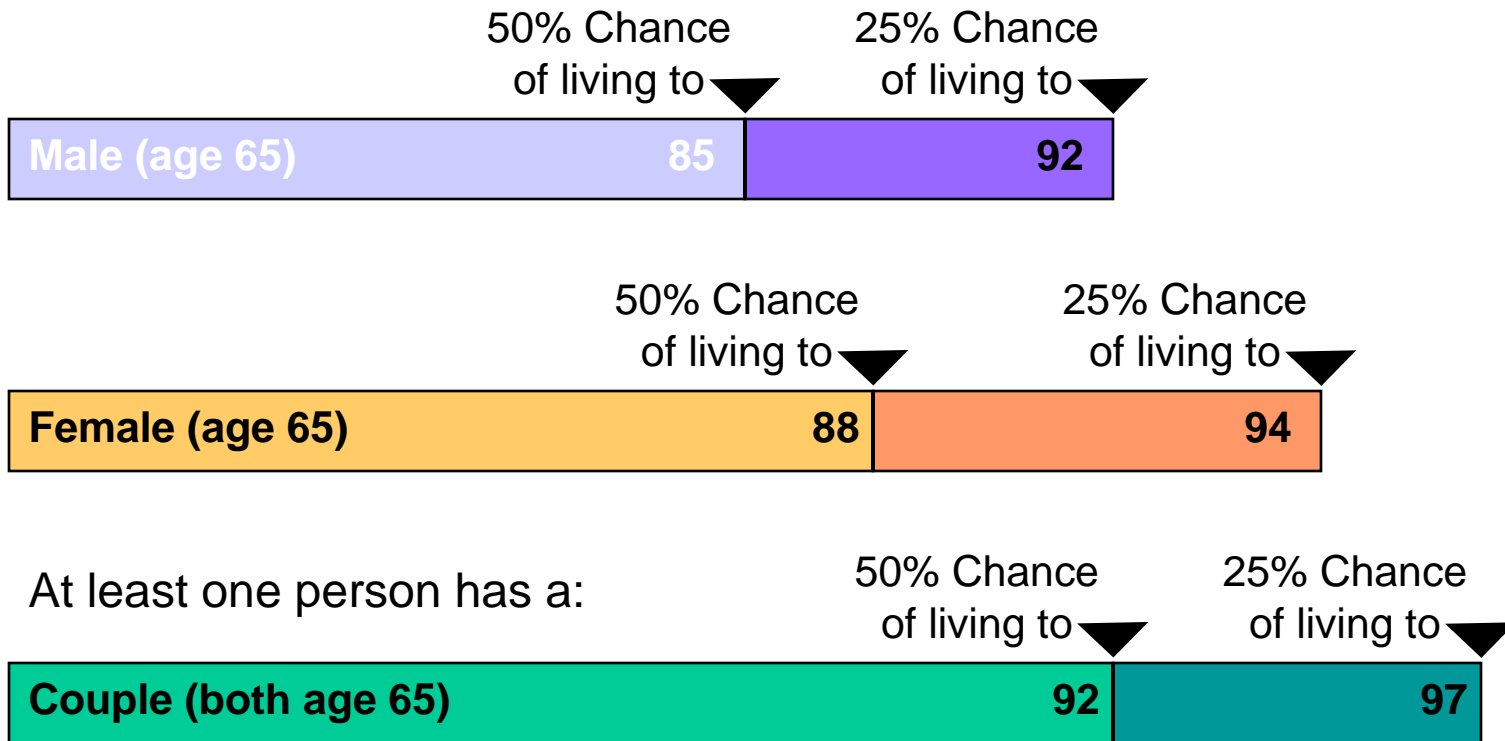
Average Number of Years Spent in Retirement is Climbs



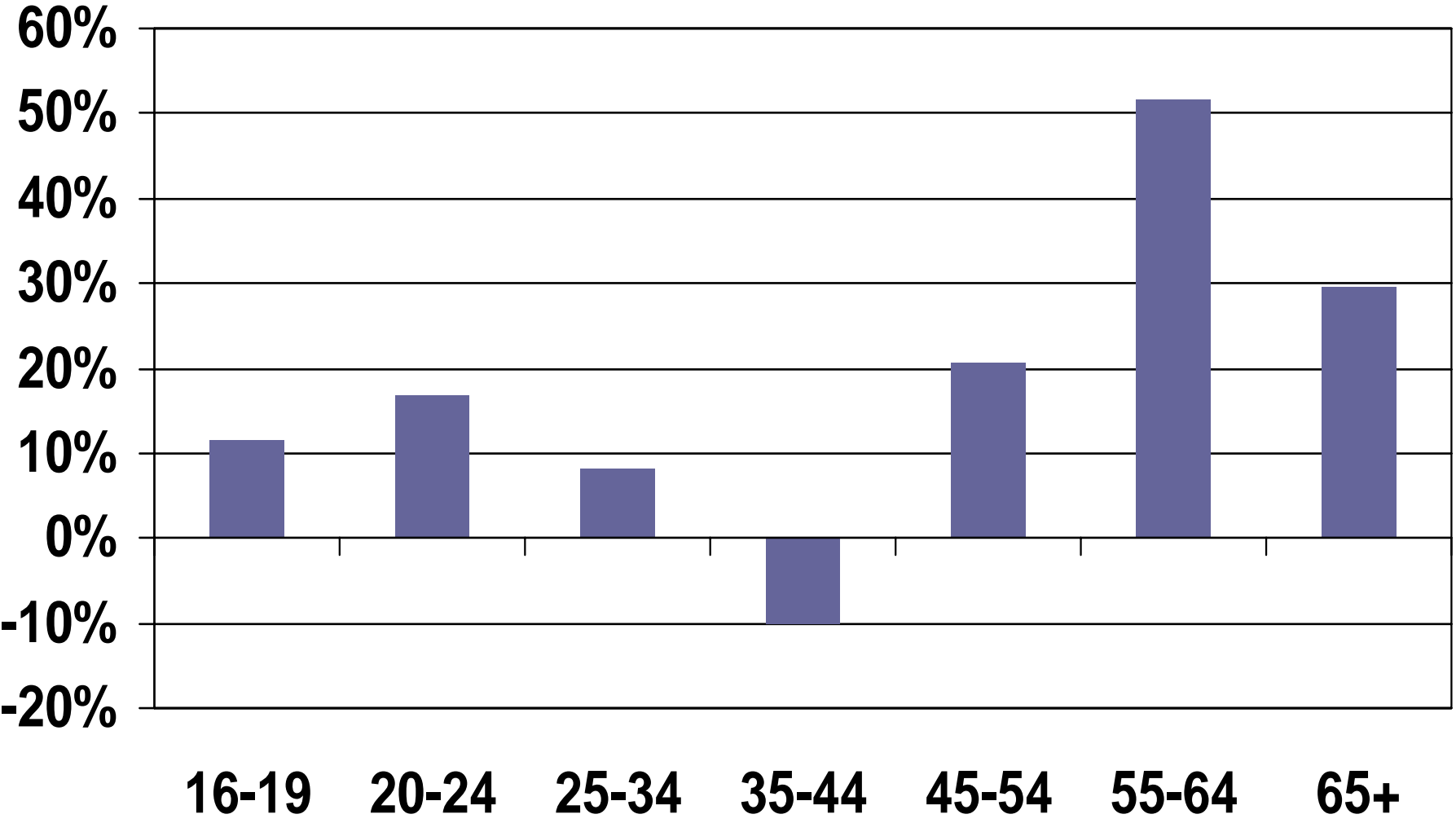
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And, Living Longer, Means Longer

How Long Will You Live?



The Population Shifts

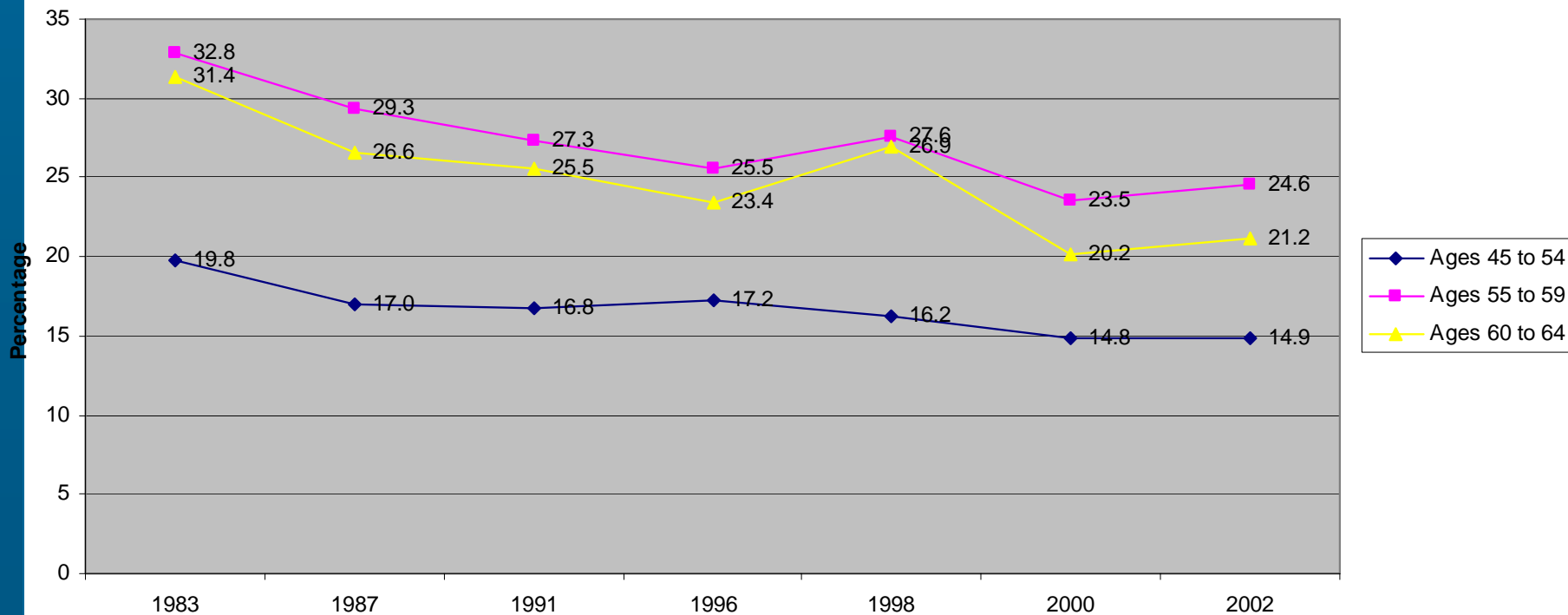


Source: Howard N Fullerton and Mitra Toossi, Monthly Labor Review, November 2001

Percentage of Older Long Tenure Male Workers Was Never Above 1/3

For all workers 55-64 it is now 17.5%

Percentage of Male Wage & Salary Workers with 25+ Years of Tenure,
 by Cohort Ages 45+ (1983--2002)



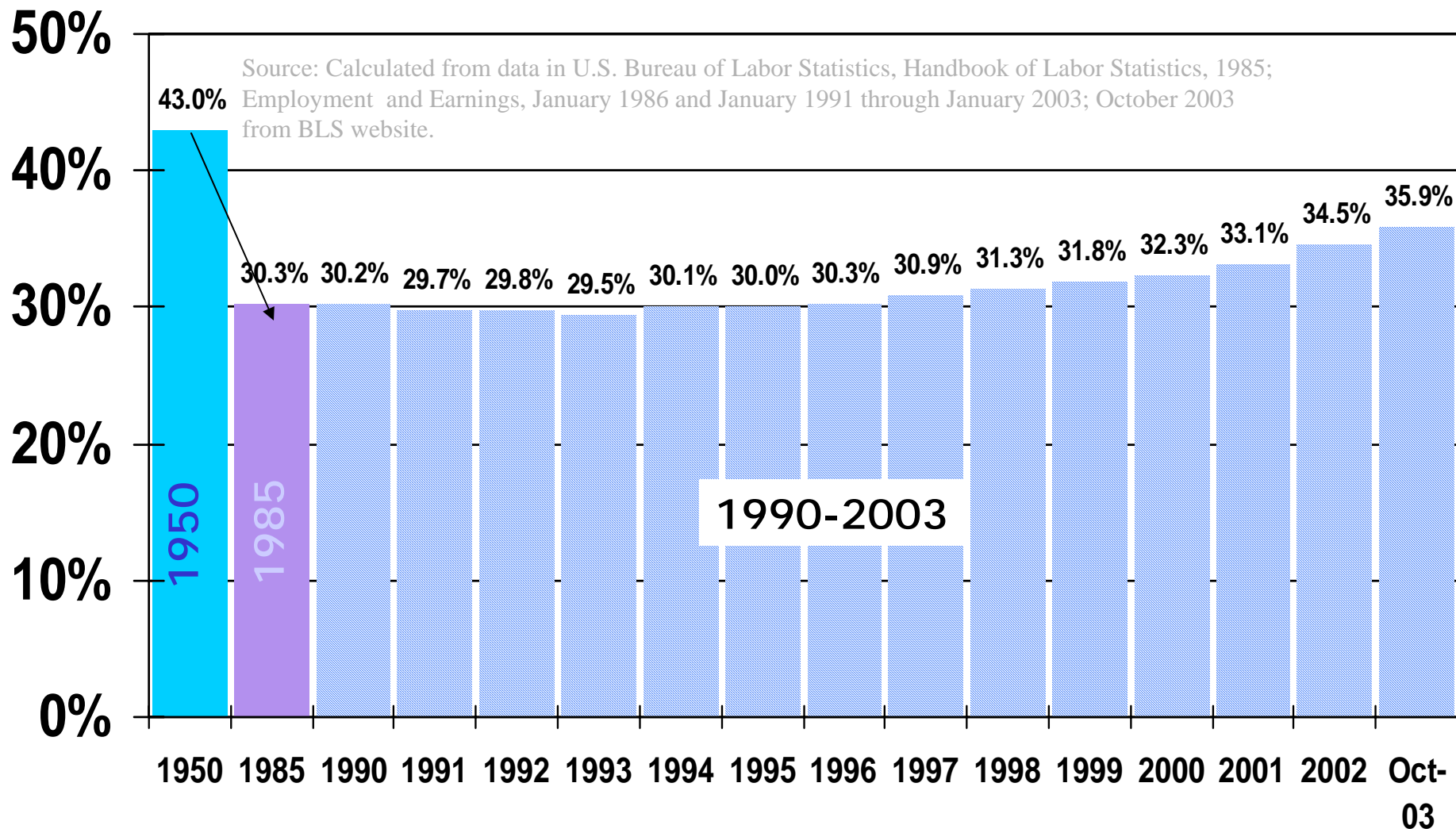
Source: EBRI tabulations of data from the Bureau of Labor Statistics

Four Possible Options

- Pensioners are poorer relative to the rest of society
- Taxes rise to pay for state pensions and health insurance
- Pension savings increase – in present and future generations (someone has to buy your assets to keep prices up)
- Average retirement ages rise
- Caveat: the most frequent reason for retiring early: disability and medical problems.

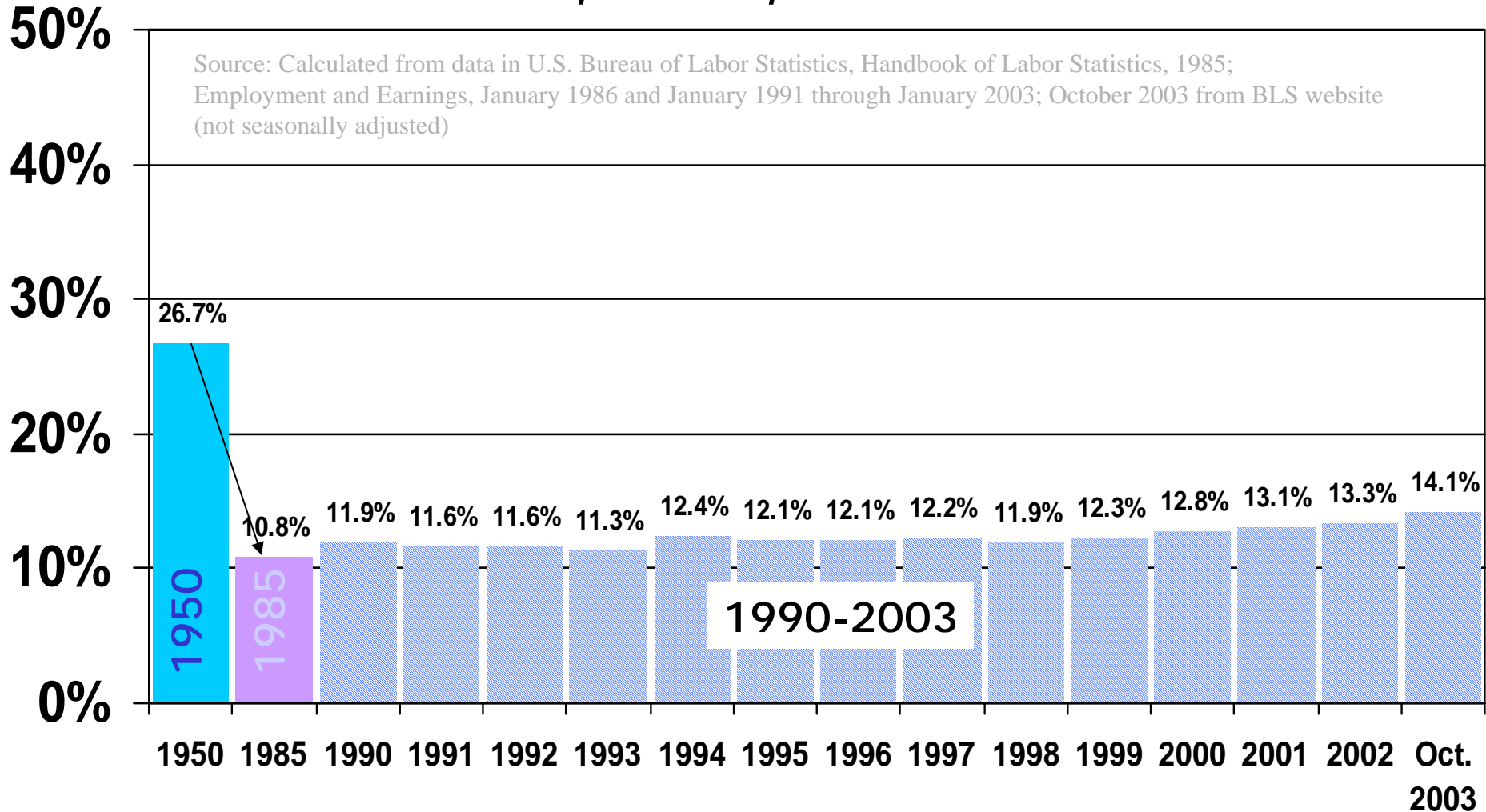
What Are Some People Doing? Working Longer.

U.S. Labor Force Participation Rates 55+ 1950, 1985, & 1990-2003



U.S. Labor Force Participation Rates 65+ 1950, 1985, & 1990-2003

Source: Calculated from data in U.S. Bureau of Labor Statistics, Handbook of Labor Statistics, 1985; Employment and Earnings, January 1986 and January 1991 through January 2003; October 2003 from BLS website (not seasonally adjusted)



What Does It Mean for the Retirement Industry?

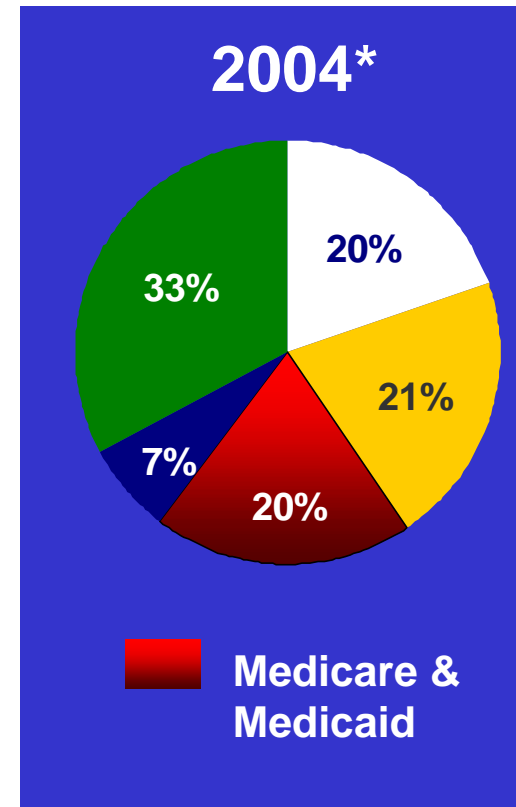
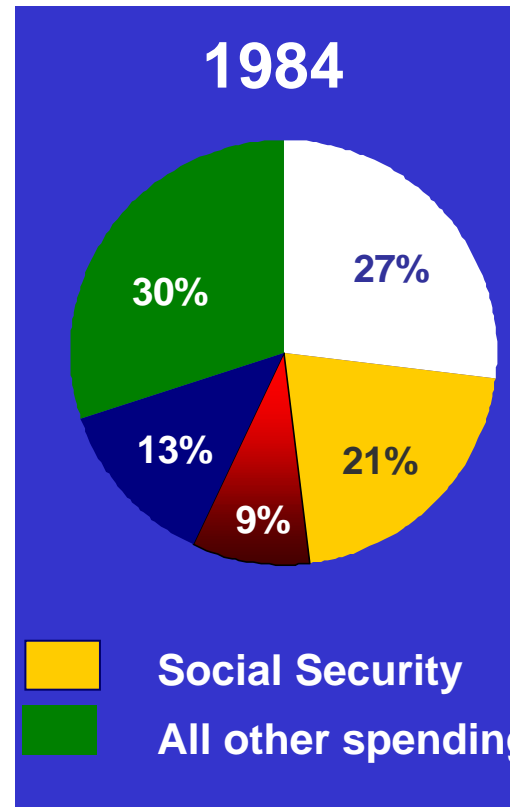
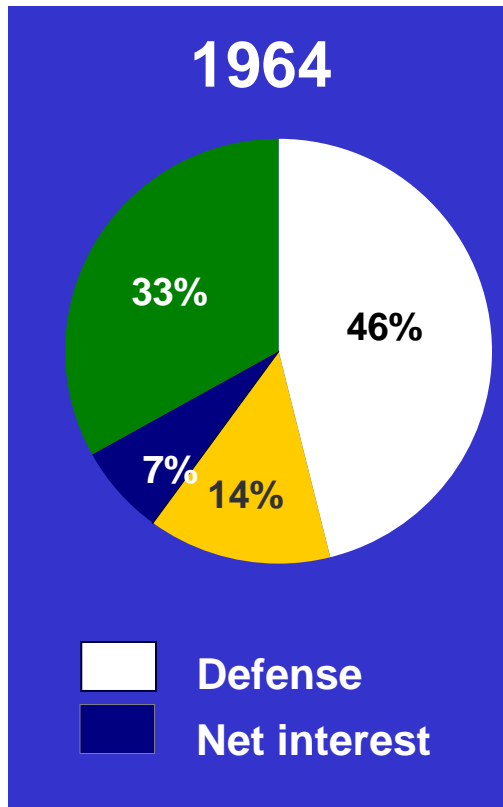
- Most with retiree medical have left the workforce as soon as they can take a “pension”.
- Most without retiree medical have left as soon as they can take a “pension”.
- Even if they move to another job, and even if they work longer, it is likely to be for another employer.
- DB plans are not likely to see ‘gains’ from working longer or shorter retirements, as it will not be their beneficiaries doing it.
- DC plans are likely to see longer distribution tails₁₆ and IRA’s will be where “the money” flows.

Federal Fiscal Drivers

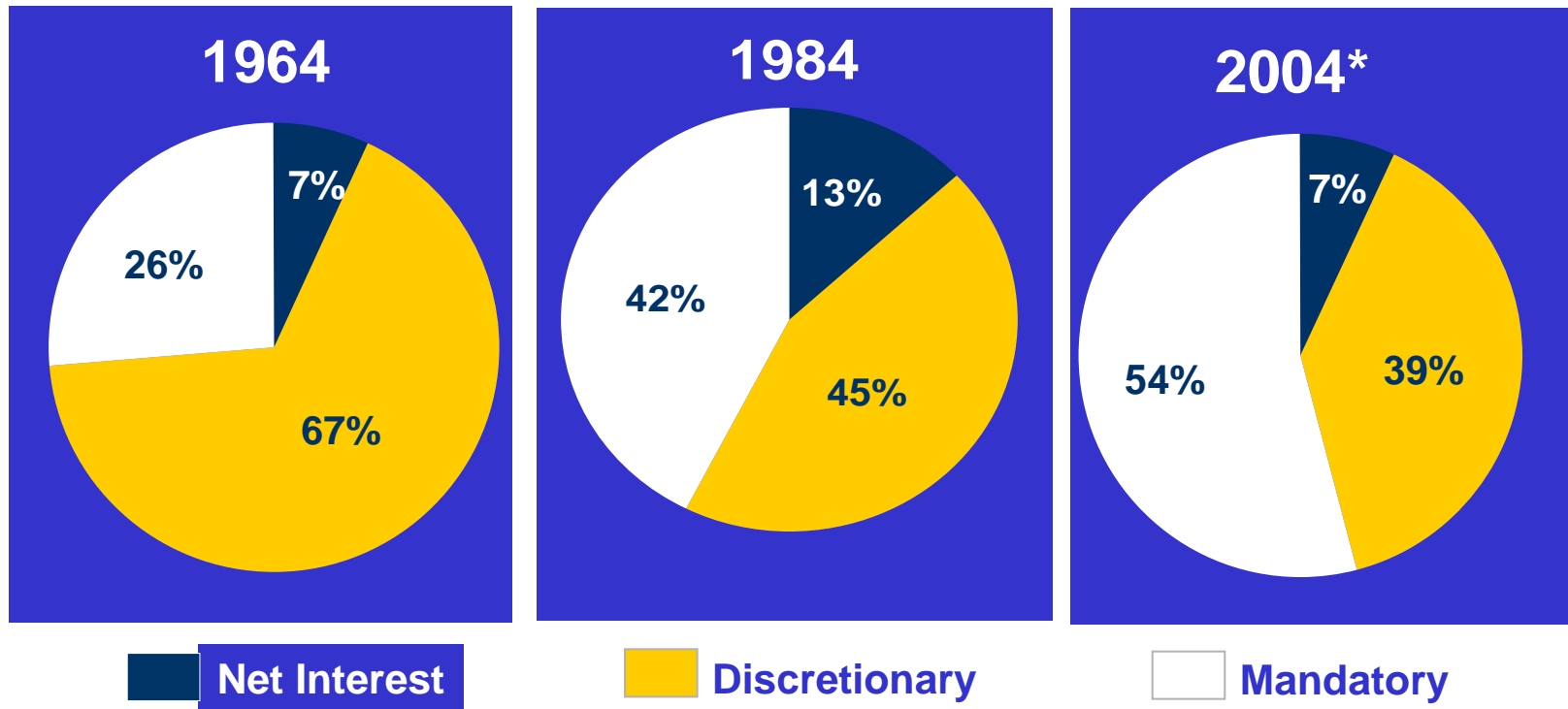
(Mirrored at the State and Local Level)

With consequences for the value of the dollar, equity values, interest rates, and the balance sheet of pension plans and the spending capacity of endowments and foundations.

Composition of Federal Spending



Federal Spending for Mandatory and Discretionary Programs



*Current services estimate.

Note: Numbers may not add to 100 percent due to rounding.

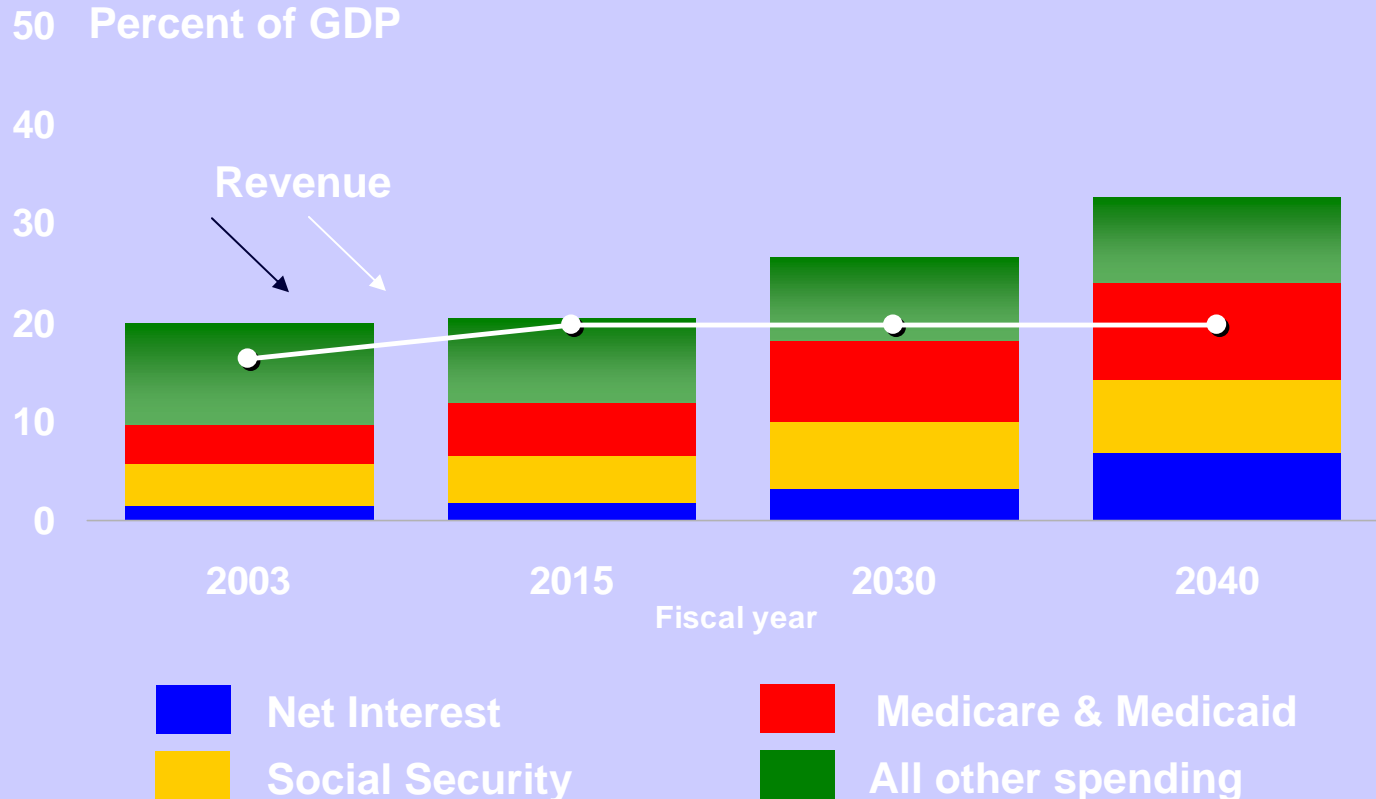
Source: *Budget of the United States Government, Fiscal Year 2005* (February 2004) and *Budget of the United States Government, Fiscal Year 2005, Mid-session Review* (July 2004), Office of Management and Budget.

Debt

- Debt held by the public—\$4.3T
- Trust fund debt—\$3.1T
- Gross debt—\$7.4T
- Gross debt per person—about \$25,000
- If we add everything on the previous slide that is not included in gross debt, the burden rises to more than \$145,000 per person or more than \$350,000 per full-time worker.
- Alternatively, it amounts to a total unfunded burden of more than \$43 trillion in current dollars, which is about 19 times the current annual federal budget or about 4 times the current annual GDP.

Composition of Spending as a Share of GDP

Under Baseline Extended

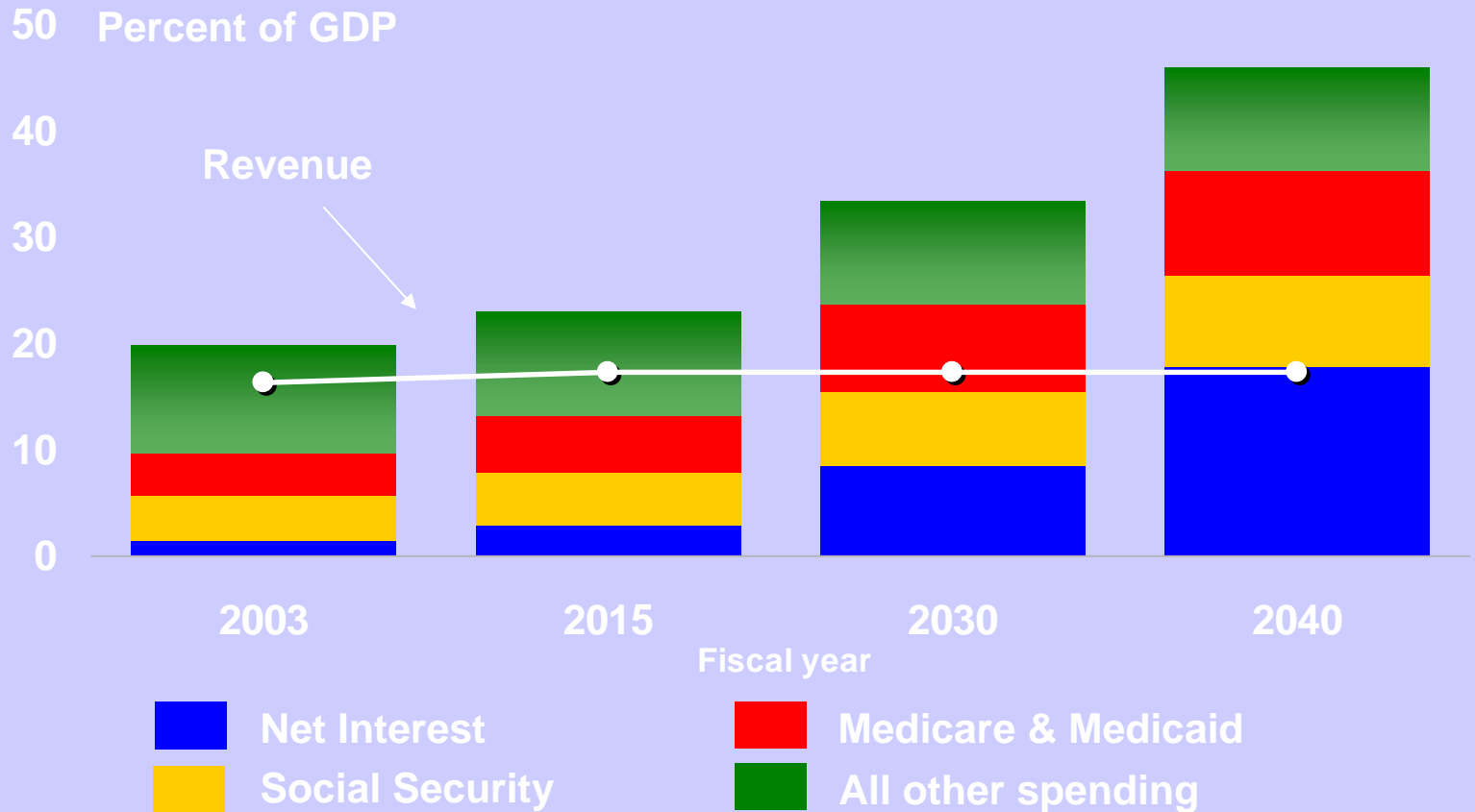


Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant. Budgetary effects due to passage of the Working Families Tax Relief Act of 2004 are not reflected in this simulation.

Source: GAO's September 2004 analysis.

Composition of Spending as a Share of GDP

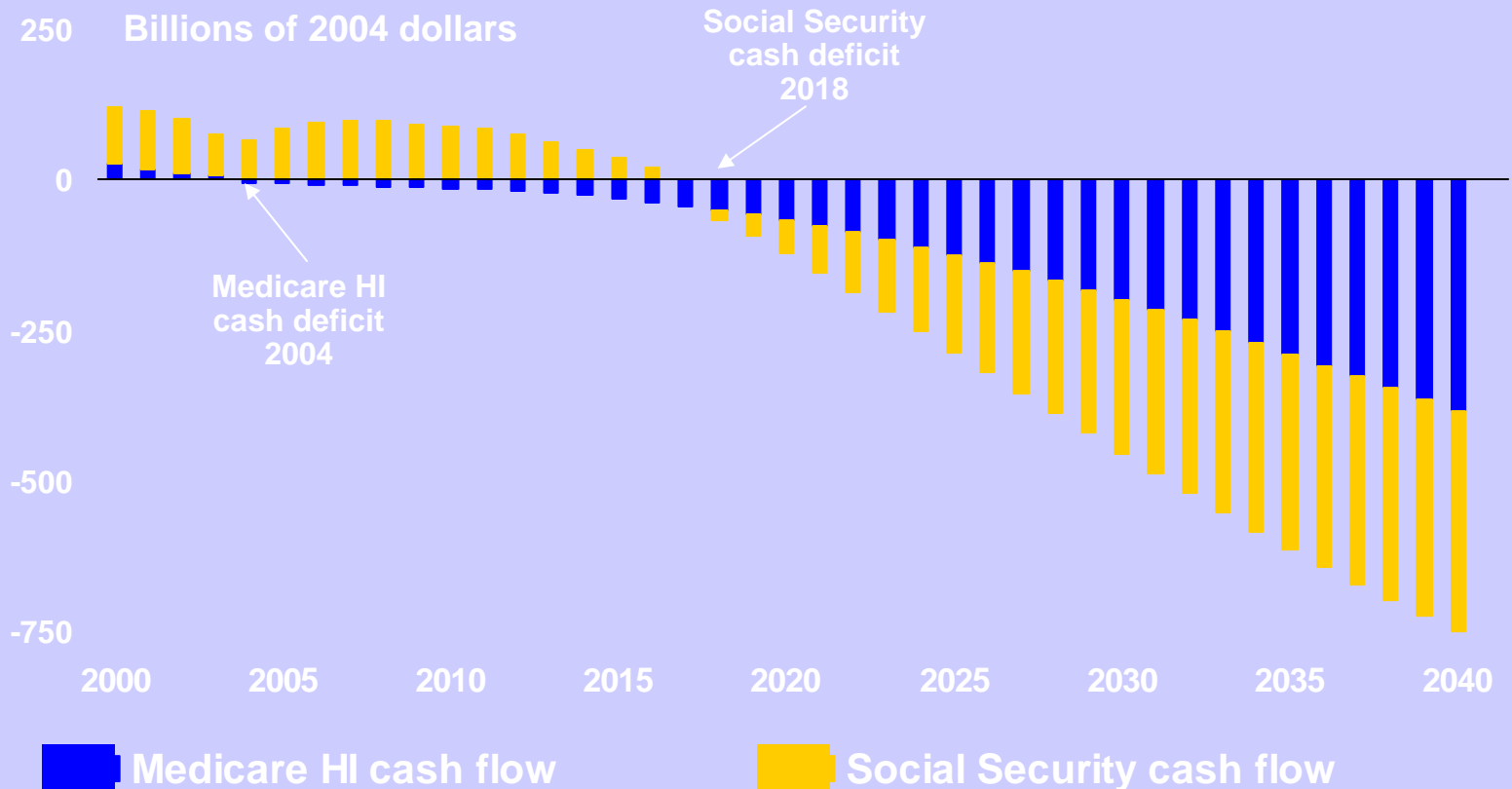
Assuming Discretionary Spending Grows with GDP after 2004
 and All Expiring Tax Provisions are Extended



Notes: Although expiring tax provisions are extended, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant.

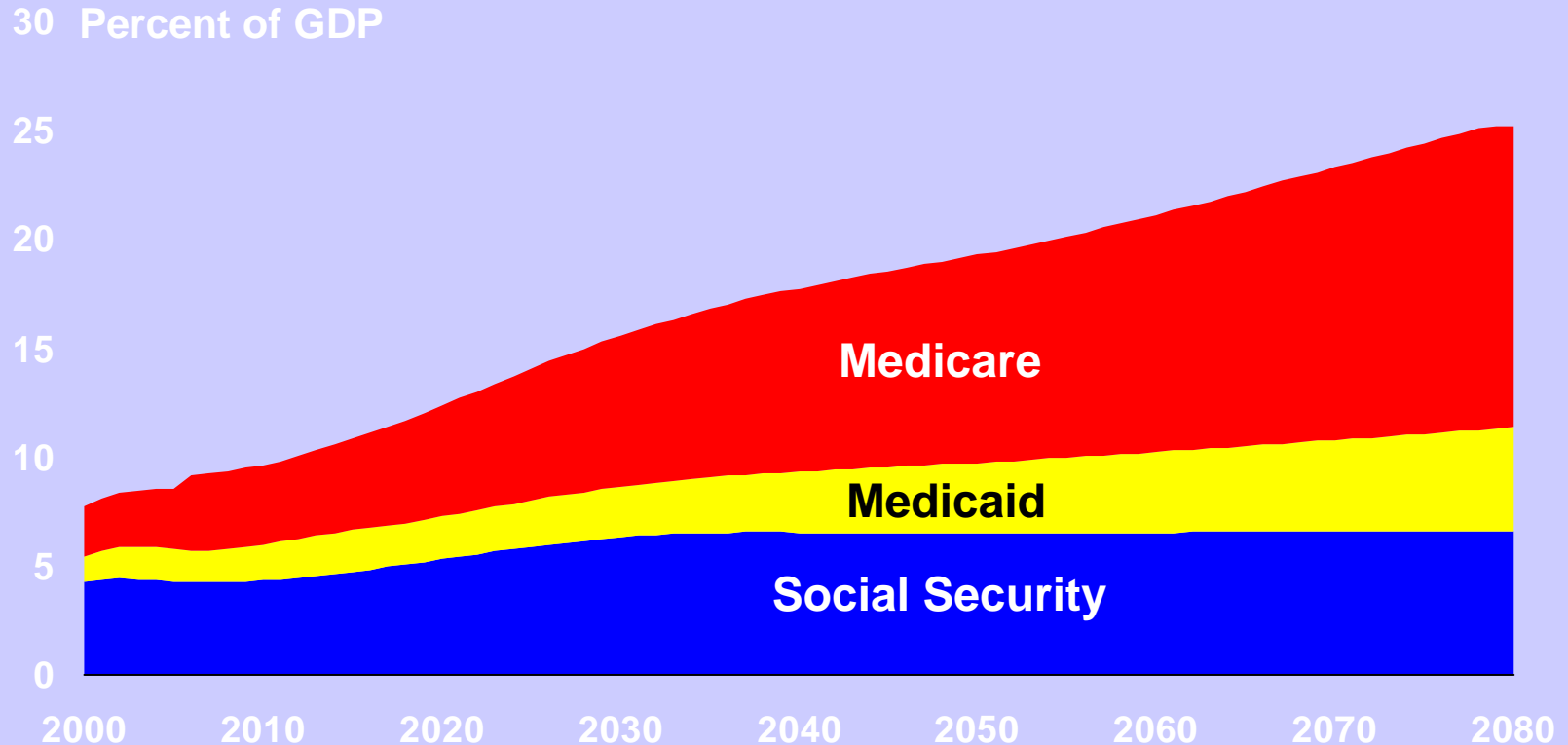
Source: GAO's September 2004 analysis.

Social Security and Medicare's Hospital Insurance



Source: GAO analysis based on the intermediate assumptions of *The 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and the Federal Disability Insurance Trust Funds* and *The 2004 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*. The above excludes Medicare Part B and the newly enacted Medicare Part D benefit.

Social Security, Medicare, and Medicaid Spending as a Percent of GDP



Note: Social Security and Medicare projections based on the intermediate assumptions of the 2004 Trustees' Reports. Medicaid projections based on CBO's January 2004 short-term Medicaid estimates and CBO's December 2003 long-term Medicaid projections under mid-range assumptions.

Source: GAO analysis based on data from the Office of the Chief Actuary, Social Security Administration, Office of the Actuary, Centers for Medicare and Medicaid Services, and the Congressional Budget Office.

Are Funded Systems Different?

- In any pension system today's pensioners are dependent on resource transfer from today's workers
- Funded systems only help overcome demographic challenges if they increase savings – in current and future generations
- Funded systems face demographic risks
- The implications are closely similar for funded and non-funded systems

Against This Backdrop of Demographic and Public Policy Change, What Has Happened to the Retirement Industry ?

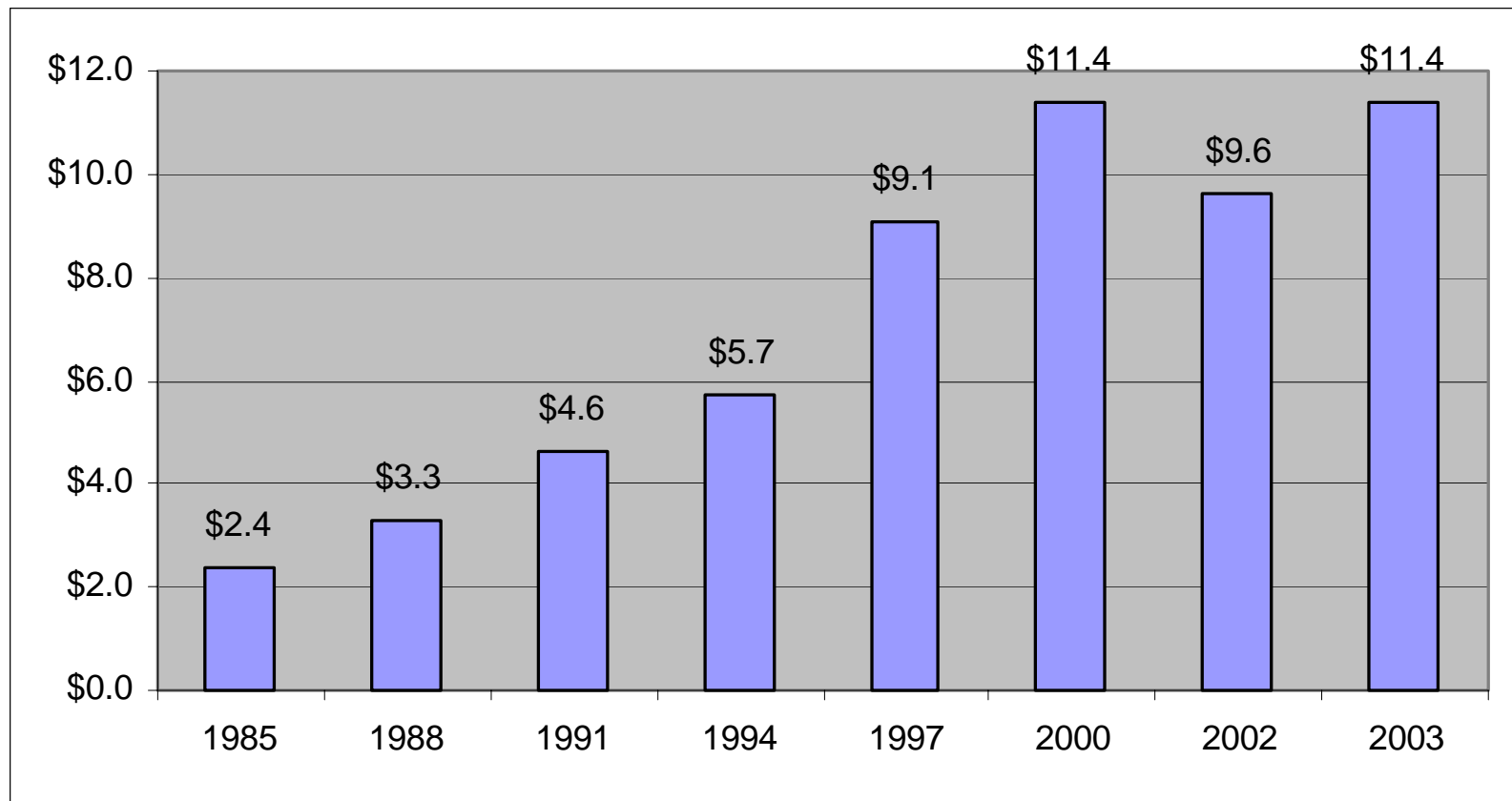
The Post ERISA Years

	1974	2004
Private Non-Farm Workforce	62 million	114 million
Active Participants in a Private DB Plan	43.7%	Single 17%
65+ With Private DB Pension Annuity	15.9%	22.8%
DB CB %	0%	22-25%
DC %	18%	58%

The Post ERISA Years

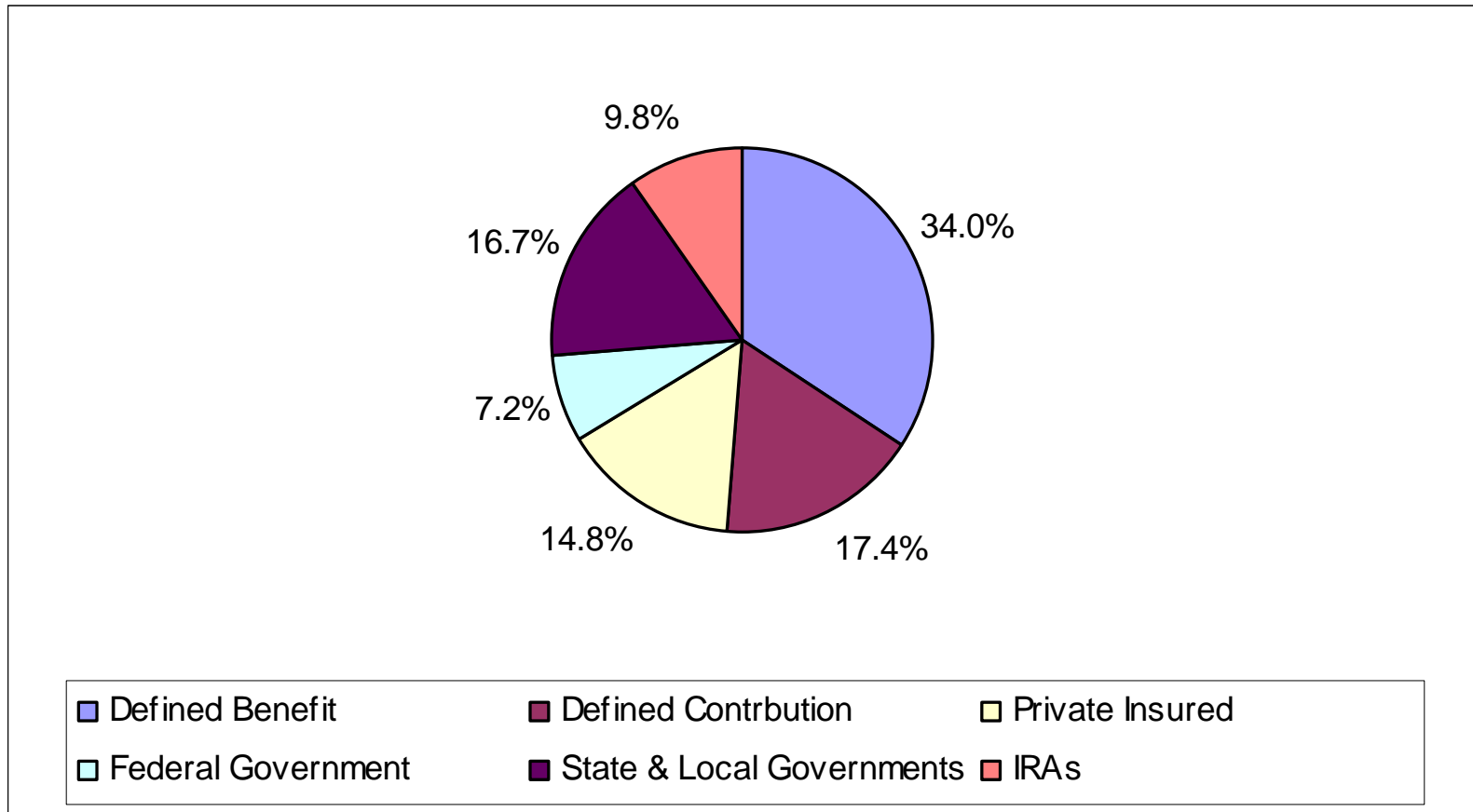
	1974	2003/04
State and Local Participants	8 million	14 million
Participants %	76.9%	75.1%
Percentage in DC Plans	1% ?	17%
Percentage in DB Plans	90%	90%
Deferral Ability	? %	40%

Total Assets in U.S. Retirement Income Plans, 1985-2003



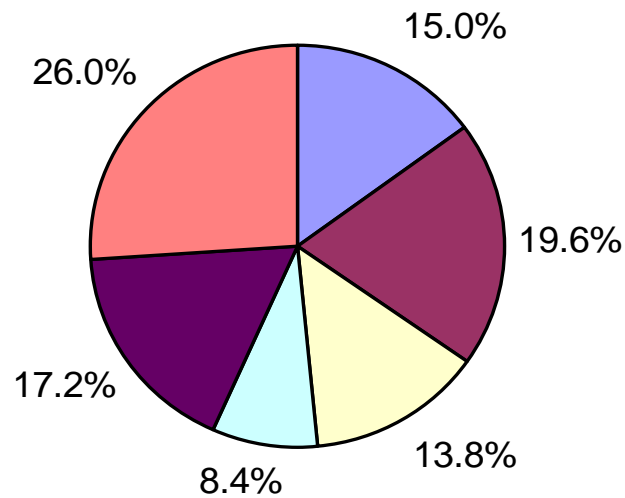
Retirement Plan Assets by Plan Type, 1985

DB 51% DC+IRA 34%



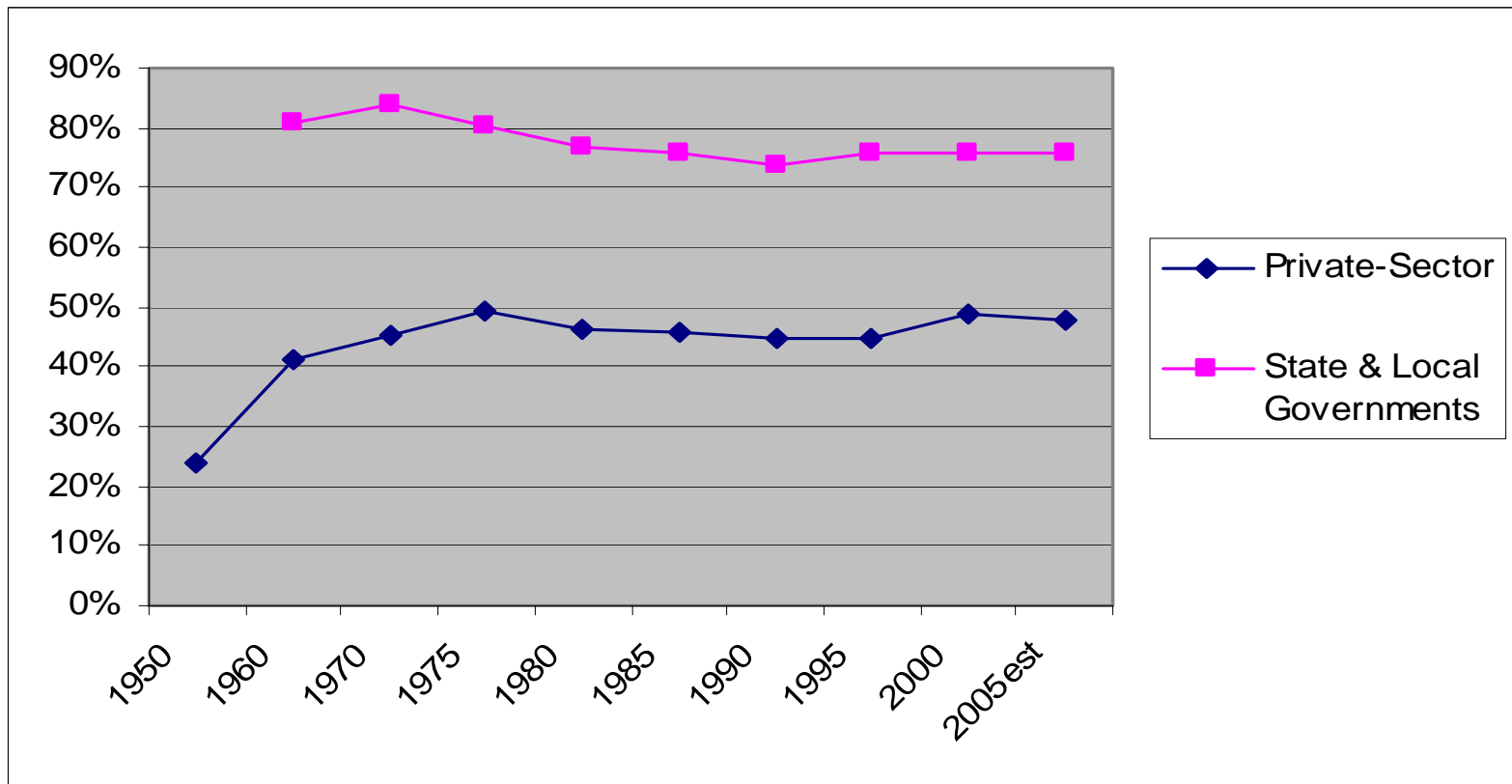
Retirement Plan Assets by Plan Type, 2003

DB 32% DC+IRA 54%

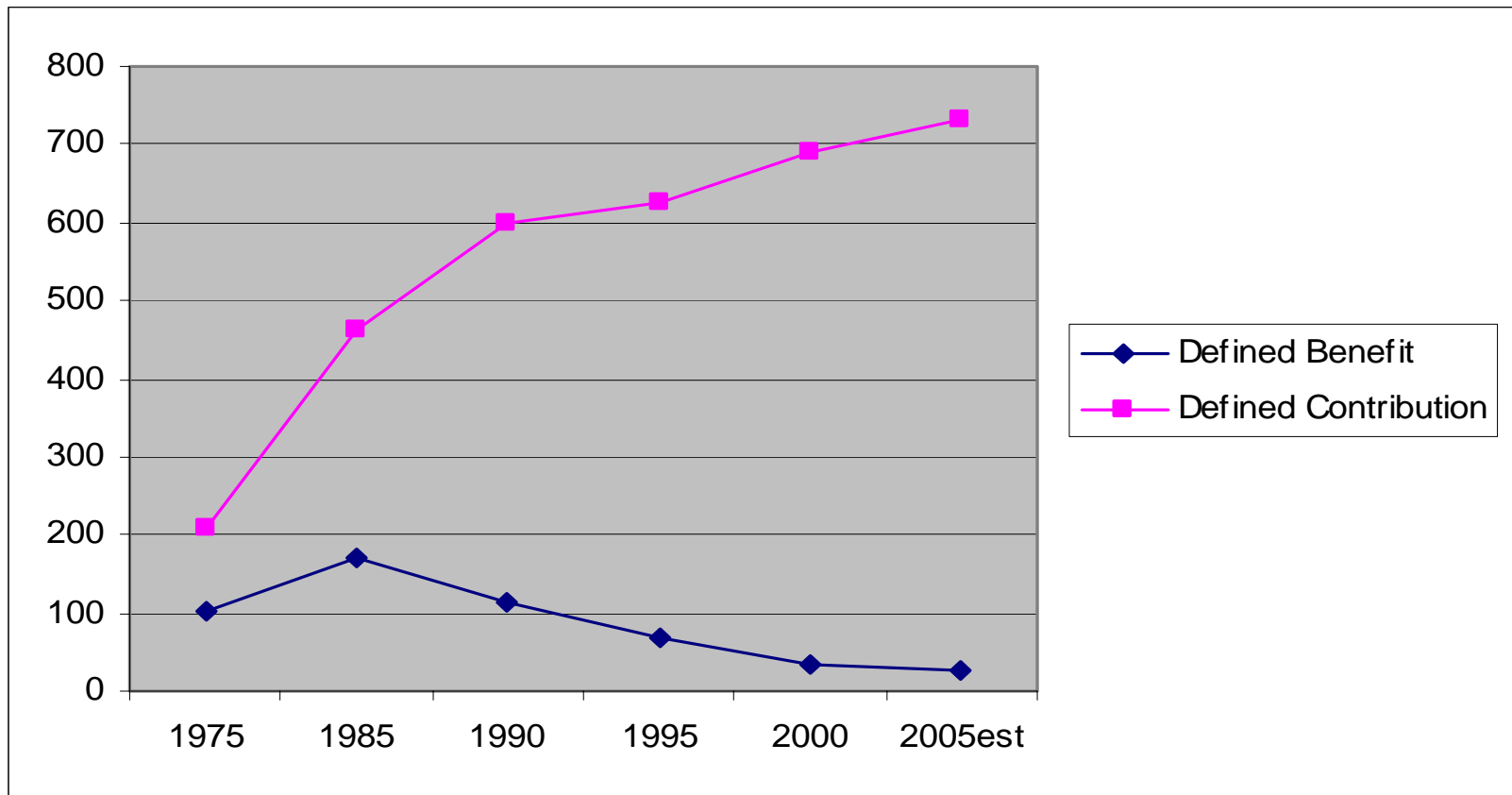


Defined Benefit	Defined Contribution	Private Insured
Federal Government	State & Local Governments	IRAs

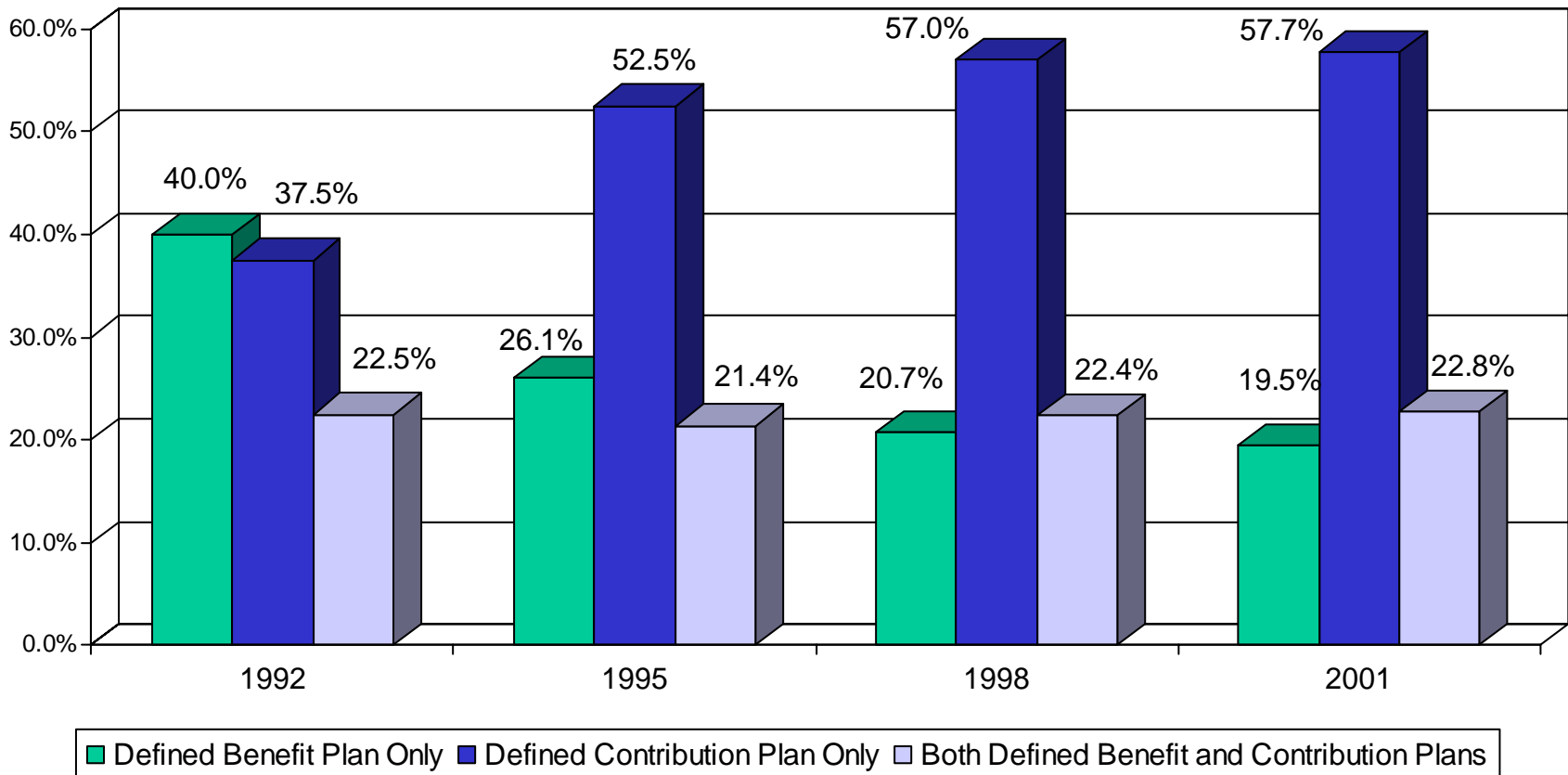
Active Retirement Plan Participants as a Percentage of the Work Force, 1950-2005



Number of Defined Benefit and Defined Contribution Plans, 1975-2005

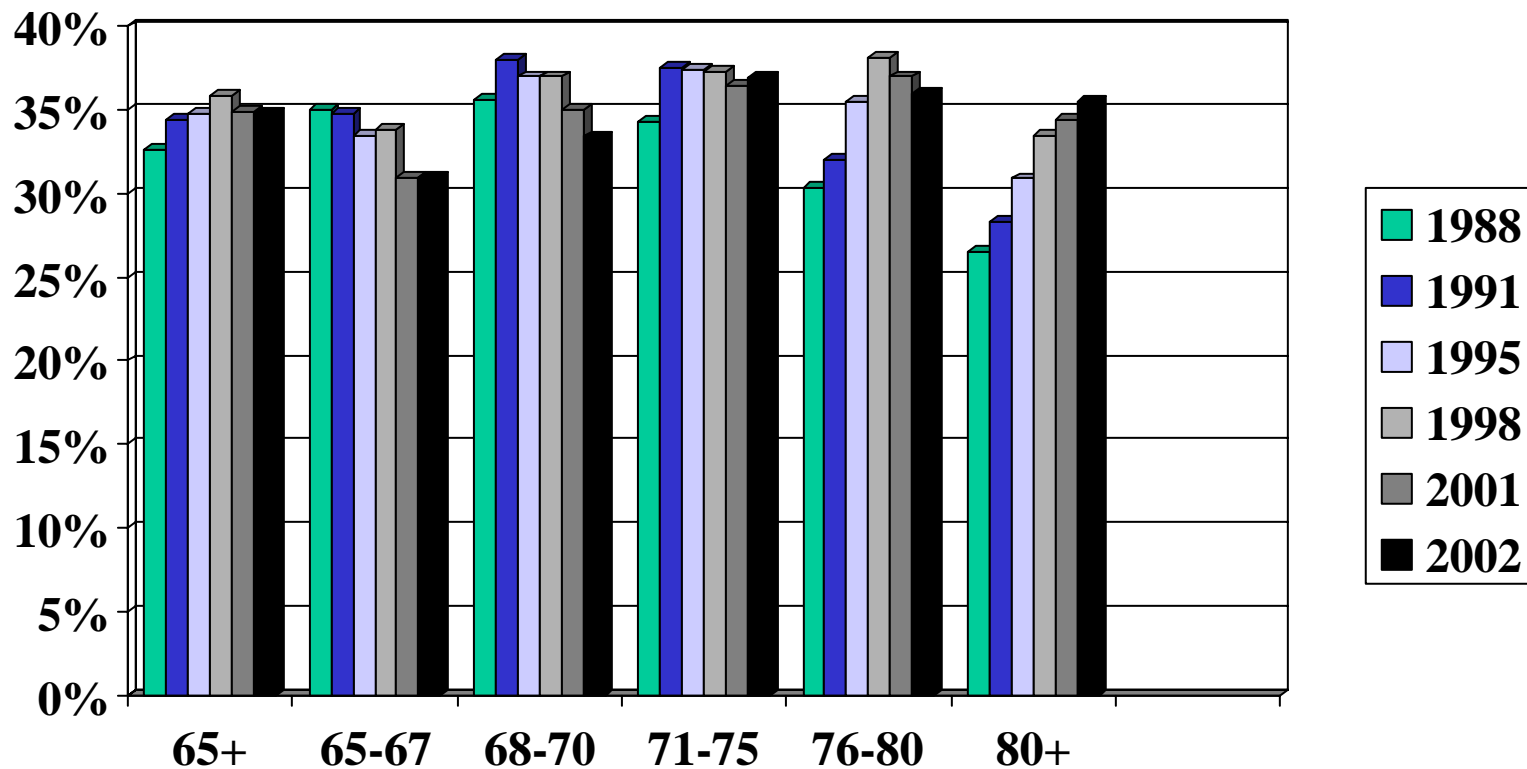


Percentage of All Families With an Employment-Based Retirement Plan Participant (Public or Private) In Each Plan Type, 1992-2001



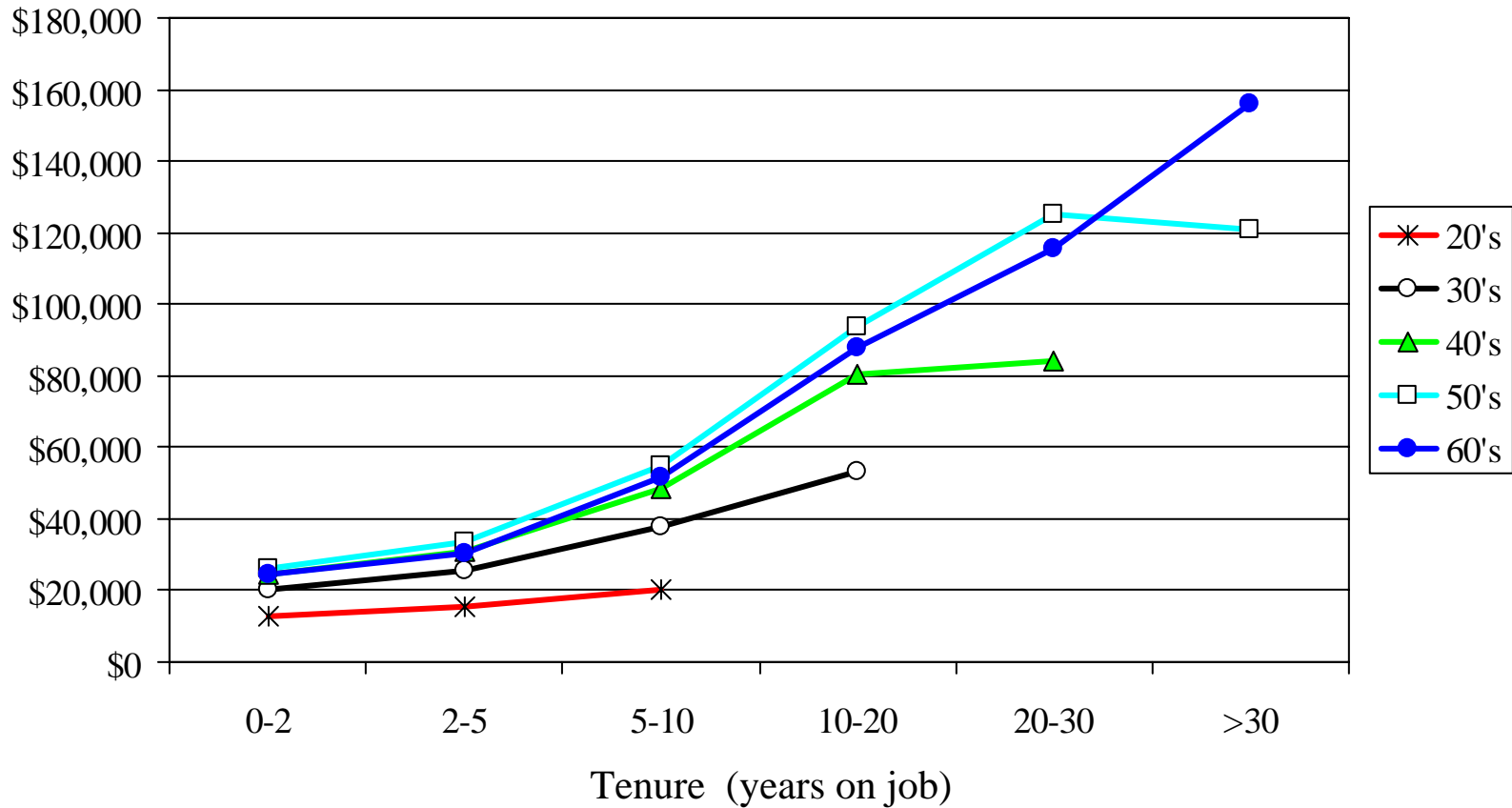
Source: *EBRI Issue Briefs*, July 2000 and 2003.

Percent of 65+ With Pension and Annuity Income 1988-2002



Source: EBRI CPS tabulations, EBRI Notes v24n12, 12/03
 13% are from Public Employers

Average 401(k) Account Balances, by Age and Tenure, 2003



Average Account Balances Among 401(k) -Participants
 Are Not Yet Sufficient for Adequacy – Even for Long
 Service Workers – and Prospects for **ADEQUACY** are
 Not Positive

	EOY 1999	EOY 2000	EOY 2003
Total	\$64,074	\$63,470	\$76,809
20s	\$9,571	\$12,074	\$23,888
30s	\$35,112	\$36,559	\$50,937
40s	\$66,702	\$66,854	\$82,999
50s	\$103,626	\$100,241	\$112,854
60s	\$134,964	\$125,601	\$127,130

Figure 7

Percentage Increase in Median Percentage of Additional Compensation That Must Be Saved Annually Until Retirement for a 75% Chance of Covering Simulated Expenses as a Result of Assuming All Defined Benefit Participants Take LSDs at Retirement

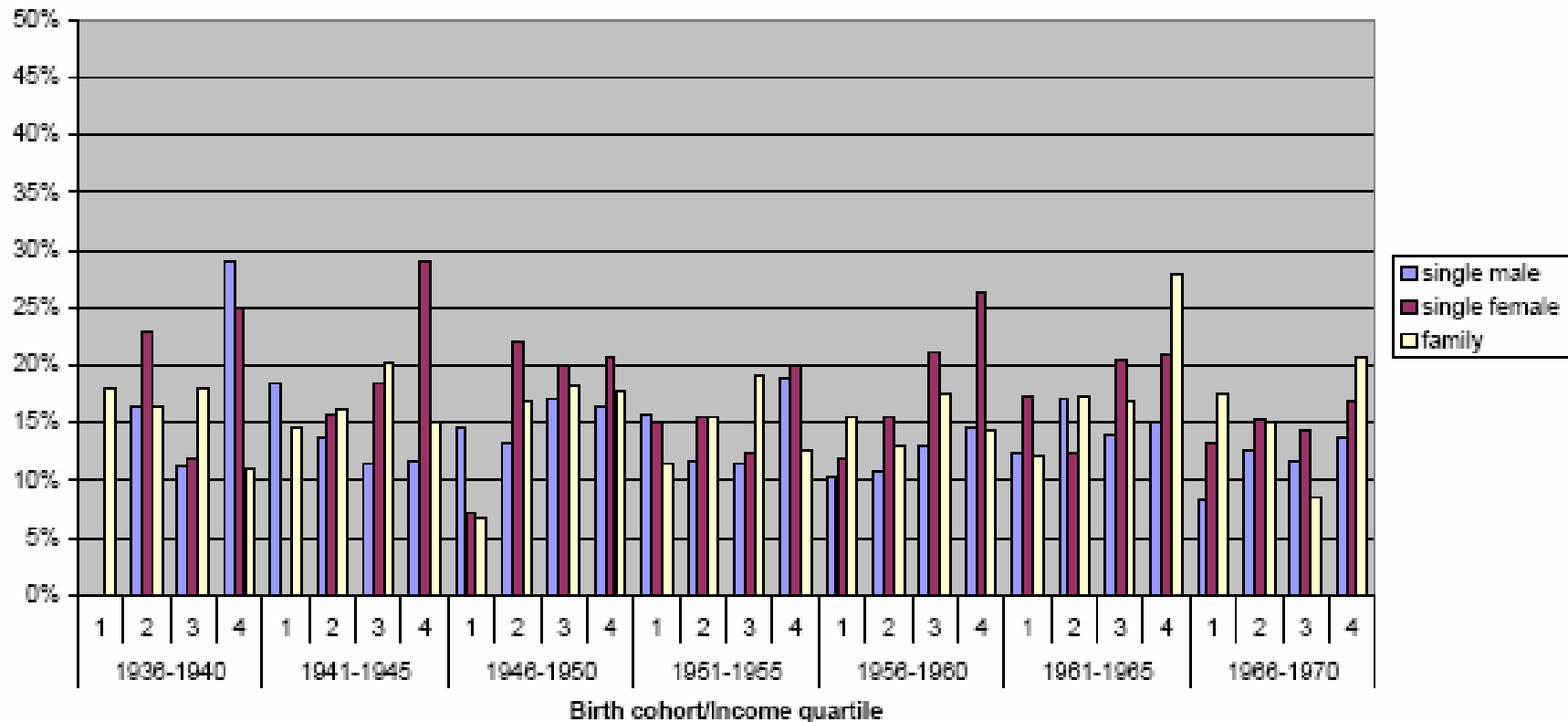
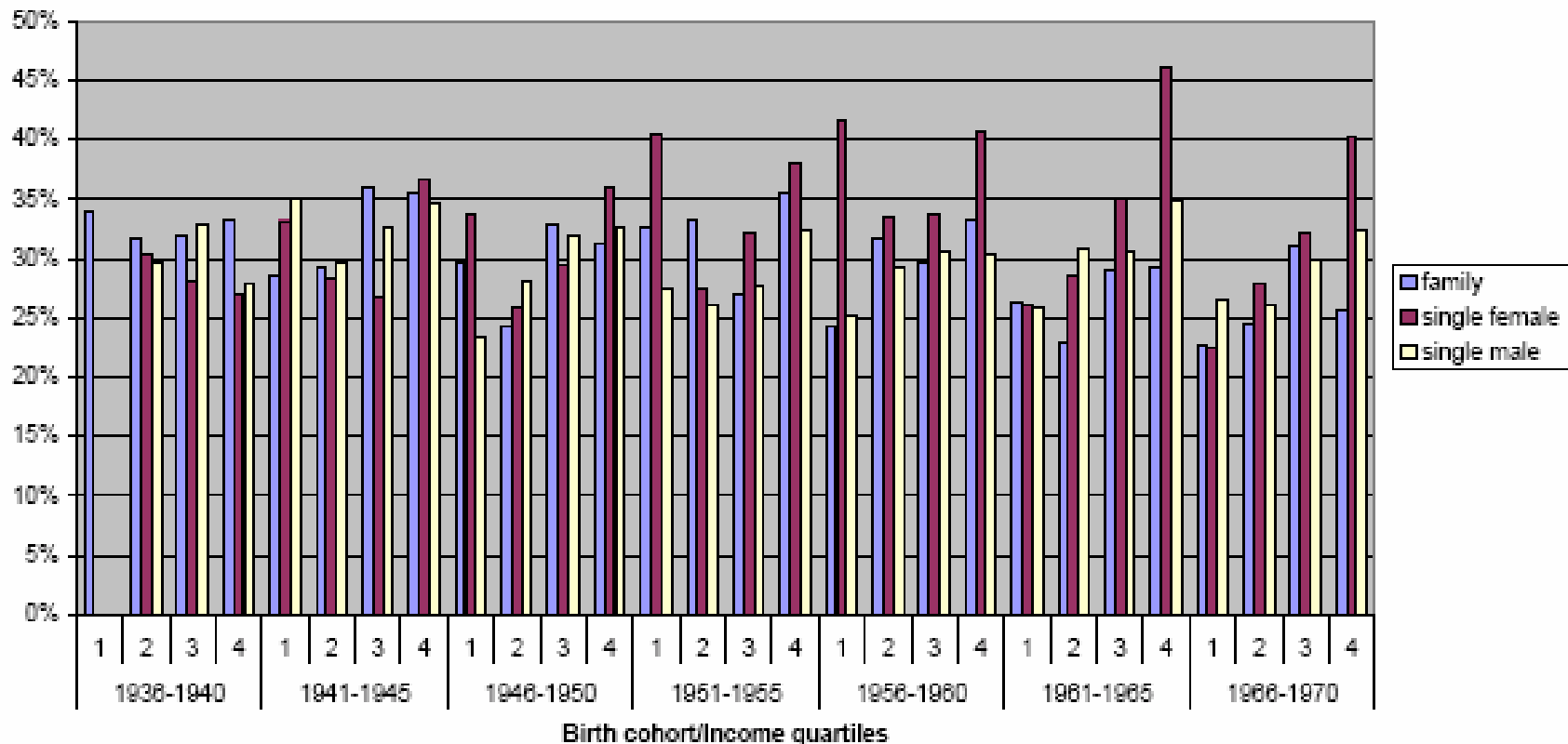


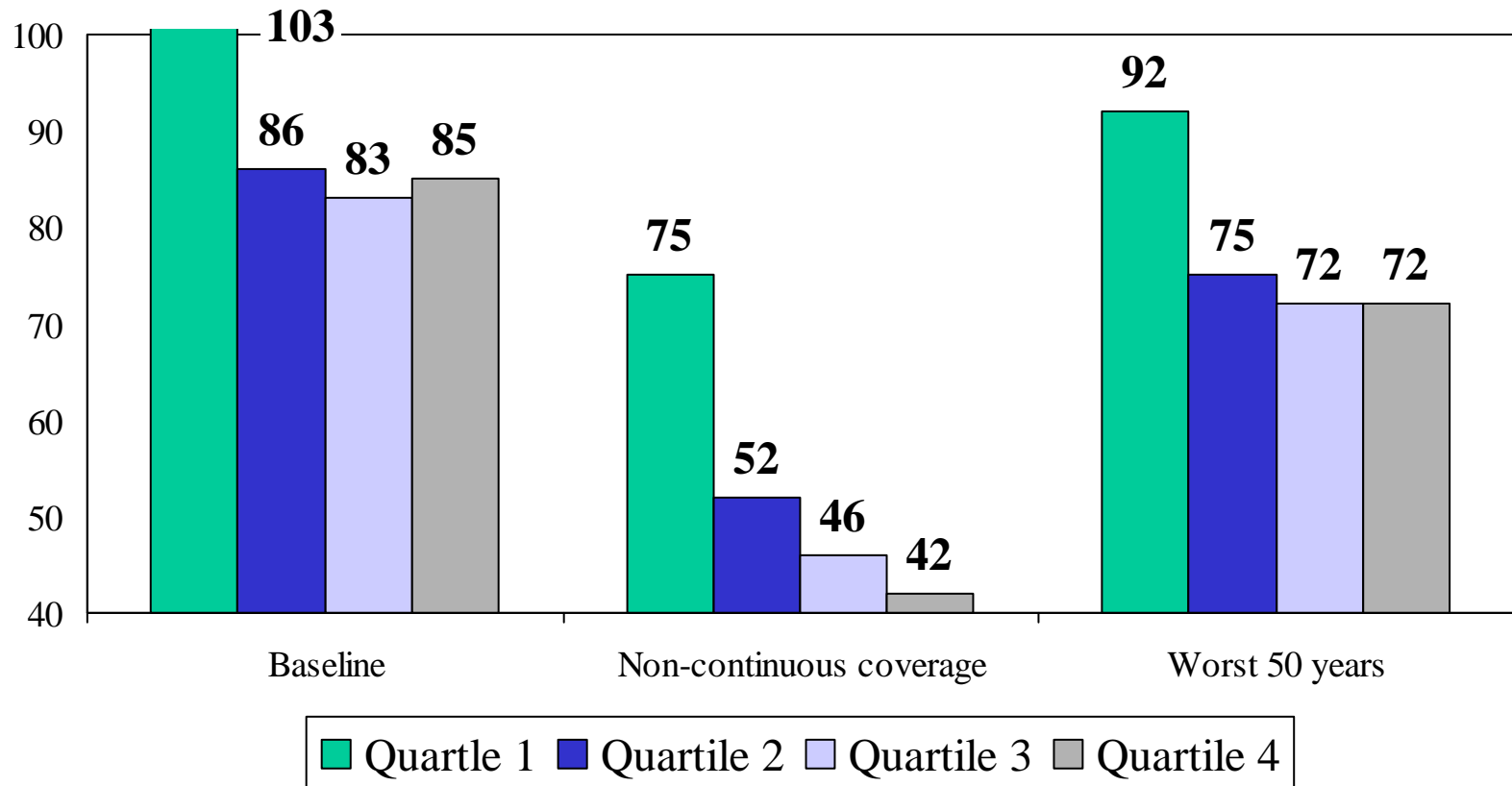
Figure 8
 Percentage Reduction in Median Percentage of Additional Compensation That Must Be Saved
 Annually Until Retirement for a 75% Chance of Covering Simulated Expense as a Result of
 Annuitizing All Individual Accounts at Retirement



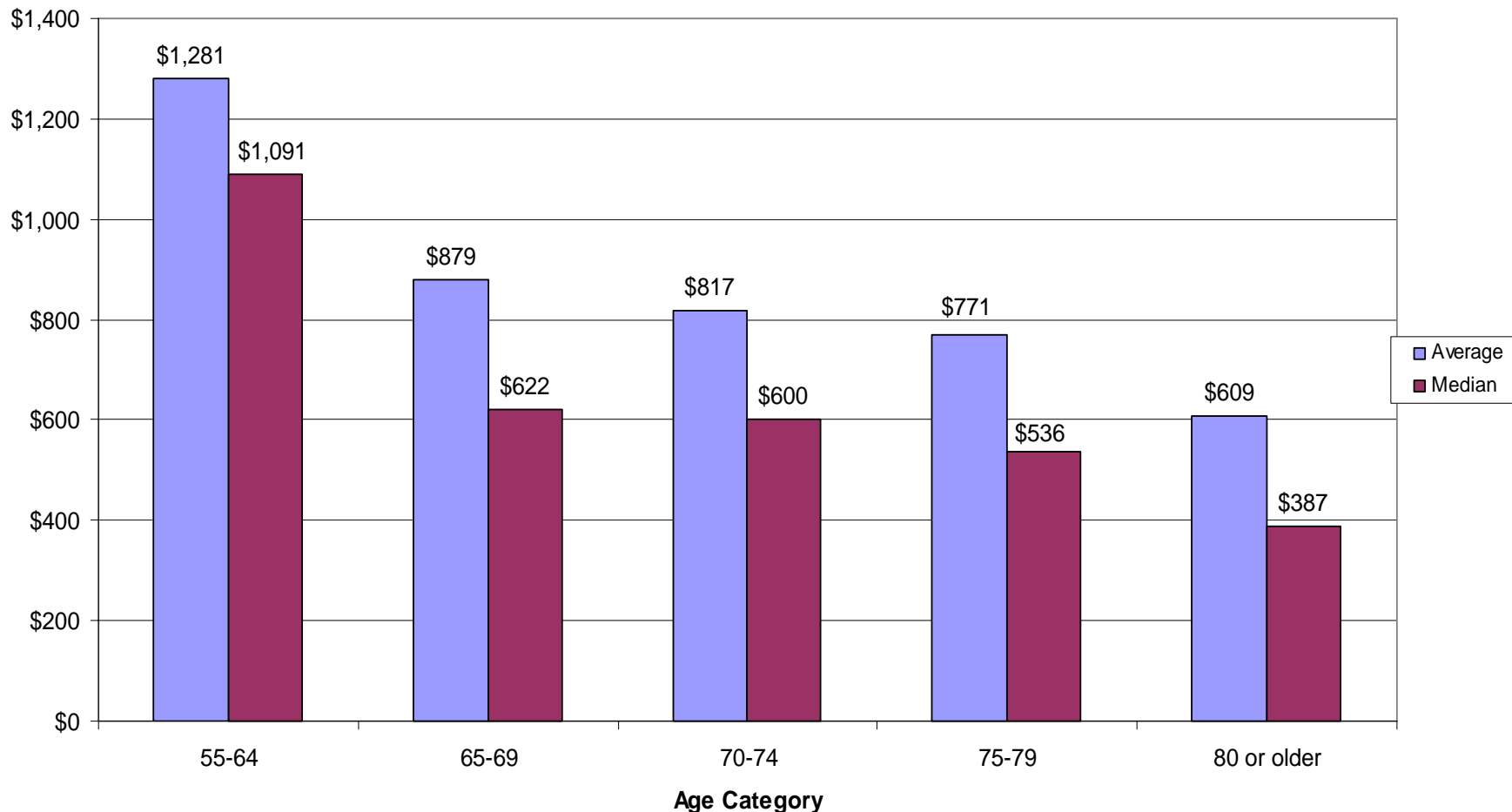
Source: EBRI-ERF Retirement Security Projection Model

Possible Median Replacement Rates for K Participants Turning 65 Between 2035 and 2039, by Income Quartile at Age 65

(percentage of final five-year salary replaced by Social Security and 401(k) Accumulations)



Average and Median Monthly Private Pension Income Amounts, By Age



Source: Employee Benefit Research Institute estimates of the 2001 SIPP (2003).

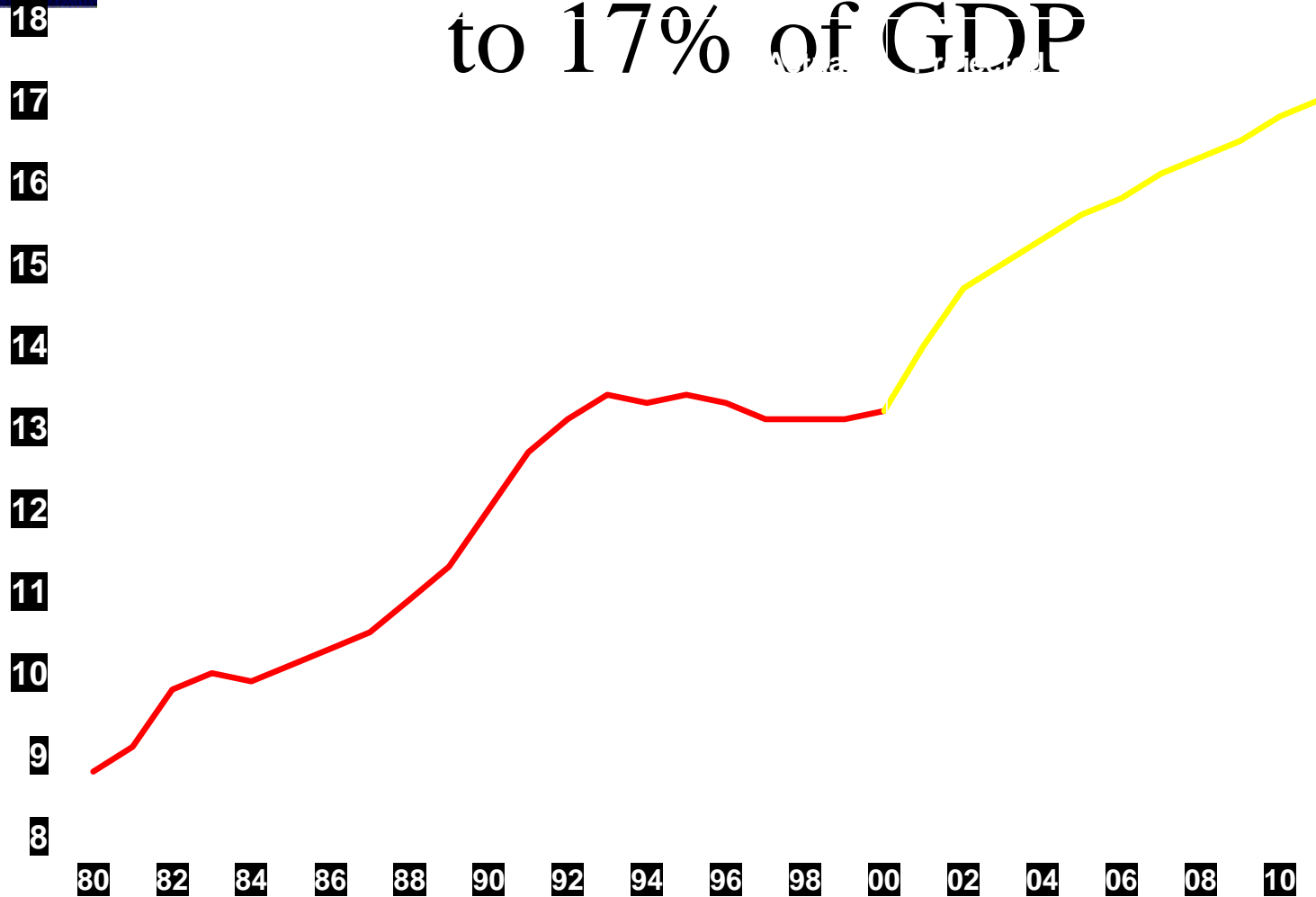
Putting Income in Perspective

- 7.7 million retirees have a private DB annuity. The median value is \$6,000 or a wealth equivalent of about \$170,000.
- 3.0 million retirees have a public DB annuity. The median value is \$13,000 or a wealth equivalent of about \$375,000.
- Median SSA income is \$11,800 or a wealth equivalent of about \$339,000.
- For 65+ with no pension income a median SSA of \$8,988 or a wealth equivalent of \$256,000.

Note: Annuity conversion rate of 3.5% assumed.

Savings Needs for Health
Care in Retirement Are Not
Being Adequately Planned
For – Which Will Squeeze
Retiree Spending

Health Expenditures: Headed to 17% of GDP



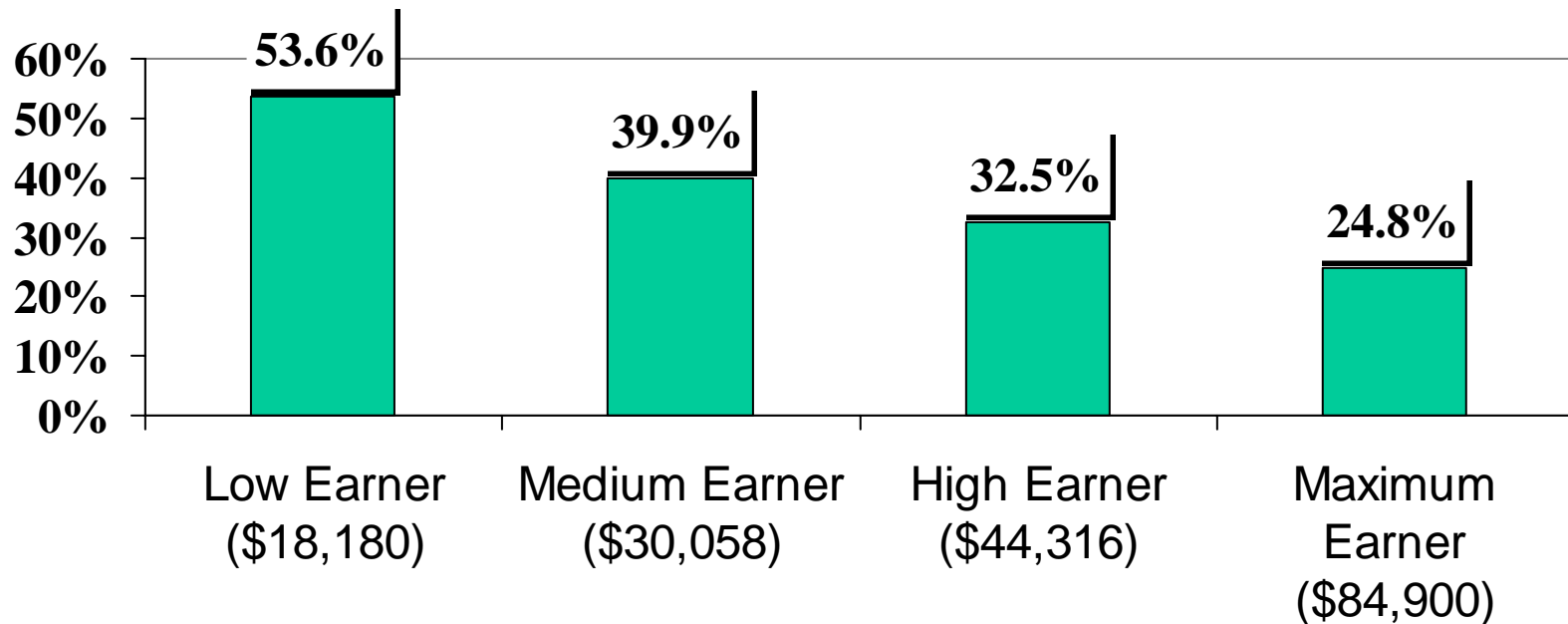
Sources: CMS, Office of the Actuary, National Health Statistics Group

Savings Needed for Medigap Coverage at Age 65 in 2004 at 7% Health Inflation

Age at Time of Death	Medigap + B&D	+ 500 OP Drug	+ 2850 OP Drug
80	\$58,000	\$66,000	\$114,000
85	\$82,000	\$95,000	\$169,000
90	\$110,000	\$129,000	\$235,000
95	\$142,000	\$168,000	\$315,000
100	\$179,000	\$213,000	\$411,000

SSA Replacement ratios

Percentage of Pre-Retirement Earnings Replaced by Social Security



Realities

Realities

- Financial literacy is low.
- Savings is low and debt is high.
- IRA's are not being used.
- 401(k) type plans are not being used at high enough levels with high enough contributions.
- DB plan annuities are in phase-out, and all DB plans could phase-out over time with new hires shifted to DC only.
- Government policy could make matters worse.

Opportunities

- Add automatic features to help workers.
- Add base contributions to entice full participation.
- Add distribution features that protect against life expectancy risk.
- Add education that makes the amount that must be contributed for a meaningful result crystal clear.

Opportunities

- Add investment options that do not require financial literacy.
- Expand education on the distribution phase.
- Provide more payout options.
- Consider annuities as an asset class.

Discussion



2121 K Street NW, Suite 600

Washington, DC 20037

Phone: 202-659-0670

Fax: 202-775-6312

EBRI.org

ChooseToSave.org

EBRI.org

for data and research

2121 K Street NW, Suite 600

Washington, DC 20037

Phone: 202-659-0670

Fax: 202-775-6312

ChooseToSave.org

for retirement saving education and tools

Appendix: Public Policy Context

Political Context for Retirement Policy

- Unified Republican Control
- Natural Focus on Presidential Legacy
- Interest in Fundamental Reforms
- Philosophical Underpinnings
 - Individual Initiative and Control
 - Ownership/Wealth Creation
 - Skepticism Re Government and Employer DB Promises
- Yet Many of the Usual Constraints Remain

Social Security Reform

- Bush Posture and Proposals
- Key Substantive Issues
 - Carve-Out or Add-On Accounts
 - Transition Costs
 - Benefit and Tax Changes
 - Employer and Plan Repercussions
- Political Dimensions
- Congressional Perspectives
- Timetable and Enactment Outlook



Pension Funding Reform

- The Context
 - Interest Rate Expiration
 - Airline Pensions/PBGC Exposure
- Bush Proposals
- Key Substantive Issues
 - Fundamental vs. Incremental Reforms
 - Yield Curve
 - Lump Sums
- Congressional Perspectives
- Timetable and Enactment Outlook



Savings Account Reform

- The Return of the Three Sisters
 - LSAs, RSAs and ERSAs
- Key Substantive Issues
 - Employer Plan Ramifications
- Congressional Perspectives
- Likely Link to Tax Reform Debate
- Timetable and Enactment Outlook



Tax Reform



- Bush Posture and Process
 - Role of Permanence of Prior Tax Cuts
 - Simplification and Savings/Investment Focus
 - Treasury Advisory Panel
- Retreat from Radical Reforms
- Key Issues for Retirement Plans
- Congressional Perspectives
- Timetable and Enactment Outlook

Appendix: Administration Proposal

Administration Single-Employer Pension Reform Proposal

Challenges Facing the Defined-Benefit Pension System

- The pension insurance system is broken and threatening workers, healthy plan sponsors, and taxpayers
- There are three keys to fixing the system:
 - **Reform funding rules** – to induce employers to fully fund their plans
 - **Reform insurance premiums** -- to better reflect costs and risks
 - **Improve disclosure** -- to better inform workers, investors and regulators

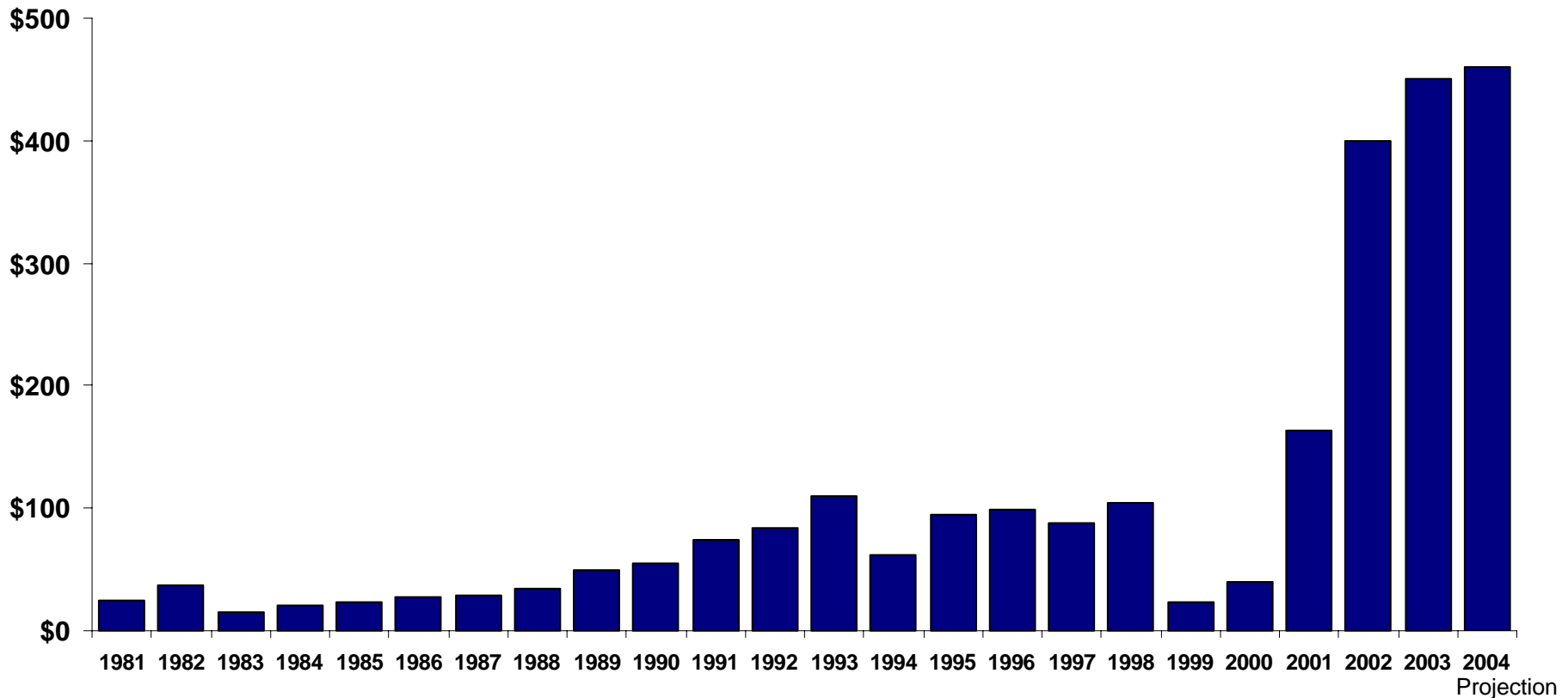
Administration Goals

- Protect workers
- Avoid a taxpayer bailout of PBGC

Problem: Underfunding has skyrocketed...

Total Underfunding of Insured Single-Employer Plans

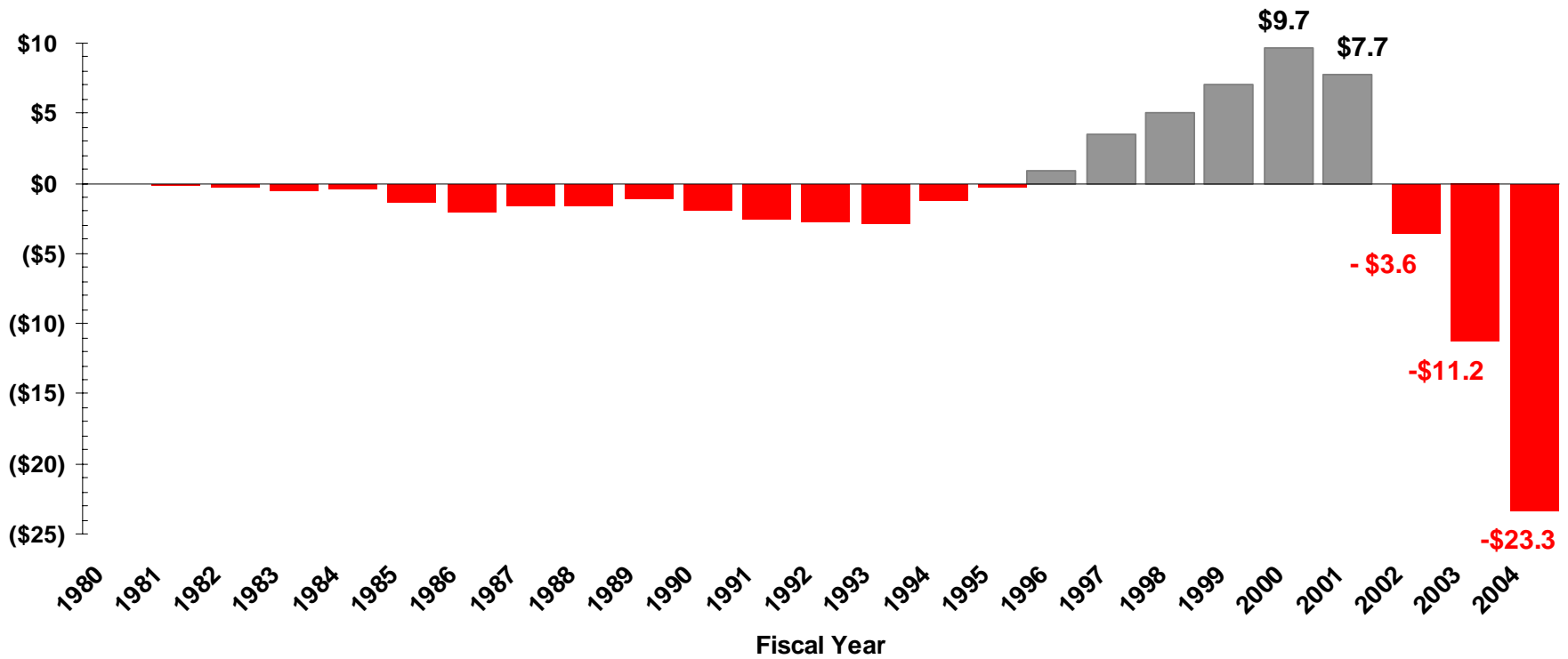
Billions



...and PBGC has fallen into a deep hole

PBGC Net Position Single-Employer Program

Assets minus Liabilities
 (Billions \$)



The Administration Single-Employer Pension Reform Proposal

One single, accurate measure of liabilities valued according to current duration-matched yield curve of corporate bond rates

Assumptions that appropriately reflect the plan's risk of termination

Plans given a reasonable period of time to reach their funding targets

Sponsors allowed to make additional deductible contributions during good economic times

Underfunded plans or financially weak sponsors restricted from increasing unfunded benefits

Premiums that meet PBGC's long-term funding needs

Better disclosure of plan information to workers, markets, and regulators

Clarify the treatment of hybrid (cash-balance) plans to expand pension options

Improve PBGC's standing to enforce contributions on firms in bankruptcy

The Administration proposal would simplify the system by replacing multiple measures of pension liabilities with one basic concept

Current Practice

Actuarial Liability

Current Liability

RPA
Current
Liability

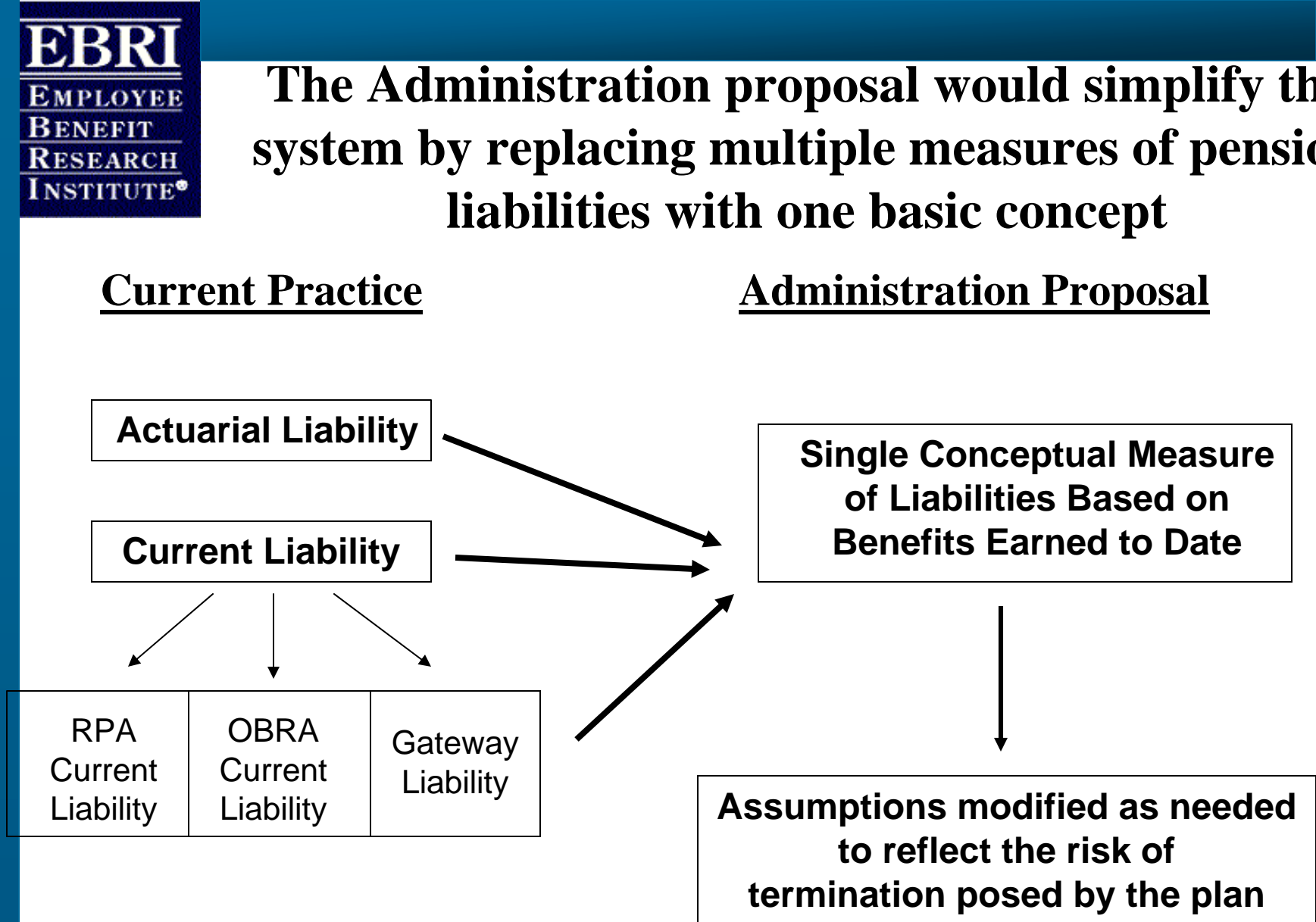
OBRA
Current
Liability

Gateway
Liability

Administration Proposal

Single Conceptual Measure
of Liabilities Based on
Benefits Earned to Date

Assumptions modified as needed
to reflect the risk of
termination posed by the plan



Under the Administration proposal, a plan's funding target would be based on the plan's Ongoing or At-Risk liability, depending on the sponsor's financial health

Company Status

Funding Target

Investment Grade (Baa or better)	→	Target assumes it is an <u>Ongoing</u> plan
Junk bond credit status less than 5 years	→	Target in between <u>Ongoing</u> and <u>At-Risk</u> status
Junk bond credit status 5 years or more	→	Target assumes it is an <u>At-Risk</u> plan

In an Ongoing plan, employees are assumed to retire and to choose lump sums as they have in the past. In an At-Risk plan, the rules will assume that employees will take lump sums and retire as soon as they can

Empirical evidence shows that a firm's time spent in junk bond status is a strong indicator of the likelihood of plan termination

The Administration proposal gives plans a reasonable period of time to address underfunding

- Under the Administration proposal, plans would annually contribute enough to address their funding shortfall over a reasonable period of time

The Administration proposal would allow plan sponsors to make additional deductible contributions during good economic times

Minimum Required Contribution	Maximum Deductible Contribution
<ul style="list-style-type: none">- Pursuant to funding target (not including future salary increases)	<ul style="list-style-type: none">- May pre-fund projected salary increases- May fund to include a “volatility cushion” equal to 30% of their funding target

The Administration proposal requires employers to pay for additional benefits immediately if the sponsor is financially weak or has a significantly underfunded pension plan

Percentage Points Below Required Funding Level (Target)	Bankrupt Sponsor	Junk Grade Sponsor (At-Risk Liability Target)	Investment Grade Sponsor (Ongoing Liability Target)
0 to 19	<ul style="list-style-type: none"> • No benefit increases • No lump sums • No accruals 	<ul style="list-style-type: none"> • No new restrictions 	<ul style="list-style-type: none"> • No new restrictions
20 to 39	<ul style="list-style-type: none"> • No benefit increases • No lump sums • No accruals 	<ul style="list-style-type: none"> • No benefit increases • No lump sums 	<ul style="list-style-type: none"> • No benefit increases
40 or worse	<ul style="list-style-type: none"> • No benefit increases • No lump sums • No accruals 	<ul style="list-style-type: none"> • No benefit increases • No lump sums • No accruals • No preferential funding of executive compensation 	<ul style="list-style-type: none"> • No benefit increases • No lump sums

The Administration proposal would reform the PBGC premium structure

- **Flat rate premiums** will be adjusted (initially to \$30) to reflect the growth in worker wages since 1991, when the current \$19 figure was set. Going forward, the flat rate premium will be indexed for wage growth
- **Risk based premiums** will be charged to each plan based on underfunding relative to its funding target. The risk-based premium rate will be adjusted periodically by the PBGC's Board so that premium revenue is sufficient to cover expected losses and improve PBGC's financial condition

The Administration proposal would improve the content and timeliness of disclosure

Better Content

- Require plans to disclose funding status relative to funding target annually
- Require funding trend data in participant disclosure

Greater Transparency

- Make certain financial information filed with PBGC by underfunded plans publicly available

More Timely Information

- Accelerate filing deadline for certain plan funding reports
- Accelerate disclosure of information to workers

Administration proposal would protect plans in bankruptcy

- Allow PBGC to perfect its lien against missed contributions while plan sponsor is in bankruptcy
- Notify participants when plan sponsor files for bankruptcy, including effect on plans

What is the Administration doing to help employers and workers expand retirement choices?

- Hybrid plans (e.g., “cash balance” plans) combine the best of defined benefit and defined contribution
 - Plans are portable
 - Employees understand and appreciate benefits
 - Investment risk borne by employer
 - Insured by the PBGC
- Enact the Treasury proposal to create legal and regulatory environment that supports continuation and adoption of hybrid plans
- Establish Employer Retirement Savings Accounts (ERSAs) that will simplify the rules surrounding employer-provided portable savings plans
- Increase worker access to investment education
- Allow workers in defined contribution plans to diversify out of company stock after three years

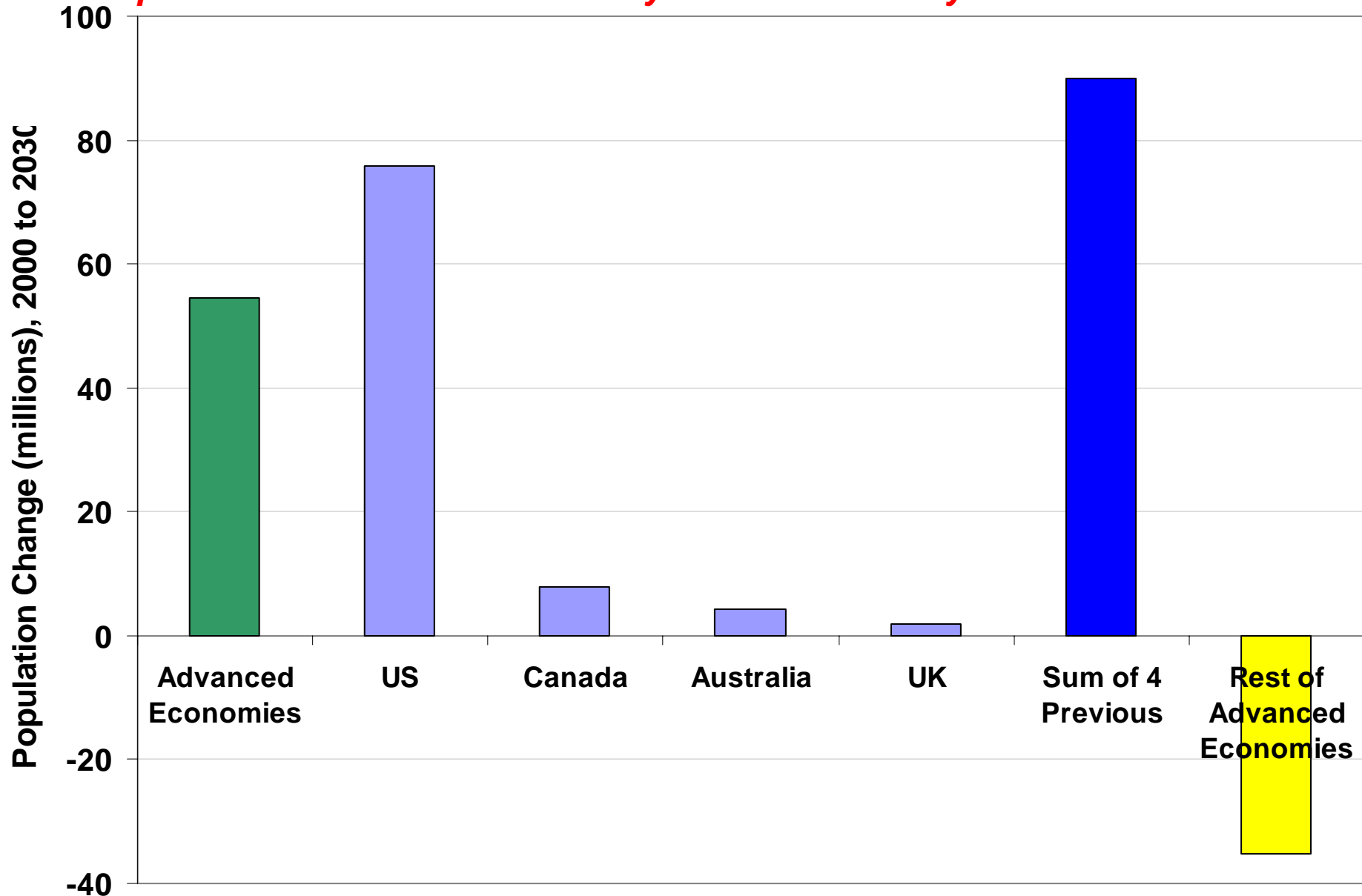
Summary:

- **The Administration single-employer pension reform proposal would make defined-benefit plans a more viable option for employers and workers by achieving:**
 - Sounder long-term pension funding
 - Reduced risk to workers and to the pension insurance system
 - Increased transparency and simplified measurements
 - Improved incentives for sound pension funding and greater flexibility for employers to fund up in good times
 - Opportunities for sponsors to reduce volatility in required pension contributions
 - Premiums that meet PBGC's long term funding needs
 - Reduced risk to the taxpayers of having to bail out the PBGC

World Demographics

Europe and Japan Face Consumer Decline

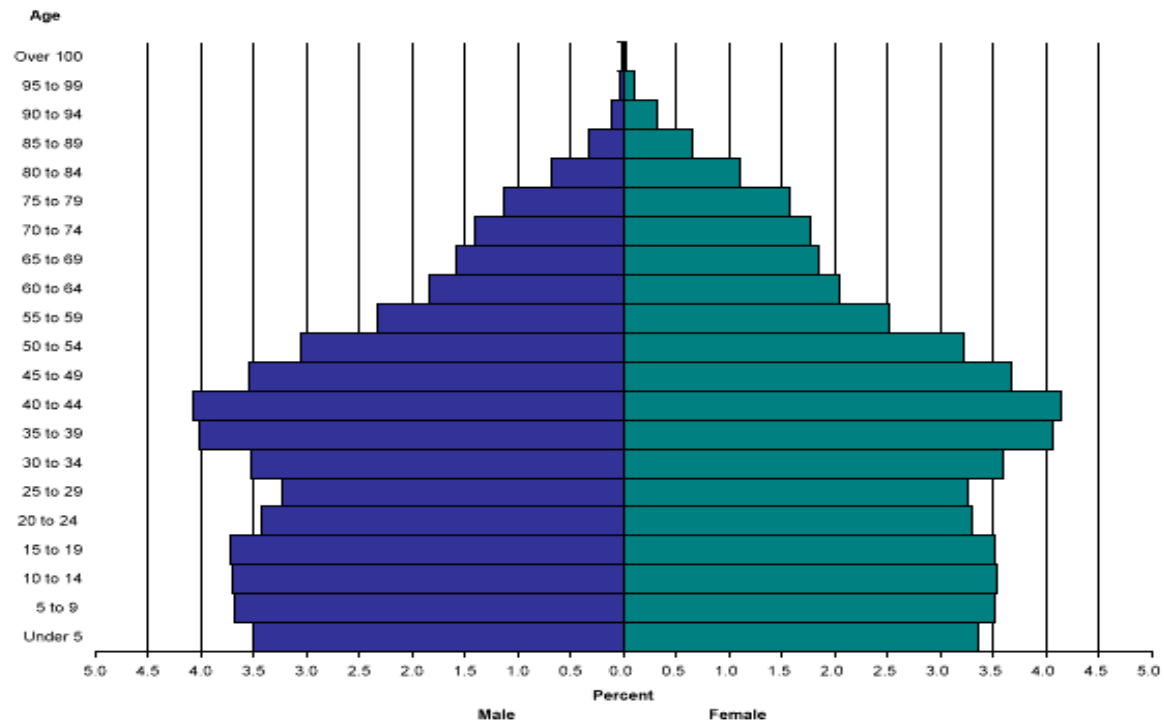
Population Growth in the Wealthy Nations is Mainly in North America



Data source: US Census Bureau, International Data Base.

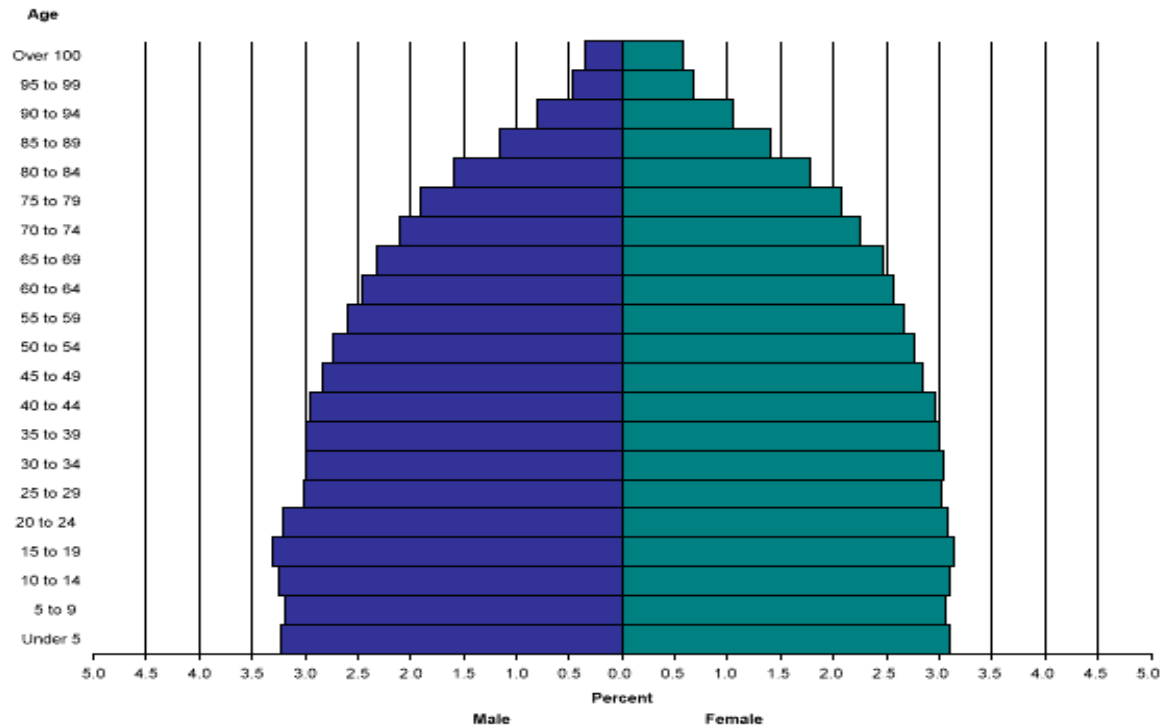
Population 2000

(NP-P2) Projected Resident Population of the United States as of July 1, 2000, Middle Series.



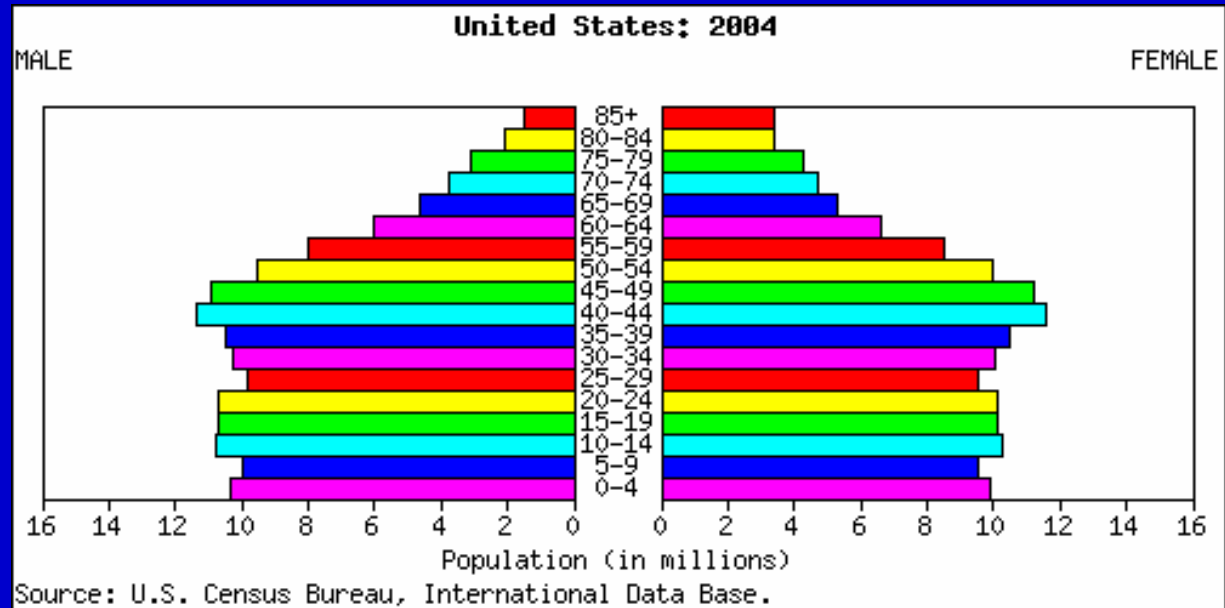
Population 2100

(NP-P5) Projected Resident Population of the United States as of July 1, 2100, Middle Series.

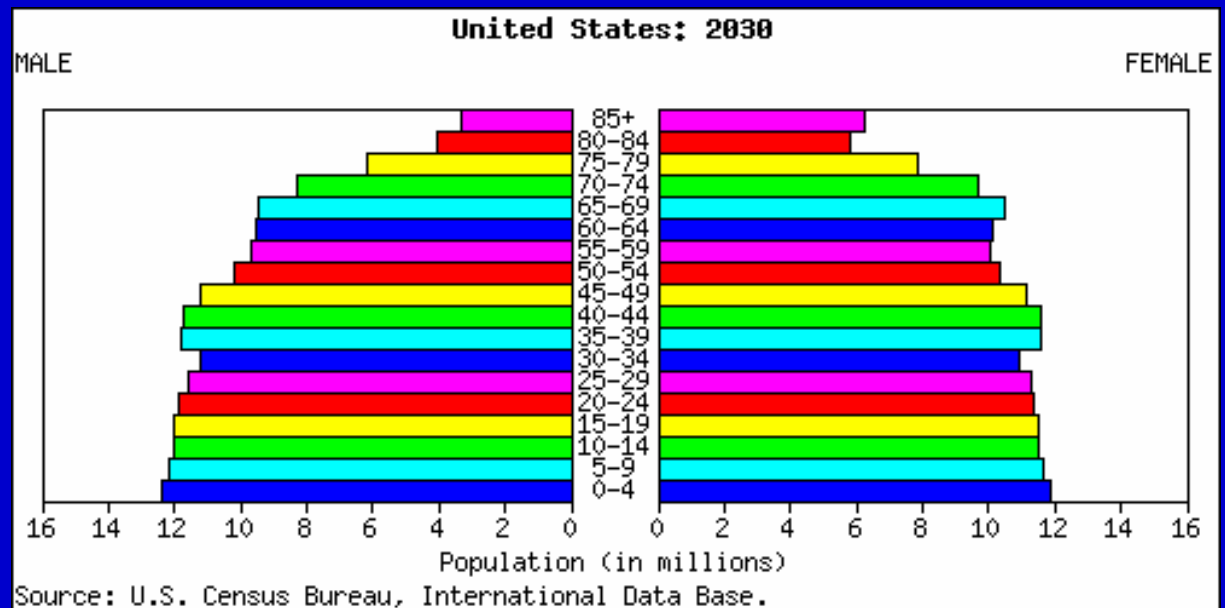


United States' Demographics

2004

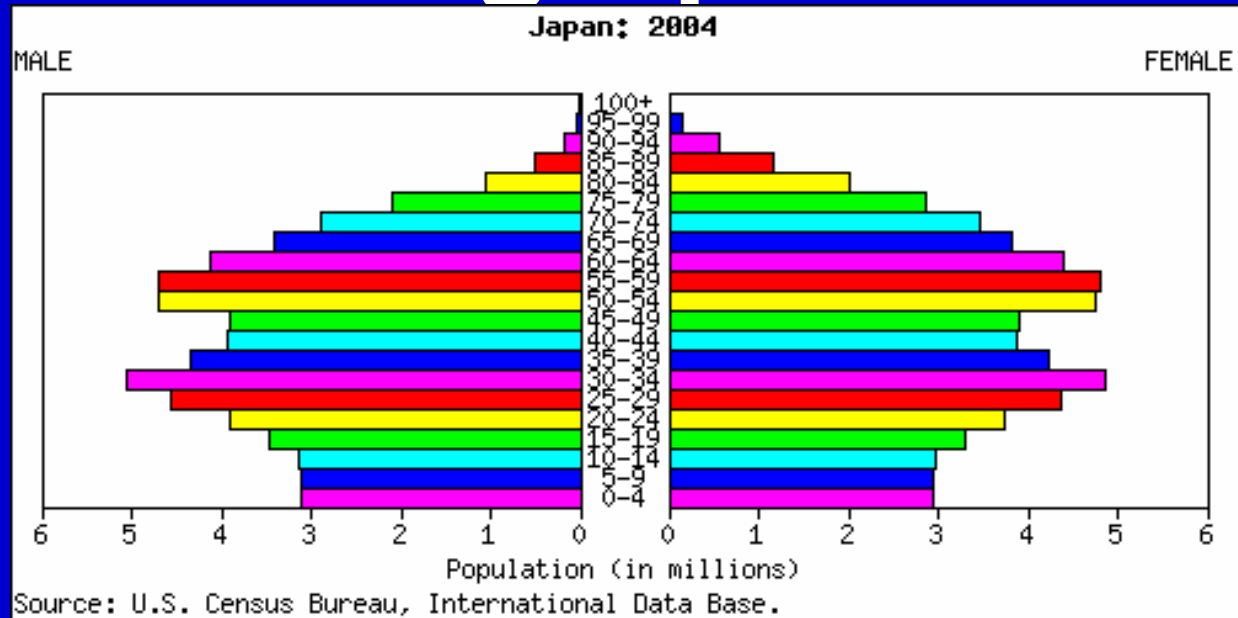


2030

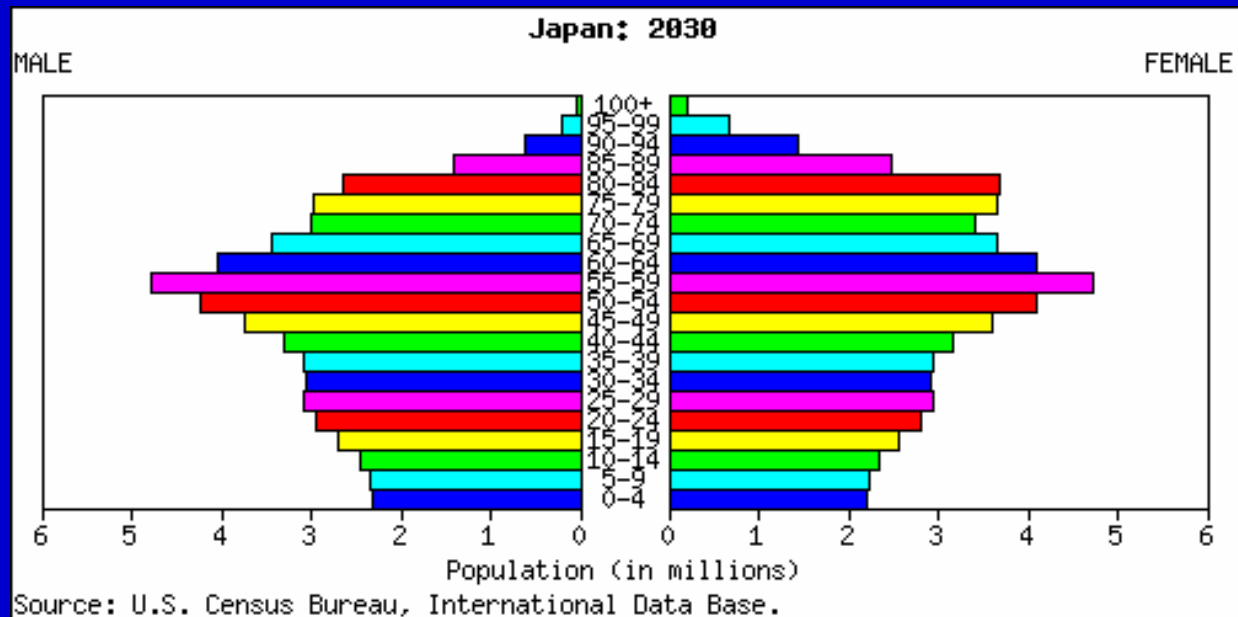


Japan's Demographics

2004

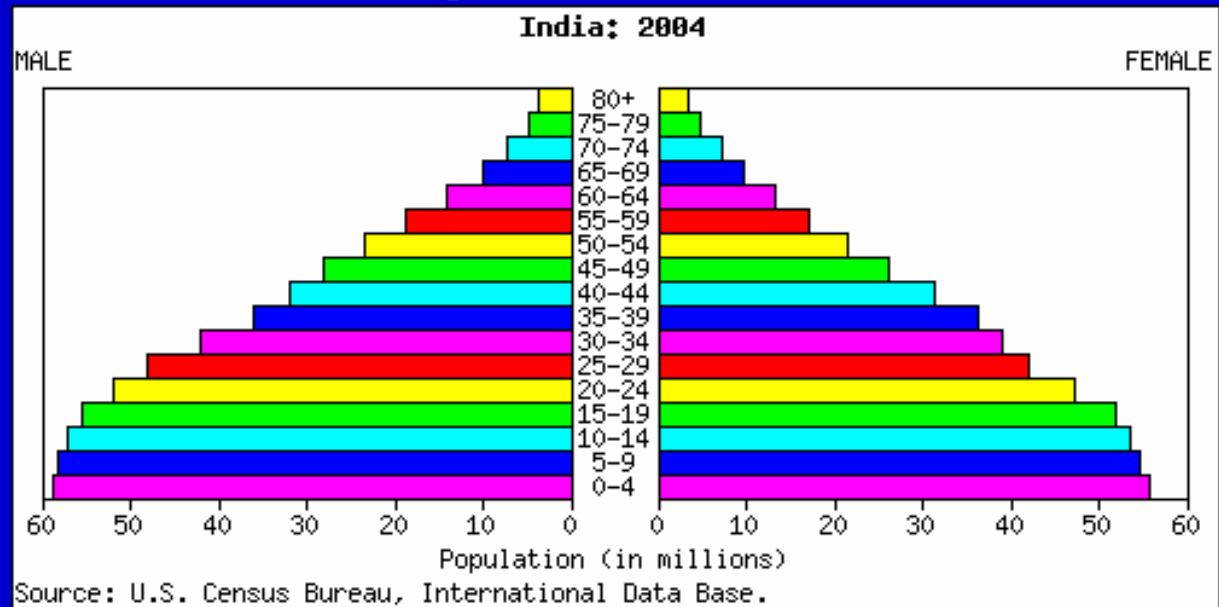


2030

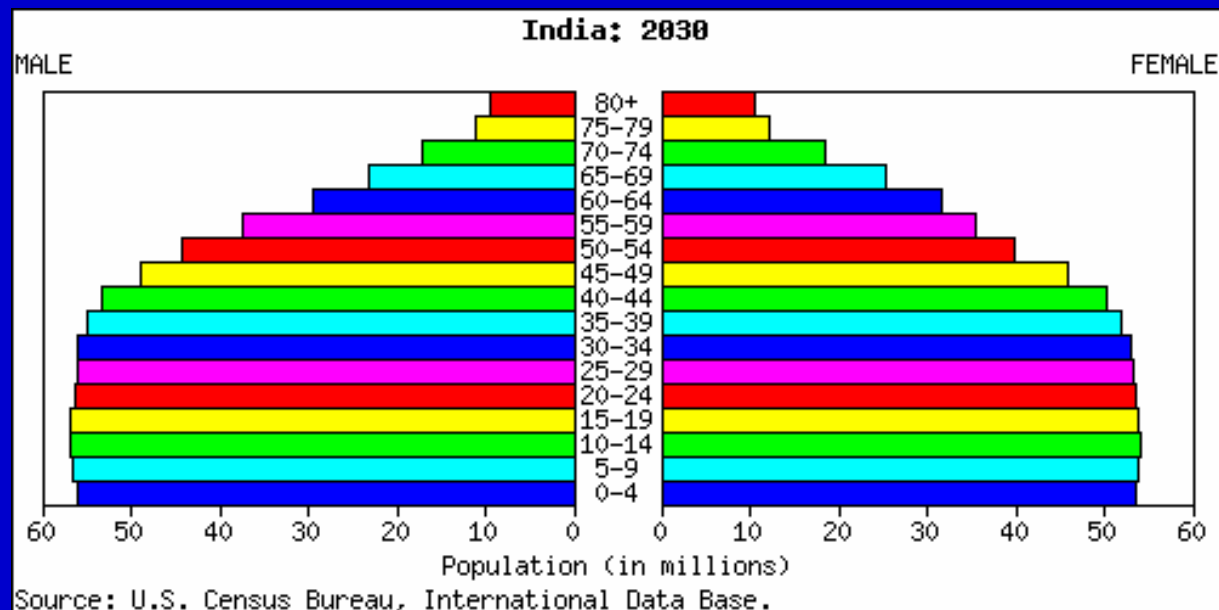


India's Demographics

2004



2030



Retirement Assets 1985 – 2002

End of	Private Trusteed			Private Insured	Federal Government Retirement	State and Local Government	Total w/o IRA & Keogh	IRA & Keogh	Total w/ IRA & Keogh
	Defined Benefit	Defined Contribution	401(k)/a						
1985	\$814	\$417	\$144	\$355	\$172	\$399	\$2,157	\$235	\$2,392
1986	885	478	183	418	202	477	2,460	319	2,779
1987	883	523	215	467	233	522	2,628	390	3,018
1988	883	549	277	525	268	609	2,834	451	3,285
1989	942	672	357	582	304	753	3,253	546	3,799
1990	896	676	385	649	340	801	3,362	637	3,999
1991	1,048	829	440	691	382	868	3,818	776	4,594
1992	1,043	892	553	706	426	960	4,028	873	4,901
1993	1,170	1,014	616	750	268	1,051	4,253	993	5,246
1994	1,193	1,076	675	794	512	1,088	4,662	1,056	5,718
1995	1,444	1,312	864	n/a	541	1,303	n/a	1,288	n/a
1996	1,542	1,520	1,061	880	606	1,495	6,043	1,467	7,510
1997	1,783	1,853	1,264	1,288	659	1,817	7,400	1,728	9,128
1998	1,945	2,105	1,541	1,418	718	2,054	8,240	2,150	10,390
1999	2,085	2,272	1,817	1,532	776	2,227	8,893	2,651	11,544
2000	2,014	2,272	1,739	1,571	799	2,290	8,945	2,629	11,574
2001	1,820	2,141	1,638	1,331	862	2,180	8,334	2,540	10,874
2002	1,603	1,868	1,811	1,310	897	1,967	7,644	2,333	9,977