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America Needs a 21st-Century Retirement System

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While our nation has experienced other financial crises, the current one is the first to occur when so many Americans bear so much responsibility for their own retirement savings. Never before have those savings been as exposed to the markets, as workers are experiencing acutely. While we expect stocks will eventually recover, we should take time to rethink how Americans achieve lifetime financial security – and the mechanisms in place to help them do it.

Traditional pension benefits can no longer be relied upon when global competition and rapid technological change challenge the ability of even the greatest companies to make good on future commitments. Moreover, Americans switch employers and even careers several times over the course of their working lives.

Yet the 401(k)s and other accounts that replaced those pensions are not producing sufficient retirement savings. According to the McKinsey Global Institute, two-thirds of Americans between the ages of 54 and 63 have not saved enough for retirement. It's not that 401(k)s are bad, it's just that they were conceived as supplementary retirement vehicles, not as a holistic retirement system.

A new approach, combining the best of traditional pensions and new savings vehicles, is needed. Here are the elements:

Automate participation and savings. Automatically enrolling employees in plans, then hiking savings with pay raises, overcomes the inertia that results in nearly a quarter of workers eligible for an employer-sponsored retirement plan not signing up. Automatic enrollment plans should mandate employer and employee contributions and the percentage amounts of each. That's the approach some higher education retirement plans follow. It may be one reason why 35% of faculty feel very confident in their retirement income prospects, compared with 25% of working Americans, according to the TIAA-CREF Institute.

Give workers the information they need. Most of us need advice that is objective, and tailored to our individual goals. Retirement plans must include such advice for everyone who signs up.

Guarantee an income floor. Many retirement accounts focus on accumulation, but fail to include a payout mechanism to help ensure retirees will not outlive their savings. Retirement plans should provide that by automatically converting all or a portion of the account balance to a low-cost annuity at retirement.

Encourage savings for health-related expenses. According to the Employee Benefit Research Institute, a couple that retires today will need from \$200,000 to \$635,000 to pay out-of-pocket health care costs (above Medicare). Few private sector employers offer workers an account to save for such costs. Last year's agreement among the Big Three automakers and the United Auto Workers to establish tax-free trusts for worker health is an approach gaining favor among academic institutions. Now Congress needs to enable people with these accounts to leave any unused balance to heirs. This will encourage people to hold onto their savings until the last years of their lives when health care money is most needed.

Diversify risk. If you had all your retirement investments benchmarked to the S&P 500, your portfolio probably lost about 40 percent of its value this year. If you had a mix of stocks and fixed income holdings, your portfolio may be down as much as 20 percent this year, depending on your allocation. Individuals need to properly diversify, and rebalance their accounts regularly to maintain a prudent mix of assets.

Taken together, these measures offer a holistic way to convert our patchwork of individually owned accounts into a stronger retirement system. All are achievable, provided that policymakers, public officials and companies seize the opportunity this crisis presents to help assure that American workers will have the retirement savings they'll need.

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Individual and institutional client figures as of October 31, 2008.

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