Defined Contribution Plans: Pitfalls and Potential

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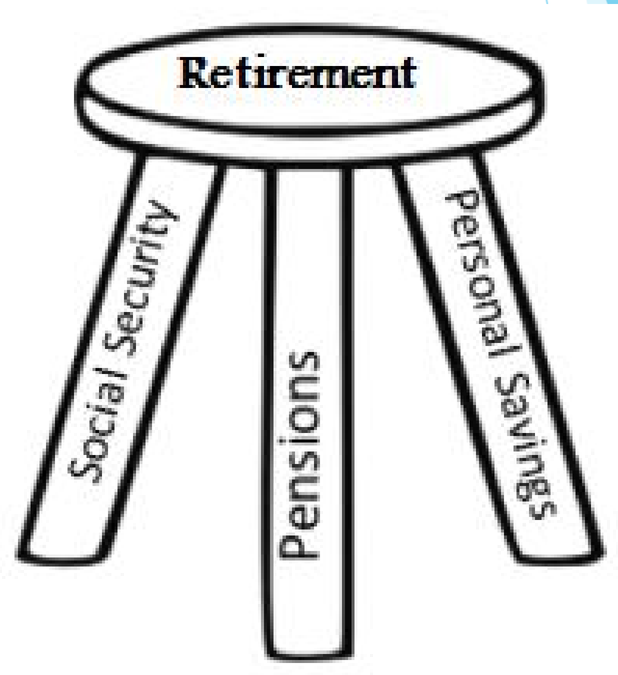
Agenda: DC Pitfalls and Potential

- Retirement Trends
- DC Pitfalls
- Role of Education
- Role of Employers
- DC Plan Reforms
- Conclusion

Best Chance for a Secure Retirement: "3-Legged Stool"

- ***Social Security:*** Basic near-universal benefit; keeps retirees out of poverty
- ***Pension:*** Provides monthly income to supplement Social Security
- ***Personal Savings:*** 401(k) & other savings for "extras" beyond monthly bills



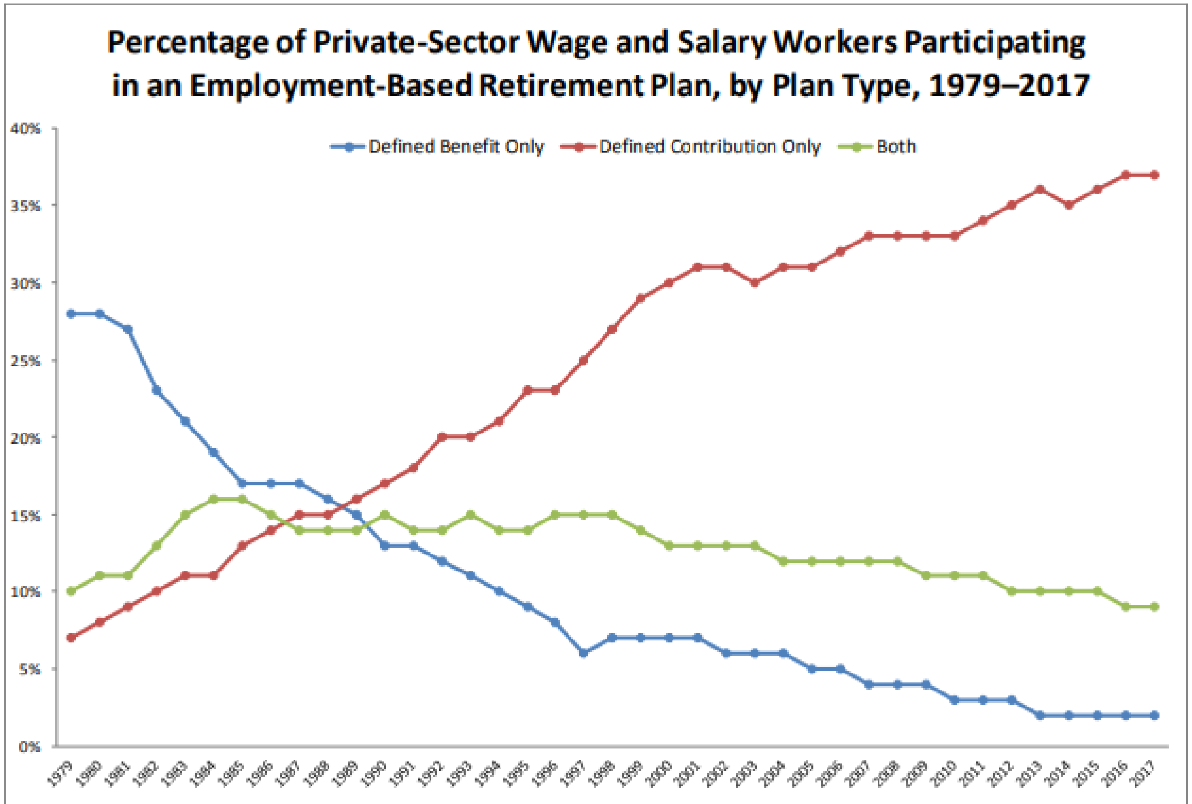
Employer Legs of the Stool

Characteristic	Traditional "Defined Benefit" Pension	"Defined Contribution" 401(k), 401(a), 457, 403(b)
How is the value of the benefit set?	Fixed formula	Depends on account balance at retirement
How is the benefit doled out?	Monthly income stream	Typically a lump sum
What is the benefit timeline?	Lifetime income	Lump sums are spent down at retiree's discretion
Are investments pooled?	Pooled investments	Usually individually invested
Who makes investment decisions?	Professional asset management	Individuals choose from plan choices
Who bears the risk?	Employer(s) / plan sponsor(s)	Employees
Is there a guarantee?	Usually guaranteed	No guarantee

DB and DC: Who Bears the Risk?

	Defined Benefit	Defined Contribution
Funding Risk	**Employer.** If the plan becomes underfunded, employer must make up the difference.	**Employee.** Employer bears no additional cost if account is "underfunded."
Investment Risk	**Employer.** Pension benefits are guaranteed despite investment performance.	**Employee.** If investments perform well, account balance increases; if poorly, balance decreases.
Inflation Risk	**Employee,** unless COLA is provided (rare).	**Employee.**
Longevity Risk	**Employer,** but may be shared if lump sum option is provided.	**Employee.**

Private Sector Has Been Moving to 401(k)s Only



Source: U. S. Department of Labor, "Private Pension Plan Bulletin: Abstract of Form 5500 Annual Reports" through 1999. Employee Benefit Research Institute estimates 2000–2017 using Bureau of Labor Statistics, Current Population Survey, U.S. Department of Labor, and Pension Benefit Guaranty Corporation data.

DC Pitfalls Abound

Pitfalls Abound…

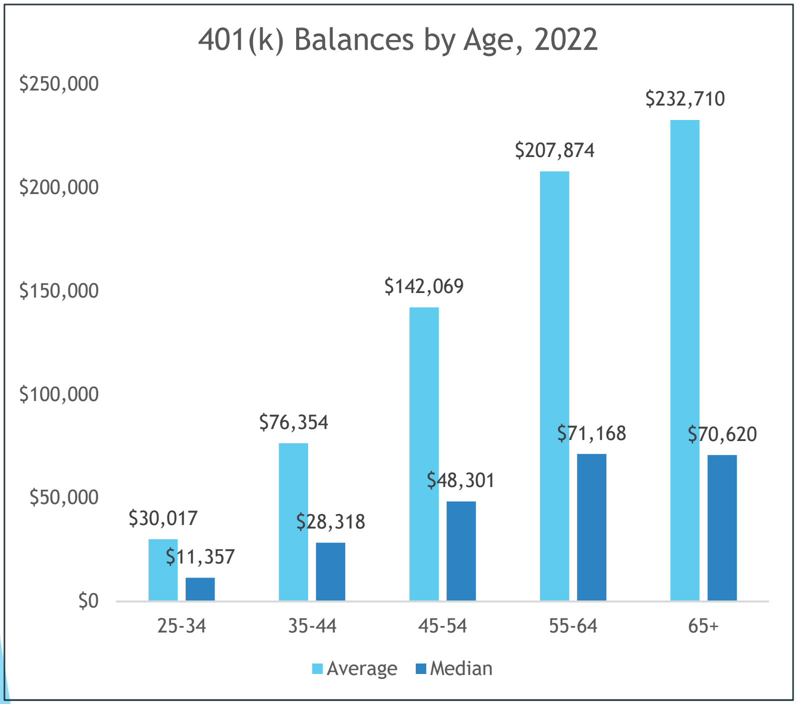
- Not knowing how much to contribute / contributing enough
- Investment decisions and downturns
- Leakage
  - Forfeited unvested employer contributions
  - Not rolling over
  - Taking cash out upon termination
  - Needing cash for other emergencies
- How to spend down money in retirement
- Lack of spousal protections

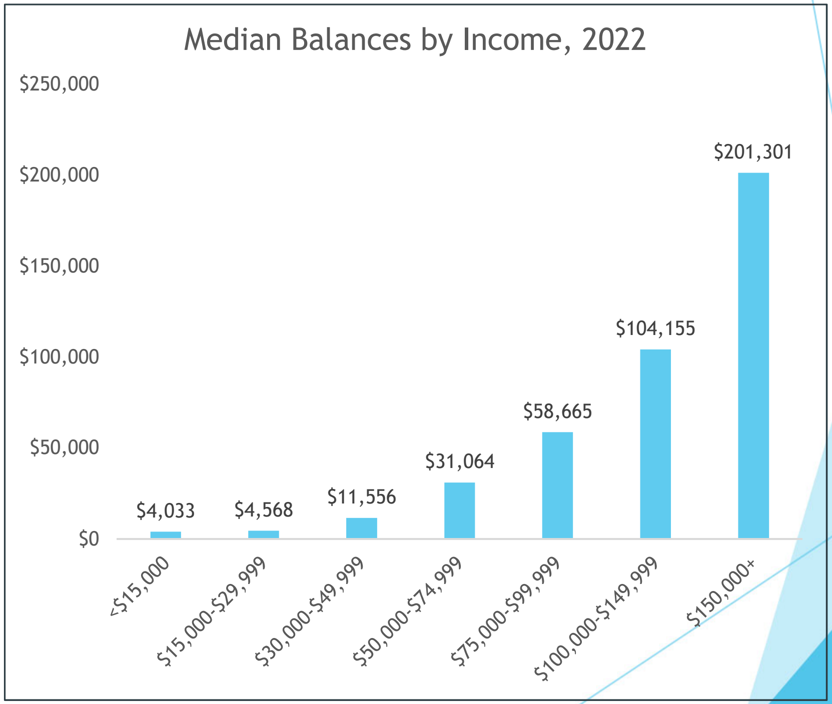
Doing It Yourself: How Much Is Enough?

In the absence of a pension, workers need FAR MORE saved in their 401(k) accounts than most realize.

	Average Worker *NEEDS…*	Workers Actually *HAVE…*
Annual Savings Rate	**12-15% of pay** for 30 years	***5% or less*** if earning under $100,000
Account Balance at Retirement	**10-12x** annual pay	***2-3x*** annual pay

20 Years Later… Workers Don’t Have Enough





Source: Vanguard

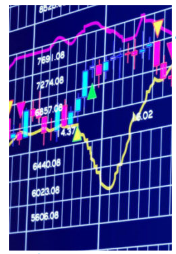
Education Alone Will Not Save Us!

Problem	Education Solution	However…
Not knowing how much to contribute	Learn the benchmarks!	…but what if you don’t have the financial means to put away 15% per year every year?
Not knowing what to invest in	Learn about diversification, fee structures!	… but what about another “historic” investment downturn… or two or three?
Leakage	Understand the importance of rolling over, and keep track of your accounts!	… but what if it’s needed for an emergency? (And could still get lost)
Spending down money in retirement	Purchase an annuity!	… but they’re expensive (and the market is sketchy)
Lack of spousal protections	??	…More annuities?

…Will Good Quality Jobs / CBAs?

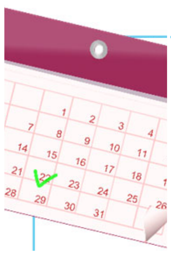
Low Contribution Rates / Emergency Cash

- Increase employer contributions
- Increase wages!



Large Market Downturns

- Realistic for employers to commit to make up losses?



Vesting Rules

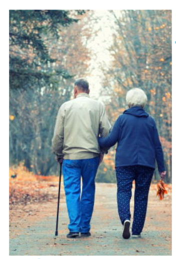
- Immediate vesting of employer contributions

Investment Issues

- Employee say in investment menu

Leakage Issues

- Increase retention?



Spousal protections

- Hire the spouse?

What About DC Plan Improvements?

Automatic Enrollment

- Safe harbor created to default workers into participating
- But 3% is not enough!
- If employer willing to match more = money left on the table

Target Date Funds

- Safe harbor created to default workers into a fund balanced to their retirement age
- But is that appropriate for 100% of assets; for all workers?
- What about the fees charged?

Automatic Escalation

- Safe harbor to increase in 1% increments, up to a cap
- Cap (8%) is often far lower than what's necessary

What About More DC Plan Improvements?

Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019:

- Eases rules for “multiple employer plans”
- Increases safe harbor for auto enrollment & escalation
- Eases rules for part-time workers
- Delays mandatory distributions
- Makes lifetime income options easier

Securing a Strong Retirement Act (“SECURE 2.0”) of 2022:

- Mandatory auto enrollment & escalation
- Further eases rules for part-time workers
- Further delays mandatory distributions
- Allow Roth matching contributions and “match” for student loan payments
- Further makes lifetime income options easier
- Create national database for lost accounts

…“Bipartisan retirement proposals are mostly just more tax cuts for the wealthy.”

What About *Even More* Improvements?

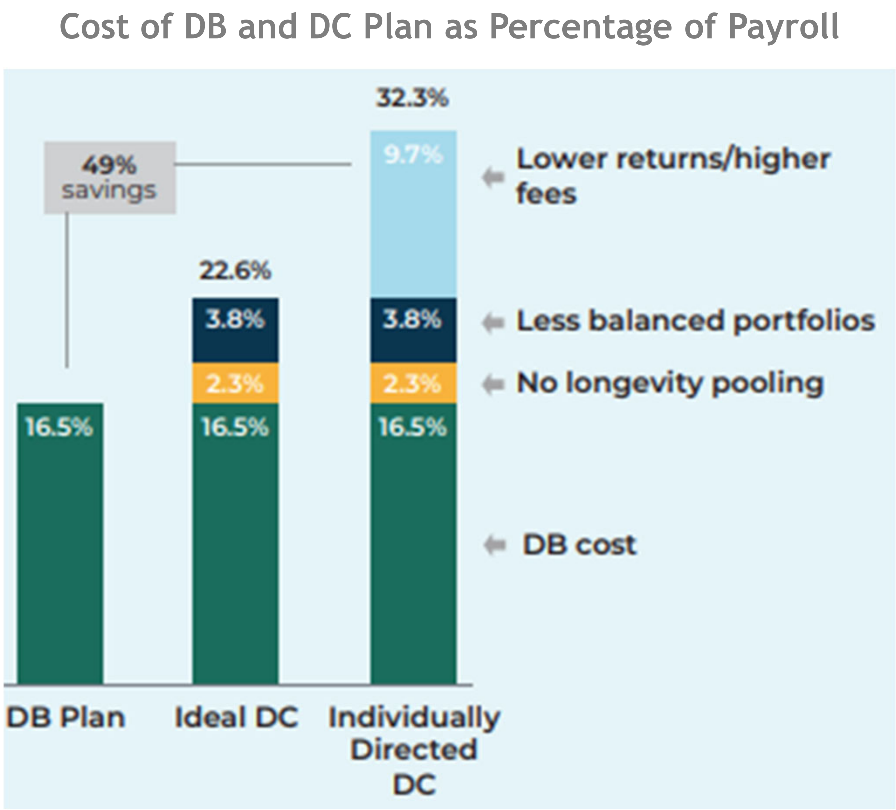
DC Plan Reforms Can Address Issues Like:

- Vesting Rules
- Fee transparency / disclosure; Target Date Fund standardization
- Leakage: DOL's Lost Accounts initiative; adding emergency savings features; automatic rollovers
- Annuity Market Improvements

But These Are Extremely Limited; Cannot Address:

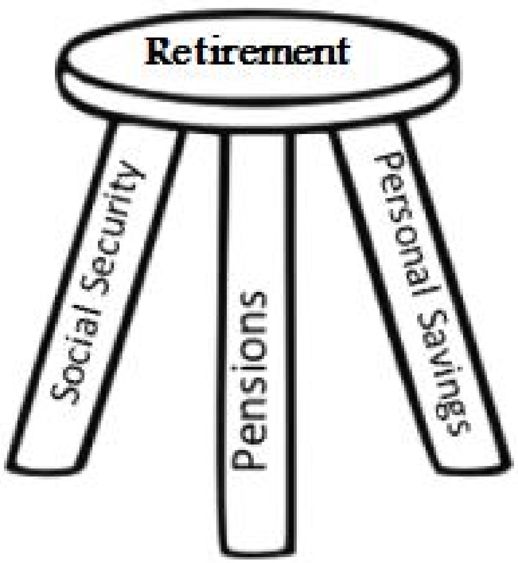
- Low Contribution Rates
- Large Market Downturns
- Needing additional cash for life's emergencies
- Annuities are likely to remain expensive; Workers don't trust them
- Lack of spousal protections

Even an “Ideal” DC Cannot Replicate a Pension



Source: The National Institute on Retirement Security

Conclusion: The Three-Legged Stool (Still) Is Where It's At!



- DC Plans were created as a supplement to traditional pensions → They still work very well in that regard
- As the main retirement vehicle, they are extremely problematic → Participants bear most of the cost, and all of the risk
- There are infinite problems if we rely on them 100% → Many of which are extremely difficult to resolve