PENSION RIGHTS CENTER

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RETIREMENT SECURITY FUNDS

SUMMARY

Retirement Security Funds would provide a new private retirement plan structure to supplement Social Security. They would incorporate a novel approach to risk-sharing, a unique benefit formula, and other features to increase retirement security.

Retirement Security Funds are proposed as alternative arrangements within a voluntary system. They are designed to appeal to employers interested in contributing to their employees' retirement security, and to employees and unions interested in simple, fair, and efficient pension plans.

Retirement Security Funds are:

- licensed single-purpose retirement institutions
- that provide for risk-sharing by participants, and
- incorporate a "reverse-match" benefit formula.

Retirement Security Funds also provide pooled professional investment; money locked in until retirement; and lifetime payouts to retirees and spouses.

RETIREMENT SECURITY FUNDS

I. Retirement Security Funds would be licensed single-purpose retirement institutions.

Retirement Security Funds (RSFs) would be single-purpose financial institutions, or subsidiaries of financial institutions, dedicated solely to retirement. They would be licensed and regulated by the federal government.

RSFs would be administered by professional money managers advised by an Advisory Board consisting of employee, retiree, and employer representatives.

Insurance companies, mutual funds, banks, credit unions, and other financial institutions authorized to issue IRAs would be eligible to compete for RSF licenses.

Financial institutions awarded RSF licenses would be required to commit to long-term, conservative investment practices, and to meet capital and other requirements prescribed by the regulating agency.

Financial institutions sponsoring RSFs as subsidiaries would be permitted to offer IRAs, 401(k)s, and other vehicles for additional tax deferred retirement savings independent of the RSF structure, up to current limits.

II. Retirement Security Funds would provide for risk-sharing by employees and retirees.

U.S. pension plans have traditionally placed all of the risks of loss on employers. These risks include investment risk, longevity risk, and interest rate risk. By contrast, retirement savings plans, such as 401(k) plans, place all of these risks on individual employees and retirees.

The Retirement Security Funds proposal borrows from a concept developed in the Netherlands for their Collective Defined Contribution plans (CDCs). Instead of all risks being on employers or all risks being on individuals, the risks are shared by all of the employees and retirees participating in a plan.

Under the proposal, in the event of poorer than projected investment returns (or other unanticipated events), RSFs could, if they follow specified procedures, reduce benefits for both employees and retirees. As noted below, better-than-expected returns above certain limits could be allocated to increased benefits for employees and retirees.[1]

From a participants' perspective, assumption of risks by employers (particularly with a government backup through a federal insurance program) is far preferable to collective risk-sharing by participants. But U.S. private employers have made it plain that relatively few are willing to continue to assume those risks. Given this reality, and our current voluntary system, collective risk-sharing by employees and retirees would provide much greater security for participants than plans where they are required to individually assume the risks, such as 401(k)s.

III. Retirement Security Funds would incorporate a reverse-match benefit formula.

The Retirement Security Fund proposal incorporates a "reverse-match" benefit formula. Unlike a 401(k), where employers typically match contributions made by employees, a reverse-match formula allows employees to match the contributions of their employers.

Employers choosing to participate (or required by collective bargaining agreements to participate) in RSFs would contribute a minimum of 3 percent of each employee's pay.

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[1] In Netherlands' CDCs employers have a contractual obligation to make a specified contribution for a limited number of years, usually five. If investment performance is less than anticipated, or there are unexpected changes in interest rates or life expectancy, during that period, the employers' obligations remain unchanged. The risk of loss is borne by the plan and, therefore, by the participants. The plan is permitted to reduce benefits for employees and retirees as a group.

Although CDCs are relatively new in the Netherlands and cover only a small proportion of the workforce, a recent Pension Accord is likely to result in a significant expansion of these plans.

For many reasons, among them conservative investment practices, extensive regulation by the Dutch Central Bank, and involvement of participants in oversight of the plans, reductions have been rare in the past. However, Dutch pension plans lost 20 percent of their assets in 2008. As a result, unless the plans recover more quickly than anticipated, reductions are likely in approximately one-fifth of all pension plans, both the predominant career average defined benefit plans and CDCs. The reductions are likely to average 2 to 3 percent, but for a few plans they could be much larger.

The Netherlands is different from the U.S. in many ways. It is heavily unionized; its pension plans are virtually mandatory; and it has a very strong collective tradition. Nonetheless, the CDC concept, particularly if combined with the other elements of this proposal, would offer a middle ground between guaranteed pensions and 401(k)s that could be appealing to many employers and employees.

Employees would be permitted to match their employer's contributions on a tax deferred basis, up to a maximum of two employee dollars for every one dollar contributed by the employer for a total maximum employer-employee contribution of 9 percent of pay.

If employers opted to contribute more than the minimum, that would increase the amounts that could be contributed by employees, up to current limits. It is likely that higher-income employees would urge employers to contribute more than the minimum so that they could contribute more. This would benefit all employees, including those who could not afford to put any money into the plans.

An expanded refundable Saver's Credit would apply to matching contributions of lower-income employees up to specified limits, and would be contributed directly to the RSFs.

Benefits would be calculated by reference to the amounts credited to employees' notional accounts with employer and employee and Saver's Credit contributions each year, plus investment earnings and dividends, as described below.

The RSF would credit employees' accounts with an annual interest credit equal to investment earnings (minus expenses) up to a 3 percent return adjusted for inflation. Any investment return in excess of the 3 percent ceiling would be credited to a reserve. The reserve would be available to protect participants' benefits in the event of severe market downturns, and, when appropriate, to provide dividend credits for employees and cost of living adjustments for retirees.

At retirement amounts credited to the employees' accounts would be paid out as annuities.

IV. Retirement Security Funds would also provide pooled professional investment; money locked in until retirement; and lifetime payouts to retirees and spouses.

Money contributed to a Retirement Security Fund would be pooled and professionally invested in a collective trust with appropriate diversification across asset types. Accounts would be notional rather than actual.

There would be no payouts from RSFs until retirement (or disability).

Employees would be permitted to move their money among RSFs but would not be permitted to withdraw RSF funds for non-retirement (or non-disability) purposes

Payouts from RSFs would be for the lifetime of the retiree, with survivor benefits for widows and widowers, including domestic partners, unless the couple jointly opted for an approved alternative payout option.

Benefits would be payable to spouses and domestic partners in the case of death before retirement age.

V. Retirement Security Funds would provide full disclosure to participants.

Employees would receive provisional annual statements showing the amounts allocated to their notional accounts to date, and what those amounts would provide in estimated lifetime benefits payable at retirement age, using interest rate and mortality assumptions prescribed by the regulating agency.

For married participants, the projections would assume a 75 percent joint and survivor annuity.

The statements would clearly state that the estimates are based on current assumptions about investment performance, interest rates, and life expectancy, and that payouts could be less if these assumptions proved to be incorrect.

VI. Retirement Security Funds would relieve employers of fiduciary, regulatory, administrative, and accounting requirements.

Since the RSFs would be licensed and regulated by the federal government employers would not have any fiduciary responsibilities in selecting an RSF. Their administrative costs would be minimal since their only obligations would be to transmit contractually agreed upon amounts plus employee matching contributions. The contracts between employers and RSFs would be enforceable under federal law. No obligations beyond those specified in the contract would be required to be disclosed on corporate financial statements.

RSFs are likely to appeal to small business owners and nonprofit organizations that view retirement as an essential part of their compensation package. It will also provide an option for unions in bargaining with employers who are unable or unwilling to assume the risks of traditional pensions, and for larger employers that are looking for an alternative to 401(k)s for their employees.