Remarks of Ronald P. O'Hanley

A National Framework for Closing the Retirement Saving Coverage Gap

Tuesday, June 14, 2016 | Washington, DC | Pensions & Investments' Global Future of Retirement Conference

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Thank you. It's an honor to join so many great thinkers and leaders to discuss one of the biggest challenges of our era.

I particularly want to thank *Pensions & Investments* for making this conference possible — for spurring this remarkable discussion and for convening so many brilliant minds to focus on how to address the issue of retirement security.

What We've Heard

Over the course of the last day-and-a-half, we have heard a number of important and thoughtful viewpoints on retirement.

We have heard how a host of factors has conspired to make saving for retirement both more complex and more challenging, from low interest rates, stalled income growth, and rising healthcare costs to the persistent and frustrating lack of overall financial literacy in society.

These factors have arisen as the US and much of the world have moved from traditional defined benefit pension plans to individually directed defined contribution plans.

With this move from defined benefit plans — coupled with limits on Social Security — individuals are required to take on more responsibility and assume more risk — often unknowingly — for managing their retirement savings outcomes.

Contribution rates, asset allocation, longevity risk. Drawdown risk, portfolio yield, manager selection, embedded correlation: these and other factors that represent full-time jobs for retirement professionals are now the responsibility of the retirement saver to get right.

At the same time, employers struggle to manage costs and do right by their employees, all while minimizing their own exposure.

Many state and local governments — seeing this looming crisis and aware of their citizens' needs — have considered a variety of policy options.

And of course, the elephant in the room is the fact that gridlock in Washington appears to be here for the foreseeable future — as legislative solutions to address this growing crisis become more elusive than ever.

STATE STREET GLOBAL ADVISORS.

Congress managed to enact and achieve important improvements to retirement security with the Pension Protection Act.

That was a great accomplishment...but that was also 10 years ago, and we have not had significant advances toward retirement security since then.

At State Street Global Advisors (SSGA) we have a front row seat on the issue of retirement security. As the third-largest asset manager in the world, the bulk of our $2.3 trillion[1] in assets under management represents DB, DC, or other forms of retirement savings. In the 70 countries in which we have clients, we see the challenges facing plan sponsors, employers, governments, intermediaries and individuals. We and each of these stakeholders are focused on the same thing: Make retirement work.

Retirement Is Not Working

Right now, the retirement savings system is not working for many Americans. I don't need to tell anyone in this room that we have a retirement crisis in the United States.

Exhibit 2: EBRI $4 Trillion Retirement Savings Gap

We have all seen the headlines highlighting what the Employee Benefit Research Institute estimates is a staggering $4 trillion retirement savings shortfall in this country.[2]

While $4 trillion dollar is a big number, the crisis becomes even more profound when examined at an individual level.

Exhibit 3: Gen Xers Retirement Saving Shortfalls

Let's look at Gen X. They are the generation that is between the ages of approximately 35 and 50, which should be prime earning years. EBRI estimates that more than 40% them are off track and are expected to run out of money in retirement.

Single men are running a $129,000 deficit and single women are running a $133,000 deficit. And Gen Xer families are running an $82,000 deficit per person for a total of $164,000 for both adults.

And the math is invidious. Each day the deficit is not closed, it grows and gets worse.

The New Urgency Around Access

Retirement savings and coverage gaps are not news. As I mentioned earlier, policy makers and practitioners came together 10 years ago around the PPA and made good improvements. What is news is that certain environmental factors risk turning the retirement savings problem into a runaway crisis.

Indeed, I am here today to tell you that the need to get more Americans saving for retirement with a workable, comprehensive plan has taken on a new degree of urgency we have not seen before.

Two truly game-changing shifts — significantly longer life spans and lower-for-longer investment returns — require urgent actions around our retirement savings system.

Let's talk about each of these shifts.

Expected lifespans have improved steadily since the enactment of the Social Security system. In fact, the oldest American today now lives in my home state of Massachusetts.

Exhibit 4: Goldie Michelson

Meet Goldie Michelson from Worcester. She turns 114 in August.

In case you are wondering, Goldie says she never smoked or drank and was a big walker...but she does love chocolate!

Thanks to rapid advances in genomics and medical technology, we are on the verge of an age in which the Goldies of the world will represent the norm rather than the exception.

As an example, researchers focused on cancer, one of the top causes of death in the US,[3] talk about cures within a decade.

Some studies now show that in industrialized nations more than half of all babies born since 2000 will live past 100.[4]

In fact, the other day, I was speaking with a senior executive at a prominent insurer, which is beginning to prepare for a world in which people live to 120 and beyond.

That is not the world that most retirement savings programs were designed for.

So the good news is that we're living longer; the sobering news is that we'll have to finance much longer retirements.

The other seismic shift is that we are living in a lower-for-longer return environment.

Exhibit 5: IQ New Investment Reality

The secular forces that boosted investment returns over the last 30 years have now reversed.

Instead of the double-digit market returns investors enjoyed in the 1980s and 1990s as interest rates declined and economies and earnings grew robustly, we expect this New Investment Reality to consist of years of modest, single-digit returns, amid aging populations and sluggish economic and income growth.[5]

What does that mean for retirement savings? Well, according to McKinsey's recent research report analyzing these trends, even a two-percentage point difference in average annual returns will leave a 30-year-old today needing to save twice as much or work seven years longer to live as well in retirement.[6]

What Kind of Approach Is Necessary to Move the Needle NOW?

This perfect storm of low savings rates, longer life spans and lower investment returns means it is more important than ever to get Americans saving now so they can harness the power of compound returns over longer lifetimes.

As this room knows well, the key to retirement savings success is not about identifying the next hotshot as your fund manager.

It's about starting early, saving more and allocating your assets appropriately over time.

It's much harder if you wake up at age 50 and say, I am going to start saving.

Exhibit 6: The Power of Starting Early

This slide illustrates what I mean.

Someone earning $30,000 who starts to save 11% annually at 25 years old would have a balance at retirement of about $370,000.

The same person, saving at that same 11% rate but starting at the age of 40 would only accumulate approximately $150,000. That's nearly 60% less.[7]

But you can't start saving – and you can't start saving early — if you can't easily access a retirement plan. And unfortunately that describes nearly half of all American workers — men and women who cannot access a retirement plan in the workplace.[8]

That is why we at State Street believe that we face an Access Imperative — and addressing it is the single most important starting point.

Expanding access to retirement savings plans is the precondition for fixing this crisis.

Because simply put: time is not on our side.

Every day we fail to act is another day that Americans fail to save sufficiently for the future and the crisis deepens.

The time has come to enact a plan that will quickly and comprehensively expand access to retirement savings programs for all American workers.

Choosing the Right Path Forward

There are a number of ideas out there for expanding retirement savings plan access.

Indeed, we applaud efforts by the White House, Congress and many states to expand workplace retirement savings opportunities by leveraging IRAs.

We know they share our sense of urgency — and the goal of expanding access to retirement savings programs.

But we are concerned that none of those alternatives goes far enough — and many of them could end up inadvertently lowering overall savings rates.

Allow me to explain.

Let's look at the President's myRA program for a moment. Now, given the program's requirement to invest in low-risk government bonds, expected investment returns are low. Consequently, few expect myRA to move the needle in a significant way.

Far more challenging is the fact that it relies on Individual Retirement Accounts. While IRAs can be valuable tools in building retirement savings, they are far less effective than workplace savings vehicles like a 401(k).

Exhibit 9: IRA vs. 401(k) Savings

That's because employees have lower contribution limits — $5,500 for a traditional IRA vs. $18,000 for a 401(k) — and there is no ability to have an employer match. This chart demonstrates the difference in expected retirement outcomes under a 401(k) vs. an IRA.

This is a challenge we are seeing at the state level, too, as states begin to implement their own IRA-centered solutions.

Exhibit 10: States Taking Action

Maryland and Connecticut are just the latest of more than half of all states that have either instituted or are considering auto-IRAs or voluntary marketplaces.[9]

While we commend their efforts, we are deeply concerned by the prospect of 50 different retirement programs in 50 different states and the new burdens these would place on employers — particularly those whose operations extend across state lines and individuals who move from state to state or work on a contract basis.

And so, between the limited effectiveness of IRAs and the web of regulations these state approaches will create for employers — including those who already have retirement plans — these solutions could actually end up exacerbating the savings challenge.

And that is a risk we cannot afford to take.

Yesterday, you heard about a proposal from my friend, Tony James, of Blackstone and Teresa Ghilarducci.

I admire the ambition and scope of their proposal — and its recognition of the important role employers play in helping people save for the future.

Yet because we see how difficult it is to move the ball forward on anything in Washington, my fear is...that same ambition and scope could put us back to square one — because it requires a comprehensive new government program and a mandatory employer match.[10] This proposal will likely struggle to attract the broad political support we need to make changes.

Ultimately, none of these efforts allows us to get at the problem immediately, as they are either too small, too complex or too difficult to pass and set up.

And put simply, we don't have the luxury of contemplating or litigating the future of retirement.

We need to act now.

Our Plan

That's why we are proposing a national framework that is comprehensive, straightforward, consistent, and politically feasible.

One that extends the best practices of existing retirement savings plan practices — which have already received bipartisan support in the past — to have an immediate and positive impact on expanding access and coverage.

We are calling for federal legislation that ensures that all working Americans have access to a retirement savings plan in the workplace.

Our framework has four key elements.

First, it requires all private employers to auto-enroll all workers into a DC plan.

Secondly, it requires auto-escalation and qualified default investment solutions to help employees maximize retirement savings.

Third, it enacts tax credits for small employers to cover the administrative costs of implementing these plans and to encourage matching contributions.

And fourth, it eliminates barriers to open Multiple-Employer Plans or MEPs, so that businesses can band together to offer affordable retirement savings plans.

We believe these four elements will immediately and significantly increase access to retirement savings vehicles, boost savings rates and give us a platform from which to build on for the future.

Why the Workplace?

The first question many of you may be asking is: why focus on the workplace, given all we know about the shortcomings of our current system and the imperfections of America's 401(k) system?

Put simply, workplace savings works. Decades of experience shows that savings levels are higher in workplace-based plans than elsewhere.

So, if our goal is to get people saving quickly and at more appropriate levels, the fastest and most effective way to do this is to enroll people in workplace retirement plans. It's that simple.

As behavioral economist Richard Thaler has noted, behavioral insights have taught us how to create, "a pretty satisfactory DC retirement plan"[11]

Workplace-based retirement plans blend easily into the overall process and structure of a job. Well-structured plans overcome the inertia and procrastination that often get in the way of making the right choices, and taking action when it comes to savings.

Indeed, people are used to getting their pay and benefits at work and signing up for them when they start a new job — whether it's direct deposit, healthcare, flexible spending accounts or commuter benefits. Retirement savings plans should be part of that mix.

Secondly, there are a range of important ERISA protections and best practices from the PPA already included in the workplace savings system such as auto-enrollment and auto-escalation, which we should extend to all workers.

Third, we've seen how requiring coverage in the workplace has moved the needle in other countries.

Four years ago, the UK began rolling out a workplace retirement system in which employers are required to enroll all eligible employees automatically into a retirement plan. Employees are allowed to opt out, but those who opt out are automatically re-enrolled again after three years.

Exhibit 14: UK's Pension NEST

So far the plan has made a huge impact on increasing participation. Private sector employees participating in a workplace retirement plan in the UK increased from 42 percent when the initiative began in 2012 to 63 percent in 2014.[12]

Automatic enrollment will continue to be phased in until it extends to all employers in 2018, so participation rates are likely to keep rising.

In just two years, Britain used auto-enrollment to boost coverage by over 20%.[13]

We have a similar opportunity here in the US by expanding 401(k)-like plans to cover all workers by embracing the best practices of auto-enroll and auto-escalation. But unlike the UK, acting on our Access Imperative would not require a new government program.

Under our national framework, auto enrollment would begin at 6% of an employee's salary in the first year — and would be automatically escalated up to 12% over three years in 2% increments.

Employers would, of course, be permitted to default employees at higher rates if they choose.

Our framework would also ensure appropriate investment offerings that protect employers and employees alike.

One of the biggest challenges with a number of the alternative proposals we are seeing from states and with myRA is they either invest employees in a very low-yield strategy or include expensive principal-protection features. In a lower-for-longer environment, these requirements impede adequate retirement savings.

As everybody in this room knows, proper asset allocation and rebalancing — buying low and selling high — are critical to maximizing returns. We think every worker should be able to access effective investment solutions that appropriately map the risk/return spectrum over the life of the investor to manage both growth and protection.

Exhibit 16: Recently Hired Participants and Target Date Funds

As a result of the PPA and the related Qualified Default Investment Alternative, or QDIA, regulation, today more than 70 percent of 401(k) plans include target-date funds in their investment lineup and participation by recent hires has been steadily climbing.[14]

Requiring auto-enrollment, auto-escalation and defaulting into appropriately designed funds will leverage practices that we already know work and help address the human behavior challenge.

As early as a decade ago a report showed that two-thirds of people surveyed said their savings rate was too low, and more than a third of them said they planned to increase their savings rate in the next few months.

However, only 1-in-7 of those people actually did.[15]

This is why the auto features of our plan — auto-enrollment, auto-escalation, and a default option that automatically asset allocates and rebalances — are so important. Good outcomes can occur even if a worker pays no attention to his or her retirement savings.

Why Small Businesses?

Our plan also focuses on enabling small businesses to cost-effectively set up retirement savings plans. Why?

Because small business is big business in the United States. It's where the jobs are.

How big?

Well, according to the SBA, small businesses create about two out of every three new private sector jobs, more than 43 percent of the high tech jobs, and constitute 98 percent of firms exporting goods to countries around the world.[16]

They are among the most important job creators within our economy. But when it comes to retirement savings, workers at small firms are at a severe disadvantage.

Why?

Because, put simply, it can be challenging and expensive to set up a retirement plan and offer it as a benefit for a small employer.

First, small businesses have no or limited HR resources to manage benefits and engage employees. Setting up and administering a plan today often costs more per employee than it does for a larger firm.

Small businesses face myriad plan choices, from investments to plan design.

And if managing a small business didn't involve enough risk, small businesses also take on fiduciary risk if they offer a retirement plan.

So many of them simply don't.

More than a third of full-time, full-year private sector American workers do not have access to a workplace retirement plan — more than 30 million full-time American workers in all. A disproportionate number work in small businesses.[17]

Indeed, half of US small business employees do not have access to a workplace retirement savings plan.[18]

Our national framework would address this gap in two fundamental ways.

First, by easing the burdens on employer participation through targeted tax credits.

By covering administrative costs for small employers for the first five years through tax credits, we can make participation far easier than it is today.

Specifically, we are recommending that the annual cap on the credit be increased from $500 to $5,000 for employers that incur greater start-up costs for establishing and administering the plan and for educating employees about the plan.

Our national framework should also provide sufficient savings incentives for small employers to provide their employees with a company match.

While we don't believe a company match should be a requirement, it should absolutely be encouraged because matches boost savings and participation alike.

Under our framework, employers that do offer a match on contributions up to 12% would receive a tax credit and a safe harbor from nondiscrimination and top-heavy testing.

This would encourage employers to do the right thing by their workers while also protecting them.

Finally, we propose to make it easier for small employers to band together in a consistent way by eliminating barriers to open MEPs.

Trade groups like the American Bar Association and the American Dental Association have been sponsoring MEPs for decades for tens of thousands of members at reduced costs — and these vehicles need to be part of the solution.

Eliminating barriers to open MEPs by private organizations will help small employers pool assets and reduce the costs and administrative complexities of sponsoring a plan.

Our framework would also do a host of other things to make MEPs more consistent and workable, including streamlining nondiscrimination and top-heavy testing rules — as well as shifting the fiduciary responsibility for selecting and monitoring investments to the MEP sponsor, who would have far greater expertise on this front.

As important, expanding access to open MEPs will be a critical step toward helping employees at small firms or contractors who are part of our growing gig economy.

As Princeton professor Alan Krueger recently noted, while the gig economy is still a relatively small portion of the American economy, the percentage of workers hired out through contract companies has increased five-fold in the last decade.[19]

It is the single fastest-growing segment of our economy. Yet very few workers in this segment have any access to a workplace savings plan.

We need to help these workers save for retirement as well — and the flexibility of MEPs can be a critical tool to make that possible.

How Our Plan Stacks Up

So, how does our framework stack up?

Let's take a look at how much EBRI estimates these plans would reduce that $4 trillion shortfall in retirement savings I mentioned earlier.

Exhibit 21: Impact of Modifying Coverage

Let's start by looking at auto-IRA proposals that mandate 3% savings.[20]

As we would imagine, the fewer opt-outs, the better employees do ... but even with zero opt-outs, auto-IRAs that help employees save 3% annually only reduce the shortfall by about six-and-a-half percent.[21]

We certainly see some improvement when we increase savings to 6%, which narrows the gap by nearly 12%.[22]

And I would note that despite concerns about how much employees can save, the fact is that opt-out rates are really no different for 6% plans than they are for 3% plans.[23]

Now, let's look at the framework I've just described.

Exhibit 22: Impact of Modifying Coverage — SSGA Plan

This framework could reduce the shortfall by nearly 18% — up to $740 billion, and nearly three times what many auto-IRA plans would do.[24]

Even if a quarter of participants were to opt out — which is about double the opt-out rate we see in auto-enrollment plans today — this framework still reduces the retirement savings shortfall by more than 13%.[25]

Let's break this down even further at an individual level. For someone earning $40,000 a year who can now start saving in the workplace because he or she will now have access to a retirement plan, our proposal would mean an additional $272,000 in retirement.[26]

That, as they say, is real money.

Compared to a plan that mandates a 6% saving split evenly between the individual and the employer, it is clear that the framework I've just described produces more savings, more participation and more positive outcomes.

Exhibit 23: Reduction in Retirement Savings Shortfalls by Age

This is also true when we look at savings by age. Indeed, if we can reach workers before they turn 40, this plan will, by itself, reduce about a quarter of the shortfall — about two-and-a-half times what we see from an auto-IRA.[27]

And all we are doing is simply extending the current DC system — a system with protections and best practices that policymakers already understand well — to employers and employees who cannot currently access it.

Making Retirement Work

Now, I don't want to suggest that this framework will solve all our retirement challenges.

Additional measures should be looked at, such as reducing leakage in retirement savings by limiting loans against plans and limiting the ability to access savings prior to retirement.

Nor am I naïve enough to believe it will have universal political support. It is a mandate, which can be a 4-letter word in certain political lexicons.

This is a big, complex challenge in an enormously difficult environment.

So as we explore what is possible in today's environment, let us remember that there is a straightforward, pragmatic solution out there that can give us a big running start — at a time when we don't have a moment to waste.

To those who suggest making progress requires a wholesale reinvention of America's retirement system, we say: "It doesn't have to."

With a pragmatic approach to retirement security — one that is evidence-based, targets a demographic we can all support and builds on what works — a meaningful solution is possible.

A solution that allows us to put aside our differences and our politics and work toward a common goal.

A solution that policymakers can act on now but build on in the future as new things become possible.

This solution doesn't require us to reinvent the wheel or create a new government program.

If at some point we muster the political will to adopt a more comprehensive solution, by all means let's do it. But, in the meantime, let's make real progress quickly and provide access to retirement security for the millions of Americans who today are shut out.

At a moment like this, when the interests of all demographics are at stake and the problem is so clear, we can't let this opportunity pass us by.

Just because we couldn't come together.

Because we let the perfect be the enemy of the good.

With this framework, I believe we can do something meaningful — something that helps every stakeholder at every level.

By expanding access and building on what works, we can make retirement work for millions of Americans.

And with your help and leadership, I know we will.

Thank you.

[1] SSGA. AUM as of March 31, 2016.

[2] EBRI, "Retirement Savings Shortfalls: Evidence from EBRI's Retirement Security Projection Model," February 2015.

[3] CDC: http://cdc.gov/nchs/fastats/leading-causes-of-death.html.

[4] The Lancet, British Medical Journal, June 4, 2016.

[5] SSGA Investment Solutions Group as of Dec. 31, 2015 see the IQ: https://ssga.com/publications/investment-quarterly/2016/iq-spring-2016.pdf.

[6] McKinsey: Diminishing Returns, May 2016: http://mckinsey.com/industries/private-equity-and-principal-investors/our-insights/why-investors-may-need-to-lower-their-sights.

[7] SSGA: The calculations assume a retirement age of 65, a savings rate of 11%, annually salary of $30,000, expected return of 5.17% and an investment in a 60% (S&P 500)/40% (U.S. Aggregate Bond) balanced fund as of December 2015. The simulation assumes a simple annual contribution and no wage growth.

[8] State Street Global Advisors, "Marking State-Based Retirement Plans Work for Private Employers," August 30, 2015.

[9] Georgetown University Center for Retirement Initiatives, as of May 2016.

[10] "A Smarter Plan to Make Retirement Savings Last," The New York Times, Jan 1, 2016 http://nytimes.com/2016/01/02/opinion/a-smarterplan-to-make-retirement-savings-last.html?_r=0.

[11] SSGA: "Make it Easy," Richard Thaler quote: https://ssga.com/investment-topics/defined-contribution/2016/Only-Human.pdf.

[12] Department for Work and Pensions, October 2015, "Official statistics on workplace pension participation and savings trends of eligible employees: 2004–2014."

[13] Ibid.

[14] EBRI: 401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2014. Note: The analysis includes the 4.1 million recently hired participants (those with two or fewer years of tenure) in 2014, the 4.4 million recently hired participants in 2013, the 3.6 million recently hired participants in 2012, the 3.4 million recently hired participants in 2011, the 3.2 million recently hired participants in 2010, the 3.1 million recently hired participants in 2009, the 4.0 million recently hired participants in 2008, the 3.8 million recently hired participants in 2007, and the 2.8 million recently hired participants in 2006.

[15] Choi et al. (2006) report that two-thirds of subjects surveyed said their savings rate was too low, and 35 percent of them said they planned to increase their savings rate in the next few months. However, only 14 percent actually did. Automatic Escalation Helps Fight Inertia.

[16] US Small Business Administration: https://sba.gov/sites/default/files/FAQ_Sept_2012.pdf.

[17] "Moving the Coverage Needle," State Street Global Advisors, https://ssga.com/definedcontribution/us/docs/SSGA_Moving_the_Coverage_Needle_Final.pdf?ts=1465656900499.

[18] Ibid.

[19] Alan B. Krueger, The Rise and Nature of Alternative Work Arrangements in the United States, 1995–2015.

[20] Jack VanDerhei (June 2015), "Auto-IRAs: How Much Would They Increase the Probability of 'Successful' Retirements and Decrease Retirement Deficits? Preliminary Evidence from EBRI's Retirement Security Projection Model®", EBRI Notes http://bit.ly/ebri-2015-june-notes-pdf.

[21] Ibid.

[22] Ibid.

[23] Ibid.

[24] Source: EBRI Retirement Security Projection Model® Version 2590.

[25] Ibid.

[26] Ibid.

[27] Ibid.

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ID15197-2357049.1.1.AM.RTL 1218 Exp. Date: 12/31/2019