July 2009

PRIVATE PENSIONS

Alternative Approaches Could Address Retirement Risks Faced by Workers but Pose Trade-offs

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Highlights

Highlights of GAO-09-642, a report to the Chairman, Committee on Education and Labor, House of Representatives

Why GAO Did This Study

Recent losses in the stock market and poor economic conditions underscore that many U.S. workers are at risk of not having an adequate income in retirement from pension plans. The dramatic decline in the stock market has diminished pension savings and reportedly led to low levels in older Americans' confidence in their ability to retire. Even before the current economic recession, research indicated that pension benefits are likely to be inadequate for many Americans.

This report addresses the following questions: (1) What are key risks faced by U.S. workers in accumulating and preserving pension benefits? (2) What approaches are used in other countries that could address these risks and what trade-offs do they present? (3) What approaches do key proposals for alternative plan designs in the U.S. suggest to mitigate risks faced by workers and what trade-offs do they entail?

To complete this work, we reviewed research on defined benefit and defined contribution plans, and interviewed pension consulting firms, industry experts, academics, and other relevant organizations in the U.S. and abroad. In addition, we used a microsimulation model to assess the impact of certain strategies to increase pension coverage on accumulated benefits.

The Department of Labor and Department of Treasury provided technical comments on this report.

View GAO-09-642 or key components.

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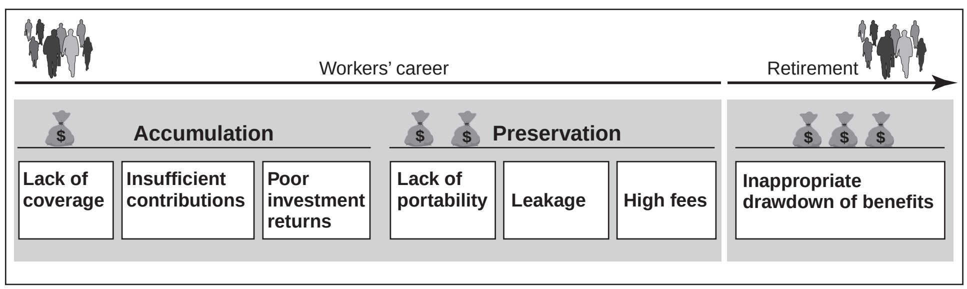
What GAO Found

U.S. workers face a number of risks in both accumulating and preserving pension benefits. Specifically, workers may not accumulate sufficient retirement income because they are not covered by a defined benefit (DB) or defined contribution (DC) pension plan. For example, according to national survey data, about half of the workforce was not covered by a pension plan in 2008. Furthermore, workers covered by DC plans, in particular, risk making inadequate contributions or earning poor investment returns, while workers with traditional DB plans risk future benefit losses due to a lack of portability if they change jobs. Preretirement benefit withdrawals (leakage), high fees, and the inappropriate drawdown of benefits in retirement also introduce risks related to preserving benefits, especially for workers with DC plans.

Key Risks in Accumulating and Preserving Pension Benefits



Sources: GAO analysis; images, Art Explosion.

The private pension systems of the Netherlands, Switzerland, and the United Kingdom represent alternative approaches to address these key risks, but they also pose trade-offs to consider in applying them in the U.S. We selected these countries from a larger group after an initial review indicated that their private pension systems addressed many of the risks that U.S. workers face and had the potential to yield useful lessons for the U.S. experience. Their systems offer ideas for mitigating risks in accumulating and preserving benefits, such as mandating coverage, sharing investment risk among workers and employers, restricting leakage, and using annuities to drawdown benefits. However, these approaches pose trade-offs. For example, in the Dutch and Swiss systems, sharing investment risk requires assets to be pooled and thus limits individual choice. Additionally, while annuitizing benefits at retirement can mitigate longevity risk, doing so also limits retirees' access to their assets.

Several proposals for alternative pension plan designs in the U.S. incorporate approaches to mitigate the risks faced by workers, such as incentives to increase voluntary coverage or mandating annuitization. However, these approaches also pose trade-offs and costs for workers and employers, and in some cases the federal government. In particular, important trade-offs arise with mandating coverage and contributions, guaranteeing investment returns, and annuitizing benefits. For example, mandatory approaches reduce risks but also raise concerns about the impact of higher benefit costs, particularly on small employers.