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My name is Anna Rappaport. I appreciate the opportunity to testify on Financial Literacy and the Role of the Employer.

My major interests include retirement security for all Americans, with a focus on women and the dangers of post-retirement risks. I have chosen to focus my comments primarily on the decision to retire and the subsequent post-employment period. Here is a little about my background. Prior to forming Anna Rappaport Consulting, I was a worldwide partner of Mercer Human Resource Consulting. I served as President of the Society of Actuaries in 1997-1998 and have been an active volunteer in that organization for four decades. I currently chair its Committee on Postretirement Needs and Risks, and much of the research supporting my testimony is sponsored by that committee. I have been heavily involved with the consumer education efforts of the Actuarial Foundation and am proud of its partnership with the Department of Labor to develop the ideas and material for "Taking the Mystery Out of Retirement Planning." Today my activities include consulting for clients, continued volunteer service to the pension community including Board Service for WISER, the Pension Research Council and the National Academy of Social Insurance. I serve as Senior Fellow on Pensions and Retirement for The Conference Board. More information about my background can be found on my website, www.annarappaport.com.

My testimony today focuses on what employers can do to improve retirement security results for employees. I will focus on:

- Where we are today and what we have learned from research
- What employers should do
- The role of the DOL and nonprofit community in helping
- Dreams for a brighter future

Where we are today and what we have learned from research

Research has repeatedly shown significant gaps in knowledge about retirement. I want to stress a few points that are particularly relevant:

- Many people are short-term focused as they plan for retirement. Retirement planning often does not include serious and deliberate analysis of life and financial issues.
- When people focus on retirement planning, it is common to think about this primarily as an investment management issue. Saving and investments are very

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important, but only part of the picture. Professional advisors vary in their approaches, but many of them are primarily investment focused.

- There is significant misunderstanding about potential life spans and their variability. It is not uncommon to overestimate the amount that can be safely withdrawn from a retirement account. It is not uncommon to only consider average investment returns without weighing the downside risk and results if there are poor years.

- There is a lack of understanding about financial products that are useful in helping to mitigate risk and when they might be most helpful. The most commonly used risk reduction strategy is to reduce spending.

- There is over optimism about expected returns on investments and ability to manage investments.

- The risks in retirement are complex and interacting. Transferable and poolable risks include increasing longevity, the cost of disability and long-term care, the cost of acute health care, economic loss on death of a spouse, and investment risk and interest rate risk. Risks that can't be transferred or pooled include the inability to find a job, premature retirement risk, family members needing help and aspects of inflation risk. These are some of the key risks, and there are others as well.

- While people repeatedly say when asked that they want guaranteed income, when given a choice, they usually choose lump sums.

The Society of Actuaries has identified a range of risks and performed several studies that look at knowledge of post-retirement risks and at how people invest their assets at retirement. (http://www.soa.org/research/pension/research-post-retirement-needs-and-risks.aspx) A list of these studies has been provided with links to the individual studies. Detailed reports are available for all of them. I would like to point to several of them.

- There was a series of focus groups conducted on "Spending and investing in retirement: Is there a strategy" that looks at how people decide when to retire and how to invest their money. The focus group members were people who were two to five years beyond retirement with significant 401(k) balances at the time of retirement. The report includes many quotes from the participants and offers excellent insights into the short-term thinking that many of them used. A new survey based on this study is just starting and will build on the focus group results, working to quantify and expand them. Results are expected in 2008.

- I also want to point out the series of surveys on public knowledge of post-retirement risk. These surveys have been performed in 2001, 2003, 2005 and 2007. Special reports were prepared for the 2005 survey focusing on the Risks of Retirement, Impact of Retirement Risk on Women, Longevity and Retirement Risk, and the Process of Retirement. These four reports and the full report are on the website. The reports on the 2007 survey will be available within the next few months.

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- Two reports have been prepared summarizing information on public misperceptions about retirement risk. The first summarizing the misperceptions and the second offering information about filling the gaps.
- The Society of Actuaries with LIMRA and INFRE did a study several years ago to understand how retirement planning software handles post-retirement risks. It found many gaps. This report is very helpful in identifying questions that people should ask in choosing and using software. The Society of Actuaries and several partners are working together to update the study. A Request for Proposal seeking researchers has been issued.

I hope that this research will be helpful to the Department of Labor as it seeks to help people manage their assets more effectively.

What employers should do

Employers can assume a number of different roles in supporting retirement planning and financial literacy including:

- Providing retirement and capital accumulation benefits that are paid for and offered to all employees without choice
- Providing retirement and capital accumulation benefit plans that include optional methods of payout, which can be used as defaults or as options that must be affirmatively chosen
- Serving as "purchasing agent", to allow employees access to financial products such as long-term care insurance on a group basis, usually with features and/or pricing more favorable than can be obtained in the individual market
- Creating expectations and providing information about how retirement is usually integrated into the life cycle
- Advising
- Educating
- Acting as a resource for information
- Acting as a facilitator to help support and organize networks of employees – can be used to help those with common interests, such as caregivers or those with family members with a common illness, work together

It is my view that retirees should receive the following messages as they are nearing the time of retirement:

- Importance of having a longer-term planning horizon
- Impact of earlier vs. later retirement including effect on Social Security, pensions, and how long assets are likely to last and method to evaluate how this will affect them
- Variability and potential length of lifespan

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- Information on how to translate lump sum amounts into regular annual income and information about options that can be used to provide regular income
- For couples, information about survivor benefits and the needs of the survivor
- Importance of long-term care
- How to think about whether buying risk protection products is a good idea
- Basics re investing in retirement and alternatives for getting advice

It can be argued that this list is very basic and obvious, but yet this is exactly the type of information that many retirees have not used effectively in thinking about retirement. The Society of Actuaries research that was cited earlier documents this problem. I specifically focused on the term "used effectively" because much of this information is available and may have been given to the retirees. However, the evidence is still that they have not used it effectively.

This brings me to my recommendations about what employers should do. Employers should provide information on their own plans and benefits. In fact, employers are required to provide participants and beneficiaries with a summary plan description for each plan. However, even if employers and plan sponsors provide this information in accordance with ERISA's requirements, there is no guarantee that employees will read, or, in some cases, understand these documents.

In addition to information that employers and plan sponsors currently are required to provide, they should be encouraged to provide the following types of information to help employees manage during the post-retirement period:

- Basic information on life span, types of income alternatives, and risks. Many employers will not want to create this information and recommendations are made for involvement of the DOL and not-for-profit organizations in creating resources.
- Strong recommendation for longer planning horizon that matches potentially increasing life spans. Many people have a much shorter planning horizon and often they rely on the employer, so this is an important message.
- Strong recommendation that planning for the retirement period reflect a balance between investment management and a focus on managing risks. The DOL's Taking the Mystery Out of Retirement Planning is a good start in that direction.
- Methodology and/or tools to help evaluate the impact of retirement at different times.
- Questions to ask and information to help people think about decisions and alternatives. Many of the decisions involve trade-offs and are not easy.
- Explanation of how lump-sums can be used to generate income and the amount of income that can be generated by a specific lump-sum with some examples. Recommendation that employers taking a balanced approach and include communication of potential future income with communication of account balances or lump sum values.

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- General information about products that can be used to enhance personal risk management, and tips about buying them.
- Issues to think about in choosing and using retirement planning software.
- Issues to think about in choosing and using advisors.

In addition to providing education, there are other steps that employers can and should take. They include the following:

- Recognize that education is good but has its limits, so that program structure is key. The program structure ideally will respond to the limitations of retirement literacy. Support education by offering it on company time.
- Focus on default options for the distribution phase. There has been a great deal of discussion about default options for investment and auto-enrollment. Much more discussion is needed about distribution options, particularly default options in defined contribution plans. The Society of Actuaries will be issuing a call for papers on the broad topic of pension distribution options later this year, and the papers will be discussed at a symposium in September, 2008 as part of the Retirement 20/20 effort.
- Do group purchasing of financial products for voluntary purchase to enable employees to get a better deal and be assured that the design and provider of the product has been subject to due diligence. If an employer does not want to offer group purchase of annuities directly, it can work with a third party and use of an Individual Retirement Account to hold funds until the annuity is purchased.
- My dream is for financial products which include more of a risk protection portfolio and are linked to defined contribution plans. Help develop that dream and make it reality.
- Offer good employment options to people who want to retire gradually and those who want to work longer but on a different basis. Think about phased retirement to help employers and employees.
- Make good planning tools available.
- Explore use of community resources to help employees.

The role of the DOL and the nonprofit community in helping

Some employers provide retirement and investment planning advice to employees, often using an outside service. Hopefully more will do so. However, there are some limitations with regard to the post-retirement period and issues for those who do not offer advice. My focus here is on supporting educational efforts.

The matter is complicated because for many issues relating to retirement, managing assets and income there are no "right" answers. If you ask the questions discussed below to ten experts, you would probably get a range of different answers, particularly if they come from different disciplines or points of view.

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> <u>How much of my assets should I convert to life income</u>? There is no agreement on the answer to this question with some experts saying you can do better by managing the money yourself or hiring advisors to manage it. Others will focus on the fact that only through an annuity can you and your survivors be guaranteed a life income. Some will focus on average returns without much consideration of the downside risk while others will look for a strategy that works in adverse circumstances. Some will consider the total portfolio including any defined benefit plans, and others will look only at a part of it.
>
> <u>When should I retire</u>? There is no agreement on the answer to this question either, with some experts encouraging early retirement and enjoying life while you can. Others focus on the long period of retirement and the need to make money last and are much more likely to encourage people to retire later.

One of the challenges in dealing with questions such as these is that they involve trade-offs, and personal preferences can dictate what the best answer is for any individual. It is my opinion that the appropriate goal is to enable people to make informed choices. Default choices and signals are very important in influencing these choices, but they are beyond the scope of this discussion. This discussion focuses on the educational part of that support.

There are also factual matters on which there are knowledge gaps but no major disagreements about the facts. For example, expected life spans and their variability are generally understood as factual information. The first hurdles to understanding are lack of awareness and focus on these matters. However, once there is awareness and focus then there is disagreement about what to do about them.

Employers are very concerned about fiduciary liability and most will probably not want to invest a lot of money and time in preparing this information. Employer prepared information or commercial information recommended by employers potentially could expose them to liability. However, there are governmental and not-for-profit resources to support education that could be effectively used by employers.

I believe that resources provided by the DOL, the NAIC, and not-for-profit organizations can be very helpful. If employers direct employees to these resources and help them see where they fit into their planning, that can be a great help, because employees often rely heavily on their employers. Therefore I would like to see the DOL encourage the use of outside resources to help people with the issues described above, and work to create or encourage the creation of good informational resources.

In the area of purchasing financial products, I would like to suggest that NAIC Buyer's Guides be reviewed to see if they are suitable for this purpose, and to suggest that the DOL may with to collaborate with the NAIC if modifications are needed for this use and/or if additional buyer's guides are needed. The Actuarial Foundation is also a potential partner and can supply expertise, as it did in "Taking the Mystery Out of Retirement Planning."

Some other existing materials which come to mind are "Making Your Money Last a Lifetime", developed through a collaboration of WISER and the Actuarial Foundation, and the DOL's "Taking the Mystery Out of Retirement Planning."

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I have some dreams. I hope that you can dream as well and work to bring people together to improve the post-retirement system. In addition to supporting educational efforts, I hope that the DOL can encourage the development of a climate that supports a broader range of default distribution options in DC plans, and that it will help in the study and discussion of what options would work well.

Dreams for a brighter future

My dreams include:

- General awareness of the variability and length of life span plus a focus on longer term planning as individuals plan for their retirement.
- General understanding of the options for timing of retirement and the implications.
- Strong social safety net, recognizing that more than 4 in 10 older women alone depend almost entirely on government programs for their retirement security.
- Default options (with the chance to make other choices) that include some timed purchase of life income for a part of the account balance.
- Risk protection products that offer a portfolio of options to protect against different risks and the potential to offer this risk protection directly through employer sponsored retirement plans and on a group purchase basis.
- Software that handles the post-retirement period well and without too much difficulty.

Thank you for the opportunity to meet with you today.

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