

# PENSION RIGHTS CENTER

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## **STATEMENT OF THE PENSION RIGHTS CENTER**

**ON**

**“SAVING SMARTLY FOR RETIREMENT:  
ARE AMERICANS BEING ENCOURAGED TO BREAK  
OPEN THE PIGGY BANK?”**

**BEFORE THE UNITED STATES SENATE  
SPECIAL COMMITTEE ON AGING**

**WASHINGTON, D.C.  
JULY 16, 2008**

The Pension Rights Center—the nation's only consumer organization dedicated solely to protecting and promoting the retirement security of American workers, retirees and their families—commends the Senate Aging Committee for holding this aptly-named hearing “Saving Smartly for Retirement. Are Americans Being Encouraged to Break Open the Piggy Bank?”

The hearing could not be more timely as many American families, faced with the stresses and strains of an uncertain economy, have to decide whether to save for retirement or take the money out of their 401(k) plans to help pay for the rising costs of food, fuel, health care and housing costs. But raiding a 401(k) plan is at best a short-term, stop-gap response to these financial pressures and could lead to long-term financial devastation. Breaking open the piggy bank today will mean that all too many individuals are robbing themselves of needed future

retirement income to supplement Social Security, leaving themselves vulnerable to retiring with inadequate income. Our hope is that today's hearing will start a dialogue on the extent to which employees should be able to access 401(k) funds before retirement.

Let's start with some history. There was a time when most large and medium-sized American businesses sponsored *real* pension plans, which provided employees with a guaranteed lifetime benefit when they retired. In such plans, employees could not withdraw benefits before they retired and plan loan programs were virtually non-existent.

In this universe, defined contribution plans—such as today's 401(k) plans—were usually supplemental retirement plans, the savings leg on the proverbial three-legged stool of retirement preparation. It thus made some sense for our legal rules to permit employers to provide some pre-retirement access to account balances through loans and in-service withdrawals, since many employees were not dependent on these plans for the majority of their retirement income. Moreover, as 401(k) plans increasingly came onto the scene, advocates for withdrawals argued forcefully that employees would be reluctant to contribute to such plans unless they had some emergency access to their money.

But the landscape of retirement savings has undergone seismic change during the last two decades. In 1983, 63 percent of private sector workers had defined benefit plans and 12 percent had defined contribution plans. In 2004, this was totally reversed: 63% had defined contribution plans (primarily 401(k) plans) and only 20 percent had defined benefit plans. What this means is that for millions of people, their 401(k) plan accumulations will be their only source of retirement income other than Social Security. The issues with respect to whether 401(k) plans will provide adequate retirement income are legion and well-documented. These plans require working people to decide whether to contribute, and if so, how much. They require them to

properly manage their investments. And they require retirees to figure out how to make their savings last throughout their retirement.

In recent years, there has been a movement to address some of these issues by making 401(k) plans look more like defined benefit plans by adopting automatic enrollment and automatic escalation features and providing default investments. But these features will be ineffective if policymakers do not address the very real problem that all too many workers are withdrawing their 401(k) money for non-retirement purposes.

Unfortunately, both market forces and misguided policy have compounded rather than ameliorated the problems of leakage. An employee can now access 401(k) plans to pay medical bills, to pay for a child's education, to help purchase a home, to address other financial hardships, and for any reason at all when he or she change jobs. In fact, according to the Profit Sharing/401(k) Council of America 87.5 percent of 401(k) plans in 2006 allowed participants to take loans and of the plans allowing loans, 84 percent offer loans for any reason. Ultimately, it is low and moderate wage earners who will be most hurt by taking out the money early. They will have to pay back the money in after-tax dollars. Also in a struggling economy, a worker who has taken a loan but loses her job will face the additional pressures of having to repay the loan or face substantial taxes and penalties.

So should Congress simply shut the door on pre-retirement withdrawals and loans? If this Committee were writing on a clean slate—reinventing the 401(k) plan so as to make it a less imperfect retirement savings vehicle—we would urge you to support a zero tolerance for pre-retirement access to 401(k) accounts. While this might mean that some employees would not contribute quite as much to their 401(k) plans, it would also mean that what they did contribute would be there for retirement.

However, you are not writing on a clean slate. Changes to the rules would be regarded as unexpected and unfair by workers who made contributions under a prior set of rules and expectations. We also recognize that there are some reasonable policy arguments to permit employees to have some pre-retirement access to their contributions. The pre-retirement economic stresses that people are facing are real. However, we think there are better solutions than asking Peter to pay Paul, which is exactly what happens when policymakers effectively encourage people to invade their retirement accounts to meet immediate financial concerns. (It goes without saying that we very much oppose the latest market “initiative” the 401(k) debit card).

As you continue to examine these critically-important issues of pre-retirement withdrawals, it is important to remember that 401(k) plans, as the beneficiaries of a very sizeable tax subsidy, are partially supported by *all* American taxpayers (including those who do not contribute to these plans). The challenge is to ensure that this tax subsidy promotes enhanced retirement income security for all Americans. We commend the Senate Aging Committee for starting this important dialogue.