EXECUTIVE SUMMARY

Retirement for All

A Wisconsin Solution to the Retirement Crisis

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(Protect Our Wisconsin Retirement Security)

POWRS is a statewide group of citizens concerned about retirement-related issues. POWRS advocates for protection of the Wisconsin Retirement System (WRS) and enhancing retirement security for all Americans, including stronger and better retirement options for private sector employees and businesses. This paper was written by Philip Anderson, Roger Springman, Patrick Murphy, and Kathleen Marsh. POWRS can be reached at: powers111@gmail.co

EXECUTIVE SUMMARY

Retirement security is declining in America. Reliable experts say that a retirement crisis is developing and that many older Americans will be unable to retire, will have to work longer, or will live out their "golden years" in poverty. This decline in secure, adequate income for seniors will have a negative impact on the economy as a whole, and Wisconsin will not be immune. Direct action is needed to solve the problem.

There are many contributing factors to the crisis: declining wages, exportation of middle class jobs, increasing healthcare costs, inadequate individual savings, and companies defaulting on pension promises. Since 1980, there has been a profound shift in the structure of retirement programs. Guaranteed**, defined benefit (DB)** company pensions have largely been replaced with individual, **defined contribution (DC)** retirement savings plans known generally as 401(k)s. The result is a perilous shift in retirement program management from companies to individual employees.

> **IMPORTANT NOTE:** In a *defined contribution* plan, the employer's *only* responsibility is *to make* contributions to an employee's account. Employees are responsible for saving enough, choosing investments, and "managing" their own retirement. DC plans provide no guaranteed retirement income; investment risks and fees are born by individuals. In a *defined benefit* plan, the employer is responsible for making contributions AND for managing the retirement program to ensure sufficient funds to pay promised benefits. Risks are more evenly shared, and retirement benefits are guaranteed.

In Wisconsin, 88% of employers offer defined contribution plans compared to just 8% that offer defined benefit plans.[1] But research shows that individuals who save on their own using defined contribution plans get lower investment returns, pay higher management fees, and have dramatically less at retirement than those with defined benefit retirement plans. Specifically, 75% of 401(k)s have an average balance of $60,000 with the median account balance less than $20,000. This means one-third of households will end up with virtually no retirement savings and be entirely dependent on Social Security.[2]

The potential impact of the retirement crisis on families, local communities, and the state as a whole is significant. Senior citizens made up 13 percent of the state's total population in 2000; this is expected to rise to 22 percent in 2035.[3] A growing elderly population with greatly reduced income security will pose a serious challenge for Wisconsin. It has the potential to place overwhelming burdens on tax-supported social network programs.

Wisconsin can avoid many of the above concerns by taking lessons from its very successful Wisconsin Retirement System (WRS) for public employees, managed by the Department of Employee Trust Funds (ETF). Rated #1 in the United States, the WRS is a shared risk, defined

1 The Imbalance Between Public and Private Pensions in Wisconsin, Wisconsin Policy Research Institute, http://www.wpri.org/Reports/Volume23/Vol23No2/Vol23No2.html

2 Are 401(k) Plans a Failed Experiment?, Daily Finance web site, Sarah E. Murphy, The Motley Fool, http://www.dailyfinance.com/2012/10/15/are-401k-plans-a-failed-experiment/?source=edddlftxt0860001

3 Wisconsin Population 2035, Wisconsin Department of Administration, 2008, www.doa.state.wi.us/docview.asp?locid=9&docid=2108

benefit pension program serving 572,000 active public employees and retirees. The system is fully funded (meaning WRS assets are large enough to cover *all* expected current and future retirement payments). WRS has provided guaranteed, family-supporting retirement income since 1985. Pensions are paid with participant contributions and investment earnings, *not taxpayer dollars*. WRS has never failed to meet an obligation or required a taxpayer bailout. The system is also affordable. Wisconsin state and local government spending for pension contributions were 1.26% of total government spending in 2009.[4]

The WRS can serve as a model to create a private sector, defined benefit retirement program that, over time, could help ensure that all Wisconsin workers, not just public sector workers, have a secure retirement income. Such a program would not involve any taxpayer obligation. It would utilize the best practices of WRS and the State of Wisconsin Investment Board (SWIB) to create market-based solutions to the retirement crisis. Two program offerings are suggested. One, the Wisconsin Retirement Security Fund, would be a pension plan. The other, the Wisconsin Individual Retirement Savings Program, would be an individual deferred compensation program.

A defined benefit system for private sector workers, built on the operating principles and practices of the WRS, could greatly benefit Wisconsin and its thousands of small businesses, 80% of which have fewer than 25 employees. Businesses that are too small to afford quality retirement benefits could now offer them through a state-assisted system. This would enable them to compete more effectively for quality employees. Such an approach could attract more businesses to Wisconsin, helping to rejuvenate our economy. ***Retirement for all is a "win-win" for Wisconsin business, workers, retirees, economy, and taxpayers.***

4 Pensionomics 2009 and 2012, National Institute on Retirement Security, http://www.nirsonline.org/index.php?option=com_content&task=view&id=684&Itemid=48

Retirement for All: A Wisconsin Solution to the Retirement Crisis

The ability to retire with dignity and financial independence was once part of the American Dream. But for many people, a secure retirement is slipping out of reach. Many experts claim we are facing a retirement crisis which will adversely affect individuals, families, communities, and the economy.

Wisconsin is not immune to the negative impact of these national trends, and there is no reason to believe that these trends are naturally self-correcting. Decisive action will be needed to make retirement security for all a reality in Wisconsin. This document examines the looming retirement crisis and proposes solutions based on the Wisconsin experience.

National and State Retirement Crisis Context

No matter where you turn, information abounds on the failing nature of retirement security in America. This "slow-moving train wreck" began in the 1980s with traditional company defined benefit pensions (DB) being replaced by defined contribution (DC) retirement savings plans, commonly called 401(k)s. This change shifted total responsibility for adequate retirement savings to the employee. Stagnant wages, inadequate individual retirement planning, and companies defaulting on existing pension obligations have contributed to the problem.

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On top of this, efforts are being made to reduce benefits and increase the qualifying age for Social Security. Given that many people will depend exclusively on Social Security benefits for retirement income, such changes will only increase retirement insecurity. As a result, the average American will have to work longer, or not be able to retire at all. Many people will face poverty in old age because they will have lost the ability to create and keep a diversified retirement base.

Historically, financial advisers have described retirement security with the "three-legged stool" concept. Social Security benefits, personal savings, and an employer-provided pension are seen as necessary to provide essential diversity. Unfortunately, for a majority of Americans, this "three-legged stool" is now broken. Consider these facts:

- Only 42% of private sector workers age 25 to 64 have pension coverage in their current job.
- Only half of workers have access to a 401(k) plan; about 30% take advantage of that plan.
- Three-fourths of 401(k)s have an average balance of $60,000. The median account balance is less than $20,000[5].

5 17 Frightening Facts About Retirement Savings in America, Daily Finance web site, John Reeves, The Motley Fool, Oct 15, 2012, www.dailyfinance.com/2012/10/15/17-frightening-facts-about-retirement-savings-in-/

- One-third of households end up entirely dependent on Social Security, and for low wage earners that portion is 75%[6].
- Only 21% of private employers offer a defined benefit, guaranteed retirement pension.

Let there be no doubt, a significant percentage of future seniors WILL NOT be entering their "golden" years. They will be entering poverty, largely surviving on a day-to-day basis, unable to handle medical emergencies, unexpected expenses, maintain their homes, or remain financially independent. The financial impact on families, local communities, and the state will be significant as seniors will increasingly need emergency assistance programs that taxpayers must fund.

Seniors and the Wisconsin Economy

Retirement security for all Wisconsin residents is essential to maintaining a vibrant and growing state economy. The ability of the elderly to maintain adequate income and buying power will be important to everyone. Inadequate income will have a ripple effect that will negatively impact Wisconsin and its many small businesses.

Wisconsin's population is relatively stable and growing moderately in comparison to other states; however, the "baby-boomer" generation will dictate our demographic patterns as Wisconsin's elderly population is projected to double by 2035. Senior citizens were 13 percent of the state's total population in 2000 and this is expected to rise to 22 percent in 2035.

A national economic study found that defined benefit pension benefits from both the private and public sectors have a significant economic impact, generating 6.5 million American jobs, and $1 trillion in economic output, and . They supported more than $134 billion in federal, state, local tax revenue.[7] This holds true in Wisconsin where the state's retired population provides significant support and stability to the state economy and its tax base. In 2010 Wisconsin residents received $14.2 billion dollars in Social Security benefits.[8] This amount was equivalent to 5.8 percent of the state's annual GDP. In addition, Wisconsin's public pension dollars supported more than 50,000 jobs and contributed directly or indirectly more than $6.2 billion dollars to the Wisconsin economy.

Expenditures made in Wisconsin from public and private pension benefits in 2009 had large multiplier effects. For every dollar paid out in pension benefits, $2.37 in total economic output was generated. For every taxpayer dollar contributed to state and local pensions, $6.22 in total output was supported.[9] DB pension dollars also account for more than $3 million dollars in taxes.[10]

It goes without saying that a growing elderly population with greatly reduced income security will not be good for the Wisconsin economy. It has the potential to place new and added burdens on tax-

6 Are 401(k) Plans a Failed Experiment?, Daily Finance web site, Sarah E. Murphy, The Motley Fool, http://www.dailyfinance.com/2012/10/15/are-401k-plans-a-failed-experiment/?source=edddlftxt0860001

7 Pensionomics 2012, National Institute on Retirement Security, http://www.nirsonline.org/index.php?option=com_content&task=view&id=684&Itemid=48

8 Social Security: 2012 Wisconsin Quick Facts, AARP, www.aarp.org/content/dam/aarp/research/surveys_statistics/econ/2012/Social-Security-2012-Wisconsin-Quick-Facts-AARP.pdf

9 Wisconsin Fact Sheet, Pensionomics 2012, National Institute of Retirement Security, March, 2012, http://www.nirsonline.org/storage/nirs/documents/factSheetsPreviews/Factsheet_WI.pdf

10 Pensionomics 2012, National Institute of Retirement Security, March, 2012

supported social network programs, undermine family structures, and even adversely affect the health of retirees.

Wisconsin's Unique Pension Approach: An Opportunity

The value of a predictable, adequate income at retirement has long been appreciated by policy-makers. Social Security was created in the mid-1930s as testament to the belief that everyone deserves a secure income at age 65 and beyond. Concomitantly, another tradition evolved based in large measure on the need for workers to enjoy a secure retirement. The innovation was a defined benefit (DB) pension system, managed by employers. This system successfully anchored retirement security for working Americans through the 1970s.

In Wisconsin, state and local governments realized the value of such benefits to the individual as well as the state's economy. They created a public pension program: the Wisconsin Retirement System (WRS), managed by the Department of Employee Trust Funds. Crafted as a defined benefit pension program, the WRS is the result of over 100 years of bipartisan effort to provide retirement security to public servants. The system is a model for the nation and a tremendous asset that serves both retirees and ALL of the citizens of Wisconsin. The WRS currently serves 572,000 active public employees and retirees. That number represents 12% of Wisconsin's adult population. When families are included, the number rises to about 20% of Wisconsin's population.

The Pew Center for the States says Wisconsin was the ONLY state with a "fully funded" retirement system in 2010 and one of 11 states it called "solid performers".[11] As recently as September 2013, Morningstar rated the WRS as 99.9% funded.[12] This means that its assets are large enough to cover all expected current and future retirement payments without relying on taxpayers to ever have to "bail out" the program.

In 2010, WRS paid out $3.9 billion in retirement payments to 155,000 retirees. The average annual retirement benefit was $23,800, or about $1,983 per month. Public employees nationally average $23,407 per year. Private sector defined benefit pensions average $20,298 per year.[13]

The WRS is good for Wisconsin's economy. In 2006, WRS beneficiaries (86% of whom live in Wisconsin) spent $4.5 billion, accounting for over 33,000 private sector jobs that paid $1.7 billion in wages and salaries and over $730 million in federal, state, and local taxes. In 2010, the WRS invested $13 billion in Wisconsin companies and companies with Wisconsin employees.[14]

Private Sector Pensions in Wisconsin

There are significant differences between public and private sector pensions in Wisconsin. Public employee pensions are marked by stability and provide guaranteed retirement income. This stands in stark contrast to private sector pensions where 88% of employers offer defined contribution plans

11 The Widening Gap Update Pew Center on the States, June 2012 http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_Pensions_Update.pdf
12 The State of State Pension Plans 2013, Morningstar, Sept, 2013
13 Debunking Myths About the Wisconsin Retirement System, POWRS publication, May 2012, http://webiva-downton.s3.amazonaws.com/432/8a/0/501/WRS_Myths_vs_Facts.pdf
14 Wisconsin Department of Employe Trust Funds.

and just 8% offer defined benefit plans. It is worth noting that benefits provided under WRS are far more generous than those in private sector defined benefit plans. This is due to the top-notch management of WRS, its inherent efficiencies, shared risk, large numbers of participants, and economies of scale characteristic of DB pensions.

Defined contribution (DC) plans and other retirement savings accounts are good tools for *supplemental* retirement savings. When combined with Social Security and a defined benefit (DB) employer pension, they provide the third leg of a good retirement program. But DC plans do not make good, stable, retirement pensions by themselves.[15] Research shows that individuals who save on their own using DC plans get lower investment returns, pay higher management fees, and have dramatically less at retirement than defined benefit retirement plans. The median household headed by a person age 60 to 62 with a 401(k) account has less than one-quarter of what is needed to maintain a reasonable standard of living in retirement.[16]

Administrative fees for DC plans eat up savings. According to a Demos study, a two-earner household will pay an average of $155,000 in 401(k) fees and lost returns over 40 years.[17] Research also shows that DB pension plans have substantially lower administrative costs than DC plans.

Sadly, there has been a fundamental shift in retirement plan options available to American workers. Wage-earners are increasingly forced to take responsibility for their own retirement investments, and yet evidence shows voluntary retirement savings plans don't work well for many people. The simple fact is most people don't know how to invest successfully.[18] Staying the course with consistent, long term investing is the key to saving enough money for a secure retirement. Too many employees don’t save enough, don’t manage their accounts well, take lump sum withdrawals (with 10% tax penalties) when they change jobs, and take emergency withdrawals that never get paid back.

As if all this isn’t bad enough, the income of the ordinary wage earner has stagnated. Many workers do not earn the income necessary to adequately save for retirement. Adjusting for inflation, median income for four-person families in Wisconsin has fallen $8,500 in the past decade. More than one in five Wisconsin workers, and one in four African American workers, held a poverty-wage job in 2011 (wages under $10.97 per hour). Just 20 percent of poverty-wage workers participate in their employer-provided pension benefit.[19]

A Wisconsin Retirement Solution

How do we avoid the negative impact of the retirement crisis? How do we ensure that all Wisconsin citizens can retire in dignity with adequate income? Providing employers and employees with new and better tools to achieve retirement security is the solution. These tools are modeled on the highly successful Wisconsin Retirement System. A wide body of research finds that people with DB

15 The Retirement Crisis and a Plan to Solve It. U.S Senate Committee on Health, Education, Labor, and Pensions, July 2012, www.harkin.senate.gov/documents/pdf/5011b69191eb4.pdf

16 Retirement Security 2011: National Institute on Retirement Security. www.nirsonline.org/storage/nirs/documents/Public%20Opinion/final_report.pdf

17 Fees Skim Big Bucks From 401(k)s, Consumer Reports, July 2012, Pg. 7.

18 Are 401(k) Plans a Failed Experiment?, Daily Finance web site, Sarah E. Murphy, The Motley Fool, www.dailyfinance.com/2012/10/15/are-401k-plans-a-failed-experiment/?source=edddlftxt0860001

19 The State of Working Wisconsin 2012, Center on Wisconsin Strategies, www.cows.org/_data/documents/1280.pdf

pension income are far better positioned to be self-sufficient in retirement than those without. This is because DB pensions provide a stable monthly retirement benefit that cannot be outlived; they offer optional spousal protections; they do not fluctuate with short term market results."[20] Wisconsin's public retirement program proves it can be done at low cost without placing the taxpayer at risk.

State and local government spending for pension contributions in Wisconsin amounted to just 1.26% of total government spending in 2009. Each $1 in taxpayer contributions to Wisconsin's state and local pension plans supported $6.22 in total output in the state.[21] Investment returns pay 80% of pension annuities and all operating costs. WRS receives no GPR funding for operations. WRS has NEVER failed to meet any obligation nor required any taxpayer bailout. Even when suffering large investment losses, such as during the 2007-08 economic crisis, the WRS, though its internal risk management features, successfully weathered the crisis.

WRS has specific management and oversight safeguards that account for its success. It is politically isolated with participant oversight. Investment is professionally managed by a separate agency (SWIB). It has mechanisms, such as annual actuarial reviews, to adjust contributions to maintain full funding. It adjusts retirees' annuities to reflect investment gains and losses. It uses a five-year "smoothing" procedure to handle large losses. Most important, it has a *fiduciary duty* to act in the best interests of retirees and participants. These, and other best practices, make it the best pension system in the nation.

Implementing a Sensible Fix

What has been achieved for public employees can be replicated for private sector employees *at no cost to Wisconsin taxpayers*. Although there may be some initial start-up costs, investment returns can cover administrative costs as done in the WRS. Wisconsin can have retirement security for all. Here's how, with a two-faceted approach:

1. Establish the Wisconsin Retirement Security Fund

Creation of a Wisconsin Retirement Security Fund would enable retirement security for all by establishing a voluntary defined benefit retirement program for the private sector. It would pool contributions from employers and employees and invest the funds in appropriate market securities. Similar to WRS, the fund would harness the power of sound insurance principles, self-purchasing, pooled assets, good management, and market forces to create a low cost, high quality, private sector retirement program. Such a program, along with Social Security and tax-deferred savings programs available to employers and employees, can offer the opportunity for all Wisconsin residents to retire with the peace of mind that pension security provides.

The Wisconsin Retirement Security Fund would be a benefit to Wisconsin businesses, especially those too small to afford quality programs on their own. Many businesses would be able to compete more effectively to attract and keep good employees. Because retirement funds would be held in

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20 Retirement Security 2011, National Institute on Retirement Security, www.nirsonline.org/storage/nirs/documents/Public%20Opinion/final_report.pdf

21 NASRA Issue Brief. "State and Local Government Spending on Public Employee Retirement Systems". National Association of State Retirement Administrators. February 14, 2012.

non-company accounts, many risks associated with "benefit legacy costs" at the time of company bankruptcies, corporate takeovers, job losses, etc., would be minimized or perhaps eliminated.

All fund expenses would be paid by contributions and investment income. There would be NO tax support for this program. The program would be managed separately from WRS with NO co-mingling of funds.

2. Wisconsin Individual Retirement Savings Program

Personal savings are an important supplement to pensions and Social Security benefits, making up the "third leg" of the stool. As noted earlier, many people have difficulty generating significant personal savings and they lack fundamental investing skills and discipline.

For several decades, the Department of Employee Trust Funds has offered public employees access to a personal savings program that includes strong investing skills and discipline: deferred compensation or a 403 (b) program. This program allows individual employees to select from a wide range of investments (money market, mutual funds, index funds, etc.) managed by professionals with investment money automatically taken from paychecks on a tax-delayed basis.

Deferred compensation is a very popular option for public employees and there is certainly no reason why such investment services could not be offered to private sector participants and businesses on the same basis. Investment savings would be held in personal accounts and not mixed in any way with other account holders. Such a program could be extended to private sector 4services would allow private sector employees and businesses to enjoy greater security coupled with improved investment returns.

Conclusion

Creation of a Wisconsin Retirement Security Fund and Individual Retirement Savings Program offers the solution to the challenges posed by an aging population with woefully inadequate retirement prospects. Adoption of the proposal would provide future retirees with stable incomes. It could also be a huge benefit to the overall economy by keeping retirement savings in-state, increasing investment in existing state companies, and attracting new businesses to Wisconsin. *Retirement for all is a "win-win" for Wisconsin businesses, workers, retirees, and taxpayers. Do we have the vision to make it happen?*

Additional Sources and Suggested Reading

Center of Retirement Research at Boston College, http://crr.bc.edu/

National Institute on Retirement Security at http://www.nirsonline.org/index.php

Our Ridiculous Approach to Retirement, by Professor Teresa Ghilarducci, http://www.nytimes.com/2012/07/22/opinion/sunday/our-ridiculous-approach-to-retirement.html?_r=1&

Pew Charitable Trusts research on pensions at http://www.pewstates.org/research/featured-collections/pensions-and-retiree-health-benefits-85899373138

Retirement Security for All, Secure Choice Pension Plan, National Conference on Public Employee Retirement Systems, http://www.ncpers.org/retirementsecurity

When I'm Sixty Four: The Plot Against Pensions and the Plan to Save Them, by Teresa Ghilarducci, Princeton University Press, 2008

Wisconsin Pensionomics: Measuring the Economic Impact of State and Local Pension Plans, National Institute on Retirement Security, 2012, http://www.nirsonline.org/storage/nirs/documents/factSheetsPreviews/Factsheet_WI.pdf