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E X E C U T I V E   S U M M A R Y

Coverage of Dependent Children to Age 26 Under the Patient Protection and Affordable Care Act

PPACA'S ADULT DEPENDENT CHILD MANDATE: Recent laws require that group health plans and insurers make dependent coverage available for children until they attain the age of 26 regardless of tax, student, or dependent status as it relates to financial support. The overall increase in employment-based coverage due to newly enrolled 19−25-year-olds in 2011 ranges from 680,000 to 2.12 million individuals, and these costs are expected to increase health insurance premiums about 0.7 percent in 2011, 1 percent in 2012, and 1 percent in 2013.

SIZE OF ENROLLEE POPULATION: This study finds these estimates may understate the size of the population that might enroll in their parents' employment-based coverage. If the initial enrollment estimates are too low, the effect of the age 19−25 provision will be higher.

EBRI's Spring Policy Forum: Retirement Income Adequacy—How Big Is the Gap and How Might the Market Respond?

EBRI POLICY FORUM: The Employee Benefit Research Institute May 2010 policy forum addressed the topic "Retirement Income Adequacy: How Big Is the Gap and How Might the Market Respond?" This was EBRI's 66th policy forum held in Washington, DC, and was attended by about 100 policy and professional experts. This article provides highlights of the new research and experts' reactions to it.

THE RSPM MODEL® AND THE EBRI RETIREMENT READINESS RATING:™ EBRI has been providing assessments of national retirement income adequacy using its proprietary Retirement Security Projection Model® (RSPM) since 2003. The 2010 EBRI Retirement Readiness Rating™ (RRR), based on the model, provides a benchmark for every American and their prospects for having sufficient resources to cover basic expenses and uninsured health expenses. This latest update includes consideration of the effects of automatic enrollment, auto escalation of contributions, and qualified default investments in terms of higher rates of participation, deferrals, and investment diversification.

NEW RESULTS SINCE THE POLICY FORUM: The 2010 EBRI RRR™ finds that more than two-fifths (41 percent) of Americans in the lowest preretirement income level will have insufficient resources to cover basic expenses and uninsured health costs after 10 years in retirement. Almost a third (29 percent) of those in the next-to-highest income level will run short of money to cover basic expenses and uninsured health costs after 20 years in retirement, as will more than 1 in 10 (13 percent) of those in the highest-income level. By age group, almost one-half of the Early Baby Boomer cohort (those now ages 56–62) are at risk of running short of money to cover basic expenditures in retirement.

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Coverage of Dependent Children to Age 26 Under the Patient Protection and Affordable Care Act

by Paul Fronstin, Employee Benefit Research Institute

Introduction

The Patient Protection and Affordable Care Act (PPACA) enacted March 23, 2010, and the Health Care and Education Reconciliation Act (HCERA) enacted March 30, 2010, require that group health plans and insurers make dependent coverage available for children until they attain the age of 26 regardless of tax, student, or dependent status as it relates to financial support. Group plans and insurers also may not limit dependent coverage based on whether the child is married, although the law does not extend the mandate for access to coverage to the married child's spouse and/or children. Grandfathered group health plans are not required to offer coverage to adult children if they currently have their own employment-based coverage or if they are eligible for such coverage.

The mandate to offer coverage to adult children ages 19−25 takes effect for policy years that begin on or after September 23, 2010. However, many insurers have already announced that they will adopt the requirements of the law early.[1]

Recently released regulations suggest that between 190,000 and 1.6 million uninsured individuals ages 19−25 will gain coverage in 2011, with an increase in premiums of 0.7 percent in 2011, 1.0 percent in 2012, and 1.0 percent in 2013.[2] This report reviews the estimates presented in the recently released regulations and discusses why the enrollment estimates may understate the number of 19−25-year-olds who enroll in their parents' employment-based health plan. Then, among the 19−25-year-old age cohort, the analysis compares the population with employment-based coverage with the uninsured population in order to get a sense of the types of individuals employers may see joining their plans in terms of their health status and health behavior.

Enrollment of Adult Dependents Ages 19−25 in Group Plans

As mentioned above, recently released regulations suggest that between 190,000 and 1.6 million uninsured individuals ages 19−25 will gain coverage in 2011 as a result of the mandate for group plans and insurers to extend coverage to age 26. Another one-half million individuals will leave the nongroup market for group coverage. Hence, the overall increase in employment-based coverage due to newly enrolled 19−25-year-olds in 2011 would range from 680,000 to 2.12 million individuals.

The analysis starts with the entire 29.5 million population of 19−25-year-olds. Among them, about 7 million will not be eligible for coverage because they have coverage through their own employer, and 5.8 million will not be eligible because they have employment-based coverage as dependents.[3] Of the remaining 19−25-year-olds, about 9.3 million are either uninsured or have nongroup coverage, and about 5.8 million have a parent with employment-based coverage. The analysis assumes that 3.5 million of them are unlikely to switch to their parents' plan for various reasons, leaving 2.4 million who might enroll in their parents' coverage.

The regulations assume 2.4 million is the maximum number of 19−25-year-olds who will enroll in their parents' coverage, but underestimates the size of the population that might enroll for a number of reasons.

- The regulations assume that the 2.6 million 19−25-year-olds in the states that already allow them to enroll in extended coverage have chosen not to enroll and are therefore unlikely to enroll in their parents' plan under the PPACA. There are a number of shortcomings in this assumption. First, these state laws do not apply to self-insured plans. Second, individuals may not be aware of the state law, whereas they may be aware of the federal law because of the amount of attention it has received, especially in May 2010, when the regulations were released and many graduating college students were losing their dependent status. Third, a study that examined the impact of state laws used data through 2007, and only nine states had implemented their laws before 2007; there may be a lag effect that is not being picked up.[4] Fourth, until PPACA was passed and guidance[5] was

provided on the tax treatment of health coverage for adult children, such coverage did not provide the same favorable tax treatment that policyholders, their spouses, and minor children received. Employers had to impute income when adult children were covered by the plan. With the removal of this restriction, the value of employment-based health benefits provided to adult children ages 19−25 will not be treated as taxable income. This has the effect of reducing the price of insurance, which may increase take-up rates relative to rates cited in previous studies.

- There is no way to factor in parents' decisions when it comes to enrolling their children. One might look at take-up rates in public and private programs, but should a child be eligible to remain in a plan, the parent may choose to keep him or her enrolled without the child's explicit permission. Furthermore, because employers are unable to add a premium for 19−25-year-olds, families with younger children already enrolled on the plan are already paying a family premium. In such cases, there would be no additional premium to enroll the 19−25-year-old.

- The analysis in the regulations assumes that none of the 7.5 million 19−25-year-olds with some other form of coverage, such as Medicaid or Tricare, will be eligible for employment-based coverage through their parents. Three million of these 7.5 million individuals have a parent with employment-based coverage.

- As more individuals gain employment, more will have access to health coverage through the work place. The regulations provide an initial estimate of the potential enrollment of 19−25-year-olds in their parents' employment-based coverage. Over time, that number may grow as an increasing number of parents become eligible for health benefits.

The regulations not only provide a range of estimates for take-up but they also provide estimates on the impact of premiums. It is expected that, among those enrolling in their parents' plan, the annual premium (using mid-range assumptions) will be $3,380 in 2011, $3,500 in 2012, and $3,690 in 2013. When distributing these costs across the entire population of families with employment-based coverage, premiums are expected to rise 0.7 percent in 2011, 1 percent in 2012, and 1 percent in 2013. If the initial enrollment estimates are too low, the effect of the age 19−25 provision will be higher.

Characteristics of Individuals Ages 19−25

This section examines the characteristics of the 19−25-year-old population by insurance status using data from the 2007 Medical Expenditure Panel Survey (MEPS). Initially, only individuals who are not eligible for employment-based health coverage are eligible to be enrolled in their parents' health plan. However, starting in 2014, there are no such restrictions—any individual age 19−25 can enroll in his or her parents' plan. For purposes of understanding differences in the characteristics of the population with and without employment-based coverage, the entire population ages 19−25 is examined by insurance status. The analysis is not limited to persons ages 19−25 with a parent with employment-based coverage because over time that population may change. Because of the small sample size, individuals with nongroup coverage are not shown separately in the figures.

Overall, of the 28.2 million 19−25-year-olds in 2007, 13.4 million, or 47 percent, had employment-based coverage either through their own job or as a dependent (Figure 1). Another 3 million, or 11 percent, had private insurance, but the exact source of this coverage was not known. In some cases, the coverage was provided by someone living outside the household or by another group. Slightly more than 3.5 million, or 13 percent, had only public coverage during 2007. The remainder, 7.7 million, or 27 percent, were uninsured the entire calendar year.

The population with employment-based coverage is evenly split between men and women. Among those with public coverage, 68 percent were women, whereas among the uninsured, 66 percent were men. When examining the age distribution, the uninsured population is slightly older than the population with employment-based coverage. Sixty-four percent of the uninsured were ages 22−25, whereas 60 percent of the 19−25-year-olds with employment-based coverage were 22−25 years old.

Figure 1
Demographics, Individuals Ages 19–25, by Insurance Status, 2007

		Private Insurance			
	Total	Employment-based	Outside Household, Other Group or Don't Know	Public Only	Uninsured All Year
Total (millions)	28.2	13.4	3.0	3.6	7.7
Percentage	100%	47%	11%	13%	27%
Gender					
Male	52	50	45	32	66
Female	48	50	55	68	34
Age					
19–21	42	40	49	52	36
22–25	58	60	51	48	64
Race/Ethnicity					
White	60	66	77	44	50
Black	13	12	10	23	13
Hispanic	19	13	4	24	32
Other	8	9	10	9	5

Source: Employee Benefit Research Institute estimates from the 2007 Medical Expenditure Panel Survey.

With respect to race and ethnicity, among the population with employment-based coverage in 2007, 66 percent were white, 12 percent were black, and 13 percent were Hispanic. Among the uninsured, 50 percent were white, 13 percent were black, and 32 percent were Hispanic.

Self-reported health status varies by insurance status. Seventy-seven percent of the population with employment-based health coverage considered themselves either in excellent or very good health, and another 21 percent considered themselves in good health in 2007 (Figure 2). Only 2 percent considered themselves as in fair health, and none ranked their health as poor. Among the uninsured population, 69 percent considered themselves either in excellent or very good health, and another 24 percent considered themselves in good health. Five percent rated their health as fair and 1 percent as poor. Similarly, when examining self-reported mental health status, it was found that those with employment-based health benefits were more likely than the uninsured to report excellent mental health, whereas the uninsured were more likely than those with employment-based health benefits to report good, fair, or poor mental health (Figure 3).

The use of selected preventive services is presented in Figure 4. The uninsured used preventive services less frequently than the insured population. Individuals with employment-based coverage were roughly twice as likely as the uninsured to have received a flu vaccination, cholesterol check, or routine checkup within the past year of being interviewed in 2007. They were also more likely to have had their blood pressure checked, and among women, to have had a pap smear or breast exam. The uninsured were more likely than those with employment-based coverage to have never received these preventive services.

When it comes to receiving health advice, those with employment-based coverage were more likely than the uninsured to have been told by a doctor or other health professional to eat fewer high-fat or high-cholesterol foods (Figure 5). Those with employment-based coverage were also more likely than the uninsured to have been told to exercise more. These differences may not be related to health status but instead due to the fact that individuals with employment-based coverage use more health care services than the uninsured. However, it was found that individuals with employment-based coverage are slightly more likely than the uninsured to exercise and to be of normal weight, whereas the uninsured are more likely to be overweight. Obesity rates were the same for the two groups. The uninsured were also more likely than those with employment-based coverage to smoke. Nearly 30 percent of the uninsured population reported that they smoke, compared with 17 percent of individuals with employment-based coverage.

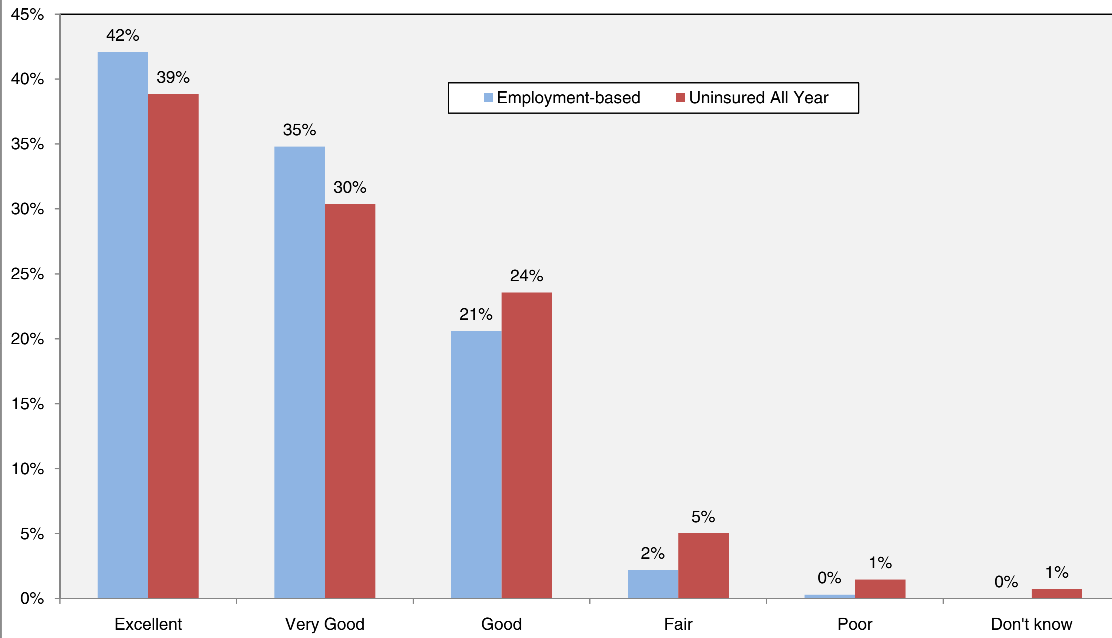


Figure 2
Perceived Health Status, Individuals Ages 19–25, by Insurance Status, 2007
45%
40%
35%
30%
25%
20%
15%
10%
5%
0%
Employment-based
Uninsured All Year
42%
39%
35%
30%
21%
24%
2%
5%
0%
1%
0%
1%
Excellent
Very Good
Good
Fair
Poor
Don't know
Source: Employee Benefit Research Institute estimates from the 2007 Medical Expenditure Panel Survey.

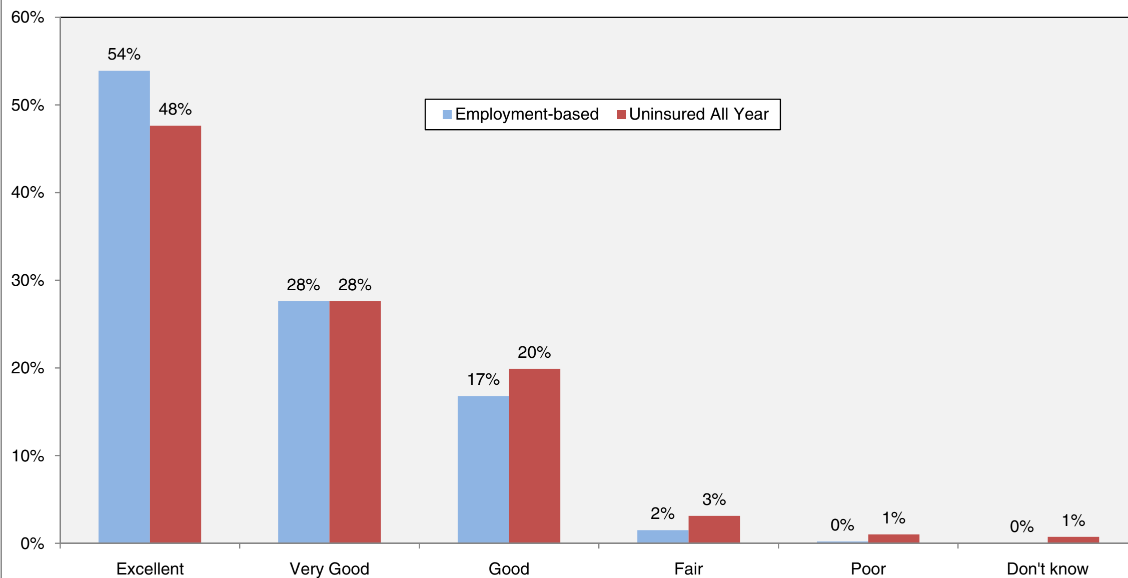


Figure 3
Perceived Mental Health Status, Individuals Ages 19–25, by Insurance Status, 2007
60%
50%
40%
30%
20%
10%
0%
Employment-based
Uninsured All Year
54%
48%
28%
28%
17%
20%
2%
3%
0%
1%
0%
1%
Excellent
Very Good
Good
Fair
Poor
Don't know
Source: Employee Benefit Research Institute estimates from the 2007 Medical Expenditure Panel Survey.

Figure 4

Time Since Use of Selected Preventive Services, Individuals Ages 19–25, by Insurance Status, 2007

		Private Insurance			
	Total	Employment-based	Outside Household, Other Group or Don't Know	Public Only	Uninsured All Year
Total (millions)	28.2	13.4	3.0	3.6	7.7
Percentage	100%	47%	11%	13%	27%
Time Since Last Flu Vaccination					
Within past year	13	16	15	14	7
Within past 2 years	6	5	13	6	5
Within past 3 years	3	3	6	3	3
Within past 5 years	3	2	3	4	4
More than 5 years	6	4	10	6	8
Never	65	66	52	66	69
Don't know	4	4	1	3	5
Time Since Last Blood Pressure Check					
Within past year	63	67	71	79	43
Within past 2 years	16	16	19	10	18
Within past 3 years	5	4	4	2	9
Within past 5 years	2	1	1	1	5
More than 5 years	3	2	2	1	8
Never	4	3	1	3	8
Don't know	6	6	3	4	9
Time Since Last Cholesterol Check					
Within past year	21	25	20	26	13
Within past 2 years	10	12	10	8	8
Within past 3 years	3	2	2	2	5
Within past 5 years	2	1	1	2	3
More than 5 years	3	2	2	1	5
Never	50	47	58	50	53
Don't know	11	11	7	12	13
Time Since Last Routing Checkup					
Within past year	42	47	45	56	24
Within past 2 years	19	19	25	15	18
Within past 3 years	9	8	7	5	12
Within past 5 years	5	5	8	5	6
More than 5 years	10	8	8	5	17
Never	9	7	3	11	14
Don't know	6	5	3	3	9
Time Since Last Pap Smear (females only)					
Within past year	58	62	54	67	43
Within past 2 years	14	14	12	15	16
Within past 3 years	4	3	4	3	6
Within past 5 years	1	0	0	0	3
More than 5 years	1	0	1	0	1
Never	16	14	25	13	21
Don't know	6	7	3	3	10
Time Since Last Breast Exam (females only)					
Within past year	54	59	53	58	39
Within past 2 years	14	13	12	16	16
Within past 3 years	4	3	3	3	7
Within past 5 years	1	1	1	1	4
More than 5 years	1	1	1	0	1
Never	18	14	24	17	23
Don't know	8	10	6	4	10

Source: Employee Benefit Research Institute estimates from the 2007 Medical Expenditure Panel Survey.

Use of health care services does not tell much about differences in the 19−25-year-old population by insurance status. The uninsured in this age group had fewer office visits than individuals with employment-based coverage (Figure 6). They also had fewer outpatient visits, emergency room visits, nights in the hospital, dental care visits, and prescription drugs. It is important to note that individuals with employment-based coverage also used few of these services, on average, because most people ages 19−25 are healthy and do not use a lot of health care.

Not surprisingly, one of the reasons this analysis does not include the incidence of disease (which is more likely than use of health care services to be independent of insurance status) is because there is very little disease among the 19−25-year-old age cohort. Very few people have heart disease, high blood pressure, and high cholesterol at this age. Similarly, the incidence of stroke, emphysema, diabetes, and arthritis is negligible. Asthma is the exception, with about 9 percent of 19−25-year-olds having been diagnosed with the disease.

Conclusion

Group health plans and insurers will be required to make dependent coverage available for children until they attain age 26 in policy years that begin on or after Sept. 23, 2010. Recently released regulations suggest that between 680,000 and 2.12 million individuals ages 19−25 will gain coverage. However, as shown in this study, there is reason to believe that these estimates understate the size of the population that might enroll in their parents' employment-based coverage. It was determined that when compared with the population with employment-based coverage, the uninsured population age 19−25 is more likely to be male, older, Hispanic, and less physically and mentally healthy. It was also determined that the uninsured population is less likely than the population with employment-based health coverage to use preventive health services, to exercise, and to be of normal weight. The uninsured are more likely to smoke and more likely to have asthma.

It is critical that group plans and insurers understand the size and characteristics of the 19−25 population that might be eligible for their parents' health coverage in order to determine the impact that this provision of PPACA may have on enrollment and costs of employment-based coverage.

Endnotes

[1] A main reason for adopting this provision early is to avoid de-enrolling college graduates only to re-enroll them when the new policy year begins after September 23, 2010. See www.dol.gov/ebsa/faqs/faq-dependentcoverage.html for a list of early adopters.

[2] See http://edocket.access.gpo.gov/2010/pdf/2010-11391.pdf

[3] The law states that grandfathered plans do not have to offer coverage to 19−25-year-olds who either have employment-based coverage or are eligible for it. However, some of the 7 million individuals with coverage through an employer may be covered through a parent's employer or former employer through COBRA, which means they would be eligible for coverage through a parent.

[4] A. Monheit, J. Cantor, et al., "State Policies Expanding Dependent Coverage to Young Adults in Private Health Insurance Plans," presented at the Academy Health State Health Research and Policy Interest Group Meeting, Chicago, IL, June 27, 2009.

[5] See www.irs.gov/pub/irs-drop/n-10-38.pdf

Figure 5
Health Advice and Healthy Behavior, Individuals Ages 19–25, by Insurance Status, 2007

		Private Insurance			
	Total	Employment-based	Outside Household, Other Group or Don't Know	Public Only	Uninsured All Year
Total (millions)	28.2	13.4	3.0	3.6	7.7
Percentage	100%	47%	11%	13%	27%
Doctor or other health professional ever advised person to eat fewer high fat or high cholesterol foods					
Yes	11	12	7	12	8
No	87	86	92	86	89
Don't know	2	2	1	2	3
Doctor advised person to exercise more					
Yes	15	16	19	18	10
No	83	82	80	80	87
Don't know	2	2	1	2	3
Spends half hour or more in moderate to vigorous physical activity at least three times per week					
Yes	64	68	66	51	62
No	35	31	34	48	36
Don't know	1	1	0	1	2
BMI					
Underweight	4	3	4	3	4
Normal	48	50	56	46	44
Overwight	27	27	24	24	31
Obese	18	17	15	24	16
Don't know	3	3	1	3	4
Smokes					
Yes	21	17	13	23	29
No	68	71	76	69	59
Don't know	11	12	11	7	12

Source: Employee Benefit Research Institute estimates from the 2007 Medical Expenditure Panel Survey.

Figure 6
Use of Health Care Services, Individuals Ages 19–25, by Insurance Status, 2007

		Private Insurance			
	Total	Employment-based	Outside Household, Other Group or Don't Know	Public Only	Uninsured All Year
Total (millions)	28.2	13.4	3.0	3.6	7.7
Percentage	100%	47%	11%	13%	27%
Office Visits	2.3	2.4	2.5	3.8	0.9
Outpatient Visits	0.1	0.1	0.2	0.3	0.0
ER Visits	0.2	0.2	0.1	0.4	0.1
Nights in Hospital	0.2	0.2	0.1	0.9	0.1
Dental Care Visits	0.6	0.7	0.9	0.5	0.2
Prescription Drugs	3.0	3.0	4.4	4.6	1.1

Source: Employee Benefit Research Institute estimates from the 2007 Medical Expenditure Panel Survey.

The EBRI Retirement Readiness Rating™ and Retirement Income Adequacy: How Big Is the Gap and How Might the Market Respond?

by John MacDonald, Employee Benefit Research Institute

Introduction

Kathleen Casey-Kirschling of Earleville, MD, stands at the head an 80-million-member parade. Born one second after midnight on Jan. 1, 1946, she was formally recognized in late 2007 as the nation's first Baby Boomer to file for Social Security retirement benefits, beginning in January 2008.

Casey-Kirschling's milestone, and that of the post-World War II Baby Boom generation who will follow, has gained an extraordinary amount of attention in recent years as policymakers, employers, financial services providers, and others seek to determine whether older workers will have enough income to carry them through their retirement years, and what younger workers should do to try to avoid running short of money in retirement.

Some early Baby Boomers got a rude introduction to retirement when the deep recession hit many defined contribution (401(k)) accounts hard in 2008−2009, making the subject of retirement income adequacy all the more important. At the same time, an annual Employee Benefit Research Institute (EBRI) survey showed that the percentage of workers very confident about having enough money for a comfortable retirement has been at or near record-low levels for three consecutive years (Helman, Copeland, and VanDerhei, 2010).

"Americans in 2010 were collectively less confident than their grandparents had been in 1945 that reality would favor their dreams; the world was catching up to America, and the bill for all the previous dreaming was coming due," wrote University of Texas historian H.W. Brands (Brands, 2010).

Retirement security is familiar territory for EBRI and Mathew Greenwald & Associates, which conducted their first Retirement Confidence Survey 20 years ago. Since 2003, EBRI has used its Retirement Security Projection Model (RSPM)® to evaluate workers' retirement income prospects.

EBRI Research Director Jack VanDerhei, assisted by Craig Copeland of EBRI, presented the latest of these evaluations at the May 2010 EBRI policy forum, titled "Retirement Income Adequacy: How Big Is the Gap and How Might the Market Respond?" Their research formed the basis of the newly updated EBRI Retirement Readiness Rating,™ initial results of which were presented at the policy forum. The full analysis is published in the July 2010 *EBRI Issue Brief,* online at http://tinyurl.com/26e9cep

The forum was held May 13 in Washington, DC, and attended by about a hundred people. After VanDerhei's presentation, 20 experts took turns discussing various aspects of retirement income and how private-sector financial products are evolving to serve future retirees' needs. A synopsis of the presentations follows.

The State of Retirement Income Preparation and Future Prospects

EBRI has been providing assessments of national retirement income adequacy using the Retirement Security Projection Model® (RSPM) since 2003, and recent updates to the model permit factoring in many of the new retirement plan changes (e.g., automatic enrollment and auto escalation of contributions for 401(k) plans), as well as updates for financial market performance and employee behavior (based on a database of 24 million 401(k) participants). Jack VanDerhei and Craig Copeland of EBRI presented the new model results to analyze the state of retirement income preparation for those currently ages 36–62 as well as future prospects for these households (for complete results, see the July 2010 *EBRI Issue Brief*, "The State of Retirement Income Preparation and Future Prospects: New Results From the EBRI Retirement Security Projection Model," online at http://tinyurl.com/26e9cep).

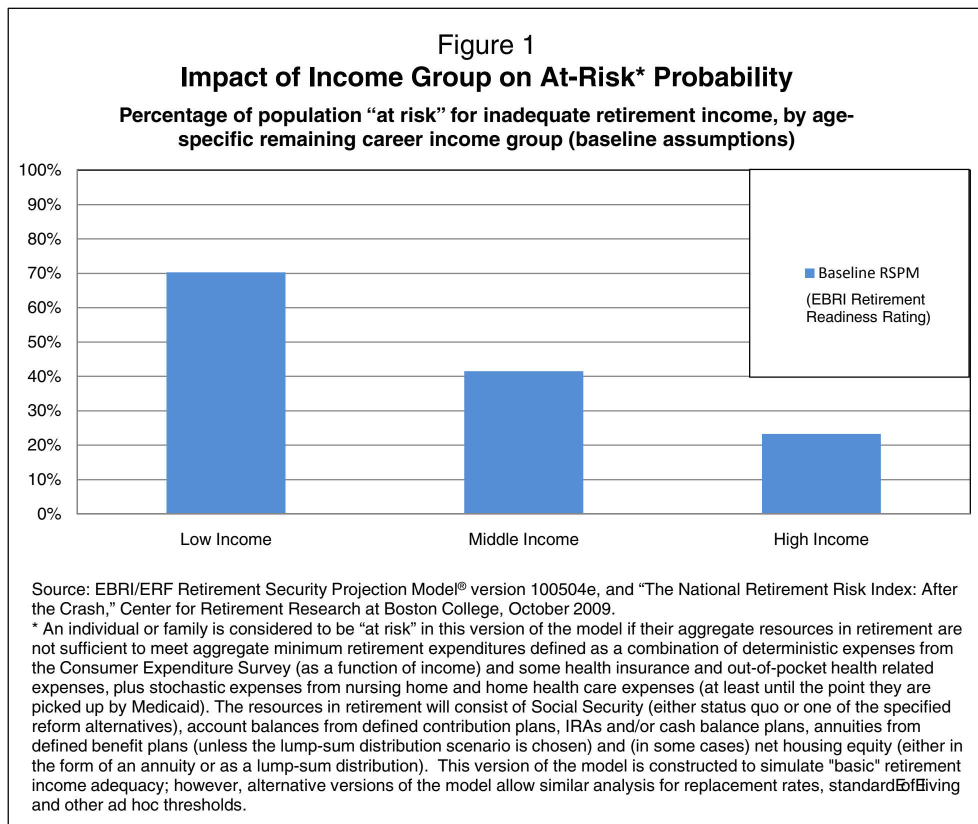


Figure 1
Impact of Income Group on At-Risk* Probability

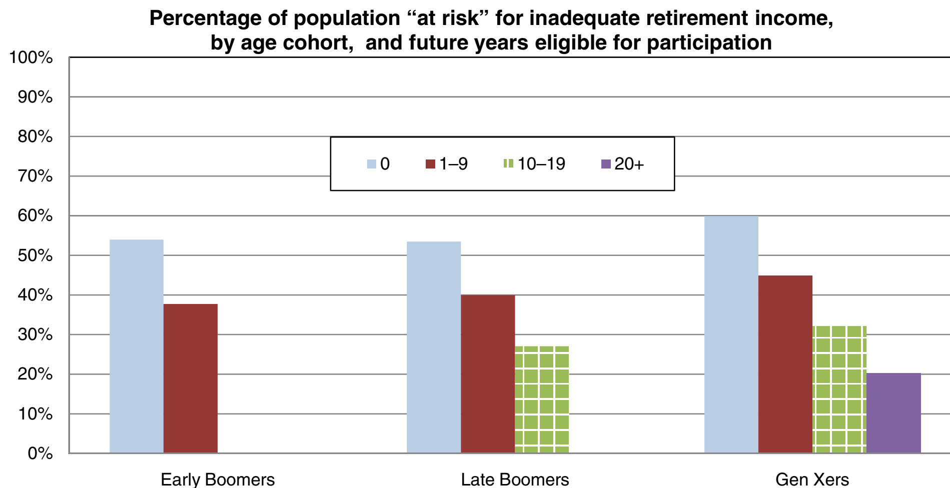
Source: EBRI/ERF Retirement Security Projection Model® version 100504e, and "The National Retirement Risk Index: After the Crash," Center for Retirement Research at Boston College, October 2009.
* An individual or family is considered to be "at risk" in this version of the model if their aggregate resources in retirement are not sufficient to meet aggregate minimum retirement expenditures defined as a combination of deterministic expenses from the Consumer Expenditure Survey (as a function of income) and some health insurance and out-of-pocket health related expenses, plus stochastic expenses from nursing home and home health care expenses (at least until the point they are picked up by Medicaid). The resources in retirement will consist of Social Security (either status quo or one of the specified reform alternatives), account balances from defined contribution plans, IRAs and/or cash balance plans, annuities from defined benefit plans (unless the lump-sum distribution scenario is chosen) and (in some cases) net housing equity (either in the form of an annuity or as a lump-sum distribution). This version of the model is constructed to simulate "basic" retirement income adequacy; however, alternative versions of the model allow similar analysis for replacement rates, standard-of-living and other ad hoc thresholds.

Under the baseline projections in the model, nearly one-half (47.2 percent) of the oldest cohort (Early Boomers) are simulated to be "at risk" of not having sufficient retirement income to pay for "basic" retirement expenditures as well as uninsured health care costs. The percentage "at risk" drops for the Late Boomers (to 43.7 percent) but then increases slightly for Generation Xers to 44.5 percent. Households in the lowest one- third when ranked by preretirement income are simulated to be "at risk" 70.3 percent of the time, while the middle income group has an "at-risk" level of 41.6 percent. This figure drops to 23.3 percent for the highest income group (see Figure 1).

When the results for Early Boomers are bifurcated by future eligibility in a defined contribution plan, the difference in the "at-risk" percentages is quite large (16 percentage points), even after at most nine years of future eligibility. Late Boomers and Gen Xers are able to have significantly larger future periods of time eligible to participate in a defined contribution plan and therefore the differences are much larger. Late Boomers with no future eligibility are simulated to have an "at-risk" level 26 percentage points larger than those with 10–19 future years of eligibility. Gen Xers have the largest differential (40 percentage points): Those with no future years of eligibility have an "at-risk" level of 60 percent, compared with only 20 percent for those with 20 or more years of eligibility (see Figure 2).

While knowing the percentage of households that are "at risk" is obviously valuable, it does nothing to inform one of how much additional savings is required to achieve the desired probability of success. Therefore, this analysis also models how much additional savings would need to be contributed from 2010 until age 65 to achieve adequate retirement income 50, 70, and 90 percent of the time for each household. While this concept may be difficult to comprehend at first, it is important to understand that a retirement target based on averages (such as average life expectancy, average investment experience, average health care expenditures in retirement) provides, in essence, a retirement planning target that has approximately a 50 percent "failure" rate. Adding the 70 and 90 percent probabilities allows more realistic modeling of a worker's risk aversion.

Figure 2
Impact of Age and Future Years of Eligibility for Participation in a Defined Contribution Plan on At-Risk* Probabilities



Source: EBRI/ERF Retirement Security Projection Model® version 100504e.
* An individual or family is considered to be "at risk" in this version of the model if their aggregate resources in retirement are not sufficient to meet aggregate minimum retirement expenditures defined as a combination of deterministic expenses from the Consumer Expenditure Survey (as a function of income) and some health insurance and out-of-pocket health-related expenses, plus stochastic expenses from nursing home and home health care expenses (at least until the point they are picked up by Medicaid). The resources in retirement will consist of Social Security (either status quo or one of the specified reform alternatives), account balances from defined contribution plans, IRAs and/or cash balance plans, annuities from defined benefit plans (unless the lump-sum distribution scenario is chosen), and (in some cases) net housing equity (either in the form of an annuity or as a lump-sum distribution). This version of the model is constructed to simulate "basic" retirement income adequacy; however, alternative versions of the model allow similar analysis for replacement rates, standard-of-living, and other ad hoc thresholds.

Reactions

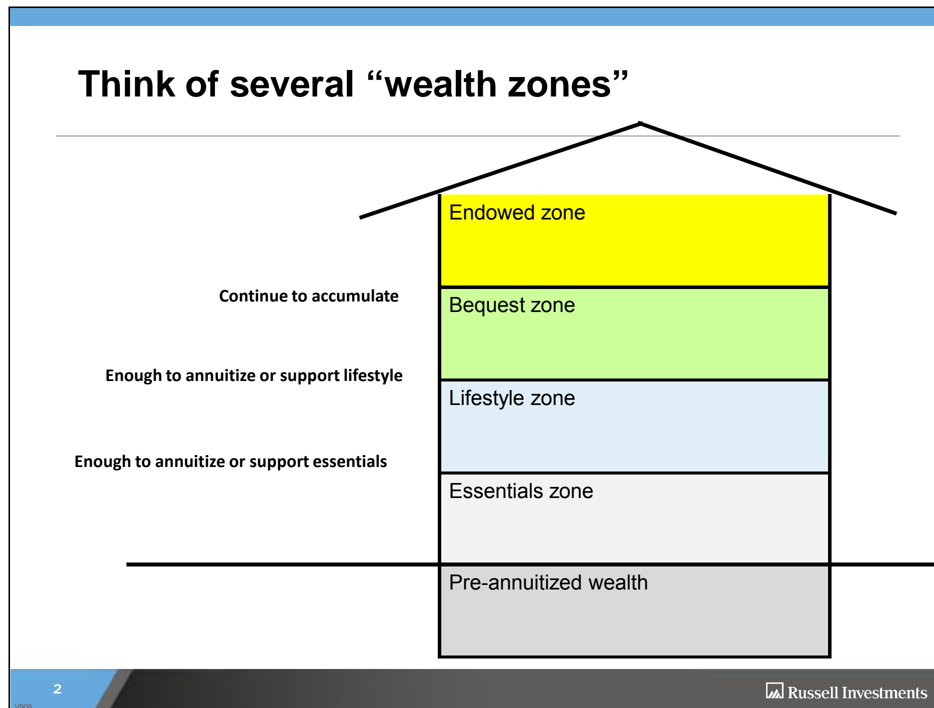
Don Ezra, Russell Investment Group, presented a five-tier framework for evaluating various levels of retirement income adequacy. His first, or "basement" zone, included Social Security, Medicare, and perhaps a defined benefit pension plan. "This is wealth we tend not to count explicitly, because it's tough to estimate the present value, but it's very important," Ezra said (see Figure 3).

His next levels, in ascending order, were: the essentials zone (enough wealth to buy an annuity to cover the essentials of life), lifestyle zone (enough wealth to lock in desired lifestyle), bequest zone (a surplus of wealth relative to lifestyle), and endowed zone (ability to live comfortably on just investment income from wealth).

How much of the population falls into each zone? Getting numbers is difficult, Ezra said, although many retired households maintain their previous standard of living just on Social Security and Medicare. "That places them at the ceiling of the lifestyle zone, even if for some of them there's really almost no difference between the lifestyle and the essential zone."

The importance of VanDerhei's presentation is that he is saying that 45 percent of current workers, given their current rate of savings, are at risk of not making it out the essentials zone, Ezra said.

Figure 3



Howard Fluhr, Segal Company, offered some "personal musings," based on a look at the past and a look forward.

As for the past, Fluhr said that "We've had a failed public policy for a good number of years, a complete lack of political will and courage, a lack of appreciation of macroeconomics and the importance to society of a safety net." He added: "We've become essentially enslaved to 'short-termism' in virtually everything we do and everything we consider."

If there is reason for a more hopeful future, Fluhr said, it is a picture he sees in his crystal ball—one that includes a minimum mandatory benefits level above Social Security, which would be provided through employers and/or individuals with some 401(k) features and a mix of defined benefit and defined contribution plans. "That's this hopeful feeling I have," Fluhr said, adding: "Which is somewhat out of character."

Steve Goss, Social Security Administration, offered several suggestions for refining or expanding the model VanDerhei used to produce his estimates of retirement income adequacy. One suggestion was to include the health conditions of people before retirement. He also suggested using a wider distribution of people with various levels of retirement income "instead of just saying what percentage of people fall below the threshold of having enough to be able to meet" their retirement needs.

Goss focused on the EBRI model's unique ability to incorporate variability: The way individuals' different circumstances lead to radically different outcomes, and to project different results by age and income. This makes it possible to tailor projections to realistic situations.

"Some people die young, shortly after retirement. Some people live a very, very long time. Some people go into a nursing home, some people don't. Some people have big acute health care episodes. And all these are modeled at a micro level, which is really, really good," Goss said. "If you live a long time or have a severe long-term care situation, or have a severe, acute health episode, you're probably more likely to burn through all your assets and be in the position where you're not going to have enough money."

John Rother, AARP, said that VanDerhei's presentation, combined with the recent recession, provided "a pretty big wake-up call."

"We're going to have to say over and over again to people still in the work place, 'You will not have your parents' retirement,'" Rother said. "This is different. Your sources of income will be different. Your longevity will be different. Your health costs will be very different, and you are not going to get by with the same kind of preparation that your parents had."

Rother had seven "takeaways" from VanDerhei's presentation: the importance of Social Security; the lack of participation of half of the work force in any retirement savings plan; the need to plan to work longer; the threat of health care costs to retirement income adequacy; the importance of nursing home and long-term care costs; the importance of living alone as a risk factor in retirement; and the growing gap between the haves and have-nots in retirement income distribution. "Plenty to think about," Rother said.

Implications for Retirement Plans

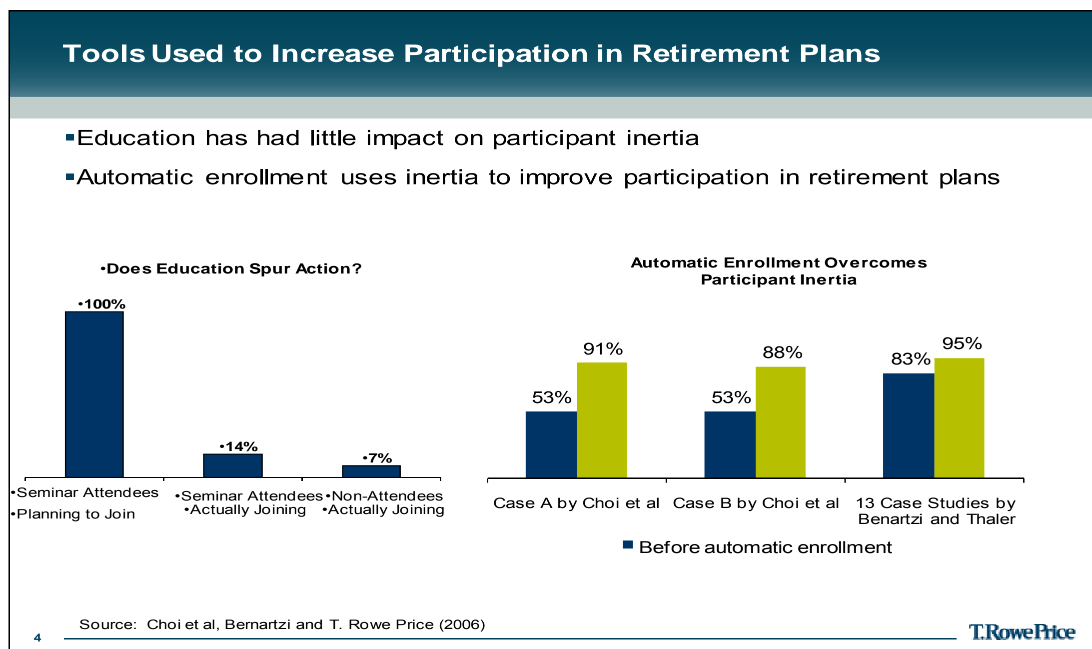
The policy forum next heard from three speakers discussing the period during which workers accumulate retirement income, and three discussing how that income is spent in retirement (also known as the decumulation phase).

Mark Robinson, T. Rowe Price, the first speaker to discuss accumulating retirement assets while working, described what he said were the positive effects on savings of automatically enrolling a worker in a firm's 401(k) plan and automatically increasing the amount the worker contributes to the plan.

Auto-enrollment overcomes worker inertia with regard to participating in a 401(k) plan when one is available, and is much more effective than relying purely on voluntary enrollment and education, Robinson said. When automatic enrollment is used, the result has been to increase participation from just over 50 percent to as high as 90 percent among workers at T. Rowe Price client firms, he said.

Inertia also comes into play in trying to persuade workers to increase their contribution above the initial amount, and auto-escalation of participants' contributions can overcome that, even if the increase is in small increments, perhaps even 1 percent a year. Among T. Rowe Price clients, the effect of these automatic increases means that some participants are contributing up to 20 percent of salary to their 401(k) plan, Robinson said (see Figure 4).

Figure 4



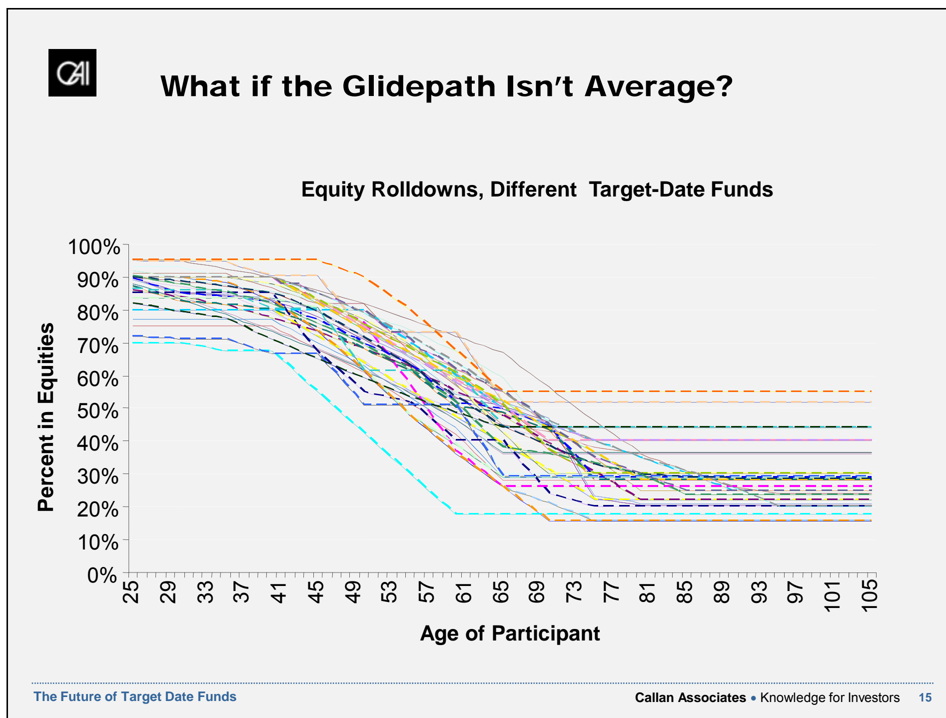
Lori Lucas, Callan Associates, discussed a survey her firm did of 38 target-date funds. It found that the median fund is on track to replace just over 60 percent of preretirement income for workers at age 65, but that the results can vary significantly because of the differences in the way funds allocate assets over time. This changing asset allocation as participants age—known as the glide path—generally takes a more conservative investment approach as the worker approaches age 65.

The average glide path has a 54 percent chance of replacing 65 percent of preretirement income through age 85, according to Callan's analysis, but only a 33 percent chance of replacing 65 percent of preretirement income through age 95.

What this all means, Lucas said, is that employers that sponsor 401(k) plans need to think about total plan design—including the glide path and participant demographics—in deciding whether to offer a target-date fund. Employers need to be aware, Lucas said, that target-date funds involve trade-offs: Funds with conservative glide paths probably mean workers will have to save more to achieve adequate retirement income, while more aggressive glide paths will require "a lot more communication" with participants to explain the risks involved (See Figure 5).

Employers should consider tailoring the target-date funds they offer to take into account the specific composition of their work force, Lucas said. "I've had a lot of conversations with plan sponsors, and they value these trade-offs differently. There's not one formula you can use."

Figure 5



Judy Miller, American Society of Pension Professionals & Actuaries, discussed trends in defined benefit pension plans. Among newly created plans, the trend is definitely toward hybrid arrangements, Miller said, and gave two reasons: Employees using these arrangements can better see and appreciate their account balance, compared with traditional plans. In addition, costs for employers are a little more controllable and a little less volatile compared with traditional final-average plans. To some degree, hybrid plans also shift some of the investment risk from the employer to the worker, Miller added.

The most popular type of hybrid plan is the cash balance plan, which was formally recognized by the Pension Protection Act of 2006. A new "DB(k) plan," combining elements of a defined benefit plan and a 401(k), is available this year for the first time to small employers (two−500 workers), but it has gained little traction because federal rules for the operation of these plans have not been issued.

If defined benefit pension plans are to grow in the future, Miller said "we need to take a step back and take a clean look at the rules that govern them, make sure they allow for flexibility and creativity in the future development of the system and allow employers some flexibility to use them for good corporate purposes."

Tom Johnson, New York Life, was the first of three speakers to discuss how retirees consume their assets when they stop working (the decumulation phase). His topic was a relatively new retirement product called an "institutional IRA" that could be available to employers.

Johnson said New York Life's concept of an institutional individual retirement account (IRA) is based on work he did for a former employer and blends income annuities and model mutual fund portfolios. These are just beginning to emerge in the marketplace today, he said.

As Johnson described it, the institutional IRA has four key components:

- Objective individual income planning that includes major risks in retirement.
- Professionally selected and pooled investment vehicles (such as target-date funds) that are risk appropriate.
- Fiduciary-friendly income annuities that address employers' concerns about liability.
- No commissions, but rather a "wrap-around fee" so that participants can see what they are paying for advice.

Elizabeth Heffernan, Fidelity, discussed the comparative value of three products: fixed-income annuities, variable-income annuities with a minimum income benefit guarantee, and variable annuities with a guaranteed minimum withdrawal benefit. Financial services companies need to understand that workers have different needs, so that none of these three will be right for everyone, she said.

The key, she said, is to start helping workers understand the value and the trade-offs of different income-protection options. She showed a number of slides comparing the three products she was discussing and commented, "This really demonstrates that while the fixed-income annuity really maximizes [guaranteed income] from day one, other products will start to approach that guarantee over time and may even surpass that amount, depending on the performance of the underlying markets."

What is often most difficult to explain is an appreciation of longevity protection, she said. "When you look at how many people take their lump-sum from their defined benefit plan and don't really appreciate that long-term protection, it's a little startling how many people underestimate how long they are going to live."

Jason Scott, Financial Engines, discussing spending assets in retirement, focused on longevity insurance, which he described as a product that provides a maximum long-term benefit for a minimum initial investment, thus making more efficient use of retirement resources.

As Scott described it, longevity insurance is like an immediate annuity, but the payments to the beneficiary do not begin until he or she is well into retirement, say age 85. However, as Scott noted, longevity insurance as a stand-alone product does not comply with federal minimum distribution rules. "So that has created a large barrier to actually offering these things," he said.

Still, Scott said that retirees need liquid assets at retirement and long-term protection. "Longevity insurance gives us an ability to kind of have the best of both worlds," he said, "because you can have a lot of liquidity but you can still get a lot the insurance benefit."

Discussion of Retirement Issues

The policy forum next heard a panel of seven experts discuss a wide range of retirement issues and financial services products designed for retirees and those approaching retirement.

Greg Ahern, Investment Company Institute, discussed the challenges of communicating to a lay audience the need to plan for a secure retirement at a time when about 50 percent of workers do not have an employer-based retirement plan, and the main channel of communications—the news media—is going through a severe contraction because of a decline in revenue.

"We face some real challenges…we want to make sure that we are able to use the kind of facts we have here [at the policy forum] to deal with the media," he said.

Drew Denning, Principal Financial Group, said he liked to keep things simple. His main point: "You need to save 15 percent of your salary for 40 years to replace 85 percent of your income"—a formula he described as "15, 40, 85." The numbers are not absolute and may vary by individual, but they provide a "simple set of metrics for individuals to follow," he said.

Some may say they cannot save 15 percent of their salary, but it's a matter of making lifestyle choices, Denning said. "They need to find out early what kind of lifestyle they can expect, to know if they're going to be in the 'bequest category' or just meeting essential expenses," he said, referring to Don Ezra's presentation.

Christine Marcks, Prudential Retirement, discussed three challenges she sees in designing financial products that will respond to workers' retirement income needs:

- The need for products that make a connection between what a worker saves and the income that will be available in retirement. This includes calculators and regular statements with illustrations. Too many financial advisors focus on the accumulation stage and too few on the income end, she said.
- The need for more retirement plans that include automatic features—auto-enrollment, auto-escalation, the use of target-date funds, and a guaranteed income option default for distributions. These can address inertia and longevity risk, she said.
- The concerns of many plan sponsors about taking on additional fiduciary responsibility, which need to be resolved with the Department of Labor in designing new products.

Lew Minsky, Defined Contribution Institutional Investment Association, a lawyer and former retirement plan sponsor, said he would like to see plan sponsors focus more on helping workers achieve their retirement needs and less on the traditional goals of meeting participation and income-testing requirements.

"Large plans are starting to shift from that traditional view to an alternative view, where outcomes matter," Minsky said. "But it's a real challenge because, obviously, there's a concern about liability." He said he was not proposing to throw out nondiscrimination rules, but would like to see the retirement plan industry shift much more of its attention to retirement income results.

"I think if we did, the way their plans are designed would change significantly overnight," he added.

Robert Moore, Nationwide Financial, said retirement plans need to be simple to understand so that workers can see the benefit of savings. That often is not the case now, he added. Workers often do not understand what they pay for and the terminology that the retirement industry uses can be confusing. "For instance, how many workers really understand what an immediate annuity is? We say we 'sign to a contract' (scary word), when in reality it is an agreement to purchase," Moore said. "Consumer-friendly terminology is a challenge in our highly regulated industry, but is worth the effort."

Moore said workers need to be shown the rewards of saving along the way throughout their retirement savings journey, to encourage them to continue. "Let them know they are on the right track, are doing the right thing, and are on the road to benefiting themselves and their families, even if it does take 30 years to get there," he advised. "Scare tactics do not work. Workers simply want to know if they will have enough and of course the earlier they know where they are at, the better, so that they can make the needed adjustments. We need to give them that help even if they are not asking for it. The opportunity to help is there as an industry and we need to embrace it."

Stacy Schaus, PIMCO Defined Contribution Practice, suggested the retirement plan industry needs to be cautious about the assumptions it builds into its income projection models. "If anything, I think we need to be more risk-averse," she said, "and make sure that we're not putting people on a path where we might have 30 years of no return in the stock market." That's not to say she anticipates 30 years of no-return markets, she said, "but let's be careful with those assumptions."

Simplicity may not lead to long-term retirement income security, Schaus added. Workers need to be able to take advantage of advanced institutional investment approaches and management that can bring down investment risks, she said.

Jean Young, Vanguard Center for Retirement Research, said automatic enrollment may not be the solution to retirement plan participation that some believe because the recent growth in auto-enrollment may be hitting a plateau.

Young said auto-enrollment does not assure that workers will participate in a well-designed retirement plan. Among Vanguard clients, about 40 percent of those who had adopted automatic enrollment have plan designs where, after five years, total worker and employer contributions are less than 9 percent, even after taking auto-escalation into account. In these cases, contribution levels may remain too low, she noted. In addition, most clients adopt the design "prospectively," applying it to new hires only.

Another opportunity Vanguard is seeing evolve is "what appears to be obvious portfolio construction errors," Young said. Five years ago, more than half of Vanguard plan-sponsor participants had retirement plan accounts that had no equities, all equities, or an overconcentration in employer stock. The good news, she said, is that the trend is toward professionally managed options, leaving only about one-third of participants with what appear to be poorly constructed portfolios in 2009. Young noted that "it's very encouraging" to see that 25 percent of all Vanguard participants were solely invested in a single automatic-investment option such as a target-date fund, a balanced fund, or a managed account program—compared to just 7 percent only five years ago.

Implications of Retirement Plan Changes

The policy forum concluded with a panel of human resource benefit managers offering opinions on how retirement plans have changed and what they see for the future.

Marty Solhaug, Ameriprise Financial, said that since being spun off from American Express his company has reduced its defined benefit plan and lowered its 401(k) match based on its review of competitive levels and trends within the financial services industry. The result is a retirement plan that is "quite a bit less rich" than when the company was spun off but still pretty competitive, he said.

At Ameriprise Financial, like a lot of other companies, a retirement plan is seen as a cost of doing business and a necessary element of total rewards in attracting skilled workers. There is more focus in the design process on current plan costs instead of what the plan will deliver in potential income replacement.

Solhaug said Ameriprise also uses target-date funds, and has not capped contributions of company stock. The company provides workers a comprehensive total rewards statement that reinforces the need to save for retirement, he said. He also said he sees a "tremendous need" among employees for financial planning and financial advice, even for employees who are just beginning to save.

John Wade, National Rural Electric Cooperative Association, said electric cooperatives around the country remain strong supporters of defined benefit plans, but doing so is an increasing struggle in light of current economic conditions and changes in federal regulations.

Wade said that his member plans have a lump-sum option in their defined benefit pension plans, and most participants take it when they retire and claim a distribution. His members are facing the same issues as others in getting workers to consider guaranteed-income annuities when taking a distribution from their 401(k) plan, Wade said, adding it would be a helpful if required minimum distribution rules for defined contribution plans were changed. It's up to plan sponsors to come up with proposals, he said.

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