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BOOMER BUST? SECURING RETIREMENT IN A VOLATILE ECONOMY

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BEFORE THE

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UNITED STATES SENATE

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BOOMER BUST? SECURING RETIREMENT IN A VOLATILE ECONOMY

WEDNESDAY, FEBRUARY 25, 2009

U.S. SENATE,
SPECIAL COMMITTEE ON AGING,
Washington, DC.

The Committee met, pursuant to notice, at 10:35 a.m. in room SD–106, Dirksen Senate Office Building, Hon. Herb Kohl, Chairman of the Committee, presiding.

Present: Senators Kohl [presiding], Lincoln, Casey, Whitehouse, Udall, Gillibrand, Martinez and Specter.

Index: Senators Kohl, Martinez, Casey, Udall, and Lincoln.

OPENING STATEMENT OF SENATOR HERB KOHL

The CHAIRMAN. Good morning to everyone. Thank you for being here, first and foremost. I would like to extend a warm welcome to Senator Mel Martinez, the Aging Committee's new ranking member, hailing from the great State of Florida. He is no stranger to the constituency we serve, and the issues we confront.

I'm so pleased to join together with Ranking Member Mel Martinez in leading this Committee, and I'm confident that he and his staff will contribute greatly to the Committee's agenda.

With the country aging at a rate never seen before, the issues that come before this Committee are timely, urgent and ever-changing. Just two years ago this month, we held a hearing to examine how the onslaught of baby boomer retirees would affect our, then robust, economy.

But what a difference two years can make. Today we will turn that issue on its head as we examine how the now flailing economy is affecting baby boomers.

For the millions of Americans who thought they were on the precipice of retirement, a dark cloud has rolled in and obscured the golden years they were just beginning to see over the horizon.

This morning, we will hear from a woman whose struggles typifies those that many boomers are now experiencing. She is not alone. Over the past year, 401K plans and other defined contribution participants have experienced devastating losses.

In these hard times, American companies have also had to cut back benefits. Thousands of American employers, large and small, have stopped providing 401K plans, 401K matching contributions to their employees. With the volatility in the stock market, many Americans are left wondering whether they should continue investing in their 401K at all.

The answer is yes, they should continue to save for their retirement, but perhaps with updated strategies, and more reliable investments. That is why, with more and more Americans relying on 401Ks and other defined contribution plans as their primary source for retirement savings, we need to make sure their savings are well protected with strong oversight and regulation.

In the past, this Committee has called for the disclosure of 401K fees to employers and participants and a ban on ill-conceived products like the 401K debit card.

Today, we will take a close look at 401K target day funds, which are designed to gradually shifts to more conservative investments, as workers approach their retirement.

A Committee investigation of investment funds designed for people planning to retire in 2010 has found that there's a wide variety of stock exposure. The results of excessive risk can be devastating for those on the brink of retirement. One 2010 fund lost 41 percent in 2008.

Despite their growing popularity, there are absolutely no regulations regarding the composition of these funds. I've sent letters to Secretary Linda, Holly Solis, and U.S. Securities and Exchange Commission Chairman, Mary Shapiro, asking them to consider regulations to better define target date funds. Depending upon their response, I may consider legislation options, as well.

Today's hearing will also focus on the housing downturn, and its affects on seniors and retirees, so many Americans who were counting on the value of their home to provide a secure retirement, are now at a loss and wondering what to do.

The result is that older Americans are forced to consider all their options. For many of them, the economic downturn will mean working longer. One of our witnesses today will describe the labor market for older workers, and the challenges they face.

To confront those challenges, I'm introducing several pieces of legislation this week that would make it easier for older Americans to continue working past retirement age.

Finally, experts will share with the Committee how boomers should move forward with a revised plan to shore up their retirement savings. Now, more than in recent decades, older Americans will need to rely on our bedrock government programs like social security and Medicare, and many may find some relief from provisions passed in the recent stimulus package.

None of us can say when we will see the end of this economic downturn. The best we can do is to reassess, reallocate, and recommit to finding stability in a volatile economy.

We thank the witnesses for being with us today, and we now turn to Ranking Member Martinez for his statement.

STATEMENT OF SENATOR MEL MARTINEZ

Senator MARTINEZ. Mr. Chairman, thank you so very much, and thank you for your very kind welcome to the Committee. I really have looked forward to working with you. I have been a very interested member of the Committee, and now as a—in a position of ranking member—it's a real honor to work with you, and a pleasure, and I know there's so much that working together, we can accomplish for the good of the American people, particularly those—the aging population of our country.

I want to thank our panelists for coming today to join us on this very important topic of the issues impacting America's baby boomer and retiree generation. One of the greatest concerns of these Americans is the current financial crisis, and what it meant for their future. From losses in the stock market to declining home values, those focused on retirement are right to be concerned about their financial future.

According to the Employee Benefit Research Institute, Americans aged 55 to 64, who have been enrolled in a program for 20 years or more, saw the value of their 401K retirement account decline by an average of 20 percent this year.

One consequence of the worsening economy, is that an increasing number of Americans have had to put retirement on hold. According to a recent AARP study, an estimated 70 percent of employee 62 and older plan to continue working. Numbers from the Bureau of Labor Statistics also suggest this trend. The number of Americans 55 and older with full-time jobs increased from 15.5 million in 2005, to almost 18 million in 2008.

Another concern among baby boomers and retirees is the state of the housing market. For many Americans, a home is the largest investment a family will make. As widespread foreclosures continue to take a direct toll on families, the value of nearby homes is also negatively affected. This is a huge concern for seniors looking to downsize their homes, and use the proceeds of a home sale to help with their retirement.

Every American should have the opportunity to live comfortably after retirement. Through some financial planning, aging Americans can better plan for their future, by learning ways to save enough to enjoy retirement. I have talked to a number of these individuals in my home State of Florida, where an estimated 17 percent of the residents are 65 and older, compared to 12 percent of the nation, as a whole.

Among the top concerns for financial security—preparing to live on a fixed income, paying healthcare and hospital bills, and finding affordable housing during retirement. I look forward to working with Chairman Kohl to develop practical solutions to help aging Americans weather the current storm, and prepare for some of the challenges that lie ahead.

I also look forward to hearing from our experts joining us today, here. One of our experts will discuss the importance of entitlement reform, which I believe is necessary to ensure the availability of programs vital to seniors. Programs such as Medicare, Medicaid, and Social Security could be rendered insolvent, if Congress fails to act.

To address this problem, I support the Conrad-Gregg bill that would help Congress and the President find the political will to address the nation's long-term fiscal imbalances. The bill would establish a task force that would recommend changes to current law related to spending and taxes, especially on entitlement programs.

The task force will consist of equal number of an equal number of Republicans and Democrats, and two members from the Administration. This effort will ensure bipartisan solutions to entitlement reform, and long-term fiscal stability.

The plan the task force sends to Congress will require a super-majority for passage, meaning that we would truly reach a bipartisan solution to one of the most vexing issues facing our nation today. Decisions on entitlement solvency have been delayed for far too long.

I want to thank the panel for being here today, and for joining us to lend your expertise to these serious problems that we face. I know that from your information that you will share, we will be better informed, and better able to guide legislation that will need to be looking at the entirety of the landscape that we face today, which is so different than what we have had in year's past. Oh, thank you for being here, I look forward to hearing from you.

[The prepared statement of Senator Martinez follows:]

PREPARED STATEMENT OF SENATOR MEL MARTINEZ

Thank you Chairman Kohl. It gives me great pleasure to take part in my first Aging Committee Hearing as Ranking Member. I would like to thank our panelists for joining us today to discuss several issues impacting America's Baby Boomers and retirees.

Among the greatest concerns of these Americans is the current financial crisis and what it means for their future. From losses in the stock market to declining home values, those focused on retirement are right to be concerned about their financial future. According to the Employee Benefit Research Institute, Americans age 55 to 64 who have been enrolled in a program for 20 years or more saw the value of their 401k retirement accounts decline by an average of 20 percent last year.

One consequence of the worsening economy is that an increasing number of Americans have had to put retirement on hold. According to a recent AARP study, an estimated 70 percent of employees 62 and older plan to continue working.

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Another concern among Baby Boomers and retirees is the state of the housing market. For many Americans, a home is the largest investment a family will make. As widespread foreclosures continue to take a direct toll on families, the value of nearby homes is also negatively affected. This is a huge concern for seniors looking to downsize their homes, and use the proceeds of a home sale to help with retirement.

Every American should have the opportunity to live a comfortable life after retirement. Through sound financial planning, aging Americans can better plan for their future by learning ways to save enough and enjoy retirement. I have talked to a number of these individuals in my home state of Florida, where an estimated 17 percent of the residents are 65 and older, compared to 12 percent of the nation as a whole. Among their top concerns is financial security—preparing to live on a fixed income, paying health care and hospital bills, and finding affordable housing during retirement.

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The task force will consist of equal Republicans and Democrats, and two members from the Administration. This effort will ensure a bipartisan solution to entitlement reform and long-term fiscal stability.

The plan the task force sends to Congress would require a supermajority for passage meaning we would truly reach a bipartisan solution to one of the most vexing issues facing our nation today. Decisions on entitlement solvency have been delayed for that too long. This bill will force Congress to vote on a bipartisan plan to make sure that future generations do not bear an incredible burden on debt.

So I want to thank our panel of experts for joining us today, and I look forward to hearing your thoughts on how we might better prepare this critical group of Americans for the challenges presented by today's turbulent economy.

The CHAIRMAN. Thank you very much, Senator Martinez.

We're very pleased to welcome our panel today. Our first witness will be Jeanine Cook.

Mrs. Cook has worked as a business agent for SEIU Local 47, in Cleveland, OH, and for the United Way of Lake County. She was active in a variety of charity organizations in the Cleveland area, before recently moving to Myrtle Beach, SC. She will testify about the challenges boomers are facing as they transition toward retirement.

Our second witness will be Dallas Salisbury, the CEO and President of the Employee Benefit Research Institute. Mr. Salisbury has written and lectured extensively on economic security topics, winning several awards for his professional excellence. He has served on the ERISA Advisory Council, and the PBGC Advisory Committee, the U.S. Advisory Panel on Medicare Education, as well as the Board of Directors of the National Academy of Social Insurance.

Also joining us today is Dean Baker. Mr. Baker is the co-director of the Center for Economic and Policy Research. His analysis economic issues is frequently cited in major media outlets, and he was one of the leading economists warning of a housing bubble. Today, he is releasing a new report analyzing the effects of the housing downturn on baby boomers.

Next, we will be hearing from Ignacio Salazar. Mr. Salazar is the head of SER—Jobs for Progress, an organization that trains low-income, older Americans in over 18 States, including my own State of Wisconsin. He will share with us the challenges and opportunities for those who may want to or need to continue working.

He's a previous President of the Detroit, MI affiliate of SER, and has had leadership positions with several Detroit non-profits.

Barbara Kennelly is our next witness. She is currently the President and CEO of the National Committee to Preserve Social Security and Medicare. She has spent 25 years serving the citizens of Connecticut at local, State, and Federal levels, including 17 years as a member of the U.S. Congress.

We welcome you all here today, we look forward to your testimony, and I would like to ask Senator Martinez to introduce our last witness.

Senator MARTINEZ. Thank you very much, Mr. Chairman.

I would like to say a few words about Deena Katz who is an Associate Professor in the Personal Financial Planning Division at the Texas Tech University in Lovett, TX. Deena is an internationally recognized financial advisor and practice management expert, the author of six books on financial planning and practice management topics, and a frequent guest on local and national network programs for CBS, ABC and PBS.

Deena, thank you for being with us today.

The CHAIRMAN. Thank you.

Before we commence our testimony, I'd like to ask Senator Casey to make a few comments, if he wishes.

STATEMENT OF SENATOR ROBERT P. CASEY, JR.

Senator CASEY. Mr. Chairman, thank you very much, I appreciate you calling this hearing, and appreciate the presence of the new ranking member, Senator Martinez.

I won't be here for the entire hearing, and I wanted to make sure that it was stated on the record. I'll be here for a limited period of time, but I want to thank the witnesses for your presence here today, for the commitment that you bring to all of these issues that come under, I guess, a broad umbrella of retirement security, especially at this time in our nation's history.

I know that in the State of Pennsylvania, where we have the second-highest percentage of people over the age of 65, other than the ranking member's home State, I know how worried people are. I have some sense of the anxiety that they feel, and this issue is critically important—not only for our State, but for the country.

We have an obligation in the Congress, in both parties, to do everything we can to provide some peace of mind that comes with retirement security for those who fought our wars, or worked in our factories, or taught our children, or gave us life and love, and today's testimony that you will provide—and the passion and scholarship and experience you bring to that testimony—will inform us and will keep us focused on making sure that we're doing everything possible, especially at a time of this trauma—economic trauma—for our families, that we stay focused on the urgent question of retirement security.

So, we're grateful for your presence and for your work here, and we will make sure even if we're not here for the whole hearing that we review, and try to incorporate the testimony in our work. Thank you very much.

The CHAIRMAN. Thank you, Senator Casey.

Senator Udall.

STATEMENT OF SENATOR MARK UDALL

Senator UDALL. Thank you, Mr. Chairman, I'll be brief. I, too, want to let it be known that I'm particularly honored to be a member of your Committee, and the ranking member, as well. I want to associate myself with the fine words of you and Senator Martinez, and Senator Casey. I don't think I can improve on them.

I do have a statement, I would like to ask unanimous consent that I can include in the record. Again, I look forward to working with you, Mr. Chairman, to understand and then act in ways that are appropriate to ensure retirement security, and be an active and involved member of this Committee.

So, thank you.

[The prepared statement of Senator Udall follows:]

PREPARED STATEMENT OF SENATOR MARK UDALL

First, I would like to thank Chairman Kohl and Ranking Member Martinez for holding this hearing today. I am pleased to have the opportunity to serve as a member of the Special Committee on Aging. With millions of baby boomers reaching retirement age, issues facing older Americans continue to be important to the people in my home state of Colorado and across the country. I look forward to bridging the divide and working with the members of the Committee on both sides of the aisle to address policies that will improve the lives of older Americans.

The state of our nation's economy is at the forefront of people's minds. I have heard from many Coloradans greatly concerned about the economic crisis facing all of us. The volatility and uncertainty of these distressed economic times have left people fearful of losing their jobs, their homes and their life savings. Older Americans, who worked hard and planned for the future, are faced with the reality of diminishing funds for retirement. Increasingly, they are being forced to reenter the workforce—into a growingly difficult job market—to make ends meet.

Additionally, the baby boom generation is quickly approaching retirement age, and in the coming years, millions of Americans will begin receiving Social Security funds and drawing on their pensions and retirement savings. In recent months, as the stock market has plummeted, these boomers have watched their nest eggs shrink, and as housing prices tumbled, they have experienced decreasing equity in their homes. Due to these financial constraints, they are faced with tough choices, such as delaying retirement. Many are seeking guidance on the best ways to protect their pensions, manage their 401(k)s and ensure that they are financially secure when they reach retirement.

This hearing is timely, and I look forward to the testimony of the witnesses today. I hope to learn not only more about the scope of the issue, but I am seeking solutions to share with Coloradans affected by these challenges.

The CHAIRMAN. Thank you, Senator Udall.

Senator Lincoln.

STATEMENT OF SENATOR BLANCHE LINCOLN

Senator LINCOLN. Mr. Chairman, thank you once again—as always—bringing up such great issues for us to focus on, and we appreciate so much—we appreciate the panel being here to share your wisdom and background, in terms of retirement security.

I noticed, at dinner the other night, my husband looked at my kids and said, "Ya'll got to get to basketball practice, because we may need a scholarship." When you look at what's happened to people's savings in so many ways—whether it's for college, or retirement, or anything else—people are frightened, and there's lots to be done. We're all going to be working hard to make sure we turn our economy around, so all of those things do prove out to be a good and positive thing. We're looking forward to having your suggestions of how we can ensure the confidence that Americans need in their retirement security.

So, thank you, Mr. Chairman, and thanks to all of you all. We appreciate it.

The CHAIRMAN. Thank you, Senator Lincoln.

So, we will now turn to Jeanine Cook, and for your statements, if you would be so kind as to keep them to 5 minutes.

Jeanine Cook.

STATEMENT OF JEANINE COOK, BABY BOOMER, MYRTLE BEACH, SC

Ms. COOK. Thank you.

Chairman Kohl, Ranking Member Martinez, and distinguished member of the Committee, my name is Jeanine Cook, and I would like to tell my story. It's a very personal story, and bear with me.

I am 58 years old, and have been married for 36 years. My husband Robert and I lived in our home in Ohio for 33 of those years. My husband retired last July at age 61, he has severe heart damage; half of his heart is functioning. He also is an insulin diabetic.

Robert served in the United States Marine Corps for 8 years, then he worked for the Gould Corporation, which closed, and he went to work for CEI, which is now First Energy, and Paines Fellow in East Lake, OH, as an Operating Engineer for a fossil fuel plant. This job requires a lot of physical labor, as well, which he was unable to do.

Our house was fully paid, but we ended up having to take out a home equity line on our home a few years ago to help our children, and family members, hurt by the recession in Ohio. We thought the hardship was—the one we were experiencing—would be only temporary.

Early this year, we ended up defaulting on the payments for that home equity line, and our home went into foreclosure. At home, when I open the local newspaper, there were five pages of foreclosures, and it's a large paper, our News Herald. Neighbors names were in, but it was absolutely humiliating to see my own name.

My husband and I decided that the only thing that we could do to bring our payments current was to use his retirement fund he received from working—we took it out as a lump sum, even though he had to retire early, at 61, we received 5 percent less, and we had no other avenue in which to use. We even have to pay taxes on that money.

Our son lost his job 6 months ago, he ended up moving into our home with us, in Ohio. Then our daughter, and 5-year-old granddaughter needed to move in because her husband walked out on her.

While we planned to sell our home in Ohio when we retired, we cannot sell our home, because our children would have no place to live.

With the current housing market, we were told that our home was worth 30 to 40 percent less than it was a few years ago, and this was our nest egg. Yet, we cannot sell our home, because our children would be homeless.

We had to get away because the stress was eating me alive. So, we moved in with my sister, Mary, and her husband. They retired in Murrells Inlet, SC, which is just south of Myrtle Beach.

We took about $175,000 out of the retirement lump sum to buy a small home, because we could not live with my sister forever. Now we have about $50,000 left in the account, until my husband reaches 62 years of age, and that won't be until next July, when he begins to draw Social Security out of that.

We have to keep our health insurance, which has doubled since my husband retired. We pay about $425 a month. We both have serious medical conditions. In addition to Rob's heart disease and diabetes, I suffer from depression, I have a genetic blood disorder, and I'm in Stage 3 kidney failure. I am also a diabetic.

I have had six surgeries in the last 6 years. I filed for Social Security Disability, and was denied, and I plan to appeal that decision.

My problem is, once the $50,000 is gone, we have nothing else to live on but the Social Security income, and I still have four years to go before I retire.

This is not how I thought we would live during our golden years. We thought our retirement was secure. We played by the rules, we both worked very hard, we paid our taxes, we did everything right. But there's too many Americans in our position. You save for a rainy day, and it's pouring. It's pouring out there, and it isn't getting better.

We need some relief. We are all—all we do is worry. What will our children look forward to? What will their future, and our grandchildren's future be like? Is this what they have to look forward to?

In closing, I would like to thank you for the opportunity you gave me today to testify and I would be pleased to answer any questions you may have.

[The prepared statement of Ms. Cook follows:]

Testimony of Jeanine L. Cook

Before the

Special Committee on Aging

United States Senate

"Boomer Bust?" Securing Retirement in a Volatile Economy"

February 25, 2009

Chairman Kohl, Ranking Member Martinez, and distinguished members of the Committee, my name is Jeanine L. Cook, and I would like to tell you my story.

I am 58 years old and have been married for 36 years. My husband Robert and I lived in our home in Ohio for 33 years until my husband retired in July of last year at the age of 61 due to sever heart damage. Robert is also an insulin diabetic. I personally suffer from depression, hives due to stress, and Graves' disease of the eyes. I have a genetic blood disorder, and I am in stage three kidney failure and also a diabetic. I have had a total knee replacement and my hip repaired. In the past few years, I have had six surgeries, and while I filed for Social Security disability, I was denied. I plan to appeal that decision.

We have two children—Meghan and Mark both who are still in Ohio. Meghan, 34, has been married twice and has three children. Her youngest Isabella, age five, lives with her full time while her other two children, Mary, age 11 and Robert, age 9, live with their father. My daughter pays child support for Mary and Robert, but does not receive support for her daughter Isabella because her father has three other children that he is required to support, although he doesn't. He is a true dead beat father. Meghan has filed for child support for Isabella, but was told it could take weeks. She cannot afford to file for divorce. She works a minimum of 55 hours a week as a service writer paid only on commission. She currently makes $350.00 a week, but has to pay $135.00 for day care for Isabella and $140.00 per week child support. Although she works very hard, she does not make enough to live on her own and still afford to eat. She is an insulin diabetic and profoundly hypertensive, but she cannot afford health insurance.

Our son Mark is 28 years old and has been unemployed for five months. He cannot find a job even with a temporary service, and therefore, has no health insurance which is troublesome given that he also is an insulin diabetic.

Our children currently live in our home in Ohio, and we have supported both of them financially and still do. They live rent free in our home, and we pay the insurance and property taxes, while they try to pay the utilities. However, the phone has been turned off. Meghan is the only one working she works everyday and ½ a day on Saturday.

While we planned to sell our home in Ohio when we retired, we cannot sell our home. Where would they go? With the current housing market, we were told our home is worth 30 to 40 percent less than what it was just a few years ago. This was our nest egg. Yet, we cannot sell, our children would be homeless. What would our children do without us? We had to get away, because the stress was eating me alive.

So, we moved in with my sister Mary. She and her husband are retired and live in Murrells Inlet, South Carolina, which is just south of Myrtle Beach. While we originally planned to move to the south to be close to my sister, this was NOT our plan when we retired.

When my husband retired from CEI, he received a lump sum that we rolled over into diversified mutual funds and money market accounts. I had an investment account also, but between the stock market crashes, me not being able to work, and our need to help our children, we were forced to use it all. We have lost 40 percent of our retirement investments. But, we feel lucky when we get 2 to 3 percent on our investment.

We used $150,000 to buy a small retirement home in South Carolina, because we could not stay with my sister forever. As a result, we have about $50,000 left to live on until my husband reaches 62, when he will be able to draw Social Security. I wish I was able to work but I know if I did, I would not survive. This is supposed to be our golden years.

We were taught to save for that rainy day. Well, it is pouring. This was never our plan. We now pay twice the amount for health insurance that we did when my husband was working and the older we get the more medicine we take and the prescription costs have increased. We are not alone there are so many of our friends both in Ohio and in South Carolina that are living hand to mouth.

We need some relief. All we seem to do is worry. What about our children and grand children's future, is this what they have to look forward to? In closing, I would like to thank you for the opportunity to testify. I would be pleased to answer any questions you may have.

The CHAIRMAN. Thank you, Ms. Cook.
Mr. Salisbury.

STATEMENT OF DALLAS SALISBURY, PRESIDENT & CEO, EMPLOYEE BENEFITS RESEARCH INSTITUTE, WASHINGTON, DC

Mr. SALISBURY. Chairman Kohl, Senator Martinez, member of the Committee, it's a pleasure to be here. I will focus my comments on some new research that we have put out on the total system.

Supplementation of Social Security has been—it has been stressed—left a voluntary effort. Just released survey data from the Federal Reserve show dramatic increases in family asset levels since 1989, as a result of participation in voluntary programs.

The most recent data suggest today that from this voluntary system about 17 percent of all private workers, or about 20 million, are active participants in defined benefit plans, and 56 percent—or about 66 million workers—are active participants in a defined contribution plan.

About 36 million individuals are also separated participants or retirees who are receiving income from these programs.

In addition, in the voluntary system, small employers can sponsor plans such as Individual Retirement Accounts, and an estimated 50 million individuals are now in such programs at some level.

The Pension Protection Act which the Congress enacted in August 2006, sought to increase the use of these voluntary programs through auto-enrollment and default investment in order to increase diversification. Record-keeping data suggest that auto-enrollment since the passage of PPA has increased dramatically, and in some programs participation has gone from 50 percent to in excess of 80 percent as a result of those provisions.

Related to portfolios, EBRI data showed that at year-end 2007, 13 percent of participants had no money in equities, while 43.4 percent had 80 percent or more in equities, in other words, another objective change from PPA. Data show widespread adoption of defaults in the life cycle and target date funds that provide for automatic diversification, and ongoing rebalancing.

Of those offered target date funds in the most recent year, 36.9 percent had at least some portion of their accounts in those funds at the end of 2007.

Among those identified as auto-enrollees, approximately 80 percent of those investing in target date funds had all of their assets in those funds, which is the intent of the way that they are designed.

Among participants between the ages of 56 and 65 who had been in the average target date fund at the end of 2007, approximately 40 percent would have had at least 20 percent decrease in their equity concentrations, again, leading to the greater diversification, was an objective of PPA.

Based on simulations we've looked at with a survey population for 2000 to 2006, if all participants in 401K plans had invested in target date funds, at the median, balances would have been larger than they were, in fact, based on individually selected allocations—again, meeting the objective of PPA.

Compared to actual participation in 401K plans, we found that with the use of target date funds, all four age cohorts that we analyzed would have had larger balances had they been in target date funds. When the most conservative target date funds were compared to actual participation, 3 of 4 of the cohorts would have had better returns; only those over the age of 45 would have seen relative losses.

Our February Issue Brief just released, presents calculations on how long it might take for individual participants to make up for the significant equity market losses that have taken place since the market high in the fall of 2007. Looking at a 5 percent equity rate of return assumption, those with the longest tenure would need about 2 to 5 years in order to recover.

If equity rate of return, instead, ends up being a zero rate of return for the next 5 years, on average, the recovery would take 2.5 years, at the median, and for those at the extreme, 9 to 10 years. This is both from investment returns and new contributions going into the fund.

To conclude, voluntary defined benefit and defined contribution plans in the private sector provide current retirement income to millions of retirees, and hold assets for million of workers and retirees. Recent public policy changes are increasing the number of participants, and the diversification of those accounts.

Mr. Chairman, member of the Committee, I commend you for exploring thee topics, offer our help in the future, and thank you for the opportunity to appear today.

[The prepared statement of Mr. Salisbury follows:]

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Written Statement

for the

United States Senate Special Committee on Aging

Hearing on the

February 25, 2009

"Boomer Bust? " Securing Retirement in a Volatile Economy"

By

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Oral Statement of Dallas Salisbury

Chairman Kohl, Senator Martinez, and members of the committee: My name is Dallas Salisbury. It is a pleasure to appear before you today. I will focus my comments on significant EBRI research findings that speak to securing retirement in a volatile economy.

1. Supplementation of Social Security has been left to voluntary effort. Just released survey data from the Federal Reserve shows dramatic increases in family asset levels since 1989 as a result of participation in voluntary retirement programs.
2. The most recent data suggests that today about 17% of all private workers, or about 20 million workers, are active participants in a defined benefit plan, and 56%, or about 66 million workers, are active participants in a defined contribution plan. About 36 million are separated participants or retirees in pay status.
3. Small employers can sponsor plans based upon an Individual Retirement Account (IRA), and individuals can create an IRA. An estimated 50 million have some type of IRA.
4. Concern over the large number of employers and individuals that have not chosen to create plans or contribute to them have led to changes in public policy. The Pension Protection Act of 2006 included auto enrollment and default investment diversification provisions seeking to (a) increase (a) participation and (b) portfolio diversification and rebalancing over time.
5. Record keeping data suggests that auto enrollment increased participation in a broad group of plans from under 50% to over 80%.
6. Related to portfolios, EBRI data showed that at year end 2007 13% of 401(k) participants had no money in equities and 43.4% had 80% or more in equities. Data shows widespread adoption of defaults into lifecycle or target-date funds that set the asset allocation according to the age of the participant and rebalance the asset classes on an ongoing basis. The forthcoming March 2009 EBRI Issue Brief finds that of those 401(k) plan participants who were in plans that offered a target date fund, 36.9% had at least some portion of their account in target date funds in 2007. Among those identified as auto enrollees, approximately 88% of those investing in target date funds invested all of their assets in target date funds, regardless of their account balance. The one clear result of the target date fund use is that it shifts

participant's asset allocations away from all or nothing allocations in equities across all ages.

7. EBRI research has found that if 401(k) participants between the ages of 56 and 65 had been in the average target-date fund at the end of 2007, approximately 40 percent of the participants would have had at least a 20 percent decrease in their equity concentrations. Based on counterfactual simulations from years 2000 through 2006, inclusive: If all 401(k) participants had invested in target-date funds with the age-specific average equity allocations, their median 401(k) balances would have been larger at year-end 2006 for all four age cohorts analyzed. When the most aggressive target date funds were compared to actual participant directed decisions, the median 401(k) balances for three of the four age cohorts would have been larger had they been in target date funds. When the most conservative target date funds were compared to actual participant directed decisions, the median 401(k) balances for those up to age 45 would have been larger had they been in target date funds; however those over age 45 would have ended up with smaller median 401(k) balances if they had adopted target date funds.
8. The February 2009 EBRI Issue Brief finds that those with low account balances relative to contributions who were in 401(k) plans at year-end 2007 experienced de minimis investment losses that were typically more than made up by contributions: those with less than $10,000 in account balances had an average growth of 40 percent during 2008. However, those with more than $200,000 in account balances had an average loss of more than 25 percent. 401(k) participants on the verge of retirement (ages 56-65) had average changes during this period that varied between a positive one percent for short tenure individuals (1 to 4 years) to more than a 25 percent loss for those with long tenure (more than 20 years).
9. The February 2009 EBRI Issue Brief also presents calculations on how long it might take for the 12/31/08 401(k) balances to recover to their 1/1/08 levels. At a 5 percent equity rate of return assumption, those with the longest tenure would need nearly two years at the median but approximately five years at the 90th percentile. If the equity rate of return is assumed to drop to zero for the next few

years, this recovery time increases to approximately 2.5 years at the median and 9 to 10 years at the 90th percentile.

10. To conclude, voluntary defined benefit and defined contribution plans in the private sector provide current retirement income to millions of retirees, and hold assets for millions of workers and retirees. Recent public policy changes are increasing the numbers of participants and the diversification of their accounts.
11. Mr. Chairman and members of the committee, I commend you for exploring these topics, and thank you for the opportunity to appear before you today.

Written Testimony of Dallas Salisbury

Chairman Kohl, Senator Martinez, and members of the committee: My name is Dallas Salisbury. I am president and chief executive officer of the nonpartisan Employee Benefit Research Institute (EBRI) and Chairman of the American Savings Education Council. I am pleased to appear before you today. All views expressed are my own, and should not be attributed to EBRI, or any other individual or organization. I have personally worked on retirement and pension issues since joining the Labor Department in 1975 as it was organizing to fulfill its responsibilities under the Employee Retirement Income Security Act of 1974 (ERISA). I was later on the staff of the Pension Benefit Guaranty Corporation, before joining EBRI in 1978 as its first employee.

Established in 1978, EBRI is committed exclusively to data dissemination, policy research, and education on financial security and employee benefits. EBRI does not lobby or advocate specific policy recommendations; the mission is to provide objective and reliable research and information. All of our research is available on the Internet at www.ebri.org and our savings and financial education material is at www.choosetosave.org

Voluntary Pension Saving in the United States

Social Security was established in 1937 to provide a base level of retirement income for nearly all those who have worked in our nation, and their survivors. Supplementation of Social Security has been left to voluntary effort on the part of employers and individuals. The Social Security Administration reports that over 80 percent of retirees have income that supplements Social Security.[1] Supplemental retirement programs are most important for those for whom Social Security replaces the lowest proportion of their income. (see slide 2).

Survey data from the Federal Reserve shows dramatic increases in family asset levels since 1989 as a result of participation in voluntary retirement programs, with median values growing from just under $18,000 to $45,000 in 2007. (see slide 3). Data taken from numerous contributors and compiled by the Investment Company Institute shows dramatic asset growth in voluntary defined benefit plans, defined contribution plans, and Individual Retirement Accounts as well, amounting to trillions of dollars. (see slide 4)

Employers and unions have been encouraged by public policy to voluntarily provide programs to assist workers in building supplemental savings and income. Since 1974 when Congress enacted the Employee Retirement Income Security Act (ERISA) a range of minimum standards have been specified that these voluntary plans must meet in order to receive favorable tax treatment.

ERISA includes as pension plans both defined benefit (such as CSRS and FERS) and defined contribution plans (such as TSP). The former promises a benefit while the later promises a contribution. The Federal Government had only a defined benefit plan until 1987 (CSRS), when the TSP began to operate and new hires were moved to the less generous FERS defined benefit plan. At the same time Federal workers began to participate in the Social Security program.

There are multiple data sources on the number of workers participating in these programs. Data from the IRS Form 5500 annual plan report is the most reliable for aggregate numbers.[2] Over the last 35 years since ERISA passed some trends are clear in the voluntary private system (see table below):

The number of defined benefit plans has declined, along with active participants (see slide 5). It should be noted that defined benefit plans do not just provide life income annuities. Over one third of defined benefit plans have been purposely redesigned to communicate an account balance versus an annuity value; over 50% of those reaching retirement age with a defined benefit plan are offered a single sum distribution; and, the vast majority of those offered the single sum take it (Not at retirement see Vanguard's study. Still working typically yes.).

The number of defined contribution plans has grown dramatically along with the number of participants in both absolute numbers and as a proportion of the workforce, as well as the number of workers that view this plan as their primary retirement plan. (see slides 5 and 6)

While the proportion of workers who's employer sponsors a plan or participates in a plan has changed little in the last 30 years, the number with a non-forfeitable right to a vested benefit has increased 71%. (see slide 7) The change in vesting standards since 1974 served to change the nature of defined benefit plans from providing value only for longer service workers to providing something to over half of those that passed through an employer. Small distributions going to millions of short service workers also served to increase the cost of plans. Since defined contribution plans were generally designed to provide a contribution to most workers as a set percent of salary, faster vesting had limited impact on plan cost or purpose. Thus, well intentioned reforms encouraged the movement from defined benefit to defined contribution plans.

What numbers you look at makes a big difference in assessing the voluntary system, as 41.5% of all workers participate in a plan at work, but 55.3% of full-time, full-year private wage and salary workers between 21 and 64 (see slide 8). Of those where the employer sponsors a plan over 87% do participate. While, from employer to employer, the numbers vary dramatically.

Plan Type	1975	1986	2006
DB Number of Plans	103,000	173,000	48,000
DC Number of Plans	208,000	545,000	631,000
DB Total Participants	33 million	40 million	42 million
DC Total Participants	12 million	37 million	80 million
DB Active Participants	27 million	29 million	20 million
DC Active Participants	11 million	35 million	66 million
Private Wage/Salary Workers	68 million	90 million	118 million
DB Active Percent	40 %	32%	17%
DC Active Percent	16 %	38%	56%

Source?

Retirement plan coverage is highest among those with employer provided health insurance, underlining how economic security programs fit together. (see chart 9). For example, the EBRI Health Confidence Survey finds that over 60% of workers reported an increase in health costs last year and over half covered that cost by reducing their contribution level to retirement savings programs.

Small employers can choose the lower cost option of sponsoring an IRA type program for their employees. The Investment Company Institute (ICI) projects that 10 million workers are in such employer based IRA programs, representing another 8% of wage and salary workers. It is unlikely that these workers are active participants in any other plan at their place of employment. Are other small employer plans worth mentioning?

Since 1974 when Congress established Individual Retirement Accounts tax policy has also encouraged individuals to save directly for retirement outside of employment.[3] The ICI estimates that 37.5 million individuals have traditional IRA's and 18.6 million individuals a Roth IRA, and a total of 47.3 million with some type of IRA. Both the IRS and ICI report that a significant proportion of the assets in these IRA's were rollovers from employment based plan single sum distributions. For example, in 2004 rollovers totaled $214.9 billion compared to contributions of $48.7 billion. The IRS reported a total of 50.9 million IRA's in 2004 and total assets of $3.3 trillion dollars. By the end of the second quarter of 2008 the ICI estimated assets at $4.5 trillion, but it is safe to assume that market declines since that time have moved the number back towards the 2004 level. Past studies suggest that more than half of the total assets in IRA's came from employment based pension rollovers.

I also want to emphasize that a substantial portion of these rollovers come from defined benefit plans. Over half of private defined benefit plans offer single sum distributions at retirement, as well as paying small single sum distributions to millions of short service workers who accumulate small amounts. Even the Pension Benefit Guaranty Corporation reports significant single sum payments from terminating defined benefit plans.[4] In this regard, the notion of conventional wisdom that ***all*** those in defined benefit plans receive life income annuities and are thus protected against market risk and longevity risk, is wrong.

The Pension Protection Act of 2006 changed the rules for defined contribution plans when it put "auto-enrollment" into the statute. This change was driven by a concern over the large number of workers that were not choosing to participate in a voluntary defined contribution plan at work. One large record keeper, Fidelity Investments, has recorded dramatic increases in the adoption of this approach (see slide 10) and another, Vanguard, has documented the increase in actual plan participation that comes with the approach. (see slide 11)

As was recognized in PPA, and documented for many years by EBRI, there is very wide variation in how 401(k) participants allocate their contributions and account balances. At year end 2007 13% had no money in equities and 43.4% had 80% or more in equities (see slide 12). Such extremes, combined with concerns over concentrations in employer stock, led to proposals for auto diversification. Such defaults were provided in PPA and have brought increased use of funds that balance asset classes (see slide 13), with PSCA.org reporting (see slide 14) that by 2007 nearly 65% were being defaulted into lifestyle or target date funds compared to 15% in 2002. Fidelity found that between September 2005 and December 2008 the movement in their plans was from 4% to 60% using the lifecyle or target date default (see slide 15). Such funds include multiple asset classes and are rebalanced as the markets move to maintain a 'target' asset allocation.

The forthcoming March 2009 EBRI Issue Brief will report that of those 401(k) plan participants who were in plans that offered a target date fund, 36.9 percent had at least some portion of their account in target date funds in 2007. The likelihood of a participant investing in target date funds decreased as the age of the participant increased: 43.7 percent of participants under age 30 compared with 27.0 percent of those ages 60 or older. Those with salaries less than $40,000 were more likely to use target date funds than those with salaries larger than this amount.[5] Furthermore, as tenure and account balance increase, the likelihood of the participant using target date funds declines. (see slides 16, 17 and 18)

Consequently, those that use target date funds relative to those that do not are more likely to be younger, have lower salaries, less tenure, have smaller account balances, and/or be in plans with a smaller number of participants. The average target date fund investor is about 2.5 years younger than those that do not invest in target date funds. They make about $11,000 less on average in salary, have about 3.5 years on average less in tenure, have $25,000 on average less in their account, and are in plans with an average of 1,200 less participants.

Among the participants who invested in target date funds that could be completely identified within the study database (name of fund, target date year, and asset allocation within the fund by target date year), 7.2 percent were determined to be auto enrollees under the identification methodology used in the March 2009 *EBRI Issue Brief* (see slide 16).[6]

In general, auto enrollees were younger, lower salaried, more likely to be in the largest plans, more likely to have all their account balance in target date funds, more likely to use only one target date fund, more likely to have 75 percent to 89 percent of their assets in equities, and be in target date funds with dates further in the future (Slide 16). In particular, 33.3 percent of those determined to be auto enrollees were younger than age 30, while only

13.7 percent of those determined not to be auto enrollees were younger than age 30. Approximately 50 percent of those determined to be auto enrollees had salaries less than $20,000, compared with just over 15 percent of those using target date funds but were not determined to be auto enrollees, while 55.5 percent of auto enrollees were in plans with more than 5,000 participants compared with 46.5 percent who were not. Furthermore, 73.8 percent of auto enrollees had a total (inside the target date fund plus any equity outside the target date funds) equity allocation of 75 percent to 89 percent. The nonautoenrollees had a more diverse distribution, as only 40.2 percent had a total equity allocation in this range. A larger percentage of these nonautoenrollees had allocations of 90 percent or more to equities or allocations of less than 75 percent of equities than the auto enrollees had.

Another factor of auto enrollment is the likelihood of being only invested in target date funds. Those identified as auto enrollees were significantly more likely to have all their assets invested in the target date funds. As shown in slide 17, except for participants in the largest plans (more than 10,000 participants). Over 90 percent of those automatically enrolled into target date funds had all their allocation in target date funds. However, for those who appeared to select target date funds on their own, 50 percent of those in the smallest plans to 30 percent of those in the largest plans had 100 percent of their assets in the target date fund.

A similar result held true across account balance size. Among auto enrollees, approximately 80 percent of those investing in target date funds invested all of their assets in target date funds, regardless of their account balance. However, among those who were not auto enrolled, the likelihood of a participant being completely invested in target date funds decreased significantly as the account balance increased. Over 60 percent of target date investors with account balances less than $5,000 had all their assets in target date funds, compared with just over 10 percent of target date investors with balances of $200,000 or more (slide 18).

The one clear result of the target date fund use is that it does shift participant's asset allocations away from all or nothing allocations in equities across all ages (see slide 12). This results in participants having a theoretically superior long term asset allocation of taking larger risks when they are young and lower these risks as the participant becomes closer to retirement. For example, a target date fund designed for someone in their 30's who would expect to retire around 2040 has on average allocation of about 90 percent in equities. Yet, as the individual gets closer to their target retirement year such as those with a 2010 target retirement date, the average allocation to equities is 45 percent (slide 19).

Target date funds are actively managed funds that vary widely in asset allocation for given stated years (see slide 19). This resulted in wide variation in losses in the recent market decline for similarly dated funds, causing some confusion.

As we all are painfully aware, the markets have taken a significant dip since the fall of 2007. This is true for both defined benefit and defined contribution plans.

The performance of institutional investors' portfolios for the 2008 calendar year was down approximately 25%, according to the Wilshire Trust Universe Comparison Service (Wilshire TUCS). According to a news report "a news release said Taft Hartley funds with assets greater than $1 billion saw the worst returns at -27.49% for the year and -15.59% for the fourth quarter. The median performance of all master trusts for the year ended December 31, 2008, according to Wilshire data, was -24.54% with a quarterly return of -12.83%. The median performance of corporate pension plans was -25.85% for the year and -13.09% for the quarter, while public pension funds' median performance was -24.91% for the year and -13.18% for the third quarter."

Defined contribution participants were hit hard if they were exposed to equities, as many were. While 2007 and 2008 brought significant market adjustment, these programs still hold trillions of dollars. Individual account balances in 401(k) plans, and similar plans grew through the end of 2007 (see slide 20). Many reports look at a single average and median account balance across all accounts, but it is more important to look at variation tied to age and tenure of participants. For example, at the end of 2007 the overall 401(k) median was about $19,000 compared to about $345,000 for high income long tenured workers in their 60's. (see slides 21 and 22).

Applying an estimated decline since 12/31/2007 of 27%, the average account had declined from over $65,000 on 12/31/2007 to about $48,000 at 12/31/2008.

A central question that our research has explored is how long it will take participants to rebuild account balances going forward. The February 2009 EBRI Issue Brief examined this question against several possible future rates of return. Changes in average 401(k) balances were estimated from 1/1/08 to 1/20/09 based on the EBRI/ICI database of more than 22 million participants. Not surprisingly the impact of this recent financial market performance on 401(k) account balances is a function of size of the participant's account balance. Those with low account balances relative to contributions experienced de minimis investment losses that were typically more than made up by contributions: those with less than $10,000 in account balances had an average growth of 40 percent during 2008. However, those with more than $200,000 in account balances had an average loss of more than 25 percent (see slide 23).

401(k) participants on the verge of retirement (ages 56-65) had average changes during this period that varied between a positive one percent for short tenure individuals (1 to 4 years) to more than a 25 percent loss for those with long tenure (more than 20 years) (see slides 24 and 25).

While much of the focus has been on market fluctuations in the last year, investing for retirement security should be a long-term proposition. When a consistent sample of 2.2 million participants who had been with the same plan sponsor from 1999 though 2006 was analyzed, the average estimated growth rates for the period from 1/1/00 through 1/20/09 ranged from 29 percent for long-tenure older participants to more than 500 percent for short-tenure younger participants.

The February EBRI Issue Brief also presents calculations on how long it might take for the 12/31/08 401(k) balances to recover to their 1/1/08 levels. At a 5 percent equity rate of return assumption, those with longest tenure would need nearly two years at the median but approximately five years at the 90^{th} percentile. If the equity rate of return is assumed to drop to zero for the next few years, this recovery time increases to approximately 2.5 years at the median and 9 to 10 years at the 90^{th} percentile (see slide 26).

As I noted, nearly 1 in 4 participants between the ages 56 and 65 had more than 90 percent of their account balances in equities at year-end 2007 and more than 2 in 5 had more than 70 percent. Also as noted, many sponsors are now moving to lifecycle/target date funds. These funds automatically rebalance asset allocations and move them to what are thought of by many practitioners as more "age appropriate." Had all 401(k) participants been in the average target date fund at the end of 2007, 40 percent of the participants would have had at least a 20 percent decrease in their equity concentrations.

My concluding point today comes back to the ongoing discussion of defined benefit versus defined contribution plans in a voluntary system. Prior to the passage of ERISA nearly all defined benefit plans paid retirement benefits as a life income annuity. Today, most private plan participants have the option of a single sum distribution, as is the rule in defined contribution plans. Our highly mobile workforce has median job tenure of less than four years, and less than ten years for those between 55 and 64. As a result, most workers in both plan types earn limited amounts with any one employer. Long tenure workers can accumulate substantial amounts. When single sums are chosen, less than half of workers under the age of 50 save the entire distribution for retirement, as do less than 50% of those getting a distribution of less than $20,000 (see slides 28 and 29). New data from the Federal Reserve suggests why this is so: only about one third of workers have 'retirement' as the primary reason for their savings (see slide 30). Yet, saving through a 'retirement' plan at work is the most effective and lucrative way to save, even if not actually saving for retirement. And, loan provisions, hardship withdrawal provisions, single sum distributions, and other legal design features workers the flexibility to use 'retirement' plans to save, while using the funds to meet other objectives.

Conclusion

Advocates reach different conclusions on what all of the data should mean for future public policy. I will not enter that debate. I will note, however, that 401(k) and other voluntary plans are currently meeting the explicit objectives of current public policies. Different objectives would demand different laws and regulations, but the system should be judged first against current rules, and then the debate over whether the objectives and the rules should change can proceed. Voluntary does mean voluntary.

Mandates would clearly allow different objectives to be met. Fixed government set investments would lead to different outcomes.

I want to end where I started, with Social Security. It is unique in our nation as it is mandatory, universal, involves each generation in a family in the support of each other, provides a floor of income in the event of worker death, disability, or retirement, pools mortality so that payments are distributed exclusively to meet a life income objective, and has extremely low administrative expense. History and data suggest that no voluntary program can ever meet these objectives. History also suggests that no mandated program outside the government could do so as efficiently, and no program that allows single sum distributions could provide life income for the population as cost effectively.

Private voluntary defined benefit and defined contribution programs were created as asset accumulation programs for the workers of those employers that choose to create a plan. They have and are meeting that objective.

Mr. Chairman and members of the committee, I commend you for exploring these topics, and thank you for the opportunity to appear before you today.

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Statement Appendix*

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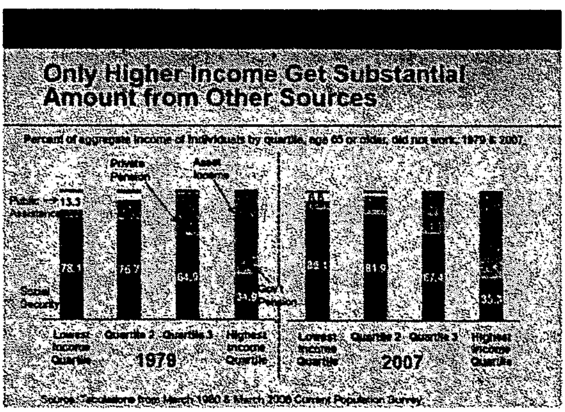
*This testimony expresses the views of Mr. Salisbury alone and should not be attributed to any other individual or organization unless specifically noted in the statement.

1

Retirement Plans Most Important Where Social Security Provides Least



2

Retirement Accounts Have Resulted in Individual Asset Growth

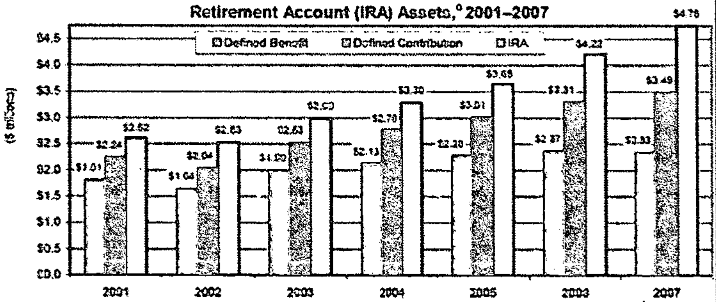
Median value of retirement accounts for families with holdings

Year	All families
Level (thousands of 2007 dollars)	
1989	17.7
1992	20.3
1995	23.0
1998	30.8
2001	34.2
2004	38.7
2007	45.0
Three-year change (percent)	
1992	14.7
1995	13.9
1998	33.0
2001	11.8
2004	13.2
2007	16.3

Source:http://www.federalreserve.gov/pubs/oss/oss2/2007/scf2007home.html

Total Assets Grew Significantly Through 2007

Figure 4
Private Employment-Based Retirement Plan and Individual Retirement Account (IRA) Assets,ᵃ 2001–2007



Source: For the IRAs, Investment Company Institute (ICI) using their own data and data from the Federal Reserve Board, American Council of Life Insurers, and Internal Revenue Service Statistics of Income Division. The most recent data from ICI can be found in Investment Company Institute, "The U.S. Retirement Market, 2007," Research Fundamentals, Vol. 17, No. 3 (Investment Company Institute, July 2008), www.ici.org/pdf/fm-v17n3.pdf. For the employment-based plans, Board of Governors of the Federal Reserve, Flow of Funds Accounts of the United States: Flows and Outstandings, First Quarter 2008 (July 6, 2008), and the Department of Labor.

ᵃ The asset level of IRAs for organizations include Keogh accounts held there.

30 years of DC growth and 20 years of DB decline

Plan Type	1975	1986	2006
DB Number of Plans	103,000	173,000	48,000
DC Number of Plans	208,000	545,000	631,000
DB Total Participants	**33** million	**40** million	**42** million
DC Total Participants	**12** million	**37** million	**80** million
DB Active Participants	**27** million	**29** million	**20** million
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Private W/S Workers	68 million	90 million	118 million
DB Active Percent	40 %	32%	17%
DC Active Percent	16 %	38%	56%

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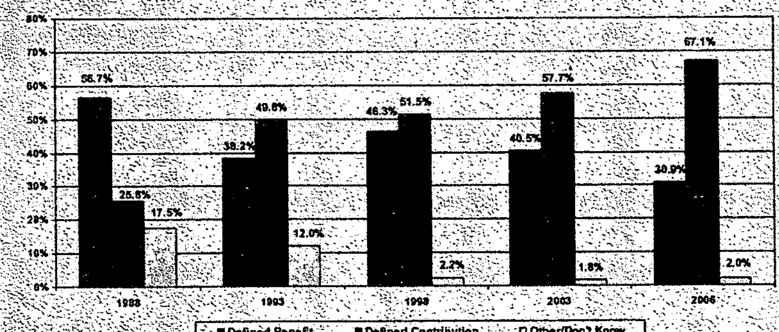
5

Primary Retirement Plan Identity Has Shifted to DC
(As Reported by the Workers)



Source: Employee Benefit Research Institute estimates of the May 1988 and April 1993 Current Population Survey employee benefit supplements and the 1996, 2001, and 2004 Panel of the Survey of Income and Program Participation Topical Module 7.

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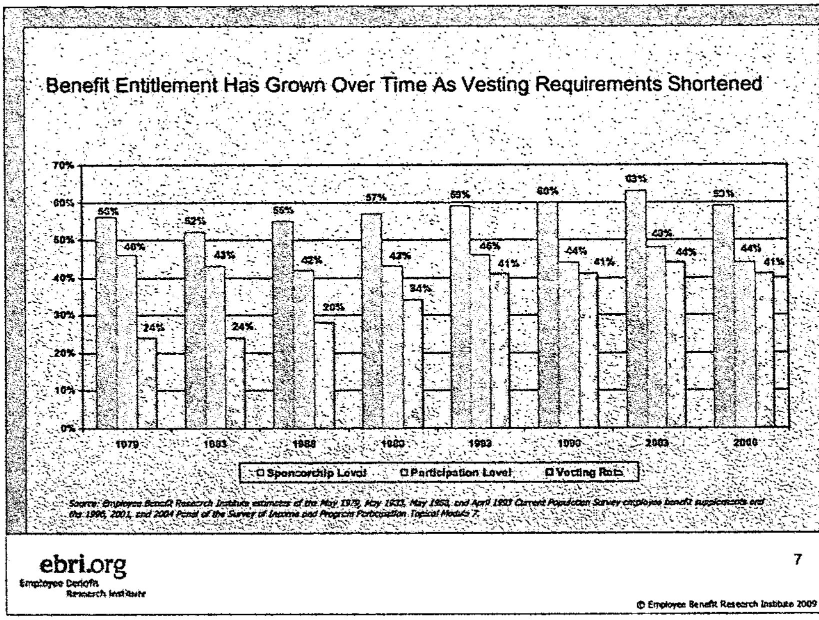
6



Who Is Counted Matters in Reported Percentages

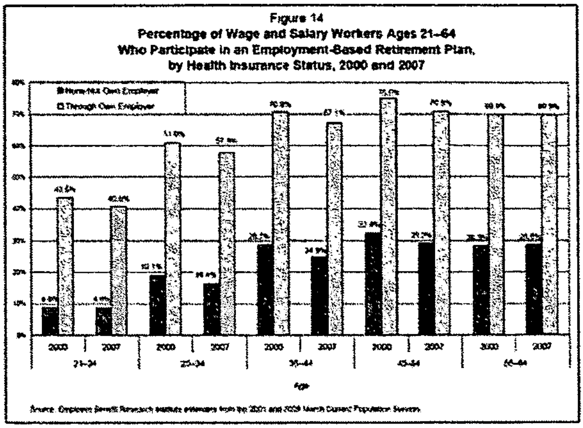
Figure 1
Percentage of Various Work Forces Who Work for an Employer That Sponsored a Retirement Plan, and the Percentage Who Participated in a Plan, 2007

	All Workers	Wage and Salary Workers Ages 21–64	Private-Sector Wage and Salary Workers Ages 21–64	Public-Sector Wage and Salary Workers Ages 21–64	Full-Time, Full-Year Wage and Salary Workers Ages 21–64
			(millions)		
Worker Category Total	158.1	131.2	110.1	21.1	97.1
Works for an employer sponsoring a plan	81.9	75.6	58.0	17.6	61.3
Participating in a plan	65.6	62.2	46.3	15.9	53.7
			(percentage)		
Worker Category Total	100.0%	100.0%	100.0%	100.0%	100.0%
Works for an employer sponsoring a plan	51.8	57.6	52.7	83.3	63.1
Participating in a plan	41.5	47.4	42.0	75.4	55.3

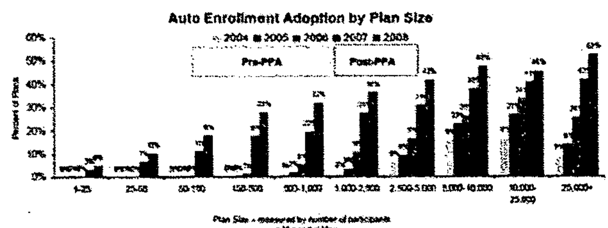
Source: Employee Benefit Research Institute estimates from the 2008 March Current Population Survey.

Highest for those with employer sponsored health insurance

Employer health premium payment frees up income for savings.



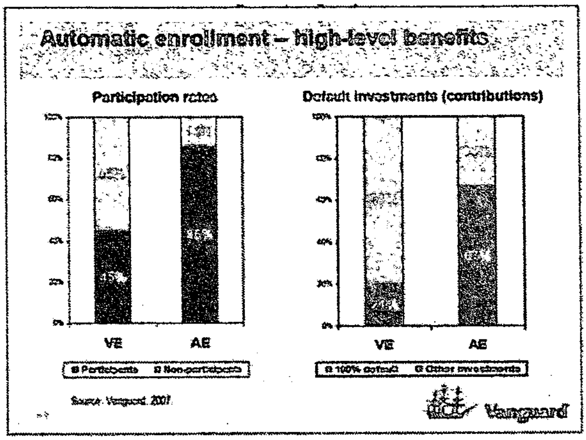
PPA Auto Enrollment Adoption By Plan Size



- While larger plans have led the early trend of plan adoption of Auto Enrollment, smaller plans are increasingly adopting auto enrollment.
- Pre-PPA adoption of Auto Enrollment among small plans was minimal.
- Post-PPA growth in adoption of Auto Enrollment has been significant across all plan sizes.

Fidelity

PPA auto enrollment is raising participation rates



11

Extremes Show Up

Figure 27
Asset Allocation to Equities Varies Widely Among Participants
Asset allocation distribution of 401(k) participant account balance to equities,[a] by age, percentage of participants,[b] 2007

	Percentage of Account Balance Invested in Equities[a]					
Age Group	Zero	1–20%	>20–40%	>40–60%	>60–60%	>80–100%
20s	19.2%	2.4%	3.8%	7.1%	19.4%	48.3%
30s	10.9%	2.5%	3.9%	7.9%	20.0%	54.8%
40s	10.8%	3.4%	4.7%	9.1%	28.4%	43.6%
50s	12.2%	5.0%	6.3%	17.5%	23.9%	35.1%
60s	17.7%	7.1%	9.7%	17.2%	18.2%	30.1%
All	13.2%	3.8%	5.3%	11.2%	23.0%	43.4%

Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.
[a] Equities include equity funds, company stock, and the equity portion of balanced funds.
[b] The analysis includes the 21.8 million 401(k) plan participants in the year-end 2007 EBRI/ICI database.
Note: Row percentages may not add to 100 percent because of rounding.

12

Equities Dominate Plans and Auto Diversification is Growing

Figure 18

Average Asset Allocation of 401(k) Accounts, by Participant Age

Percentage of account balances, 2007

Age Group	Equity Funds	Lifecycle Funds[a]	Non-Lifecycle Balanced Funds	Bond Funds	Money Funds	GICs[b]/Stable Value Funds	Company Stock	Other	Unknown	Total[c]
20s	48.1%	13.0%	9.2%	6.0%	3.7%	5.9%	6.4%	1.3%	2.7%	100%
30s	56.8%	9.3%	7.4%	6.9%	3.0%	4.9%	8.9%	1.7%	1.0%	100%
40s	54.0%	7.4%	7.6%	7.1%	3.3%	6.8%	10.7%	2.0%	0.8%	100%
50s	45.6%	7.1%	8.4%	8.0%	4.3%	11.3%	11.5%	2.2%	0.6%	100%
60s	38.5%	6.5%	8.3%	10.4%	5.9%	17.6%	9.7%	2.1%	0.5%	100%
All	48.2%	7.4%	8.0%	8.3%	4.2%	10.0%	10.6%	2.1%	0.7%	100%

Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.

[a] A lifecycle fund typically rebalances to an increasingly conservative portfolio as the target date of the fund, which is usually included in the fund's name, approaches.

[b] GICs are guaranteed investment contracts

[c] Row percentages may not add up to 100 percent because of rounding. Percentages are dollar-weighted averages.

13

PPA QDIA Driven Diversification/Rebalancing

Impact of the 2006 Pension Protection Act

Automatic Enrollment Default Investment

Year	Stbl. Val.	MM	Bal.	Life/ Target	Other
2007	8.9%	2.5%	13.9%	64.6%	10.1%
2006	19.2	6.4	14.6	53.4	6.4
2005	30.3	9.7	17.0	37.0	6.1
2004	26.9	23.7	29.0	8.6	11.9
2003	30.3	19.7	36.4	9.1	4.5
2002	31.5	25.9	22.2	14.8	5.6

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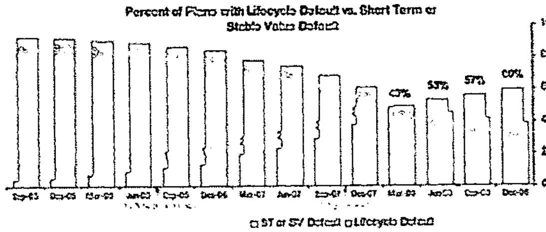
Lifecycle Default



- Across all plans, the usage of lifecycle options as the default investment option has steadily increased.
- As of 12/31/08 60% of plans use a lifecycle option as the default investment option.

Distribution of Target Date Fund Users, by Auto enrollment and Nonautoenrollment Status, and Age, Salary, and Total Equity Allocation, 2007

	All With Target Date Funds	Auto-Enrollees	Nonauto-Enrollees		All With Target Date Funds	Auto-Enrollees	Nonauto-Enrollees
All	100%	7.2%	92.8%		100%	7.2%	92.8%
Age	100%	100%	100%	Total Equity Allocation	100%	100%	100%
Under 30	15.1	33.3	13.7	1-9%	1.7	0.0	1.8
30-39	27.6	23.4	27.5	10%-24%	3.2	1.7	3.4
40-49	28.9	22.4	29.4	25%-49%	10.6	3.0	11.2
50-59	21.7	18.0	22.4	50%-74%	30.4	16.7	31.4
60 or Older	6.7	2.9	7.0	75%-89%	42.6	73.8	40.2
				90%-100%	11.5	4.8	12.1
Salary*							
<$20,000	20.1	50.7	15.0				
$20,000-$39,999	24.0	27.6	24.3				
$40,000-$59,999	10.1	9.3	10.6				
$60,000-$79,999	11.4	4.1	12.6				
$80,000-$99,999	6.6	1.0	7.3				
$100,000 or more	19.2	6.4	21.5				

*These tabulations only include those observations with complete salary data.

Source: EBRI tabulations from the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.

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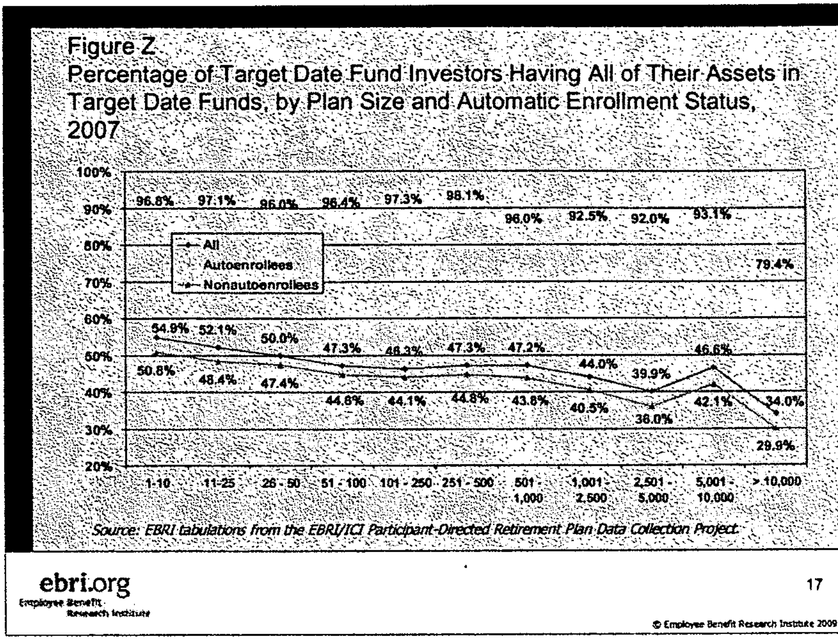
Figure Z
Percentage of Target Date Fund Investors Having All of Their Assets in Target Date Funds, by Plan Size and Automatic Enrollment Status, 2007
100%
90%
80%
70%
60%
50%
40%
30%
20%
96.8% 97.1% 96.0% 96.4% 97.3% 98.1%
96.0% 92.5% 92.0% 93.1%
79.4%
All
Autoenrollees
Nonautoenrollees
54.9% 52.1% 50.0% 47.3% 46.3% 47.3% 47.2% 44.0% 39.9% 46.6%
50.8% 48.4% 47.4% 44.8% 44.1% 44.8% 43.8% 40.5% 36.0% 42.1% 34.0%
29.9%
1-10
11-25
26 - 50
51 - 100
101 - 250
251 - 500
501 - 1,000
1,001 - 2,500
2,501 - 5,000
5,001 - 10,000
> 10,000
Source: EBRI tabulations from the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.
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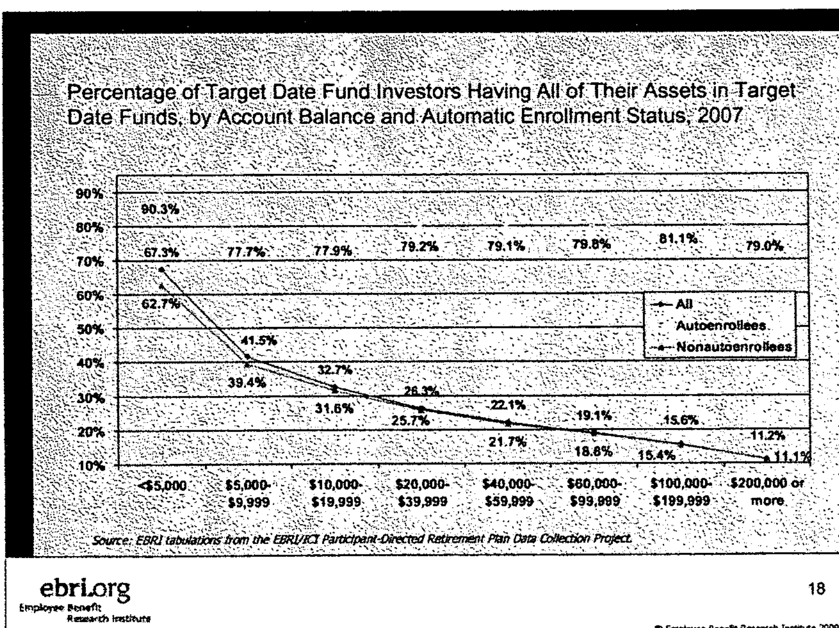
Percentage of Target Date Fund Investors Having All of Their Assets in Target Date Funds, by Account Balance and Automatic Enrollment Status, 2007
90%
80%
70%
60%
50%
40%
30%
20%
10%
90.3%
67.3% 77.7% 77.9% 79.2% 79.1% 79.8% 81.1% 79.0%
62.7%
41.5%
39.4%
32.7%
31.6%
26.3%
25.7%
22.1%
21.7%
19.1%
18.8%
15.6%
15.4%
11.2%
11.1%
All
Autoenrollees
Nonautoenrollees
<$5,000
$5,000-$9,999
$10,000-$19,999
$20,000-$39,999
$40,000-$59,999
$60,000-$99,999
$100,000-$199,999
$200,000 or more
Source: EBRI tabulations from the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.
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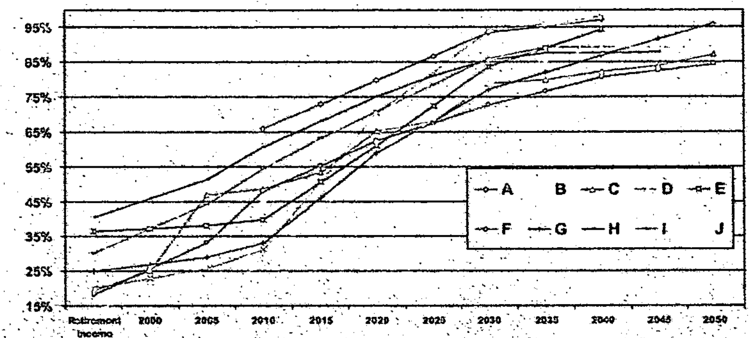
Figure y
Equity Allocation of Ten Target Date Fund Families, by Year of Target Date Fund, End of Year 2007



Source: Asset allocations of the target date funds as reported by Target Data Analytics from Morningstar Principia. Retirement Income would also represent Target Income, Target Today, Target Now, and other similar names used by Target Date Funds.

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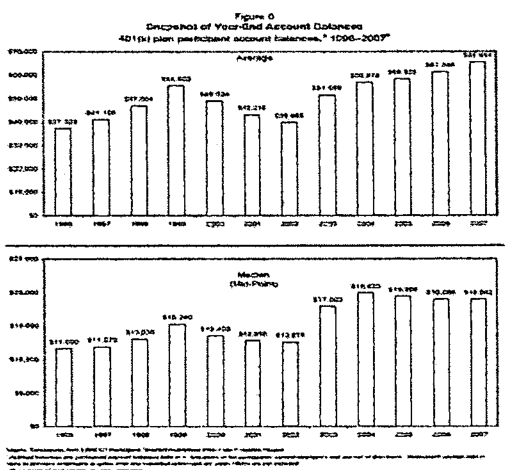
Average and Median Account Balance History



20

Age and Tenure Affect Balances

Figure 10
Account Balances Increase With Age and Tenure
Average 401(k) account balance, by age and tenure, 2007

	Tenure (years)					
Age Group	0–2	>2–5	>5–10	>10–20	>20–30	>30
20s	$4,491	$10,748	$18,564			
30s	$11,502	$23,024	$42,861	$62,207		
40s	$16,872	$31,055	$56,262	$100,856	$151,193	
50s	$20,603	$34,882	$63,783	$111,840	$194,385	$191,225
60s	$24,544	$35,398	$60,525	$105,504	$172,584	$210,457

Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.
Note: At year-end 2007, the average account balance among all 21.8 million 401(k) participants was $65,454; the median account balance was $18,942.

21

Age and Tenure Affect Balances

Figure 13
Median Account Balance[a] Among Long-Tenured[b] Participants, by Age and Salary, 2007

	Participant Age Group				
Salary Range	20s	30s	40s	50s	60s
$20,000–$40,000	$8,759	$21,187	$51,130	$66,378	$58,028
>$40,000–$60,000	$15,510	$37,578	$82,667	$102,410	$97,413
>60,000–$80,000	$33,155	$64,811	$133,488	$160,324	$162,883
>$80,000–$100,000	$49,002	$100,995	$194,832	$226,266	$236,612
>$100,000	$52,268	$150,678	$280,624	$344,528	$344,849

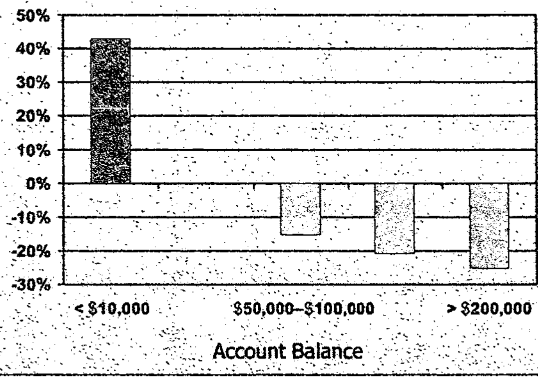
Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.

[a] Account balances are based on administrative records and cover the account balance at the 401(k) plan participant's current employer. Retirement savings held in plans at previous employers or rolled over into individual retirement accounts (IRAs) are not included. Account balances are net of loan balances.

[b] Long-tenured participants are used in this analysis to capture as long a work and savings history as possible. The tenure variable tends to be years with the current employer rather than years of participation in the 401(k) plan. Particularly among older participants, job tenure may not reflect length of participation in the 401(k) plans; the regulations for the 401(k) plans were introduced about 27 years ago.

22

Change In Average Account Balances From Jan. 1, 2008 – Jan. 20, 2009, Among 401(k) Participants with Account Balances as of Dec. 31, 2007



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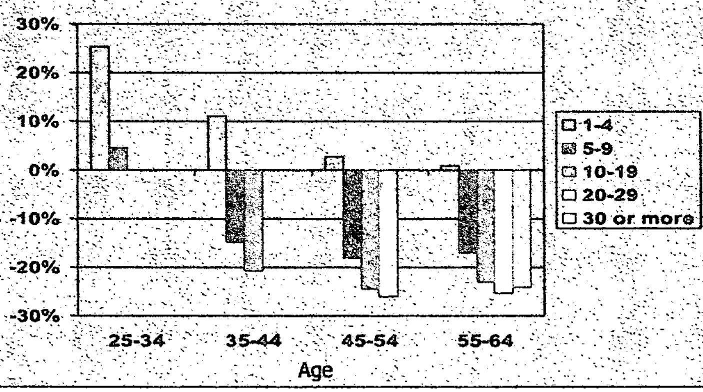
Sources: 2007 Account Balances: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project; 2008 and 2009 Account Balances: EBRI estimates. The analysis is based on all participants with account balances at the end of 2007 and contribution information for that year.

23

Tenure Matters a Great Deal in Account Growth and Decline

Change In Average Account Balances From Jan. 1, 2008 – Jan. 20, 2009, Among 401(k) Participants with Account Balances as of Dec. 31, 2007



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Sources: 2007 Account Balances: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project; 2008 and 2009 Account Balances: EBRI estimates. The analysis is based on all participants with account balances at the end of 2007 and contribution information for that year.

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Looking At the Long Term Versus the Short Term Makes a Big Difference

Change in Average Account Balances Among a Consistent Sample of 401(k) Participants, by Age and Tenure, Jan. 1, 2000 through Nov. 26, 2008

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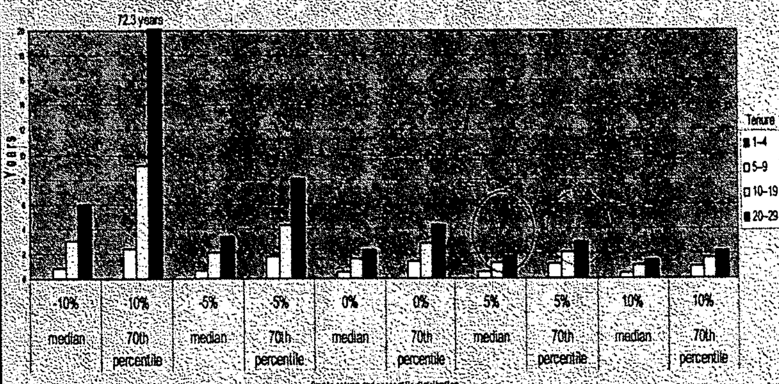
Sources: 1999 and 2006 Account Balances: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project; 2007 and 2008 Account Balances: EBRI estimates. The analysis is based on a consistent sample of 2.2 million participants with account balances at the end of each year from 1999 through 2006.

25

Time Needed to Recover from 2008 401(k) Losses, Using Various Equity Return Assumptions



Source: Author's calculations based on year-end 2007 data from the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.

NB: Losses are defined as the difference between year-end 2007 and 2008 account balances. This is NOT limited to investment loss.

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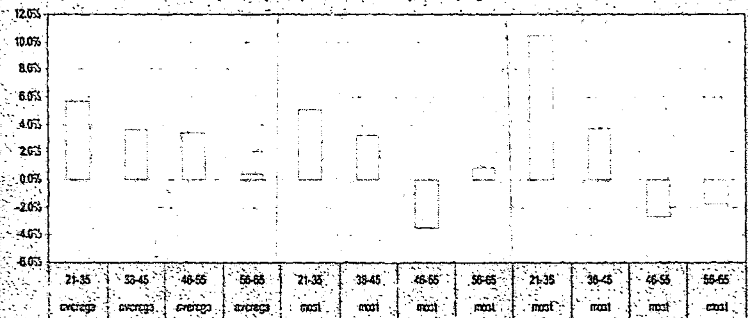
Median "Excess" Returns from Target Date Funds, by Participant Age and Investment Style: 2000–2006

The "excess" is calculated by comparing the projected account balances generated by target date funds to actual account balances.



Notes:
1. All asset allocations for target date funds are based on 2007 data.
2. Due to inconsistencies in plan loan data provision, there is a slight negative bias to the computed value of the "excess" returns. This will be quantified at a later stage.
Source: Author's calculations based on consistent sample data from the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.

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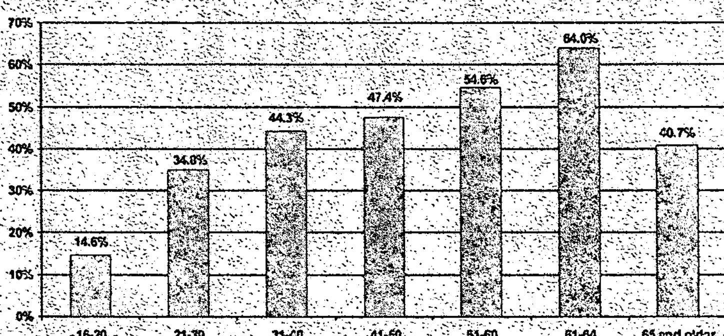
Proportion of Lump-Sum Recipients Using Entire Portion of Their Most Recent Distribution Through 2006 for Tax-Qualified Financial Savings,[a] by Age at Time of Most Recent Distribution, Workers Aged 21 and Over



Source: Employee Benefit Research Institute estimates from the 2004 Panel of the Survey of Income and Program Participation Topical Module 7.
[a]Includes rollovers to IRAs, individual annuities, and other employment-based retirement plans.

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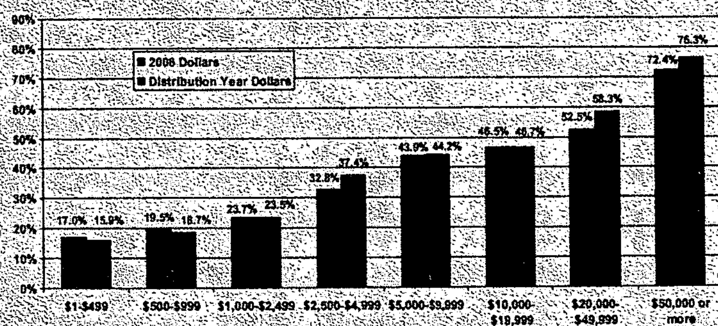
Proportion of Lump-Sum Recipients Using Entire Portion of Their Most Recent Distribution Through 2006 for Tax-Qualified Financial Savings,[a] by the Amount of the Most Recent Distribution, Workers Aged 21 and Over



Source: Employee Benefit Research Institute estimates from the 2004 Panel of the Survey of Income and Program Participation Topical Module 7.
[a]Includes rollovers to IRAs, individual annuities, and other employment-based retirement plans.

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Why People Save

3. Reasons respondents gave as most important for their families' saving, distributed by type of reason, 1998–2007 surveys

Percent

Type of reason	1998	2001	2004	2007
Education	11.0	10.9	11.6	8.4
For the family	4.1	5.1	4.3	5.5
Buying own home	4.4	4.2	5.0	4.2
Purchases	9.7	9.5	7.7	10.0
Retirement	33.0	32.1	34.7	33.9
Liquidity	29.8	31.2	30.0	32.0
Investments	2.0	1.0	1.5	1.6
No particular reason	1.3	1.3	.7	1.1
When asked for a reason, reported do not save	4.9	4.9	4.0	3.3
Total	100	100	100	100

NOTE: See note to table 1 and text note 13.

Source: Federal Reserve, 2009

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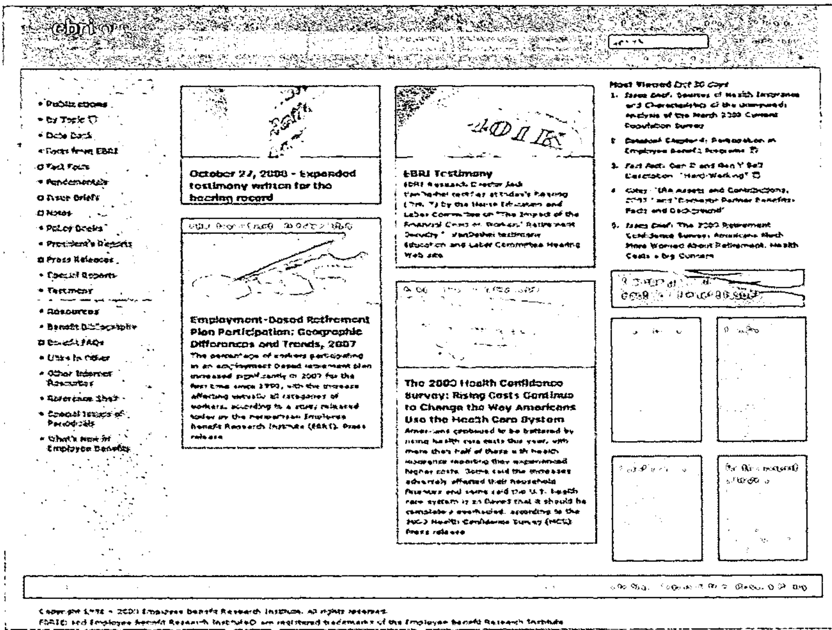

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[1] See SSA reports on Income of the elderly at http://www.socialsecurity.gov/policy/docs/statcomps/income_pop55/2006/faq.html There are differences reported based upon differences in data sources. See http://www.socialsecurity.gov/policy/docs/ssb/v67n2/v67n2p55.html in the Social Security Bulletin.

[2] See http://www.dol.gov/ebsa/PDF/2006pensionplanbulletin.PDF and http://www.dol.gov/ebsa/pdf/privatepensionplanbulletinhistoricaltables.pdf and http://www.dol.gov/ebsa/publications/bullet1995/e_4.htm

[3] For the most recent IRS research report (2004 data) see http://www.irs.gov/pub/irs-soi/04inretirebul.pdf For a private report including projections see http://www.ici.org/stats/res/fm-v18n1.pdf

[4] See http://www.pbgc.gov/practitioners/plan-trends-and-statistics/content/page13270.html and the 2008 annual report at http://www.pbgc.gov/about/annreports.html

[5] The salary breakout only includes those participants with complete salary data.

[6] Vanguard found 15 percent of the plans they administer had adopted automatic enrollment by the end of 2007. Eighty percent of these plans had a target date fund as the default investment. See Nessmith and Utkus, 2008 for further information.

The CHAIRMAN. Thank you very much, Mr. Salisbury.

Mr. Baker.

STATEMENT OF DEAN BAKER, CO-DIRECTOR, CENTER FOR ECONOMIC AND POLICY RESEARCH, WASHINGTON, DC

Mr. BAKER. I want to thank you, Chairman Kohl and Ranking Member Martinez for inviting me to testify.

I want to take my time to talk primarily about this financial situation of the baby boom cohorts in the wake of the collapse of the housing bubble and the recent decline in the stock market.

Then I also would like to take at least a couple of moments to talk about what I see as some of the main policy implications of this collapse which I think have not been fully appreciated.

My analysis—we released a paper today, based on analysis of the survey, Federal Reserve Board's Survey of Consumer Finance from 2004. I should say they just released the data from 2007, we haven't fully analyzed it, yet, but I can tell you that basically, we got the same results. Although this is somewhat dated, nothing substantive, I don't think, would change.

Our analysis shows that there's a huge decline in the wealth of the baby boom cohorts, primarily because of a decline, first and foremost, in their home. I think it—we often fail to appreciate the extent to which housing equity is, in fact, the primary form of wealth for most middle income people. Even if middle income people may not perceive housing wealth as being a source of retirement income it, in fact, is in very fundamental ways, first and foremost because people anticipate not having a mortgage to pay off through their retirement years, so that's based on the fact of accumulated equity.

Second, people often anticipate moving during their retirement years to a home that may be more suited for their retirement, as opposed to the home that they raised their children in, and third, because of emergency situations, healthcare or other unfortunate situations as Ms. Cook had just described to us.

So, the equity in people's homes, for middle income people, that is their major source of wealth in retirement. The sharp drop in housing prices over the last two—two and a half—years, has in effect, decimated the wealth that baby boomers have managed to accumulate in their working years.

So, just to give some quick numbers to sort of summarize the circumstance, if we look at the median wealth for younger baby boomers—those aged between 45 and 54—that fell by 45 percent from what it was in 2004 to what we project for 2009. So that the median household would have just over $82,000 in wealth. This, again, is the median—$82,000 in wealth would translate to less than half of the purchase price of the median home. In other words, if they took all of their wealth, all of their assets, everything they had accumulated, they would be able to pay for less than half the price of a typical home.

Alternatively, if we think of it the other way, they took all of the equity out of their home, and they were looked by annuity at age 65, that would get you an annuity of about $7,000 a year, less than $600 a month in income. Again, this is the median. If we got to the second quintile, people between the 20th percentile and 40th percentile, the wealth for that group—the average wealth for that group—is $23,200.

Even the fourth quintile—relatively well-off, elderly, people between 60th and 80th percentile—their wealth would simply be $215,000—enough for an annuity of $17,000. Again, not a very good income; not a very good supplement to Social Security, for people who were relatively affluent in the scheme of things.

For older baby boomers who had a comparable situation, the decline of wealth for this group—age 55 to 64—was 38 percent that gave them a median wealth of $142,000. Enough, if they took their whole accumulation to purchase 80 percent of the median house price, or alternatively, to get an annuity of about $11,000 a year.

What this means is that most baby boomers—the vast majority of baby boomers—would be almost entirely dependent on Social Security and Medicare. I should also point out, another number we looked at, we said, "How many people—what percent of the people in these age groups would actually need to bring money to a closing?" They wouldn't have enough to pay off their mortgage, pay the closing costs—it was 30 percent of the younger-aged cohort, 15 percent of the older-aged cohorts. In other words, these people would have literally nothing to put down as a down payment for a home in retirement.

Now, just very quickly, a point on new generational equity that, for whatever reason, I don't think has been fully appreciated. The loss in wealth that we've seen, due to the collapse of the housing bubble, and the stock market collapse, is an intergenerational transfer.

What we've seen was a loss in the order of $15 trillion of wealth, which was overwhelmingly held by older people—young people don't have wealth. This is, in effect, a huge loss to the older generations, it's in effect a gain to the younger generations, they will be able to buy homes at 30 to 40 percent below the prices they anticipated just 2 years ago, and they'll be able to buy our nation's capital stock on the stock market for half the price you would have paid just one and a half years ago.

When we have discussions of intergenerational equity, and we've just had a transfer of wealth on the order of $15 trillion, from those who are older to those who are younger, it's a little hard for me to see that we're doing some injustice to those who are younger. I hope that Congress will take that into consideration when it thinks about policy for Social Security and Medicare in the future.

Thank you.

[The prepared statement of Mr. Baker follows:]

Testimony of Dean Baker
Before the Senate Special Committee on Aging
February 25, 2009

Thank you, Chairman Kohl and Ranking Member Martinez for inviting me to share my views on the impact of the current economic crisis on the elderly with the committee. My name is Dean Baker and I am the co-director of the Center for Economic and Policy Research (CEPR). I am an economist and I have been writing about issues related to retirement security since 1992.

I will focus my comments on the main findings of a new report that the CEPR is putting out today. This report updates an earlier set of projections on the wealth of the baby boom cohorts that CEPR had done last summer. These projections are based on data from the Federal Reserve Board's 2004 Survey of Consumer Finance (SCF).[1]

The full report is available at CEPR's website (www.cepr.net), but some of the highlights are:

1) The median household with a person between the ages of 45 to 54, saw their net worth fall by more than 45 percent between 2004 and 2009, from $150,500 in 2004, to just $82,200 in 2009 (all amounts are in 2009 dollars). This figure, which includes home equity, is not even sufficient to cover half of the value of the median house in the United States. In other words, if the median late baby boomer household took all of the wealth they had accumulated during their lifetime, they would still owe more than half of the price of a typical house in a mortgage and have no other asset whatsoever.[2]

2) The situation for older baby boomers is similar. The median household with a person between the ages of 55 and 64 saw their wealth fall by almost 38 percent from $229,600 in 2004 to $142,700 in 2009. This net worth would be sufficient to allow these households, who are at the peak ages for wealth accumulation, to cover approximately 80 percent of the cost of the median home, if they had no other asset.

3) As a result of the plunge in house prices, many baby boomers now have little or no equity. According to our calculations, nearly 30 percent of households headed by someone between the ages of 45 to 54 will need to bring money to their closing if they were to sell their home. More than 15 percent of the older baby boomers, people between the ages of 55 and 64, will need to bring money to a closing when they sell their home.

These calculations imply that, as a result of the collapse of the housing bubble, millions of middle class homeowners still have little or no equity even after they have been homeowners for several decades. These households will be in the same situation as first-time homebuyers, forced to struggle to find the money needed to put up a down payment

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[1] We used the 2004 SCF, because the micro data from the 2007 is not yet available. This analysis, by my colleague David Rosnick and myself, is available on the website of the Center for Economic and Policy Research, www.cepr.net.

[2] These calculations exclude wealth in defined benefit pensions.

for a new home. This will make it especially difficult for many baby boomers to leave their current homes and buy housing that might be more suitable for their retirement.

The crash of the housing bubble and the subsequent collapse in the stock market has left the baby boom cohorts very poorly prepared for retirement. Since the vast majority of the members of these cohorts do not have traditional defined benefit pensions, they were forced to rely on their homes and defined contribution pensions as their main sources of wealth in retirement. These assets proved not to be safe mechanisms for preserving wealth.

The plunge in house prices has been especially devastating both because it was by far the largest source of wealth for most baby boomers, and also because of the high leverage in housing. The fact that housing is highly leveraged is, of course, a huge advantage to homeowners in times when prices are rising. If a homeowner can buy a $200,000 house with a 20 percent down payment, and the house subsequently increases 50 percent in value, the homeowner gets a very high return, earning $100,000 on a down payment of just $40,000.

However, leverage also poses enormous risks. In this case, if the home price falls by 20 percent, then the homeowner has lost 100 percent of her equity. This is exactly the sort of situation confronting tens of millions of baby boomers at the edge of retirement. As our analysis shows, millions of baby boomer homeowners have just witnessed the destruction of most or all of the equity in their homes.

The main lesson from the experience of the last two years is that family wealth is subject to much greater risk than had been generally appreciated. Even after the stock market crash of 2000-2002, most families continued to under-estimate the risk associated with holding stock. Clearly they were encouraged in this attitude by many professional investment analysts who promoted stocks as financial assets that were associated with relatively little risk if held for a long enough period of time. While the market could always rally and reverse much or all of its decline over the last 18 months, there are few investors who would be prepared to take that bet at present.

Even more striking was the failure to recognize the risks associated with home ownership. Very few homeowners understood that their homes could lose much of their value. They planned their consumption and saving with the assumption that their house price would continue to appreciate, or at least not decline in value.

While this is a reasonable assumption in most times and places, it clearly was not a reasonable assumption in the first half of this decade, as house prices were rising at prices that vastly outpaced the rate of inflation in large parts of the country. While it should have been easy for analysts to recognize that house prices in many areas had risen to levels that were far out of line with incomes and rents, few economists or housing analysts either noticed this imbalance or bothered to issue warnings to current and future homeowners.

As a result, most homebuyers felt that they were being perfectly rational in buying a home at a bubble-inflated price. Similarly, tens of millions of homeowners felt little qualm about either borrowing directly against the bubble equity in their house or not saving for retirement because the growing equity in their home made such saving unnecessary.

As a result, the crash of the housing bubble caught most homeowners by surprise. The loss of much or all of a family's equity would be difficult for any family, but for those who are near retirement it presents a special hardship. Few of these families will have enough years in the labor market to offset more than a small portion of these losses with additional saving. They will be forced to either work later in their lives than they had expected and/or have a lower standard of living in retirement than they had become accustomed to in their working years.

The sudden collapse in the wealth of baby boomer households shows the need for establishing more secure savings vehicles for the country's workers. Traditional defined benefit pension plans did shield workers from the sort of market fluctuations that decimated the value of 401(k) and other defined contribution plans in the last two years.

However, defined benefit plans are rapidly dwindling in the private sector. Many of the plans that are still surviving are also struggling as a result of the recent downturn in the market. Employers will find it very costly to restore these plans to proper funding levels. In some cases the burden will be too great and companies will end up declaring bankruptcy and turning their pension liabilities over to the Pension Benefit Guarantee Corporation.

This suggests a vacuum that can usefully be filled by a government-managed pension plan. The government could, at very little cost and risk, make available a system that provided a guaranteed return on a modest voluntary investment. For example, if the government guaranteed a 3 percent real rate of return on an investment of up to $1,000 or 3 percent of a worker's wage, it would be sufficient to provide an annuity of $4,200 for a worker at age 65. This would be a substantial supplement to the Social Security benefits for low- and moderate-income workers.

However, even if Congress acted immediately to establish a pension system that allowed for more secure retirement savings, this would provide little help for most baby boomers, who will not be in the labor force long enough to get much benefit from this system. The baby boom cohorts will be even more dependent on their Social Security and Medicare benefits than the generations that preceded them. They were the victims of the largest intergenerational transfer of wealth in the history of the world, as they disproportionately incurred the loss of $8 trillion in housing wealth and $7 trillion in stock wealth.

Their children and grandchildren will in a perverse way be the beneficiaries of this loss, since they will be able to buy the country's stock of housing and corporate capital at prices that are 30-50 percent less than what they would have faced just two years ago. There is nothing we can or should do reverse this enormous intergenerational transfer, however, Congress can act to protect the social insurance programs on which the baby boomers will be dependent. Social Security and Medicare have long been the bedrock of the country's social safety net. They will be more important than ever as the baby boomers enter their retirement years.

The CHAIRMAN. Thank you very much, Mr. Baker.

Mr. Salazar.

STATEMENT OF IGNACIO SALAZAR, PRESIDENT & CEO, SER-JOBS FOR PROGRESS, WASHINGTON, DC

Mr. SALAZAR. Mr. Chairman, and members of the Senate Special Committee on Aging, I am pleased to have the opportunity to testify before you today. The training, and retraining, of the elder worker is not a political issue, but a people issue, and the employment and training needs of the older workforce must remain a priority for this Congress and this new Administration.

For over 44 years, SER-Jobs for Progress, National, and its network of partners, have worked to ensure that workforce development needs throughout our communities are met. Currently SER National, its affiliate network, provides services in the areas of education, employment and training, as well as services focused on economic development, business growth, and job creation.

The SER Network remains steadfast in our continued efforts to cultivate America's greatest resource—its people. The SER Network consists of 35 affiliates operating more than 200 offices in 19 States, Puerto Rico, and the District of Columbia, serving over 100 million people annually.

Additionally, SER National manages the training and employment needs of over 3,500 mature workers, 55 or older, in the Senior Community Service Employment Program, SCSEP, funded by the United States Department of Labor. In its 5th year of operation, SCSEP is administered by SER sub-grantees in Wisconsin, Florida, California, Colorado, Illinois, Kansas, Rhode Island, and Texas.

Today there is a new crisis in the American workforce. This conflict unfolding before us in the 21st workplace is being defined by a series of increasing generational collisions that are affecting American productivity. In similar fashion, whether diversity movements have partially paralyzed the labor force—whether racial, religious, or gender related—generational conflicts at work are causing dysfunctional results, like reduced profitability, loss of valuable employees, poor customer service, and wasted human potential.

The former flow of power, authority and responsibility from older to younger employees has been disrupted because of significant economic downturn, changes in life expectancy, increases in the average individual period of productivity, and demographic trends of the American workforce.

In addition, changes in lifestyles, the distribution of highly desirable technological skills, and the possession of a knowledge base necessary for global competitiveness have creating a jarring upheaval to the natural flow of career progression. The pecking order is eroding, and so is the social and physical separation of generations in the workplace. Upward mobility in the job setting is now facilitated by rapid access to information, and the ability to disseminate such information in efficient fashion. The gold standard of a senior, experienced applicant is no longer as valuable as in the past.

Experience alone is no longer an indicator or predictor of success. The above factors are leading to an increase in the number of older workers being forced out of careers with no viable retraining mechanism currently in place. The economic downturn has created an overwhelming demand for Federal and State employment and training programs within the one-stop system.

Programs offered through the Workforce Investment Act, in partnership with Wagner Peyser Services were never designed to serve the older worker demographic. Traditional WIA services tend to focus on services such as youth programs, young adult training, and dislocated worker training, leaving little or no resources available for the harder-to-serve older worker.

In reality, the increasing number of one-stop customers, coupled with the specialized training needs of the older workers, make it apparent that the one-stop system is ill-equipped to meet the employment and training needs of the elder worker.

In 2006, the Older Americans Act, Title V Program, or SCSEP, was amended to allow for workforce skills training. This minor change in this legislation has made a world of change in our SCSEP participants.

With renewed hope and an enhanced skill set, our older worker participants are finding better employment opportunities, and are returning to the workforce with increasing success. We would suggest that funding be appropriated to providing workforce skills training to the older worker population who are currently ineligible, or just outside the SCSEP program.

We feel strongly that short-term training focused on core skill areas of language acquisition, with a limited English speaker, financial literacy, critical 21st Century technology skills, and mature worker career readiness training, can create the pillars for success for the retraining of the elder worker.

On behalf of SER-Job for Progress, and the participants we serve, I would like to thank the Committee, and the Chairman for the opportunity to present these recommendations as we move forward in our joint mission of preparing America's workforce for the future.

Thank you.

[The prepared statement of Mr. Salazar follows:]

Testimony of Mr. Ignacio Salazar
President and CEO
SER-Jobs for Progress National, Inc.
Senate Special Committee on Aging
United States Senate
March 25, 2009

Testimony:

Mr. Chairman and Members of the Senate Special Committee on Aging - I am pleased to have the opportunity to testify before you today. The training and re-training of the older worker is not a political issue- But a people issue, and the employment and training needs of the older workforce must remain a priority of this Congress and The New Administration.

For over forty-four years, SER- Jobs for Progress National and its network of partners have worked tirelessly to ensure that workforce development needs throughout our communities are met. Currently, SER National and its affiliate network provide services in the areas of education, employment and training and cadre of services focused on economic development, business growth and job creation. The SER Network remains steadfast in our continual effort to cultivate *America's greatest resource, people."*

The SER Network consists of 35 affiliates operating in more than 200 offices in 19 states, Puerto Rico and the District of Columbia- serving over One Million People Annually.

Additionally, SER National manages the training and employment needs of over 3,500 mature workers (55+) in the Senior Community Service Employment Program (SCSEP) funded by the U.S. Department of Labor. In its fifth year of operation, SCSEP is administered by SER sub grantees in Wisconsin, Florida, California, Colorado, Illinois, Kansas, Rhode Island and Texas.

Today, there is a new crisis in the American workforce. This conflict, unfolding before us in the 21st century workplace, is being defined by a series of increasing generational collisions that are affecting American productivity. In similar fashion that other diversity movements have partially paralyzed the labor force—whether racial, religious, or gender-related—generational conflicts at work are causing dysfunctional results like reduced profitability, loss of valuable employees, poor customer service, and wasted human potential.

The former flow of power, authority, and responsibility from older to younger employees has been disrupted because of: significant economic downturn, changes in life expectancy, increases in the average individual periods of productivity, and demographic trends of the American workforce. In addition, changes in life styles, the distribution of highly desirable technological skills, and the possession of a knowledge base necessary for global competitiveness have created a jarring upheaval to the "natural flow" of career progression.

The "pecking order" is eroding and so is the social and physical separation of generations in the workplace. Upward mobility in the job setting is now facilitated by rapid access to information and the ability to disseminate such information in efficient fashion. The "gold standard" of a senior, experienced, applicant is no longer as valuable as in the past.

Experience alone is no longer an indicator or predictor of success.

The above factors are leading to an increase in the number of older workers being forced out of careers with no viable re-training mechanism currently in place.

The economic downturn has created an overwhelming demand for Federal and State Employment and Training Programs within the One Stop System. Programs offered through the Workforce Investment Act in partnership with Wagner Peyser services were never designed to serve the older worker demographic. Traditional WIA services tend to focus resources for services such as: Youth Programs, Young Adult Training and Dislocated Worker Training- leaving little or no funding available for the harder to serve older worker. In reality, the increasing number of One Stop Customers coupled with the specialized training needs of the Older Worker, make it apparent that the One Stop System is ill-equipped to meet the employment and training needs of the older worker.

In 2006, The Older Americans Act Title V Program or SCSEP was amended to allow for workforce skills training. This minor change in legislation has made a world of change for our SER SCSEP Participants. With renewed hope and an enhanced skill-set, our Older Worker Participants are finding better employment opportunities and are returning to the workforce with increasing success. We would suggest that funding be appropriated to provide workforce skills training to the older worker population who is currently ineligible for the SCSEP program. We feel strongly that short term training focused on the core-skills areas of: Language Acquisition for the limited English Speaker, Financial Literacy, Critical 21st Century Technology Skills, and Mature Worker Career Readiness training can create the pillars of success for the re-training of the older worker.

On behalf of SER-Jobs for Progress National and the millions of participants we serve, I would like to thank the committee and the chairman for the opportunity to present these recommendations, as we move forward in our joint mission of preparing America's workforce for the future.

The CHAIRMAN. Thank you, Mr. Salazar.
Ms. Kennelly.

STATEMENT OF BARBARA B. KENNELLY, PRESIDENT AND CEO, NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE, WASHINGTON, DC

Ms. KENNELLY. I greatly appreciate the opportunity to come before you today and testify, regarding the current economic crisis, and its impact on retirement security, and I thank Senator Martinez for taking this additional duty on.

As President of the National Committee to Preserve Social Security and Medicare, I represent over 3 million seniors who understand the importance of Social Security and Medicare, and share a passion to see these critical programs preserved and strengthened.

Mr. Chairman, it's particularly appropriate to include Social Security in your hearing on the economic crisis today because the program was borne out of economic circumstances somewhat like we're living in today.

Today, Social Security provides modest benefits—the average benefit is only $13,800. But these benefits are crucial. A full two-thirds of the elderly receive more than one-half of their income from Social Security and one in five have no other income but Social Security.

If you don't count Social Security today, almost one-half of those over age 65 would have incomes below the poverty line, just about the same poverty rate as before the enactment of Social Security.

Many people don't realize that Social Security is also our nation's largest disability program, and our largest children's program. Social Security is a rock in the chaotic financial world we live in today. Unlike what you've just heard about the condition of private retirement savings, Social Security checks keep coming, every month, like clockwork.

The Social Security Administration did not miss a step after Hurricane Katrina and Rita, and the first benefit checks went out to the families of those who perished in 9/11 within 2 weeks of that catastrophic situation. Through wars, national disasters, or financial calamity, Social Security checks provide stability and cash to those who have lost everything else.

Some economists have been pushing for cuts in Social Security benefits as a way of addressing a long-term budget deficit. I'm here to tell you, this would be an extraordinarily bad idea. Benefits are modest to begin with, and benefits for future retirees are already being reduced as a result of a phase-in of an increase in retirement age.

Seniors spend significant portions of their income on healthcare. Even with Medicare, and if current projections hold true, future retirees could see one-half of their Social Security check absorbed by healthcare out-of-pocket cost by 2025. Skyrocketing healthcare costs are the true economic crisis. Future retirees also face a traditional pension system that is significantly eroded, plummeting housing values and individual savings that have evaporated. They will also need to stretch their retirement savings over a longer period of time as they will live longer than the generations before them. Our children will clearly need a dependable, solid Social Security benefit just as much as today's retirees.

Mr. Chairman, I would like to conclude by thanking this Committee for its support of including seniors in the American Recovery and Reinvestment Act. The $250 check that was included in the legislation will be much appreciated, and should provide a stimulative effect, as seniors historically spend over 90 percent of their income.

The funds included for the Social Security Administration are desperately needed to address the additional disability claims that always accompany bad economic times, especially at a time when the agency is already straining to clear our extensive disability backlog. Funds for programs funded through the Older Americans Act will help meet an ever-increasing need.

I thank you very much for looking at Social Security as a basic need; something that people can rely on. For the first time, seniors seem to be in better position than some others, and I thank you, Mr. Chairman, for appreciating that.

[The prepared statement of Ms. Kennelly follows:]

THE NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE

BARBARA B. KENNELLY, PRESIDENT/CEO

Testimony before the Senate Special Committee on Aging
Boomer Bust? Security Retirement in a Volatile Economy
Barbara B. Kennelly, President
National Committee to Preserve Social Security and Medicare
Wednesday, February 25, 2009

Mr. Chairman and members of the Committee:

I greatly appreciate the opportunity to come before you today and testify regarding the current economic crisis and its impact on retirement security. As President of the National Committee to Preserve Social Security and Medicare, I represent over 3 million seniors who understand the importance of Social Security and Medicare, and share a passion to see these critical programs preserved and strengthened.

Mr. Chairman, it is particularly appropriate to include Social Security in your hearing on the economic crisis today because the program was born out of economic circumstances much like these during the Great Depression. At that time, only a few companies offered pensions and no one had invented 401(k) plans or IRAs. Prior to Social Security, people saved what they could during their working lives, and those with families routinely moved in with their children. Over one-half of older adults lived their retirement years in poverty.

When the Great Depression hit, it wiped out what little savings both workers and their parents had accumulated over the years. Social Security created a reliable, modest stream of income for older adults, providing a cushion for them to leave the workforce and make their jobs available for younger generations desperate to find work.

It is much the same today. Social Security provides modest benefits – the average benefit is only $13,800 a year – but those benefits are crucial. A full two-thirds of the elderly receive more than one-half of their income from Social Security, and one-in-five have no other income but Social Security. If you don't count Social Security today, almost one-half of those over age 65 would have incomes below the poverty line – just about the same poverty rate as before the enactment of Social Security.

Many people do not realize that in addition to providing a stable, reliable source of retirement income, Social Security is also our nation's largest disability program, and our largest children's program. The disability benefit is often the only disability insurance available to workers, especially those in high-risk occupations who are most likely to need the coverage. Similarly, families with younger children who have competing demands on scarce resources often neglect to purchase sufficient life insurance coverage, leaving surviving spouses and children struggling to replace the primary wage earner's income. Social Security provides life and disability insurance worth over $400,000 each to every eligible worker.

Benefits such as those provided by Social Security cannot be found on the private market. Unlike any other retirement program, Social Security provides a steady stream of income that you cannot outlive, with built-in protection against the ravages of inflation. It provides benefits not just for workers but for their spouses and dependent children, as well as for divorced spouses and their dependent children. A guaranteed benefit that is unaffected by the ups and downs of the stock market is especially important at times like these.

Social Security's benefits are particularly important to women and minorities. Almost one-half of all widowed, divorced and single women age 65 or older receive 90 percent or more of their income from Social Security. Thirty percent of African-American elderly couples and almost 60 percent of unmarried African-American seniors also receive 90 percent or more of their incomes from Social Security. For Hispanics, those percentages are even higher – almost 40 percent of couples and almost two-out-of three elderly singles with almost total reliance on Social Security.

Franklin Roosevelt had intended to create Medicare at the same time as Social Security but his goal was accomplished thirty years later. At that time, much like today, private insurance companies had little interest in insuring the health of older Americans. I used to represent Harford, CT, the insurance capital of the world, in the U.S. House of Representatives and I can assure you, most insurance companies don't want to insure seniors. They have to answer to their stockholders and to the public, and seniors tend to have more claims than younger workers. Prior to Medicare, this left less than one-half of those over age 65 with any kind of health insurance, and what they had was very expensive.

Medicare changed all that. By pooling large groups of seniors together and sharing risk, Medicare has provided basic, universal and affordable health care to those over age 65. Medicare today provides insurance coverage to 97% of older adults, and although costs are growing, the program's efficiencies have allowed it to keep cost growth over time at about the same level as private insurance for workers, despite seniors' higher utilization of health care services.

Social Security is a rock in a chaotic financial world. Unlike what you have just heard about the condition of private retirement savings, Social Security checks keep coming every month like clockwork. The Social Security Administration did not miss a step after Hurricanes Katrina and Rita, and the first benefit checks went out to the families of those who perished on 9/11 within 3 weeks of that catastrophe. Through wars, natural disasters, or financial calamity, Social Security checks provide stability and cash to those who have lost everything else. Unfortunately we don't have statistics, but we hear anecdotally that the economic crisis has created a situation exactly the reverse from the Great Depression – instead of seniors moving in with their adult children, today's boomerang generation is moving in with their elders. And in both cases, their Social Security check is the foundation of the extended family's income.

Some economists have been pushing for cuts in Social Security benefits as a way of addressing our long-term budget deficits. I'm here to tell you that would be an extraordinarily bad idea. Benefits are modest to begin with, and benefits for future retirees are already being reduced as a result of the phase-in of an increase in the retirement age. Although essential to keep the elderly from completely losing ground to inflation, Cost-of-Living Adjustments can't keep up with the dramatic increases in the cost of health care over the long term.

Seniors spend significant portions of their incomes on health care, even with Medicare, and, if current projections hold true, future retirees could see over one-half of their Social Security check absorbed by health care out-of-pocket costs by 2025. Future retirees also face a traditional pension system that has significantly eroded, plummeting housing values, and individual savings that have evaporated. They will also need to stretch their retirement savings over a longer period of time as they will live longer than the generations before them. Our children will clearly need a dependable, solid Social Security benefit just as much as today's retirees.

Mr. Chairman, despite all the popular press, we do not have an entitlement crisis in this country – we have a health care crisis.

Please don't misunderstand me: I recognize that the long-term deficit is real. But it is not caused by Social Security or Medicare. Instead, it is a symptom of a problem that extends far beyond the federal government's outlays and revenues. Unless we address the real issue, any attempt at a solution simply will not work.

The growth in our nation's health care costs, in both the public and private sector, has far outpaced the growth of income in the United States for decades. If the historical rate of growth were to continue unabated into the future, we would end up spending virtually every penny of our GDP on health care in 75 years – something that is clearly not sustainable. In fact, if you look at CBO's projections under this scenario, if every entitlement in the federal budget were repealed outright – eliminating Social Security, Medicare, Medicaid, food stamps and other critical programs – but nothing were done to slow the growth in health care costs overall, we would still find ourselves spending almost 70 percent of GDP on health care by 2082.

If we successfully slow the rate of growth of health care to equal per capita GDP, the root cause of Medicare's long-term funding gap will disappear. If, on the other hand, all we do is cut Medicare, it will do nothing to slow the overall growth in health care costs, and we certainly won't make the costs disappear. They will merely be shifted to seniors, who are least able to bear the additional cost burden, and to the private sector and state budgets. In the end, health care costs will still consume ever-increasing amounts of our GDP, making our businesses less competitive and crowding out other needed spending in the budgets of both individuals and government.

As for Social Security, today it costs 4.3 percent of GDP and is expected to rise to a high of 6.1 percent and then drop back down to 5.8 percent by 2046. This is a modest increase, especially when considering that the percentage of the population composed of people over age 65 will grow from 12 percent to about 20 percent in that time.

Unfortunately, Social Security has been unfairly singled out by those concerned about the federal budget. It has been swept up, together with Medicare and Medicaid, into the scary sound-bite of an 'entitlement crisis.' The word 'entitlement' itself is a pejorative these days: it reminds us of those seemingly 'entitled' fat cats on Wall Street. It also implies a program that is out-of-control – with spending on automatic pilot until it completely drains our Treasury.

But Social Security is anything but out-of-control. In fact, it is the most fiscally conservative and responsible part of the federal budget. Most people don't realize that Social Security is prohibited by law from paying benefits unless it has sufficient revenue to cover the cost of the outlays. As a result, it has a built-in check on its spending. If revenues fall short of the amount needed to pay benefits, the benefits are automatically reduced. It takes an act of Congress to pay full, promised benefits if there is a shortfall – much like any discretionary government program.

Finally, we come to the issue of Social Security's finances. According to the program's Trustees, Social Security will have enough funds to pay full benefits through 2041 even if no changes are made to the program – and about 78 percent of benefits thereafter. To put this in perspective, the cost of closing this deficit is about the same as making President Bush's tax cuts for the top 1 percent of taxpayers permanent. Nothing about Social Security's long-term funding has changed as a result of the economic downturn. Unlike virtually every other facet of our economy, Social Security's financial condition has not deteriorated, and it is not placing any additional burden on our economy or the long-term budget.

Social Security and Medicare are the only programs in the federal budget that are required to project their finances over 75 years. This period is also considerably longer than any private pension or the public pensions of most other countries. The longer valuation period was intentional. Because Social Security is such a linchpin to retirement, it was understood that any changes would need to be implemented gradually over a period of many years. Instead, this 75 year projection – along with even more speculative projections into the infinite future – have been used by opponents of the program in an opportunistic way to convince younger Americans that the program is broken and won't be there for them, when this could not be further from the truth.

A final fallacy I would like to discuss for a moment is the myth surrounding the Social Security Trust Funds themselves. The Treasury bonds in the Trust Funds are often described by conservative economists as 'worthless IOUs', implying they are not worth the paper they're printed on. In fact, the bonds in the Trust Funds are legally no different than the bonds that represent the rest of our federal debt – they are all backed by the full faith and credit of the United States. And U.S. bonds are the safest investment possible in these uncertain economic times. When the stock market goes into a tailspin, where do investors put their money for safety? In U.S. Bonds. In fact, they are so safe compared to the stock market that at one point investors were effectively paying the U.S. government to hold their money for them.

At a time like this, when we are looking at the potential of trillions of dollars in borrowing over the next few years, we should be thankful, not dismissive, that some of our debt is held by the United States in trust for its own people. Most of our debt is held by foreign investors, and their interests do not necessarily align with ours. The money invested in Social Security will never move offshore in a chase for profits.

Much of the theory behind the push to cut Social Security and Medicare comes from economists who believe older people should be forced into consuming less by reducing the level of resources available to them in the future. But seniors today have median incomes about one-half the level of their children, even with Social Security. If the percentage of GDP allocated to them does not increase as their percentage of the population grows, each succeeding generation will become increasingly less well off than the generation behind them. America is the most powerful and economically well off country in the world. And yet even at its most expensive, our Social Security system will cost a substantially smaller percentage of our GDP than many other industrialized nations are already spending on their programs for the elderly today.

The bottom line is we can afford Social Security and Medicare in the future, and indeed, we should be focusing on strengthening and expanding these critical programs rather than attempting to cut them. We especially should not be using them as pawns in some grand budget deal that focuses more on the dollars they cost than about the people they protect or as a bargaining chip for other legislation. Every industrialized country has a social insurance system that spreads risk and protects its people, especially its younger generations. We in the United States can afford to do no less.

Mr. Chairman, I'd like to conclude by thanking this Committee for its support of including seniors in the American Recovery and Reinvestment Act. The $250 checks that were included in the legislation will be much appreciated and should provide a stimulative effect as seniors historically spend over 90% of their income each year. The funds included for the Social Security Administration are desperately needed to address the additional disability claims that always accompany bad economic times – especially at a time when the agency is already straining to clear out extensive disability backlogs. And funds for programs funded through the Older Americans Act will help meet an ever increasing need.

Thank you for inviting me to testify here today.

The CHAIRMAN. Thank you very much, Ms. Kennelly.
Ms. Katz.

STATEMENT OF DEENA KATZ, CFP, ASSOCIATE PROFESSOR, TEXAS TECH UNIVERSITY, AND CHAIRMAN, EVENSKY & KATZ, CORAL GABLES, FL

Ms. KATZ. Thank you, Mr. Chairman.

Thank you, Ranking Member Martinez and other distinguished member of this Committee for providing me the opportunity to address the critical issue from the perspective of the financial planning professional.

I'm a certified financial planner, and a Professor of Personal Financial Planning at Texas Tech University, as well as Chairman of Evensky & Katz, a fee-only firm in Florida, and a member of the Board of Directors of Financial Planning Association. But I am attending this hearing on my own cost as a concerned professional.

You've heard many statistics here today, the following are the only ones I will use. There are 77 million baby boomers. According to research, one boomer will turn 59.5 every 7 seconds between now and 2025. We need to put all of these statistics into context, and that's what I'm going to do.

Boomers have been big consumers, known for wearing and driving all of our assets, rather than saving or investing them. We've made a massive use of credit, and its over-reliance on credit has threatened our future security. We haven't done a very good job of teaching our children to be fiscally responsible, otherwise why would they wind up back in our spare bedroom, between jobs, with three kids and a dog?

Many of us are caring for our aging parents, either physically, financially, or both. This drains our already limited retirement resources. As we've heard, the housing crisis resulted in a serious drop in boomer home values.

Additionally, the economic typhoon of the last year has seriously damaged boomer portfolios. Boomers are now moving into their financial de-cumulation phase, which is not just about withdrawing money, it's about timing and strategies, and frankly about how best you can make the peanut butter and the jelly last until the end of the sandwich.

But it's also about making lifestyle changes that come with the next phase choices. Boomers have an unrealistic view of their own mortality; many say they don't intend to live to their nineties, but mortality tables suggest otherwise.

The good news is that we're living longer, the bad news is we're living longer, and we need to figure out how to pay for it. To address their investment issues, many retirees search for a safe retirement portfolio, 100 percent bonds to generate income or replicate paychecks. This confuses certainty and safety. Payment of bonds is certain, but it' certainly not safe, especially in terms of purchasing power. The fact is, boomers don't need income at retirement, we need an income stream that grows regularly with the inflation rate.

The use of target date funds to solve this has an inherent problem, I believe. Target date funds should not be age-specific, but risk specific.

Boomers want to stay vital and active. We will work. But it will be a positive action, not a forced reaction to lack of resources, even if that's true.

Truthfully, I'm not comfortable with the word retirement—few boomers are. As a country, we need to keep a positive spin, encourage our boomers to plan for their next phase with the independent advice of a financial planner who will holistically examine their lives, not just their investment issues.

As professional advisors, we tell our boomer clients, "Don't focus on how much you were worth yesterday, begin your planning with a realistic appraisal of your financial position today. Plan your future without simple solutions, and don't adopt rules of thumb. Continue to invest in your 401K, even if your employer is no longer making matching contributions. Utilize any available catch-up provisions that may allow you more money to put away for the future.

"You have no control over investment markets, but you do have a significant control over expenses and taxes. All you can really count on is what you've earned after expenses, after taxes, and net of inflation. Seek competent financial planning assistance. Insist that your advisor acknowledge, in writing, his fiduciary responsibility to you." My suggestions for this legislative body include, use the prestige and visibility of the Federal Government to remind the financial services industry of its responsibilities to its clients. Ensure all financial advice offered to investors be based on fiduciary principles, and hold all professionals who provide advice to retirees to that fiduciary standard.

When developing plans and solutions for us, remember, we are boomers, and not senior citizens. Encourage the offering of financial education for retirees, but focus on financial planning as a process, and not one that promotes product-centric solutions.

Do not restrict our ability to continue to participate in an active way in our economy. Revisit legislation that makes it difficult or impossible for us to continue working into our seventies and eighties.

Mr. Chairman, Ranking Member Martinez, I thank you for addressing this topic. As you well know, the financial services industry represents billion of dollars of economic clout. Wall Street can well afford to provide professional, sophisticated representation for its interests before Congress.

My professional affiliations are with organizations that identify more closely with the public's interests, and not those of Wall Street. That's why—along with my academic and professional colleagues and the investing public—are pleased that you, the true representatives of public interest, are taking the time to consider these issues related to securing our good retirement in the volatile economic times. I'm confident that your collective wisdom will result in actions that will benefit us all.

Once again, I thank you, I will respond to any questions you have.

[The prepared statement of Ms. Katz follows:]

Testimony of

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on

"Boomer Bust? Securing Retirement in a Volatile Economy"

Before the
Senate Special Committee On Aging

United States Senate

February 25, 2009

Thank you, Mr. Chairman, Ranking Member Martinez, and other distinguished members of the Committee, for providing me the opportunity to address this critical issue from the perspective of the financial planning profession.

INTRODUCTION

I am Deena Katz, a CERTIFIED FINANCIAL PLANNER™ practitioner, an associate professor in the Department of Personal Financial Planning at Texas Tech University in Lubbock, Texas, Chairman of Evensky & Katz, a Coral Gables, Florida based, fee-only, financial planning firm, and a member of the Board of Directors of the Financial Planning Association. I am honored and sincerely appreciative of the invitation to address a number of concerns regarding boomer retirement during in the present financial crisis..

Although I have the privilege of serving in a leadership role in my profession, I am attending this hearing at my own costs and I am speaking solely on my own behalf, although not for my own benefit. I am speaking also as a professional concerned for the generation of Baby Boomers who are now in or will soon be contemplating retirement.

I am a full-fledged boomer, having made my initial appearance in 1950. There were 77 million of us born between 1946 and 1964. Boomers are the products of a post-war, global phenomenon that started abruptly and ended the same way. For most people the term "boomer" conjures up rebellious, protesting hippies of the 1960s, who became the materialistic *uber*-consumers of the 1990s.

A nineteen-year span separates the vanguard boomers of the late 1940s and the later boomers of the early 1960s. When the early boomers were staging protests, the late boomers were barely into grade school; nevertheless, society tends to view us as a monstrous homogenous cohort. But we're not. Yes, we're big, but we're diverse—in lifestyle, experiences, and values.

Today you have listened to a number of leading experts on retirement and been presented reams of statistical data. My contribution will be that of a generalist practitioner/academic who has devoted over three decades to advising clients regarding retirement and instructing financial planning students on this issue. The general theme of my testimony is that as Boomers rapidly approach the traditional age for retirement, we realize that after years of uncontrolled consumption and extravagant lifestyles coupled with the new demands of family circumstances, we simply have not saved enough to retire. So in inimitable boomer style, we find an alternative: we won't retire. But we're not likely to admit that the decision to reject traditional retirement is forced on us by lack of resources. Boomers have never seen themselves as limited by a lack of resources. No. Boomers will undoubtedly "retire" conventional retirement by redefining it. However, in order to successfully redefine retirement, we will need help.

My testimony addresses a number of issues facing Boomers retiring during this turbulent market environment. First, I briefly review the boomer financial history, followed by a review of the risks Boomers face in what financial planners call the de-cumulation phase of life. Third, I review a number of actions and investment strategies considered by Boomers in managing these risks. Finally, I conclude with a few thoughts on the actions Boomers and you, our political leadership, might consider in helping us reach and maintain our retirement goals.

1. BOOMER FINANCIAL HISTORY

There are 77 million of us. According to research in the marketplace, one Boomer will turn 59 ½ every seven seconds between now and 2025. According to the U.S. Census Bureau, by 2020 more than 115 million people will be over age 50. That's an astounding 50 percent increase from 2005. But despite our getting older, we don't feel older.

Earlier this month I turned 59. I am that Boomer. We are the product of the post-World War II birth explosion, born between 1946 and 1964. We have been big consumers, known for driving or wearing all our assets, rather than saving or investing them. My 12-year-old nephew walked into our house one day and announced, "This house looks just like Sharper Image." Sadly, Sharper Image went bankrupt when it became clear that we Boomers already bought every single gadget they'd ever offered.

Not only have we been uber-consumers, we have made massive use of credit and are still paying for it. I like to tell people that the difference between my generation and my parents is that when my folks needed a new refrigerator, (the operative word being "needed,") they saved for it, then bought one. When my generation wanted (operative word, "wanted,") one, we put it on credit, had it delivered instantly, and paid for it for years afterward. This over-reliance on credit has threatened our future security. We are seeing the terrible effects of that right now.

We're products of the "immediate now" and the paper-plate generation. We are used to getting what we want instantly; we thrived on instant gratification. More importantly, we always tossed out what was worn or broken, because it always cost less to just get a new one. Recently, I think, we've made the connection to ourselves, just like our vintage goods, we're older, but not useless, and perhaps even more valuable because of our age and experience.

Let's look at other issues facing Boomers. We haven't done a very good job of teaching our children to be fiscally responsible, otherwise why would they wind up back in our spare bedroom with three kids, a dog and no job? I maintain that children have little boomerangs on their behinds when they are born. We hurl them out into the world and someday, they return to us, with more problems for us to solve and more need for financial support. Add to that the fact that many of us are caring for our aging parents, either physically or financially or both. These circumstances strain our already limited resources earmarked for retirement.

The economic typhoon of the last year has seriously damaged Boomer portfolios and even the gurus in Washington and on Wall Street have no clue how long recovery may take. Although the risks of outliving one's assets are present in any economic climate, the current crisis has unquestionably heightened those fears and caused professional advisors and their academic colleagues like myself to review how our investment strategies correlate with system risk in the marketplace.

2. DE-CUMULATION - FINANCIAL RISKS BOOMERS FACE IN A SEVERE MARKET DOWNTURN

This new phase of life; that is, the withdrawal of funds for living expenses, moves Boomers into their financial "de-cumulation" phase. As planners, we recognize that "de-cumulation" is not just about withdrawing money, it's about how and when you will withdraw, and how you can structure your portfolio to last your lifetime. I call that making the peanut butter and jelly last to the end of the sandwich. De-cumulation also includes making lifestyle changes and considering alternatives that may naturally come with the "next phase" choices.

This de-cumulation phase as certainly required financial planners to address more questions from their clients than ever before, given the trillions of dollars in paper losses – and depending on their phase of retirement, real losses – in their accounts. It has also caused us, as professionals, to re-examine our client's understanding of market volatility and the true meaning of risk.

As a result of this perfect storm in the marketplace, our Boomer clients are asking us more questions than ever before. But the same basic principles that planners use in retirement planning remain unchanged in working with Boomers. For one, Boomers have an unrealistic view of their own mortality. Many Boomers say they don't intend to live into their 90s. My partner and husband Harold always tells his clients who say this: "Go ahead, die; make my day. What keeps me up nights (and ought to keep you awake) is that you will outlive your assets." The 2000 mortality tables suggest that a couple 65 years old would have a 95% chance of one of them living to age 91. If that's not sobering enough, we have begun "squaring" the mortality curve, so that we living more active and healthier lives for much longer. We have enjoyed better healthcare than our parents and medical advances have helped improve our quality of life. Our generation is living an extended middle age. Forty is the new 60, as they say. The good news is that we are living longer; the bad news is that we're living longer and need to figure out how to pay for it. And with the uncertainty of today's economic crisis, the question is hitting home with Boomers who are still years away from retirement.

Additionally, Boomers face far more daunting financial issues such as family obligations, healthcare, housing, and probably the most critical, inflation. The events of the past two years has devastated Boomers' plans toward a successful retirement. The recent housing crisis has considerably reduced the value of Boomer homes and in some cases has resulted in over-leveraged and underwater assets. Many Boomers expected to follow in their parents footsteps by using the built-up equity in their homes to help fund their retirement years. This strategy has been seriously damaged.

Our migration in the last three decades from defined benefits plans to defined contribution plans have continually eroded the income stream "pension" concept. Behaviorally, Americans are dominated by the "paycheck syndrome," quite reliant upon receiving period payments to care for the monthly expenses. They simply do not have the education or the emotional security to turn their portfolios in to inflation-proofed income streams. The financial impact of these issues is the risk of outliving their assets. As I've noted, we are likely to live much longer than our parents. Even better, we're likely to stay vibrant and healthy longer. However; a long healthy retirement means more time to spend money. Our retirement resources need to be managed wisely.

The most common "solution" is to search for a "safe" investment, yet most retirees believe that a safe retirement portfolio should be 100% in bonds, reasoning that only fixed income vehicles can generate the income they need post-retirement. Our paycheck mentality demands that we try to replicate our periodic payment methods at retirement. It's a concept we are used to. Unfortunately the focus on bonds confuses certainty with safety. The payment on bonds is certain but it's certainly not safe, especially in terms of purchasing power. One of the biggest risk exposures is inflation. Can anyone name a major purchase that is cheaper today than it was 10 years ago? Certainly not; inflation ensures that prices go up, not down. Over the long haul, even a modest inflation rate can substantially erode future purchasing power. Bonds do not protect a portfolio against inflation.

The fact is Boomers don't need income at retirement; we need real cash flow; that is, an income stream that grows regularly with the inflation rate.

Other product-centric alternatives are offered as a "one shoe fits all" solution; unfortunately, there is no single "safe" investment product that can guarantee long term financial success. As a professional financial planner I am obviously biased; however, that does not negate the truth of my belief. Namely, investment safety is based on good strategic, long term financial planning, one that focuses on an investment portfolio's net-net-net total return – after expenses, after taxes and after inflation; not fixed interest payments.

3. BOOMER SOLUTIONS

Boomers are nothing if not resourceful, inventive and creative. While planners have figured out that it is getting harder to make the peanut butter and jelly last to the end of the sandwich, Boomers have concluded that we aren't ready to make that sandwich just yet. So, in the quintessential Boomer style, we have reinvented retirement. We aren't planning to sit on the porch in the rocker until we drop dead. We aren't going to play golf until we can't see the ball anymore. We are going to work at something we would love to do. Those of us who can will assume leadership roles, in government, in teaching, in counseling and consulting. We'll work on public policy such as older-worker rights or we'll find creative jobs like florists or event planners. We will work but it will be a positive action, not a forced reaction to lack of resources (even if that's true.)

The 2007 Annual Gallup Personal Finance Poll discovered that 78% of the people surveyed will continue to work. What is unclear is whether they will stay in their current jobs or move into lower-paying but more personally satisfying ones. I believe that the current economic crisis may have them planning to stay a few years longer (if they have the option) but then pursuing more personally satisfying work that, quite frankly, will seem less like work and more like the fulfillment of a dream. We have been seeing this trend in our practice recently. Of course, for many Boomers, there may be fewer work opportunities and less flexibility in their choices. Unfortunately, with the neither myriad of financial risks facing us, neither working longer nor simplistic "safe" product solutions are likely to be a total solution to funding our retirement.

The solution is to design a total return portfolio, one that focuses on the return and not fixed interest payments. As planners, we can then help our clients implement a more flexible strategy by diversifying assets to generate higher investment returns over the long-term, and protect ourselves against inflation and the real risk of outliving our assets.

4. SOLUTIONS

Truthfully, I am not comfortable with the word "retirement." Few Boomers do. From a positive standpoint, we are entering our "next phase." As a country, we need to keep the positive spin, encourage our Boomers to plan that next phase with the independent advice of a financial planner who will holistically examine their lives, not just their investment issues.

I recognize that all of these issues are complex. However, I believe that if you recognize the fundamental nature of the problems we Boomers face you will arrive at the right solutions to empower us to help ourselves.

As a professional adviser, the common recommendations we make to our Boomer clients are:

- Acknowledge reality. Don't focus on how much you were worth yesterday. Begin you planning with a realistic appraisal of your financial position today.
- Plan your future holistically and with care. Do not look for simple solutions and adopt rules-of-thumb.
- Continue to invest in your 401k, even if your employer is no longer making matching contributions.
- Utilize any available "catch-up" provisions that may allow you to put more money away for your future.
- In your planning, recognize that you have no control over investment markets; however, you do have significant control over expenses and taxes and

minimizing those costs may make the difference between a penurious and a pleasant retirement.

- Recognize that investment market returns historically have been relatively modest and do not come in smooth patterns. Don't count on winning the lottery, plan accordingly. Base your expected investment returns on realistic forward looking market returns.
- Remember, all you can really count on is what you have earned after expenses, after taxes and net of inflation.
- Seek competent financial planning assistance. Do your due diligence to insure that the advisor you select has the education, experience and resources appropriate to your unique needs.
- Insist that your advisor acknowledge in writing that he or she will place your interest first and will clearly disclose all significant conflicts of interest.

My suggestions for actions that this legislative body might take to ensure that as many Boomers as possible can enjoy a satisfying retirement include:

- Use the prestige and visibility of the federal government to remind the financial services industry of its responsibilities to its clients.
- Insure that ALL financial advice offered to investors be based on fiduciary principals; i.e., the simple and equitable concept that recommendation will be made based on the best interest of the client, that conflicts of interest will be minimize and that any remaining conflicts be clearly disclosed.
- As in the case with ERISA, hold all professionals who provide advice to retirees to that fiduciary standard.
- When developing plans and solutions for us, remember we are Boomers, not Senior Citizens.
- Encourage the offering of financial education for retirees that will focus on financial planning as a process, not one that promotes product-centric solutions.

- Help us help ourselves. Do not restrict our ability to continue to participate in an active way in our economy. Revisit legislation that makes it difficult or impossible for us to continue working into our 70s or possibly 80s.
- Again, acknowledging my bias as an academic, fund research directly related to developing improvements in and solutions for Boomer retirement income funding. Examples would include the impact of expenses and taxes on sustainable withdrawals and the efficacy and use of immediate annuities and longevity insurance in retirement planning.

CONCLUSION

Mr. Chairman, and ranking Member Martinez, I thank you for addressing a topic so important to the investing public and Boomers such as myself. As you well know, the financial services industry represents billions of dollars of economic clout. Notwithstanding the recent anger and frustration with Wall Street, it can well afford to provide professional and sophisticated representation for its interests before Congress. Although in some ways I suppose financial planners are part of the financial services industry, my professional affiliations are with organizations that identify more closely with the public's interest, not those of Wall Street. That's why I, along with my academic and professional colleagues and the investing public are pleased that you, the true representatives of the public interest, are taking the time to consider the issues related to securing a good retirement in these volatile economic times. I am confident that your collective wisdom will result in actions that will benefit us all. Once again, thank you. I am happy to respond to any questions.

The CHAIRMAN. Thank you very much, Mrs. Katz.

We turn now to Senator Martinez for questions.

Senator MARTINEZ. Mr. Chairman, thank you very, very much. I want to thank you for convening this hearing, and I'm pleased that I had a part in it as well, because I think this is a very timely and important topic, and one that I think cuts across Republican, Democrat, Floridian, or Ohioan—this is really an American issue that has hit at the real core, and at the heart of what is happening to our country today.

Ms. Cook, I'd just like to begin with you, and first of all to—my heart goes out to you for all of the concerns and problems that you and your family have had. I am most intrigued as to whether or not you have pursued your Social Security Disability appeal, because there's a timeframe for that, and I do think that you may have a very valid case, there, so I want to make sure you don't lose your—I used to be a lawyer, you know? I can't help myself but want to be lawyering here for you.

Ms. COOK. Thank you, I appreciate that.

Yes, in fact, I am appealing the decision. But I was told that this is rule of thumb, everybody's denied.

Senator MARTINEZ. Right. Are you having—do you have some help in doing this? I mean, are you—

Ms. COOK. Yes, I have a—I have a counsel, yes sir. Thank you.

Senator MARTINEZ. OK, very good.

Beyond that, I hope that all of your different issues sort themselves out, but I think your problems are emblematic of what our generation is going through. So, I think it's very, very opportune that you would be here with us today, and thank you for sharing your personal problems with us, and with the nation. I think it's important that we hear stories like yours, so that we might better deal with the problems of so many others who are here, not speaking directly, but speaking through you. So, thank you.

Ms. COOK. Thank you. I really think that I'm here speaking for a lot of the seniors that are out there. Thank you.

Senator MARTINEZ. You know, I'm not accustomed to thinking of myself as a senior, I think of myself as a boomer, but anyway, I think that the two may be about to—

Ms. COOK. I think so.

Senator MARTINEZ [continuing]. Coincide here, pretty good.

Mr. Baker, I want to talk to you about housing, and your thoughts on the housing situation. I thought—I was very intrigued by your analysis that there is a wealth transfer taking place, here, I really hadn't thought of it in those terms, and I'm not sure I fully agree with you, but I think it's an interesting thought that perhaps there is a wealth transfer taking place.

What I wanted to ask is, since you were one of those who were forecasting a bubble while many of us were being convinced by so many others that that wouldn't happen, what is your forecast now as to how we might evolve out of the current depression in housing prices, into a more normal market?

Mr. BAKER. Well, Senator, first let me just say that if I got you to re-think your view of housing, my trip here was very much worthwhile. But, in terms of where we're going, I'm very concerned that, basically was, looking at—with the housing bubble and how

I recognized it—was that we'd had a long pattern where house prices had just more or less kept even with the rate of inflation. We had a sharp divergence from that, beginning in the mid-nineties, and it peaked in 2006 with house prices more than 70 percent above the overall trend level.

Now, we're about to fall back at the current rate of house price decline, we'll be back at the trend level, probably at about the middle of this year. House prices are now falling extremely rapidly—more than 20 percent at an annual rate, in most recent data.

My concern is that we'll overshoot. So, instead of just getting back to where we might think house prices should be—and not that we know exactly where that is, but roughly where they should be—house prices will continue to fall, which is going to dampen the economy, and further drag on the economy, certainly further drag on the situation of baby boomers as they prepare for retirement, and could cause the downtrend to last much, much longer than would otherwise be the case.

My concern—I don't think you want to get extensively in housing policy—my concern is that there's been a failure to focus on trying to shore up prices where you can do it, where the bubble has already deflated, as opposed to, in effect, throwing good money after bad, trying to shore up prices everywhere, including markets where the bubble has not yet fully deflated.

Senator MARTINEZ. So, your view is that it should be more targeted assistance?

Mr. BAKER. Exactly. So, you have many markets where you could say that there either was not a bubble, or whatever was there has since deflated. There, I think, it makes sense to try to do what we can to shore up prices. Other markets where you still have a long way to go, you're just throwing your money away.

Senator MARTINEZ. So, a targeted approach?

Mr. BAKER. Exactly.

Senator MARTINEZ. To where to help, as opposed to helping everywhere in the country?

Mr. BAKER. Exactly.

Senator MARTINEZ. That's politically difficult to do.

Mr. BAKER. I understand.

Senator MARTINEZ. Yeah.

Mr. BAKER. I'm just an economist.

Senator MARTINEZ. I understand. [Laughter.]

Mr. Salazar, I'm so pleased to see you again, and I'm again very proud of the work that you're doing. I just wanted to ask whether you could share with us, beyond what you told us during your testimony, any strategies that you think could be employed.

As we look at what Mr. Baker said, and that wealth transfer taking place, the obvious need, as others have testified, for folks to be dependent, really almost solely on their Social Security, extending the work life may become a total necessity. Have you confronted issues that we, perhaps, ought to be addressing from a legislative standpoint, while allowing folks to continue to work longer, without receiving penalties until their Social Security entitlement, benefits, and things of that nature?

Mr. SALAZAR. That would be an obvious benefit, of course, Senator.

The areas that we focused on, in trying to promote changes, have centered around the area of retraining individuals. We have the opportunity to work with individuals who fall at 125 percent of the poverty level. So, for example, the poverty level for an individual—a single individual—is $10,000. Anyone making less than $12,500 is eligible for our program.

They come to us with many barriers. Obviously, with age we have some challenges ahead of us, and some of those are lack of finances, obviously, but lack of training, and retraining, to go into an adequate job. Transportation is an issue, supportive services is an issue. We're working with individuals who were trained in a different economy, and this is a different kind of world that we live in today that we need to prepare them for. So those are the kind of things that we're centered around, is providing those kinds of supports, so they can be self-sufficient.

I was looking last night at some of the kinds of things that we do with individuals who, in our program, working probably up to 20 hours per week at minimum wage, making the transition, and I was looking at Milwaukee as an example. There, individuals going through our program, where they were provided the opportunity to have supports, to have retraining, to prepare them to do something differently, were drivers.

There was an individual, George Taylor, who was with J.C. Triplett Moving, he's a driver today, making $11 an hour. James Jones at Arbor Gardens, in Milwaukee, making $11 an hour. We have Jane Jankowki, Milwaukee Security Detention Facility, who is a Program Assistant there, making $13 an hour, and Adolfo Villaral, who's with Raul's Construction, who is making $12 per hour. These are individuals who were making the minimum wage, before, of $6.55, who have been given the opportunity to go out and get full-time employment so they have additional income.

What we provide is up to, usually, between 15 to 20 hours per week, and it's a short-term program. It used to be long-term for individuals, and that was changed. If that's changed, we need to prepare them to be successful, once they're exited the program because of a term limitation, in terms of how long they can be in the program. But, to provide support for individuals to continue their life in a productive way is what we're attempting to do with those kinds of supports.

Senator MARTINEZ. Mr. Chairman, my time is up.

Thank you.

The CHAIRMAN. Thank you, Senator Martinez.

Senator Gillibrand.

Senator GILLIBRAND. Thank you, Mr. Chairman, for holding this hearing. This could not be more timely.

Thank you, all of you, for coming to testify before our Committee.

I've spent the last few weeks traveling around New York State. When I've met with my seniors, their concerns are overwhelming. They're very worried about being able to afford their retirement. They are very worried about their savings—should they have any—that they've declined so rapidly, that they feel enormous economic insecurity, and financial insecurity.

I want to talk a little bit about some of the issues that you've brought up on the 401Ks. I understand the issues that you've raised about the target date and the need for regulation. So, I'd like to hear what kind of regulation you think would be most effective.

Second, some of the seniors I've spoken to have said that their 401Ks have required draw-downs. I know that's something that we were looking at through the Fed, to adjust that, that they don't have to draw down. Because if their portfolio has been declined by over 30 percent, now is not the time, necessarily, to draw down, when those stock prices are so reduced.

Third, I wanted to talk a little bit about commercials that you see on television where you have these organizations that are offering services that say, "If you have a paid settlement or an annuity, it's your money, get your cash now." Those are very appealing ads to many members of my community, because they have such a financial need, currently, and they're willing to cash in those annuities or those paid settlements, but those companies are taking an enormous cut into the value of those annuities. In some respects, they may well be inappropriate, or really taking advantage of our seniors. So I want your thoughts on that.

Then the last issue on the financial issues is, we had a hearing in my former district in upstate New York that Congresswoman Carolyn Maloney, who's the subcommittee chairwoman on the Financial Services Committee on the House side, about seniors being taken advantage of through credit card advertisements.

I heard the worst stories of seniors who were, you know, encouraged to take out a credit card, and they would buy, you know, a television for maybe $300. Then because they couldn't make the payments regularly enough, or fell behind, those payments, and the requirements—because of the fees—they would be paying over $1,000 in fees, for one $300 purchase.

So, I have very grave concerns about that, and we did pass some legislation to begin to address it, but I'd like your thoughts on whether that legislation has taken care of that problem, or if that problem still exists. To whomever wants to take those questions.

Mr. SALISBURY. I'd start, Senator, on a couple of your points, not all of them.

On the issue of commercials and settlement agencies, that is something that has been out there, and to your point, has proven attractive to individuals. I just use an example from the retirement income system more broadly, defined benefit pension plans, those like Federal employees receive that only pay life income annuities', they do not offer single-sum distributions.

Over half of private defined benefit plans now offer single-sum distributions as an alternative to annuity income, and when that offer is given, on average, 95 percent choose the single sum distribution, only 5 percent choose the life income annuity.

If one looks at the most recent trend in defined benefit plans, it was announced last week that Coca-Cola had followed this, shifting from a so-called "traditional" defined benefit plan to a hybrid cash balance plan, that now accounts for about 30 percent of the private defined benefit plans that are covered by the Pension Benefit Guaranty Corporation. Almost all of those plans offer single-sum distributions, and out of those plans, again, more than 95 percent of participants take the single sum; only less than 5 percent take a life-income annuity.

Finally, if you look at it vis-a-vis 401K plans, only about 20 percent of defined contribution plans even offer an annuity option, but like the Federal Thrift Plan, where they do have extensive numbers, less than 1 percent of those given the choice of a life-income annuity or a single-sum distribution take the life-income annuity.

So, the settlement issue, and why people are driven there, is very symptomatic of designs and behavior in most of the population, regardless of age. So, I think your regulatory issue on that is the need to make sure there is not fraud, and there's proper pricing.

But as long as that market is there, what we know from retiree behavior, coming out of the retirement system, if you give people a way to take all of the money right now, as opposed to spreading it over a lifetime, what we know from the hard research, is that will most always do that.

It goes back to Social Security, why it is an annuity-only, COLA annuity. During the debates of the past, if individuals out of Social Security were given the ability, the choice, the data says they would take the single sum.

Senator GILLIBRAND. Mr. Chairman, may I just ask one follow-up on that line?

If you were going to propose regulation, what would it be, and would you ever recommend there be an alternative—some kind of not-for-profit organization, or some kind of government-led organization, that is in the seniors' interest, and can offer very little overhead fee for that payout? Some competition, as it were, in the market of being able to give those funds in a lump sum? Would you recommend that? I'd like your thoughts.

Mr. SALISBURY. Well, there is regulation in that area, there is competition in that area. The regulation tends to be somewhat limited. I think that, again, it may need to be increased vis-a-vis fraud in advertising.

On the retirement side, I think this is an issue—I first testified before this Committee and the late Senator John Heinz on this topic in 1981, of annuities versus single-sum distributions. That becomes, frankly, you either mandate annuitization if you want people to have life income security or they will not make that choice.

Senator GILLIBRAND. I guess I want you to address the current practice. If these companies are taking 20 percent or 30 percent of the value of that annuity in exchange for the lump-sum cash payment, do you think there should be competition in the system that might only take 2 percent or 3 percent as a fair overhead of the transaction cost?

Mr. SALISBURY. Ideally, absolutely, yes.

Ms. KENNELLY. Senator? Senator?

The CHAIRMAN. Ms. Kennelly.

Ms. KENNELLY. I can remember when I first went to Congress, employees had defined benefit pension plans. Then came the 401K plans, and I remember being on Ways and Means, and addressing the issues raised by those changes. When you talk about annuities, they're not necessarily wise choices for everyone.

The reason I'm sitting here today is we have one solid rock, and that's Social Security. The beauty of Social Security is you can't out-live it, and it's adjusted for inflation. So, we should have all of these private products, no doubt about it, if you want as a supplement. But the main thing is to keep the rock, Social Security.

The CHAIRMAN. Ms. Katz.

Ms. KATZ. All of the things that you've asked about have really one common thread, and that is that our seniors at—frankly, the American public—are not really well-educated about their financial lives. So when they get desperate, they make the wrong choices. Leaving an annuity or an income stream for a lump sum is appealing because they have some control over it, but they don't know what to do with it.

So, when we talk about legislation, I think we need to talk about the inherent issue, is most people are not educated to their own financial life. They do not know how to handle a lump sum. We've made proposals to even make changes to Social Security, which is a serious issue, of letting people handle their own situation. So, we're just creating more and more opportunity for them to make bigger mistakes.

We need to tighten up all of those things with legislation, so that they cannot make these mistakes, and we need to educate them, starting at a much earlier age then when they start retirement years.

Senator GILLIBRAND. Many folks believe you should start educating children in the earliest years, so that they understand what financial health is, at a very young age.

Ms. KATZ. Absolutely.

Mr. BAKER. Just very quickly, I think the situation you're describing—because there's both the issue about people getting—replacing annuity with a lump sum, but also, I think the question you specifically asked about the fees involved. I think there of a situation that's very analogous to what we just saw with the mortgage chaos the last few years, is that it's very easy for a sophisticated person to come in there, and take advantage of someone who's not engaged in these transactions on a daily basis, and I think there, there really is a role for the government to regulate this, to make it very difficult—we're not going to make it illegal for someone to take their annuity and take a lump sum, but I think it's important to say that we have standardized contracts, and make it very difficult for someone to go outside that, so it's an unfriendly legal environment for those who might try and take advantage of people that way.

One other point, just very quickly, the issue of draw-downs from retirement funds I think has been misrepresented. I was testifying yesterday and the gentleman from the Investment Institute agreed with me on this, that there are very few people who reach age 70 and have their whole fund invested in equities.

So, the idea that someone's going to have to sell their stock and lock in a really big loss, that's almost inconceivable. I mean, there may be a few people in that situation, but almost everyone's going to have enough money in their account at that age, in a money fund or a bond fund that they could make their withdrawal from that.

Now there's a separate issue, do you want to force withdrawals? That's a separate issue that Congress should reasonably consider.

But the idea that you're forcing someone to lock in a loss, that really isn't a plausible scenario.

Senator GILLIBRAND. What's your opinion with regard to the last point you just made? About forcing people to draw down or not?

Mr. BAKER. Well, there is an issue, you may change the timing on that, given increased life expectancies. I mean, I wouldn't consider that a top priority, but obviously as we go through the years, and we project, and certainly, hopefully will see increasing life expectancy, we may want to change the timing on that, that' a reasonable thing, certainly, for Congress to consider.

The CHAIRMAN. Thank you very much.

Ms. Kennelly, listening to you talk about Social Security this morning, I am led to wonder whether or not you were a strong supporter of President Bush's thoughts about privatizing Social Security?

No?

Ms. KENNELLY. Senator, you know I wasn't. [Laughter.]

The CHAIRMAN. But, you talk about it, in terms of how important it is, and maybe all of you, how important Social Security and Medicare is.

You know, President Obama is talking about the need to reform the entitlements, and I—while he hasn't been specific, he hasn't talked about expanding the benefit, he's talking about the hard choices that we have to look forward to. What are some of your thoughts on that?

Ms. KENNELLY. Well, Senatòr, I—look, I've been around a long time, and I know that we have a long-term problem with Social Security. I was on the Ways and Means Committee in 1983 when we reformed it the last time. We took some very hard votes. You know, I voted to increase the payroll tax, increase the retirement age. I wonder how I got reelected. But the fact of the matter is Social Security still is the basic retirement system for the United States of America.

What I really have great worries about, is this idea of a fast-track Commission to look at entitlements.

Now, last night the President made it very clear that the real crisis we have in this country is healthcare. But is there a long-term gap in Social Security? Yes. We have a shortfall. But I would hate to see a Commission produce legislation that is on fast track with no amendments, permitted. I think the Committees—Ways and Means, Finance—they've got the expertise to do a reform bill through regular order. You could have the debates, and the public could understand what we have to do.

Do we have to make sacrifices? Of course we do. But, there isn't a lot of room to cut Social Security. When you think about it, Senator, two-thirds of those people who collect Social Security—that's half their income, half their income. For twenty percent—20 percent—Social Security is all they've got. I saw a statistic recently, African-Americans—40 percent of those collecting Social Security—that's all they've got.

But I think we have to understand, the very reasons that Franklin Deleanor Roosevelt created Social Security are still there. When you get old, the paycheck stops. That's it. Jeanine was talking about helping her children—life can get tough. But if you have Social Security, at least you have something. Any nation worth its salt has a Social Security program that's much more robust than the one we have.

So I would urge the President to be very careful. He's got to do healthcare reform, it's going to be the toughest thing elected officials are going to have to deal with. But, you know, be careful with Social Security, because it's the basis of our retirement system.

The CHAIRMAN. How so is the Medicare benefit any less important to seniors than a Social Security benefit? Aren't they on a par, almost?

Ms. KENNELLY. Well, of course they are. But the point is that—

The CHAIRMAN. No, I'm bringing this up by way of asking your opinion on that entitlement program, in terms of its cost, and the President's discussion about having to reform that program, as well as Social Security.

Ms. KENNELLY. No, you've heard how passionate I am about Social Security, because I feel it's a necessity. Medicare is in crisis, there's no doubt about it, just like the whole healthcare system is in crisis.

What I'm scared to death, about Senator, is that we're going to try to look just at Medicare, not at the whole healthcare system. Right now, the only ones that have a universal healthcare system are those 65 and older. We've got to keep that in place.

I came from Hartford, CT. I can remember when those insurance companies didn't want to touch people over 65. But once you put them in a pool, and spread the risk, it was OK.

So, I'm delighted to hear the President and his people want to look at healthcare, because they've got to look at it together—Medicare, and the whole healthcare system. Because I will tell you something, Senator—if they can fix healthcare, then half the cost of Medicare will disappear. We'll be OK because what's left of the long-term funding problems will be easier to fix.

The CHAIRMAN. Any comments from the rest of the panel on Medicare and Social Security?

Mr. Baker.

Mr. BAKER. Yeah, just very quickly—I would say in the case of Medicare—and I was very happy to see that President Obama, I think, has said exactly this, that the problem with Medicare is the problem with healthcare. That our healthcare costs on a per-person basis are about twice those for other nations—Canada, Germany, whoever you throw in there—and they're projected to keep growing, relative to the rest of the world. This is a problem for the economy as a whole.

One of the reasons General Motors is coming to us—coming to the government for help is its healthcare costs. They did a back of the envelope calculation, if we had the same per-person healthcare costs as Canada—everything else exactly the same, but just paid the same per-person healthcare costs—General Motors, over the last 10 years, would have $22 billion more than it does today.

Healthcare is going to devastate our economy, even if we got rid of Medicare and Social Security. So, the priority has to be to fix healthcare. If we fix healthcare—not to say Medicare won't be an issue—but it will be a much more minor issue, it will be a workable issue. If we don't fix healthcare, there's nothing we can do to fix Medicare.

The CHAIRMAN. Mr. Salisbury.

Mr. SALISBURY. Senator, I'd add a point on that, which is that with the dramatic decline in what private employers have provided as supplemental medical coverage for individual populations, Medicare becomes even more important with the accounting standards that have just gone into place for State and local governments for retiree medical benefits. For the very first time they're having to deal with the long-term costs of the commitments that they have made. We expect that you will begin to see State and local governments back away from the retiree medical promises that they've made in the past, for at least new hires and those not yet retired, even if they honor those promises for current public sector retirees.

As you know, in the last budget that President Bush submitted to this Congress he had proposed for even Federal workers that the eligibility for retiree medical upon Federal retirement be based on tenures of work immediately before retiring, as opposed to the current provision of 5 years. Were that to be done in the context of this, that would affect the Federal workforce.

So, essentially what we're seeing through the voluntary system is a cutting back in a way that essentially, with each and every year, is making Medicare even more important to a larger proportion of the seniors in our population.

If you then take a point that the Congresswoman made, which is so compelling to me, that the Part B and Part D expenses of Medicare, which currently absorb about 19 percent of the average Social Security beneficiary's Social Security income, one currently projected to go to 50 percent of the average Social Security income by 2025. That frankly is using a health inflation assumption that is about 40 percent less than what is actually occurring in the economy.

So, our estimate is that if health costs are not somehow brought under control by 2025, the proportion is likely to be closer to 70 percent, as opposed to 20 percent.

As someone whose mother at 93 is now dependent for all of her income on Social Security and the size of the payment she is making for health insurance. The concept of the Medicare payment proportion of her Social Security income continuing to climb is concerning.

There will be inter-family transfers to make sure Mom's fine, but for the overall population, to reemphasize Deena's point, figuring out a way to bend the cost curve on future medical expense is absolutely essential to the long-term security of Social Security, and for Social Security income to be enough for anyone—even at the very high replacement levels—meaning lower income individuals. If you don't solve the health cost problem, then Social Security will have more and more retirees facing poverty-level income in retirement.

The CHAIRMAN. How important is it to do everything we can, legislatively, and offering inducements to employers, as well as individual retirees to continue in the workforce after age 65?

Mr. SALISBURY. I personally think that it is essential—one of the points that was made by Deena is that in our surveys, individuals—she hadn't mentioned our surveys, but I will—what we know is that individuals dramatically underestimate how long they will live today.

My mom and dad were born in the teens, meaning 1913, and 1916. My father lived to one month short of age 94, and my mother is 93 and doing quite well from a health perspective. That means I should expect to live to 105 to 108. Most individuals today believe that even if they retire in their early sixties, they will only be alive for 20 years. Which means everybody assumes they won't make it to average life expectancy.

Why don't they take a life income annuity? Because they think a cash sum distribution is a better deal, because I'm going to die young. You then add all of this together, working an extra 2 or 3 or 4 years, and with the current economy, my wife has told me to plan on at least 5 to 6. I'm turning 60, so I've said, "OK, I'll go to 66, and that's full Social Security eligibility."

But, I think for everybody, if one has the ability to keep working, physically, the easiest way to deal with what would otherwise be an adequate retirement income is to work an extra few years, either full-time or part-time, and the easiest way to make sure one can deal with health insurance provision and avoid catastrophic health problems is to keep working until at least age 65, when Medicare becomes available.

Mr. BAKER. If I can just very quickly throw in a point on that, that again, this points out the urgency of healthcare, that obviously if employers are providing healthcare insurance, it makes them very reluctant to take on an older employee, because they know that's a very large bill.

So, again, if Congress could pass legislation that will bring healthcare costs more down to reasonable levels, then the prospect of hiring an older employee will be less burdensome to employers.

The CHAIRMAN. Ms. Katz.

Ms. KENNELLY. Mr. Chairman, as you know, you and I—we are the models of working longer, and older. But, you have to remember something. I said in my testimony that the average payment for Social Security is $13,800—it's very moderate. What we always have to remember, and you have to remember as you address this question, is that if, in fact, you raise the retirement age for Social Security, you are effectively cutting benefits—especially in an economy where jobs are scarce.

The CHAIRMAN. Ms. Katz.

Ms. KATZ. I think we need to explore, also, partial retirement benefits, so that people can work on a part-time basis, or even full-time, and still have access to some of their benefits.

Boomers, as I pointed out before, want to stay vital and active in the workforce. The fact is, if we all quit, we wouldn't have enough people to replace us, anyway. So, we need to take a very positive view on working, we need to take a look at those arbitrary restrictions on mandatory retirement. I mean, 65 was an arbitrary number to begin with. So, we need to take a good long look at this.

Coupled with giving employers some benefits for supporting that healthcare, will also help prop up a lot of the problems that we're having.

The CHAIRMAN. You want to say something, Mel?

Senator MARTINEZ. I was going to ask—yes, thank you.

Ms. Katz, I was going to ask whether—in your financial planning—you take a different approach with, you know, the baby boom generation, I guess, spans from those of us at the beginning of it, at 46 to mid-sixties, I guess, right? Are there different challenges in trying to prepare for retirement, obviously, depending on the age of the people within that timeframe?

Ms. KATZ. Well, there are, simply because their resources are being strained from so many different levels. So, one of the things we do is to encourage people to work longer. But, there are not—there's not a lot of flexibility in making those plans, and I think that's where legislation can help.

Most boomers that I see are making a life transition. They are willing to accept working in a less lucrative business, to be able to have more personal satisfaction, that's the nature of boomers moving into the next phase of their life, that's why we don't relate to the word retirement.

So, as a result, we're going to see people working in a lot of other areas that they haven't been working in before, for less money, changing their lifestyle, downsizing, which is why we call it "decumulation," it's not distribution, it's "decumulating" in a whole lifestyle.

So, we're talking more about lifestyle choices, and fitting those into needs and circumstances with boomers than we ever did with the past generation.

Senator MARTINEZ. Thank you.

The CHAIRMAN. Go ahead, Mr. Salazar.

Mr. SALAZAR. In our experience in providing financial education to the SCSEP population that we work with, we found that it makes a huge difference in their lives. I mean, we encounter so many individuals that are un-banked—that don't have any kind of a relationship with a financial institution, and then become very vulnerable to predators out there. There's just a huge market that we encounter that have never opened up an account, anywhere.

The kinds of things that they learned and the situations that they relate to you, is shocking at times. But it makes a huge difference in preparing them, to once they're making an income, to be able to keep that income and pay for the—for the things that they have that are necessities in their life, as opposed to giving it away to somebody who's just trying to take advantage of them.

The CHAIRMAN. Yes.

As you point out, Ms. Katz, there is a real need for older people to stay in the workforce. It's not that we have to find a way to keep them there even though we don't need them there—the opposite is true. That employers need their experience, and their wisdom, and their willingness to work in a more flexible, part-time arrangement to run their business. All of the predictions about the future indicate that this is going to be true, isn't it?

Ms. KATZ. Absolutely. I mean, we don't have enough people in the workforce under retirement age to replace us. So, I think that's going to be a very big issue.

Having legislation dealing with older workers' rights, and opportunities will be very vital in the future. We can't go away, and second, we don't want to go away. We want to stay active.

The CHAIRMAN. Yes.

Ms. KATZ. That's part of why we need to encourage a whole shift in what we have been looking for in the past.

The CHAIRMAN. There's a big mental satisfaction in keeping people in the workforce beyond 65, to them, isn't there?

Ms. KATZ. Well, you know what? As planners, we had started out saying, "You can't retire. You're going to have to work longer." Boomers would say back to us, "We don't want to retire. We want to stay in this. We want to contribute, we have a knowledge base that can't be replaced." So you is us. But give us that opportunity to be used.

So, what they're doing is putting a positive spin on something they have to do anyway, and that's work longer because we need the resources. But now, we're working longer because we really want to stay in the economic community. We want to participate.

The CHAIRMAN. Very good.

Mr. SALISBURY. Senator, and even for those that may not be so thoroughly motivated, this is America Saves Week, and we released yesterday a survey that we had done with the Consumer Federation of America, tied to America Saves Week.

One of the things that that new survey data showed, which was just collected 2 weeks ago, is that the proportion of individuals who—as a result of the current economic situation—say that they now intend to work significantly longer, has gone up significantly.

If one's looking for some potential silver linings out of the current situation that we're facing, is it does appear to be serving as somewhat of a sledgehammer against many people's realities as to really thinking through what their savings levels are, how much they need in the future, and whether they can actually afford to retire. I think that the good news of that is that as our data has always suggested, a large proportion of those that retire have done it, literally, without having made any calculation of what their income or expenses would be.

They hit eligibility, somebody said, "Oh, you're eligible to retire. Oh, that means I must be able to do it." They have done it. The current situation is causing people, from the survey data and behavioral data, to at least stop, think, plan, far more thoroughly. So, I think that is in and of itself going to lead to later retirement ages, and to far more thorough planning by individuals, relative to their exit from the workforce.

Since Mr. Bernanke said yesterday that we're likely to be in a recession through the balance of 2009, the data suggest that that extended period is going to cause tens of millions of older Americans to very thoroughly reevaluate what their plans were, and boomers—if you will, Senator—and that that is likely to change patterns dramatically from what some might have thought as recently as a year or two ago.

The CHAIRMAN. Ms. Katz.

Ms. KATZ. The big problem is, we give people the opportunity to retire, but we don't give them the tools to make the decision intelligently. I'm surprised that, in the Stimulus Package, we didn't include some kind of financial planning support for people, because it's really what we're talking about here, at every age. They do not have the tools to make good decisions about their retirement, so the forced working is a result of not planning very well earlier, as well as a lot of economic downturn that we've suffered in the last couple of years.

So, legislatively, I would like to see us provide more financial literacy programs, more education, more tools to retirees, more encouragement to seek intelligent, non-biased, fee advice to be able to make those decisions. More people make—spend more time on what kind of refrigerator to buy—then what they're going to do with their retirement.

The CHAIRMAN. Well, that's great. This has been a wonderful panel, I guess I'm moved to say that hearings like this where the Senators learn an awful lot by listening to the panelists don't occur every day, but it's occurred today. You brought a lot of information and wisdom to the table, and I think a lot of it's going to be translated in action in the months to come.

So, I thank you so much for being here and we thank you all for being here.

We are adjourned.

[Whereupon, at 12 p.m., the hearing was adjourned.]

APPENDIX

Written Testimony

U.S. Senate Special Committee on Aging

"Boomer Bust? Securing Retirement in a Volatile Economy"

Submitted by Thomas M. Shapiro, Ph.D.
Director, Institute on Assets and Social Policy
Pokross Professor of Law and Social Policy, Brandeis University
February 25, 2009

Thank you to Chairman Kohl, Ranking Member Martinez and the committee for organizing this hearing and for the opportunity to comment on this timely topic.

The Institute on Assets and Social Policy is a research institute at the Heller School for Social Policy and Management at Brandeis University, dedicated to promoting a better understanding of how assets and asset-building opportunities improve the well-being and financial stability of individuals and families left out of the economic mainstream. Our recent report "Living Longer on Less: The New Economic (In)Security of Seniors" (attached), reveals many of challenges facing seniors today and provides insight into the challenges ahead as the Baby Boomers and subsequent generations reach retirement and old age.

In this report we outline economic strength and risks of seniors in five areas: housing costs, healthcare expenses, housing expenses, home equity, household budgets and projected household assets over their life actuary. Our findings paint a dismal portrait of US seniors' economic status. Overall, we find that 78 percent of seniors do not meet the criteria for long-term economic security. Particular areas of vulnerability include:
Insufficient Asset: More than half of all senior households (54 percent) do not have sufficient financial resources to meet projected expenses based on their current financial net worth, projected Social Security, and pension incomes.
Housing Expenses: 45 percent of senior households spend nearly a third of their income on housing. 31 percent either rent or have no home equity to draw on in tough times.
Healthcare Costs: 40 percent of senior households spend more than 15 percent of their income on healthcare.

Despite the challenges evidenced in the report, we emphasize that today's generation of retirees are in many ways a "best case scenario" as many have enjoyed better employer-based benefits (mostly defined pension benefits), and greater opportunities to avoid debt and build assets than future generations will experience. Those approaching retirement have faced the double-burden of falling values in their defined-contribution pensions along with falling home values. As our data reveal high levels of vulnerability before the current crisis; the current economic crisis will only exacerbate the shaky situation of future older adults in the U.S.

The authors of *Living Longer on Less* call on our policy makers in Congress and in the Obama administration to take action to strengthen the security of today's seniors and to ensure that younger generations will experience long-term economic stability through their senior years. Such actions include:

- Strengthening Social Security.
- Increasing Asset Building Opportunities.
- Supporting Flexibility to Allow Americans to Work Longer and More Productively
- Addressing The Medicare Crisis
- Instituting Long-Term Care Insurance

Thank you for the opportunity to provide testimony.

Statement by Mellody Hobson, President, Ariel Investments, LLC and Chairman, Ariel Mutual Funds Board of Trustees

For the Hearing on "Boomer Bust: Securing Retirement in a Volatile Economy"

Special Committee on Aging

February 25, 2009, 10:30 a.m., 106 Dirksen Senate Office Building

Chairman Kohl, Ranking Member Martinez, distinguished Members, thank you for the opportunity to submit this statement for the hearing "Boomer Bust: Securing Retirement in a Volatile Economy." My name is Mellody Hobson and I am the President of Ariel Investments, LLC, a privately owned Chicago-based money management firm with more than $4.4 billion in assets under management, founded in 1983 by John W. Rogers, Jr. In addition to managing separate accounts for corporate, public, union and non-profit organizations, Ariel Investments also serves as the investment adviser to the publicly-traded, no-load Ariel Mutual Funds.

Patience serves as the core of our investment philosophy. Ariel Investments was built around the belief that patient investors will be rewarded—that wealth can be created by investing in great companies, selling at excellent prices whose true value would be realized over time. As such, we believe our long-term performance is driven by our disciplined and focused approach, our stock selection across industries where Ariel has proven expertise, our exhaustive investigative research process and our commitment to investing in quality businesses that are typically undervalued or ignored.

With the largest generation in American history set to begin retiring, the country is facing a retirement crisis. Almost half of Americans today have little or nothing saved. The vast majority have far short of what they will need. Fewer and fewer Americans today have jobs offering guaranteed pensions and many public and private pension systems are underfunded. Many pensions affiliated with financially troubled companies are also at risk of collapse, and the federal agency set up to insure them is severely underfunded.

By most estimates, Social Security is in need of supplement and even under the best of circumstances is inadequate to funding a secure retirement for working Americans. The typical retiree lives for 17 years after retiring at 65. The typical retired couple spends more than $200,000 on health care in their old age. Defined contribution plans (401(k), 403(b), and 453) were never intended to replace traditional pensions (defined benefit plans) but for more and more people today, they are the only way of saving for retirement. The problem, however, is that most people do not save nearly enough and do not manage well the money they have.

These problems are even more extreme among minorities, who have less first-hand experience with money management than society as a whole. I have provided the results of the 2008 Ariel-Schwab Black Investor Survey and the Ariel-Schwab Black Paper. At Ariel we have learned that for middle-class African-Americans, the march toward financial security has been an uphill journey marked by half steps, pauses and, for some, retreat. Over the last decade, Ariel

Investments and The Charles Schwab Corporation have commissioned annual research comparing the saving and investing habits of middle- and upper-income Black and White Americans. The results consistently reveal that Blacks save less than Whites of similar income levels and are less comfortable with stock investing which impedes wealth building across generations and contributes to the growing retirement crisis.

The 11th Annual Black Investor Survey shows White Americans have more than twice as much saved for retirement as Blacks, but finds employers well positioned to make a difference. African-Americans are on equal footing with Whites when it comes to accessing and enrolling in employer-sponsored defined contribution plans, but save far less each month and have a considerably smaller nest egg than their White counterparts, according to the 11th annual Ariel/Schwab Black Investor Survey. The survey also found that with some help from employers, all employees, but particularly African-Americans, would be likely to ramp up their monthly 401(k) savings

This year's survey found that for many younger African-Americans, saving for retirement is more of a dream than a priority. Both Ariel and Schwab have made a major investment in financial education for youth. Through Ariel's foundation, the Ariel Education Initiative, the company supports the Ariel Community Academy, a Chicago public school that integrates financial literacy into the school's curriculum. Charles Schwab Foundation funds *Money Matters: Make it Count*, an after-school financial literacy program with Boys & Girls Clubs of America.

I thank the Committee again for taking up this important issue, and welcome any questions or comments you may have.

Prepared Statement

Women's Institute for a Secure Retirement

Senate Aging Committee

Hearing on "Boomer Bust? Securing Retirement in a Volatile Economy"

Wednesday, February 25, 2009

106 Dirksen Senate Office Building

Introduction

The Women's Institute for a Secure Retirement (WISER) is a non-profit organization whose primary mission is financial education — providing women with the crucial skills and information they need to improve their economic circumstances. As the only organization to focus exclusively on the unique financial challenges that women face, WISER supports women's opportunities to secure adequate retirement income through its research, training workshops, education materials and outreach.

We commend the Committee for examining retirement security in our volatile economy. We are submitting this testimony to ensure that Committee members recognize the significant financial risks women face. While all of us feel the pain of today's economic crisis in some way, it is especially troubling for older women, many of whom are already living on the edge. This testimony will highlight the challenges women face. We will summarize some of the activities WISER continues to undertake to help women deal with these challenges.

Background

After a lifetime of caring for others, women face a host of obstacles that jeopardize their economic security in retirement. Women live longer than men do. They earn less for the same work. Caregiving responsibilities cause them to spend about nine years out of the job market. Fewer years at work means that they are less likely to be eligible for employer retirement benefits and, combined with lower pay, means smaller Social Security benefits and lower savings. Older women are much more likely to live alone than older men, which increases the likelihood of poverty.

Divorce is especially pernicious for women's financial security in retirement. Most women (and many lawyers) fail to take the appropriate action during the divorce proceedings to secure their rights to retirement benefits. What's more, women who are married less than 10 years are not eligible for spousal Social Security benefits. The average length of a first marriage is eight years.

Even older women who seem to be financially secure are at risk. Elder financial abuse is a growth industry and predatory lending costs Americans billions annually. It robs elderly women of precious assets and puts their home ownership at risk. A Consumers Union study found that subprime loans are concentrated in geographical areas with higher concentrations of elderly residents. A high concentration of elderly predicts a higher rate of predatory lending. The face of the victim is often a "cash poor, house rich" elderly widow.

Here are some eye-opening facts:

- In 2008, women working full-time earned a median salary of $35,308, compared to $44,668 for men. The disparity is even more dramatic for minority women: $27,535 for black women and $22,285 for Hispanic women. When women who work part-time are included, the median income for all working women drops by one-third, to $29,074.

- Only 28% of women over age 65 receive income from pensions or annuities compared to 44% of men. The median annual benefit for women was $4,488. In contrast, the median benefit for men was $9,600 — more than double the median benefit for women

- The average Social Security benefit for retired women workers in 2007 was $890 a month compared to $1,171 received by men.

- Women aged 65 and older have a median income of $14,021. This is just 58% of the $24,323 that retired men receive.

- Women represent 70% of the older population living in poverty.

The Story Stays the Same

Just this week, an article on the front page of the *Wall Street Journal* shed light on the elderly as a class of those who are jobless.[1] While this may be news to the *Wall Street Journal* staff, it's simply more of the same to us. For more than a decade, hundreds of thousands of women in their 60's have been forced to stay in the workforce because they lack sufficient money to retire. We have heard from and about women in their 60s, 70s, and even 80s who struggle to survive on Social Security benefits alone. They've lost jobs, had to quit working for health reasons, or made the mistake of retiring too early. We know of women who have lived out of their cars – women who once had good-paying and steady jobs. The financial tightrope older women must walk often drops them into poverty. In fact, one in five women over age 65 live in poverty today.

You read a lot in the mainstream media about working longer as the solution to drained retirement savings. But this isn't a realistic option for many people. A host of reasons prevents older workers from working: a lack of jobs, poor health, or in the case of many women, providing care for a spouse, a mother, or mother-in-law. The grim economy will likely make jobs even harder to come by for older workers.

WISER's Program on Women's Education for Retirement

One of WISER's key initiatives is a program administered cooperatively and funded by the Administration on Aging—the National Education and Resource Center on Women and Retirement Planning. The AoA/WISER Resource Center's primary goal is to educate the most women we can possibly reach with information that can assist in future retirement planning. We seek to provide average and low-income women the opportunity to take the first step toward controlling their financial futures.

The do-it-yourself nature of retirement preparation has left millions of workers to make complex decisions. These aren't just retirement planning decisions; they are life-defining

[1] Elderly Emerge as a New Class of Workers – and the Jobless. *Wall Street Journal*, February 23, 2009.

decisions, and most people aren't prepared to make them. This puts women in the difficult position of making big decisions while being unable to afford even a small mistake.

WISER's approach is to bring financial planning back to the basics. Our goal is to help women make the best decisions they can with the limited resources they may have. We educate them on the risks of longevity, inflation, and lifestyle changes. We train-trainers who assist women in their communities. We explain the hard reality of having to adjust living standards to live within their means and to find resources in their communities that they may not be aware of.

Before the economic crisis, the women we reached were often confounded and intimidated. If they were following any advice, it was from a coworker or a family member— not the best basis for making life-defining decisions. Now many are in a state of panic. They want someone to help guide them to do the right thing.

The Resource Center has directly reached tens of thousands of women through our workshops, our partners' workshops and millions with our publications and website. WISER's strength is providing women with core financial knowledge that encourages them to make financial and retirement planning a priority in their lives. We focus on such issues as health and retirement benefits at work (or the implication of the lack of such benefits), the financial implications of providing care for children, parents and spouses, and the risks of longevity.

This initiative began in 1996, and now includes many partners—employers, aging and women's organizations and community-based groups. We have also worked with other federal agencies, including the Department of Agriculture's Cooperative Extension Service, the Department of Labor, and the Social Security Administration.

Our core message is this: women face unique challenges that threaten their financial security in retirement. As Congress and the Administration look to find ways to address the impact of the current economic crisis on older workers, please keep in mind the unique situation of women.

Promoting Economic Security at Older Ages through Workforce Development

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Written Testimony to the

Senate Special Committee on Aging

U.S. Congress

February 25, 2009

The views expressed are those of the author and should not be attributed to the Urban Institute, its trustees, or its funders.

Thank you for the opportunity to submit written comments on the retirement income challenges facing the boomer generation. The collapse of the stock market, which lost about 50 percent of its value between June 2007 and mid-February 2009, highlights the fragility of the American retirement income system.[1] The destruction of trillions of dollars in retirement account wealth is forcing millions of boomers in their fifties and sixties to rethink their retirement plans. Many workers will likely respond to unexpected shortfalls in future retirement income by delaying retirement. In fact, extending the work life is commonly seen as the key solution to the retirement financing dilemma. Working longer allows people to receive additional earnings, save more, accumulate more Social Security and pension credits, and reduce the time over which their savings must be spread. Simulations show that workers can increase their annual retirement income by 9 percent on average by working only one additional year (Butrica, Smith, and Steuerle 2006). Average retirement incomes would grow by 16 percent for low-wage workers.

Many older people with limited education, however, are unable to continue working into later life. Health problems force many out of the workforce, but even those healthy enough to keep working are unable to find jobs. They often lack the skills that employers value and the tools to find available jobs. Congress could improve the economic security of these older adults in retirement and in the years leading up to retirement by increasing government-funded employment and training services.

Financial Hardship among Older Americans with Limited Education

Adults with limited education often struggle to get by at older ages. In 2005, 12.1 percent of men and 18.9 percent of women age 65 to 69 who did not complete high school were living in poverty (table 1). By contrast, the poverty rate for college graduates age 65 to 69 was only 0.5 percent for men and 2.5 percent for women. Financial hardship rates for seniors with limited education are even more pronounced when we consider those near poverty, with household incomes between 100 percent and 124 percent of the federal poverty level, all of whom struggle to make ends meet. Among women age 65 to 69, 27.2 percent of those who did not complete high school lived in households with incomes below 125 percent of the poverty level, compared with 5.3 percent of college graduates. Yet, even these numbers may understate the number of older Americans with limited schooling who struggle to get by, because the official poverty thresholds do not adequately reflect older Americans' spending needs, including out-of-pocket medical expenses. Using a better measure of poverty developed by the National Academy of Sciences (2005) that represents a more current and accurate picture of family resources and needs pushes the 2005 poverty rate for adults age 65 and older from 9.6 to 15.9 percent, increasing the estimated number of poor older adults by nearly 60 percent (Zedlewski 2009).

Financial hardship for older adults with limited education is often more serious in the years leading up to 62, when Social Security retirement benefits become available, than at the most advanced ages. For example, 18.8 percent of men and 28.0 percent of women age 55 to 61 who did not complete high school had incomes below the official poverty level in 2005 (table 1). Poverty rates increase steadily for adults who lack high school diplomas as they move through their fifties. Among those born between 1937 and 1939 who did not complete high school,

[1] The S&P 500 index fell from 1,539 on June 4, 2007—the all-time high—to 777 on February 19, 2009.

Table 1. Percentage of Older Adults with Low Incomes, by Age, Gender, and Education, 2005

	Men					Women				
	55–61	62–64	65–69	70–79	80+	55–61	62–64	65–69	70–79	80+
Household Income below the Federal Poverty Level										
All	6.4	7.2	4.4	2.4	5.3	9.2	9.8	7.8	9.4	11.8
Education										
Not high school graduate	18.8	18.2	12.1	10.6	12.6	28.0	23.8	18.9	20.6	24.9
High school graduate	7.2	7.3	4.0	2.9	2.2	10.3	9.5	6.6	7.9	7.9
Some college	4.5	3.9	3.1	2.7	0.6	5.1	6.6	3.6	4.9	5.7
4+ years of college	3.2	4.4	0.5	0.9	2.8	3.3	2.3	2.5	2.7	2.2
Household Income below 125 Percent of the Federal Poverty Level										
All	9.2	8.9	8.0	7.3	9.8	11.4	12.6	12.2	15.0	20.9
Education										
Not high school graduate	26.9	21.4	21.4	17.7	20.3	35.2	30.9	27.2	32.1	37.6
High school graduate	9.6	9.4	8.1	5.1	5.5	12.3	12.3	10.2	12.6	18.2
Some college	7.9	5.5	4.2	5.9	4.5	6.4	8.4	6.5	8.6	11.0
4+ years of college	4.0	4.9	1.0	1.7	5.1	4.2	2.5	5.3	4.7	4.2

Source: Author's calculations based on the 2006 Health and Retirement Study.

poverty rates increased from 23 percent at age 52 to 54 to 31 percent at age 60 to 61, a relative increase of 36 percent (Johnson and Mermin 2009). Poverty rates for those without a high school diploma then fell to 24 percent at age 63 to 64 as Social Security retirement benefits became available, and to 22 percent at age 66 to 68. Poverty rates for college graduates in this birth cohort did not increase significantly as they approached age 62, however, nor did they decline after age 62.

Declines in economic well-being in one's late fifties and early sixties are closely tied to employment status. Two-fifths of adults working full-time at age 52 to 54 reduce their work hours before age 62; one-fourth completely stop working, leaving the labor force directly from full-time employment; and another one-seventh move to part-time employment before leaving the labor force (Johnson and Mermin 2009). Financial hardship rates more than quadruple between age 52 to 54 and age 60 to 61 for workers who exit the labor force early directly from full-time employment. The consequences are particularly serious for those with limited education, more than half of whom report incomes below the poverty level at age 60 to 61 (up from fewer than 1 in 10 at age 52 to 54).

Many early labor force departures appear to be at least somewhat involuntary. More than a quarter of those who move directly out of the labor force from full-time employment have been laid off from a job in their fifties or early sixties, and slightly more than half report having a health problem that limits their ability to work (Johnson and Mermin 2009). By contrast, fewer than one in six workers employed full-time through age 62 report any work disabilities.

Older adults with limited education are less likely to work both before and after age 62 than those with more schooling. For example, the 2006 employment rate for men age 65 to 69 was 30.4 percent for those who did not complete high school, 32.5 percent for high school graduates, and 51.9 percent for college graduates (table 2). Women age 65 to 69 who graduated from college were about twice as likely to be employed in 2006 as those who did not complete high school (36.4 percent vs. 17.6 percent). Older adults with limited education are less likely to work than those with more schooling because many experience health problems, lack the skills that employers value (Munnell, Sass, and Soto 2006), and worked previously at physically demanding jobs that are difficult to hold at older ages (Johnson, Mermin, and Resseger 2007).

Table 2. Percentage of Older Adults Who Are Employed, by Age, Gender, and Education, 2006

	Men				Women			
	55–61	62–64	65–69	70–74	55–61	62–64	65–69	70–74
All	74.7	53.8	38.4	25.8	62.1	43.6	27.7	17.0
Education								
Not high school graduate	62.6	34.5	30.4	17.3	35.3	22.2	17.6	12.0
High school graduate	67.1	51.8	32.5	23.8	59.2	44.7	26.8	15.0
Some college	76.6	53.9	38.4	26.0	66.1	51.0	32.6	22.7
4+ years of college	83.7	64.7	51.9	36.2	74.7	51.4	36.4	22.6

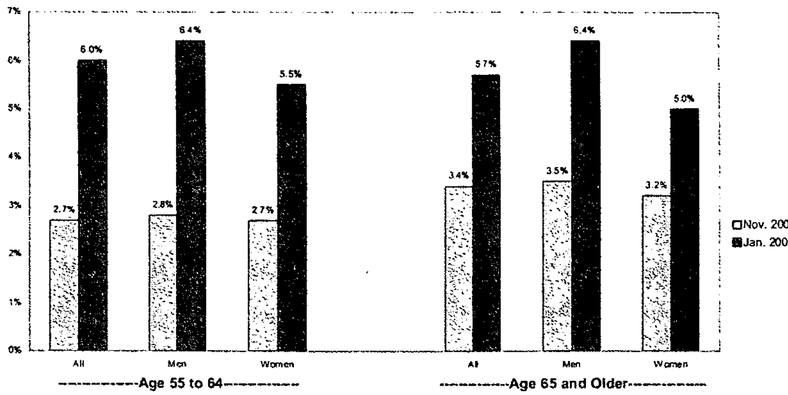
Source: Toder et al. (2008), based on the 2006 Health and Retirement Study.

The Recession Further Reduces Employment for Low-Skilled Older Workers

The recession is hitting older workers hard and further reducing employment for those with limited education. In January, 1.7 million adults age 55 and older were unemployed, more than twice as many as in November 2007, just before the recession began (Bureau of Labor Statistics 2009). About 1.3 million adults age 55 to 64 and 373,000 adults age 65 and older were unemployed. The unemployment rate for adults age 55 to 64 increased to 6.0 percent in January 2009 (figure 1), the highest rate since April 1983. At age 65 and older, the unemployment rate reached 5.7 percent, a 31-year high. The unemployment rate was lower for women than men, who are more likely to work in the hard-hit manufacturing and construction sectors.

Last month's unemployment rate for those age 25 to 54 was 7.7 percent, higher than the rate at older ages. However, the consequences of job loss are more serious at older ages. Older workers who are laid off are less likely to get another job than younger people. For example, among workers laid off between 1981 and 1983, those age 55 to 59 were about 20 percentage points less likely to become reemployed than those age 40 to 44 (Munnell et al. 2006). Additionally, older displaced workers who eventually become reemployed suffer a greater loss in hourly wages than younger displaced workers. A new Connecticut study shows that 58-year-old displaced workers earned, on average, 50 percent less on the new job than on their old job, whereas hourly wages declined by only 20 percent for 40-year-old displaced workers who found new jobs (Couch, Jolly, and Placzek 2009).

Figure 1. Unemployment Rates for Older Adults, Nov. 2007 and Jan. 2009



Source: Johnson and Mommaerts (2009), from Bureau of Labor Statistics data.
Note: Estimates are not seasonally adjusted.

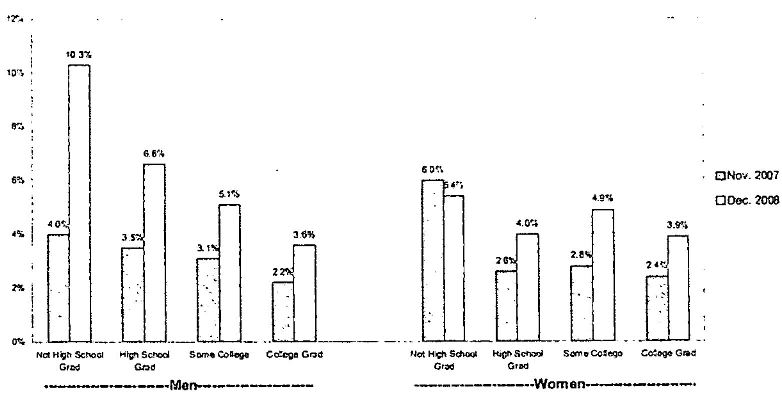
The current recession is hitting older workers harder than past downturns. For example, 12 months into the severe 1981–82 recession—the most recent downturn to have lasted as long as the current one—the number of unemployed older adults had not increased at all. What's different this time? Fewer older Americans can afford to retire now. When older workers lose their jobs today, they tend to stay in the labor force and look for new jobs, instead of dropping out of the labor force and retiring.

The dismal stock market, which has wiped out trillions of dollars in retirement account wealth, is part of the reason that many people can no longer afford to retire. Housing prices are also slumping. The combination of sagging housing prices, collapsing stock values, and a weak job market is unprecedented in recent decades. During the 1981–82 recession, the S&P 500 index fell by only 6 percent. And back then, the stock market didn't affect retirement incomes as much because many people had traditional defined-benefit pension plans that paid a guaranteed benefit until death, regardless of what the stock market did. Nearly two-fifths of private wage and salary workers had traditional pension coverage in 1980 (Bureau of Labor Statistics 2007; Pension and Welfare Benefits Administration 2001–2002). Today, the coverage rate is down to about a fifth.

The stock market plunge only accentuates a long-term decline in retirement income security that keeps older people at work. Other concerns for retirees and near retirees include declining retiree health insurance coverage, rising out-of-pocket health care costs, and cuts in Social Security benefits. Social Security's full retirement age is 66 for people who are now 62, up from 65 in previous years. People can still collect retirement benefits at age 62, but they must forfeit 25 percent of their full benefits. Past generations of early retirees only had to forgo 20 percent of their full benefits when they began collecting at 62. Rising Medicare premiums are taking a bigger bite out of Social Security benefits. And more Social Security benefits will be subject to federal income tax in the future, because the income thresholds that determine taxability are not indexed to inflation.

The recession is hitting hardest older people with little education, who can least afford to retire early. The unemployment rate for men age 55 and older who did not complete high school increased 6 percentage points since the recession began (figure 2). These men were slightly more than twice as likely to be unemployed in December 2008 as those with some college education. The recession has increased the unemployment rate for male college graduates age 55 and older by only 1.4 percentage points so far. However, the unemployment rate did not increase for women age 55 and older who did not complete high school. The unemployment rate increased by 2 percentage points for women with at least a high school diploma, roughly the same increase experienced by their male counterparts.

Figure 2. Unemployment Rates by Education, Age 55 and Older, Nov. 2007 and Dec. 2008



Source: Johnson and Mommaerts (2009), from Bureau of Labor Statistics data.
Note: Estimates are not seasonally adjusted

Focus on Workforce Development

To improve economic security for older adults with limited education, both before and after they retire, Congress needs to increase government-funded employment and training services. These efforts would raise employment rates and earnings for older workers. To make ends meet, most low-skilled older people who are too young to qualify for Social Security benefits need to work. Extending full-time employment into later life and waiting to begin collecting retirement benefits raise future retirement incomes. Many older people could also improve their economic security by working in retirement and supplementing their Social Security benefits. Yet, many older workers with limited education have trouble finding work and earning decent wages, partly because they lack skills that employers need and partly because they are unable to connect with potential employers.

Federally funded workforce development programs could help older workers. One-Stop Career Centers, funded by the Workforce Investment Act of 1998 (WIA), provide valuable employment and training services. However, although they are designed to serve workers of all ages, performance appraisal standards appear to discourage centers from serving older adults. Centers are partly evaluated by whether clients earn more on their new jobs than their former jobs, yet mature workers are less likely to experience earnings growth than their younger counterparts, potentially discouraging center staff from focusing on seniors (General Accounting Office 2003). The Department of Labor should explicitly account for clients' ages when evaluating One-Stops.

The Senior Community Service Employment program (SCSEP) is the nation's only workforce development initiative targeted to older adults. This program helps workers age 55 and older with incomes below 125 percent of the federal poverty level acquire job skills, provides training and other supportive services, and places participants in subsidized, part-time community services assignments. Because of funding constraints, however, SCSEP now serves only about 80,000 adults (Sum and Khatiwada 2008), just a small fraction of the older adults who could benefit. The stimulus plan provides the program with an additional $125 million, but those funds would cover only 24,000 more participants. For perspective, 1.4 million adults age 55 and older were unemployed in December 2008 and more were underemployed. Additional older Americans also want to work but have given up looking for a job.

Funding constraints limit the entire workforce development system. Government spending for WIA programs has declined by nearly 70 percent since the late 1970s (Holzer and Martinson 2008). More funds for job training and employment services could improve employment outcomes for older workers and bolster their retirement security. Efforts to encourage low-skilled adults to save for their retirement, such as by subsidizing retirement plan contributions, can succeed only if they are working at good jobs.

For most older workers, long-run employment prospects are promising. The stagnating pool of adults age 25 to 54, whose numbers will increase by only about 2 percent between 2008 and 2020 (U.S. Census Bureau 2000), will boost the demand for older workers. The steady decline in the physical demands of the workplace will help more older adults stay employed (Johnson, Mermin, and Resseger 2007). In the short run, however, the recession will leave hundreds of thousands of older Americans out of work. Employment prospects will be especially bleak for low-skilled older workers. More workforce development funds could raise employment levels, helping older adults make ends meet until they qualify for Social Security and helping others supplement their retirement benefits with part-time work.

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Statement for the Record

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"Solutions to ensure that Americans can enjoy a safe and secure retirement after a lifetime of hard work."

Five Steps to Restoring Trust in the 401(k) System

Presented to the
Committee on Education and Labor
U.S. House of Representatives

February 24, 2009

Five Steps to Restoring Trust in the 401(k) system

INTRODUCTION

It is widely accepted that 401(k) and similar arrangements are the way most Americans will invest for retirement. Therefore, it is incumbent upon us all to be absolutely certain there are no unnecessary obstacles (whether intentional or unintentional) to its long-term success.

The 401(k) concept is excellent. It has always had great potential, but that potential was sacrificed on Wall Street's altar of greed, corruption, and the 401(k) industry's harmful business model. It is not too late for the 401(k), but that will require a complete and unequivocal shift in public thinking. In other words, the public—including elected representatives, and regulators—must cast off the marketing-induced stupor that has befallen them.

It is with a deeply felt commitment to the success of our private retirement system that this statement is shared with the Committee. There are reasons the 401(k) is failing. If those reasons are understood and acted upon, the 401(k) can be saved. This statement will explain those reasons and what is required to correct and restore the viability of the 401(k) for generations to come. If all five of the steps described herein are not implemented, the 401(k) system will be doomed to mediocrity – and, more likely, continuing failure.

Step 1: Elevate stature of 401(k) to the original level contemplated by statute

"Give a dog a good name and he'll live up to it."[1]

While the 401(k) as a concept is excellent, the way the plan has been interpreted, marketed, delivered, implemented and operated is not. The 401(k) is suffering because many people inside and outside of the 401(k) and financial services industry view its purpose incorrectly. It is seen as a financial product, not a delicate retirement-income-generating system deserving of fiduciary protections and care.

Many believe that 401(k) plans are nothing more than financial planning or simple savings tools. That is incorrect. 401(k) plans are ***true retirement plans***, with all the attendant obligations and implications. They must be viewed and operated as such for the system to begin to restore the public trust.

From a statutory perspective, a 401(k) plan is as much a retirement plan as a traditional pension plan. Until the 401(k) plan, and the system that it operates within is elevated to the intended stature of a "pension benefit plan" under ERISA section 3(3) (which is why 401(k) plans are reported as a pension benefit plan on form 5500), society and the 401(k) and financial services industry will continue to view the 401(k) as being of "lesser" importance and stature. Behavior and attitudes toward the 401(k) will follow accordingly.

The 401(k) needs a fine reputation to live up to, and that can only happen if all Americans begin viewing it not as just another financial product, more like E*Trade than ERISA, but as an income-producing mechanism, as correctly stated under ERISA, with the ability to financially undergird society as it ages.

Step 2: Create the right types of safe harbors and incentives

> *"Faced with this statutory and regulatory riddle, the Department of Labor ("DOL") and now, Congress, support various investment advice schemes that allow plan sponsors to seek fiduciary relief under ERISA section 404(c). Although these schemes have the potential to resolve the ERISA section 404(c) dilemma, their structural flaws only create more problems—for example, they allow investment advisors to self-deal and operate despite conflicts of interest. And so the riddle of ERISA section 404(c) continues."*[2]

The conventional 401(k) system is not founded solely upon principles that will yield favorable results for participants and beneficiaries. Ironically, there are regulatory incentives to produce mediocre or poor results. Nothing has produced more chaos and confusion in the 401(k) system than Department of Labor section 2550.404c-1, commonly referred to as "404(c)."

404(c) is not just one of many problems with the 401(k) system. It's ***the*** problem.

We wouldn't let our loved ones get on an airplane that does not strictly adhere to principles of aeronautical science and physics. And we certainly wouldn't knowingly let our loved ones ride in an airplane with a missing wing or a visibly cracked fuselage. That airplane will surely fall short of its destination; and that fact would be obvious long before takeoff. Yet we have a system that permits our loved ones to do just that with 401(k) plans operating within the meaning of Department of Labor regulation 404(c). In many cases, participants merely guess about which funds to invest in, and they often guess wrong. It is commonplace for incomplete or sub-optimal portfolios to be randomly selected. Without even realizing it, participants choose the wrong funds, or the wrong combination of funds, or the most expensive funds–thereby unnecessarily sacrificing years of potential retirement income. To continue the analogy, they choose a portfolio that is not "flight-worthy." Sadly, they will discover that reality far too late in life, and find that their only option is to work harder and longer – perhaps well into their 70's or even beyond.

Section 404(c) was not originally meant for 401(k) plans anyway. It was intended for Defined Benefit Plans with after-tax mandatory employee contribution requirements or the precursor to the 401(k) – the Thrift Savings plans that some employers sponsored in addition to a traditional Defined Benefit Plan. Since the benefits provided under a traditional Defined Benefit Plan were protected by employer funding and the PBGC, it mattered far less if a participant made poor decisions with their after-tax mandatory or Thrift Savings account. The number of participants affected by 404(c) prior to the creation of the 401(k) is not known – but likely insignificant. Perhaps most 401(k) participants today participate in a plan with a section 404(c) provision. The drafters of ERISA could not have foreseen how 404(c) would damage a system that did not yet exist. ERISA section 404(c) existed prior to the 401(k), and its corrosive effects could not have been known.

In 1991, final regulations under 404(c) were issued by the Department of Labor as a provision that 401(k) plans could utilize. That regulation was ill-conceived. By issuing those regulations, the Department of Labor consigned the 401(k) to mediocrity or worse. It should have been clear that 404(c) should be the exception, not the rule – as there were pre-existing laws in place that gave participants the right to a well diversified, prudent portfolio.

The application of 404(c) to 401(k) plans opened the floodgates to the chaos in speculation and deviation from sound economic and financial principles – placing the burden of "flight-worthiness" on the passenger and taking it away from trained professionals at the airline or the FAA, as it were.

If trust in the 401(k) system is to be restored, the strangle-hold of 404(c) must be broken. That will prevent participants from making incorrect decisions based on emotion, ignorance, greed, or all of the above. It will place investment decision-making back where it belongs – with prudent fiduciaries.

If 404(c) is allowed to remain, it should require a beneficiary waiver before a participant may choose to disregard the portfolios put in place by professional fiduciaries because the result will almost certainly be less favorable for both the participant and the beneficiary. If both agree, so be it. However, a prudent portfolio constructed by an investment fiduciary should be the standard established by law, and it should be accompanied by a safe harbor.

Congress should consider clarifying for the courts that complying with 404(c) requires affirmative proof that all of its requirements have been satisfied. That of course is impossible, because there is no way to determine whether plan participants are "informed." It is the "informed" requirement that gives 404(c) legitimacy, not the offering of a broad selection of funds. The Courts have missed that point entirely. Since it is impossible to know who is truly informed and who is not, even after extensive efforts to provide investor education, 404(c) is simply not viable in a system where the overwhelming population of American workers persists in its failure to grasp the elementary differences between a stock and a bond.[3] Again, 404(c) could perhaps be the exception, but it is a mistake of massive proportions to have permitted it to become the rule.

> *"Many Americans, alas, know little about stocks, bonds, and retirement. This is the conclusion reached by none other than the companies and organizations that would benefit most from a system of private accounts. The Vanguard Group, the National Association of Securities Dealers, the Securities Industry Association, the Investment Protection Trust, Merrill Lynch, Money magazine, and the Securities and Exchange Commission have all done studies or issued reports that reach the same general*

conclusion. To make matters worse, much of the research over the past five years has focused on the knowledge of individuals who already own stock and are thus presumably more familiar with the workings of financial markets; the research has still found severe financial illiteracy."[4]

Beyond the requirement that participants be "informed," virtually everyone in the 401(k) industry knows that only a tiny fraction of any plan actually complies with the long list of requirements. Section 404(c) is a waste of time, money, and it is also the cause of many billions of dollars wasted each year that otherwise would have been legitimately earned by professionally constructed and managed portfolios. When employers see a safer route (less fiduciary risk) that also has the promise of better results, the system will begin to heal and public trust will be restored.

An employer that sponsors a 401(k) plan should be assured by a clear, unequivocal statutory safe harbor for appointing a professional independent fiduciary, acting pursuant to sections 3(21) or 3(38) of ERISA, or both. That will do more to protect the plan sponsor from fiduciary risk than anything else, and it is consistent with the duty of loyalty in a way that participants do not currently enjoy. Such a safe harbor would reduce or eliminate conflicts of interest. Results would improve through professional application of sound economic and financial principles. No longer would America's employers have to wear two hats and grapple with divided loyalties to their shareholders and their 401(k) plan participants. Such a safe harbor would restore order to the system.

Creating better safe harbors and other incentives that give plan sponsors confidence and a sense of security for having done the right thing the right way will wean the 401(k) from concepts that have only confused and frustrated an otherwise excellent program with potential for long-term success.

Step 3: Participants have a right to know the *expected return* of their portfolio

"If [investment] returns could not be expected from the investment of scarce capital, all investment would immediately cease, and corporations would no longer be able to produce their sellable goods and services. The truth is that we invest, not with an eye to making speculative gains, but because we have an expectation of a specific return over time."[5]

Every week, thousands of enrollment meetings are held in the lunch-rooms of corporate America. Those enrollment meetings seek to explain to participants why they should enroll in their company's 401(k), and which investment options are available to them.

That is fine, with one exception. Most of the paperwork and enrollment materials will provide participants with useless information about the type of investor they are. Participants will take a 5 minute quiz, and that quiz will tell the participant that they are a "conservative" investor, or a "moderate" investor, or perhaps an "aggressive" investor. Perhaps a particular list of funds with suggested ratios for which to allocate new contribution dollars will be associated with each investor type.

There are two fundamental flaws with that approach.

First, whether a participant has a conservative or an aggressive investor profile is dependent on emotion; how much market volatility they can stomach. A participant's tolerance for market turbulence is not static. It can change day-to-day. For example, if a participant with an aggressive profile gets in a car accident, their profile may immediately switch to conservative. That is an emotional profile that does not tie well to the economics of prudent, long-term investing.

Second, the emotion of identifying an investor profile does not help the participant understand the interplay between new funding (ongoing contributions/deposits to the plan) and future retirement income streams that can be ***expected*** (not to be misunderstood as "guaranteed.")

Therefore, the most important thing a participant needs to know is not their emotionally determined ability to endure market turbulence, but rather the long-term economic output of the participant's portfolio. This is called the "***expected return***." Knowing that, a participant cannot truly understand how much money they should be contributing to the plan, when coupled with any employer generosity, if any, to achieve a future income-replacement goal.

The expected return is the most fundamental concept of investing because if those with capital to invest could not expect a return, that capital would be invested elsewhere – or not at all. The concept of expected return is perplexingly absent in the current 401(k) system and is not understood by participants or fiduciaries. That misunderstanding can easily be corrected.

It should be mandated by law that all participants be told what the expected return is for the actual portfolio they are in. That way, the one thing that participants can control – the amount they contribute to the plan – is a decision made in light of the expected return of the portfolio they will invest in so their decision is both informed and founded upon a process that is likely to yield favorable results.

Participants may not be able to afford what they wish they could contribute based on the expected return of their portfolio. For example their portfolio may have an expected return of 5%, and to comfortably retire they may learn that they will need to contribute twice as much as they can afford in order to get there. That is an understood reality of life that many face each day when purchasing goods and services. However, participants should at a minimum know the economic characteristics of their portfolio so they can choose to get more education in order to earn more, work longer, spend less on other things, or a combination thereof.

Consider how different things would be if we stopped inducing emotional decisions in participants and began given them solid, reliable information based on modern principles of economics and finance.

Step 4: Transparency

Our retirement savings system and its participants deserve protection. The bedrock of any mechanism as delicate as the 401(k) should be clarity and transparency.

The debate over whether the cost of a 401(k) plan is reasonable is pointless without standardized transparency. Can something be determined reasonable if it cannot first be seen and understood in a comparative context?

In the case of plans with known economic impact to participants, perhaps all fees and costs are deemed reasonable when compared to the industry as a whole, yet simultaneously excessive in light of the quality or value of services rendered to a specific plan. In other words, all 401(k) plans could eventually have fees that someone deems reasonable, but those same fees may be genuinely excessive at the same time – therefore it is not an either-or scenario.[6] That conundrum cannot be resolved in an environment of opacity.

Given the seriousness of the crisis we face, where an estimated $1 trillion in 401(k) assets has been lost in the past few months, we cannot accept anything less than full and absolute transparency – even if fees and other charges become very low by today's standard. In other words, there may come a time when fees are reasonable, non-excessive, and absolutely transparent. It is in times such as those, transparency will be no less important or necessary for the purpose of protecting trust in the system.

Passage of HR 3185 or a fundamentally similar Bill will begin the process of restoring broken trust. Distilling disclosure of expenses into an understandable format will deliver value to participants, beneficiaries, and employers. The gross-to-net methodology, which means clearly showing gross returns on the investments in a 401(k) account and also showing the net returns that the participant gets to keep, makes the most sense. It reveals total investment returns, the net return to each participant, and by simple subtraction, the actual costs of delivering those net returns to each participant.[7] Any other method obscures both returns and costs from the view of the participants, plan sponsors, and regulators alike. Gross-to-net disclosure establishes true transparency, a pre-requisite to restoring trust in the 401(k).

Transparency should also be required for new financial products that are developed in the future, such as fund-of-funds, lifestyle, and target date funds. Some of those may be well constructed. Some of them are not. Transparency is required to ensure fiduciaries and plan participants understand the difference.

Step 5: Retire-ability measurements

As stated earlier, the 401(k) has not been managed to produce future retirement income. Rather, it has been managed like merely another of an array of ordinary financial products. Thus, the ability of conventional 401(k) plans to produce financially secure retirees is not a primary discussion item of fiduciaries and committee members in their meetings.

Many factors go into creating a successful program, each having differing importance and weight at different stages of a participant's progression from entry into the workforce to retirement. Also, participants at different ages are affected differently by plan provisions or economic conditions.

For example, younger participants with smaller account balances are most affected by matching or other employer contributions. Older participants with larger account balances are most impacted by fees and other charges. Employers and fiduciaries must understand what helps participants, what hurts them, and when those effects are most likely.

If 401(k) plans are to thrive, employers and fiduciary committees must engage in regular proactive and thoughtful assessments of the "retire-ability" qualities of their plan, while taking into account the demographics of the plan participants as a whole.

Society requires more that ever a more astute body of fiduciaries who understand that improved future retirement income for individuals also enables an improved future economy for all. Higher retirement incomes can help stabilize the economy, sustain tax revenues necessary to deliver essential government services and provide economic opportunity for the rising generation.

Employers must not fear the question, and then answer honestly, "Will our employees be able to retire at their chosen time? If not, what can we do to improve their chances?"

SUMMARY

1. **Return to Roots** – Congress can make it unequivocally clear that plan sponsors need to understand 401(k) plans must not as mere financial planning tools, but rather the a pension benefit mechanism that produces retirement income that will be the financial undergirding mechanism of society.

2. **Safe Harbors & Incentives** – Congress can create meaningful safe harbors and incentives that give employers confidence to proceed in managing their 401(k) plans in accordance with modern principles of economics and finance – thus improving results. Congress can remove or suppress harmful elements of the conventional system, such as Department of Labor regulation 404(c). That regulation, 404(c), is the lead in the paint, the salmonella in the peanuts, the goose in the jet engine of the retirement system. Fix it, and you will fix the root cause of the problems that plague the 401(k).

3. **Expected Returns** – Congress can require that participants be given the expected return (economic characteristic) of the portfolio in which their funds are invested. Unlike knowing the expected return of a portfolio, the emotional risk profile most 401(k) participants are given to help them choose investments is not useful in calculating future retirement income nor is it helpful in making appropriate portfolio changes. The expected return is already required by case law to be known and understood by fiduciaries. That same information should also be made known to participants.

4. **Pass HR 3185** – Congress can pass HR 3185 or its fundamental equivalent to clarify plan expenses by a simple gross-to-net calculation in order to help employers and plan participants make better decisions, and also to restore trust and confidence in the system. No system as important as the 401(k) should have any lingering questions about fee or expense transparency. Thus, the passage of HR 3185 or its equivalent is at a minimum, urgent.

5. **Retire-Ability Measures** – Congress can encourage employers to look beyond the robotic fund selecting process that has become synonymous with being a 401(k) committee member and to look more deeply at how their plans are designed to produce financially secure retirees. And participants can be provided tools to assess their projected retirement dates and expected income levels.

CONCLUSION

There are problems with how the 401(k) has been delivered; that goes without saying. That does not mean we need to accept what has not worked and protect the status quo. No one is suggesting that employers guarantee benefits. It is proposed, rather, that 401(k) plans be managed like the retirement-income-producing mechanism they were always intended to be. It is because the benefits delivered by a 401(k) are not guaranteed that we should demonstrate particular care and compassion. Participants are entirely vulnerable, and deserve better protections. Protecting the interests of participants will require a sweeping shift in thinking toward a system that enables (1) A fiduciary level of care; (2) Improved safe harbors and incentives; (3) Disclosure of expected investment returns; (4) Transparency via actual gross-to-net disclosure; and (5) Measurements of each participant's ability to retire at targeted dates and income levels. The benefits of these five reforms to the 401(k) system will reach more than fifty million working Americans. Without this shift in thinking and behavior, including abandoning the misused 404(c) provisions, the 401(k) will fail to deliver on its original promise. There is hope for the 401(k) to rebuild savings and regain the trust of American workers, but it must be operated as ERISA originally contemplated; like a "pension benefit" plan.

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[1] Attributed to Dale Carnegie

[2] Chicago-Kent Law Review. ERISA Section 404(c) and investment advice: What is an Employer or Plan Sponsor to do? Stefanie Kastrinsky. Page 3 May 16, 2005.

[3] Dave Mastio, "Lessons our 401(k)s Taught us. How much do Americans know about investing for retirement? What investors don't know." http://www.hoover.org/publications/policyreview/3552047.html

[4] Ibid

[5] "Investment Risk vs. Unprincipled Speculation" Journal of Pension Benefits ©Wolters Kluwer Law and Business. Volume 16, Number 2, Winter 2009. Page 76.

[6] See 9th Meigs question for further explanation about the relationship between "reasonable" and "excessive" fees and expenses. http://www.401khelpcenter.com/401k/meigs_mdh_interview.html

[7] See "Gross-to-Net" proposed fee and expense disclosure reporting grid. http://www.dol.gov/ebsa/pdf/IF408b2.pdf. See also http://advisor.morningstar.com/articles/article.asp?s=0&docId=15714&pgNo=2

AMERICAN BENEFITS COUNCIL

STATEMENT FOR THE HEARING RECORD

FOR THE

SENATE SPECIAL COMMITTEE ON AGING

HEARING ON

**"BOOMER BUST?
SECURING RETIREMENT IN A VOLATILE ECONOMY"**

WEDNESDAY, FEBRUARY 25, 2009

AMERICAN BENEFITS COUNCIL

February 24, 2009

Employer-sponsored 401(k) and other defined contribution retirement plans are a core element of our nation's retirement system and successfully assist tens of millions of families in accumulating retirement savings. While individuals have understandable retirement income concerns resulting from the recent market and economic downturns – concerns fully shared by the American Benefits Council – it is critical to acknowledge the vital role defined contribution plans play in creating personal financial security.

Congress has adopted rules that facilitate employer sponsorship of these plans, encourage employee participation, promote prudent investing, allow operation at reasonable cost, and safeguard participant interests through strict fiduciary obligations. As a result 401(k) plans are valued by workers who participate in them as important resources for delivering retirement benefits. Nevertheless, improvements to the system can certainly be made. Helping workers to manage market risk and to translate their defined contribution plan savings into retirement income are areas that would benefit from additional policy deliberations. An additional area in which reform would be particularly constructive is increasing the number of Americans who have access to a defined contribution or other workplace retirement plan.

The goal should be a 401(k) system that functions in a transparent manner and provides meaningful benefits at a fair price. At the same time, we all must bear in mind that unnecessary burdens and cost imposed on these plans will slow their growth and reduce participants' benefits, thus undermining the very purpose of the plans. It is important to understand the facts relating to these plans. The Council believes the following principles are critical in evaluating any reform measures in this area:

- **Defined Contribution Plans Reach Tens of Millions of Workers and Provide an Important Source of Retirement Savings.** There are now more than 630,000 private-sector defined contribution plans covering more than 75 million active and retired workers, with another 10 million employees covered by tax-exempt and governmental defined contribution plans.

- **Employers Make Significant Contributions Into Defined Contribution Plans.** Many employers make matching, non-elective, and profit-sharing contributions to complement employee deferrals and share the responsibility for financing retirement. Recent surveys of defined contribution plan sponsors found that at least 95% make some form of employer contribution.

- **Employer Sponsorship Offers Advantages to Employees.** Employer sponsors of defined contribution plans must adhere to strict fiduciary obligations established by Congress to protect the interests of plan participants. Employers exercise oversight through selection of plan investment options, educational materials and workshops about saving and investing and professional investment advice.

- **Defined Contribution Plan Coverage and Participation Rates Are Increasing.** The number of employees participating in these plans grew from 11.5 million in 1975 to more than 75 million in 2005, and 65% of full-time employees in private industry had access to a defined contribution plan in 2008.

- **Defined Contribution Plan Rules Promote Benefit Fairness.** Congress has established detailed rules to ensure that benefits in defined contribution plans are delivered across all income groups. Extensive coverage, nondiscrimination and top-heavy rules promote fairness regarding which employees are covered by a defined contribution plan and the contributions made to these plans.

- **401(k) Plans Have Evolved in Ways That Benefit Workers.** Both Congress and private innovation have enhanced 401(k) plans, aiding their evolution from bare-bones savings plans into retirement plans. Among these enhancements have been incentives for plan creation, catch-up contributions for older workers, accelerated vesting schedules, tax credits, automatic contribution escalation, single-fund investment solutions and investment education programs.

- **Recent Enhancements to the Defined Contribution System Are Working.** The Pension Protection Act of 2006 (PPA) encourages automatic enrollment and automatic contribution escalation. PPA also provided new rights to diversify contributions made in company stock, accelerating existing trends toward greater diversification of 401(k) assets.

- **Defined Contribution Plan Savings is an Important Source of Investment Capital.** With more than $4 trillion in combined assets as of March 2008, these plans represent ownership of a significant share of the total pool of stocks and bonds, provide an important and ready source of American investment capital.

- **Defined Contribution Plans Should Not Be Judged on Short-Term Market Conditions.** Workers and retirees are naturally concerned about the impact of the recent market turmoil. It is important, however, for policymakers and participants to judge defined contribution plans based on whether they serve workers' retirement interests over the long term.

- **Inquiries About Risk Are Appropriate But No Retirement Plan Design is Immune from Risk.** The recent market downturn has spawned questions about whether defined contribution plan participants may be subject to undue investment risk. Yet it is difficult to imagine any retirement plan design that does not have some kinds of risk. Any efforts to mitigate risk should focus on refinements to the existing successful employer-sponsored retirement plan system and shoring up the Social Security safety net.

The Council has prepared the attached white paper to more fully develop these principles. We encourage a full and vigorous debate over ways to improve retirement security for American workers. At the same time, it is critical that the debate not serve to undermine retirement security by inadvertently increasing the costs to participants or discouraging plan sponsorship.

AMERICAN BENEFITS COUNCIL

February 5, 2009

DEFINED CONTRIBUTION PLANS: A SUCCESSFUL CORNERSTONE OF OUR NATION'S RETIREMENT SYSTEM

Introduction

Employer-sponsored 401(k) and other defined contribution retirement plans are a core element of our nation's retirement system, playing a critical role along with Social Security, personal savings and employer-sponsored defined benefit plans. Defined contribution plans successfully assist tens of millions of American families in accumulating retirement savings. Congress has adopted rules for defined contribution plans that:

- facilitate employer sponsorship of plans,
- encourage employee participation,
- promote prudent investing by plan participants,
- allow operation of plans at reasonable cost, and
- safeguard plan assets and participant interests through strict fiduciary obligations and intensive regulatory oversight.

While individuals have understandable retirement income concerns resulting from the recent market and economic downturns -- concerns fully shared by the American Benefits Council -- it is critical to acknowledge the vital role defined contribution plans play in building personal financial security.

Defined Contribution Plans Reach Tens of Millions of Workers and Provide an Important Source of Retirement Savings

Over the past three decades, 401(k) and other defined contribution plans have increased dramatically in number, asset value, and employee participation. As of June 30, 2008, defined contribution plans (including 401(k), 403(b) and 457 plans) held $4.3 trillion in assets, and assets in individual retirement accounts (a significant share of which is attributable to amounts rolled over from employer-sponsored retirement plans, including defined contribution plans) stood at $4.5 trillion.[1] Of course, assets have declined significantly since then due to the downturn in the financial markets. Assets in 401(k) plans are projected to have declined from $2.9 trillion on June 30, 2008 to $2.4

trillion on December 31, 2008,[2] and the average 401(k) account balance is down 27% in 2008 relative to 2007.[3] Nonetheless, 401(k) account balances are up 140% when compared to levels as of January 1, 2000.[4] Thus, even in the face of the recent downturn (which of course has also affected workers' non-retirement investments and home values), employees have seen a net increase in workplace retirement savings. This has been facilitated by our robust and expanding defined contribution plan system. As discussed more fully below, employees have also remained committed to this system despite the current market conditions, with the vast majority continuing to contribute to their plans.

In terms of the growth in plans and participating employees, the most recent statistics reveal that there are more than 630,000 defined contribution plans covering more than 75 million active and retired workers with more than 55 million current workers now participating in these plans.[5] Together with Social Security, defined contribution plan accumulations can enable retirees to replace a significant percentage of pre-retirement income (and many workers, of course, will also have income from defined benefit plans).[6]

Employers Make Significant Contributions Into Defined Contribution Plans
When discussing defined contribution plans, the focus is often solely on employee deferrals into 401(k) plans. However, contributions consist of more than employee deferrals. Employers make matching, non-elective, and profit-sharing contributions to defined contribution plans to complement employee deferrals and share with employees the responsibility for funding retirement. Indeed, a recent survey of 401(k) plan sponsors with more than 1,000 employees found that 98% make some form of employer contribution.[7] Another recent study of employers of all sizes indicated that 62% of defined contribution sponsors made matching contributions, 28% made both matching and profit-sharing contributions, and 5% made profit-sharing contributions only.[8] While certain employers have reduced or suspended matching contributions as a result of current economic conditions, the vast majority have not.[9] Those that have are often doing so as a direct result of substantially increased required contributions to their defined benefit plans or institution of a series of cost-cutting measures to preserve jobs. As intended, matching contributions play a strong role in encouraging employee participation in defined contribution plans.[10]

The Defined Contribution System is More Than 401(k) Plans
The defined contribution system also includes many individuals beyond those who participate in the 401(k) and other defined contribution plans offered by private-sector employers. More than 7 million employees of tax-exempt and educational institutions participate in 403(b) arrangements,[11] which held more than $700 billion in assets as of earlier this year.[12] Millions of employees of state and local governments participate in 457 plans, which held more than $160 billion in assets as of earlier this year.[13] Finally, 3.9 million individuals participate in the federal government's defined contribution plan (the Thrift Savings Plan), which held $226 billion in assets as of June 30, 2008.[14]

401(k) Plans Have Evolved in Ways That Benefit Workers

Even when focusing on 401(k) plans, it is important to keep in mind that these plans have evolved significantly from the bare-bones employee savings plans that came into being in the early 1980s. As discussed more fully below, employers have enhanced these arrangements in numerous ways, aiding their evolution into robust retirement plans. Congress has likewise enacted numerous enhancements to 401(k) plans, making major improvements to the 401(k) system in the Small Business Job Protection Act of 1996, the Taxpayer Relief Act of 1997, the Economic Growth and Tax Relief Reconciliation Act of 2001, and the Pension Protection Act of 2006. Among the many positive results have been incentives for plan creation, promotion of automatic enrollment, catch-up contributions for workers 50 and older, safe harbor 401(k) designs, accelerated vesting schedules, greater benefit portability, tax credits for retirement savings, and enhanced rights to diversify company stock contributions.

There also has been tremendous innovation in the 401(k) marketplace, with employer plan sponsors and plan service providers independently developing and adopting many features that have assisted employees. For example, both automatic enrollment and automatic contribution escalation were first developed in the private sector. Intense competition among service providers has helped spur this innovation and has driven down costs. Among the market innovations that have greatly enhanced defined contribution plans for participants are:

- on-line and telephonic access to participant accounts and plan services,
- extensive financial planning, investment education and investment advice offerings,
- single-fund investment solutions such as retirement target date funds and risk-based lifestyle funds, and
- in-plan annuity options and guaranteed withdrawal features that allow workers to replicate attributes of defined benefit plans.

These legislative changes and market innovations have resulted in more employers wanting to sponsor 401(k) plans and have -- together with employer enhancements to plan design -- improved both employee participation rates and employee outcomes.

Long-Term Retirement Plans Should Not Be Judged on Short-Term Market Conditions

Workers and retirees are naturally concerned about the impact of the recent market turmoil. It is important, however, for policymakers and participants to evaluate defined contribution plans based on whether they serve workers' retirement interests over the long term rather than over a period of months. Defined contribution plans and the investments they offer employees are designed to weather changes in economic conditions -- even conditions as anxiety-provoking as the ones we are experiencing today. (Market declines and volatility are, of course, affecting all types of retirement plans and investment vehicles, not just defined contribution plans.) Although it is difficult to predict short-run market returns, over the long run stock market returns are linked to the growth of the economy and this upward trend will aid 401(k) investors. Indeed, one of the benefits for employees of participating in a defined contribution plan through regular payroll deduction is that those who select equity vehicles purchase these investments at varying prices as markets rise and fall, achieving effective dollar cost averaging. If historical trends continue, defined contribution plan participants who remain in the system can expect their plan account balances to rebound and grow significantly over time.[15] That being said, the American Benefits Council favors development of policy ideas (and market innovations) to help those defined contribution plan participants nearing retirement improve their retirement security and generate adequate retirement income.

It is important to note that in the face of the current economic crisis and market decline, plan participants remain committed to retirement savings and few are reducing their contributions. Rather, the large majority of participants continue to contribute at significant rates and remain in appropriately diversified investments. One leading 401(k) provider saw only 2% of participants decrease contribution levels in October 2008 (1% actually increased contributions) despite the stock market decline and volatility experienced during that month.[16] Another leading provider found that 96% of 401(k) participants who contributed to plans in the third quarter of 2008 continued to contribute in the fourth quarter.[17] Research from the prior bear market confirms that employees tend to hold steady in the face of declining stock prices, remaining appropriately focused on their long-term retirement savings and investment goals.[18]

Demonstrating the importance of defined contribution plans to employees, a recent survey found that defined contribution plans are the second-most important benefit to employees behind health insurance.[19] The same survey found that 9% of employees viewed greater deferrals to their defined contribution plan as one of their top priorities for 2009.[20]

Defined Contribution Plan Coverage and Participation Rates Are Increasing
Participation in employer-sponsored defined contribution plans has grown from 11.5 million in 1975 to more than 75 million in 2005.[21] This substantial increase is a result of many more employers making defined contribution plans available to their workforces. Today, the vast majority of large employers offer a defined contribution plan,[22] and the number of small employers offering such plans to their employees has been increasing modestly as well.[23] In total, 65% of full-time employees in private industry had access to a defined contribution plan at work in 2008 (of which 78% participated).[24] Small businesses that do not offer a 401(k) or profit-sharing plan are increasingly offering workers a SIMPLE IRA, which provides both a saving opportunity and employer contributions.[25] Indeed, as of 2007, 2.2 million workers at eligible small businesses participated in a SIMPLE IRA.[26]

The rate of employee participation in defined contribution plans offered by employers also has increased modestly over time[27] – with further increases anticipated as a result of automatic enrollment adoption. Moreover, participating employees are generally saving at significant levels -- levels that have risen over time.[28] Younger workers, in particular, increasingly look to defined contribution plans as a primary source of retirement income.[29]

There are understandable economic impediments that keep some small employers, particularly the smallest firms, from offering plans. The uncertainty of revenues is the leading reason given by small businesses for not offering a plan, while cost, administrative challenges, and lack of employee demand are other impediments cited by small business.[30] Indeed, research reveals that employees at small companies place less priority on retirement benefits relative to salary than their counterparts at large companies.[31] As firms expand and grow, the likelihood that they will offer a retirement plan increases.[32] Congress can and should consider additional incentives and reforms to assist small businesses in offering retirement plans, but some small firms will simply not have the economic stability to do so. Mandates on small business to offer or contribute to plans will only serve to exacerbate the economic challenges they face, reducing the odds of success for the enterprise, hampering job creation and reducing wages.

Some have understandably focused on the number of Americans who do not currently have access to an employer-sponsored defined contribution plan. Certainly expanding plan coverage to more Americans is a universally shared goal. Yet statistics about retirement plan coverage rates must be viewed in the appropriate context. Statistics about the percentage of workers with access to an employer retirement plan provide only a snapshot of coverage at any one moment in time. Given job mobility and the fact that growing employers sometimes initiate plan sponsorship during an employee's tenure, a significantly higher percentage of workers have access to a plan for a substantial portion of their careers.[33] This coverage provides individuals with the opportunity to add defined contribution plan savings to other sources of retirement income. It is likewise important to note that individuals' savings behavior tends to evolve over the course of a working life. Younger workers typically earn less and therefore save less. What younger workers do save is often directed to non-retirement goals such as their own continuing education, the education of their children or the purchase of a home.[34] As they age and earn more, employees prioritize retirement savings and are increasingly likely to work for employers offering retirement plans.[35]

Defined Contribution Plan Rules Promote Benefit Fairness

The rules that Congress has established to govern the defined contribution plan system ensure that retirement benefits in these plans are delivered across all income groups. Indeed, the Internal Revenue Code contains a variety of rules to promote fairness regarding which employees are covered by a defined contribution plan and the contributions made to these plans. These requirements include coverage rules to ensure that a fair cross-section of employees (including sufficient numbers of non-highly compensated workers) are covered by the defined contribution plan and nondiscrimination rules to make certain that both voluntary employee contributions and employer contributions for non-highly compensated employees are being made at a rate that is not dissimilar to the rate for highly compensated workers.[36] There are also top-heavy rules that require minimum contributions to non-highly compensated employees' accounts when the plan delivers significant benefits to top employees.

Congress has also imposed various vesting requirements with respect to contributions made to defined contribution plans. These requirements specify the timetable by which employer contributions become the property of employees. Employees are always 100% vested in their own contributions, and employer contributions made to employee accounts must vest according to a specified schedule (either all at once after three years of service or in 20% increments between the second and sixth years of service).[37] In addition, the two 401(k) safe harbor designs that Congress has adopted -- the original safe harbor enacted in 1996 and the automatic enrollment safe harbor enacted in 2006 -- require vesting of employer contributions on an even more accelerated schedule.[38]

Employer Sponsorship of Defined Contribution Plans Offers Advantages to Employees

As plan sponsors, employers must adhere to strict fiduciary obligations established by Congress to protect the interests of plan participants. ERISA imposes, among other things, duties of prudence and loyalty upon plan fiduciaries. ERISA also requires that plan fiduciaries discharge their duties "solely in the interest of the participants and beneficiaries" and for the "exclusive purpose" of providing participants and beneficiaries with benefits.[39] These exceedingly demanding fiduciary obligations (which are enforced through both civil and criminal penalties) offer investor protections not typically associated with savings vehicles individuals might use outside the workplace.

One area in which employers exercise oversight is through selection and monitoring of the investment options made available in the plan. Through use of their often considerable bargaining power, employers select high-quality, reasonably-priced investment options and monitor these options on an ongoing basis to ensure they remain high-quality and reasonably-priced. Large plans also benefit from economies of scale that help to reduce costs. Illustrating the value of this employer involvement, the mutual funds that 401(k) participants invest in are, on average, of lower cost than those that retail investors use.[40] Recognizing these benefits, an increasing number of retirees are leaving their savings in defined contribution plans after retirement, managing their money using the plan's investment options and taking periodic distributions. With the investment oversight they bring to bear, employers are providing a valuable service that employees would not be able easily or inexpensively to replicate on their own outside the plan.

Employers also typically provide educational materials about retirement saving, investing and planning, and in many instances also provide access to investment advice services.[41] To supplement educational materials and on-line resources, well over half of 401(k) plan sponsors offer in-person seminars and workshops for employees to learn more about retirement investing, and more than 40% provide communications to employees that are targeted to the workers' individual situations.[42] Surveys reveal that a significant percentage of plan participants utilize employer-provided investment education and advice tools.[43] Although participants can obtain such information outside of the workplace, it can be costly or require significant effort to do so, yielding yet another advantage to participation in an employer-sponsored defined contribution plan.

Recent Enhancements to the Defined Contribution System Are Working

Recent legislative reforms are improving outcomes for defined contribution plan participants. The Pension Protection Act of 2006 ("PPA"), in particular, included several landmark changes to the defined contribution system that are already beginning to assist employees in their retirement savings efforts.

Employee participation rates are beginning to increase thanks to PPA's provisions encouraging the adoption of automatic enrollment. This plan design, under which workers must opt out of plan participation rather than opt in, has been demonstrated to increase participation rates significantly, helping to move toward the universal employee coverage typically associated with defined benefit plans.[44] And more employers are adopting this design in the wake of PPA, in numbers that are particularly notable given that the IRS's implementing regulations have not yet been finalized and the Department of Labor's regulations were not finalized until more than a year after PPA's enactment.[45] One leading defined contribution plan service provider saw a tripling in the number of its clients adopting automatic enrollment between year-end 2005 and year-end 2007,[46] and other industry surveys show a similarly rapid increase in adoption by employers.[47] Moreover, many employers that have not yet adopted automatic enrollment are seriously considering doing so.[48]

Employers are also beginning to increase the default savings rate at which workers are automatically enrolled,[49] which is important to ensuring that workers have saved enough to generate meaningful income in retirement. Studies show that automatic enrollment has a particularly notable impact on the participation rates of lower-income, younger, and minority workers because these groups are typically less likely to participate in a 401(k) plan where affirmative elections are required.[50] Thus, PPA's encouragement of auto enrollment is helping to improve retirement security for these often vulnerable groups.

PPA also encouraged the use of automatic escalation designs that automatically increase an employee's rate of savings into the plan over time, typically on a yearly basis. This approach is critical in helping workers save at levels sufficient to generate meaningful retirement income and can be useful in ensuring that employees save at the levels required to earn the full employer matching contribution.[51] Employers are increasingly adopting automatic escalation features.[52]

In PPA, Congress also directed the Department of Labor (DOL) to develop guidance providing for qualified default investment alternatives, or QDIAs -- investments into which employers could automatically enroll workers and receive a measure of fiduciary protection. QDIAs are diversified, professionally managed investment vehicles and can be retirement target date or life-cycle funds, managed account services or funds balanced between stocks and bonds. There has been widespread adoption of QDIAs by employers and this has helped improve the diversification of employee investments in 401(k) and other defined contribution plans.[53] Congress also directed DOL in PPA to reform the fiduciary standards governing selection of annuity distribution options for defined contribution plans, and the DOL has recently issued final regulations on this topic.[54] As a result, fiduciaries now have a clearer road map for the addition of an annuity payout option to their plan, which can give participants another tool for translating their retirement savings into lifelong retirement income.

Defined Contribution Plans Provide Employees with the Tools to Make Sound Investments

As a result of legislative reform and employer practices, employees in defined contribution plans have a robust set of tools to assist them in pursuing sound, diversified investment strategies. As noted above, employers provide educational materials on key investing principles such as asset classes and asset allocation, diversification, risk tolerance and time horizons. Employers also provide the opportunity for sound investing by selecting a menu of high-quality investments from diverse asset classes that, as discussed above, often reflect lower prices relative to retail investment options.[55] Moreover, the vast majority of employers operate their defined contribution plans pursuant to ERISA section 404(c),[56] which imposes a legal obligation to offer a "broad range of investment alternatives" including at least three options, each of which is diversified and has materially different risk and return characteristics.

The development and greater use by employers of investment options that in one menu choice provide a diversified, professionally managed asset mix that grows more conservative as workers age (retirement target date funds, life-cycle funds, managed account services) has been extremely significant and has helped employees seeking to maintain age-appropriate diversified investments.[57] As mentioned above, the use of such options has accelerated pursuant to the qualified default investment alternatives guidance issued under PPA.[58] These investment options typically retain some exposure to equities for workers as they approach retirement age. Given that many such workers are likely to live decades beyond retirement and through numerous economic cycles, some continued investment in stocks is desirable for most individuals in order to protect against inflation risk.[59]

One potential challenge when considering the diversification of employee defined contribution plan savings is the role of company stock. Traditionally, company stock has been a popular investment option in a number of defined contribution plans, and employers sometimes make matching contributions in the form of company stock. Congress and employers have responded to encourage diversification of company stock contributions. PPA contained provisions requiring defined contribution plans (other than employee stock ownership plans) to permit participants to immediately diversify their own employee contributions, and for those who have completed at least three years of service, to diversify employer contributions made in the form of company stock.[60] And today, fewer employers (23%) make their matching contributions in the form of company stock, down from 45% in 2001.[61] Moreover, more employers that do so are permitting employees to diversify these matching contributions immediately (67%), up from 24% that permitted such immediate diversification in 2004.[62]

The result has been greater diversification of 401(k) assets. In 2006, a total of 11.1% of all 401(k) assets were held in company stock.[63] This is a significant reduction from 1999, when 19.1% of all 401(k) assets were held in company stock.[64]

New Proposals for Early Access Would Upset the Balance Between Liquidity and Asset Preservation

The rules of the defined contribution system strike a balance between offering limited access to retirement savings and restricting such saving for retirement purposes. Some degree of access is necessary in order to encourage participation as certain workers would not contribute to a plan if they were unable under any circumstances (e.g., health emergency, higher education needs, first-home purchase) to access their savings prior to retirement.[65] Congress has recognized this relationship between some measure of liquidity and plan participation rates and has permitted pre-retirement access to plan savings in some circumstances. For example, the law permits employers to offer workers the ability to take loans from their plan accounts and/or receive so-called hardship distributions in times of pressing financial need.[66] However, a low percentage of plan participants actually use these provisions, and loans and hardship distributions do not appear to have increased markedly as a result of the current economic situation.[67] To prevent undue access, Congress has limited the circumstances in which employees may take pre-retirement distributions and has imposed a 10% penalty tax on most such distributions.[68]

In 2001, as part of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA), Congress took further steps to ease portability of defined contribution plan savings and combat leakage of retirement savings. EGTRRA required automatic rollovers into IRAs for forced distributions of balances of between $1,000 and $5,000 and allowed individuals to roll savings over between and among 401(k), 403(b), 457 and IRA arrangements at the time of job change.[69]

As a result of changes like these, leakage from the retirement system at the time of job change has been declining modestly over time – although leakage is certainly an issue worthy of additional attention.[70] Participants, particularly those at or near retirement, are generally quite responsible in handling the distributions they take from their plans when they leave a company, with the vast majority leaving their money in the plan, taking partial withdrawals, annuitizing the balance or reinvesting their lump sum distributions.[71] In sum, policymakers should acknowledge the careful balance between liquidity and preservation of assets and should be wary of proposals that would provide additional ways to tap into retirement savings early.

Defined Contribution Plan Savings is an Important Source of Investment Capital
The amounts held in defined contribution plans have an economic impact that extends well beyond the retirement security of the individual workers who save in these plans. Retirement plans held approximately $16.9 trillion in assets as of June 30, 2008.[72] As noted earlier, amounts in defined contribution plans accounted for approximately $4.3 trillion of this amount, and amounts in IRAs represented approximately $4.5 trillion (much of which is attributable to rollovers from employer-sponsored plans, including defined contribution plans).[73] Indeed, defined contribution plans and IRAs hold nearly 20% of corporate equities.[74] These trillions of dollars in assets, representing ownership of a significant share of the total pool of stocks and bonds, provide an important and ready source of investment capital for American businesses. This capital permits greater production of goods and services and makes possible additional productivity-enhancing investments. These investments thereby help companies grow, add jobs to their payrolls and raise employee wages.

Inquiries About Risk Are Appropriate But No Retirement Plan Design is Immune from Risk
The recent market downturn has generated reasonable inquiries about whether participants in defined contribution plans may be subject to undue investment risk. As noted above, the American Benefits Council favors development of policy proposals and market innovations that seek to address these concerns. Yet it is difficult to imagine any retirement plan design that does not have some kind or degree of risk. Defined benefit pensions, for example, are extremely valuable retirement plans that serve millions of Americans. However, employees may not stay with a firm long enough to accrue a meaningful benefit, benefits are often not portable, required contributions can impose financial burdens on employers that can constrain pay levels or job growth, and companies on occasion enter bankruptcy (in which case not all benefits may be guaranteed).

Some have suggested that a new federal governmental retirement system would be the best way to protect workers against risk. Certain of these proposals would promise governmentally guaranteed investment returns, which would entail a massive expansion of government and taxpayer liabilities at a time of already unprecedented federal budget deficits. Other proposals would establish governmental clearinghouses or agencies to oversee retirement plan investments and administration. Such approaches would likewise have significant costs to taxpayers and would unnecessarily and unwisely displace the activities of the private sector. Under these approaches, the federal government also would typically regulate the investment style and fee levels of retirement plan investments. These invasive proposals would constrain the investment choices and flexibility that defined contribution plan participants enjoy today and would establish the federal government as an unprecedented rate-setter for many retirement investments.

Rather than focusing on new governmental guarantees or systems, any efforts to mitigate risk should instead focus on refinements to the existing successful employer-sponsored retirement plan system and shoring up the Social Security safety net.

The Strong Defined Contribution System Can Still Be Improved
While today's defined contribution plan system is proving remarkably successful at assisting workers in achieving retirement security, refinements and improvements to the system can certainly be made. Helping workers to manage market risk and to translate their defined contribution plan savings into retirement income are areas that would benefit from additional policy deliberations. An additional area in which reform would be particularly constructive is increasing the number of Americans who have access to a defined contribution or other workplace retirement plan. The American Benefits Council will soon issue a set of policy recommendations as to how this goal of expanded coverage can be achieved. We believe coverage can best be expanded through adoption of a multi-faceted set of reforms that will build on the successful employer-sponsored retirement system and encourage more employers to facilitate workplace savings by their employees. This multi-faceted agenda will include improvements to the current rules governing defined contribution and defined benefit plans, expansion of default systems such as automatic enrollment and automatic escalation, new simplified retirement plan designs, expanded retirement tax incentives for individuals and employers, greater use of workplace IRA arrangements (such as SIMPLE IRAs and discretionary payroll deduction IRAs), more effective promotion of existing retirement plan options, and efforts to enhance Americans' financial literacy.

ENDNOTES

[1] Peter Brady & Sarah Holden, *The U.S. Retirement Market, Second Quarter 2008*, INVESTMENT COMPANY INST. FUNDAMENTALS 17, no. 3-Q2, Dec. 2008. This paper reveals that, as of June 30, 2008, total U.S. retirement accumulations were $16.9 trillion, a 13.4% increase over 2005 and a 59.4% increase over 2002. As noted above, these asset figures have decreased in light of recent market declines although assets held in defined contribution plans and individual retirement accounts still make up more than half of total U.S. retirement assets. *See* Brian Reid & Sarah Holden, *Retirement Saving in Wake of Financial Market Volatility*, INVESTMENT COMPANY INST., Dec. 2008.

[2] 2007 Account Balances: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project; 2008 Account Balances: Estimates from Jack VanDerhei, EBRI.

[3] Press Release, Fidelity Investments, Fidelity Reports on 2008 Trends in 401(k) Plans (Jan. 28, 2009).

[4] 1999 and 2006 Account Balances: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project; 2007 and 2008 Account Balances: Estimates from Jack VanDerhei, EBRI. The analysis is based on a consistent sample of 2.2 million participants with account balances at the end of each year from 1999 through 2006 and compares account balances on January 1, 2000 and November 26, 2008. *See also* Jack VanDerhei, Research Director, Employee Benefit Research Institute, What Is Left of Our Retirement Assets?, PowerPoint Presentation at Urban Institute (Feb. 3, 2009).

[5] According to the Department of Labor, there were 103,346 defined benefit plans and 207,748 defined contribution plans in 1975. In 2005, there were 47,614 defined benefit plans and 631,481 defined contribution plans. U.S. Department of Labor, Employee Benefits Security Administration, *Private Pension Plan Bulletin Historical Tables* (Feb. 2008). *See also* Sarah Holden, Peter Brady, & Michael Hadley, *401(k) Plans: A 25-Year Retrospective*, INVESTMENT COMPANY INST. PERSPECTIVE 12, no. 2, Nov. 2006.

[6] A joint ICI and EBRI study projected that 401(k) participants in their late 20s in 2000 who are continuously employed, continuously covered by a 401(k) plan, and earned historical financial market returns could replace significant amounts of their pre-retirement income (103% for the top income quartile; 85% for the lowest income quartile) with their 401(k) accumulations at retirement. Sarah Holden & Jack VanDerhei, *Can 401(k) Accumulations Generate Significant Income for Future Retirees?*, INVESTMENT COMPANY INST. PERSPECTIVE 8, no. 3, Nov. 2002.

[7] *Report on Retirement Plans – 2007*, Diversified Investment Advisors (Nov. 2007).

[8] *401(k) Benchmarking Survey – 2008 Edition*, Deloitte Consulting LLP (2008).

[9] In an October 2008 survey, only 2% of employers reported having reduced their 401(k)/403(b) matching contribution and only 4% said they planned to do so in the upcoming 12 months. WATSON WYATT WORLDWIDE, EFFECT OF THE ECONOMIC CRISIS ON HR PROGRAMS 4 (2008).

[10] According to one study, defined contribution plans with matching contributions have a participation rate of 73% compared with 44% for plans that do not offer matching contributions. *Retirement Plan Trends in Today's Healthcare Market – 2008*, American Hospital Association & Diversified Investment Advisors (2008). Some have wondered whether employers would reduce matching contributions as they adopt automatic enrollment since automatic enrollment is proving successful in raising participation rates. Current data suggest this is not occurring. For example, from 2005 to 2007 the number of Vanguard plans offering automatic enrollment tripled. During the same period, the percentage of Vanguard plans offering employer matching contributions increased by 4%. *How America Saves 2008: A Report on Vanguard 2007 Defined Contribution Plan Data*, The Vanguard Group, Inc. (2008); *How America Saves 2006: A Report on Vanguard 2005 Defined Contribution Plan Data*, The Vanguard Group, Inc. (2006).

[11] W. Scott Simon, *Fiduciary Focus*, Morningstar Advisor, Apr. 5, 2007.

[12] Brady & Holden (Dec. 2008), *supra* note 1.

[13] Brady & Holden (Dec. 2008), *supra* note 1.

[14] Gregory T. Long, Executive Dir., Fed. Ret. Thrift Inv. Fund, Statement Before the House Subcommittee on Federal Workforce, Postal Service, and the District of Columbia (July 10, 2008).

[15] The average 401(k) account balance increased at an annual rate of 8.7% from 1999 to 2006, despite the fact that this period included one of the worst bear markets since the Great Depression. Sarah Holden, Jack VanDerhei, Luis Alonso, & Craig Copeland, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2006*, INVESTMENT COMPANY INST. PERSPECTIVE 13, no. 1/EMPLOYEE BENEFIT RESEARCH INST. ISSUE BRIEF, no. 308, Aug. 2007.

[16] Jilian Mincer, *401(k) Plans Face Disparity Issue*, WALL ST. J., Nov. 6, 2008, at D9.

[17] Fidelity Investments (Jan. 28, 2009), *supra* note 3. *See also* Reid & Holden (Dec. 2008), *supra* note 1 (noting that only 3% of defined contribution plan participants ceased contributions in 2008); *The Principal Financial Well-Being Index Summary – Fourth Quarter 2008*, Principal Financial Group (2008) (finding that, in the six months leading up to its October 2008 survey, 11% of employees increased 401(k) contributions, while only 4% decreased contributions and only 1% ceased contributions entirely); *Retirement Outlook and Policy Priorities*, Transamerica Center for Retirement Studies (Oct. 2008) (finding that participation rates are holding steady among full-time workers who have access to a 401(k) or similar employer-sponsored plan, with 77% currently participating; 31% of participants have increased their contribution rates into their retirement plans in the last twelve months; only 11% have decreased their contribution rates or stopped contributing); Press Release, Hewitt Associates, Hewitt Data Shows Americans Continue to Save in 401(k) Plans Despite Economic Woes (Nov. 24, 2008) (finding, in a November analysis, that average savings rates in 401(k) plans have only dipped by 0.2%, from 8.0% in 2007 to 7.8% in 2008).

[18] *See* Sarah Holden & Jack VanDerhei, *Contribution Behavior of 401(k) Plan Participants During Bull and Bear Markets*, NAT'L TAX ASS'N 44 (2004) (citing a number of studies which indicate little variation in before-tax contributions and a slight decrease in employer contributions as a percentage of participant pay during the 1999-2002 bear market).

[19] Principal Financial Group (2008), *supra* note 17.

[20] *Id.*

[21] *Private Pension Plan Bulletin Historical Tables* (Feb. 2008), *supra* note 5.

[22] In 2007, 82% of employers with 500 or more employees offered 401(k) plans to their employees, and 19% of these employers offered a defined contribution plan other than a 401(k) plan to their employees. *9th Annual Retirement Survey*, Transamerica Center for Retirement Studies (2008).

[23] 59% of employers with between 10 and 499 employees offered their employees 401(k) plans in 2007, as compared with 56% in 2006. Transamerica Center for Retirement Studies (2008), *supra* note 22; *8th Annual Retirement Survey*, Transamerica Center for Retirement Studies (2007).

[24] U.S. DEP'T OF LABOR & U.S. BUREAU OF LABOR STATISTICS, BULL. NO. 2715, NATIONAL COMPENSATION SURVEY: EMPLOYEE BENEFITS IN THE UNITED STATES, MARCH 2008, tbl. 2 (Sept. 2008).

[25] As of December 2007, there were more than 500,000 SIMPLE IRAs. At the end of 2007, $61 billion was held in SIMPLE IRAs. *See* Brady & Holden (Dec. 2008), *supra* note 1; Peter Brady & Stephen Sigrist, *Who Gets Retirement Plans and Why*, INVESTMENT COMPANY INST. PERSPECTIVE 14, no. 2, Sept. 2008.

[26] Brady & Sigrist (Sept. 2008), *supra* note 25. *See also* U.S. DEP'T OF LABOR & U.S. BUREAU OF LABOR STATISTICS, BULL. NO. 2589, NATIONAL COMPENSATION SURVEY: EMPLOYEE BENEFITS IN PRIVATE INDUSTRY IN THE UNITED STATES, 2005 (May 2007) (indicating 8% of private-sector workers at eligible small businesses participated in a SIMPLE IRA).

[27] Among all full-time, full-year wage and salary workers ages 21 to 64, 55.3% participated in a retirement plan in 2007. This is up from approximately 53% in 2006. Craig Copeland, *Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2007*, EMPLOYEE BENEFIT RESEARCH INST. ISSUE BRIEF, no. 322, Oct. 2008 (examining the U.S. Census Bureau's March 2008 Current Population Survey). *See also* The Vanguard Group, Inc. (2008), *supra* note 10 (noting that, out of all employees in Vanguard-administered plans, 66% of eligible employees participated in their employer's defined contribution plan); *51st Annual Survey of Profit Sharing and 401(k) Plans*, Profit Sharing/401(k) Council of America (Sept. 2008) (noting that 81.9% of eligible employees currently have a balance in their 401(k) plans).

[28] Participants in plans administered by Vanguard saved 7.3% of income in their employer's defined contribution plan in 2007. The Vanguard Group, Inc. (2008), *supra* note 10. Among non-highly compensated employees, the level of pre-tax deferrals into 401(k) plans has risen from 4.2% of salary in 1991 to 5.6% in 2007. Profit Sharing/401(k) Council of America (Sept. 2008), *supra* note 27.

[29] *See* Transamerica Center for Retirement Studies (Oct. 2008), *supra* note 17 (finding that 35% of Echo Boomers, 34% of Generation X, 28% of Baby Boomers, and 7% of Matures consider employer-sponsored defined contribution plans as their primary source of retirement income).

[30] Jack VanDerhei, *Findings from the 2003 Small Employer Retirement Survey*, EMPLOYEE BENEFIT RESEARCH INST. ISSUE NOTES 24, no. 9, Sept. 2003.

[31] Both small employers and workers in small businesses consider salary to be a greater priority than retirement benefits, but the inverse is true for the majority of larger employers and workers in larger businesses. *See* Transamerica Center for Retirement Studies (2008), *supra* note 22 (finding that 56% of employees in larger businesses consider retirement benefits to be a greater priority, where 54% of employees in smaller companies rank salary as a priority over retirement benefits). *See also* Brady & Sigrist (Sept. 2008), *supra* note 25.

[32] For example, one survey found that more than half of small business respondents would be "much more likely" to consider offering a retirement plan if company profits increased. VanDerhei (Sept. 2003), *supra* note 30. *See also* Transamerica Center for Retirement Studies (2008), *supra* note 22 (finding that large companies are more likely than smaller companies to offer 401(k) plans (82% large, 59% small)).

[33] It should also be remembered that those without employer plan coverage may be building retirement savings through non-workplace tax-preferred vehicles such as individual retirement accounts or deferred annuities.

[34] *See* Brady & Sigrist (Sept. 2008), *supra* note 25.

[35] Based on an analysis of the Bureau of Labor Statistics' Current Population Survey, March Supplement (2007), of those most likely to want to save for retirement in a given year, almost 75% had access to a retirement plan through their employer or their spouse's employer, and 92% of those with access participated. Brady & Sigrist (Sept. 2008), *supra* note 25.

[36] Voluntary pre-tax and Roth after-tax contributions must satisfy the Actual Deferral Percentage test ("ADP test"). The ADP test compares the elective contributions made by highly compensated employees and non-highly compensated employees. Each eligible employee's elective contributions are expressed as a percentage of his or her compensation. The numbers are then averaged for (i) all eligible highly compensated employees, and (ii) all other eligible employees (each resulting in a number, an "average ADP"). The ADP test is satisfied if (i) the average ADP for the eligible highly compensated employees for a plan year is no greater than 125% of the average ADP for all other eligible employees in the preceding plan year, or (ii) the average ADP for the eligible highly compensated employees for a plan year does not exceed the average ADP for the other eligible employees in the preceding plan year by more than 2% <u>and</u> the average ADP for the eligible highly compensated employees for a plan year is not more than twice the average ADP for all other eligible employees in the preceding plan year. Treas. Reg. § 1.401(k)-2.

Employer matching contributions and employee after-tax contributions (other than Roth contributions) must satisfy the Actual Contribution Percentage test ("ACP test"). The ACP test compares the employee and matching contributions made by highly compensated employees and non-highly compensated employees. Each eligible employee's elective and matching contributions are expressed as a percentage of his or her compensation, and the resulting numbers are averaged for (i) all eligible highly compensated employees, and (ii) all other eligible employees (each resulting in a number, an "average ACP"). The ACP test utilizes the same percentage testing criteria as the ADP test. Treas. Reg. § 1.401(m)-2.

[37] A trust shall not constitute a qualified trust under 401(a) unless the plan of which such trust is a part satisfies the requirements of section 411 (relating to minimum vesting standards). *See* I.R.C. § 401(a)(7).

[38] *See* I.R.C. §§ 401(k)(12) and (13).

[39] ERISA § 404. I.R.C. § 401(a) also requires that a qualified trust be organized for the exclusive benefit of employees and their beneficiaries.

[40] Sarah Holden & Michael Hadley, *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2007*, INVESTMENT COMPANY INST. PERSPECTIVE 17, no. 5, Dec. 2008.

[41] *See* Transamerica Center for Retirement Studies (2008), *supra* note 22 (finding that, regardless of company size, almost two-thirds of employers offer investment guidance or advice as part of their retirement plan; of those who do not currently offer guidance or advice, 18% of large employers and 7% of small employers plan to offer advice in the future); Deloitte Consulting LLP (2008), *supra* note 8 (51% of 401(k) sponsors surveyed offer employees access to individualized financial counseling or investment advice services (whether paid for by employees or by the employer)); *Trends and Experience in 401(k) Plans 2007 – Survey Highlights*, Hewitt Associates LLC (June 2008) (40% of employers offer outside investment advisory services to employees).

[42] Profit Sharing/401(k) Council of America (Sept. 2008), *supra* note 27.

[43] 46% of plan participants consulted materials, tools, or services provided by their employers. John Sabelhaus, Michael Bogdan, & Sarah Holden, *Defined Contribution Plan Distribution Choices at Retirement: A Survey of Employees Retiring Between 2002 and 2007*, INVESTMENT COMPANY INST. RESEARCH SERIES, Fall 2008.

[44] *See, e.g., Measuring the Effectiveness of Automatic Enrollment*, Vanguard Center for Retirement Research (Dec. 2007) (stating that "[a]n analysis of about 50 plans adopting automatic enrollment confirms that the feature does improve participation rates, particularly among low-income and younger employees"); Deloitte Consulting LLP (2008), *supra* note 8 (stating that "[a] full 82% of survey respondents reported that auto-enrollment had increased participation rates"); *Building Futures Volume VIII: A Report on Corporate Defined Contribution Plans*, Fidelity Investments (2007) (stating that in 2006 overall participation rates were 28% higher for automatic enrollment-eligible employees than for eligible employees in plans that did not offer automatic enrollment; overall, automatic enrollment eligible employees had an average participation rate of 81%).

[45] A recently-surveyed panel of experts expects automatic enrollment to be offered in 73% of defined contribution plans by 2013. *Prescience 2013: Expert Opinions on the Future of Retirement Plans*, Diversified Investment Advisors (Nov. 2008).

[46] *See* The Vanguard Group, Inc. (2008), *supra* note 10.

[47] *See* Deloitte Consulting LLP (2008), *supra* note 8 (42% of surveyed employers have an automatic enrollment feature compared with 23% in last survey); Hewitt Associates LLC (June 2008), *supra* note 41 (34% of surveyed employers have an automatic enrollment feature compared with 19% in 2005); Profit Sharing/401(k) Council of America (Sept. 2008), *supra* note 27 (more than half of large plans use automatic enrollment and usage by small plans has doubled).

[48] *See* Deloitte Consulting LLP (2008), *supra* note 8 (stating that 26% of respondents reported they are considering adding an auto-enrollment feature).

[49] One leading provider has noted an upward shift since 2005 in the percentage of sponsors that use a default deferral rate of 3% or higher, and a corresponding decrease in the percentage of sponsors that use a default deferral rate of 1% or 2%. The Vanguard Group, Inc. (2008), *supra* note 10.

[50] *See, e.g.*, Copeland (Oct. 2008), *supra* note 27 (noting that Hispanic workers were significantly less likely than both black and white workers to participate in a retirement plan); Jack VanDerhei & Craig Copeland, *The Impact of PPA on Retirement Savings for 401(k) Participants*, EMPLOYEE BENEFIT RESEARCH INST. ISSUE BRIEF, no. 318 (June 2008) (noting that industry studies have shown relatively low participation rates among young and low-income workers); Fidelity Investments (2007), *supra* note 44 (stating that, in 2006, among employees earning less than $20,000, the participation boost from automatic enrollment was approximately 50%); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-8, PRIVATE PENSIONS: LOW DEFINED CONTRIBUTION PLAN SAVINGS MAY POSE CHALLENGES TO RETIREMENT SECURITY, ESPECIALLY FOR MANY

LOW-INCOME WORKERS (Nov. 2007); Daniel Sorid, *Employers Discover a Troubling Racial Split in 401(k) Plans*, WASH. POST, Oct. 14, 2007, at F6.

[51] *See* Fidelity Investments (2007), *supra* note 44 (noting that, in 2006, the average deferral rate for participants in automatic escalation programs was 8.3%, as compared to 7.1% in 2005).

[52] *See* The Vanguard Group, Inc. (2008), *supra* note 10 (post-PPA, two-thirds of Vanguard's automatic enrollment plans implemented automatic annual savings increases, compared with one-third of its plans in 2005); Hewitt Associates LLC (June 2008), *supra* note 41 (35% of employers offer automatic contribution escalation, compared with 9% of employers in 2005); Transamerica Center for Retirement Studies (2008), *supra* note 22 (26% of employers with automatic enrollment automatically increase the contribution rate based on their employees' anniversary date of hire).

[53] A leading provider states that "QDIA investments are often more broadly diversified than portfolios constructed by participants. Increased reliance on QDIA investments should enhance portfolio diversification." The Vanguard Group, Inc. (2008), *supra* note 10. *See also* Fidelity Investments (2007), *supra* note 44 (where a lifecycle fund was the plan default option, overall participant asset allocation to that option was 19.4% in 2006; where the lifecycle fund was offered but not as the default option, overall participant asset allocation to that option was only 9.8%).

[54] Selection of Annuity Providers: Safe Harbor for Individual Account Plans, 73 Fed. Reg. 58,447 (Oct. 7, 2008) (to be codified at 29 C.F.R. pt. 2550).

[55] *See* Holden & Hadley (Dec. 2008), *supra* note 40.

[56] One survey found that 92% of companies surveyed stated that their plan is intended to comply with ERISA section 404(c). Deloitte Consulting LLP (2008), *supra* note 8.

[57] In 2006, the percentage of single investment option holders who invested in lifecycle funds – "blended" investment options – was 24%. 42% of plan participants invested some portion of their assets in lifecycle funds. The average number of investment options held by participants was 3.8 options in 2006. Fidelity Investments (2007), *supra* note 44.

[58] In 2007, 77% of employers offered lifecycle funds as an investment option, compared with 63% in 2005. Hewitt Associates LLC (June 2008), *supra* note 41. *See also* Fidelity Investments (2007), *supra* note 44 (noting that, in 2006, 19% of participant assets were invested in a lifecycle fund in plans that offered the lifecycle fund as the default investment option, compared with 10% of participant assets in plans that did not offer the lifecycle fund as the default investment option).

[59] *See Target-Date Funds: Still the Right Rationale for Investors*, The Vanguard Group, Inc. (Nov. 28, 2008) (noting that "even investors entering and in retirement need a significant equity allocation" and citing the 17- to 20-year life expectancy for retirees who are age 65). *See also* Fidelity Investments (2007), *supra* note 44 ("In general . . . the average percentage of assets invested in equities decreased appropriately with age . . . to a low of 45% for those in their 70s.").

[60] I.R.C. § 401(a)(35); ERISA § 204(j).

[61] Hewitt Associates LLC (June 2008), *supra* note 41.

[62] Hewitt Associates LLC (June 2008), *supra* note 41.

[63] Holden, VanDerhei, Alonso, & Copeland (Aug. 2007), *supra* note 15. *See also* Fidelity Investments (Jan. 28, 2009), *supra* note 3 (noting that, at year-end 2008, company stock made up approximately 10% of Fidelity's overall assets in workplace savings accounts, compared with 20% in early 2000).

[64] Holden, VanDerhei, Alonso, & Copeland (Aug. 2007), *supra* note 15. *See also* William J. Wiatrowski, *401(k) Plans Move Away from Employer Stock as an Investment Vehicle*, MONTHLY LAB. REV., Nov. 2008, at 3, 6 (stating that (i) in 2005, 23% of 401(k) participants permitted to choose their investments could pick company stock as an investment option for their employee contributions, compared to 63% in 1985, and (ii) in 2005, 14% of 401(k) participants permitted to choose their investments could pick company stock as an investment option for employer matching contributions, compared to 29% in 1985).

[65] *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO/HEHS-98-2, 401(K) PENSION PLANS: LOAN PROVISIONS ENHANCE PARTICIPATION BUT MAY AFFECT INCOME SECURITY FOR SOME (Oct. 1997) (noting that plans that allow borrowing tend to have a somewhat higher proportion of employees participating than other plans).

[66] *See* I.R.C. §§ 72(p) and 401(k)(2)(B).

[67] *See, e.g.*, Reid & Holden (Dec. 2008), *supra* note 1 (stating that, in 2008, 1.2% of defined contribution plan participants took a hardship withdrawal and 15% had a loan outstanding); Fidelity Investments (Jan. 28, 2009), *supra* note 3 (noting that only 2.2% of its participant base initiated a loan during the fourth quarter of 2008, compared with 2.8% during the fourth quarter of 2007, and 0.7% of its participant base took a hardship distribution during the fourth quarter of 2008, compared with 0.6% during the fourth quarter of 2007); Holden, VanDerhei, Alonso, & Copeland (Aug. 2007), *supra* note 15 (noting that most eligible participants do not take loans); Fidelity Investments (2007), *supra* note 44 (noting that only 20% of active participants had one or more loans outstanding at the end of 2006). Most participants who take loans repay them. *See* Transamerica Center for Retirement Studies (2008), *supra* note 22 (only 18% of participants have loans outstanding, and almost all participants repay their loans).

[68] I.R.C. § 72(t).

[69] *See* I.R.C. § 402(c)(4).

[70] In 2007, among participants eligible for a distribution due to a separation of service, 70% chose to preserve their retirement savings by rolling assets to an IRA or by remaining in their former employer's plan, compared with only 60% in 2001. The Vanguard Group, Inc. (2008), *supra* note 10; *How America Saves 2002: A Report on Vanguard Defined Contribution Plans*, The Vanguard Group, Inc. (2002).

[71] *See* Sabelhaus, Bogdan, & Holden (Fall 2008), *supra* note 43 (stating that retirees make prudent choices at retirement regarding their defined contribution plan balances: 18% annuitized their entire balance, 6% elected to receive installment payments, 16% deferred distribution of their entire balance, 34% took a lump sum and reinvested the entire amount, 11% took a lump sum and reinvested part of the amount, 7% took a lump sum and spent all of the amount, and 9% elected multiple dispositions; additionally, only about 3% of accumulated defined contribution account assets were spent immediately at retirement).

[72] Brady & Holden (Dec. 2008), *supra* note 1.

[73] *Id.* It is highly doubtful that Americans would have saved at these levels in the absence of defined contribution plans given the powerful combination of pre-tax treatment, payroll deduction, automatic enrollment and matching contributions.

[74] *See* BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, FEDERAL RESERVE STATISTICAL RELEASE Z.1, FLOW OF FUNDS ACCOUNTS OF THE UNITED STATES (December 11, 2008); Brady & Holden (Dec. 2008), *supra* note 1.

Target Date Funds—a good idea co-opted

Comments submitted by Joseph C. Nagengast, Target Date Analytics LLC

Terminology:

Target Date Funds are also sometimes called LifeCycle Funds. They are intended to be comprehensive investment solutions rather than single asset-class funds; such as a large cap growth fund or a high yield bond fund.

Target date funds ("Tdfs") use a broad range of **asset classes** in an **asset-allocation portfolio** and adjust the mix of assets over time.

Asset allocation is simply the process of assigning a portion of the portfolio's assets to different asset classes; for example: 25% domestic equities (stocks); 15% foreign equities; 40% mid-term bonds; and 20% treasury bills.

Asset classes are those categories (and others) just mentioned, such as domestic equities, foreign equities, real estate, commodities, domestic bonds, foreign bonds, etc.

Asset Allocation funds have been around for a long time. They include such strategies as **balanced funds** (a set mix of stocks, bonds and cash) and **risk-based funds** (balanced funds with varying degrees of inherent portfolio risk) such as conservative, moderate aggressive funds.

Risky asset and reserve asset The principles of modern portfolio theory call for building portfolios out of a mix of a **Risky Asset** (with high potential performance and corresponding high risk) and a **Reserve Asset** (with relatively low earnings and risk characteristics. As commonly practiced, these two broad asset classes are often interpreted to be Stocks (risky) and Bonds (less risky) although that is not quite accurate.

What makes target date funds different from other asset allocation strategies is the use of a **Glidepath.**

A **glidepath** is quite simply the line, as it changes over time, between the risky asset and the reserve asset. (See Figure 1, Glidepath illustration)

Accumulation Phase is the part of an investor's lifecycle (this term actually has a long-accepted economic meaning quite separate from its use as a label for tdfs) during which investors set aside money for their retirement. During this phase, cash flows are predominantly positive; that is, contributions are going in, (except for occasional loans and hardship withdrawals) and very little dollars are coming out. This will be seen to have important implications for the design of the glidepath.

Decumulaton (distribution) Phase is the period beginning concurrent with retirement or shortly thereafter when investors begin drawing down their accumulated savings to fund their retirement. Note that current law requires minimum withdrawals begin at age 70 ½. This also has important implications for the glidepath design.

Background: a brief history of target date funds

(See figure 2 for an illustration of the growth of target date mutual funds.)

The first tdfs were designed in response to one of the most persistent problems plaguing 401(k) plan sponsors (the employer) and service providers; that is, with the investment responsibility now in the hands of each participant, it was clear that the challenge was greater than the average skills of plan participants. Those in the retirement plan business began to acknowledge that participant education efforts were never going to make every participant into an expert investor, and they began to distinguish "do-it-myself" participants from "do-it-for-me" participants. Target date funds were specifically designed for this latter type of participant, those who preferred to have someone do it for them.

Wells Fargo and Barclays Global Investors, working together at the time, rolled out the first target date funds in March 1994. Their strategy was to get the investor safely to the target date and at that point to fold the dated fund into their Income fund (known there as "Today"). The LifePath 2000 Fund was "folded into" the Today fund in the year 2000. They didn't introduce their mid-decade funds (2015, 2025) until after 2005 so we didn't see a 2005 fund folding in at its target date.

Later in that decade and in the next, Fidelity, T. Rowe Price, Principal and Vanguard got into target date investing and began promoting them more heavily. The numbers of dollars pouring into target date strategies swelled when the ranks of former do-it-myself investor gave up and became do-it-for-me investors following three rough years in the market, 2000—2002.

When plan sponsors and participants really started adopting tdfs in big, meaningful numbers (2002—2007), the race was on for performance numbers.

Where the train went off the track

The way to win the short term performance horse race (and the resulting market share) was through higher equity allocations. Each of the major fund families found justifications for 1) increasing the equity allocations across the glide path, and 2) extending the glidepath from the target date out to some imagined date based on life expectancy. Some extend their glidepath as much as thirty years beyond the target date.

We suspect that investors in 2010 funds believe that date in the name of the fund is significant to the design of the fund, but in these extended glidepath funds that date has no significance to the design of the fund. Rather the point at which the glidepath finally ends is the significant date. If the fund managers are going to continue this risky practice, at the very least they should be required to re-label their funds. 2040 would be a more appropriate and transparent name for the fund in the example above.

These two changes correspond to the two biggest contributors to risk in tdfs are 1) the amount of equity in the fund, and 2) the design of the glidepath. Remember, the glidepath is merely the dynamic aspect of the asset allocation.

There is some theoretical rationale for employing a glidepath throughout the accumulation phase. No credible rationale has ever been proffered for using a glide path in the distribution phase.

This is what drove the majority of target date funds so far off course and caused the unacceptably large losses to 2010 funds in 2008. The problem arises from fund managers attempting to use the key engine of target date funds, the glidepath, for purposes other than its primary function—getting investors safely to their target date with their accumulated contributions plus inflation, intact. When the glidepath is enlisted to perform other functions, its ability to achieve its primary function is degraded. (See "What Target Date Funds Can Do.doc")

In popular discourse, the cause for the unacceptable and very great losses in short-dated funds, is also attributed to the dominance of all -proprietary funds in the underlying investments and to the lack of alternative investments such as commodities and TIPS in the portfolios. It is true that these two factors contribute to poor performance but their impact on overall performance is much less than the two primary causes, 1) excessive equity-laden portfolios close to and beyond the target date, and 2) glide paths which ignore the target date.

Both of these flaws stem from misunderstanding or misappropriating the purpose of target date funds as we discussed above. These excessive losses weren't necessary. Please see "Dec 2008 OTI Defensive.pdf" and "OTI Performance Report 12312008.pdf."

Recommendations

We at Target Date Analytics LLC are very much in favor of target date investing. Tdfs can be an enormous boon to the investment needs of defined contribution participants. Properly designed and managed they will stand participants very well as they accumulate and prepare to spend down their retirement nest egg. We urge the Senate to do nothing that would stop the adoption of target date funds in qualified retirement plans. At the same time, we think there are legitimate areas for improvement, improvements that may not be effected by market forces alone. These include the following:

- The name of each fund must bear some relationship to the way the fund is managed, that is, its glidepath. As in the example above, if a fund labeled 2010 is actually targeted to "land' at 2040, it should be re-labeled as a 2040 fund.
- In turn, the glidepath must be designed to provide for a predominance of asset preservation as the target nears and arrives.
- Prospectuses should be clear about the objectives of the funds—specifically, no circular definitions of fund objective should be allowed. Language describing the objective of a fund as dependent on its allocation should not be permitted. The objective is properly dependent on the fund's allocation; not the other way around.

Target Date Analytics LLC is an independent registered investment advisor, dedicated to the analysis of target date funds. We develop and maintain target date indexes for accurate benchmarking and for licensing purposes. For more information, go to: www.tdbench.com.

PLANSPONSOR ON TARGET INDEX

Built and maintained by Target Date Analytics LLC

www.TDBench.com

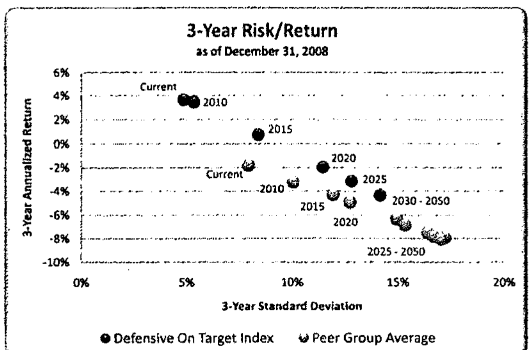
See next page for Important Notes

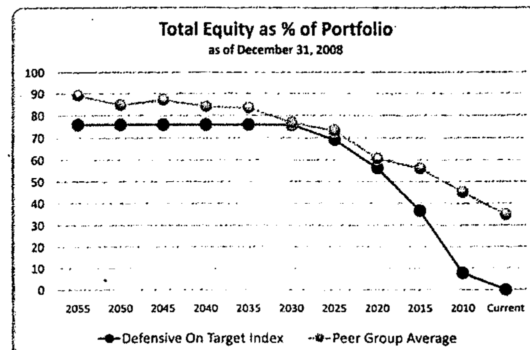
DEFENSIVE MODEL

Performance as of December 31, 2008

Target Fund Peer Group (as of 12/31/2008)

PLANSPONSOR ON TARGET DEFENSIVE MODEL	TOTAL RETURN 4th Quarter	1 Month	3 Month	YTD	12 Months	3 Year	5 Year	10 Year	[illegible]	[illegible]	(as of Dec 31, 2008) Total % Equity Allocation	Peer Group 3-Year Return	[illegible]	(as of Dec 31, 2008) Average % Equity Allocation
Current	-1.98%	3.18%	-1.98%	-0.37%	-0.37%	3.63%	3.87%	5.50%	4.88%	4.27%	0.0	-1.83%	7.96%	34.9
2010	-3.90%	3.40%	-3.90%	-4.68%	-4.68%	3.45%	4.89%	5.11%	5.37%	4.85%	7.8	-3.26%	10.06%	45.1
2015	-9.01%	4.08%	-9.01%	-13.98%	-13.98%	0.75%	3.87%	4.37%	8.42%	7.32%	36.7	-4.33%	11.97%	56.0
2020	-14.12%	4.76%	-14.12%	-23.28%	-23.28%	-1.95%	2.85%	3.63%	11.48%	9.79%	56.3	-4.94%	12.76%	60.7
2025	-16.13%	5.03%	-16.13%	-26.58%	-26.58%	-3.14%	2.25%	3.34%	12.83%	10.85%	69.2	-6.37%	14.97%	73.3
2030	-18.14%	5.31%	-18.14%	-29.89%	-29.89%	-4.34%	1.66%	3.05%	14.18%	11.92%	76.0	-6.87%	15.36%	76.8
2035	-18.14%	5.31%	-18.14%	-29.89%	-29.89%	-4.34%	1.66%	3.05%	14.18%	11.92%	76.0	-7.54%	16.42%	83.5
2040	-18.14%	5.31%	-18.14%	-29.89%	-29.89%	-4.34%	1.66%	3.05%	14.18%	11.92%	76.0	-7.86%	16.70%	84.2
2045	-18.14%	5.31%	-18.14%	-29.89%	-29.89%	-4.34%	1.66%	3.05%	14.18%	11.92%	76.0	-7.96%	17.24%	87.1
2050	-18.14%	5.31%	-18.14%	-29.89%	-29.89%	-4.34%	1.66%	3.05%	14.18%	11.92%	76.0	-8.07%	17.05%	84.7
2055	-18.14%	5.31%	-18.14%	-29.89%	-29.89%	-4.34%	1.66%	3.05%	14.18%	11.92%	76.0	N/A	N/A	89.3





IMPORTANT NOTES

Information about the Data and Figures Displayed in This Document

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Total Return and Average Total Return for the PLANSPONSOR On Target Indexes were calculated by using the widely reported returns of the underlying indexes and funds which constitute the OTI. The glide path and allocation model for the OTI do not change with market fluctuations thus providing additional support for the use of back-tested returns. Nevertheless, the decisions made by Target Date Analytics LLC with regard to the models are not necessarily the same decisions they would have made at the theoretical inception of the Indexes, ten years prior.

All of the underlying funds which constitute the PLANSPONSOR On Target Indexes are commercially available investment funds. The returns for the OTI reflect the full cost of the underlying funds which constitute the OTI. That is, the reported returns are net of all expenses of the underlying funds.

Total Return and Average Total Return for the non-TDA commercially available target date fund products in this report were obtained from Morningstar Principia® as of the date indicated in the report. Morningstar makes every effort to ensure accuracy of this data but cannot guarantee completeness and accuracy. Target Date Analytics LLC has no affiliation with any of the funds reported by Morningstar® and no affiliation with Morningstar®.

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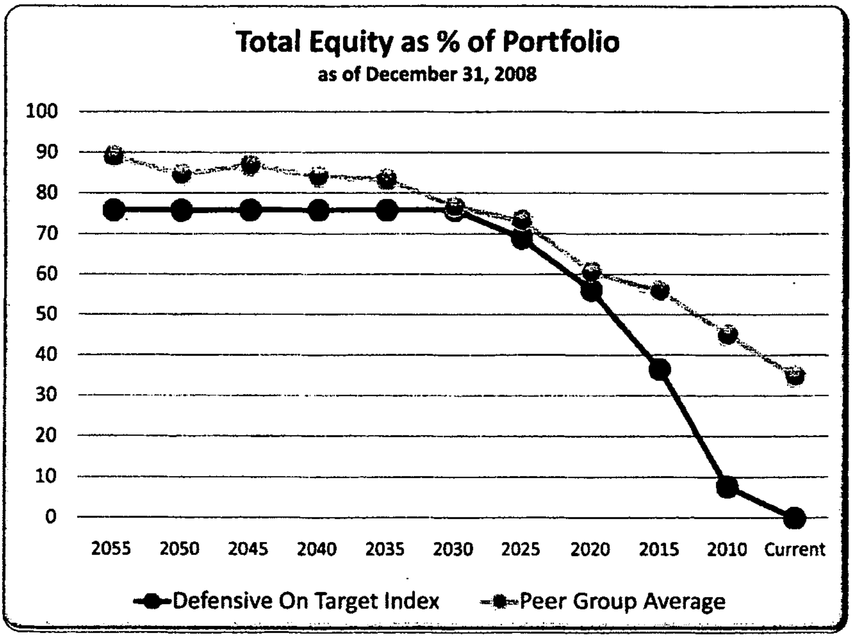
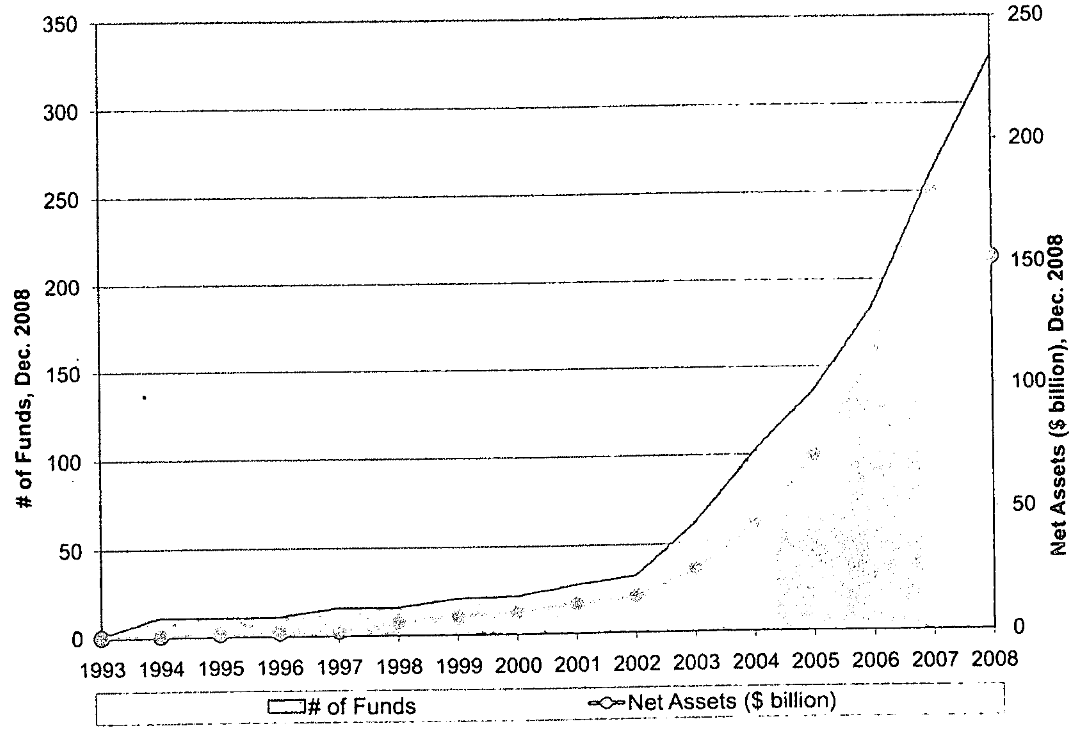


Total Equity as % of Portfolio
as of December 31, 2008
100
90
80
70
60
50
40
30
20
10
0
2055
2050
2045
2040
2035
2030
2025
2020
2015
2010
Current
Defensive On Target Index
Peer Group Average

Growth in Target Date Funds: # & $

12/31/2008

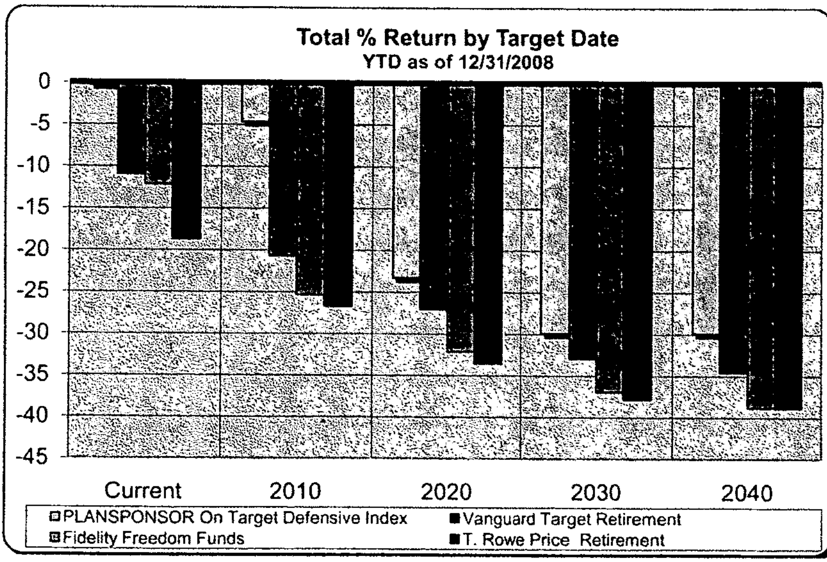


PLANSPONSOR On Target® Defensive Index (OTI)

Year-to-Date PERFORMANCE REPORT*
(as of December 31, 2008)

One-Year Total Percentage Return January 1, 2008 – December 31, 2008

Target Date	PLANSPONSOR On Target Defensive Index	Vanguard Target Retirement	Fidelity Freedom Funds	T. Rowe Price Retirement
Current	(0.37)	(10.93)	(12.14)	(18.69)
2010	(4.68)	(20.67)	(25.32)	(26.71)
2020	(23.28)	(27.04)	(32.12)	(33.48)
2030	(29.89)	(32.91)	(36.93)	(37.79)
2040	(29.89)	(34.53)	(38.80)	(38.85)



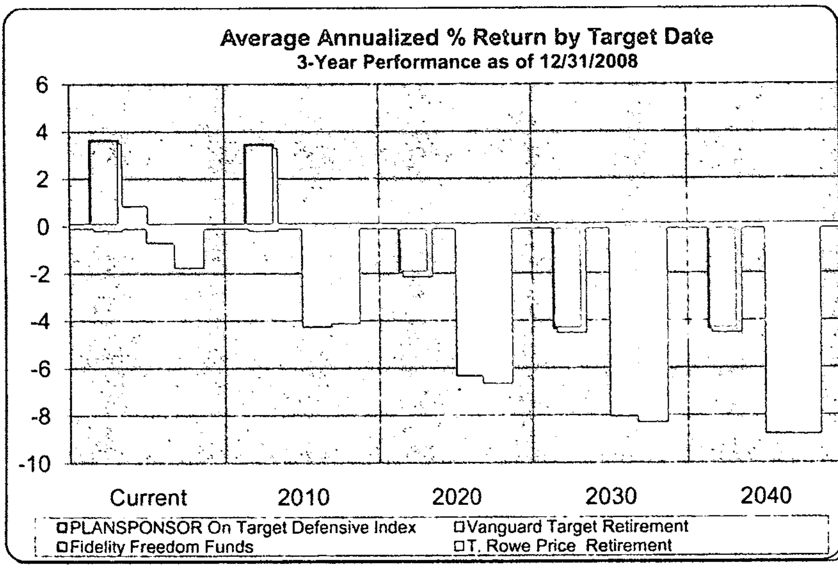
*See IMPORTANT NOTES section of this document.

PLANSPONSOR On Target® Defensive Index (OTI)

3-Year PERFORMANCE REPORT*
(as of December 31, 2008)

3-Year Average Annualized Percentage Return January 1, 2006 – December 31, 2008

Target Date	PLANSPONSOR On Target Defensive Index	Vanguard Target Retirement	Fidelity Freedom Funds	T. Rowe Price Retirement
Current	3.63	0.82	(0.68)	(1.74)
2010	3.45	-	(4.24)	(4.10)
2020	(1.95)	-	(6.32)	(6.63)
2030	(4.34)	-	(8.03)	(8.27)
2040	(4.34)	-	(8.77)	(8.78)



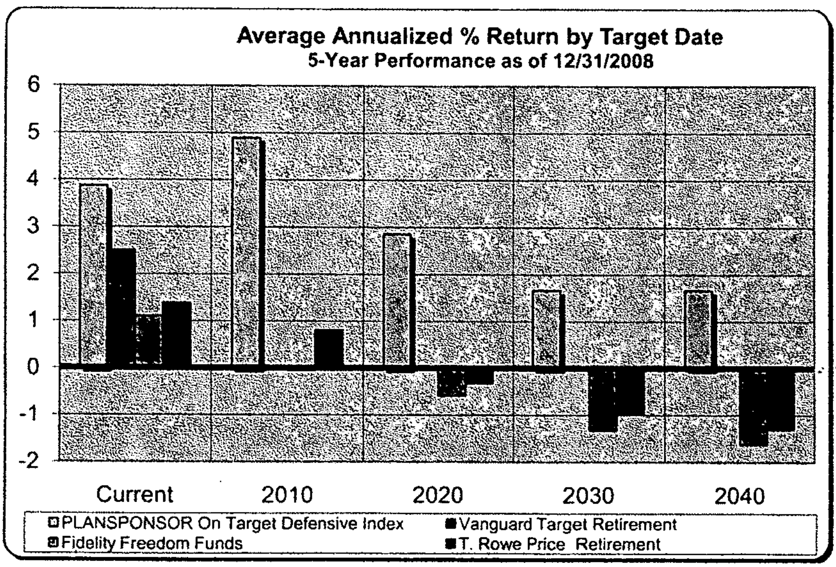
*See IMPORTANT NOTES section of this document.

PLANSPONSOR On Target® Defensive Index (OTI)

5-Year PERFORMANCE REPORT*
(as of December 31, 2008)

5-Year Average Annualized Percentage Return January 1, 2004 – December 31, 2008

Target Date	PLANSPONSOR On Target Defensive Index	Vanguard Target Retirement	Fidelity Freedom Funds	T. Rowe Price Retirement
Current	3.87	2.50	1.10	1.38
2010	4.89	-	(0.05)	0.81
2020	2.85	-	(0.59)	(0.32)
2030	1.66	-	(1.32)	(0.97)
2040	1.66	-	(1.62)	(1.30)



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TDA
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Selecting a target date fund family is an important but complex decision that is best made by matching the objectives of the fund family to those of the plan's participants. Several such objectives have been suggested but only one set stands out as universal and practical: (1) The floor objective (high likelihood) is to deliver at target date accumulated contributions intact plus inflation, and (2) A target objective (reasonable likelihood) is to grow assets as much as possible without jeopardizing the floor objective. For reasons described in the article attempts to achieve other objectives jeopardize the attainment of these universal objectives. These alternative objectives include:

- *Make up for inadequate savings*
- *Overcome "longevity risk"*
- *Guarantee returns*
- *Guarantee income*
- *Provide adequate retirement income*
- *Adjust for individual human capital differences*

What Target Date Funds Can Do... and what they can't

At the core of the target date concept is the glide path; which is nothing more than an asset allocation strategy that changes over time. The glide path itself is the line marking the difference between the risky asset and the reserve asset, as it changes over time. It is important to understand what a glide path strategy can do and what it cannot do.

Throughout the eighties, nineties and well into the first decade of this millennium, we, in the retirement plan and investment businesses, worried aloud and often about participants' poor investment decisions. Aside from inadequate deferral rates, the biggest issues were inadequate diversification, inappropriate risk profiles and failure to adjust over time.

The simple genius of a glide path solves each one of those problems. They can efficiently deliver time-based portfolio management—allocation and rebalancing services—to millions of Americans saving for retirement. Target date funds offer a substantial improvement over the current investment portfolios of most participants in DC plans, who previously had been left to compete as amateurs in a professional arena.

Why a glidepath?

Imagine a twenty-year old participant, at the start of her investment life-cycle. Assuming she will retire at age seventy, this participant has fifty years to put aside money for retirement, fifty years to manage or delegate an investment strategy that will get her safely to her retirement date with her contributions intact, plus whatever growth can be managed without jeopardizing the protective goal. Now allow us the liberty of letting this investor represent virtually all twenty-year olds in the work force, dependent on what they put aside, employer contributions, if any, and the rate of growth for the financial success of their retirement. We can aggregate most participants this way, based on their age, because the one factor we know about all of them is their age, and *we can assume they all have approximately the same number of years until retirement. Moreover, to improve the model, we allow participants to choose which target date they want to aim for.*

In the early years, our cohort of twenty-year old participant investors can take a swing-for-the-fences approach. They don't need to worry about too much about short-term losses, or short-term variability. They have small account balances and so even large percentage losses translate to small dollar losses. Their own contributions can quickly replace short term losses, and if anyone enjoys the benefits of long-term reversion to mean forces to help restore their account balances, they do.

In the later years, as the target date nears, we assume their account balances have grown geometrically, and as a result even small percentage losses can mean very large, unacceptable dollar losses. Moreover, when the target date is near, the probability that reversion-to-mean will restore any sustained losses is greatly reduced. Finally, participants near their target date can't hope to make up for losses by contributing more; that power too has been eroded by the passage of time.

To adjust the balance between asset growth and principle protection over time the investment glidepath was developed—allow for more growth (and volatility) in the early years and then begin reducing that exposure to risk over time according to a strategic plan—the glidepath.

There it is. That's the basic rationale for employing a glidepath.

Given the above, we can posit a working definition of the primary objective of target date funds. That primary objective might be stated as follows, "Manage the portfolios of all participants over their saving life cycle so that they arrive at the target date with their total contributions intact, plus inflation." In addition, to the extent we don't jeopardize this primary, or floor objective, we can add a secondary, target, or 'stretch' objective, "To the extent the primary objective is not sacrificed, the fund will attempt to achieve growth of assets."

We don't suggest that the above language will be suitable for every situation. However, we do believe that these two objectives, along with their priority ordering could serve as a guideline or starting point for most target date fund objectives.

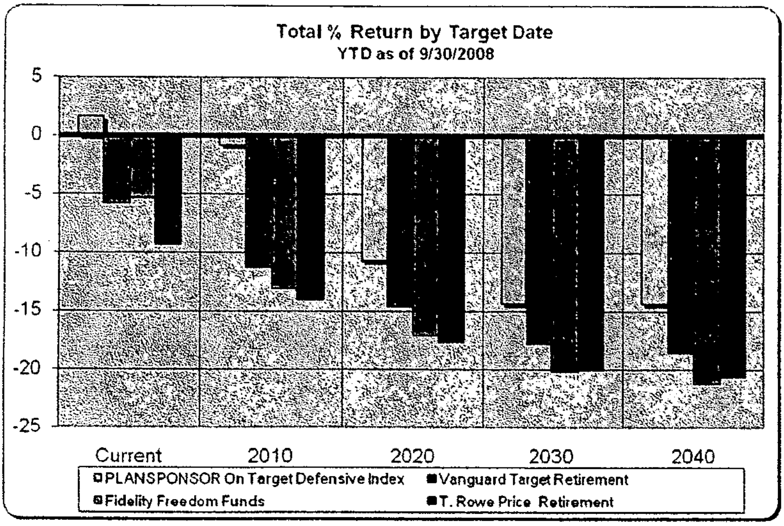
But as the target date arena gets more competitive, and providers seek ways to differentiate themselves from the pack, the competitive positioning may be taking its toll. Coming to market with a difference may make for a compelling ad campaign, but if the difference is more gimmick than substance, worse yet if the distinction of a new fund family is its ability to provide a non-core benefit, the ability of the glide path to deliver on its core promise will likely be compromised. Said another way, if the glide path is pressed into service for other missions it may lose its ability to deliver on its core mission.

Here's a list of objectives that many target date funds attempt to achieve, but which can only be attempted by sacrificing the fundamental glide path proposition—the primary objective. If these goals could be achieved without sacrificing the primary goal of target date funds, we would indeed live in the best of all possible worlds. Unfortunately, we still live in a financial world in which increased returns come at the cost of increased risk. Plan sponsors should be aware that each of these ancillary objectives comes at a cost.

- Make up for inadequate savings
- Overcome "longevity risk"
- Guarantee returns
- Guarantee income
- Provide adequate retirement income
- Adjust for individual human capital differences

Let's take a look at each of these non-primary objectives and see how they jeopardize the core, or primary objective of target date funds.

Make up for inadequate savings
This is an admirable goal, but it is also naïve. It has been said, you can't solve a savings problem with an investment solution. Why? Because in attempting to do so, you not only fail to solve the savings problem, you also must put at serious risk, the already inadequate portfolio of savings. Remember the simple risk/return dynamic Taking more risk means incurring increased chance of loss. This is true in the long term and the short term but it is most painfully true in the short term. Consider this year, in which some 2010 funds have lost over 14% of their value between January 1 and September 30, 2008.



Overcome "longevity risk"
This goal has lots of 'street appeal.' It is sometimes stated as the risk of outliving your money. But it muddles the carefully defined roster of investment risks (market risk, financial risk, interest

rate risk, enterprise risk, liquidity risk, counterparty risk, economic risk, etc.) by pandering to investor fears that they may not have enough money to last their lifetimes. Do investment management companies list "longevity risk" in their prospectuses along with these well-defined investment risks? Of course not, because it is not an investment risk at all. Living a long time is generally considered to be a good thing. Longevity is not the risk. The risk comes from not having enough money to last as long as your do. The only real way to make sure your money will last is to have so much you can self-insure, or to pool your assets and your risk with others in insurance contracts.

Guarantee returns
The only ways to "guarantee" returns are to invest in a no-risk portfolio, which by definition will not provide enough returns to keep pace with inflation, or to purchase an annuity. Scores of academics and professional researchers are involved in the task of developing combinations of insurance and portfolio-based strategies designed to provide investors with a comfortable level of returns without giving up so much in cost that the game is not worth the candle. If the solution were as simple as increasing the amount of equity in a portfolio the discussion would have been over long ago.

Guarantee income
Again, the only guarantees in finance come from insurance, either self-insuring, which in this case means you don't need it, or through a contract with an insurance company, which, for an individual terminating defined contribution participant, means no purchasing power. The argument that you can assure an investor of income through portfolio construction, always seems to hinge on the requirement that the participant hold a lot of equities when he or she can least afford losses, at or near the beginning of the withdrawal period. And these strategies are not guarantees, although from the materials and the presentations one would think that the results are certain.

Provide adequate retirement income
This objective is really a combination of "make up for inadequate savings" and "guarantee income," and the objections to it are the objections already raised for those two distracting objectives. Clearly, in this country we are facing a problem of insufficient retirement income, but the solutions proposed in the construction of target date portfolios won't provide the answer. They will only serve to disable the one thing target date funds can do, provide suitable portfolio management over the accumulation phase.
Moreover, attempting to provide retirement income for participants by extending the glidepath past the target date reveals a fundamental misunderstanding of the purpose for a glide path. While we can provide a rationale for utilizing a glidepath in the accumulation phase, no one to date has offered a rationale that can connect a glide path to the recurring, regular withdrawal of assets from a portfolio.
We may yet get to a national solution for ensuring that every person entering retirement has adequate income, but asking a glidepath to carry that load is surely not the answer. Every day I see people riding their bikes past my office to the beach, but they're usually smart enough to get off once they get to the sand. What worked on the road doesn't work in the sand and surf.

Adjust for individual human capital differences
This is a particularly baffling development. Target date funds employ a glide path to make one very big, and very useful assumption, that most participants with the same number of years until their retirement date, can be efficiently aggregated into pools of investors with the same broad characteristics that change in the same way over time. Admittedly, this is an imperfect strategy, but its imperfections are easily overweighed by the great efficiency and utility it brings to large

numbers of investors. Many young investors have too little financial assets to be able to afford personal financial planning assistance. As their assets grow, over time, with the efficient use of a glide path and age aggregation, the investors will reach the position wherein they can and should be able to benefit from more personalized investment strategies. Until then, attempts to undo the aggregation feature of the glidepath will be counterproductive.

Concluding Remarks

In selecting a suite of target date funds, plan sponsors need to keep their eye on the ball; that is, the primary objective of target date funds. Unfortunately, competition for plan assets has led providers to offer target date structures that focus on other objectives. These offerings have appeal because they appear to solve additional problems; however, those objectives jeopardize the attainment of the primary objective and for that reason they should be avoided. Providers and plan sponsors need to come back to the basics. Then we can get on to the other problems facing plan participants, inadequate savings and security of retirement income.

BY A THREAD
REPORT #4

LIVING LONGER ON LESS: THE NEW ECONOMIC (IN)SECURITY OF SENIORS

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The multi-factor approach to measuring economic security applied in this report builds on previous work on middle class economic security published by IASP and Dēmos.

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About the Institute on Assets and Social Policy

The Institute on Assets and Social Policy (IASP), a research institute at the Heller School for Social Policy and Management at Brandeis University, is dedicated to the economic well-being and social mobility of individuals and families, particularly those traditionally left out of the economic mainstream. Working in close partnership with state and federal policy makers, constituencies, grassroots advocates, private philanthropies, and the media, IASP bridges the worlds of academic research, government policy-making, and the interests of organizations and constituencies. IASP works to strengthen the leadership of policy makers, practitioners, and others by linking the intellectual and program components of asset-building policies.

Thomas M. Shapiro, Director

Tatjana Meschede, Research Director

INSTITUTE ON ASSETS
& SOCIAL POLICY

About Dēmos

Dēmos is a non-partisan public policy research and advocacy organization. Headquartered in New York City, Dēmos works with advocates and policymakers around the country in pursuit of four overarching goals: a more equitable economy; a vibrant and inclusive democracy; an empowered public sector that works for the common good; and responsible U.S. engagement in an interdependent world.

The Economic Opportunity Program addresses the economic insecurity and inequality that characterize American society today. The program offers fresh analysis and bold policy ideas to provide new opportunities for low-income individuals, young adults and financially-strapped families to achieve economic security.

Dēmos was founded in 2000.

Miles S. Rapoport, President
Tamara Draut, Vice President for Policy and Programs, Director of the Economic Opportunity Program

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Executive Summary

A just society treats seniors with dignity, respecting their purpose, independence, and contributions. Promoting lifelong sustainable well-being for seniors benefits all citizens and strengthens the nation. This report examines the long-term economic security of seniors, depicts current trends and suggests policies promoting the enduring well-being of seniors.

Security for seniors was built on the three-legged stool of retirement (Social Security, pensions, and savings) at the core of the social contract that rewards a lifetime of productivity. Economic security of seniors, however, is being challenged by two simultaneously occurring trends: a weakening of the three legs of retirement security income and dramatically increasing expenses, such as for healthcare and housing. These fundamental changes in the lives of older Americans make it not only more difficult for seniors to enter retirement with economic security but also to remain economically secure throughout retirement.

In light of these altering conditions, this report assesses how the social contract is holding up into the Twenty-First Century. Using national data[1] for seniors age 65 or above, we created the Senior Economic Security Index (SESI) to measure the long-term economic security of senior households throughout their retirement years. The fundamental components that frame economic stability for older Americans in the SESI are Housing Costs, Healthcare Expenses, Household Budget, Home Equity, and Household Assets. These factors are critical because:

- Research documents that the largest living expenses for older Americans are housing and health expenses.
- Household budgets measure the capacity of senior households for meeting annual essential expenses.
- Research points to home equity as the largest source of wealth for all US citizens and in particular for older Americans.
- Financial household assets establish long-term stability.

The Senior Economic Security Index finds that 78 percent of all senior households are financially vulnerable. That is, close to four of five senior households do not have sufficient economic security to sustain them through their lives. This risk is especially pronounced for single senior households—with 84 percent among them facing financial insecurity.

The data used in this report do not reflect the housing and stock market meltdowns and economic recession of 2008. This changing economic environment accentuates the challenges facing seniors today and highlights the importance of a comprehensive assessment of security. The SESI provides a benchmark of the economic life prospects of older Americans and underscores areas of strength and vulnerability that public policy can address.

SOURCES OF ECONOMIC RISK

- More than half of all senior households (54 percent) do not have sufficient financial resources to meet median projected expenses based on their current financial net worth, projected Social Security, and pension incomes.

- Single seniors face an even more troublesome situation. Fifty-seven percent among them are at risk of financial crisis based on their projected assets. Forty-nine percent of senior couples face the same risk.

- Only one third of seniors (31 percent) have household budgets that allow for additional savings for larger and unforeseen expenses, and another third have no additional funds after paying for essential expenses.

- Paying out-of-pocket health expenses, including costs for additional insurance coverage, is burdensome for four out of ten senior households. With increased healthcare needs associated with older age, as well as cuts in medical provisions, these expenses will eat up an increasingly larger share of fixed budgets in senior households in the future.

- High housing costs put forty-five percent of all seniors' budgets at risk. Single seniors face even more pronounced challenges with more than half (55 percent) at risk with respect to their monthly housing expenses.

- Overall, more than half of all senior households are secure with respect to home equity due to the large number of homeowners among them, especially among senior couples. Single seniors are much more vulnerable in this area with three out of ten either not owning their home or holding a low amount of home equity.

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FIVE FACTORS OF THE SENIOR ECONOMIC SECURITY INDEX (SEE ALSO TABLE 1 ON PAGE 8):

- Housing Costs: Households with housing expenses exceeding 30 percent of household income are economically at risk, and those who spend 20 percent or less are secure.

- Healthcare Expenses: Households who spend 15 percent or more for healthcare are economically at risk, and those who spend 10 percent or less are secure.

- Household Budgets: Budgets that are negative after expenditures for essential expenses pose a risk to economic security, and households with annual additional funds of $10,000 or more, after essential expenses, are secure.

- Home Equity: Households who rent their home, and therefore do not have any home equity, are at risk, and households with home equity of $75,000 or more, are economically secure.

- Household Assets: Project the amount of resources based on the three legs of retirement security income over the expected lifespan for each household and deduct from it estimated median expenses over the life course. Asset risk is evident when this amount is negative, and asset security is set at $50,000 for single seniors, and $75,000 for couples.

SESI: Asset security (or risk) plus security (or risk) on at least two additional factors.

LIVING LONGER ON LESS

The current generation of Americans age 65 or older is better prepared for retirement than subsequent generations will be, primarily due to declining employer-based retirement savings and rising debt of younger families. Even with current trends that include dramatic cuts in defined benefit pension provisions, persistent increases in healthcare costs, increasing debt for seniors, the current housing crisis, and sharp declines in the stock market, today's senior citizens represent a best case scenario of senior economic security for the foreseeable future.

Our recommendations therefore focus on policies that impact households at different life stages in their retirement planning. Thus, while we report on the economic security status of older Americans, this work helps to identify retirement-related vulnerabilities for younger families and policy interventions designed to ensure their economic security in retirement.

POLICIES TO REBUILD THE FOUNDATION OF SENIOR ECONOMIC SECURITY

In order to rebuild the foundations of the social contract that promotes retirement security, policy approaches need to focus on income provisions and expense controls for seniors. Our policy recommendations on the income side of senior economic security include:

- ***Strengthen Social Security,*** especially for vulnerable groups. Not only does Social Security need to remain a secure source of financial support for all retirees, it should be strengthened for beneficiaries, particularly to ensure that those with lifetime employment in low wage work receive economically sustainable benefits. Strengthening the special minimum benefit to assure above poverty benefit levels is one example of a first step to achieve this goal.

- ***Strengthen Pension Provisions.*** With increasingly reduced worker access to pension plans and a marked shift from defined benefit to defined contribution plans, this leg of retirement security no longer holds its weight. Pension provisions need to be rebuilt by providing incentives for employer-based access to pensions and government interventions that secure the stability of existing pension benefits.

- ***Expand Asset Building Opportunities for all Households Throughout the Life Course,*** including access to, and automatic enrollment in, defined contribution pension plans, financial education, adequate income opportunities, matched savings accounts for those with lower incomes, and protection of assets (mostly housing wealth).

- ***Provide Employment Flexibility*** for seniors who desire and are able to remain in the work force. Examples include flextime and bundled work days; amount of time spent working, including job-sharing options; and career flexibility with various points of entry, exit, reentry over a working career. When, where, and how to work, as well as what to receive for working are key to flexible work arrangements providing a better institutional fit for older workers and their continued productive employment.

Policy recommendations addressing the expense side of retirement security encompass:

- ***Address the Medicare Crisis*** as part of the larger national healthcare crisis. Healthcare costs, especially Medicare expenses, consume a prominent and growing proportion of the national budget. The need for building a more cost effective and equitable healthcare system can no longer be ignored. Without attention to healthcare access and affordability, progress in all other areas of retirement security will be negated.

- ***Institute a Universal Long-Term Care Public Insurance Program*** to protect against the cost of long-term care, as done in other countries, to mitigate economic risks associated with ill-health and long-term care needs.

Future retirees will be worse off, unless we attend to policies that grow and stabilize their resources for the future, and attend to the rising costs for seniors. Policymakers have an opportunity to reaffirm their commitment to ensure that elders have the resources to live without fear of poverty. Building on past commitments to our elders, we must strive to construct a new retirement security system of the Twenty-First Century that meets the needs of our diverse and aging population.

Introduction

The social contract for seniors in the Twentieth Century was based on the assumption that years of work should be rewarded with a retirement characterized by economic security. With the incorporation of Social Security, and newer programs such as Medicare, our society has continuously seen the contract grow and adapt to changing times. Promoting lifelong sustainable well-being for seniors benefits not only them but is a broader family policy for all citizens, thus strengthening the nation's stability. This report examines the long-term economic security of older Americans, depicts current trends, and suggests policies promoting long-term senior well-being.

The traditional conception of senior economic security builds on income support from three complementary sources: Social Security, pensions, and savings. Often referred to as the three-legged stool of retirement security, seniors have relied on income from these three sources as part of the social contract that rewards a lifetime of productivity with security, dignity, and respect in older age.

Economic security of seniors is being challenged by two simultaneously occurring trends: a weakening of the three legs of retirement security and dramatically increasing expenses, such as for healthcare and housing. These fundamental changes in the lives of older Americans make it more difficult for seniors to enter retirement with economic security as well as to remain economically secure throughout retirement.

Seniors are living longer than ever before, an average of 18 years after they reach age 65. This means that they need sufficient income and assets to meet essential needs, to be able to spend a modest amount above essential expenses, to manage unexpected costs such as healthcare expenditures or long-term care expenses, and to pass anything along to help children or grandchildren get a good start in life. These shifting realities also mean that many opt for working longer, if they have the opportunity to do so.

At a time when the economic resources of seniors must last more years, there is a dramatic shift in employer-provided pensions. Employer-based retirement coverage is declining, as employers continue to cut back costs among those who have employer-based pensions.[2] Even when private pensions are available to workers, they are increasingly less secure with the ongoing shift from defined-benefit to defined-contribution pensions. The current economic crisis clearly reveals the vulnerability of pensions.

In 1980, among private employees with pensions, the vast majority (83 percent) had defined-benefit pensions, which provide a guaranteed monthly income to retirees upon retirement. Workers with defined-contribution plans, however, have no such guarantee since the value of their retirement accounts may fluctuate due to changes in the value of their investments. By 2004, 89 percent of private workers with pensions had defined-contribution plans, while just 39 percent of workers had defined benefit plans.[3]

With the decline of guaranteed pension incomes for older Americans, more and more face economic uncertainty during their retirement years. Many employers are also cutting back on health benefits for retirees either by cutting them entirely, reducing covered benefits, shifting health insurance costs to current employees and retirees, or increasing out of pocket medical expenses. The proportion of companies who offer health coverage for retirees has declined from 66 percent in 1988 to 33 percent in 2007.[4]

The retirement and health systems that older Americans rely on, Social Security and Medicare, are becoming stretched by expanding numbers of beneficiaries. As baby boomers retire, there will be fewer workers paying Social Security taxes to support a growing number of retirees eligible for benefits. Medicare costs continue to rise much faster than inflation, the result of rapidly rising overall healthcare costs. Because today's retired workers, particularly blue collar workers, are more likely to have healthcare coverage and pension income under an employer-based retirement plan, the current generation of retirees is in a very real sense the best prepared generation for retirement that we will see for decades to come.

Subsequent generations will face even more severe challenges. From this perspective, this study of the economic security of seniors in 2004 paints a highly optimistic picture of the economic prospects that workers who are not yet 65 will face when they retire—if current trends in pensions and health coverage are not reversed.

The impact of the current housing crisis which has reduced the asset holdings of many households, and thereby reduced the largest asset of most retired households, will be seen many years down the road. An indication of the impending crisis is that the number of older Americans who are filing for bankruptcy has now reached record levels.[5] The 2008 recession bodes a more uncertain future.

This report examines the economic security of senior households with members age 65 and above. While Social Security and Medicare have been successful in reducing abject poverty among seniors by providing a stable minimal source of income and health coverage for almost all people 65 and older, significant pockets of economic insecurity persist for many older Americans.

These economic challenges are immediately in front of the nation. Within the context of Social Security, Medicare, and the U.S. economy, this report provides evidence in three key areas:

- Description of the economic status of older Americans: Are senior households able to maintain economic well-being above the income poverty line to ensure long-term economic security; and how many are holding on by a thread, having difficulty even meeting essential needs?
- Analysis: Why are some seniors economically secure while others are vulnerable and living by a thread?
- Policies: Are there areas that can be strengthened through public policies to ensure the economic security of seniors?

SUBSEQUENT GENERATIONS WILL FACE EVEN MORE SEVERE CHALLENGES...IF CURRENT TRENDS IN PENSIONS AND HEALTH COVERAGE ARE NOT REVERSED.

Measuring Senior Economic Security

The Senior Economic Security Index (SESI) measures the economic capacity of older Americans over their lifetime. This approach differs from previous methods of measuring senior economic security. Traditionally senior economic security has been measured in relation to the prevailing federal poverty line. The poverty line is a snapshot in time that gauges the capacity for annual income to provide basics needed for minimal well-being. The life course approach of the SESI moves the discussion to a more policy-relevant conversation about the capacity of older Americans to sustain an adequate level of economic well-being throughout every stage of their life.

SESI offers a framework to assess the strengths and vulnerabilities of economic security among older Americans—and, importantly, helps to identify policy areas to strengthen well-being. In developing this concept, we identified essential factors for economic security and well-being, and set common-sense and research-tested thresholds while creating an index anchored to a single, easily understood and interpreted metric.[6]

The traditional view of retirement security focuses on three complementary income sources to cover living costs during retirement. These are Social Security, pensions, and savings.

The SESI examines these resources but widens its lens to encompass other factors affecting economic stability and vulnerability:[7] Housing Costs, Healthcare Expenses, Household Budgets, Home Equity, and Household Assets.

These five factors were selected for the following reasons:

- A body of research documents that largest living expenses for older Americans are housing and health expenses.
- Household budgets are important because they measure the capacity of senior households to meet annual essential expenses.
- Research points to home equity as the largest source of wealth for all U.S. citizens and in particular for older Americans.
- Financial assets establish long-term stability.

Our understanding of senior economic stability has come a long way. Previous efforts to examine senior economic security have focused on the self-sufficiency capacities of older Americans for short periods, typically regionally determined living expenses for one year. The Elder Economic Security Standard[8] provides a benchmark for the capacity of seniors to meet a realistic level of basic expenses. The National Retirement Risk Index uses replacement rates comparing pre and post retirement consumption to assess whether assets and savings would support proportionate consumption levels during retirement.[9]

The SESI extends this line of research by delivering a policy-relevant marker with significant implications for revitalizing America's social contract. By building financial assets and housing wealth into a longer-term, economic security calculation, SESI provides a benchmark of the life prospects of older Americans that underscores areas of strength and vulnerability that public policy can address.

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The Senior Economic Security Index (SESI)

The five components that comprise the Senior Economic Security Index (SESI) include measures for housing, health security, family budgets, home ownership and equity, and asset security. We used the 2004 Consumer Expenditure Survey to build this Index.[10] The Consumer Expenditure Survey contains detailed information on household budgets as well as income and assets and other critical elements comprising the SESI. In the analyses we include households in which all members are age 65 or older, excluding single seniors that live in multi-generational households. The data also do not contain information of elders in long-term care institutions.[11]

Below we outline the rationale for each of the factors measured by the SESI on a spectrum from economic security to risk.

TABLE 1: ECONOMIC SECURITY AND RISK THRESHOLDS FOR EACH FACTOR

Factor	Standard for Senior Economic Security	Risk to Senior Economic Security
Housing	Housing consumes 20 percent or LESS of income	Housing consumes 30 percent or MORE of income
Health	Medical expenses, including supplemental health insurance, LESS THAN 10 percent of total before tax income	Medical expenses, including supplemental health insurance, 15 percent or MORE of total before tax income
Budget	$10,000 or MORE after annual essential expenses	Risk when budget at zero or negative after essential expenses
Home Equity	Home equity of $75,000 or above	Renter/no home equity
Assets	Net financial assets plus Social Security/pension income MINUS median expenses over life expectancy GREATER or EQUAL to $50,000 for single seniors, $75,000 for senior couples.	Net financial assets plus Social Security/pension income MINUS median expenses over life expectancy EQUAL to zero or less.
SESI	*Asset secure PLUS security in at least two[12] other factors*	*Asset fragile PLUS fragility in at least two other factors*

HOUSING SECURITY AND RISK FOR OLDER AMERICANS

Housing costs are the largest expense, not only of seniors but for all U.S. households. The Department of Housing and Urban Development (HUD) has set guidelines that declare housing expenses at 30 percent or more of income as a financial burden. We adopt this standard for senior households. Senior households spending 30 or more percent of their total income on housing are at increased economic risk, as defined in the SESI, whereas senior households spending 20 or less percent of their income on housing are housing secure.

HEALTH SECURITY AND RISK FOR OLDER AMERICANS

Rising medical expenses, chronic conditions that need medical attention, and anxiety regarding unforeseen medical issues are challenges for most senior households. Indeed, healthcare needs and healthcare costs rise considerably for older Americans. The SESI health factor measures out-of-pocket medical expenses in relation to income. Although formally insured through Medicare, more and more healthcare needs and expenses that used to be covered now fall onto private family budgets. These out-of-pocket medical expenses include expenditures for supplemental health insurance, medical services and supplies, and prescription drugs.

For the purpose of the SESI, a senior household is considered secure when the household spends less than 10 percent of its income on medical costs, the threshold used for assessing underinsurance in prior research.[13] By contrast, median health expenses for working age families amount to two to four percent of family income. A senior household is at risk when the household's medical expense-to-income ratio is 15 percent or higher.[14]

BUDGET SECURITY AND RISK FOR OLDER AMERICANS

Most seniors rely on fixed incomes. As a result, their budgets have a smaller cushion than many younger households. In the SESI, we calculate the household's total income and deduct its essential expenses, which include expenditures for housing, food, clothing, transportation, healthcare, personal care, education, and personal insurance.

We assess a senior household's annual budget as secure when it has a cushion of $10,000 after essential expenditures. A cushion of $10,000 provides a basis for common but non-essential expenses, and savings to meet unexpected expenses. Such unexpected expenses might include home repair, new appliances, car repair, and higher out-of-pocket essential expenses such as medical costs in case of illness, or large increases in the price of necessities such as heating fuel, gas, or medicine. The marker for budget security thus is a scant $833 per month for a quality of life beyond basic necessities and a minimal safety net. A senior household is clearly at risk when it spends more than comes in, leaving the household with no additional resources to cover expenses that are not essential. 9

HOMEOWNERSHIP AND HOME EQUITY OF OLDER AMERICANS

Homeownership provides a backbone of economic security for older Americans, both for those who own their home with a mortgage and those who have paid off their mortgage. Typically, homeownership allows for stable and relatively fixed costs, as well as a potential source of equity. Especially if the home was purchased a long time ago and/or if the mortgage is paid off, housing costs may have been locked in at comparatively low rates.

Owning a home by itself does not provide more economic security. Equally important is the amount of home equity senior households hold as home equity is the largest asset for most senior households. It is the asset that many plan to use for assisted living or nursing home expenses. At age 65, a person has a 25 percent chance of entering a nursing home. At age 85, the majority of older Americans have long-term care needs. In 2005, the average annual cost of a private room in a nursing home was over $74,000—ranging from a low of $42,000 to a high of $194,000[15]. Average monthly assisted living expenses are estimated to range from $2,100-$2,900 (not including application fees) with a large range among the different types of such communities.

Based on this information, we set the security threshold for the home equity factor at $75,000 which would provide for just over two years in an average priced assisted living community or one year at a nursing home. Senior households are at risk on this factor if they do not own a home and therefore have no home equity. This is a conservative approach to setting economic security as most seniors require more than one or two years of long-term care.

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ASSET SECURITY AND RISK FOR OLDER AMERICANS

Do older Americans have sufficient financial assets to support a moderate lifestyle during their remaining years of life (as projected by actuarial estimates)? Our asset calculation includes all financial assets such as savings, stocks, bonds and equity in real estate other than one's own home. In addition to these financial assets, we include the projected income for Social Security, pension and other retirement income over the expected life span for each household (for couples based on the age of the head of household). Home equity is not included in the asset measure because homeownership and home equity are a separate factor of the index. Further, we do not want to incorporate an assumption that families must sell their homes to provide for essential living expenses.

We used median total expenses for single seniors and senior couples as the measure of what seniors need to support themselves over their remaining years, thus defining a basic standard of living across income groups.[16] After deducting the total sum of median expense estimates for all of the projected remaining years of life from each household's asset estimates, we set the thresholds for asset security and risk as follows. Asset security for senior households requires $50,000 for individuals and $75,000[17] for couples for long-range economic security. Equivalent to about three years of expenses for these households, these amounts could cover more than three years of median total expenses above and beyond their actuarial life expectancy. This represents a crucial economic buffer given that, by definition, half of seniors will live beyond average life expectancy. A senior household therefore is worse off when there are no sufficient assets to cover the actuarial life span.

SENIOR ECONOMIC SECURITY AND RISK

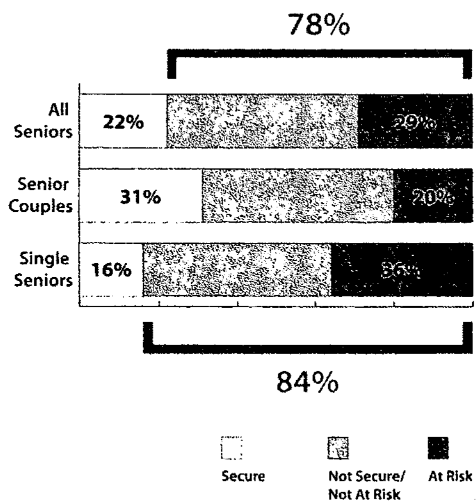
Overall *economic security* is established when a senior household is assessed as asset secure in addition to security in at least two of the other four factors. Asset security captures the three income legs of traditional retirement security, thus providing the foundation of economic stability for seniors. Accordingly, overall economic risk to senior households is established when these households are at risk based on the asset factor in addition to at risk status in at least two additional factors.

HOW SECURE ARE SENIORS?

According to the SESI, only 22 percent of seniors meet the criteria for long-range economic security. More than one in four, or 29 percent, of all seniors are at risk and vulnerable.

The story for senior couples is better—31 percent are secure and 20 percent are at risk. For single seniors, the Index demonstrates less security and more risk—only 16 percent among them are secure while 36 percent of all single seniors are vulnerable and at risk of inadequate resources to sustain their older age life cycle.

FIGURE 1: OVERALL ECONOMIC SECURITY AND FRAGILITY OF SENIORS



Put in a larger perspective, the SESI shows that 78 percent of seniors are not economically secure; that is, they are economically at risk or borderline (not secure and not at risk). This means that if present conditions continue, close to four out of five senior households do not have economic security sufficient to sustain them through their lives. This risk is especially pronounced for single senior households with 84 percent among them not reaching an adequate level of financial security. For senior couples, this rate is at 69 percent.

The SESI thus pinpoints not only areas of vulnerability, but provides a fuller picture of economic security among senior citizens. The power of examining the long horizon of the later part of one's life course is illustrated by a comparison with the traditional, income-based poverty line.

According to official government data, 13 percent of older Americans live in poverty—SESI demonstrates how the traditional poverty line vastly underestimates the life prospects of seniors as 29 percent are presently at risk as defined by the more comprehensive factors in the SESI. In addition, another 49 percent are just getting by on a slender thread where an unforeseen crisis puts them at risk.

IF PRESENT CONDITIONS CONTINUE, CLOSE TO FOUR OUT OF FIVE SENIOR HOUSEHOLDS DO NOT HAVE ECONOMIC SECURITY SUFFICIENT TO SUSTAIN THEM THROUGH THEIR LIVES.

Sources of Economic Security and Risk

Of the five factors that comprise the Senior Economic Security Index, not surprisingly the asset or wealth factor poses the greatest risk for most seniors. This factor annuitizes current Social Security and pension incomes[18] and adds current assets such as savings, property values (excluding one's own home), and investments. Such privately held assets are less important when Social Security and pensions provide adequate benefit levels for seniors and protections for long-term care expenses have been instituted. In fact, secure incomes of Social Security and defined-benefit pensions provide among the securest of economic resources given the volatility of other assets as has been demonstrated so clearly in the markets volatile markets of 2008. However, with more and more emphasis put on private savings, including 401(k) plans, assets have become increasingly more vital to fill the gap between Social Security income and living expenses.

With an average life expectancy of 83 years at age 65, seniors need net financial assets, secure income such as Social Security, and/or home equity to provide economic security for 18 years, despite other income losses or increasing expenses. Absent of employment income, few seniors have total assets that can provide security for even a much smaller number of years.

More than half of all senior households (54 percent) are at risk of not having sufficient financial resources to face median projected expenses based on their financial net worth and projected Social Security and pension incomes. Only 30 percent of senior household are secure with respect to their financial net worth, Social Security and pension assets, the three traditional legs of senior economic security, as captured by the asset risk factor.

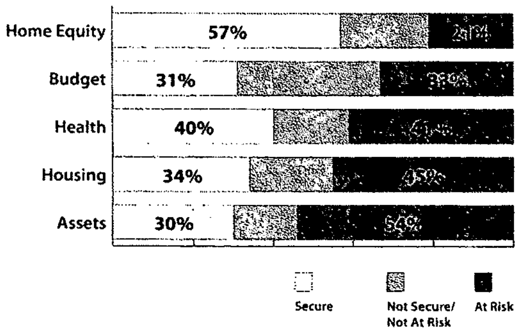
- Overall, close to one third of seniors (31 percent) have budgets that allow for an additional cushion of savings for larger and unforeseen expenses. Another one-third have no additional funds after paying for essential expenses.

- Despite surprisingly high homeownership rates well above rates of younger families (71 percent for single seniors, 93 percent for couples), housing-related expenses are high. Forty-five percent of all seniors are economically at risk based on their housing expenses.

- Four out of ten senior households are at risk based on their current health expenses. With increased age, these expenses tend to increase as well, demonstrating that all households should expect costs to increase with age. Also, given the overall rising health costs in the U.S. system, healthcare premiums are rising disproportionately to income for seniors relying on fixed incomes, posing an even larger burden for senior economic security in the future.

- Home equity is the largest asset of seniors. Approximately half of all seniors have median home equity worth $90,000 or more (pre-2008 housing values). Close to three in five of all senior households (57 percent) are secure with respect to home equity, and one in five is at risk.

FIGURE 2: SOURCES OF ECONOMIC SECURITY AND RISK



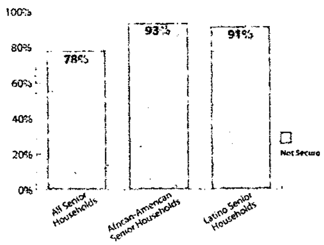
Greater economic hardship falls on single seniors. Single seniors are for the most part older (close to 40 percent age 80 or older) and more likely to be female (73 percent). This group also includes a higher proportion of African Americans and tends to have lower educational attainment.

Among the five SESI factors, asset and housing for single seniors are especially troublesome. Fifty-eight percent of single seniors are at risk based on their assets, and 55 percent are at risk based on their housing expenses.

The budget factor yields the greatest security and risk gap between single and couple senior households. Only 19 percent of single seniors are budget secure as compared to 46 percent of senior couples.

As single seniors tend to be older, this points to the economic risk of older seniors, who are often women because women generally live longer than men. Subsequent analyses will focus on long-term economic security of older African-American and Latino senior households as well as older seniors. We already know this will be critically important as 93 percent of older African-American households and 91 percent of older Latino households are not economically secure as captured by the overall SESI measure.

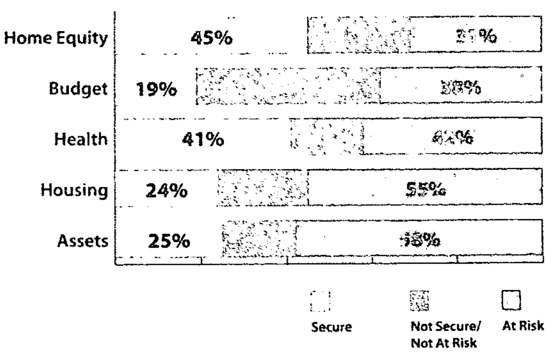
FIGURE 3: ECONOMIC SECURITY OF AFRICAN-AMERICAN AND LATINO SENIOR HOUSEHOLDS



AFRICAN-AMERICAN, LATINO, AND SINGLE FEMALE SENIOR HOUSEHOLDS ARE LEAST SECURE AND MOST AT RISK.

These compelling statistics reflect the realities of many seniors and demonstrate the roots of economic security and fragility—a fundamental mismatch between income and costs of essential and other day-to-day expenses. Put simply, many seniors have too little income and face costs that are too high and rising.

FIGURE 4: SOURCES OF ECONOMIC SECURITY AND RISK FOR SINGLE SENIORS



Policies to Strengthen the Foundation of Senior Economic Security

Many countries are undergoing demographic changes that are characterized by an increase in the proportion of older citizens. Unlike the years before the implementation of Social Security and Medicare in the United States, older U.S. citizens now have independent income sources and health insurance coverage, and therefore much more participation in public life. The uncertainties of older life are mitigated by the risk-sharing policies of our social insurance programs that address unexpected life circumstances. One of the key advantages of Social Security and Medicare is the large risk pool (most everyone over 65) that no private plan can replicate.

Unable to keep pace with the trends described in this report, the brittle three-legged stool currently undermines senior economic security, and we need to rebuild the social contract for our current and future senior citizens. Our policy recommendations address a combination of income- and expense-related policies that together can reduce the economic risk for all seniors.

STRENGTHEN SOCIAL SECURITY

Social Security, which significantly reduced poverty among seniors when it was implemented, is the only strong (certain and inflation-adjusted) leg of the three-legged stool. It therefore continues to play a vital role in supporting the economic well-being of many older households.

Thirty-six percent of senior singles and 17 percent of senior couples rely solely on income from Social Security.[19] Social Security provides at least three-quarters of income for low-income and poor elderly who have few other resources.[20] With Social Security as the only widely available income source that is guaranteed and adjusted for inflation, it needs to be strengthened and not further weakened by replacing it with private accounts that favor the more affluent.

In addition, Social Security benefit levels need to be adjusted to provide more adequate income for low-earning beneficiaries. For example, strengthening the special minimum benefit which was instituted in 1972 to ensure, at a minimum, poverty level Social Security income for low-wage workers but no longer provides benefits at this level, would be a first step to reducing economic risk for our elders. In addition, benefits could be strengthened by reviewing interactions between programs targeting low-income seniors, and increasing asset limits in means-tested programs to allow for reasonable amounts of savings for unexpected financial costs and emergencies.[21]

STRENGTHEN PENSION PROVISIONS

With fewer and fewer workers having access to pension plans and a marked shift from defined-benefit to defined-contribution plans, the employer-pension leg of retirement security no longer holds its weight. Pension provisions need to be rebuilt by providing incentives for employer-based access to pensions. Policymakers should keep in mind that longer range economic security is better anchored by defined-benefit provisions which provide guaranteed benefits for the rest of the beneficiary's life and do not require that the retiree stretch what has been saved in a 401(k) plan over an unknown period of time. Government interventions are also needed to secure the stability of existing pensions to ensure the stability of employer and employee investments.

ENHANCE ASSET BUILDING OPPORTUNITIES THROUGHOUT THE LIFE COURSE

Policies for seniors are in essence family policies. Most of us will be among the older population one day. Therefore, enhancements of asset building opportunities that support household asset-building and financial management across the life course are critical. These asset building opportunities should include:

- Access to and automatic enrollment in defined-contribution pension plans for all;
- Education on financial management throughout the life course as well as specifically for seniors;
- Adequate income opportunities;
- Matched savings accounts or IDAs that permit long-term savings for low-income populations; and
- Asset protection, mostly as it relates to housing wealth.

FLEXIBLE EMPLOYMENT DURING RETIREMENT

With increased life expectancies and economic insecurity in older age, more and more seniors opt to work during their early retirement years.[22] Institutional and structural gaps interfere with the desire of many older workers to continue work but not necessarily full-time.

Flexible work arrangements offer older workers choices that are perhaps more appropriate to their desires, stage in the life course, and productivity for employers. Such arrangements might include scheduling flexibility, including flextime and bundled work days; amount of time spent working, including job-sharing options; and career flexibility with various points of entry, exit, and re-entry over a working career.

When to work, where to work, how to work, and what to receive for working are key to flexible work arrangements providing a better institutional fit for older workers and continued productive employment. Indeed, one study indicates that one in four older workers continue to work because their employer provided flexible work options.[23]

ADDRESS THE MEDICARE CRISIS

Without attention to healthcare access and affordability, progress in all other areas of retirement security will be negated. Seniors are especially anxious about health risks and the volatility of healthcare costs. The U.S. healthcare system is one of the most expensive healthcare systems in the world, ironically achieving health outcomes that are often no better, and sometimes worse, than those in other countries. Like all healthcare costs, Medicare costs have risen and continue to rise disproportionately to other expenses. As such, Medicare reform needs to be addressed in the context of a reorganization of the overall healthcare system. The system needs to be restructured in order to curb current escalating costs and to provide health services to all citizens.

INSTITUTE LONG-TERM CARE INSURANCE

One of the major economic security threats to each U.S. citizen is the need for long-term care. Current policies require spending down assets in order to qualify for Medicaid, the only public program that provides coverage for such expenses in many cases. Private long-term care insurance programs are unaffordable for most. Federal long-term care insurance would spread the risk of needing long-term care among all U.S. citizens. A proposal put forward by Senators Kennedy and Harkin, the Community Living Assistance Services and Supports (CLASS) Act of 2007, addresses the need for a federal long-term care insurance program for all citizens.

Conclusions

Even though today's seniors present a best-case scenario, they face a bleak outlook based on the data presented here. Future retirees will be worse off, unless we attend to policies that grow and stabilize their resources for the future, while attending to the rising costs for seniors. Policymakers have an opportunity to reaffirm their commitment to ensure that elders have the resources to live without fear of poverty or economic insecurity. Building on past commitments to our elders, we must strive to construct a new retirement security system of the Twenty-First Century that meets the needs of our diverse and aging population.

Endnotes

1. U.S. Department of Labor, Bureau of Labor Statistics, Consumer Expenditure Survey, 2004.
2. Center for Retirement Research, Boston College, *Frequently requested data*. http://crr.bc.edu/frequently_requested_data/frequently_requested_data.html (accessed December 19, 2008).
3. Ibid.
4. Kaiser Family Foundation/HRET, *Employer Health Benefits 2007 Annual Survey*. Menlo Park: CA: Kaiser Family Foundation, 2007.
5. Deborah Thorne, Elizabeth Warren, and Teresa A. Sullivan, *Generations of Struggle*. Washington DC: AARP Policy Institute.
6. The complexity of this task requires a number of assumptions, which we will clarify in the text.
7. IASP and Dēmos first took the approach of creating a multi-factor examination of economic stability and vulnerability in measuring the financial security of middle class households. For more information on this work see, *By A Thread: The New Experience of America's Middle Class*, Dēmos/IASP, 2007.
8. Laura Henze Russell, Ellen A. Bruce, and Judith Conahan. *Elder Economic Security Initiative: The Elder Economic Security Standard for Massachusetts*. John W. McCormack Graduate School of Policy Studies, University of Massachusetts, Boston and Wider Opportunities for Women: Boston, MA, December 2006.
9. Center for Retirement Research, Boston College, *Special Projects: National Retirement Risk Index*. http://crr.bc.edu/special_projects/national_retirement_risk_index.html (accessed December 19, 2008).
10. We have been very careful to make the most conservative assumptions when creating the SESI and setting thresholds. For example, we do not adjust for change of family composition (death of a spouse which most often leaves the surviving spouse in more constraint economic circumstances), we do not adjust for inflation due to our assumption that the ratio of income to expenses remains the same over the life course of seniors, and we do not assume a worsening in health status which would prompt higher healthcare expenses. Further, seniors in long-term care institutions are not included thus eliminating households with largest healthcare expenses from these analyses
11. Because those in long-term care institutions are not included in our estimates, our findings a slightly more optimistic as those in long-term care are most likely to have few assets and savings to cover long-term economic needs.
12. We also ran the data using the criteria for the full index Assets plus at least one other factor which yielded slightly higher levels of security and much higher levels of risk. We decided to base the Index on the more conservative approach of Assets plus two for overall economic security and risk.
13. Jessica S. Banthin and Didem M. Bernard, "Changes in Financial Burdens for Health Care National Estimates," *Journal of the American Medical Association*, vol. 296, no. 22 (December 13, 2006), pp. 2712-2719.
14. Please note that we expect to update the measurement of this factor when better data on supplementary Medicare coverage will be made available. However, capturing medical expenses will remain a critical part of this measure.
15. James H. Schulz and Robert H. Binstock, *Aging Nation: The Economics and Politics of Growing Older in America* (Westport, Conn.: Praeger, 2006).
16. We chose the median over the mean as the latter tend to be inflated by extreme values on the upper end.
17. Prior research identified that senior couples' budgets and financial needs are between 41 and 66 percent of that of single seniors. We therefore chose 50 percent as the middle ground to establish the asset threshold for senior couples.

18. By no means do we advocate for the privatization of Social Security. We annuitize Social Security as it presents income that is secured throughout the end of the life course.
19. Consumer Expenditure Survey, 2004, authors' calculations.
20. Barbara A. Butrica, *Older Americans' Reliance on Assets*. Opportunity and Ownership Facts, No. 10, Urban Institute: Washington DC, March 2008.
21. Laura Sullivan, Tatjana Meschede, and Thomas Shapiro, *Enhancing Social Security for Low-Income Workers: Coordinating an Enhanced Minimum Benefit with Social Safety Net Provisions for Seniors*, National Academy of Social Insurance: Washington DC, January 2009.
22. In 2008, about 36 percent of men age 65-69 remained in the work force, as compared to 25 percent just ten years earlier.
23. D. Parkinson, *Voices of Experience: Mature Workers in the Future Workforce*. Research Report New York, NY: The Conference Board, 2002.

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BOOKS

- *The Hidden Cost of Being African-American: How Wealth Perpetuates Inequality*, Thomas. Shapiro, (Oxford University Press, 2004)

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- *Inequality Matters: The Growing Economic Divide in America and Its Poisonous Consequences*, James Lardner & David A. Smith (eds.), (The New Press, January 2006)
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A Decade of Research on African-American Wealth Building and Retirement Planning

ARIEL MUTUAL FUNDS charles SCHWAB

An open letter to the financial services industry, government policymakers, employers and community leaders:

At the very heart of this great and wealthy nation lies a terrible irony and pressing challenge: despite our wealth and in the face of decades of social progress, we are not doing enough as individuals and collectively as a nation to assure the long-term financial security of our citizens in retirement. Few other issues touch our population as broadly, yet for some, the challenge is even greater.

For middle-class African-Americans, the march toward financial security has been an uphill journey marked by half steps, pauses and, for some, retreat. Over the last decade, Ariel Mutual Funds and The Charles Schwab Corporation have annually commissioned research comparing the saving and investing habits among middle- and upper-income Blacks and Whites. The results consistently show that Blacks save less than Whites of similar income levels and are less comfortable with stock investing, which impedes wealth building across generations and contributes to an impending retirement crisis in the African-American community. This difficult situation will be worsened by the changing state of America's pension system, which will hit middle-class Blacks especially hard because of a disproportionate dependence on traditional defined benefit pensions. In short, middle-class Blacks may not be able to realize a key part of the American dream: a comfortable and secure retirement after a job well done.

To mark the survey's tenth year, Ariel and Schwab are issuing this report on African-American saving and investing. These findings raise several critical questions for a community, an industry and a nation committed to ensuring equal access to the broad benefits of life in the world's wealthiest country. What proactive measures can our industry, government, employers and communities undertake to protect middle- and upper-income Blacks from experiencing a profound decline in their financial well-being in their retirement years? How can we foster a cultural shift toward wealth building that will lead to greater economic opportunities for future generations of African-Americans? And how can we preserve Black economic gains and shrink the wealth gap?

This research suggests that **employers** play a critical role both in educating Blacks about saving and investing and in ensuring equal participation among all employees; that **family and community** can facilitate and reinforce the merits of investing; that **govemment** — including the education sector — can affect future generations by introducing basic personal finance concepts into every classroom; and that the **financial services industry** can serve as the bridge connecting all of these constituencies.

Our hope is this research will spur a national dialogue on the issue of saving and investing, and encourage a collective momentum toward action. If we can elevate the level of saving and investing in one reluctant community, we can make progress in every community, and ultimately reduce poverty and promote opportunity.

Sincerely,

Charles R. Schwab
Founder, Chairman & CEO
The Charles Schwab Corporation

Sincerely,

John W. Rogers, Jr.
Chairman & CEO
Ariel Capital Management, LLC
Ariel Mutual Funds

Sincerely,

Mellody Hobson
President
Ariel Capital Management, LLC
Ariel Mutual Funds

Introduction

In the last quarter century, the American middle-class has become increasingly familiar with the stock market. The explosive growth of mutual funds, lower-cost brokerages and channels of information about the financial markets, combined with easily accessible employer-based investment opportunities, has made stock investing, once the realm only of the privileged, available to people at every income level. Furthermore, historically stocks have outperformed all other asset classes — including the American home.

But anyone new to investing in the last 20 years — as most Black investors are — would be forgiven for thinking it is a risky proposition. The stock market crash of 1987, the bull market of the 1990s, the dot-com bubble, the terrorist events of 9-11, the radically changing pension plan system and most recently, the crisis in the sub-prime mortgage market have left many investors anxious. A decade of survey research shows that not only stock market volatility, but also social and cultural factors, are among the chief reasons more than four in ten middle-class Blacks forego stock investing entirely or have retreated from the stock market, removing them from one of the great wealth creators of the American economic system.

As the largest Black-owned mutual fund company in the country, Ariel Mutual Funds has long sought to promote saving and investing among African-Americans. Ariel and Charles Schwab joined forces to establish *The Black Investor Survey: Saving and Investing Among Higher Income African-Americans and White Americans*, which has become the definitive source of information on Black investment behavior. Every year since 1998 a random sample of 500 African-Americans and 500 Whites with household incomes of at least $50,000 are surveyed by phone.[1]

In 2007, for the first time, current retirees were also surveyed to determine the specific issues they are facing in their retirement years.[2] Not surprisingly, the results show that retired Blacks have less money saved than retired Whites with similar incomes. Together, the surveys of both retirees and non-retirees paint a picture of Black America at considerable financial risk in their retirement years — a situation that creates a challenge for the entire nation and an opportunity for the financial services industry.

Survey findings

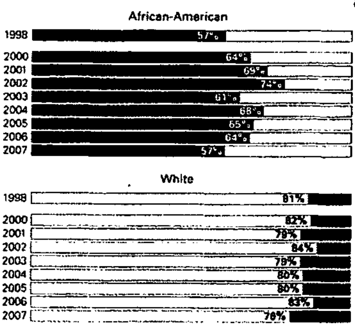
Blacks trail Whites in savings and stock market participation

Ten years of survey research indicates that middle-to-upper-income African-Americans remain underinvested in the stock market and are no more likely today to be stock investors than they were a decade ago. Whites, on the other hand, are just as likely to be investors today as when the study began.[3] Given their higher rates of involvement in the stock market, it's no surprise that Whites tend to save more on a monthly basis than their Black counterparts and therefore have accumulated nearly twice as much savings.[4] The savings gap is compounded over time, resulting in Whites having a significantly larger nest egg upon retirement. It is important to note that while Whites have saved considerably more than Blacks, the harsh reality is they, too, are underinvested and ill-prepared for retirement. Nevertheless, the large disparities between Black and White market participation and savings are consistent year over year, even when other demographic factors such as income and education are held constant.

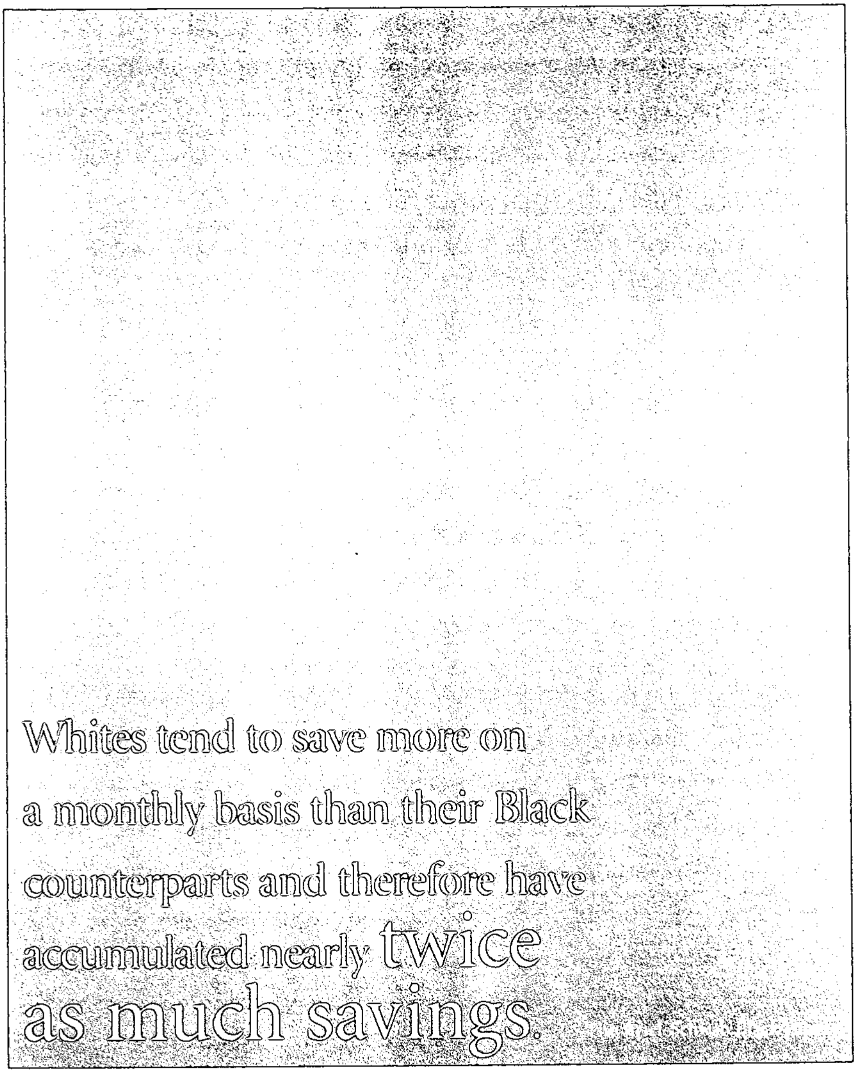
Five years into the survey, the gap between Black and White stock ownership was narrowing just as the dotcom bubble burst and the terrorist attack of September 11, 2001 occurred. The resulting drop in stock prices in time drove many Blacks to move money away from the market. By 2003, the percentage of Black investors had dropped dramatically. One of the first surveys asked whether a downturn in the market would prompt a withdrawal of money, and considerably more Blacks than Whites said yes.[5] Meanwhile, stock market participation among middle- and upper-income Whites has remained remarkably consistent.

Question: "Do you personally, or with a spouse, have any money invested in the stock market right now, either in individual stocks or in a stock mutual fund?"

Stock market participation of households with $50,000 or over in income



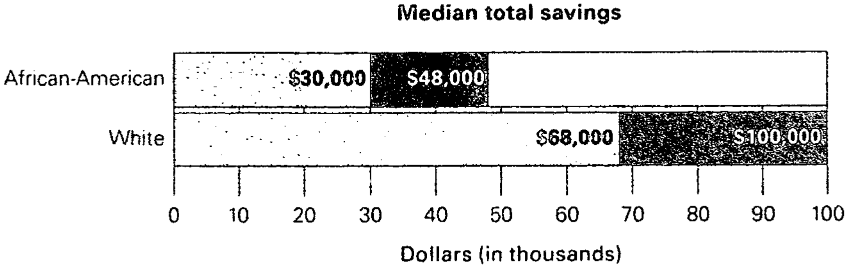
Source: *The Ariel-Schwab Black Investor Survey*

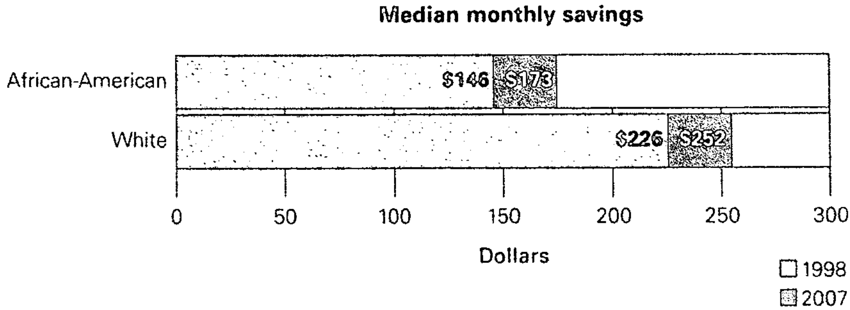

Whites tend to save more on
a monthly basis than their Black
counterparts and therefore have
accumulated nearly twice
as much savings.

Among the retirees surveyed this year, Blacks had less money saved for retirement than Whites even when controlling for factors such as peak income and education. Further straining their financial position is the fact that Blacks consistently say they plan to retire earlier than Whites, and, indeed, the retiree survey shows they did retire two years earlier in age, which means they are tapping retirement funds earlier (at 58, on average).[6]

It is important to note that a larger percentage of middle-class Blacks than Whites work for employers that tend to provide traditional pensions, such as the government. Pension plans and Social Security have traditionally played a much larger role in retirement income for African-Americans than these sources do for Whites. In this context, it is not surprising that most Black retirees surveyed say they are living comfortably despite their lower overall savings.[7]

Nevertheless, there is growing awareness that the retirement funding landscape is changing. More than four out of five working Blacks and Whites today say that a defined contribution plan, such as a 401(k), will help fund their retirement; seven years ago fewer than half of working Blacks had that expectation.[8] In fact, half of all working Blacks predict that a plan such as a 401(k) will be their most important source of retirement income. However, in the last seven years there has not been a corresponding narrowing of the gap of African-American saving and investing, suggesting that the changing perceptions among working African-Americans today about how their retirement will be funded have failed to spur changes in actual saving and investing patterns.





Source: *The Ariel-Schwab Black Investor Survey*

Despite general satisfaction, retirees within the first decade of their retirement show an undercurrent of concern: a sizeable minority of both Black and White retirees fear that they will outlive their retirement savings. About half of young retirees worry about medical issues impacting them financially with significant percentages of Blacks and Whites spending more on health care in their retirement than they expected.[9] These anxieties, not surprisingly, are correlated with the size of the nest egg — the more money saved the fewer worries people have in retirement.

So, while Blacks in the last decade have shown interest in the market (at least when it appears to be a safer option) and furthermore have come to expect that the market will be an important source of retirement funding (in the form of defined contribution plans), they nevertheless have been slow to adopt behaviors necessary for ongoing investing success. Why?

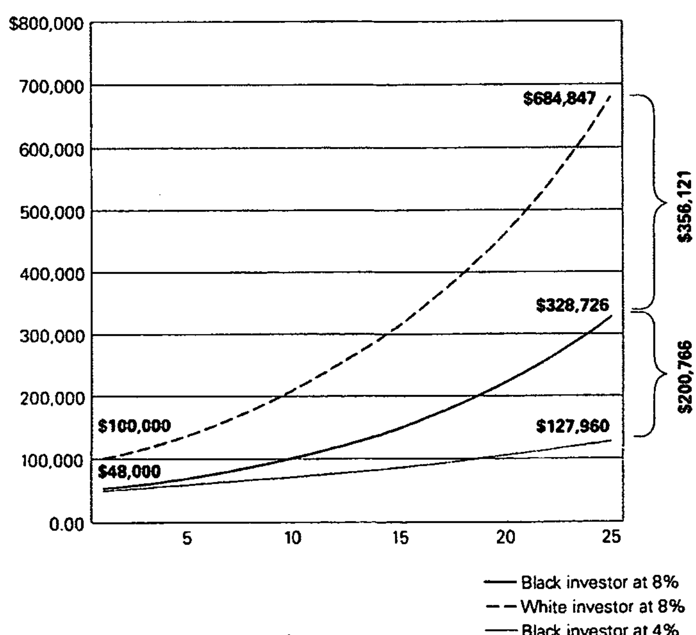
Blacks are more likely to become investors when they begin earning **six-figure incomes**, regardless of their age, whereas for Whites, becoming an investor typically occurs as they enter their thirties, regardless of income.

Attitudes about investing drive behavior

First of all, the concept of saving for retirement does not resonate in the same way in the Black community as it does among Whites. Year after year, the survey has found that fewer Blacks list "retirement" as their primary reason for saving, with higher percentages of Blacks saving for "college" or an "emergency." This is especially true for Blacks under 35, who are only half as likely as Whites under 35 to be saving for retirement.[10] In fact, all other factors being equal (age, income, etc.), Blacks are 1.5 times less likely to cite retirement as their main savings goal. And because the research shows that retirement as a savings goal is strongly correlated to investing in the market for both Blacks and Whites, it follows that fewer Blacks invest.[11]

Additionally, Blacks are more likely to become investors when they begin earning six-figure incomes, regardless of their age, whereas for Whites, becoming an investor typically occurs as they enter their thirties, regardless of income.[12] This "wage versus age" distinction means that many Blacks miss out on the benefits of compounding by waiting too long to begin.

Fewer dollars, lower expected returns:
Effect of compounding over time



Source. *The Ariel-Schwab Black Investor Survey*

Blacks are banking on real estate

One of the single most consistent findings in the *Ariel-Schwab Black Investor Survey* is that more Blacks than Whites view real estate as a better investment than the stock market. In 2007, only one-third of Blacks consider stocks and mutual funds to be the best investment overall, while nearly half feel real estate is the best investment; for Whites, these proportions are reversed.[13] Except at the very height of the bull market in 2001, real estate has outpolled stocks and mutual funds combined among Blacks, whereas Whites have generally favored stocks and mutual funds over real estate.[14]

Many Blacks think real estate is less risky, believe it can be used to earn rental income and assume it will never go down in value. In fact, nearly half of all working Blacks believe they will rely on rental income in their retirement.[15] Given these perceptions, it is not surprising that Blacks may forego investing in the stock market in favor of purchasing and upgrading real estate investments.

The retiree survey, however, tells a story that many working Blacks might find surprising. The idea that real estate is not just a nest, but also a nest egg is not borne out by real-life experience. Among retirees, far fewer Blacks choose real estate over mutual funds and stocks as the best investment, and fewer than two in ten actually rely on rental income for their retirement.[16]

Social and cultural issues play a role

Finally, in addition to behaviors and perceptions around investing that result in the Black–White gap, underlying social and cultural issues are at work, starting with the family. Middle-class Blacks tend to have greater financial burdens related to their families. Blacks are more than 1.5 times more likely to support adult children and aging parents.[17] They are more likely to have extended family living in their homes and are less likely to be married.

But the survey has found that, even when these financial burdens caused by family structure are not present, Blacks still remain less likely to invest. In fact, if one compares a Black person and a White person of the same age, income, gender, family structure and education, the White person is almost twice as likely to be an investor as the Black person — that is, all other significant demographic factors wash away, leaving race as the determinant of likelihood to invest.[18]

Broadly speaking, there is a relative lack of social and cultural attention within the African-American community focused on investment/savings matters. For example, Whites are almost twice as likely to have grown up in a household where they knew their parents were investors, giving Whites the advantage of early exposure. This trend still exists today, with Black parents being considerably less likely than White parents to expose their own children to various banking and investing activities, such as opening a savings account for a child. In 2001, just 56% of Blacks said their child under 18 had a bank savings account, compared to 68% of Whites; only 36% of Blacks had savings bonds for their children, compared to 55% of Whites; and only 21% of Blacks had bought stocks or mutual funds for their children, compared to 31% of Whites.

Less exposure to the stock market, of course, leads to less knowledge about the basics of investing. Common phrases like "bull market" and "bear market" are unclear to almost half of Blacks. Fewer Blacks than Whites know that a stock represents an ownership share of a company.[19] Adding to the general unease with financial facts and terminology is the widely held perception among Blacks that timing the market is more important than discipline in becoming a successful long-term investor — a perception that discourages investing among those who feel they are less than experts on the subject.[20]

Employers, educators and industry all play a role in empowering Blacks to invest

Both Blacks and Whites strongly believe that individuals — rather than the government or employers — are most responsible for planning for their retirement.[21] However, Blacks are more likely to believe that the government and corporate America can do more to guide them toward a secure retirement. Among Blacks who invest, employer-sponsored retirement plans have been the most significant factor in driving them toward the stock market investing. Additionally, the role of the employer has grown dramatically over the past decade, with high percentages of both Blacks and Whites saying they get investing information from their employers.[22] The 2007 survey revealed that 55% of Black investors attributed their impetus to begin investing to their 401(k) plan, versus 27% in 1998. Furthermore, among Black retirees 45% began investing through a 401(k) plan.

According to the 2007 retiree survey, fewer Blacks have gone through some of the basic steps of retirement planning, such as calculating the amount of money they need to live comfortably in retirement. But those who had sought professional advice were much more likely to have made this calculation, much more likely to have saved more than $100,000 by the time they retired and much less likely to have retired early.

The great majority of Blacks and Whites believe that financial literacy should be part of the public school curriculum. The 2001 survey showed that 90% of Blacks and 80% of Whites with teenage children agree that the stock market and investing are topics that should be taught in school.

A call to action

The trends highlighted in a decade of research by Ariel and Schwab coupled with the evolution of the pension system toward defined contribution plans present a critical challenge to the African-American community, employers and policymakers. How can we better communicate the importance of saving and investing — both to ensure a secure retirement and to be able to build wealth across generations — and provide education to those who need it? How can educators, employers and the financial services industry stimulate higher saving rates for people of all incomes? We hope the findings of these last ten years spark a myriad of ideas and answers to these questions, and that organizations and individuals take up the call to address this issue within their spheres of influence. The following are clearly important first steps.

1. Educate Our Youth

One of the most effective ways to eliminate the investment gap and savings gap in this country is to address the issues *before* they become a problem. Whether in public school classrooms or through community-based programs, educating America's youth about basic money management including saving and investing should be a top priority. In Schwab's 2007 Teens and Money Survey, only 13% of American teens ages 13 to 18 said they knew what a 401(k) plan is. Even more fundamentally, the survey results showed that only 41% of teens know how to budget their money; only 34% know how to balance a checkbook or check the accuracy of a bank statement; and only about a quarter of them (26%) understand how credit card interest and fees work. While some individual schools have made efforts to teach children the basics, there is no national investment curriculum. Likewise, many schools or organizations do not possess the materials and resources they need to help teach young people how to be educated consumers and investors.

The ideal solution would be required financial education within the school system throughout all 12 years. A mandated financial literacy exam would help assure America's children are equipped with a basic set of financial skills to make smart, informed choices. We encourage the leaders of our educational system to proceed down that path. In the short term, private enterprise can play a significant role. Another recommendation is for companies—specifically within the financial services arena—to partner with cities, school superintendents, and/or youth organizations to teach children the financial decision-making skills necessary to secure their future. Private enterprise has a critical stake here, since most of today's school-aged children will not grow up and work for an employer who offers a pension (defined benefit plan) and instead will carry the responsibility for building their own financial security largely through defined-contribution workplace retirement plans.

Following are two examples of ways in which companies have had a significant impact on increasing financial literacy.

Case Study of Ariel Community Academy

In 1996, in partnership with Ariel Capital Management, LLC and the Chicago Public Schools, Ariel Community Academy opened its doors on the south side of Chicago in a predominantly African-American neighborhood. A part of Mayor Richard Daley's Small School Initiative, the Academy is a traditional public school with classes from pre-kindergarten through eighth grade. In addition to the mandated Chicago public school curriculum, Ariel introduced the concepts of saving and investing into the classroom. The school is the first elementary school in the country to have hallways named after financial marketplaces like Wall Street and LaSalle Street and a working board room furnished with a life-size mural of a bull and bear, as well as clocks showing Chicago, New York, Tokyo and London time. Additionally, every morning a bell rings and a student announces to everyone in the building that the stock market is open and relays yesterday's closing prices for a point of reference.

Through a partnership with Nuveen Investments, a Chicago-based investment and trust company, the Ariel Nuveen Investment Program awards a $20,000 grant to each incoming first-grade class at the Ariel Community Academy. This money follows the students until their graduation.

In the first few years, the money is invested and managed by a group of investment professionals from Ariel and Nuveen. As the students advance through the school's unique investment curriculum, though, they become actively involved in making investment decisions. Ultimately, a Junior Board of Directors (made up of sixth-, seventh- and eighth-grade students) is responsible for deciding how the $20,000 is to be invested. Upon graduation, all accumulated profits made on the original gift of $20,000 are divided into two equal parts. One part is designated as a class gift to improve the school, while the other part is distributed equally among the students in the graduating class. Each graduate can choose to either receive their portion in cash or invest it in an Illinois 529 plan. Those who choose to invest in a 529 plan will receive an additional $1,000 grant. The original $20,000 gift is then turned over to the next incoming first-grade class, making the program self-perpetuating. The ultimate goal is to increase economic and investment literacy within the African-American community and to bring the topic of investing to every dinner table in Black America.

In addition to the curriculum taught by our full-time investment program director, who is a veteran of the securities industry, parents are offered financial literacy/investment dinners where speakers lead discussions on topics ranging from the differences between Roth and Traditional IRAs to large cap and small cap valuations.

This unique curriculum has had a positive impact on the academic results at the Academy. In the 2006-2007 academic year, 88.1% of the students met or exceeded state standards for math and 81.5% met or exceeded state standards on all academic areas on the state standardized tests. Moreover, nearly 40% pass out of high school algebra while in eighth grade and a large percentage of graduates are accepted at some of the most selective high schools in the Midwest.

Case Study of *Money Matters: Make it Count*℠

A Financial Literacy Program
Sponsored by Boys & Girls Clubs of America and Charles Schwab Foundation

Many of the nation's teenagers advance into adulthood without learning the skills that lead to financial independence and well-being. To address this important social issue, Boys & Girls Clubs of America and Charles Schwab Foundation entered into a national partnership in 2003 and collaborated to create *Money Matters: Make it Count*℠. The program aims to build basic money management skills and positively influence a lifetime of good financial habits for teens ages 13 to 18. Through fun, interactive activities and exercises on topics like using a checking account, learning how to budget, managing debt and saving for college, Money Matters helps teens learn practical ways to save, spend and make their money grow.

In May 2004, the program rolled out nationwide. Today, it is available to approximately 2,500 Boys & Girls Clubs across the country, reaching a large population of teens who might not normally have access to this type of education — including the large percentage of Club teens who come from disadvantaged circumstances.

In less than three years, nearly 70,000 Boys & Girls Club teens have completed *Money Matters*, and 884 Club locations across the United States have adopted the program. Since 2004, Charles Schwab Foundation has presented a total of $108,000 in college scholarship grants to 54 teens, ages 16 to 18, who have completed the program and demonstrated their newly acquired financial literacy skills.

The program components include:

- A Teen Personal Finance Guide, which includes practical tips and activities to help teens learn important money management skills, including investing for college and saving for the future.
- The *Money Matters* website, a password-protected, interactive site that contains tools to help teens learn how to balance a checkbook, make budgeting and investment decisions, and start a business.
- A Facilitator's Guide to assist Club staff and volunteers in explaining

basic financial concepts. The Facilitator's Guide offers easy-to-implement small-group activities to reinforce newly acquired money management skills.

- Schwab's Employee Volunteer Program, in which Schwab professionals are encouraged to volunteer at Clubs and share their financial expertise with teenage Club members and their families.

- The *Money Matters* Scholarships and Awards program to reward and recognize teens who have successfully applied what they have learned. Older teens (16–18) are eligible for $2,000 scholarships from Charles Schwab Foundation, and younger teens (13–15) are eligible to receive rewards such as MP3 players.

Analysis of baseline and follow-up surveys conducted with teen Club members who completed *Money Matters* reveals the program is motivating teens to take positive action:

- 80% of Club members reported that they had begun to save money (versus 63% in the baseline survey)

- 64% of Club members were in the process of open a savings account (versus 43% in the baseline survey)

- 57% had started to develop a spending plan or budget (versus 32% in the baseline survey)

- 43% had initiated a search for information on financial aid for college (versus 28% in the baseline survey)

- 51% had begun to open a checking account (versus 23% in the baseline survey)

Moreover, Boys & Girls Clubs staff and teens give high ratings to the *Money Matters* program, reporting that the program has taught them the importance of setting short-, medium- and long-term goals, how to handle money responsibly and the importance of making sound financial decisions to help save for the future.

2. Amplify Workplace Education

Employers today have both a greater opportunity and a greater responsibility to provide employees with access to suitable retirement investment vehicles and to educate them about how to plan for a successful retirement. The Pension Protection Act's sanctioning of automatic enrollment as a tool to help employers increase 401(k) plan participation will help many employees begin to save for retirement who might otherwise have sat on the sidelines.

While many employers have made great strides toward ensuring their plans consist of a well-diversified menu of investment options, too few have focused on employee participation rates by race. We suggest that corporate chief financial officers, treasurers and human resources directors investigate their internal plans and analyze participation by race to determine if differences exist and, if so, take steps to narrow the gap. The few companies that have gone through this exercise have found that the investment gap uncovered by the Ariel-Schwab Black Investor Survey is mirrored within their own 401(k) plans.

McDonald's Case Study

McDonald's is the top global foodservice retailer, with more than 30,000 restaurants in more than 100 markets. In the United States, 85% of its 13,000 restaurants are franchised. As a leader in the areas of diversity and inclusion, McDonald's incorporates these two elements into every facet of its business.

At McDonald's, the employee base reflects the diversity of its customers. For this reason, McDonald's has tracked investment patterns by ethnicity in the United States for the last three years. This data played a key role in helping McDonald's drive a three-pronged strategy that positively impacted employee investment decisions. And with more than $2 billon in assets invested in its 401(k), the enhancements have led to increased participation in company savings programs among all employees, including African-Americans.

Plan Design

McDonald's made a radical change to its existing 401(k) plan, which was open to all McDonald's staff and employees of non-franchised restaurants. To encourage greater levels of participation among its most under-invested group, restaurant managers, the company instituted automatic enrollment. Through automatic enrollment, McDonald's implemented a default 1% contribution to the restaurant manager's 401(k) unless the manager chose to opt out or select a higher contribution rate.

A one-time salary increase of 1% was also given to all current salaried restaurant managers to offset the impact on their take-home pay and to demonstrate the company's commitment to helping employees save.

In addition, the 401(k) match was front-loaded to ensure that employees, particularly those at the restaurant level, would benefit from the investment they made in their future. This enhancement gave employees \$3 for each \$1 they contributed on the first 1% of pay and \$1 for each \$1 on the next 4% employees contributed, for a total guaranteed match of 7% on the first 5% employees saved.

At the same time, McDonald's instituted a discretionary match of up to 4% for all employees participating in the 401(k). When combined with the 401(k) match, the discretionary match provided a compelling investment opportunity for employees. For example, an employee contributing 1% as a result of the automatic enrollment received a total of 7% from the company when the 401(k) match was added to the discretionary match. An employee contributing 5% received a total of 11% from the company.

Investments

The selection of investment options for employees was also expanded with the addition of three new funds within the course of two years, including an aggressive stock fund, a small company index fund and a real estate fund.

McDonald's automatically enrolled restaurant managers who defaulted to the standard funds in an advice program through GuidedChoice. The program selected and monitored the appropriate investments based on a number of factors. As with the automatic 401(k) enrollment, this enabled McDonald's to play an active role in helping employees take the first step in managing their investments. Today, GuidedChoice currently manages \$113 million – an 82% increase over last year.

McDonald's also added a no-cost online financial planning tool to make investment resources more accessible to those who might not be able to take advantage of the services of a financial planner.

Communications

To ensure employees understood their investment options and how to maximize the benefits available to them, branded employee newsletters and seminars were added with increased frequency. Outreach efforts also began with the various diversity employee groups at McDonald's, including African-American employees. While these efforts are in the initial stages, financial planning information was distributed at a recent national conference held by African-American employee network and additional tactics are underway.

Results

After only two and a half years, the positive impact of the plan design changes, new investment options and communications enhancements have not only affected African-American employees, but all McDonald's employees. Although the benefits of these changes are most dramatic at the restaurant level, where McDonald's has its most diverse employee population, they have also strengthened staff employee participation:

- Among African-American restaurant managers, the percentage participating nearly doubled, from 50% in 2004 to 95% in 2007.
- Aggregate account balances of African-American restaurant managers increased 41% since 2004 and African-American staff (non-restaurant) employees' account balances increased 34%.
- The percentage increase of minorities participating in the plan is more than double that of non-minorities. Minorities increased 24%, compared to an 11% increase among other employees.
- At 89%, the percentage of African-American staff employees participating in the plan is close to total percentage for all McDonald's employees.

While McDonald's is pleased with the outcome of these efforts, the company remains committed to further increasing the financial awareness of its employees and providing them with resources to make sound decisions about investing in their future.

Access is only the tip of the iceberg. Employers must give employees the tools they need to choose the appropriate investments. Even employees who are automatically enrolled at 3% in an appropriate target fund need to know the basics of asset allocation and understand that 3% will likely not ensure a secure retirement. Education and advice are crucial and data shows that the right approach can make a difference.

The 2005 survey showed that 49% of Blacks versus 42% of Whites preferred to receive information on their retirement plans through one-on-one meetings or in seminars, and 27% of Blacks versus 16% of Whites prefer using advisors. Additionally, fewer Blacks (28%) than Whites (37%) want information through e-mail. This year's retiree survey also found that, all else being equal, retired Blacks who used a financial advisor or attended seminars were twice as likely as those who didn't to have over $100,000 saved.

Blacks are also more likely to trust people who look like them and share their experience, with three quarters of Blacks surveyed in 2000 agreeing that there are "not enough African-American role models in the financial community." In 1998, the first year of the survey, 58% of Blacks said they would be more likely to have an account with a financial services company with a racially diverse workforce.

America faces an increasing challenge to boost the national savings rate and provide for a more secure retirement for workers with the kind of common-sense approaches described here in the Ariel-Schwab Black Paper. A decade of research conducted by Ariel and Schwab offers a roadmap for moving forward. It now falls to the financial services industry, government, employers and individuals to work together to meet this challenge and to build a brighter future for everyone.

End notes

[1] The sample, national in scope, is drawn randomly from census exchanges that have a median income of $40,000 or more. In order to bolster the African-American sample, additional interviews are conducted in census exchanges that have a median income of $40,000 or more and that have a population that is at least 25% or above African-American. All respondents are over the age of 18 and have a household income of at least $50,000. Additionally, all identify themselves as the primary or joint decision-maker in the household in terms of investment decisions.

[2] A sample of 300 Black and 300 White retirees were surveyed by phone. All respondents had household incomes of over $50,000 before retirement and had been retired between one and ten years.

[3] In 2007, 57% of Blacks own stocks or stock mutual funds, compared with 76% of Whites. In 1998, the first year of the survey, 57% of Blacks owned stocks or stock mutual funds compared with 81% of Whites. Over the years, the Black figure rose to as high as 74%, while the White figure has consistently hovered between 76% and 84%.

[4] In 2007, the mean total amount of savings and investments is $142,000 for Blacks and $269,000 for Whites. (The corresponding median numbers are $48,000 and $100,000.) For Black retirees, the mean total of savings and investments is $151,000, and for White retirees it is $373,000. (The median savings amount for retired blacks in the survey was $73,000 compared to $210,000 for Whites.)

[5] In 1999, 24% of Blacks versus just 10% of Whites said they would "take money out of the stock market" if there were a major downturn.

[6] In the first year of the survey, Blacks on average said they planned to retire at the age of 58, while Whites on average planned to retire at the age of 61. The 2007 retiree survey showed that in fact Blacks did retire, on average, at 58, while Whites waited until 60.

[7] When retirees were asked if they were living comfortably or having trouble making ends meet, 78% of Blacks and 85% of Whites said they are comfortable.

[8] In 2000, 47% of non-retired Blacks and 62% of non-retired Whites said they expected to rely on an employer-sponsored retirement plan, such as a 401(k), as a source of money in retirement. In 2007, 83% of non-retired Blacks and Whites expect that such a plan will help pay for retirement.

[9] The 2007 retiree survey shows that 25% of Black retirees and 22% of White retirees are worried that they will outlive their retirement savings, and 52% of Black retirees and 51% of White retirees worry that a medical issue could impact them financially. Forty-one percent of Black retirees and 29% of White retirees say they are spending more on health care in their retirement than they had expected to.

[10] In 1998, 37% of Blacks said their most important reason for saving was retirement, versus 58% of Whites. In 2007, the numbers were statistically identical: 40% of Blacks versus 56% of Whites said retirement was the most important reason. In 2000, an analysis of respondents under 35 showed this to be true for younger people as well, with half as many Blacks (21%) as Whites (42%) citing retirement as their most important reason for saving.

[11] In 2007, Blacks who say saving for retirement is their main goal are 2.1 times more likely to be in the market today, all key demographic factors being equal. Whites are 1.7 times more likely to be in the market when saving for retirement is their main goal.

[12] In 2001, we looked at "likelihood to invest" and it jumped dramatically for Blacks when they began earning over $100,000 and skyrocketed when income exceeded $150,000. For Whites, higher income was not the driver to invest, but rather age. Whites over 35 were three times more likely to be investors than Whites under 35, regardless of income, while Blacks of all ages were equally likely to be investors when incomes are held constant.

[13] In 2007, when asked which of the following — stocks, mutual funds, bonds, real estate, whole life insurance — is the "best investment overall," 45% of Blacks chose real estate, compared to 33% for stocks and mutual funds combined. Just 34% of Whites chose real estate, whereas 45% of Whites chose stocks and mutual funds combined.

[14] Whites have favored stock market investments over real estate investments in all but two years of the research — 2003 and 2004. Nevertheless, Blacks have found real estate investments more attractive than Whites have in every year of the study.

[15] In 1999, 32% of those Blacks who said real estate was the best investment cited "less risky" as the reason; 25% cited "never go down in value"; and 21% said you can "earn rental income." In 2007, 45% of working Blacks and 32% of working Whites said rental income would help fund their retirement. In fact, just 16% of retired Blacks and 13% of retired Whites have any real estate income in their retirement.

[16] The 2007 retiree survey shows that just 32% of retired Blacks say that real estate is the best investment overall, versus 29% of retired Whites. Additionally, only 16% of Black retirees and 13% of White retirees identify rental income as a source of retirement income.

[17] In 2000, 32% of Blacks surveyed said they expect to support adult children versus 20% of Whites; that same year, 45% of Blacks said they expect to support aging parents, versus 29% of Whites.

[18] In 2007, Blacks are 1.88 times less likely to invest than Whites, all else being equal. Variables included as controls are income, assets, age, gender, marital status, adults other than spouse in household, education, employment status, government vs. business employment, and self-employment.

[19] In 2004, just 39% of Blacks could correctly link a "bull" market with a rising stock market. Only 56% of Blacks (and 65% of Whites) knew that when you own a stock, you own an ownership share of a company. (Other choices on the multiple-choice question were a loan to a company, a bet on a company, and "I don't know.")

[20] The 2004 survey showed that 30% of Blacks (vs. 15% of Whites) think market timing is more critical to investor success than patience or discipline. Those Blacks believing in market timing are 2.5 times less likely to be investors than those who believe in patience or discipline.

[21] In 2006, virtually identical percentages of Blacks and Whites (87% and 89%, respectively) said that individuals should be "very responsible" for retirement planning.

[22] In 1998, just 27% of Black and White investors said that they started investing as a result of having a 401(k) plan, with the rest saying they started investing on their own, with the help of a broker or financial advisor, and with the help of a friend.

The Ariel/Schwab Black Investor Survey:

Saving and Investing Among Higher Income African-American and White Americans

Ariel Investments, LLC and The Charles Schwab Corporation are non-affiliated entities, but co-sponsor the "Black Investor Survey"

ARIEL INVESTMENTS

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ARGOSY RESEARCH

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BACKGROUND AND OBJECTIVES

- Ariel Investments, LLC and The Charles Schwab Corporation commissioned Argosy Research to conduct the tenth wave of a primary research study comparing and contrasting higher income ($50,000 or more) African-American and White households in terms of their savings and investment attitudes and behaviors. Ariel and Schwab have jointly conducted previous waves of this research every year since 1998.

- The main objectives of this research are the following:
  - Identify similarities and differences between high income African-Americans and Whites with regard to saving and investing.
  - Examine the factors, particularly past influences and underlying beliefs, that may impact how African-Americans and Whites think about financial matters.
  - Determine any shifts in attitudes or behaviors over time.
  - Assess the expectations and issues that African-Americans and Whites face in their financial futures.

METHODOLOGY

- 503 African-Americans and 506 Whites were interviewed by phone between June 11 and July 13, 2008.

- All respondents were over the age of 18 and had a household income of at least $50,000. Additionally, all identified themselves as the primary or joint decision-maker in the household in terms of investment decisions.

- The sample, national in scope, was drawn randomly from census exchanges that have a median income of $40,000 or more. In order to bolster the African-American sample, additional interviews were conducted in census exchanges that have a median income of $40,000 or more and that have a population that is at least 25% or above African-American.

- The survey ran for an average of 11 minutes.

- *Note: Throughout this report, a bolded number indicates a figure significantly higher from a statistical standpoint than the number to which it is being compared.*

HIGHLIGHTS OF PREVIOUS STUDIES

January 1998

- The 1998 study revealed a number of interesting differences between the two groups surveyed, such as how, relative to Whites, African-Americans:
  - Are underinvested in the stock market, due to several social and cultural reasons.
  - Prefer more conservative investment vehicles, including life insurance; also regard real estate as the best investment overall.
  - Have less wealth than Whites with similar incomes.

January 1999

- The 1999 study helped identify why certain attitudes and behaviors are so divergent. The reasons for the differences were found to include:
  - African-Americans were introduced to savings and investing tools later in life.
  - African-Americans are motivated to invest in more conservative investment vehicles because of the feeling of security those investments provide.
- At the same time, this study also uncovered heightened interest in investing among African-Americans relative to Whites.
- Other areas explored included how women and men behave differently. Women are more likely than men to consider themselves beginner investors, are relatively underinvested, and are more likely to own conservative investments than men.

HIGHLIGHTS OF PREVIOUS STUDIES (CONTINUED)

April 2000

- The 2000 study found that family obligations, including children's education, dictate African-American savings.
  - More African-Americans than Whites expect to support adult children; also, more African-Americans expect to support aging parents.
  - African-Americans are saving as much or even more for education than Whites. In addition, more African-Americans than Whites cite education as the key to financial success.
  - On the other hand, African-Americans have considerably less saved for retirement than Whites and fewer African-Americans cite "retirement" as their most important reason for saving.

June 2001

- The 2001 study found that even after controlling for demographic and behavioral variables, African-Americans are still 35% less likely to invest than Whites. In examining the key factors influencing investing patterns among African-Americans and Whites, we found:
  - African-Americans become increasingly more likely to invest as they earn more. Income is not a determinant of investing among Whites.
  - Regardless of their income, Whites begin investing at fairly young ages, while the likelihood of investing for African-Americans does not track with age.

HIGHLIGHTS OF PREVIOUS STUDIES (CONTINUED)

June 2002

- The 2002 study explored financial attitudes and behaviors in the wake of the lingering recession, a down market for much of 2001, and the September terrorist attacks:
  - Just a handful of Blacks and Whites (6% and 7% respectively) liquidated any investments as a result of the recession or acts of terrorism.
  - A sharply rising percentage of all investors agreed that, "The recent stock market volatility has shaken [their] long-term confidence in the stock market." Blacks in agreement rose from 32% to 43% since last year; Whites went from 15% to 25%.
  - More Blacks than Whites (49% vs. 39%) felt "more anxious about [their] financial situation than [they] were a year ago," and far fewer Blacks than Whites (46% vs. 68% respectively) thought the economy would improve within the next 12 months.

June 2003

- The 2003 survey showed that many higher income African-Americans were retreating from the stock market. After five straight years of steady increases in the percentages of Blacks who own stocks, only 61% of Blacks in 2003 had money in the market, down from 74% in 2002 and approaching the 1998 level of 57%. White stock ownership, held steady at 79%.
- Real estate and other investments were increasingly in favor with both groups.
  - With interest rates at 35-year lows, White attitudes toward real estate investing approached Black historical preferences for real estate investing.
  - When asked which is the "better investment" -- home improvements or stocks -- 76% of Blacks and 61% of Whites chose home improvements, while only 20% of Blacks and 33% of Whites chose stocks.

HIGHLIGHTS OF PREVIOUS STUDIES (CONTINUED)

June 2004

- The 2004 survey further explained the gap between African-American and White investing by uncovering a misperception by Blacks that investors need to be skilled at market timing, or buying and selling stocks at exactly the right time, in order to be successful.
  - Those Blacks citing patience or discipline as an important factor for investing success are two and a half times more likely to be investors than those believing that knowing how to time the market is the most important success factor.
- The survey included a 10-question investment quiz that a majority of both Black and White investors failed, showing that many Americans, both Black and White, misunderstand or are unfamiliar with market lingo commonly used by the media and investment companies. Furthermore, many do not know basic facts about investing and the stock market.

July 2005

- The 2005 study found that for African-Americans, employer-sponsored retirement plans have the potential to be an effective entrée into the world of investing.
  - African-Americans who are saving primarily for retirement are almost twice as likely to be stock investors as those who are saving for other reasons, such as to pay for education. Whites are equally likely to be investors regardless of their goals.
  - Fewer Blacks than Whites overall, however, consider retirement their most important goal.
  - Additionally, those Blacks who are investing regularly in retirement accounts contribute significantly less per month to their accounts, and more Black plan participants than White participants have withdrawn money from their accounts prior to retirement (36% vs. 24%).
  - Blacks who have help from a financial advisor contribute more money on a monthly basis to their retirement plans than those who do it alone.

HIGHLIGHTS OF PREVIOUS STUDIES (CONTINUED)

June 2006

- The 2006 study found that Black and White Americans differ in their expectations and strategies about retirement. Notably, African-Americans are significantly more reliant on employer pensions than Whites.
  - Two-thirds of employed Blacks, compared to about half of employed Whites work for employers with a traditional pension plan; however, large percentages of both Blacks and Whites (50% and 55%) believe that corporate pension funds will no longer exist in a decade.
  - All else being equal, African-Americans are twice as likely as Whites to believe government and corporations bear significant responsibility for ensuring Americans a comfortable retirement.
- African-Americans remain optimistic about retirement: fewer Blacks than Whites (24% versus 30%) say they are worried about their retirement; and more Blacks aim to retire early, with twice as many Blacks as Whites hoping to retire before the age of 60.
- However, for many African-Americans, retirement is just the beginning of a new phase of work.
  - While both groups have similar aspirations for retirement (maintain standard of living, travel more, etc.), three times the number of African-Americans versus Whites (29% versus 10%) say they plan to start a business after they retire.
  - More Blacks than Whites say they expect real estate investments to help fund retirement.
  - Twice as many Blacks as Whites (34% versus 16%) say they are currently saving to buy real estate, start a business, or both.

HIGHLIGHTS OF PREVIOUS STUDIES (CONTINUED)

October 2007

- In 2007, African-American stock market participation was at the same level as it was ten years prior (the first year of the survey): at a low of 57% (compared to a high of 74% in 2002). White investing was at 76% last year.
- Even when all other significant demographic factors are held constant (age, income, gender, education, and so on), Whites are nearly twice as likely as African-Americans to be investors than Whites.
- While 56% of Whites say that retirement is their most important goal for saving and investing, only 40% of African-Americans see retirement as their priority. All else being equal (income, age, etc.), Blacks are 50% less likely to say retirement is their primary savings goal.
- African-Americans continue to lag their White counterparts in monthly savings, and the average value of overall savings and investments by African-Americans is less than half of what it is for Whites.
- Of those who invest, more African-Americans (55%) than Whites (47%) report that they first started investing as a result of having a 401(k) or other employer-sponsored retirement plan.
- When asked which is a bigger worry: day-to-day expenses, or having enough money to retire, 41% of African-Americans cited expenses, and 59% cited retirement. In contrast, only 29% of Whites cited expenses and 71% cited retirement.

HIGHLIGHTS OF THIS YEAR'S STUDY

July 2008

- African-Americans are on equal footing with Whites when it comes to accessing and enrolling in employer-sponsored defined contribution plans, but save far less each month and have a considerably smaller nest egg than their White counterparts.
  - About nine in ten of both Blacks and Whites who are working have access to a defined contribution plan such as a 401(k).
  - Of those with such a plan, about 90% of both groups contribute regularly.
  - However, the median monthly amount that Blacks contribute to their 401(k) plan is $169, while Whites contribute about 50% more, or $249 each month.
  - As a result, the median total household savings for retirement reported by Black respondents is $53,000, in contrast to Whites at $114,000.

- For many younger African-Americans, saving for retirement is more of a dream than a priority.
  - African-American are half as likely to cite retirement as their most important goal when saving and investing (after controlling for income, education, age and other key demographics).
  - At the same time, 45% of Blacks under the age of 50 (compared to 26% of Whites) say they want to retire by age 60,
  - Among those older than 50, however, reality has set in: a far smaller 24% of Blacks and 9% of Whites still plan to retire by age 60.

HIGHLIGHTS OF THIS YEAR'S STUDY (cont.)

- With some help from employers, all employees, but particularly African-Americans, would be likely to ramp up their monthly 401(k) savings.
  - About two-thirds of African-Americans (compared to about a half of Whites) say they would increase contributions to their retirement plan if employers provided access to financial advisors, seminars about retirement investing, and/or education about the features of the plan.

- This year's findings show that 62% of higher income Blacks own stocks or mutual funds versus 82% of Whites.
  - Over the last 11 years, Black stock ownership has fluctuated between last year's low of 57% and a high of 74% in 2002.
  - Over the same period, White stock ownership has consistently hovered around 80%.

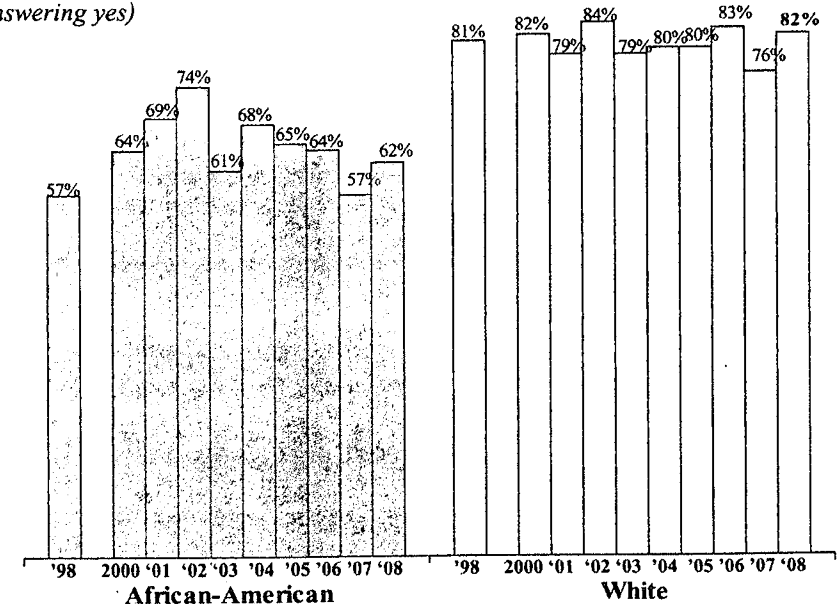
- While overall stock ownership among Blacks is still lagging, the historical preference for real estate among Blacks is at historic lows.
  - This year, just 39% of Blacks said real estate was the "best investment overall" compared to 37% of Blacks who picked stocks or mutual funds.
  - Among Whites, just 28% chose real estate compared to 55% who chose stocks and mutual funds.
  - In 2004, at the height of the real estate bubble, 61% of Blacks and 51% of Whites said it was the best investment overall.

DETAILED FINDINGS

TRENDS IN MARKET PARTICIPATION

Do you personally, or with a spouse, have any money invested in the stock market right now, either in individual stocks or in a stock mutual fund?

(% answering yes)



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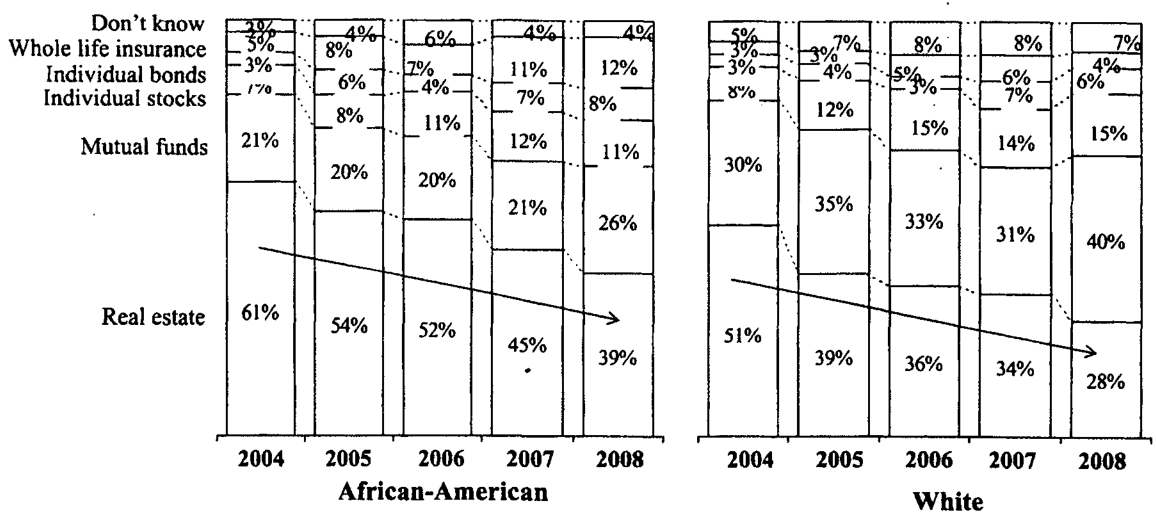
PERCEPTIONS OF BEST INVESTMENTS OVERALL

Which of the following do you think is the best investment overall?



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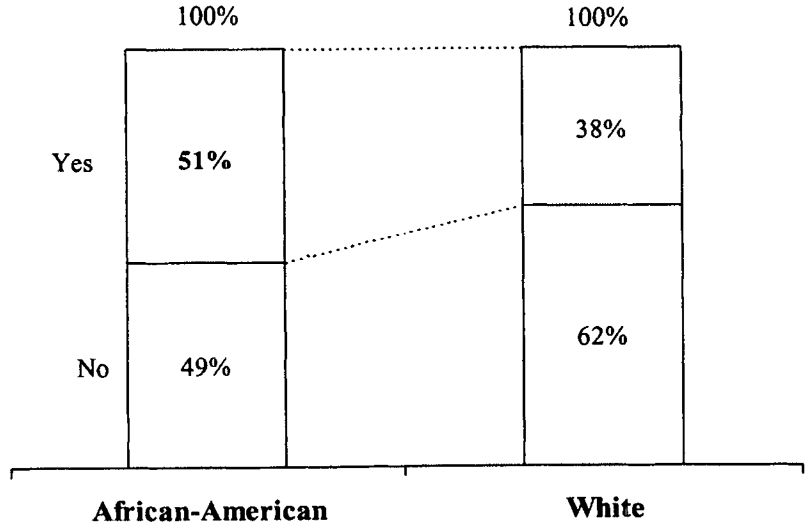
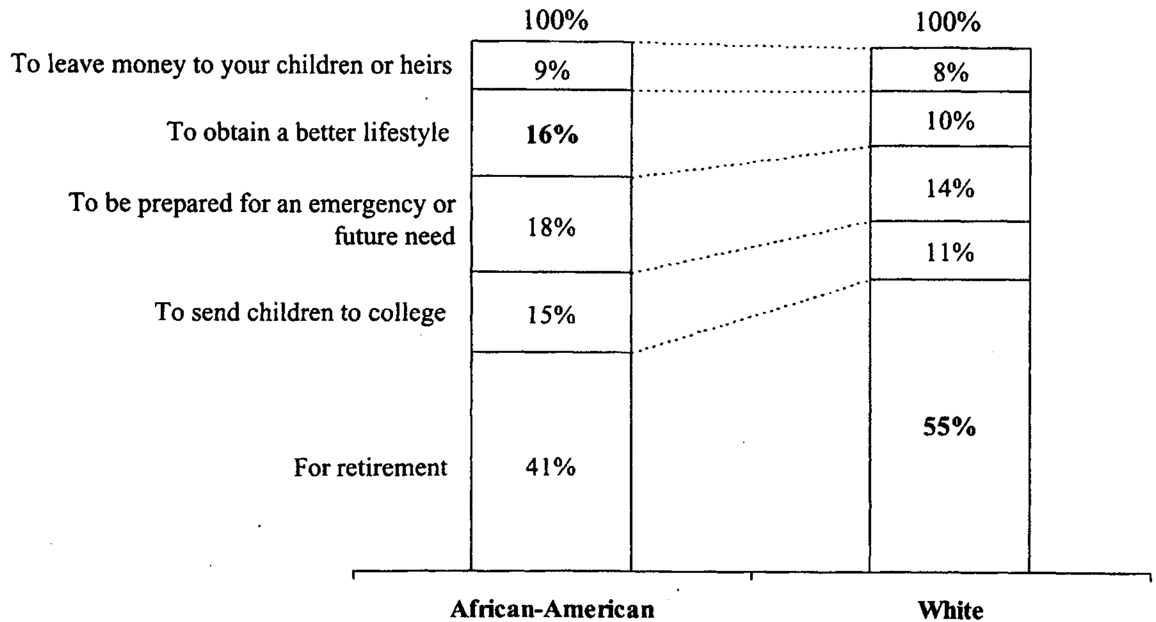
ADJUSTED FINANCIAL ACTIVITIES DUE TO HOUSING MARKET UNCERTAINTY

In the last few years, the value of many American homes has dropped considerably. Have you personally adjusted your spending, saving or investing habits as a result?



GOAL FOR SAVINGS AND INVESTING

Of the following, which would you say is your most important goal in saving or investing money?



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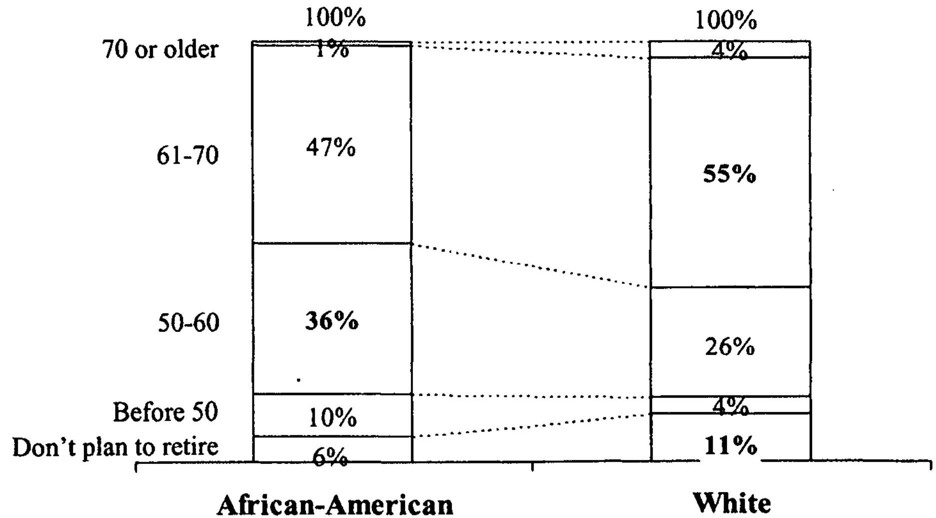
ANTICIPATED AGE OF RETIREMENT

At what age are you planning to retire?
Base: Not retired



Average Retirement Age	60 years old	**63 years old**

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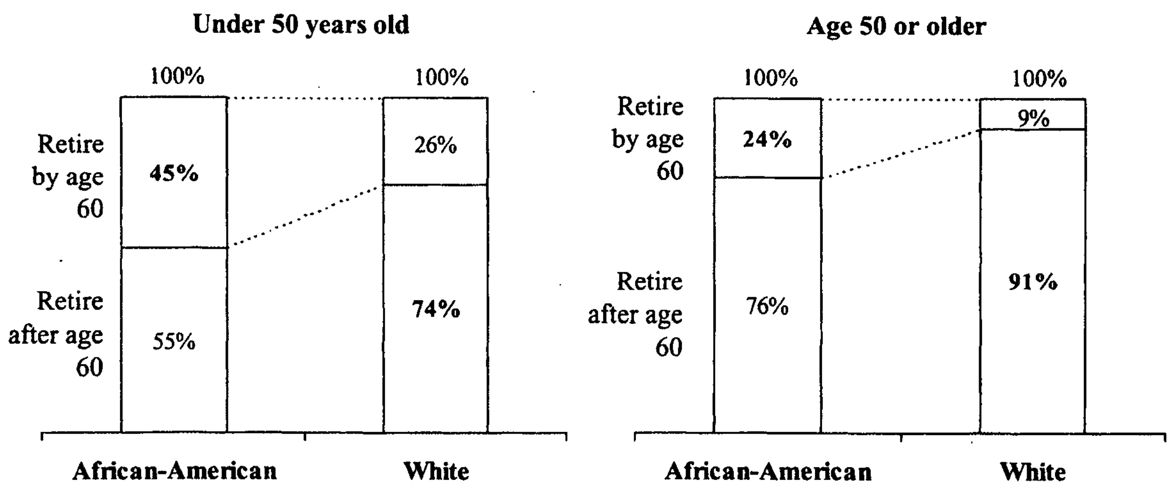
ANTICIPATED AGE OF RETIREMENT BY CURRENT AGE

At what age are you planning to retire?

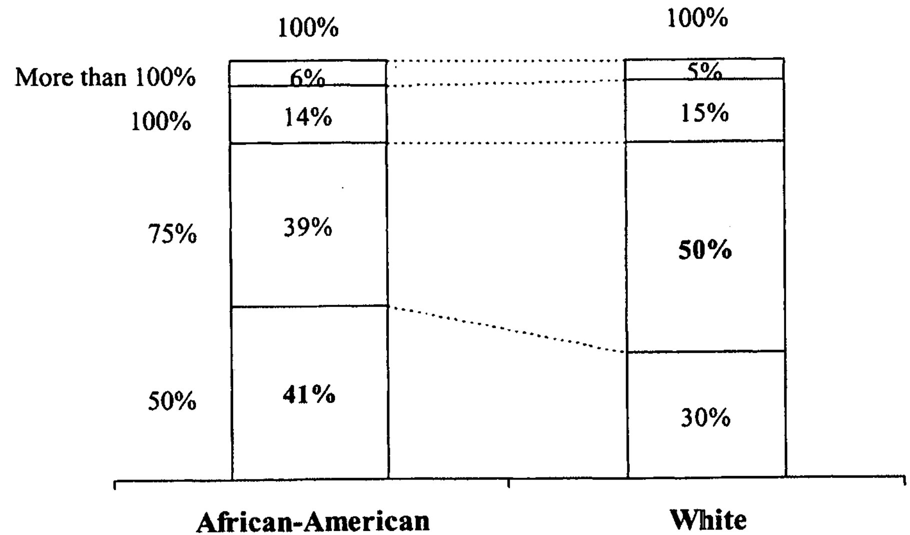
Base: Not retired



PERCEPTIONS OF INCOME NEEDED TO MAINTAIN CURRENT LIFESTYLE

When you retire, what percentage of your household income do you think you will need in order to keep your standard of living similar to what it is now? Would you say it would be closest to about…?

Base: Not retired



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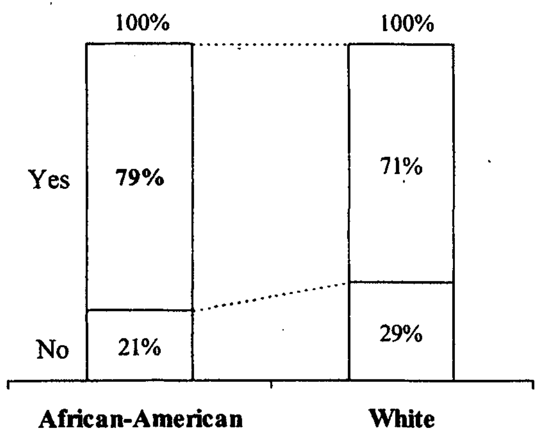
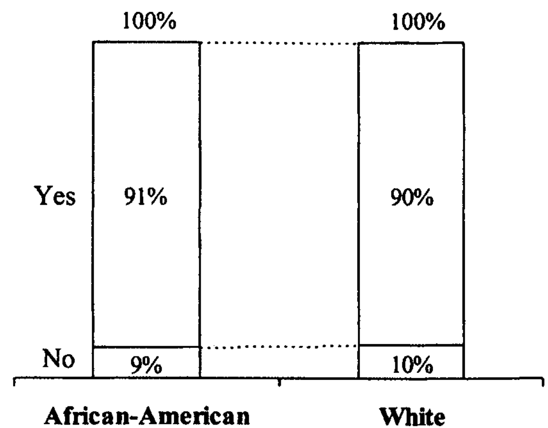
DEFINED BENEFIT/CONTRIBUTION PLAN PARTICIPATION

Do you have any defined benefit retirement plans, either with a current or former employer? Does your employer provide you with the option to save some of your earnings in a defined contribution plan? And do you participate in this plan?

DB Plan Participation



DC Plan Participation

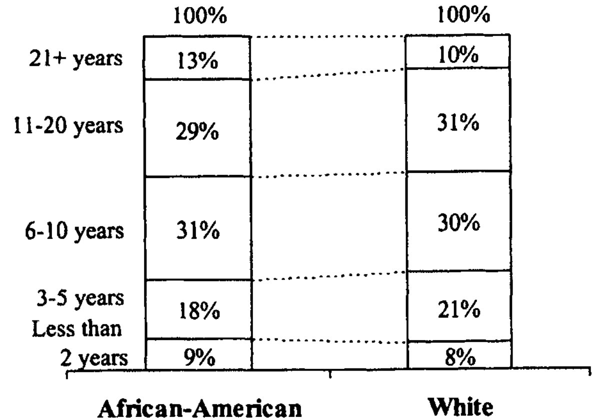


Employer offers DC plan	89%	87%

CURRENT DEFINED CONTRIBUTION PLAN HISTORY

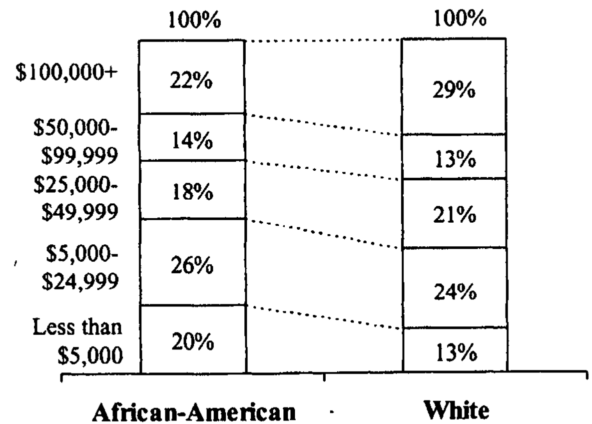
How many years ago did you first start participating in this plan?
About how much money in total have you accumulated so far in this DC plan?

Number of Years Participating



Average	12 years	11 years

Assets Accumulated in DC Plan



Median	$32,000	$40,000

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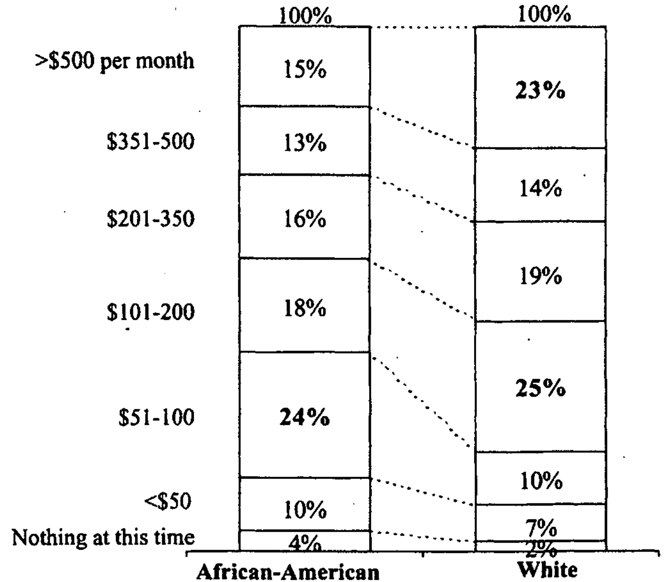
MONTHLY RETIREMENT ACCOUNT CONTRIBUTIONS

How much money are you investing per month in any sort of retirement account, including an employer sponsored retirement plan?

Base: Employed and have money in a retirement plan



	African-American	White
Mean monthly amount	$262	**$331**
Median	$169	$249

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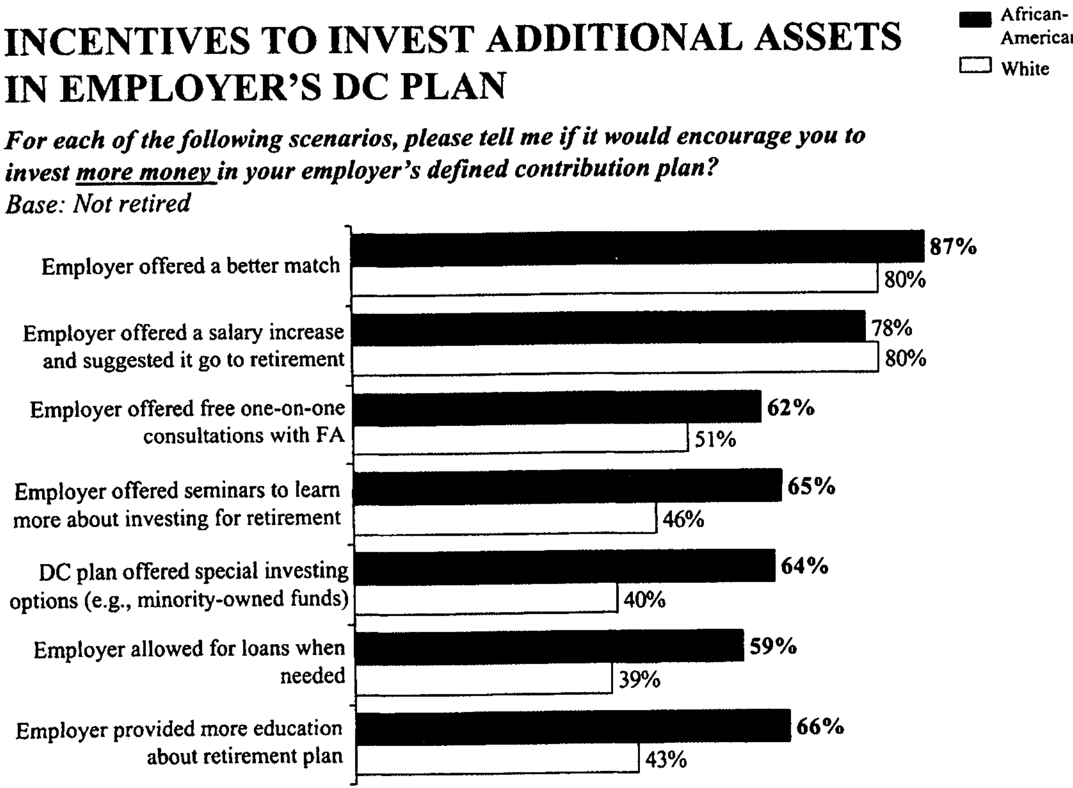
INCENTIVES TO INVEST ADDITIONAL ASSETS IN EMPLOYER'S DC PLAN

For each of the following scenarios, please tell me if it would encourage you to invest <u>more money</u> in your employer's defined contribution plan?

Base: Not retired



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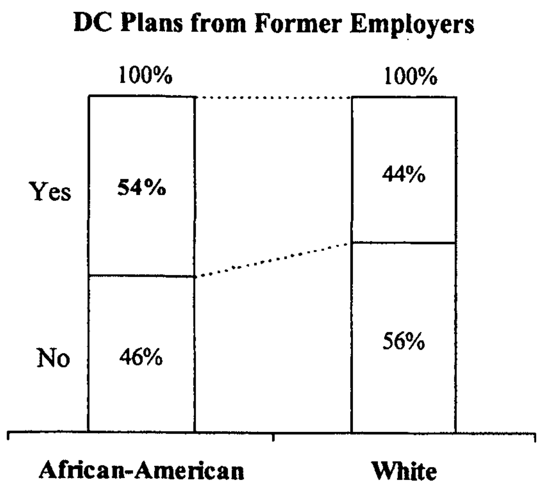
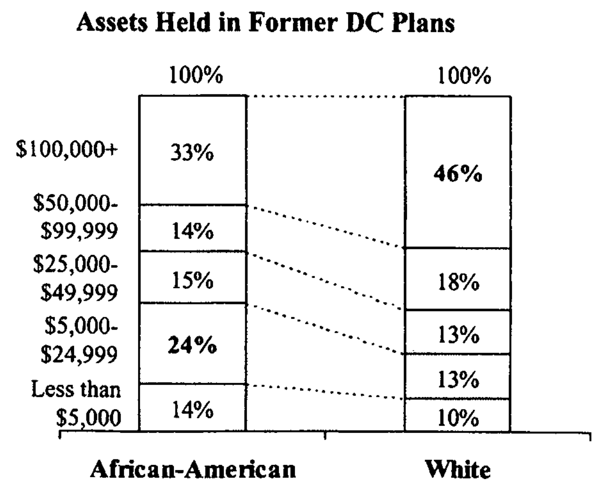
DEFINED CONTRIBUTION PLANS FROM FORMER EMPLOYERS

Do have any defined contribution plans from former employers?
And about how much money in total do you currently have in these defined contribution retirement plans?





Median	$45,000	$89,000

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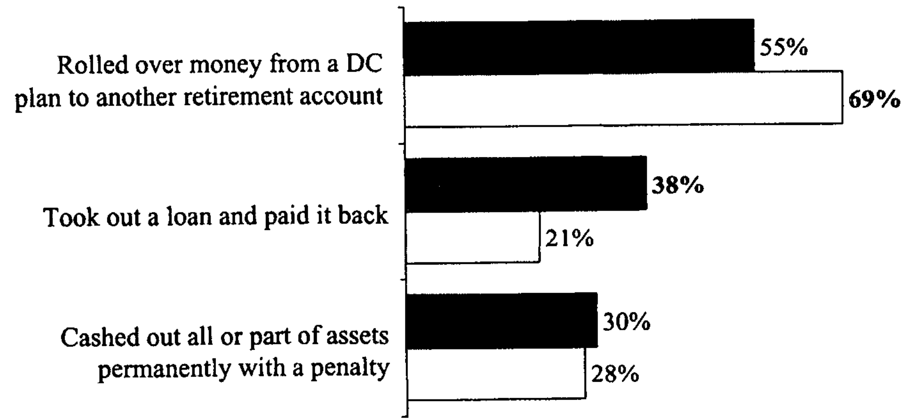
ACTIONS TAKEN WITH DC PLAN ASSETS

Have you ever…?
Base: Not retired



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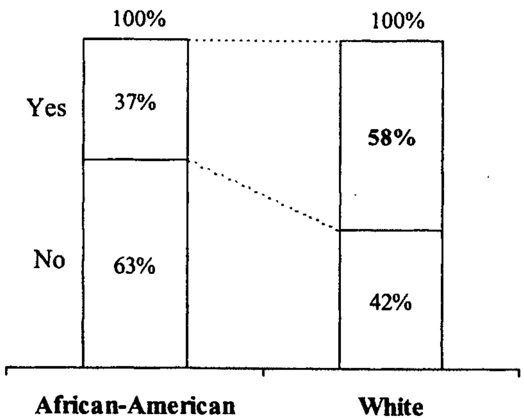
IRA OWNERSHIP

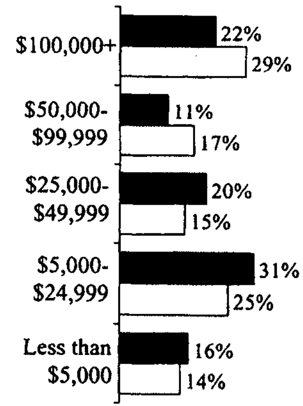
African-American
White

Do you have any Individual Retirement Accounts, commonly known as IRAs?
About how much money in total do you currently have in IRAs?

Have an IRA



Total Assets Held in IRA



Median:	African-American	White
	$28,000	$44,000

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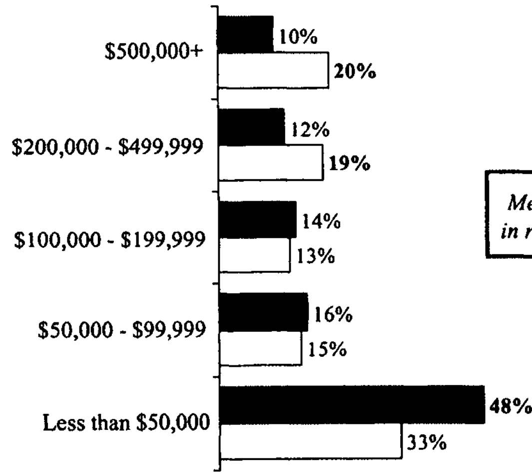
TOTAL ASSETS HELD IN RETIREMENT PLANS

Thinking about all the various retirement plans we have talked about, what would you say is the total amount of money you currently have saved specifically for retirement?



	African-American	White
Median assets held in retirement plans:	$53K	$114K

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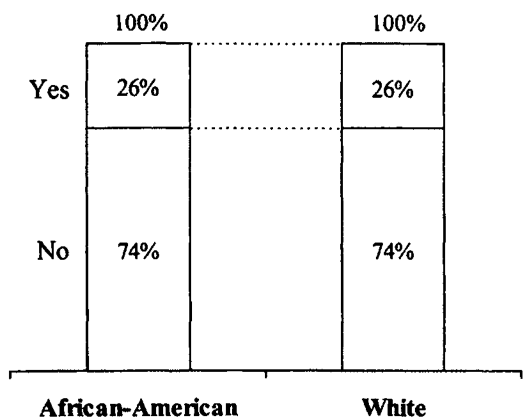
RETIREMENT SAVINGS HELD OUTSIDE PLANS

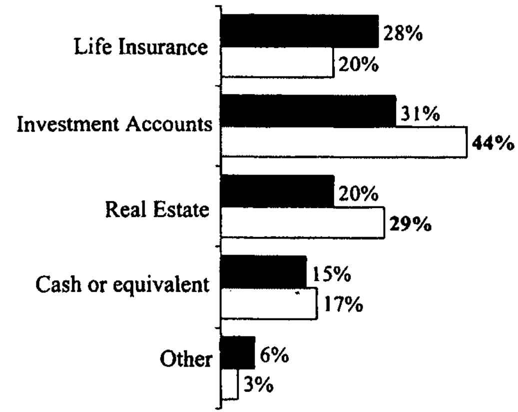
African-American
White

Apart from any of the retirement plans we've already talked about, do you have any other savings earmarked specifically for retirement?
And what form do these additional retirement savings take?

Hold Retirement Assets Outside Retirement Accounts



Additional Retirement Assets Held in…



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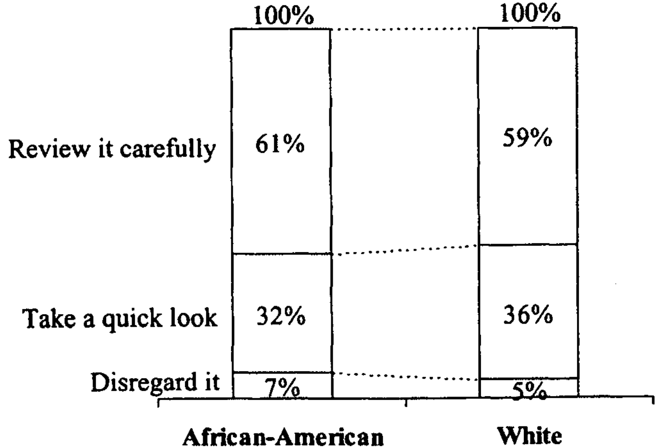
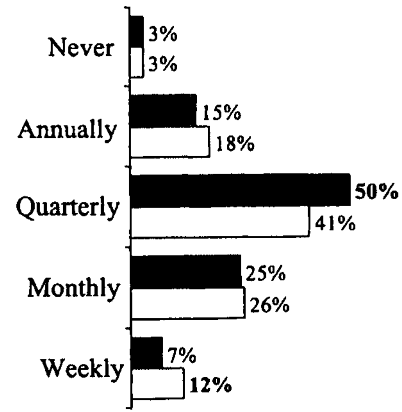
DEGREE OF INVOLVEMENT MONITORING RETIREMENT PLAN ACCOUNTS

When you receive a retirement account statement, do you usually…?
And about how often do you review the investment in any or all of your retirement accounts?

Reviewing Retirement Account Statements



How Often Review Retirement Plan Statements



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DEMOGRAPHICS

DEMOGRAPHIC/FINANCIAL PROFILE

GENDER

	African-American %	White %
Male	39	47
Female	61	53

AGE

	African-American %	White %
18-29	7	6
30-39	21	16
40-49	27	23
50-64	37	39
65+	8	16
Mean	47	51
Median	47	52

EDUCATION

	African-American %	White %
Some HS or less	5	1
HS graduate	15	13
Some college	23	18
College graduate	34	41
Postgraduate study	23	27

HOUSEHOLD INCOME

	African-American %	White %
$50,000-74,999	43	31
$75,000-99,999	24	25
$100,000-149,999	17	26
$150,000-250,000	13	13
Over $250,0000	3	5
Mean	$107K	$119K
Median	$82K	$94K

EMPLOYMENT STATUS

	African-American %	White %
Employed full time*	73	64
Retired	14	19
Employed part-time*	6	6
Unemployed	4	2
Homemaker	2	8
Full-time student	1	1

*Of these, 21% of African-Americans and 27% of Whites are self-employed.

TYPE OF EMPLOYER
(of those employed)

	African-American %	White %
Business	49	57
Government	34	28
Not-for-profit	17	15

DEMOGRAPHIC/FINANCIAL PROFILE (CONTINUED)

MARITAL STATUS

	African-American %	White %
Single/never married	25	9
Not married/living together	3	3
Married	54	79
Divorced/separated	14	6
Widowed	4	3

NON-SPOUSE ADULTS IN HOME

	African-American %	White %
Other adults present	28	26
No other adults present	72	74

VALUE OF SAVINGS AND INVESTMENTS (ex. real estate)

	African-American %	White %
>$1,000,000	3	7
$500,00-$999,999	10	14
$250,000-$499,999	14	17
$100,000-$249,999	13	18
$50,000-$99,999	20	17
$25,000-$49,999	15	9
$5,000-$24,999	14	12
<$5,000	11	6
Mean	$225K	$367K
Median	$75K	$156K

MONTHLY SAVINGS/INVESTMENTS

	African-American %	White %
$2,500+	6	8
$1,001-$2,500	7	11
$501-$1,000	17	18
$351-$500	15	13
$201-$350	10	15
$101-$200	14	11
$51-$100	13	9
<$50	6	4
Nothing at this time	12	13
Mean	$507	$599
Median	$276	$338