Center for American Progress Action Fund

Prepared remarks for testimony on the Maryland Secure Choice Retirement Savings Program and Maryland Secure Choice Retirement Savings Trust before the Maryland House of Delegates

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Thank you for inviting me here today to discuss the Maryland Secure Choice Retirement Savings Program.

My name is David Madland and I'm the Director of the American Worker Project at the Center for American Progress Action Fund, an independent, nonpartisan, and progressive education and advocacy organization dedicated to improving the lives of Americans through ideas and action.

I appreciate the opportunity to present my views on this important topic, a topic about which I have been researching for some time. I have written extensively in academic and popular publications about retirement policy, and am also the author of a proposal for a new private-sector retirement plan type called the Collective Defined Contribution, which shares many features with the proposal in front of you today.[1]

In my testimony I will discuss the many problems of our current private-sector retirement system and how the proposed Secure Choice Retirement Savings Program would help alleviate these problems.

Social Security provides an essential baseline of income for retirees, and must be strengthened to ensure that it continues to do so for generations to come, as the Center for American Progress has proposed.[2] However, Social Security was only intended to be one leg of a three-legged approach to retirement savings. Employer-sponsored retirement plans and individual savings are supposed to be the two other legs.

Unfortunately, the private-sector, workplace retirement system is broken. As the first generation to rely primarily on 401(k) plans begins to retire, we can see the cracks in the system. Boston College's National Retirement Risk Index estimates that 53 percent of households are at risk of having an insecure retirement, meaning they will be unable to maintain their preretirement standard of living.[3]

And the public has recognized this and are deeply concerned about their ability to retire. Fifty-five percent of Americans are very concerned that current economic conditions are affecting their ability to achieve a secure retirement, according to a new report by the National Institute on

Retirement Security released last week. An additional 30 percent are concerned—meaning that 85 percent of Americans are concerned about being prepared for retirement.[4]

The current system is failing in a variety of ways including a lack of coverage, high costs, and high levels of risk for savers. I'll now turn to each of these issues and discuss how the Maryland Secure Choice Retirement Savings Program and similar plans, such as CAP's collective defined-contribution plan, would alleviate these problems.

Coverage

The first major problem the Secure Choice plan would address is coverage. Our current workplace retirement system allows too many workers to fall through the cracks. According to Center for Retirement Research analysis of Federal Reserve data, more than half of all workers are not covered by an employer-sponsored pension, either defined benefit or defined contribution.[5]

Some might respond that plans that allow workers to save without an employer-sponsored plan can solve this problem. Only 5.4 percent of workers ages 21 through 64 made contributions to traditional Individual Retirement Accounts in 2009, despite 20.8 percent workers in that age group owning IRAs.[6]

The Secure Choice plan and the CDC plan would help alleviate this problem by having automatic enrollment of workers. The deduction would be opt-out, meaning workers could choose not to contribute if they like. The opt-out model has been a success with research finding that between 85 percent and 90 percent of workers stay in the plan.[7] The employer's role would merely be to deduct a certain percentage of each worker's pay and send that contribution to the retirement plan.

Costs

Excessive retirement plan costs are the second major problem that the Secure Choice plan would address. High fees and poor investment returns make saving for retirement far more costly for most workers than it should be.

The Secure Choice plan would have professional fund management—ensuring a balanced portfolio and a patient investment strategy—as well as low fees to help participants accumulate significant assets.

Professional money managers may have a hard time beating market averages,[8] but they do much better than individual investors by avoiding common investing mistakes—such as failing to diversify.[9] Secure Choice Retirement plans would also have higher returns due to the collective pooling of assets. Individuals need to become more conservative with their investments as they age, but the continued entrance of younger workers into the investing pool of the Secure Choice plan allows the fund to maintain a balanced portfolio over a long period of time, increasing returns. The increased returns from this phenomenon, known as intergenerational risk sharing, can raise pension returns by approximately 1.5 percentage points a year according to one study.[10]

High fees in retirement plans can eat away up to one-third of the total accumulations in a workers account. Typical fees for a 401(k) plan are around 1 percent—and commonly much higher in plans with only few participants.[11] These high fees can reduce employee savings by 30 percent.[12] Fees for Individual Retirement Accounts are typically even higher than in a 401(k).[13] In contrast, large investment pools such as the Secure Choice plan can have much lower fees: The federal Thrift Savings Plan, the defined contribution retirement plan for federal employees, has fees of only 0.0185 percent of assets.[14]

All of these factors combined means that achieving retirement security would be much cheaper for a participant in a collectively managed fund, like the Secure Choice plan, compared to a participant in an IRA or 401(k).

Risk

The final problem the Secure Choice plan would help address is the excessive risk born by IRA and 401(k) participants, such as the possibility the participant will outlive their savings or suffer a significant drop in the value of their account just as they are about to retire.

The Secure Choice plan would increase the security of retirees by providing a steady stream of income in retirement that cannot be outlived. Savers in an individual plan often don’t have access to such an annuity. Only one in five 401(k) plans offer an annuity plan.[15] Even if a saver purchases an annuity herself, the costs are often quite high and could skyrocket if interest rates drop when she retires. The group nature of a collective savings program would protect against these types of risks.

Similarly, savers in a 401(k) plan or any individual defined contribution are unnecessarily exposed to the risk that a large market crash happens just as a worker is about to retire. The typical near-retirement age worker saw their account balances drop by 17.4 percent on average between December 2007 and June 2009—the duration of the Great Recession.[16] For many savers, this meant that they faced a lower standard of living in retirement, or the need to continue working past expected retirement age.

Collectively managed plans spread this kind of timing risk out so that no individual saver is on their own during a market downturn—by withholding some of the upside during bull markets to make smooth out returns in bear markets. By spreading out the risk of a market downturn, collective retirement plans help workers better cope with the risks of retirement.

Conclusion

Plans like Secure Choice would be a much-needed improvement over the current private-sector retirement system. This plan would expand coverage, reduce costs, and better handle risk than

401(k) plans. We strongly support plans that share the features listed above, such as automatic enrollment, low costs, professional management, and collective savings.

Not surprisingly, the public supports efforts such as these to boost retirement security. In a National Institute on Retirement Security survey, 78 percent of the public said the government should facilitate a pension program that small employers or individuals can join and invest in.[17]

Making the Maryland Secure Choice Retirement Savings Program law would go a long way toward making retirement more secure in Maryland, and would serve as a model for the nation.

Endnotes

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