



AMERICAN BENEFITS
COUNCIL

HEARING SUMMARY

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DATE: February 3, 2011

HEARING: Simplifying Security: Encouraging Better Retirement Decisions

COMMITTEE: Senate Health, Education, Labor and Pensions (“HELP”) Committee

WITNESSES: Jean Chatzky (financial journalist and author, NBC Today), Lori Lucas (Executive Vice President, Callan Associates, and Executive Member, the Defined Contribution Institutional Investment Association), Dr. Julie Agnew (Associate Professor of Economics and Finance, William and Mary Mason School of Business) and Dr. Jeffrey R. Brown (William G. Karnes Professor of Finance, University of Illinois at Urbana-Champaign College of Business).

On February 3, the Senate Health, Education, Labor and Pensions (“HELP”) Committee held a hearing entitled “Simplifying Security: Encouraging Better Retirement Decisions.” Democratic Senators present for all or part of the hearing were Chairman Tom Harkin (D-IA), Jeff Bingaman (D-NM), Richard Blumenthal (D-CT), Kay Hagan (D-NC), Jeff Merkley (D-OR) and Sheldon Whitehouse (D-RI). Republican Senators present for all or part of the hearing were Ranking Member Michael Enzi (R-WY) and Lisa Murkowski (R-AK).

Testimony was given by Jean Chatzky (financial journalist and author, NBC Today), Lori Lucas (Executive Vice President, Callan Associates, and Executive Member, the Defined Contribution Institutional Investment Association), Dr. Julie Agnew (Associate Professor of Economics and Finance, William and Mary Mason School of Business) and Dr. Jeffrey R. Brown (William G. Karnes Professor of Finance, University of Illinois at Urbana-Champaign College of Business).

Legislative Proposals

Concurrently with the hearing, Senator Bingaman reintroduced the Lifetime Income Disclosure Act (“Act”) (S. 267). The Act is cosponsored by Senators Johnny Isakson (R-GA) and Herb Kohl (D-WI). Please see the press release on the bill below, which contains links to a bill summary and the bill text. The Act would require 401(k) plan sponsors to inform participants of estimated monthly retirement income based on their current account balance, in a manner similar to Social Security annual statements.

Chairman Harkin commended Senators Bingaman, Isakson, and Kohl for their work in connection with the Act. During his testimony, Dr. Brown expressed support for legislation such as the Act, which he believed would encourage annuitization. Senator Bingaman also stated that he intended to reintroduce his legislation regarding automatic IRAs to provide a saving opportunity for employees of small businesses.

Ranking Member Enzi discussed his plans for legislation that would permit small businesses to collectively sponsor 401(k) plans and that would generally make it easier for small employers to start and maintain 401(k) plans. Chairman Harkin noted that he is anxious to see the legislation.

Opening Statement

In his opening statement, Chairman Harkin stated that automatic enrollment was a good first step in simplifying saving for retirement and queried whether similar concepts could be applied elsewhere in the retirement plan context. He also noted the importance of financial education in encouraging saving for retirement, particularly among young individuals entering the workforce. Chairman Harkin was critical of 401(k) plans, stating that they expose workers to market risk and do not necessarily provide a guaranteed lifetime income stream like defined benefit plans.

In his opening statement, Ranking Member Enzi noted that large employers utilize automatic enrollment more frequently than small employers. As noted above, he discussed plans to introduce legislation that would simplify 401(k) plans for small businesses. Ranking Member Enzi emphasized the importance of making 401(k) plans more workable for businesses and employees. He agreed that we must focus on improving the financial literacy of younger individuals.

Both Chairman Harkin and Ranking Member Enzi referenced their past work in connection with fee disclosure and the recent Department of Labor fee disclosure regulations.

Witness Testimony

Jean Chatzky. Ms. Chatzky's testimony focused on three points. First, she encouraged policymakers to use incentives at their disposal to encourage employers – particularly small ones – to offer retirement plans and to adopt automatic IRA legislation. Second, she cited the importance of encouraging employees to save more, particularly by automatically escalating contributions. She referenced an analysis by Principal Financial in connection with the need to save more money. Third, Ms. Chatzky stated that financial education is crucial, noting a program in which an automatic escalation program coupled with financial counseling led to a tripling in the savings rate of employees.

Lori Lucas. Ms. Lucas' testimony addressed the possibility of implementing automatic features (*e.g.*, automatic enrollment, automatic escalation) on a broad scale. She noted that such features greatly enhance savings rates but are typically implemented too conservatively. Ms. Lucas encouraged policymakers to revisit the Pension Protection Act non-discrimination testing safe harbor (QACA) to increase the maximum allowed automatic escalation deferral from 10% to 15% and to start automatic enrollment deferrals at 6% rather than 3%. She also stated that it would be helpful for policymakers to provide guidance that the deferral and escalation levels in the safe harbor do not impose fiduciary obligations on all employers and that fiduciaries have flexibility to choose higher levels.

Dr. Julie Agnew. Dr. Agnew discussed certain academic research regarding investor psychology and financial literacy and their roles in retirement decision-making. She noted that research has shown that automatic features in retirement plans work and that financial education is important. Dr. Agnew asserted that, when communicating with individuals and designing plan features, materials must be simple and engaging, with limited choices. She noted that "information overload" can impair judgment. She also observed that distrust of financial institutions may play a role in employees' decisions to not participate in a retirement plan. Dr. Agnew noted that increased financial literacy may reduce some mistrust.

Dr. Jeffrey Brown. Dr. Brown suggested a need to shift focus from accumulation to decumulation. He was supportive of legislation such as the Act, noting that monthly income illustrations could encourage annuitization. Dr. Brown also encouraged policymakers to revisit the rules governing required minimum distributions ("RMDs"), noting that they were not developed with retirement security in mind. He stated that the RMD rules tend to discourage annuitization by encouraging individuals to spend down their accounts. Dr. Brown proposed implementing automatic annuitization, although he noted that more research is needed to fully analyze potential effects.

Q&A Session

Chairman Harkin asked the witnesses if they knew of a way to obtain impartial advice regarding 401(k) plans. Ms. Chatzky responded that employees tend to approach employers' benefits departments. Dr. Brown agreed that employers tend to play an important intermediary role and should not be overly prevented from providing information. Dr. Agnew asserted that available information needs to be simplified. Ms. Lucas noted that individuals do not have the time or interest to pursue financial education, thus supporting the importance of automatic features. The witnesses largely advocated for financial education beginning in grade school, with Ms. Lucas noting that, for young people, decisions must be very simple.

Ranking Member Enzi asked Ms. Lucas to elaborate on her testimony regarding the non-discrimination testing safe harbor. She noted that the safe harbor encourages employers to use automatic enrollment because they do not have to engage in costly non-discrimination testing if they satisfy certain criteria. She reiterated her view that the automatic escalation cap in the safe harbor should be increased.

Senator Bingaman stated that the monthly income illustration that would be required under the Act would encourage individuals to save more. Dr. Brown noted that it would indeed be a good first step in re-framing the retirement savings conversation. Senator Bingaman also referenced a T. Rowe Price study regarding savings patterns that people follow in 401(k) plans based on knowledge of the estimated monthly income stream derived from their account balances, and Ms. Lucas noted that a number of recordkeepers already provide monthly income estimates.

Senator Murkowski asked Dr. Brown whether employers are concerned about the possibility of liability regarding illustration assumptions. Dr. Brown stated the importance of imposing requirements on employers that they are easily able to handle, such as providing a formula or table that employers could use in determining estimated monthly income streams. He also noted that some companies are already using good methods for determining estimated income streams and should be permitted to continue.

Senator Murkowski also inquired as to how best to implement financial education for younger individuals. Ms. Chatzky recommended adding financial literacy questions to driver's license exams. Dr. Agnew cautioned against adding another burden to schools and teachers but suggested providing standard lessons that may be incorporated into school subjects.

Senator Franken stated that, although he does not want to impose a burden on teachers, he would be in favor of incorporating financial education into schools and possibly driver's license exams. He voiced support for reinstating home economics courses in school. He then engaged in a back-and-forth with Ms. Chatzky regarding the solvency

of Social Security. He also asked whether individuals do not buy annuities because of distrust of financial institutions. Dr. Brown replied that, although there is not a lot of empirical evidence, he believes it plays a role.

Senator Blumenthal noted the need to restore confidence in the financial sector. Senator Whitehouse noted that Social Security and Medicare remain important given the witnesses' views that individuals will exhaust their retirement savings during their lifetimes.

Senator Merkley voiced concern as to default allocation strategies. Ms. Lucas noted the popularity of qualified default investment alternatives in this regard. Senator Merkley also asked the witnesses how best to address the challenges of providing financial education to lower-income families and women. Ms. Chatzky noted that women are more likely to live longer and to take time off to raise children and thus tend to have lower retirement balances than men. She noted that educating women in a group setting may be useful. Dr. Brown noted the importance of having research programs to assess the effect of any financial literacy program.

Closing Remarks

Chairman Harkin followed up on Senator Franken's Social Security discussion, noting that the program is backed by the full faith and credit of the United States. Chairman Harkin also noted the importance of creating a culture of saving and wise drawdown of savings. He described a possible program whereby a percentage of every dollar paid to an individual (*e.g.*, funds for head-start program enrollment) would be deposited in a retirement account.

Ranking Member Enzi inquired as to whether there is an optimal level of employer contributions that encourages saving. Ms. Lucas noted that there is no magic number; as long as the employer contributes some amount, it encourages saving.

Witness testimony is available at:

<http://help.senate.gov/hearings/hearing/?id=c8c1c5c7-5056-9502-5dd5-8b9f87d76457>