

Statement Before

The U.S. Senate Special Committee on Aging

Hearing on

"Retiring Baby Boomers: Meeting the Challenges"

Testimony of Dallas L. Salisbury

President, Employee Benefit Research Institute (EBRI)

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Testimony Summary

Mr. Chairman and members of the Committee, my name is Dallas Salisbury. It is a pleasure to be here this morning to discuss "Retiring Baby Boomers: Meeting the Challenges." I ask that my full submission be made a part of the record of the hearing.

The mission of the Employee Benefit Research Institute (EBRI) is to contribute to, to encourage, and to enhance the development of sound employee benefit programs and sound public policy through objective research and education. EBRI does not lobby and does not take positions for or against legislative proposals. The goal of the American Savings Education Council (ASEC) is to make saving and planning a vital concern of Americans and recognized as in the economic interests of employers.

I was asked to comment this morning on "the ability of private employers to provide retiree health and pension benefits comparable to current levels for the baby boom generation when it enters retirement in 2010 and after," and on other challenges faced by the baby boom generation as it approaches retirement.

Given limited time this morning, I want to use data to emphasize a few points that put the situation of the baby boomers in perspective relative to present retirees. The data show that there is a great deal of mythology in the retirement discussion. Notably, the data show that:

Social Security has never provided an adequate income. With changes already enacted to increase the retirement age, and assuming no payroll tax increases, the baby boomers' benefits will be an average of just under 30 percent of income instead of today's 42 percent. This will require individuals to work longer and to save more. Private employers are beginning to communicate these facts to employees in

order to encourage them to save more.

Few of the baby boomers' parents had full careers with one employer. Pensions formed in the years prior to 1980 focused on the approximately 20 percent of workers who spent a full career with one employer. Defined benefit pensions were sponsored by most large private employers to do this, and large employers have also generally sponsored defined contribution savings and 401(k) plans to assist both longservice and shorterservice employees. Small employers never sponsored plans on a widespread basis but have since the advent of tax-deferred individual salary reduction plans like 401(k) plans (1981) and the Federal Employee Thrift Plan (1984). Significant legal changes in terms of vesting, funding, and tax rates, have made Defined Benefit plans much more expensive yet difficult to advance fund. Employers can, in the absence of a dramatic drop in the markets or a dramatic run of high inflation, afford to continue defined benefit plans now in existence. However, for demographic, work force mobility, and employee preference reasons, they may choose not to do so. Private employers provide more retirement savings for the average baby boomer than they have to the average retiree today.

Few of the baby boomers' retired parents have income from a traditional defined benefit pension plan or employer paid retiree medical benefits. This is contrary to much of what is written without attention to the available data, but 24 percent of retirees reporting private pension income, and 10 percent reporting fully employerpaid Medi-gap protection, cannot be presented as a panacea. It is very important to those who have it, but when considering the cost and implications for the baby boomers, it should not be overstated. Employers have shown that they cannot, on a widespread basis, afford to pay for retiree medical benefits pre or post 65. They do not today; they will not tomorrow. Private employers are communicating the retirement income and retiree medical savings need more heavily that at any time in the past so that the baby boomer has an opportunity, with employer assistance, to be better prepared in retirement than today's retiree.

Few of the baby boomer' parents saved for their own retirement. This is contrary to the implicit suggestion that today's retirees are all on cruise ships and the golf courses, having saved for retirement. Income from assets is important to a small minority of retirees today, and baby boomers are doing better than their elders at building retirement assets. Employers can afford to sponsor a retirement savings plan, and when stable and profitable, they can afford to make employer contributions as well. They can communicate the need to save in these plans for all spending needs, including retiree medical expenses. Baby boomers need to save more, and they need to preserve lumpsum distributions on job change. This will require education and understanding. They are on a positive track in growing numbers, and with savings and planning campaigns like that of the American Savings Education Council and government partners like the Department of Labor and Treasury, the Federal Reserve, and the SEC, many successes will be recorded.

Conclusion

I want to thank the Committee for the opportunity to testify today and invite you to call on EBRI and ASEC in the future. The baby boom generation is beginning to save, but only one-third have yet done an estimate of how much they need to save for retirement. Employers are doing more now than ever before to raise this number. Employers recognize that while this is a higher proportion than among today's retirees, it leaves much room for improvement. Workers also underestimate how long they will live once retired but want to retire early. Education is focusing on this as well. This combination of factors tells us that baby boomers are on a better savings path than today's retirees, and they have the tools and the opportunity to do even better. The primary challenge for employers and the government is to provide individuals the education to assure that they become planners, savers, and investors, as we have moved from a system focused primarily on the few who work for one employer for a full career to all workers.

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Mr. Chairman and members of the Committee, my name is Dallas Salisbury. It is a pleasure to be here this morning to discuss "Retiring Baby Boomers: Meeting the Challenges." I ask that my full submitted testimony be placed in the record of the hearing.

I entered the retirement income field in 1975 with the U.S. Department of Labor and also served at the Pension Benefit Guaranty Corporation. Since 1978, I have been with the Employee Benefit Research Institute (EBRI), now serving as its President and CEO, and on its Board of Trustees. During 1995, we also established a new organization, the American Savings Education Council (ASEC), which I serve as Chairman and CEO.

EBRI's mission is to contribute to, to encourage, and to enhance the development of sound employee benefit programs and sound public policy through objective research and education. EBRI does not lobby and does not take positions for or against legislative proposals. ASEC's goal is to make saving and planning a vital concern of Americans and recognized as in the economic interests of employers.

EBRI published an *Issue Brief* in 1994 titled "Baby Boomers in Retirement What Are There Prospects?" and held an invitational policy forum on the topic "Retirement in the 21st Century Ready or Not." The policy forum publication concluded:

"A review of the available evidence indicates that, on a total wealth basis and on a pension savings basis, those in the work force today are doing better than previous generations. However, a minority are building the individual and pension savings that will allow them to meet the goal of maintaining final employment income throughout retirement, without using real estate to produce income.

Should the timing and value of Social Security benefits, Medicare, and employer-based defined benefit and retiree medical benefits continue to be reduced, the levels of necessary saving will increase, not decline. Should the movement toward voluntary pension participation and lump-sum distributions continue, increases in participation rates and rates of rollover will be necessary to achieve the income levels projected by today's studies."

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Given limited time this morning, I want to use data to emphasize a few points that put the situation of the baby boomers in perspective relative to present retirees. The data show that there is a great deal of mythology in the retirement discussion. Notably the data shows that:

Social Security has never provided an adequate income. With changes already enacted to increase the retirement age, and assuming no payroll tax increases, benefits will be an average of just under 30 percent of income instead of today's 42 percent. This will require individuals to work longer and to save more. Private employers are beginning to communicate these facts to employees in order to encourage them to save more.

Few of the baby boomers' parents had full careers with one employer. Pensions formed in the years prior to 1980 focused on the approximately 20 percent of workers who spent a full career with one employer. Defined benefit pensions were sponsored by most large private employers to do this, and large employers have also generally sponsored defined contribution savings and 401(k) plans to assist both longservice and shorterservice employees. Small employers never sponsored plans on a widespread basis, but have done so since the advent of taxdeferred individual salary reduction plans such as 401(k) plans (1981) and the Federal Employee Thrift Plan (1984). Significant legal changes in terms of vesting, funding, and tax rates have made defined benefit plans much more expensive yet difficult to advance fund. Employers can, in the absence of a dramatic drop in the markets or a dramatic run of high inflation, afford to continue defined benefit plans now in existence. However, for demographic, work force mobility, and employee preference reasons, they may choose not to do so. Private employers provide more retirement savings for the average baby boomer than they have to the average retiree today.

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Few of the baby boomers' parents saved for their own retirement. This is contrary to the implicit suggestion that today's retirees are all on cruise ships and the golf courses, having saved for retirement. Income from assets is important to a small minority of retirees today, and baby boomers are doing better than their elders at building retirement assets. Employers can afford to sponsor a retirement savings plan, and, when stable and profitable, they can afford to make employer contributions as well. They can communicate the need to save in these plans for all spending needs, including retiree medical expenses. baby boomers need to save more, and they need to preserve lumpsum distributions on job change. This will require education and understanding. They are on a positive track in growing numbers, and with savings and planning campaigns like that of the American Savings Education Council, and government partners like the Departments of Labor and Treasury, the Federal Reserve, and the SEC, many successes will be recorded.

It is important to note that the private employer pension system is in solid financial condition. As Chart 1 shows, asset growth in the system has been steady. Chart 2 highlights the assets resulting from the development of both defined benefit plans (the employer promises a given benefit and is responsible for funding it) and defined contribution retirement plans (the employer sponsors a plan for the employee to save on a pre-tax basis, and may also contribute). Baby boom retirees will do better than today's retirees as a group and as individuals due to this growing "hybrid" retirement savings system. Table 1 presents financial trends in private plans from 1975 to 1993. It shows that the defined benefit system has become quite mature (more on this later). The relative relationship of contributions to benefits shown in this

table is also a result of the significant plan funding restrictions and income limitations placed in the law since 1982. These have kept employers from either providing the benefits they would like to provide or funding them as well as they would like to. This has reduced the baby boomers' retirement income prospects from employer plans. Table 2 shows the number of plans by type, participants, and primary plans. As the law shortened vesting requirements, it was understood that the role of defined contribution plans would become more important. One Census Bureau survey found that nearly 80 percent of federal employees, for example, view the Federal Employee Thrift Plan as their primary retirement plan, not the defined benefit plan. Chart 3 shows why this is true. The way in which benefit value builds in the two types of plans would cause any worker with less than about 25 years of service to receive more benefit from a defined contribution plan than from a defined benefit plan.

It is important to note that today's retirees did not save. As shown by charts 4 and 5 and table 3, Social Security is the primary source of income for most retirees. These retirees were told that Social Security benefits would allow them to retire at age 62 or 65, yet they were not given much information on what Social Security benefits would be. The implication was that benefits would be adequate. Today, we know the income replacement rates are modest for most, and that the maximum family benefit does not exceed \$25,000. Those with employer pensions do better than others, but individual savings have never been high for most Americans. Chart 4 provides a picture of the relative role of income sources.

This highlights the first baby boomer challenge: getting good information on what Social Security might provide, recognizing that Social Security alone will provide adequate income for very few, taking action to get help from employers, and finally, proactively saving towards a secure retirement.

It is important to note that most workers have never spent a full career with one employer, and even fewer will do so in the future. Charts 6 and 7 provide a picture of job tenure across age groups. A telling fact is that 50 percent of men aged 55 to 64 have spent 12 years or less with their present employer, and 50 percent of women in this group have spent 10 years or less. Table 4 provides similar news, with only 12.4 percent of those aged 55 to 64 reporting 30 or more years of service, and this number is dropping as well, even though it takes 30 years to achieve a maximum pension buildup. A system with cash benefit portability can deal with this issue. Chart 8 underlines the importance of tenure patterns relative to pension vesting, because rates rose dramatically as the law moved vesting requirements down to 10 years and then 5 years. As a result of these new requirements, while pension participation remained steady, actual entitlement to benefits rose sharply. In addition, the growth of defined contribution plans like the Federal Employee Thrift Plan and 401(k)s is very important to the baby boomers, as these plans allow them to build real value in spite of job movement.

This highlights the second baby boomer challenge: making certain that you save each and every year to ensure that your employer provides a defined contribution savings opportunity.

It is important to note that the increasing diversity of the pension system is good news, not bad, for the majority of workers due to job turnover patterns. Table 2 showed the relative existence and participation levels of defined benefit and defined contribution plans between 1975 and 1993. Defined benefit plans are primarily sponsored by the largest employers in the nation, both public and private. Since employment in organizations with more than 1,000 employees has been relatively steady in absolute numbers, but shrinking as a proportion of the labor force, the number of participants in these plans has remained nearly constant since 1980.

Defined contribution plans were always sponsored by the large organizations and favored by small ones. These plans generally include contributions by both the employee and the employer. The employer commits to sponsor the plan and may commit to contribute, but the employer makes no promise of a specific benefit at the end of the day. In other words, investment gains and the risk of loss rest with the

individual. Since Congress acted in 1978 to allow taxdeferred contributions by both the employer and the employee, both the number of defined contribution plans and participants have grown steadily.

This highlights the third challenge related to the baby boomers: understanding what plans they have available to them, how to take advantage of them, and that any plan is better than no plan.

Plan type is less important than it used to be. This is due both to the legal requirement that all plans pay some benefits in the form of a lumpsum distribution and to accelerated vesting requirements. Chart 3 shows the pattern of benefit growth under the defined contribution and defined benefit plan approaches. It makes clear that for the mobile worker that is, about 75 percent of workers the defined contribution plan can lead to higher retirement asset accumulations. This makes the point that both plan types can serve valuable purposes, but one plan type does not fit all.

Chart 9 provides a 1990 data snapshot of pension benefit payments. The chart shows that a somewhat startling \$107.2 billion was paid in lump sums in 1990, compared to \$127.1 billion in annuity payments. Chart 10 shows why this raises issues for the baby boomers retirement futures: 44 percent of the dollars paid in lumpsum distributions are not saved for retirement, and 70 percent of the people who get them do not save them for retirement. Table 5 shows simulations of what baby boomer retirement income would look like if all lumpsum distributions were rolled over and saved for retirement. Instead of the 36 percent pension income delivery to retirees today (table 1) , it would reach 77 percent as the baby boomers retire and 84 percent in later years.

This highlights the fourth baby boomer challenge: the need for preservation of lumpsum distributions upon job change or retirement in order to meet retirement income goals.

It is important to note how important involvement by institutions like the government and employers can be. The data already provided indicate how important the mandatory system of Social Security and voluntary set asides of employer pensions have been in providing income to today's retirees. Table 6 shows participation in individual retirement accounts (IRAs) relative to employer pensions and 401(k) plans. In 1992, 8.1 percent of workers contributed to an IRA (6.3 percent of those without an employer plan). This compares to 43.7 percent of all workers who are in an employer plan, and 64.9 percent of those workers given the option of participation in a 401(k) plan.

This highlights the fifth challenge related to the baby boomers: finding ways to get them to save on a taxeffective basis when they are given the opportunity.

It is important to factor retiree medical expenses into consideration when thinking about the baby boomers. Chart 11 shows the degree to which retirees depend upon Medicare and, to a lesser extent, on employer provision. Retirees have acted on their own to purchase supplementation of Medicare where employers have not provided the benefit. Charts 12, 13, and 14 show that 45 percent of have access to retiree health insurance, with wide variation in what the employer will pay. Only 10 percent to 15 percent of baby boomers being promised full employer payment for Medigap policies.

This highlights the sixth challenge related to the baby boomers: focusing on the implications of rising health care costs and increased life expectancy, and then saving enough to pay for health expenses in retirement at what is likely to be a far higher proportional cost than that faced by today's retirees.

Conclusion

I want to thank the Committee for the opportunity to testify today and invite you to call on EBRI and

ASEC in the future. The baby boom generation is beginning to save, but only one-third have yet done an estimate of how much they need to save for retirement. Employers are doing more now than ever before to raise this number. Employers recognize that while this is a higher proportion than among today's retirees, it leaves much room for improvement. Workers, like retirees, underestimate how long they will live once retired, but they want to retire early. Education is focusing on this as well. This combination of factors tells us that baby boomers are on a better savings path than today's retirees, and they have the tools and the opportunity to do even better. The primary challenge for employers and the government is to provide individuals the education to assure that they become planners, savers, and investors, as we have moved from a system focused primarily on the few who work for one employer for a full career to one focused on all workers.