Profit Sharing 401(k) Council of America

Issue Brief

Current News Regarding Defined Contribution Programs

Role of the Employer Series

The Employer's Role and Importance In Providing Retirement Income Security for America

Today, more than one million employers offer 401(k), profit sharing, and other defined contribution plans to their tens of millions of employees.

By Carol Bogosian

American workers who participate in retirement plans are able to retire at reasonable ages with adequate income because of a continuing partnership of effort among employers, workers, and the government. This partnership delivers retirement benefits generated from employer-sponsored plans, personal savings by individual workers, and government-provided Social Security and Medicare. If current American workers are to enjoy the same level of retirement comfort as today's retirees, all three partners must continue to collaborate.

This paper will focus on the value that employers as vibrant partners contribute to the financial security that is the goal of every American worker. It will explain how employers contribute, and it will provide data that documents the importance of the employer's role. It is the first of a number of issues briefs that will discuss the value that employer-sponsored benefit plans provide employees, companies, and the country as a whole.

What Does the Employer Provide?

Retirement Savings[2]

First and foremost, employer-sponsored retirement plans have generated trillions of dollars in assets accumulated for retirement. As shown here, more than $13 trillion had been set aside for retirement in the United States by the end of 2004 (more than double the amount 10 years earlier). Recognizing that most of the accumulations in IRAs are the result of rollovers from employer plans, employers have facilitated the accumulation of more than $11 trillion to help ensure America's workers enjoy a financially secure retirement.

U.S. Total Retirement Assets (in trillions)

	1994	2004
Private Defined Contribution	$1.16	$2.66
403(b), 457	$0.24	$0.72
Rollover IRA/Keogh	$1.06	$3.48
Private Defined Benefit	$1.31	$1.85
State & Local Governments	$1.11	$2.54
Federal Government	$0.51	$1.02
Annuities (Non Plan or IRA)	$0.52	$1.25
Total	$5.91	$13.36

This *PSCA Issue Briefs* is part of a continuing series highlighting the value of employers who provide retirement benefits to their employees.

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Participation in Retirement Plans [1, 12]

A significant and growing number of private employers sponsor retirement plans for their employees. The number of private retirement plans tracked by the Department of Labor has increased from 311,094 plans in 1975 to 735,651 plans in 2000, a growth rate of 3.5% per year during the 25-year period since ERISA was passed in 1974. The introduction of "SIMPLE IRAs" in 1996 has resulted in the establishment of more than 400,000 additional plans by very small companies.

These plans are either defined contribution or defined benefit plans. A defined benefit plan provides benefits based on a predetermined formula, usually in the form of annuity payments in retirement. The defined contribution plan benefit is the total of contributions by the employer, employees, or both and the earnings on those contributions. The number of participants in private sector qualified defined contribution plans has grown significantly and now covers a larger number of participants. Defined contribution plans covered 11.5 million participants in 1975, increasing to 61.7 million participants in 2000, a growth rate of 6.9% per year during the 25-year period since ERISA. The number of participants in private-sector defined benefit plans increased slightly from 33 million participants in 1975 to 41.6 million participants in 2000. While the number of plans decreased, a significant number of Americans remain participants in a defined benefit plan.

A significant reason for the increase in participant coverage is the growth in the number of plans offered by small employers. In 2000, there were 629,243, or 85.5%, of private retirement plans with fewer than 100 participants. This is up from 191,161 such plans in 1975. Most small employers that offer a retirement plan sponsor a defined contribution plan.

A significant reason for the increase in coverage is the growth in the number of plans offered by small employers.

The number of participants in defined contribution plans increased from 11.5 million in 1975 to 61.7 million in 2000, a growth rate of 6.9% per year during the 25-year period since ERISA. The significance of the participation rates is evident in that 64.8% of private sector wage and salary workers in 2003 were covered by one or more private retirement plans.

Employee Savings [6, 7, 10]

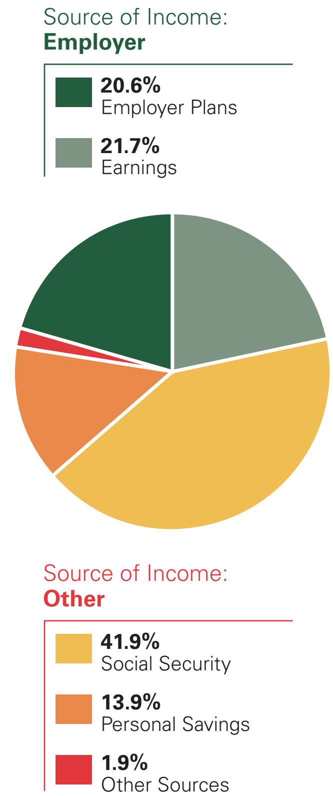
Employees are more likely to save if they have access to employer plans. Tax preferences for retirement savings are available both individually and through employer plans. IRAs have been available for personal savings for more than 30 years. Also, there are employer programs like the 401(k) with the same IRA tax preferences for individual savings. When an employer plan is offered, 77.7% of those making between $30,000 and $50,000 save in the plan. In contrast, only 4.1% of those without a company sponsored plan save in an IRA. Further, in 2001, contributions to IRAs were a relatively low $9.8 billion in comparison to rollovers of $187.1 billion from employer sponsored plans.

Employees have to be encouraged to save for their retirement. The personal savings rate in 2001 was approximately 1.8% for the total population, including workers of all ages, and remains relatively low today. However, the savings rate for the working-age population should be considered separately. The working-age personal savings rate is approximately 4.4%, primarily the result of employer-sponsored retirement plans.

Sources of Retirement Income[10, 11]

Employers provide a significant portion of retirement income for current retirees. In 2003, income sources for Americans age 65 and older consisted of:

Source of Income	Percentage
Employer	
Employer Plans	20.6%
Earnings	21.7%
Total Employer	42.3%
Other	
Social Security	41.9%
Personal Savings	13.9%
Other Sources	1.9%
Total Other	57.7%
Total All Sources	**100%**



Considering employer plans and earnings, employers provided 42.3% of retirement income for those aged 65 and older. Social Security, for which the employer pays for half through its FICA taxes, provides an additional 41.9% of retirement income. Clearly, the employer is a major provider of retirement income security for the American worker.

Recent research indicates that the majority of workers with employer retirement plans are more likely to have adequate retirement income. The study indicates that based on the employee's planned retirement age, 79% of households aged 50-61 who have a defined contribution account are likely to be able to maintain pre-retirement living standards in retirement. However, for similar households without a defined contribution account, only 47% will be able to maintain their pre-retirement living standards in retirement. For retirement at age 65, the percentages increase to 88% and 50% respectively.

Why Does the Employer Provide Retirement Benefits?

Employers provide retirement benefit programs to recruit, retain, reward, and retire a high-quality workforce. For small companies there is the added benefit that such programs are the most efficient way to provide retirement benefits to the owner-managers. Employers provide retirement benefits because of business and personal needs. The business objectives include motivating and recruiting employees, reducing turnover, rewarding valued workers, and facilitating orderly retirement. Altruistically, the employer may also want to provide employees with retirement income, increased personal savings, flexible compensation, a share of the profits, or an ownership interest in the company. Owner-managers' objectives may also include obtaining personal tax and retirement benefits or meeting estate planning goals.

The role of the employer in providing retirement income for workers in America continues to evolve. Any employer retirement plan must fit with the employer's financial goals and economic realities. For companies this means that the cost of benefit plans must be offset by an increase in the company's competitiveness. Benefit plans for non-profit and governmental workers must be considered in light of funding-raising sources or tax revenues and other spending priorities.

Employers provide meaningful retirement benefits because they have the flexibility to design and fund programs that take into account their unique business needs and the needs of a changing workforce. The maturity of the business, the demographics of the employees, the level of competition, and the expenses of complying with government regulations all influence the decision of if and what type of retirement program the employer will sponsor.

Other Employer Contributions

While sponsoring retirement plans is the principal way that employers provide retirement security to American workers, they also are instrumental in the success of the Social Security and Medicare programs. Not only do they pay their portion of the FICA tax, they also collect and transmit the employee's portion of the tax as well as keep the records necessary to track and calculate every worker's eventual benefit. Also, retirees who continue in employment may defer receipt of their Social Security and thus reduce the immediate funding needs for the system.

In addition, employers provide earnings and health care benefits in retirement years for those employees who choose to continue employment, either full time or part time, into later ages. The expectation for the future is that the role of providing continued employment will be an increasing one for employers.

Conclusion

The employer is an important partner in providing retirement security for the American worker. The employer provides benefits that promote economic security and increased living standards in the American economy. However, we need to recognize the employer's role and develop policies, regulations, and processes that enhance and enable them to continue to offer employee benefits in a cost effective manner. Retirement plans and policy need to be flexible enough to consider both the business needs of the employer and income security needs of the employee. Encouraging small employers to begin and continue to support retirement plans is a goal that would move many employees forward to retirement security. Keeping contribution, administration, and compliance costs reasonable and predictable will allow companies to better balance their perceived need and costs. Enhancing the partnership between the individual, government, and companies is a goal to ensure all three partners continue to participate fully in the retirement programs.

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Future *PSCA Issue Briefs* will highlight how employers are designing retirement plans, communicating with employees, protecting participant rights and benefits, and generally providing retirement income security for the American worker.

References

(Parenthetical numbers in article correspond to the references below).

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