Statement Presented to
The U.S. Senate Special Committee on Aging
Hearing on
"Bridging the Gap: How Prepared are Americans for Retirement?"
March 12, 2015

Chairman Collins, Ranking Member McCaskill, Members of the Committee…

Thank you for inviting me to testify today before the Special Committee on Aging and for shining a light on the fact that having enough money for a secure retirement is an enormous – and growing – problem for Americans.

THE RETIREMENT PROBLEM

According to the Federal Reserve's Survey of Consumer Finances, a typical working family in the pre-retirement years (headed by someone 55 to 64 years old) has about $104,000 in retirement savings. For more than half, that will not be enough – when combined with Social Security and pensions – to maintain the standard of living they were accustomed to before retirement, according to the Center for Retirement Research at Boston College.

This is something consumers seem to understand. Survey after survey has shown Americans fear running out of money in retirement. One from Alliance Life Insurance Company showed substantially more Americans feared a retirement shortfall more than feared death.

How likely is that outcome, really? That depends who you ask. The Employee Benefits Research Institute looked at what happened to employees who retired at 65 and lived to be 100 and found that 83% of those in the lowest-earning 25% of households and almost half of those in the second lowest would fall short.

(Among the second highest and top earning quartiles, the numbers fell to 28% and 13% respectively.)

Data from the Survey of Consumer Finances, analyzed by Morningstar, tells a somewhat different story. The old rule of thumb that says retirees will spend 70 to 80% of their pre-retirement income, and that that number should be adjusted upward with inflation each year, isn't bearing out in real life. People in their mid-40s to mid-50s spend the most (as someone with one child in college and one on the way, I can totally see why that's the case). From there, spending starts to decline as – typically – the kids leave the nest, you downsize, ditch the extra car, etc. until medical needs drive expenses up again toward the end of life. The bottom line is that the amount that people need to replace varies from under 54% to over 87%.

Interestingly, average earners, whose pre-retirement income is between $50,000 and $60,000, are actually in better shape than many experts believed they would be. Their annual spending isn't growing much in retirement. And Social Security covers a significant chunk of it.

Higher earners, on the other hand, particularly those who earn more than the median income but below what the country considers wealthy, are in greater trouble. Social Security covers far less of their monthly nut and most haven't saved enough to cover the rest.

<u>The Sources Of The Problem</u>

As I only have a few minutes to speak, I don't want to spend it focusing on what many believe is the root cause of the problem – the switch from defined benefit to defined contribution plans. That tide is not turning back. There are other issues at play where, I believe, a greater understanding could lead to improved education and, eventually, improved solutions. Among them:

* Longevity. Many Americans do not understand the concept of life expectancy. When the Social Security Administration says, for instance, that a man turning 65 will live, on average, to 84, many do not register that they may be the above-average ones who will surpass that age.

* The cost of healthcare. The oft-cited survey that a 65-year-old couple will need about a quarter million dollars in addition to their other retirement savings just for healthcare is too daunting. The February report from EBRI – which suggests looking at two-separate buckets, the stable recurring healthcare costs, which average under $2,000 a year, and the larger non-recurring ones -- makes saving for these costs much more understandable – and palatable. [1]

* The delayed adult lifecycle. Adults are marrying later and having children later: 15% of children were born to women 35 and older in 2012. For many of those parents, college costs and retirement are uncomfortably close.

* Boomerang kids and the senior sandwich generation. According to the Pew Research Center, 48% of parents are providing financial support for kids over age 18, 21% are providing support to parents over age 65, and 15% are doing both. That puts retirement savings on the back burner. [2]

* And debt. According to Consumer Financial Protection Bureau, older consumers are carrying more debt. Although 49% of parents

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[1] http://www.ebri.org/pdf/briefspdf/EBRI_IB_411_Feb15_HlthExpds.pdf_

[2] http://www.pewsocialtrends.org/2013/01/30/the-sandwich-generation/)

with kids age 15 say they'll work longer to pay for their child's college education, new research from T. Rowe Price reveals more than half are also willing to borrow. Even more troubling is the increase in mortgage debt. From 1992 to 2010, the percentage of consumers age 65 to 74 with mortgage debt doubled from 17% to 35%. Among those age 75 and up, it more than doubled from roughly 8% to nearly 22%. And not only are more consumers carrying debt, the balances – as a percentage of the value in their homes – has increased substantially. In 2000 their debt to value ratio was an average 30%. By 2011, it was 46%. Those costs add up – and eat into the money older consumers have to live on. Homeowners with a mortgage spend a median amount of around $1,250 a month on housing. Those without mortgages spend roughly 1/3 of that. [34]

Solutions To Be Explored

Solving this problem is going to require a multi-faceted approach. Clearly, Americans need to save more for their own retirement. Although the average 401(k) deferral rate is 6% to 7%, the most common deferral rate is 3% because that's where most employers auto-enroll their populations. Too often, it never budges from that mark.

The study of behavioral finance – or why individuals so often do things with their money that is not in their own best interest – has given us a powerful boost here. It is from this discipline that the idea of auto-enrolling participants into 401(k)s and similar plans sprung and it has boosted participation in plans that have implemented it from 50% to 80%. Auto-escalation, increasing contributions each year by 1-2% until a participant maxes out, can

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[3] http://files.consumerfinance.gov/f/201405_cfpb_snapshot_older-consumers-mortgage-debt.pdf

[4] http://www.multivu.com/players/English/7455231-t-rowe-price-financial-education

literally double the amount of money an employee has in retirement.

But we need to do more starting with a governmental recommendation that auto-enrollment begin at 6 percent or higher.

We need an easy, one-click mechanism that individuals without access to work-based retirement plans can use to divert a portion of their income into IRAs, SEPs and other accounts they are eligible for. We may want to consider basing it not on pay, but on spending. I've been impressed with the success of a free app called SavedPlus, that consumers can use to designate a percentage of their spending to be shifted to saving. The company works with 3,500 banks and says the average users – many of whom have figured out that this is a mindless way to fund their IRAs – save more than $4,000 a year.

We need to make it easier for small businesses to offer retirement plans to their employees. As a small business owner myself, I can see how the Collins-Nelson Retirement Security bill will make both plan administration and matching contributions more affordable.

We need to increase our focus on emergency savings – and find a way to make funding an emergency cushion possible through automatic deductions. I've spoken recently with executives focusing on financial wellness from a number of Fortune 500 companies and there is agreement that a lack of emergency savings is one reason for the 401(k) leakage that results in balances that are 20% smaller at retirement than they would have been otherwise. If the transmission blows and you don't have the $3,000 to fix it, you either put it on a credit card or pull it out of your 401(k). Neither are a desired solution.[5]

We need increased education on the best way to take Social Security. Three-quarters of Americans tap their benefits at age 62 and by doing so, singles lose an average $181,000 and couples an average $323,000, according to Social Security Solutions. Granted, some people may not be able to wait until age 70 and in couples, it often makes sense for one person to start while the other waits. But Americans need to understand just how much money they're losing – particularly in this age of increased longevity – by making these mistakes.

We need transparency when it comes to the tools flooding the market that purport to be able to make your money last. Annuities, despite their reputation, are not all bad. They can be a very helpful means of using a chunk of your retirement savings to provide lifetime income. And the fact that QLACs (Qualified Longevity Annuity Contracts) are now allowed within qualified retirement plans, means we will all be seeing much more of them.

We need greater clarity when it comes to investment commissions and fees. Whether that comes as part of the new fiduciary rule from the Labor Department or from another source, consumers need to see the toll investment costs are taking as clearly as they now see how much more they spend when they make minimum payments on their credit cards. In a recent column in The New York Times, reporter Eduardo Porter cites an example of a 30-year old worker, earning $30,000 a year, receiving 3% raises and making an annual return on her investments of 7%. If she saved 10% of her money in a passive index fund, she'd have $927,000 at age 70 and that nestegg would throw off $37,000 a year. If she put

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[5] http://www.marketwatch.com/story/vanguard-data-shows-401k-leakage-process-2014-10-17

the money instead into a typical actively managed fund, fees and expenses would reduce her nestegg to $561,000 and the amount she could withdraw annually to $22,000 if she wanted that money to last as long as she did. (This is one of the problems with the idea of the forced transfer of 401(k) and other work-based plan dollars into IRAs. The fees are typically much higher.)

I could go on, but my time is up. Again, I want to thank the committee for inviting me to be here today to weigh in on this crucial and timely issue.

Jean Chatzky
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