NATIONAL ENDOWMENT FOR FINANCIAL EDUCATION

Partnering for Financial Well-Being

Testimony of

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Before

The Special Committee on Aging
United States Senate

Regarding

"The Retirement Challenge: Making Savings Last a Lifetime"

June 16, 2010

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I am Ted Beck, President and Chief Executive Officer of the National Endowment for Financial Education®, (NEFE®), located in Denver, Colorado. We at NEFE would like to thank Chairman Kohl, Ranking Member Corker, and Members of the Special Committee on Aging for this opportunity to share our views on retirement income.

NEFE Overview

The National Endowment for Financial Education is the only private, nonprofit, noncommercial, nonpartisan, self-funded national foundation wholly dedicated to improving the financial well-being of all Americans. NEFE provides funding, logistical support, and personal finance expertise to develop a variety of programs and materials, including the award-winning High School Financial Planning Program® (HSFPP), CashCourse® college program, and the consumer-oriented Smart About Money public awareness campaign. NEFE also funds research and awards research-based development grants that advance innovative thinking and contribute to our understanding of financial behavior.

NEFE places a special emphasis on underserved audiences who face financial challenges not being addressed by others. To best serve these audiences and provide them with the most accessible, meaningful, and up-to-date financial education possible, NEFE collaborates with experienced and knowledgeable leaders of consumer organizations; financial planning practices; academia; national, regional, and local foundations and nonprofits; and state and federal governments. In addition, NEFE is in contact with financial services and education communities. Not only do we work with organizations such as the American Red Cross and Boys and Girls Clubs of America to create customized financial education resources, we serve in other roles as well. For example, we are an advisor to the Social Security Administration's Financial Literacy Research Consortium at both the Financial Literacy Research Center at Dartmouth College and at the Center for Retirement Research at Boston College, and funded a study at the University of Notre Dame Institute for Latino Studies entitled *La Tercera Edad: Latinos' Pensions, Retirement and Impact on Families*. In all areas of our work, NEFE supports collective progress rather than duplication of effort.

NEFE and Retirement Issues

Over the last twenty years, there's been a transfer of retirement decision making to the individual. However, research indicates that Americans aged 55 years and older struggle with basic financial concepts and terms, leaving many individuals unprepared to assume this responsibility in an increasingly complex investment environment. NEFE saw a need to provide tools and resources to these individuals in order to simplify and clarify the retirement decision making process.

NEFE tackles difficult financial education topics and looks for creative ways to advance knowledge, awareness, and behavior change among Americans. One way we do this is by hosting think tanks and symposia on topics that are generally challenging and/or have not received adequate consideration to the broad, underserved audience that NEFE seeks to assist. In 2006, observations by NEFE leaders inspired the idea of holding a retirement-based think tank event: Though strategies abound on how to accumulate retirement assets, less attention is given to formulating strategies for decumulation and managing retirement income. For millions of Americans of modest means about to enter retirement financially unprepared, strategies for decumulating their limited assets receive the least attention of all.

In consideration of the incomplete and fragmented body of knowledge on retirement decumulation, NEFE saw an opportunity to investigate this deficiency within the context of its mission: helping individual Americans acquire the knowledge and skills necessary to take control of their financial futures. In the case of retirement income decumulation, the households that are most often overlooked are those that are not on public assistance, but earn less than the mass affluent and are unlikely to pay for professional advice. NEFE refers to this group as "At-Risk Middle America," a large segment of the population that generally has a household pre-retirement income of between $30,000 and $100,000.

NEFE's Retirement Income Decumulation Think Tank and Outcomes

The goal of coordinating what would become NEFE's *Retirement Income Decumulation Think Tank* was to host a strategic gathering comprised of a diverse group of retirement experts and thought leaders representing consumer advocacy associations, research organizations, financial planners, academic institutions, financial services providers, regulatory agencies, and the federal government. The event required more than a year of preparation, including a preliminary roundtable, advance interviews with all participants, and the completion of a comprehensive research survey of academic literature conducted by the Center for Retirement Research at Boston College. This pioneering academic literature review aggregated the most commonly proposed consumer guidelines within key areas in which Americans make critical—and often irrevocable—decisions about initiating and paying for their retirement.

In December 2007, the *Retirement Income Decumulation Think Tank* was held for two days in the Boston area and generated considerable discussion about the best approach to influence better retirement decumulation decisions. The most important outcome of NEFE's think tank event was the creation of a set of universal retirement decumulation guidelines within eight critical "decision areas": Work, Social Security, Home & Mortgage, Insurance, Pensions, Retirement Plans, Debt, and Fraud. In research presentations and breakout work groups, NEFE's think tank experts dissected, debated, and defended countless considerations and specifics regarding which decision area guidelines are the most important to be communicated to At-Risk Middle America. Following the think tank, NEFE's team consolidated and summarized the experts' consensus as a strategic message document, which underwent additional expert review and revision. NEFE's considerable facilitation efforts finally produced a single, easy-to-understand set of the most important guidelines for all Middle American consumers—at-risk and not—to follow in preparing and paying for their retirement.

Currently, the primary vehicle to disseminate the messages resulting from the think tank is a consumer website (www.myretirementpaycheck.org) which features the eight most critical decision areas. The site's concept was tested among targeted consumers to make sure the language, approach, and content would be relevant and accessible. We found that the information and guidelines contained on the site are applicable to varied audiences:

- People who already are in retirement still have decisions to optimize. Decumulation is not an end point; it's an ongoing process.
- People expecting to retire within ten years have the most to gain from this information, because it creates awareness of these decisions in their planning timeframe.
- Even younger people, those in their 30s and 40s, benefit; knowing what decisions they'll face develops a realistic picture of retirement.
- Peers and loved ones of pre-retirees and retirees can put these guidelines to use as they set examples of successful decumulation decision making, pass on information, and influence opportunities for learning.

<u>Retirement as a Holistic Process</u>

Throughout our research and message development, we found that every decision area is important. Just as retirement planning encompasses savings, work, pensions, and Social Security, decisions about drawing down assets are interrelated as well. This synergy can work to a retiree's detriment or benefit, depending on how informed his or her choices are. By piecing together many different streams of income, taking responsibility for making wise decisions, and appropriately growing and protecting assets, Americans can make a small nest egg last longer. Academic research and evidence suggests that retirement is a holistic process, with each decision area affecting other areas of consideration. For example, a person's decision to work longer affects his or her Social Security benefits, leads to increased retirement plan contributions, and allows him or her to maintain health care benefits longer. Therefore, individuals who are informed and responsible can optimize their decision making and make their limited resources last longer, providing them with greater security and financial well-being in retirement.

This new expression of the interrelation of decumulation decisions is featured on NEFE's MyRetirementPaycheck.org. Excerpted examples across the eight decision areas include:

- <u>Work</u>: If you are healthy, aim to work at least until your full retirement age. It produces many benefits, including prolonging any health care coverage you have, building your retirement assets, and increasing your ability to reduce debt. Give additional consideration to how working relates to:
  - <u>Social Security</u>: By delaying taking Social Security, you will receive larger monthly payments over your lifetime, and Social Security retirement benefits are adjusted for inflation.
  - <u>Retirement Plans</u>: Working longer leads to increased retirement plan contributions. You will keep adding to your retirement nest egg instead of depleting it too quickly.
  - <u>Insurance</u>: You will keep your health care benefits longer, ideally to at least age 65, when you can become eligible for Medicare.
- <u>Social Security:</u> Taking Social Security payments too early means receiving less money each month than you would receive if you waited for even a few years. If at all possible, do not begin taking Social Security until you are at least your full retirement age. If you take Social Security benefits at age 62, your benefit will be approximately 25 to 30 percent less than if you have waited until your full retirement age. For an even bigger benefit, wait until age 70, when your payment will be at least 75 percent higher than if you started taking benefits at 62. Give additional consideration to how Social Security relates to:
  - <u>Work</u>: By working longer, you can delay taking Social Security benefits, and you also may be able to increase the size of your Social Security benefit based on additional years

of earnings and/or higher wages. You'll add to your nest egg and prolong any health care coverage you may have.

- Home & Mortgage: A house may be your biggest asset, but be careful about viewing the value of your house as it were a retirement plan. Housing prices fluctuate and you need other forms of savings. It's best to plan that a home's equity is one of the last assets you use in your retirement. Give additional consideration to how Home & Mortgage relates to:
  - Fraud: Protect your home equity from mortgage schemes by making decisions based on research and investigating charges, fees and other options.
  - Debt: If at all possible, plan to pay off your mortgage and otherwise reduce your housing costs before retiring.
- Insurance: Your retirement spending plan is not complete until you know how you will pay for medical and long-term care needs. Insurance companies also sell many forms of annuities. Putting at least part of your retirement savings into an immediate fixed annuity that will give you a monthly payment for the rest of your life creates a regular source of income. Give additional consideration to how Insurance relates to:
  - Work: You won't become eligible for Medicare until age 65; use your or your spouse's employer-provided health care coverage as long as possible.
  - Debt: Understand that Medicare is not a free pass; in fact, it may only pay a portion of your health care expenses. To avoid debt, one should plan to save for out-of-pocket medical expenses and premiums.
- Pensions: Your employer pension is an annuity that gives you a steady "paycheck" for your retirement. Even when you're retired, saving some of your pension benefits is a good way to protect yourself from inflation and ensure you have enough money for your later years. Give additional consideration to how Pensions relate to:
  - Work: Working longer and at higher wages can increase your pension check. Be sure you clearly understand the terms of accepting early retirement incentives and lump-sum payouts.
  - Social Security: Use your pension as a bridge to Social Security. By delaying taking Social Security, you'll receive a larger Social Security benefit. Unlike most pensions, Social Security is indexed for inflation so you'll have more purchasing power in future years.
- Retirement Plans: You do not know whether your retirement will last less than 10 years or more than 40 years. To be prepared for reaching advanced age, continue saving and making wise investments even during your retirement. At retirement, most retirees still need to invest in diversified assets that may need to last decades or help weather investment market turmoil. Give additional consideration to how Retirement Plans relate to:
  - Work: Cashing out your 401(k) savings before age 59 ½ usually will cost you money (in taxes and penalties) and have a negative impact on your ability to pay for retirement.
  - Fraud: Never forget that your retirement money is being targeted by con artists, Internet fraud, and financial scams. Never make decisions without double-checking the facts and the people they might do business with.
- Debt: To maintain a predictable cash flow in your retirement years, make every effort to pay off your consumer and credit card debt before you retire, and don't borrow money during retirement unless you know precisely how you'll pay it back. Consider the 10 years before retirement as your "debt-reduction" decade. Give additional consideration to how Debt relates to:
  - Home & Mortgage: Don't take new debt against a home but instead reduce any existing debt, if possible.

    - Retirement Plans: Don't "borrow" money by spending your 401(k) savings before you retire. It will have a negative impact on your ability to pay for retirement.
- Fraud: You've worked hard building up retirement assets. Now you need to protect them. Older Americans—even those who are experienced with investing and are financially literate—are highly targeted by scammers, misleading advertising, and fraud, so be especially on guard. Make no money decisions quickly, and never without getting a second or third opinion from people you trust. If it sounds too good to be true, it almost always is. Give additional consideration to how Fraud relates to:
    - Retirement Plans: Get good, objective advice from a qualified financial planner about how to best invest your assets to fit your personal situation.
    - Home & Mortgage: Protect your home equity from mortgage schemes by making decisions based on research. Thoroughly investigate charges, fees, and other options.

My Retirement Paycheck

The conventional approach to retirement decumulation emphasizes how an action taken (or not) within a specific decision area either produces or reduces retirement income. NEFE's research and work in this area shows that determining one's retirement paycheck involves a holistic approach to retirement. This helps individuals understand the impact of each decision, as well as have a better idea of what they can expect to pay themselves throughout retirement. The phrase "retirement paycheck" is at once relevant and practical: it describes how each decision area and income stream works together to create a "paycheck." This concept provides more opportunities for optimization and better serves Americans who do not have much leeway to make mistakes with their resources.

MyRetirementPaycheck.org is built to show interrelation and connectivity. The consumer-centric website provides a holistic and comprehensive collection of guidelines, articles, and additional links and resources to help At-Risk Middle Americans become informed, active participants in their retirement decisions. Beyond the guidelines for each decision area, users can access short articles that provide more in-depth information about special situations and considerations within each of the eight decision areas. Related links provided in each area also contain useful tools such as calculators and estimators from vetted sources such as government and nonprofit organizations.

Effective Retirement Education

In NEFE's focus groups, we found that many retirees often go to their employer as a trusted source to guide them through retirement decisions. However, many retirees aren't getting the "whole picture" when it comes to their options in retirement; it's unlikely that companies educate their employees beyond what pertains to employee benefits. Because of this narrow scope, retirement planning is often limited and incomplete. Furthermore, saving for retirement—even through an employer's plan—sometimes is perceived as daunting and unattainable. Though these attitudes are difficult to overcome, a study funded by NEFE and conducted by Dartmouth College in 2009 showed that by using simple messaging and peer education, employees are more likely to open supplemental retirement accounts on their own.

Increasing the Effectiveness of Retirement Saving Programs for Females and Low Income Employees: A Marketing Approach details this research project. The goal of the study was to encourage new employees—especially female and low income employees, since they face unique savings challenges—to voluntarily save for retirement. Specifically, the research project sought to meet three objectives: (1) to reduce anxiety about future retirement needs; (2) to increase awareness and financial knowledge, including interest in professional advice; and (3) to increase participation and contribution to supplementary retirement accounts (SRAs) among females and low income workers. To reach these objectives, researchers devised two main communication programs to overcome saving barriers for the target group: (1) a flyer that acknowledges the barriers for saving and provides specific solutions for each barrier and (2) four videos that encourage the target audience to save by providing personal testimonials from similar-type employees at the same institution.

The test group employees reported feeling less anxious about future retirement needs after exposure to the communication programs, and the programs significantly increased awareness and understanding about future financial needs. The video program resulted in a 56.2 percent increase in election behavior within 30 days of viewing the communication programs compared to SRA election rates among control group employees who were not exposed to the communication program during the same period. These differences were sustained after 60 and 90 days. Also, SRA election rates increased 147 percent amongst employees who saw the videos as compared to employees in the same time period one year earlier.

The report included recommendations that are based on the premise that there is no "one size fits all" solution to the retirement savings crisis. Recommendations include designing initiatives to overcome barriers to save for retirement. A simple flyer describing the barriers and providing simple solutions went a long way in simplifying an overwhelming financial decision process. Examples of obstacles to opening a SRA and their accompanying solutions are:

I can't afford it.	You can start with only $16 per month.
Few people like me do it.	More than 60 percent of employees contribute.
My debt is too expensive.	With the tax benefit you will save even more.
I don't know where to put money.	Make an investment selection now. You can change it at anytime.

Another recommendation emphasizes the importance of tailoring motivational and implementation materials for target audiences. For example, the videos featured peers that spoke to their own experiences in planning and saving for retirement. This speaks to NEFE's belief that in order to provide effective financial education, especially to at-risk populations, one size does not fit all. Research indicates that there are significant differences in levels of financial literacy and financial sophistication among populations that are segmented not only by income level, but by sex, age, educational levels, and race or ethnicity as well. Without some level of segmentation and customization, no program or resource will successfully address the needs of all at-risk individuals.

The Dartmouth College study shows that by using a model of messaging that makes saving for retirement achievable, employees are driven to do more to help themselves prepare for retirement. Even though this study is focused on asset accumulation, this experience may translate effectively to decumulation.

Empowerment and Encouragement

What NEFE has learned from our involvement in helping Americans make better choices for retirement is that it's more important to talk about WHY people need to optimize their savings for retirement rather than HOW they need to do it. Retirement needs to be personal, achievable, and accessible; and those planning for retirement often need encouragement. By giving them a holistic perspective about retirement and allowing them to consider all areas of retirement planning, most retirees will find a few areas in which they'll be able to make a decision that will pay off for them.

The Dartmouth study showed that once people find that they can make manageable, modest contributions to a retirement fund, they often will. Finding success in starting small translates to other areas of savings as well. In the report *Understanding the Emergency Savings Needs of Low- and Moderate-Income Households: A Survey-Based Analysis of Impacts, Causes, and Remedies,* Stephen Brobeck of the Consumer Federation of America reports that if low- and moderate-income individuals have less than $500 in emergency funds, they are often "more than twice as likely to experience financial and psychological problems than are those with more than this amount." While $500 falls considerably short of the advised three-to-nine months of living expenses, an ability to attain this modest level of financial well-being is clearly a step in the right direction.

NEFE believes that regardless of background or income level, financially informed individuals are capable of taking control of their circumstances and ensuring a stable future for themselves and their families. Once individuals have the tools and resources to start seeing the benefits of optimizing even one or two decisions, they'll likely continue to be involved, informed participants in their retirement planning. Many retirees do not have access to employer benefits and many have limited resources, but they can still make wise choices to maximize their nest eggs.

Beyond Financial Education

While financial education across one's entire financial life is important and necessary, financial education alone cannot do the job of meeting the retirement challenge. Product regulation and disclosure can inform Americans and enhance financial capability as they approach retirement. Americans need to clearly understand the consequences of engaging in either positive or negative financial behavior, and we want to empower Americans to make their own decisions about which products and strategies will maximize their financial well-being, while discouraging them from making uneducated, irreversible choices that are especially destructive to those with limited resources.

Disclosure and transparency: The terms and use of products need to be clearly defined and disclosed to consumers. The same is true for financial advisors.

For example, increased transparency for products might mimic the recent inclusion of information on a credit card statement from the CARD Act. There, a box placed on the statement includes the time and cost involved in making only the minimum payment on a credit card. This shows the credit card user the power of compounding interest on the debt side. Many employers, consumer educators, and the financial services community promote and illustrate the power of compounding for retirement savings accumulation.

Consider a box that could accompany retirement products and/or statements, showing the income stream that can be provided from an account balance. While complexity and assumptions surround such illustrations, its potential as a basic educational tool is powerful and complements the types of basic numeracy examples identified above. Alternative approaches could include the use of basic or core visual scenarios, information that parallels and complements content in Social Security statements, or referrals to income stream calculators at the Department of Labor.

Clear product design/use of technology: In NEFE's *Retirement Income Decumulation Think Tank*, participants agreed on a priority that must be addressed: the need for far wider availability of consumer-centric retirement planning and management services for lower-to middle-income households, while simultaneously creating new products and services to meet the unique needs of those who are most likely to spend down their limited resources too quickly.

Behavioral finance: Much of the challenge of retirement planning is about starting the process. Automatic enrollments and proposed innovations like the auto-IRA are powerful tools for retirement savings and access that do not conflict with inherently difficult-to-overcome financial behaviors and instincts.

Public awareness: Not only does public awareness bring attention to the why and how of retirement planning, it also highlights the relevance of retirement planning to individuals' personal financial futures. This could mirror *Financial Fitness Check Up for Everyone*, a report and model public awareness campaign prepared for The President's Advisory Council on Financial Literacy in 2009. This initiative was based on a recommendation that Americans take a financial fitness checkup similar to a health checkup. The checkup enables Americans to understand their level of financial fitness, provide them with resources to enhance their knowledge, and encourage them to take responsibility for their financial health. Similar recommendations have been made for people to calculate their net worth. The same could be done for retirement: People need to understand what they've already saved and how they will pay themselves throughout their retirement.

Sensitivity to issues of age, health, and external factors: In our economy, one cannot control important factors like inflation or changing tax and retirement policies. Nor can other circumstances be easily predicted: Retirement planning is more than just working until a target date on the calendar. Many people who wish to continue working simply cannot do so. Poor health drives many into unwanted premature retirement. In other cases, diminished capacity for numeracy and critical thinking hinder financial decision making in later years of retirement. NEFE has experience developing financial education programs and resources that respect special circumstances. Our work with the Alzheimer Association, Hospice and Palliative Care Organization, Generations United and many other health-related nonprofits such as the American Cancer Society and the American Stroke Association reflects this sensitivity. We realize the national importance of information for consumers, caregivers, and financial professionals to receive and impart these messages and key milestones of financial information delivered at the right time, in the right manner, being both objective and clear.

The Future of Decumulation Planning

We know that the challenges of retirement decumulation will affect more Americans as the baby boomers age, and it will affect them differently as traditional retirement income vehicles diminish. Already, 401(k) employer matching contributions are undergoing the stress of the economic recession, with some becoming reduced or eliminated; pensions are becoming obsolete; and health care is changing. More than ever, Americans have to build their own retirement paychecks and take individual responsibility for their financial well-being in retirement.

We recognize that all these factors, along with ever-changing products, regulation, and legislation, exist in a constantly shifting landscape. Effective evolution of decumulation education must happen in a state of ongoing attention. Organizations like NEFE and the Social Security Administration's Financial Literacy Research Consortium are monitoring the retirement landscape and we're always prepared to share what we learn with this committee, the financial literacy community, financial planners, and the Americans we serve.

For more information about retirement issues and NEFE's work in this area, contact:

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