November 2007

GAO Accountability·Integrity·Reliability

Highlights

Highlights of GAO-08-8, a report to the Chairman, Committee on Education and Labor, House of Representatives

PRIVATE PENSIONS

Low Defined Contribution Plan Savings May Pose Challenges to Retirement Security, Especially for Low-Income Workers

Why GAO Did This Study

Over the last 25 years, pension coverage has shifted primarily from "traditional" defined benefit (DB) plans, in which workers accrue benefits based on years of service and earnings, toward defined contribution (DC) plans, in which participants accumulate retirement balances in individual accounts. DC plans provide greater portability of benefits, but shift the responsibility of saving for retirement from employers to employees. This report addresses the following issues: (1) What percentage of workers participate in DC plans, and how much have they saved in them? (2) How much are workers likely to have saved in DC plans over their careers and to what degree do key individual decisions and plan features affect plan saving? (3) What options have been recently proposed to increase DC plan coverage, participation, and savings? GAO analyzed data from the Federal Reserve Board's 2004 Survey of Consumer Finances (SCF), the latest available, utilized a computer simulation model to project DC plan balances at retirement, reviewed academic studies, and interviewed experts.

What GAO Recommends

GAO is not making any recommendations.

To view the full product, including the scope and methodology, click on GAO-08-8. For more information, contact Barbara Bovbjerg at (202) 512-7215 or bovbjergb@gao.gov.

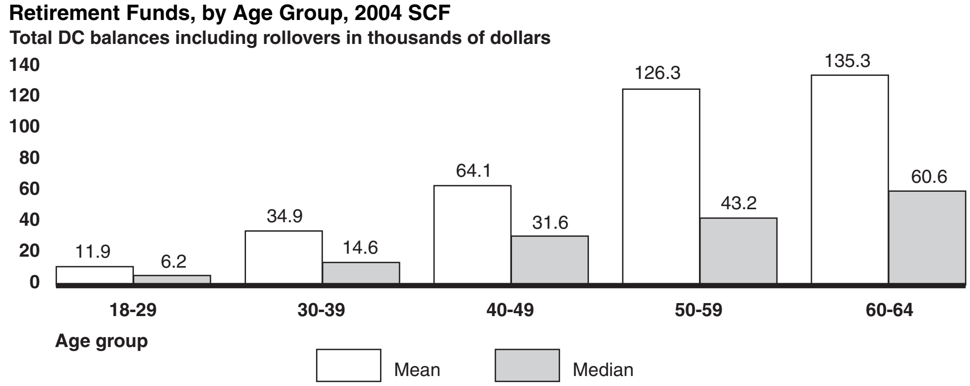
What GAO Found

GAO's analysis of 2004 SCF data found that only 36 percent of workers participated in a current DC plan. For all workers with a current or former DC plan, including rolled-over retirement funds, the total median account balance was $22,800. Among workers aged 55 to 64, the median account balance were $50,000, and those aged 60 to 64 had $60,600 (see figure below). Low-income workers had less opportunity to participate in DC plans than the average worker, and when offered an opportunity to participate in a plan, they were less likely to do so. Modest balances might be expected, given the relatively recent prominence of 401(k) plans.

Projections of DC plan savings over a career for workers born in 1990 indicate that DC plans could on average replace about 22 percent of annualized career earnings at retirement for all workers, but projected "replacement rates" vary widely across income groups and with changes in assumptions. Projections show almost 37 percent of workers reaching retirement with zero plan savings. Projections also show that workers in the lowest income quartile have projected replacement rates of 10.3 percent on average, with 63 percent of these workers having no plan savings at retirement, while highest-income workers have average replacement rates of 34 percent. Assuming that workers offered a plan always participate raises projected overall savings and reduces the number of workers with zero savings substantially, particularly among lower-income workers.

Recent regulatory and legislative changes and proposals could have positive effects on DC plan coverage, participation, and savings, some by facilitating the adoption of automatic enrollment and escalation features. Some options focus on encouraging plan sponsorship, while others would create accounts for people not covered by an employer plan. Our findings indicate that DC plans can provide a meaningful contribution to retirement security for some workers but may not ensure the retirement security of lower-income workers.

Total DC Balances for Workers with a Current or Former DC Plan, Including Rolled-Over Retirement Funds, by Age Group, 2004 SCF



Source: GAO analysis of 2004 Survey of Consumer Finances.