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Working with the World Economic Forum, Mercer has helped to highlight the potential extent of the long-term savings gap in the US, estimated to be $27.8 trillion at the end of 2015. Longer life spans will cause that number to grow significantly. What’s more, widespread lack of financial knowledge — coupled with a continued inability to save and limited access to workplace plans or other effective savings vehicles — could cause the gap to reach $137 trillion by 2050.¹

America lacks a coherent public policy strategy to help its people adequately prepare for retirement.

Policymakers should take additional steps, however, to build on the success of the employer system by expanding coverage and encouraging more savings and plan coverage.

So what should be done now to enable more Americans to retire with confidence?

Based on Mercer’s experience working with thousands of US employers, we offer several specific policy recommendations to address this urgent question, grouped into the following categories:

1. Support retirement security through tax policy.
2. Improve access to retirement plans for more Americans facilitated through the workplace.
3. Build on the success of the private retirement system.
4. Remove impediments to employers maintaining defined benefit (DB) pension plans.

The news isn’t all bad, however. Mercer’s experience working with employers tells us that many of the 90 million² Americans eligible to participate in employer-sponsored retirement plans are particularly well-positioned to receive meaningful retirement benefits in addition to their individual savings, Social Security and Medicare.

We recognize and applaud past and current efforts to achieve these goals. As a trusted advisor representing plan sponsors and participants in the retirement industry, Mercer’s objective is to contribute to this urgent policy debate and assist with policymakers’ ongoing efforts to achieve the broader goal of enhancing Americans’ retirement security. The time to act is now.

¹ World Economic Forum. We’ll Live to 100 — How Can We Afford It?, May 2017.
INTRODUCTION

Although Americans are living longer, they may not be able to afford it. According to a Boston College Center for Retirement Research study, half of today’s working-age households will not be able to maintain their current standard of living in retirement.

The Government Accountability Office (GAO) reported that:

- Fifty-two percent of households age 55 and older have no retirement savings in a defined contribution (DC) plan or individual retirement account (IRA).

- Among the 48% of households age 55 and older with some retirement savings, the median amount is approximately $109,000, which will not go far in retirement.

The inability of many people to access high-quality, affordable savings vehicles, including workplace plans, is a key cause of this savings deficit. Data from the Bureau of Labor Statistics show that one-third of all private-sector employees — close to 40 million American workers — have no access to employer-based retirement plans. The problem is particularly acute at smaller companies. Only half of workers at businesses with fewer than 100 employees have access to workplace plans. In addition, self-employed and freelance workers, a portion of the workforce that some anticipate will increase in the future, face substantial challenges in saving for retirement.

Although individuals can and do save significant amounts on a tax-favored basis through employer-sponsored 401(k) and other DC plans, Americans don’t save as much on their own as when an employer supports saving. In general, DC plans with employer matching and nonelective contributions are far more successful than IRAs in generating meaningful retirement assets. For example:

- According to research by Cerulli Associates, from 2011 to 2015, IRA contributions amounted to $92 billion, whereas our analysis of the same report shows that employee and employer contributions to DC plans over the same period amounted to almost $1.6 trillion, nearly 17 times as much.

- Similarly, according to the Investment Company Institute, 85% of the IRAs opened in 2015 were opened with rollovers, whereas just 9% came solely from contributions, again showing that IRAs are less successful as a retirement savings medium in their own right and that the vast majority of retirement savings are generated through DC plans.

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In addition, Americans’ retirement security is also threatened by the continuing decline in the number of employer-sponsored DB pension plans. As the GAO recently emphasized, the continuing shift toward DC plans has increased the burden on individuals to plan and save for retirement.

**Figure 1. Trends in Private-Sector Retirement Plans Since 1975**

![Graph showing trends in private-sector retirement plans since 1975](image)


Social Security is the only (or nearly only) retirement income source for many Americans. According to the Employee Benefit Research Institute (EBRI)’s *2017 Retirement Confidence Survey*, Social Security is a major source of retirement income for more than 60% of retirees surveyed. We cannot expect Social Security to close the retirement income gap, but the program’s bedrock benefits should be protected, and Congress needs to address its long-term solvency challenges. Although the time horizon for making changes to Social Security may seem long, it’s short for retirement planning purposes.

Indeed, the Melbourne Mercer Global Pension Index rates the United States as a “C” behind countries earning higher grades, such as Australia, Canada, Chile, Colombia, Germany and the United Kingdom.

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As Congress works on tax reform — whether as a comprehensive package or in stages — Mercer recommends that policymakers move forward with proposals to enhance Americans’ retirement security. To help advance the public debate, Mercer offers this initial set of recommendations.

<table>
<thead>
<tr>
<th>GRADE</th>
<th>COUNTRY</th>
<th>DESCRIPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Nil</td>
<td>A first-class and robust retirement income system that delivers good benefits, is sustainable and has a high level of integrity</td>
</tr>
<tr>
<td>B+</td>
<td>Denmark, Netherlands, Australia</td>
<td>A system that has a sound structure, with many good features, but has some areas for improvement that differentiate it from an A-grade system</td>
</tr>
<tr>
<td>B</td>
<td>Norway, Finland, Sweden, Singapore, Switzerland, New Zealand, Chile, Canada, Ireland</td>
<td>A system that has some good features but also has major risks and/or shortcomings that should be addressed; without these improvements, its efficacy and/or long-term sustainability can be questioned</td>
</tr>
<tr>
<td>C+</td>
<td>Germany, Colombia, UK</td>
<td>A system that has some good features but also has major risks and/or shortcomings that should be addressed; without these improvements, its efficacy and/or long-term sustainability can be questioned</td>
</tr>
<tr>
<td>C</td>
<td>France, US, Malaysia, Poland, Brazil, Austria, Italy</td>
<td>A system that has some desirable features but also has major weaknesses and/or omissions that need to be addressed; without these improvements, its efficacy and sustainability are in doubt</td>
</tr>
<tr>
<td>D</td>
<td>Indonesia, South Africa, Korea, China, Mexico, India, Japan, Argentina</td>
<td>A poor system that may be in the early stages of development or a nonexistent system</td>
</tr>
</tbody>
</table>

Source: *Melbourne Mercer Global Pension Index 2017.*
GOAL: SUPPORT RETIREMENT SECURITY THROUGH TAX POLICY

We believe the existing tax structure provides a vital, strong and effective incentive for individuals at all income levels — especially those with support from their employers — to save for retirement. For that reason, Mercer urges Congress to consider any retirement policy changes within the context of tax reform under the principle of “first, do no harm.”

Dramatic changes in the rules and incentives governing retirement plans are perilous and a gamble we cannot afford to take at a time when concern over Americans’ retirement readiness is already high. Reducing the tax incentives for workplace retirement plans could jeopardize the retirement security of these Americans and add to the challenge of maintaining adequate income for future generations of retirees. Although 401(k) plan tax incentives may not be as strong an influence on participants’ savings behavior as employer matching contributions, they appear to encourage those without access to a match to save. We, along with plan sponsors, are very concerned that changes to the tax incentives could damage participant savings rates.\(^\text{13}\)

These concerns also hold true with respect to proposals to require some or all contributions to retirement plans to be made on an after-tax basis similar to Roth IRAs, rather than on a pre-tax basis, a concept often referred to as “Rothification.” Such proposals could lower overall savings levels, increase in-service withdrawals and diminish smaller employers’ willingness to sponsor plans.

\(^{13}\) Nearly 90% of respondents to a Plan Sponsor Council of America survey strongly or somewhat agree that eliminating or reducing the pre-tax benefits of 401(k) or 403(b) retirement savings plans will discourage employee savings in workplace retirement plans. (PSCA. *PSCA Snapshot Survey: Potential Impact of Tax Reform on Employees’ Retirement Savings*, 2017, p. 4.) In a similar survey by the Committee on Investment of Employee Benefit Assets (CIEBA), 78% of respondents anticipate that a shift to Roth would have a negative impact on participation and savings rates. Furthermore, member participants overwhelmingly reject Roth deferrals today when presented with the choice. On average, about 90% of the dollars deferred into CIEBA members’ 401(k) plans were made through traditional pre-tax deferrals instead of through Roth deferrals when the option was presented to participants. (Barney L. “Plan Sponsors See Struggles if Moving to Roth-Only Retirement Savings,” *PlanSponsor*, accessed 31 October 2017).
Strong participation rates in 401(k) plans show they are an effective means to encourage savings. We urge policymakers not to exacerbate the already-significant savings gap in America and risk the progress employers have made in encouraging their employees to save by disrupting the current tax treatment of 401(k) contributions.

Finally, policymakers should take into account that tax incentives for retirement plans are not a complete revenue loss; rather, they are a deferral of taxable income. Tax incentives for retirement plans are treated as tax “expenditures” for the purposes of budget scoring. However, at the time of retirement, deferred amounts and the investment income earned on them are withdrawn and taxed at normal income tax rates. Therefore, retirement incentives are not truly tax expenditures and are often recouped outside of the congressional 10-year budget window. Mercer urges Congress to take this into account in developing retirement policy.

One of the most promising ways to address this challenge is to remove current barriers to creating “open” DC multiple-employer plans (MEPs) by private-sector organizations. Open MEPs would be freed from the current requirement that participating employers have common ownership or a common business purpose. This policy approach is consistent with the Department of Labor’s view on how ERISA would apply to state-run open MEPs.

Open MEPs could promote more plan coverage and savings by turning over much of plan sponsors’ risk and responsibilities to an outside plan administrator. They would also reduce burdens on employers by streamlining their administrative duties, lowering costs and limiting their fiduciary responsibilities. We also believe these arrangements can help employers continue sponsoring plans and provide a structure that in time could be extended to improve coverage for self-employed people. The substantial economies of scale and cost efficiencies of open MEPs also promise to cut fees and expenses — and thereby boost savings — for plan participants.

Additional changes to the rules regarding open MEPs could help expand their use and value to employers and plan participants, including:

- Allowing individual investors using an open MEP IRA trust platform to invest in the full range of investment vehicles available to employer-plan participants, such as collective investment trusts, which in many cases can be less expensive
  - This structure could also assist self-employed workers

- Ensuring that fees and costs are transparent, fully disclosed and easily compared across providers, services and products

- Allowing open MEPs to be structured as both DB and DC plans

Automatic payroll deduction IRA plans also hold promise as a way to expand plan coverage, and a number of states are moving to offer these arrangements to private-sector workers. Although Mercer supports this plan design and the goal of expanding plan coverage — particularly among small businesses — the potential patchwork of inconsistent state-run programs may create obstacles for employers with operations in more than one state. Moreover, employer-based plans offer significant advantages to IRAs in the form of substantially higher contribution limits, the possibility of employer matching contributions, generally lower costs and ERISA’s strong participant protections.
GOAL: BUILD ON THE SUCCESS OF THE PRIVATE RETIREMENT SYSTEM

The evidence is clear: Workplace retirement savings plans work, and the broad adoption of automatic features in recent years has made them even more effective. As the US retirement system continues to evolve and individuals take on more responsibility for retirement planning, it’s important to support those workers as much as possible in the transition. This goal can be achieved through key policy changes that will strengthen the current system, including the following:

- **Encourage greater access to lifetime income products.** One way to encourage the provision of lifetime income is to provide employers with a clear safe harbor from liability for selecting an annuity provider. Current Department of Labor guidance with respect to annuity selection from a DC plan is too vague to be helpful to plan sponsors. Facilitating the portability of lifetime income options, which will permit participants to preserve their lifetime income investments and avoid surrender charges and fees, would also be helpful. Encouraging lifetime income projections of DC account balances would help participants understand the value of lifetime income products.

- **Facilitate portability and consolidation of individuals’ retirement assets.** A not-for-profit industry clearinghouse, similar to the Depository Trust Clearinghouse Corporation, could facilitate the automated transfer of assets from plan to plan or from plans to individual accounts and vice-versa. This new clearinghouse would help reduce leakage associated with low-balance individuals cashing out their savings when changing jobs. It would also help individuals better consolidate and manage their retirement benefits and reduce instances of “lost benefits.”

- **Establish an alternative 401(k) safe harbor plan with higher deferral rates.** An alternative automatic enrollment/escalation 401(k) safe harbor plan should be created with higher default deferral rates. Unlike the current automatic enrollment safe harbors, which require an initial participant deferral rate of 3%, the new safe harbor plan’s initial deferral rate should be 6% and escalate to 10% in subsequent years. The design would also allow employers to match employee contributions up to 10% of pay. These increased incentives could encourage larger contributions and greater retirement savings.

- **Permit some retirement savings to be used for short-term needs.** Short-term and emergency financial needs can cause individuals to tap their retirement accounts, incurring taxes and penalties. Some of this leakage could be prevented by allowing employers to automatically enroll workers in savings programs for both retirement and more immediate needs, such as paying off student loans or buying a home. And for those currently enrolled, allowing them to continue contributing after they have made a hardship withdrawal would avoid further diminishing their savings.
GOAL: REMOVE IMPEDIMENTS TO EMPLOYERS MAINTAINING DB PENSION PLANS

Although 401(k) and other DC plans are critical components of the retirement security solution, DB pension plans continue to play an important role in providing retirement income to many Americans. Despite the decreasing numbers of DB pension plans, many employers remain committed to these plans. However, the dramatic increases in Pension Benefit Guaranty Corporation (PBGC) premiums made by Congress in recent years are forcing many sponsors to consider leaving the private DB pension system.16

Those employers’ commitments could be strengthened if Congress improved the regulatory environment for these plans in two key ways:

- **End the Federal Budget practice of “double counting” increases in the premiums that plan sponsors must pay to the PBGC.** Congress has dramatically increased PBGC single-employer plan premiums over the past several years, largely because they are scored as revenue.

- **Revise nondiscrimination testing rules that currently encourage many plan sponsors to “freeze” their DB pension plans.** When companies must reluctantly close pension plans to new entrants, they need flexibility to preserve the plan for existing employees who may have been counting on continued pension benefits. In many cases, IRS testing rules have the effect of forcing companies to close down the pension plan completely.

“Mercer believes that these [PBGC] premium increases are not only unwarranted; they are counterproductive to the goals of enhancing the agency’s financial health and improving Americans’ retirement security.” – Julio A. Portalatin, “Support for the Pension and Budget Integrity Act (HR 4955),” letter to Congress, June 8, 2016

CONCLUSION

Solving America’s retirement savings challenge will not be easy. But failure to adjust today’s policies to meet tomorrow’s needs will mean many workers will see their retirement expectations wither and will be forced to rely more on Social Security and other government programs that are themselves financially overextended. The longer we wait to address these challenges, the more drastic the solutions will have to be. Mercer believes these recommendations can lead to significant progress. We look forward to advancing the public debate and welcome the opportunity to engage policymakers, employers and employees in helping to ensure that more American workers can retire with confidence.
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