



Issue Brief

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The Value of the 401(k) System

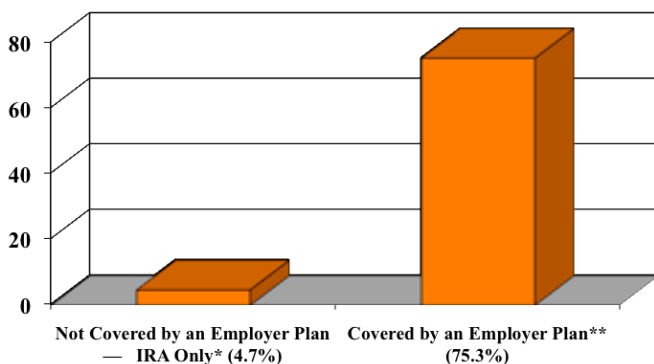
401(k) plans have come under intense fire since the recent market downturn. We've all seen the headlines – everything from “The 401(k) has Failed. Let's Admit It”¹ to “Workers Fight Uphill Battle on 401(k) Retirement Savings”² to “Why It's Time to Retire the 401(k).”³ Although 401(k)-bashing has certainly become fashionable, these headlines don't tell the whole story. In fact, the 401(k) system has been remarkably successful at getting working Americans to save for retirement. There is room for improvement, but policymakers should focus on changes that enhance the current system, not weaken it.

Coverage

401(k) plans are savings vehicles – and as a savings vehicle, 401(k) plans have worked extremely well. In fact, 401(k) plans are the only effective way we have ever gotten working Americans to save. As demonstrated in the 2008 Employee Benefit Research Institute analysis below, over 75 percent of workers making between \$30,000 and \$50,000 contribute when covered by a 401(k)-type

It also is true that lower income workers are the primary beneficiaries of 401(k) and profit sharing plans. The chart G2, based on our analysis of Internal Revenue Service data, shows 76 percent of participants in defined contribution plans have annual household incomes of less than \$100,000. Eighty-six percent of benefitting households have incomes of less than \$150,000 – and only five percent have incomes of \$200,000 or more.

G1. Participation Rates by Moderate Income (\$30,000–\$50,000) Workers Not Covered by a 401(k)-Type Plan versus Covered by a Plan



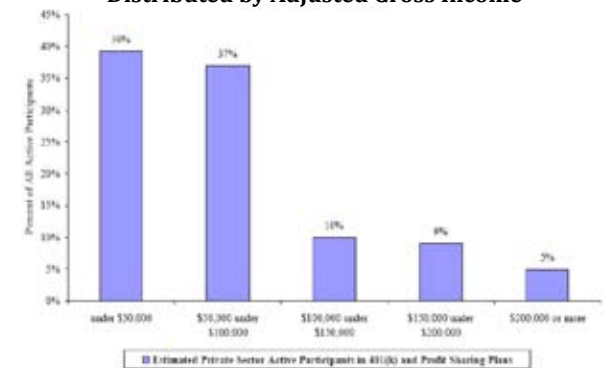
plan. These workers are 20 times more likely to save as compared to those workers not covered by an employer plan.

¹Moneywatch.com, June 24, 2009.

²USA Today, April 30, 2010.

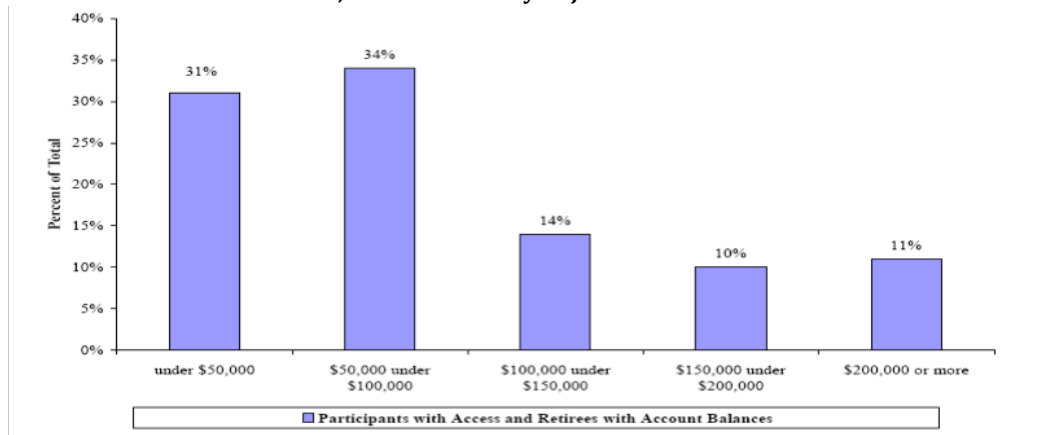
³TIME, October 9, 2009.

G2. Distribution of Estimated Private Sector Active Participants in 401(k) and Profit Sharing Plans, Distributed by Adjusted Gross Income



Our research also demonstrates that most of the tax benefits for defined contribution plans go to middle-income Americans. As shown in the chart below, approximately 65 percent of the total tax benefits go to those taxpayers who earn less than \$100,000 a year in adjusted gross income (AGI) - and about 79 percent go to those with less than \$150,000 of AGI. Almost one-third of the benefits go to Americans with less than \$50,000 of AGI.

G3. Estimated Distribution of Federal Tax Expenditure Estimates for Defined Contribution Plans, Tax Year 2008 by Adjusted Gross Income



Although 401(k) plans have been successful at increasing retirement savings, millions of workers do not have access to these arrangements. To provide access to workplace savings for millions more American workers, ASPPA is a strong supporter of expanding the availability of workplace savings through automatic individual retirement accounts (auto-IRAs), such as those proposed by the Obama administration. ASPPA believes payroll deduction auto-IRA arrangements will ultimately encourage more employers to sponsor 401(k) plans, and contribute on the employee's behalf. ASPPA also supports a simplified, refundable Saver's Credit to provide additional assistance with retirement savings for low to moderate income workers.

Investment-Related Concerns

The recent economic and financial markets crisis had a negative impact on the value of Americans' retirement accounts. However, retirement account balances have been regaining significant ground. According to the Urban Institute⁴, by the end of the first quarter of 2009, when the stock market bottomed out, retirement accounts (defined contribution plans and IRAs) had lost \$2.7 trillion or 31 percent of their peak value. However, since then, retirement account balances have rebounded sharply gaining about \$2.0 trillion (or 34 percent) since the first quarter of 2009. In addition, Fidelity has reported that from March 9, 2009, when the S&P 500 hit a 12-year low, to a year later, March 9, 2010, average 401(k) account balances surged more than 55 percent to \$71,600.⁵

That being said, the reality is that for most working Americans the 401(k) plan has become their sole and primary retirement plan. The drop in values of 401(k) plan accounts in 2009 worried many Americans about their financial security in retirement – especially those who are just a few years away from retirement. ASPPA supports strengthening the rules governing 401(k) plans to ensure that all Americans are secure in retirement. However, ASPPA believes suggestions that the government share the investment risk for retirement savings accounts, or mandate certain investment options, is misguided. Workers have different investment needs, and making a range of investment alternatives, including equities, available to workers is appropriate for a retirement savings vehicle. Guaranteeing a rate of return in a system with a range of investment options would create a serious moral hazard. If participants could shoot for high returns in equities while being insulated from downturns, the government, and taxpayers, would end up holding the bag. Improved disclosure and access to knowledgeable, independent investment advice are better solutions to concerns about long-term investment performance than government guarantees for retirement savings accounts.

Summary

The 401(k) system is worth improving because it has been successful at creating retirement savings for millions of workers. ASPPA believes payroll deduction IRAs will expand coverage, and improved fee disclosure and the availability of independent investment advice will improve the long-term benefits. ASPPA will continue to work with Congress and the administration to incorporate these improvements into the private retirement system.

⁴Butrica, Barbara A. and Philip Issa, Urban Institute, "Retirement Account Balances," April 2010.

⁵Fidelity Investments, "401(k) Balances Up 55 Percent In One Year From 2009 Market Bottom," May 19, 2010, available at: <http://www.fidelity.com/inside-fidelity/individual-investing/401k-balances-up-55-percent-in-one-year-from-2009-market-bottom>.