AARP

TESTIMONY BEFORE THE

SENATE SPECIAL COMMITTEE ON AGING

ON

Manage Retirement Assets

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Mr. Chairman and members of the Committee, I am Leroy Gilbertson, a member of AARP's National Policy Council. Thank you for convening this hearing to explore the issues facing Americans when managing their assets in retirement.

While many of AARP's members are retired, many others are part of the 76 million Boomers who are moving into retirement. Generally they will be in better financial and physical health than prior generations of retirees, and research indicates they will live longer in retirement. This hearing will give us an opportunity to examine how we can ensure that boomers do not outlive their retirement assets. It is important to note, however, that while boomers "on average" will be better off in retirement than previous generations, the distribution of income and wealth among them may be more unequal than in earlier years. In other words, there will be a relatively large number of retirees with very few assets to manage or on which to rely.

AARP is a nonprofit, nonpartisan membership organization that helps people 50+ have independence, choice and control in ways that are beneficial and affordable to them and society as a whole. We produce AARP The Magazine, AARP Bulletin, AARP Segunda Juventud, NRTA Live & Learn, and provide information via our website, www.aarp.org. AARP publications reach more households than any other publication in the United States. The AARP Foundation provides security, protection, and empowerment to older persons in need with support from thousands of volunteers, donors, and sponsors. We have staffed offices in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands.

AARP advocates for policies that enhance and protect the economic security of individuals as they move from work to retirement. Advocacy is not limited to Social Security, pensions or retirement plans; it extends to investment literacy, health and long-term care issues, work, and other areas that affect the financial well-being of our members. If AARP members have the basic tools to manage their assets successfully before and after retirement, they will be more likely to maintain, at least an adequate standard of living throughout their retirement. And, if our members manage their assets prudently, some can leave something to help their families-- a goal that many aspire to but far fewer may actually attain.

Planning for retirement is a complicated process that should begin when an individual enters the workforce. Reaching and maintaining the goal of a comfortable lifestyle for what could be three decades of retirement requires consistent effort and discipline over a worker's career. In addition, there are many unexpected challenges to successful planning, such as unexpected healthcare costs periods of unemployment and disability or sustained periods of inflation, that make it difficult for many to leave the work world financially prepared for a long retirement.

For the most part, the boomers expect and are preparing for a retirement similar to that of their parents and older relatives. In particular, they have not anticipated or tend to underestimate the gains in life expectancy that were underway during their work careers. The life expectancy for the fathers of boomers who reached age 65 in 1990 was 15.7 years. The projected life expectancy for boomer men reaching age 65 in 2015 is 17.7 years. As a result, a substantial number of boomers are in danger of outliving their assets because they underestimate their in retirement.

I. Retirement Assets

Most Americans' retirement security comes from several sources of income. For the vast majority, the Social Security system is the foundation of economic security in retirement. Social Security, however, is only part of the overall retirement security structure. A secure retirement is supported by four pillars: (1) Social Security, (2) Pensions and savings, (3) Continued earnings, and (4) Adequate and affordable health insurance. In that context, the importance of Social Security is evident as each of the other pillars faces mounting pressures.

A. Social Security

Social Security is the base of retirement -- representing the only guaranteed defined benefit income most workers will have-- and it is the one pillar of retirement security that does not present challenges to workers at retirement. Social Security is the primary source of retirement benefits for most Americans.

It provides a progressive, inflation-adjusted lifetime benefit to all individuals who qualify. Consequently, it has dramatically improved the economic status of older Americans over the past decades.

Social Security is essential to the financial well being of most retirees. Nearly two-thirds of beneficiaries derive more than half of their income from Social Security, and for 21 percent of beneficiaries Social Security represents 100 percent of their retirement income. Social Security is more than a retirement program; it is income insurance, providing benefits to the wage earners who die or who become disabled, as well as their families; to widows(ers) age 60 and over; to widows(ers) aged 50 and over with disabilities; as well as to retired workers, their spouses and their families.

About 96 percent of all workers are covered by Social Security. More than 33 million people receive retirement benefits. According to January 2006 figures, the average monthly benefit for a retired worker is $963; for a couple where both are beneficiaries the average benefit is $1583; and for a widow(er) alone the average monthly amount is $929.

Although it has been around for over 7 decades, many younger workers are concerned about the future of Social Security and whether it will be there when they retire. While Social Security will require some adjustments, the system is now projected to be able to pay full benefits until 2040, and over 70 percent of benefits for several decades after that. If adjustments are made sooner rather than later, the changes can be more modest, and it will allow those affected more time to adapt their financial plans.

AARP believes that any solvency package should maintain Social Security as a stable and progressive defined benefit program that provides guaranteed lifetime inflation projected benefits for life to all who have contributed to the system and meet the qualifications.

B. Pensions

Less than fifty percent of working Americans have a pension plan available through their workplace, and half of all private sector workers have no regular payroll deduction mechanism to save for their future. As of 2001, the latest data released by the Department of Labor, 22 million workers actively participated in defined benefit plans. Defined benefit plan participants tend to work in large, older firms, and belong to labor unions.

Participation in defined benefit plans varies by age, with 37 percent of workers ages 43 to 52 participating in 1998, versus 15 percent of workers ages 16 to 32. Participation also varies by workers' earnings, 18 percent of workers earning less than $30,000 participated in a defined benefit plan in 1998, versus 40 percent of workers earning more than $30,000.

Today, traditional defined benefit plans are disappearing. The number of firms freezing, terminating, or otherwise abandoning their pension obligations is increasing. A large number of boomers are losing the benefit of their long years of service and their peak earning years (including any early retirement subsidies) that would maximize their pension benefits. These employees may have made career and retirement decisions based upon the expectation of a certain pension benefit, only to see that expectation disappear – replaced by a defined contribution or cash balance plan under which their age precludes them from earning comparable benefits.

Many companies that do offer pensions are converting to defined contribution plans, making workers absorb more risk and responsibility for their retirement security. Frequently, workers are ill-equipped to handle this new role, especially those with limited exposure to financial products. Defined contribution plans are subject to early withdrawals, low contribution rates, poor investment decisions, and the failure to annuitize any portion of the account balance upon retirement. So, even if a worker has contributed to a retirement savings plan, it is likely to provide a much less adequate retirement income level than a defined benefit plan.

We need to take the steps necessary to deal with these trends and strengthen the retirement pillar linked to pensions. This could include

- Providing the financial education necessary to make prudent decisions about savings and investing in the work place since workers have an increased responsibly for accumulating and managing retirement assets.
- Congressional approval of features of an automatic 401(k).
- Providing quality, independent investment advice to workers.
- Establishing a regular payroll deduction mechanism for all workers to save for their future.
- Better diversification, especially for plans with heavy concentrations of employer stock.
- Adoption of pension reform legislation that strengthens the defined benefit pension system and the Pension Benefit Guaranty Corporation while protecting the benefits of older workers.
- Expanding the Savers Credit and making it permanent.

The focus of our attention with regard to defined contribution plans has been on encouraging individuals to accumulate sufficient assets to finance a secure retirement. Since many new retirees can expect to live for almost two decades in retirement and many will spend three or more decades in retirement, the challenge will be to find solutions that enable them to manage their assets for a longer time period.

AARP has long recognized the importance of a guaranteed stream of income throughout retirement. We have and will continue to support proposals that would encourage individuals to select an annuity rather than to cash out a lump sum distribution from either a defined benefit or a defined contribution plan. We also favor new incentives that would encourage 401(k) sponsors to automatically provide plan participants with an annuity option.

We are also carefully considering and evaluating the potential impact of the proposals to provide new tax incentives to encourage individuals to use annuities to insure against longevity risk.

AARP has been concerned with the high fees, complexities and marketing practices associated with certain annuity products. We want to work with others to foster products and incentives that will help individuals manage their assets and ensure their financial security in retirement. In addition, we want to assist our members to become wise consumers.

C. Personal Savings and Investments

While the 50+ age group is still the country's wealthiest cohort, with higher rates of home ownership and savings than younger groups, many of them are ill prepared for retirement. Nationwide personal savings are at an all time low, and many of the retirement savers age 50 and older have accumulated far less than they will need for a retirement that could be 3 decades or longer. And, a mere six percent of individuals contribute to an IRA or a Roth IRA.

Unfortunately, many in the age 50 and older group are going deeper into personal debt and also will not own their homes free and clear as their parents did when they retired. In the 1990's, the median amount of money older people owed doubled in every income bracket, and the burden is highest among individuals with low-incomes. The age 55-64 cohort of pre-retirees are especially troublesome because, on the one hand, they carry the most debt and, on the other, they are nearing traditional retirement age and do not have the resources to fully retire. Unfortunately, many in this age group may not know they cannot afford to retire until it is too late.

In order to encourage responsible savings and investment among those 50 and over, AARP has established five principles to guide these choices. If these time-tested investment principles are followed, a strong foundation of financial security will be established. The five principles are

→ Keep fees low

→ Use index funds

→ Diversify investments

→ Rebalance to stay on track

→ Keep it simple

→ **Keep Fees Low**

Fees and expenses limit returns over time, which, in turn, reduce the amount of retirement savings accumulated. Since fees occur in all types of financial products-- mutual funds, individual stocks and bonds, insurance vehicles, and mortgages-- individuals should scrutinize financial documents for clearly stated, as well as hidden, fees.

When it comes to mutual funds, it is important to know the difference between "load" and "no load" products. In order to maximize asset accumulation, look for no-load funds with expense ratios of less than 1 percent. Similarly, when it comes to trading individual stocks or bonds, find ways to keep costs low.

Here are examples of how fees can impact performance:

What the fees cost you on an initial $10,000 investment	Pay these fees for a low-cost fund (0.50%)	Pay these fees for a mid-cost fund (1.25%)	The low-cost fund saves you…
10 years	$796	$1,925	$1,129
20 years	$2,531	$5,902	$3,371
30 years	$6,034	$13,585	$7,551

→ **<u>Use Index Funds</u>**

Investment research shows that mutual fund managers who try to buy and sell individual companies based on their own research have difficulty outperforming the broader markets over time. That is why index funds are so attractive. Index funds offer a broad range of benefits including simplicity, lower costs, diversification, matching the market, and tax advantages.

→ **<u>Diversify to Reduce Risk</u>**

Diversification means spreading investments among different asset classes, and having exposure to a large number of different companies. It is difficult to tell with certainty which investments will rise in price; yet, when individuals diversify their portfolios they improve their chances of owning investments that will increase in value. Just as important, however, a diversified portfolio helps lessen the impact of investments that lose value.

→ **<u>Rebalance to Stay on Track</u>**

Once investment decisions have been made, many investors do not revisit those choices. Yet, markets change. Rebalancing helps maintain target asset allocation among stocks, bonds and cash, and avoids exposing workers and retirees to inappropriate risk. Some funds are regularly rebalanced to help them maintain their diversification and control risk, which may be especially helpful to individuals who are less comfortable managing their assets.

→ **<u>Keep it Simple</u>**

Since there are over 10,000 mutual funds in the United States, it is important for investors of any age to determine which fund is right for their financial situation. Having too many choices can be overwhelming, making it difficult to manage risk, ensure proper diversification, and be confident that all their investments are working toward a common goal.

As part of AARP's continued efforts to empower those age 50 and over to have a secure financial future and safeguard their assets, we have conducted seminars, consumer universities, and other educational programs on financial literacy and investment strategies. Many more are planned as we help our members to become financially literate and be smarter investors and consumers of financial products.

D. Earnings/work

Earnings are becoming a growing source of household income in old age. For example, earnings accounted for nearly 25 percent of the aggregate income of aged 65+ units in 2002, up from under 21 percent in 1998.[1] Many signs point to further increases in earnings during the "retirement "years, especially since nearly 80 percent of boomers say they expect to work in retirement.[2]

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[1] Social Security Administration, Office of Policy, Office of Research, Statistics, and Evaluation, *Income of the Population 55 or Older, 2002* (Washington, DC: Social Security Administration, March 2005), Table 7.1; *Income of the Population 55 or Older, 1998* (Washington, DC: Social Security Administration, March 2000), Table 7.1.

[2] AARP, *Boomers Envision Retirement II* (Washington, DC: AARP, 2004).

For older workers, the decision about whether and when to retire is important. For many, the decision to continue working is an economic one: additional income and/or healthcare coverage. Returning to the workforce after a period of time is not always easy for older workers. Skills may be out of date and age discrimination is a serious problem. These workers tend to be unemployed longer, are less likely to become reemployed, and are more likely to experience earnings and benefit losses if they do find work.

At what age boomer's choose to retire, will have a considerable impact on the labor force. In recent years, policymakers have encouraged later retirement by gradually raising the age for full Social Security benefits, eliminating the earnings test for working Social Security beneficiaries who are at the full retirement age, and by increasing the delayed retirement credit for those who postpone collecting benefits until age 70. Policies governing employment, retirement, and income taxation could foster longer labor force participation and protect the rights of those workers who choose to stay on the job.

AARP supports the development and implementation of work options, including phased retirement programs, that would expand employment opportunities for older men and women who want to work. We are helping create solutions to meet the needs of the workforce and older employees through research, publications, advocacy, and training programs. For their part, workers must be educated about what they need to do to remain employable.

From a public policy perspective, a number of initiatives would help keep older workers in the labor force. These include vigorous enforcement of employment discrimination laws, an older worker-friendly and better-funded job training system, increased attention to the training and employment needs of vulnerable groups, and the elimination of barriers to phased retirement programs.

E. Health Coverage

Maintaining health care coverage is important to those in the labor force as well as those who are in retirement. Without adequate health coverage, a major health problem can seriously erode or even wipe out savings at a time when replacing any lost income may be difficult or impossible.

The decline in the share of employers offering retiree health benefits in recent years is a matter of increasing concern. Between 1993 and 2004, the percentage of large employers offering health benefits dropped from 46 percent to 28 percent for retirees under age 65 and from 40 percent to 20 percent for Medicare-eligible retirees. Even those who have employer-sponsored health benefits face higher costs because employers pass an increasing portion of rising health care costs to retirees. Retirees also face changes in coverage, such as increased cost-sharing or caps on employer contributions. If the price of retiree health benefits grows beyond the reach of retirees, they may lose coverage and become vulnerable to the risk of major out-of-pocket health costs particularly if they become seriously ill—cost that can wipe out even the best financial plans.

AARP supports and strongly encourages incentives for employers to maintain and safeguard retirement health benefits. Most recently we supported the employer incentives included in the Medicare Modernization Act of 2003. Policies affecting retirement health benefits should incorporate features that prevent deterioration of health benefits. AARP also believes the time is right for Congress to reignite the debate over health systems reform so that we can begin to control rapidly rising health care costs and make affordable health care coverage available to all Americans.

Closely associated with overall healthcare coverage is protection against long-term care costs. Long-term care is a critical element of retirement planning that is often overlooked. AARP members have indicated that there is a great deal of resistance to thinking about long-term care. This may be because individuals have negative perceptions about long-term care—believing it is limited to nursing home care are often under the mistaken impression that Medicare will cover long-term care are facing more immediate financial needs or are in denial about the likelihood they will require future services. Yet men turning 65 face a 44 percent chance of needing help with at least two activities of daily living for at least three months or more. For women turning 65, the percentage is much higher--72 percent.

However, current long-term care financing options are limited and often too expensive and too complex. That's why Americans need more and better options to plan and pay for long-term care. For example, long-term care insurance should be more affordable, accessible, and have strong consumer protection standards. Improved tools to compare policies would also be helpful. In addition, consumer education on long-term care is vital. Americans should understand the likelihood of needing long-term services and support; the types, cost and availability of services; the option available to help plan and pay for services; why it is their interest to plan; and where to go for further information and assistance about how to plan.

III. Conclusion

Planning for and managing resources in retirement is difficult enough, but it has become much more complicated over the years as we move towards a "do it yourself" retirement. New retirees will need a more sophisticated knowledge of investment options and ways to preserve assets through retirement Gone are the days when boomers' grandparents retired with Social Security, a company pension, savings in the bank, and a paid-off house. There is much that can and should be done to make accumulating and managing retirement assets easier and more secure for workers and retirees. And, although times have changed, Social Security remains the critical and basic pillar of lifetime retirement income and more than ever the only one that can be counted on to provide a lifetime income stream.