ERISA Advisory Council

Working Group on
Financial Literacy and the Role of the Employer

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Any and all views expressed are those of Mr. Salisbury alone,
since he alone wrote and reviewed this submission.

It is a pleasure to meet with you today to discuss the important topic of worker financial literacy and the role of the employer. You have appropriately set out a scope that goes beyond issues of retirement and the plan participant, since many workers may be with an employer for some time before either participating in a plan or paying attention to their participation.

Several decades ago a number of corporations joined together to create the National Council on Economic Education (www.ncee.net) to build courses and materials to aid in student financial literacy education, based on the premise that their future employees needed financial knowledge. That group and many others which focus on our youth (such as www.jumpstartcoalition.org) depend for their financial support on large retirement plan sponsors and service firms, as well as on financial institutions.

The U.S. Labor Department joined with EBRI and many other public and private organizations in 1995 to launch the American Savings Education Council (www.asec.org). This organization brings together many individuals and organizations with a dedication to encourage financial education, retirement plan sponsorship, and participant and beneficiary education for the entire population, regardless of age, employment status, etc., but with a heavy focus on plan sponsors and their workers. The Choose to Save® program of educational public service announcements, videos, Internet site, and materials was created as a direct result of the efforts of DOL, with encouragement from this Advisory Council.

Does the plan sponsor have any responsibility for educating participants about their decisions at retirement?

ERISA Sec. 404c, and implementing regulations, would seem to suggest that employers that want to treat plans as being self-directed must provide substantial financial education. Since most sponsors make the declaration of being 404c compliant, they seem to answer your first question themselves: Yes, the plan sponsor does have a responsibility to educate participants about their decisions at retirement—and, I would add, during all of their years of participation. Those who do not suggest they are 404c compliant might well benefit from doing so, but would not appear to have the same ERISA responsibility.

The Pension Protection Act of 2006 would seem directly relevant to the work of this group. Testimony which encouraged its enactment by plan sponsors, and others, contended that employers were not doing as much participant financial education as was needed, and when provided, it did not seem to be leading to desired behaviors. Many behavioral finance researchers urged the explicit legislative approval of automatic features in plans that sponsors had been reluctant to adopt based only upon agency guidance. PPA accomplished that goal, and even added provisions to allow auto-enrollment, auto default and reallocation, and auto contribution escalation.

Are programs in place now adequate for sound decision making?

There are programs and tools available today that would provide the basis for sound decision-making. But the reality is that most plan sponsors do not provide them, many financial planners do not provide them, and even when they are made available most individuals do not take advantage of them.

We have sponsored the EBRI Retirement Confidence Survey® (RCS) for 17 years. We have always asked questions about what employers provide (a great deal), what employees actually use (not much), and whether use has led to self-reported changes in behavior (for a small number). Other research has taken the step of testing for results, with follow-up on whether individuals *actually* do what they *say* they will do in response to education; results have shown that a small fraction actually implement their intentions. Much of the impetus for changes in PPA was attributed to such research.

Why or why not?

- The tools that provide for full Monte Carlo analysis of life expectancy, inflation, wage growth, investment returns by class, and annuity optimization have only recently become available.
- Most financial planners are still using partial programs, and many still use static programs that do not even allow adjustment for long lives.
- Most individuals wait until ages at which it is often too late to make sufficient spending and saving course adjustments before they become willing to allocate time to financial planning. The RCS consistently finds that less than half report ever having made even a guess at what would be needed in retirement, and fewer than 1 in 4 reports ever having done a serious calculation. Less than half of those report taking action, and research suggests that over half of these did not actually take the action.
- Organizations and individuals are driven by the short term—whether it be profit cycles, pay periods, or credit card payment cycles, the short term dominates over intermediate- or long-term planning.
- When it comes to employee benefits, this has shown up consistently in the EBRI *Value of Benefits Survey.*® More than 80 percent of workers say health insurance is their top benefits priority; over one-third say more health insurance is their second priority; one-third say a savings plan is their second priority; and less than 15 percent rank a pension plan as either first or second. Individuals focus on their current needs. The EBRI Health Confidence Survey® finds that nearly two-thirds report increases in their annual health costs, and over three-fifths of this group say they covered the increase by either reducing savings or borrowing on a credit card or against their home.
- For a substantial proportion of workers, EBRI surveys indicate that these pressures and preferences are still in place as they reach “normal” retirement ages. This underlines why they would not take advantage of financial planning programs when available.

- The fact that over a third of new retirees depend *entirely* on Social Security, and two-thirds get a *majority* of their income from Social Security, provides clear evidence of these patterns.

Should the plan sponsor receive any incentives to provide this education?

- I assume that by "incentives" you mean more than the ability to deduct the cost as a business expense and possibly assist in meeting ERISA requirements. No, I do not believe direct incentives would be useful or substantially increase worker take-up rates. As described above, the primary problem is worker behavior (or lack thereof), not employer behavior.
- Workers might be offered a cash payment or an extra contribution as is increasingly being done in the health plan area to get workers to engage in wellness and prevention behavior.
- I personally believe that all plan sponsors have stronger long-term incentives than many realize or act upon:
  - The incentive to have workers who have full financial literacy so that they are more likely to remain in good financial health, which has been shown to improve job performance, attitude, etc.
  - The incentive to have retirees have **<u>lifetime</u>** supplementation of Social Security so that they have the capacity to consume, and therefore assist the economy, as long as they live, which is in the interest of all plan sponsors. Data show that, as retirees age, the proportion of their income that comes from Social Security continues on a steady climb until death because the individual has not chosen to put savings into an inflation-indexed life income annuity.

What specific message should participants receive at retirement? What are the preferred ways to deliver the message?

- It should be at the time workers say they are planning to retire—or before if the employer can get their attention—and it should be two questions:
  - First, do you understand how long you may actually live? Most will say no. Follow with an exercise with a life expectancy calculator.
  - Second, have you clearly set out what all of your expenses and income will be for the rest of your life and satisfied yourself that you can actually afford to retire? Most will say no, they have never had any kind of budget. Why should they start now? Follow with an exercise that works them through expenses and income and assets and liabilities and then feed it all into a Monte Carlo comprehensive model so that they will see exactly how much risk they are taking on and how well off or how far short they are.

- Most employers want most workers to retire at "normal" retirement age so they do not have a strong incentive to do the above for most of their workers at this late point in their careers.
- That is why we need to find ways to make it happen early. The most preferred way to deliver all of this is with one-on-one financial planning sessions by truly independent advisors.

In addition to management of retirement savings, what are the three main financial issues facing retirees?

- Based upon both RCS and U.S. Census Bureau data, one would have to say that management of retirement savings is not the primary issue faced by most retirees, since most have very limited retirement savings.
- First, living on a limited fixed income (that is an "inadequate" fraction of pre-retirement disposable income for most retirees), for more years than most planned to live. Thus, the inability to cover basic living expenses during their remaining lifetimes is the single biggest issue.
- Second, paying for medical expenses that are no longer covered by work-based benefit programs and are only partially covered by Medicare. A companion to this increasingly will be the payment of Medicare premiums, which will rise faster than annual Social Security benefit increases.
- Third, avoiding debt and loss of income and assets through fraud.

What potential disruptions to retirement income stability exist for retirees?

- This question could be answered with multiple dissertations. I will limit my list to just the personal experiences of my own retired family members:
    - Unexpected years of life.
    - Unexpected health expenses.
    - Lower interest rates than anticipated on savings.
    - Lower equity returns or larger equity losses than anticipated.
    - Higher home maintenance expenses than anticipated.
    - Selling property ahead of high periods of appreciation in value.
    - Selling property after unanticipated decline in value.
    - Greater support needs by children and other family members than anticipated.
    - Inability of children to assist financially with unexpected expenses.
    - Higher interest rates than anticipated on home equity line of credit and no assets to pay off the line of credit without selling the property (at a point 15 years later than you thought you would be dead, but many years before you may still actually die—"At 91 you begin to think you might never die").

Inherent within "advice" provided to participants is the specter of fiduciary responsibility. Can "education" be provided without fiduciary responsibility and still deliver effective information for retirement decision-making regarding finances and health care?

- DOL guidance would suggest that the answer to this question is yes, as would PPA (and, I will assume, the eventual DOL guidance to be issued on PPA).
- PPA would suggest that this is particularly true if a computer model can provide the "advice." EBRI research suggests that a comprehensive Monte Carlo model that includes a calculation of annuity optimization can accomplish this goal for purposes of finances: The model output can be deemed to be the advice. Ideally, a third party would assist the individual in understanding the output.
- Reports and tools and models now available can provide most if not all of what an individual would need to determine whether or not they should actually retire, relative to finances and health care, short of selection of the final policy or provider. Whether or not the individual (or an advisor for that matter) would choose to implement all that the model suggested is another question, including what percentage probability of success the individual is willing to accept.
- Education cannot always tell the individual enough to know from whom they should purchase a retirement product.
- Available evidence suggests that most individuals are willing to accept an average (50 percent) probability of success, based upon behavior, but they may not know that is what they are doing.

Should the prohibited transaction exemption (PTE) provided for investment advice contained within PPA be expanded to allow other forms of financial advice, e.g. insurance, health care choices? If so, what safeguards would you recommend for satisfactory regulatory oversight of such expanded PTE?

- Until all of the final regulations and interpretations are out, I will leave this to those more technical than I.

Thank you for the opportunity to appear today. All of our work since 1978 can be found on our Websites, and I encourage you—and everyone—to make use of it.

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