

**STATE OF THE AMERICAN SENIOR: THE
CHANGING RETIREMENT LANDSCAPE FOR BABY
BOOMERS**

HEARING
BEFORE THE
SPECIAL COMMITTEE ON AGING
UNITED STATES SENATE
ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

WASHINGTON, DC

SEPTEMBER 25, 2013

Serial No. 113-10

Printed for the use of the Special Committee on Aging



Available via the World Wide Web: <http://www.fdsys.gov>

U.S. GOVERNMENT PUBLISHING OFFICE

91-173 PDF

WASHINGTON : 2017

For sale by the Superintendent of Documents, U.S. Government Publishing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
Fax: (202) 512-2104 Mail: Stop IDCC, Washington, DC 20402-0001

SPECIAL COMMITTEE ON AGING

BILL NELSON, Florida, *Chairman*

RON WYDEN, Oregon	SUSAN M. COLLINS, Maine
ROBERT P. CASEY JR, Pennsylvania	BOB CORKER, Tennessee
CLAIRE McCASKILL, Missouri	ORRIN HATCH, Utah
SHELDON WHITEHOUSE, Rhode Island	MARK KIRK, Illinois
KIRSTEN E. GILLIBRAND, New York	DEAN HELLER, Nevada
JOE MANCHIN III, West Virginia	JEFF FLAKE, Arizona
RICHARD BLUMENTHAL, Connecticut	KELLY AYOTTE, New Hampshire
TAMMY BALDWIN, Wisconsin	TIM SCOTT, South Carolina
JOE DONNELLY Indiana	TED CRUZ, Texas
ELIZABETH WARREN, Massachusetts	

KIM LIPSKY, *Majority Staff Director*
PRISCILLA HANLEY, *Minority Staff Director*

CONTENTS

	Page
Opening Statement of Chairman Bill Nelson	1
Statement of Ranking Member Susan M. Collins	2
PANEL OF WITNESSES	
Joanne Jacobsen, American Senior	4
Olivia S. Mitchell, Ph.D., International Foundation of Employee Benefit Plans Professor, The Wharton School, University of Pennsylvania	6
Paula A. Calimafde, Chair, Small Business Council of America	8
Richard W. Johnson, Ph.D., Senior Fellow and Director, Program on Retirement Policy, The Urban Institute	11
APPENDIX	
PREPARED WITNESS STATEMENTS	
Joanne Jacobsen, American Senior	34
Olivia S. Mitchell, Ph.D., International Foundation of Employee Benefit Plans Professor, The Wharton School, University of Pennsylvania	37
Paula A. Calimafde, Chair, Small Business Council of America	44
Richard W. Johnson, Ph.D., Senior Fellow and Director, Program on Retirement Policy, The Urban Institute	54
ADDITIONAL STATEMENTS FOR THE RECORD	
William K. Zinke, President, Center for Productive Longevity	72

STATE OF THE AMERICAN SENIOR: THE CHANGING RETIREMENT LANDSCAPE FOR BABY BOOMERS

WEDNESDAY, SEPTEMBER 25, 2013

U.S. SENATE,
SPECIAL COMMITTEE ON AGING,
Washington, DC.

The Committee met, pursuant to notice, at 2:15 p.m., in Room 562, Dirksen Senate Office Building, Hon. Bill Nelson, Chairman of the Committee, presiding.

Present: Senators Nelson, Manchin, Donnelly, Warren, Collins and Scott.

OPENING STATEMENT OF SENATOR BILL NELSON, CHAIRMAN

The CHAIRMAN. Good afternoon. We welcome our witnesses. We want to thank you for being here as we discuss the retirement security of senior citizens, particularly Baby Boomers.

The American senior is in some difficulty of financial trouble. Changes in the retirement system, higher health care costs and this recent recession have all combined to put Baby Boomers on a shakier financial footing than their parents and their grandparents.

The American Dream—if you work hard, play by the rules, you can be rewarded with a comfortable retirement. For some of our seniors, that is fading away.

People today are not only retiring with less money coming, but more money is going out to pay off expenses like debt or medical bills, and that does not even factor in the financial challenges faced by seniors with long-term health care needs.

So, here in the Congress, in the midst that we are now, as we speak, going through a harangue on the floor about whether or not we are going to pay our bills, whether or not we are going to have a continuation of appropriations next Tuesday—well, it is important to think about all of that impact on the people who are already living with too little to no disposable income.

More than three in five just in my State of Florida, on Social Security, get at least half of their income from those retirement benefits.

Over 3.5 million Floridians—1 in 5 residents—rely on Medicare.

And what about the people in our State who could get Medicaid if the State would expand its program for 1.2 million people? Under the Affordable Care Act, if the State would expand its eligibility, that would cover health care for 1.2 million Floridians that other-

wise are between the eligibility levels in the State Medicaid and 138 percent of poverty.

So folks between the ages of 50 and 64 are particularly going to be affected, if they do not expand Medicaid, until they get to the age of 65 for Medicare.

Now we have had all kinds of stories from my State about how shaky finances are in retirement.

Michael Vita of Miami works for a financial planner. So all of his papers and investments are in order, but even he is only bringing in \$50 more per month than he has to spend. So any real expense that comes his way could have a real impact on his financial well being.

Jim Marzano of Tampa says he is nowhere near where he was a decade ago before the recession. He has been out of work a total of three years. He kept being told he was overqualified for jobs. Now both he and his wife are working, and between the 2 of them, they are making what he made by himself 11 years ago. So he, too, will be working for a long time.

And so what can be done to stem this tide?

What can we do to make sure our seniors have enough money to last them for retirement?

And that is what we are here convening today in the Aging Committee.

This is a crisis that is not only in the making, it is made, and I hope our witnesses today will shed some light on this.

I want to turn to our Ranking Member, Senator Collins, for her comments.

OPENING STATEMENT OF SENATOR SUSAN M. COLLINS

Senator COLLINS. Thank you very much, Mr. Chairman.

I also want to thank and welcome our new colleague to the Senate, Senator Scott, for coming today.

The CHAIRMAN. Welcome.

Senator SCOTT. Thank you.

Senator COLLINS. I know he is very eager to play an active role on this Committee, and it is great to have him, as well as Senator Warren, join us as we explore this very important topic.

On January 1, 2011, the first members of America's Baby Boom Generation celebrated their 65th birthday. Since that day, more than 10 million Americans have reached that milestone, and 10,000 more will be added to that number every day for the next 17 years.

After four decades in the workforce, these Americans should be confident that they will have the resources to enjoy their retirement years without fearing that they will run out of money and fall into poverty. Yet, far too many American seniors struggle to get by and have real reason to fear that they will outlive their savings.

Nationally, 1 in 4 retired Americans has no source of income beyond Social Security. In my State, Maine, the number is 1 in 3. And 4 in 10 rely on that vital program for 90 percent of their retirement income.

Bear in mind that Social Security provides an average benefit of just a little over \$1,200 per month—less than \$15,000 per year. It is hard to imagine stretching those dollars far enough to pay the

bills. Certainly, a comfortable retirement appears to be out of the question.

The importance of Social Security to low-income retirees cannot be overstated. Social Security benefits represent 85 percent of the income of low-income retirees. By contrast, retirees in the top income quarter receive just 17 percent of their income from Social Security.

According to a survey published last year, more than half of all Americans are worried they will not be able to maintain their standard of living in retirement, up sharply from 34 percent 2 decades ago, and they are right to be concerned. Projections published in the year 2010 by the Employee Benefit Research Institute, known as EBRI, showed that nearly half of the early Boomers, those between ages 56 and 62, are at risk of not having enough money to pay for basic costs in retirement, including uninsured health care costs.

EBRI found that the rate of inadequate retirement income has risen across all age groups and income levels since its previous study in 2003. Early Boomers will need to save an additional 3 percent of compensation each year to cut in half their chances of running out of money in retirement just to make up for the losses they sustained in the 2008–2009 financial crisis.

To a great extent, the decline in retirement security is traceable to the severity of that crisis, which wiped out nearly one-quarter of the accumulated wealth of all U.S. households. Seniors were particularly hard hit. While the weak financial recovery has restored some of their losses, many retirees have been forced to accept a lower standard of living that may well be permanent.

Other factors that have weakened the retirement security of today's retirees are rising health care costs, the need for long-term care and the fact that Americans are living longer.

The shift from employer-based defined-benefit plans to defined contribution pension plans, like 401(k)s, has also played a role. Employees of smaller businesses are much less likely to participate in employer-based retirement plans. According to a recent GAO study, more than half of the 42 million Americans who work for businesses with fewer than 100 workers lack access to a work-based plan to save for retirement.

Proposals to make it easier for small businesses to provide retirement plans for their workers could make a significant difference in financial security for many Americans as long as they do not impose costly new mandates that discourage smaller companies from hiring employees in the first place.

Again, Mr. Chairman, thank you for calling this important hearing. I look forward to hearing from our witnesses.

The CHAIRMAN. And, after we hear from our witnesses, I am going to turn over to our Committee members' questions, and then I will do a clean-up of remaining questions of you all.

We are delighted to have you all today. Your written testimony will be entered into the record. I would ask you to keep your comments to about five minutes so we can get into the questions.

And we are going to have:

Ms. Joanne Jacobsen. She is a senior. She is experiencing some of these difficulties that we have talked about.

Dr. Olivia Mitchell, International Foundation of Employee Benefit Plans Professor at The Wharton School.

Paula Calimafde—close. Give it to me.

Ms. CALIMAFDE. Calimafde.

The CHAIRMAN. Calimafde.

Ms. CALIMAFDE. You are in good company, Senator.

The CHAIRMAN. And she is Chair of the Small Business Council of America.

And Richard Johnson—Dr. Richard Johnson—Senior Fellow and Director, Program on Retirement Policy at The Urban Institute.

So we welcome you all.

Ms. Jacobsen, we will start with you.

STATEMENT OF JOANNE JACOBSEN, AMERICAN SENIOR

Ms. JACOBSEN. Thank you, sir.

Chairman Nelson, Senators Collins, Scott, Ms. Warren, my name is Joanne Femino Jacobsen. I am 63 years old. I was born, grew up and lived in Massachusetts until I was 56, and I now live in Venice, Florida, whose average age, by the way, is 67.6. So I am speaking for the other 24,000 people that live there.

I have two sons who still live in New England—one in Massachusetts and one in New Hampshire.

I have saved money. I supported my sons. I planned for retirement. Yet, when I reached what should have been my retirement age, the promise that I would receive health and benefits for the rest of my life was broken and so were my hopes of retiring comfortably in Florida.

Like many Baby Boomers battered by the recession, I am still in the workforce and will probably remain on the job for the foreseeable future. I have worked in some form since I was 15 years old. Although I dropped out of college at 20 because my father got sick, I had a good job at the phone company, as we used to call it, then AT&T.

I got married, got divorced, raised two sons with no support. I worked for the phone company for 18 years, got my bachelor's degree at night, which enabled me to get a promotion into management. Thus, I was able to send my sons to college and also returned to college and got my master's Degree at 50.

In January of 2002, I was laid off at age 52, 9 months short of full retirement of 30 years. It was a time when thousands of management employees were being laid off in downsizing measures in many industries.

During my time at the phone company, I did all the things I was supposed to do. Even though I was enrolled in the company's defined benefit pension plan, I also participated in the company savings plan. I even bought a few stocks.

I participated in financial planning offered by the company, and I kept track of my promised and retirement earnings benefits every year. All my booklets I have saved all these years.

I began planning my retirement in my 30s. My goal was to retire to Florida in my 50s. And I am results-oriented type of person.

All of my financial and retirement planning was centered on my employer's promised benefits and pension and retirement health care benefits. All that was factored into my budget for retirement.

After being laid off, I spent the next few years in three different jobs before fulfilling one of my retirement dreams, which was moving to Florida. Because I was concerned about what would happen to my pension payments in retirement, given all the turbulence of the company and changing of ownership, I took a lump sum payout and rolled it over into an IRA.

I was not in any position to stop working, with children in college. However, I took a series of jobs that were all, unfortunately, adversely impacted by the recession. One company went out of business. One government job—Sarasota County—was eliminated. Even finding a job was tough because I suspect I was a victim of age discrimination.

But still, at the age of 62, I felt confident enough about my financial status to convert my IRAs into annuities and enroll in Social Security benefits.

Six weeks after I enrolled in Social Security, out of the blue and one day before the Affordable Care Act was ratified, I received a letter from my company that took over the pension plan, stating that they would no longer provide health care benefits and would even discontinue my life insurance. Try buying life insurance after you are 60 years old.

For those people 65 and older, the rescission of these benefits took place almost immediately, within 30 days.

For those under 65, like me, health care premiums increased immediately. My health care premium doubled. All of the company's subsidies for health care will stop at the end of this year when the Affordable Care Act takes effect.

I have shopped around for health care plans. They all will be very expensive, especially if I want long-term care at my age. So I am back at work as a realtor to pay for health care, and my annuities and my Social Security barely cover my basic costs of mortgage, taxes, ever escalating insurance, car payments, utilities, daily living, business expenses.

But then I cannot make too much money, drawing Social Security benefits, because they will be taken away because I have not hit the full retirement age of 66. Although I visited my Social Security office four times in the last year, I did not learn until coming here that the money would not be withheld forever, that I will get an enhanced benefit at age 66.

Regardless, that does not help me now because living on a limited budget. The last year or so, I have had to charge doctor visits, dentist visits, along with unanticipated expenses to my credit cards. Until now, my debt has always been manageable, and my credit rating near 800. Now it has swollen to five figures, and my credit rating has been diminished. I even lost an opportunity to refinance my house because my credit score had dropped.

So there are no vacations or cruises or luxury items for me. There will be no thoughts of ever retiring, and I will still be working into the unforeseeable future or until my health holds out.

But what we are seeing here is we are witnessing the demise of the pension system in America as major corporations divest themselves of their fiduciary responsibilities to long-tenured employees and retirees. These corporations have ignored their obligation to fulfill pension benefits stated—stated in writing—as part of the

employee and retirement compensation package, making it an option, not an obligation.

What we need here is relief. This is truly a life or death matter. People will die for the lack of affordable and quality health care.

So I thank you today for inviting me to share my story, and I, ultimately, welcome your questions. Thank you.

The CHAIRMAN. Thank you, Ms. Jacobsen.

Dr. MITCHELL.

STATEMENT OF OLIVIA S. MITCHELL, PH.D., INTERNATIONAL FOUNDATION OF EMPLOYEE BENEFIT PLANS, PROFESSOR, THE WHARTON SCHOOL, UNIVERSITY OF PENNSYLVANIA

Ms. MITCHELL. Good afternoon, Senators, and thank you for inviting me to discuss the changing face of retirement security in America.

My name is Olivia Mitchell, and I am a professor at The Wharton School and Director of the Pension Research Council. As a researcher and as a Baby Boomer, I commend you for bringing up this important issue.

I believe, like many here, that this is a very challenging time to be reaching retirement age.

Thirty years ago, my parents retired. At that time, they had a secure lifetime pension and a generous retiree medical plan; interest rates were high enough to secure them a steady income without spending down their nest eggs too quickly. They also had inflation-protected lifetime benefits from Social Security and Medicare, and they held no debt. Moreover, they had four children they had sent to college, who were always ready to help them out.

By contrast, we Boomers face a very different future. We worry that Social Security and Medicare, as well as the disability insurance system, are fragile. Few of us have retiree medical coverage or traditional defined-benefit pensions. Some of us with defined-contribution plans have not put enough in, and what we have put in we have seen decline, nor are we converting our assets into lifetime income so that we cannot run out in old age. Interest rates are so low that holding TIPS is a losing proposition. And, with longer life spans in the offing, we very much need protection for long-term care costs, but the products simply are not available or unaffordable.

And the topic of my discussion today is debt. Many more Boomers are in debt than ever before.

In a recent report, I compared three cohorts of people, age 56 to 61, in a health and retirement study. This is a study where you can follow cohorts over their lifetimes. We focused on people age 56 to 61 in 1992, in 2002 and in 2008.

For each group, right on the threshold of retirement, we measured total debt as well as the ratio of debt to assets. Additionally, we focused on patterns of financial fragility, using both the HRS and the FINRA National Financial Capability Study, known as NFCS. We came to two major conclusions about older Americans' debt levels.

First, Americans today are much more likely to arrive at retirement with debt than in the past. For the earlier group, back in the

early 1990s, about 64 percent held debt. Over 70 percent of the Boomers now do so.

Moreover, not only do more people hold debt, they hold more debt; that is, median debt more than quadrupled between 1992 to 2008. And the top quarter of the distribution owing the most owed \$50,000 back in the early 90s. They now owe over \$100,000.

This is important because Boomers retiring in the next several years are much more likely to carry this debt into retirement compared to previous cohorts, and since debt payments typically rise faster than interest rates that retirees can earn on their investments, people will likely be more vulnerable during retirement.

Now a key reason we found that Boomers are facing retirement with so much more debt is they spent more on housing than did previous generations. As a result, Boomers are much more likely to have very expensive primary residences.

Of course, some of those declined somewhat in value over the last few years, and their mortgages values have grown faster than the values of their homes. Median home loans relative to assets rose from 6 percent back in the early 90s to over 25 percent now. So Boomers will need to continue servicing their home loans into retirement, and they are going to continue being much more leveraged than groups in the past.

We drilled down further to look more closely at debt, and we found that in addition to mortgage debt Boomers have had expensive financial habits. They have not paid off their credit cards in full. They have used their credit cards for cash advances. They are charged fees for late payments or exceeding their credit card bills.

Another piece of the story is medical bills are also a source of financial problems. This has been mentioned by almost a quarter of the Baby Boomers.

Even more striking was the fact that only about a third said that they thought they could not come up—sorry let me say that again. Only about a third said that they were likely to be able to come up with \$2,000 in the next month if faced with an unexpected bill. And this is not a huge bill. This might be a car repair bill or a moderate-size home bill.

So, in the wake of the financial crisis and the Great Recession, we now know that more can be done to protect Americans from these problems. We know, in particular, that there is a strong positive link between financial literacy, planning, saving for retirement and assets into retirement. Those who are not financially savvy are much more likely to have debt and have lower savings.

Now protective legislation can be useful when people lack the opportunity to make repeated purchases such as, for example, with annuities, where probably you buy them once. It can also be helpful to better inform Americans when they face potentially expensive decisions that they do not really understand, such as buying a home, taking out a mortgage, cashing out their 401(k) plans or taking out credit card loans.

I also believe Boomers could do better with more access to financial advice, which could generate potentially important rewards in the form of lower debt for those nearing retirement.

They also need more information on the benefits of delaying claiming their Social Security benefit. In fact, a number of Baby

Boomers have already reached this conclusion on their own. For example, delaying claiming benefits from 62 to 70, not that that is what everyone should do, but that in itself will mean an additional 76 percent more in monthly payments that can do a lot to help the income streams in retirement.

Let me stop there and thank you for your attention. I am happy to answer your questions.

The CHAIRMAN. Thank you, Dr. Mitchell.

Ms. Calimafde.

**STATEMENT OF PAULA A. CALIMAFDE, CHAIR, SMALL
BUSINESS COUNCIL OF AMERICA**

Ms. CALIMAFDE. Still Calimafde.

The Small—

The CHAIRMAN. Calim—

Ms. CALIMAFDE. Calimafde.

The CHAIRMAN. Calimafde.

Ms. CALIMAFDE. Quite honestly, I was the kid at school who all the teachers knew me by my first name, like the first day of school. They did not want to deal with my last name. So, just you can call me Paula.

So the Small Business Council of America and the Small Business Legislative Council appreciate the opportunity today to be submitting this testimony to you.

The SBCA is a national nonprofit organization which represents the interests of privately held and family-owned business in the Federal tax, health care and employee benefit matters. Through our members, we represent well over 20,000 successful small businesses in the retail, manufacturing and service industries.

Virtually all of our members provide health insurance and retirement plan benefits for their employees. That is a somewhat unusual statistic for small businesses, but that is the SBCA's statistic.

The SBLC is a 35-year-old permanent, independent coalition of 50 trade and professional associations that share a common commitment to the future of small business. And, again, SBLC members represent areas as diverse as manufacturing, retailing, distribution, professional and technical services, construction, transportation and agriculture.

And the way we decide our policy is it is developed by a consensus of all those different trade associations hammering out what they think will work in the small business area.

I am the Chair of the Small Business Council of America. I am a member of the board of directors and a past Chair of the SBLC. I am also a practicing tax attorney, and I practice in the area of retirement plans and employee benefits.

And I am here today to present our views as to how important retirement plans are to America's retirement security, also to discuss how small business retirement plan coverage can be increased, and finally, I wanted to discuss ways to incentivize employees to increase their savings inside the retirement plan.

We have some statistics that are pretty startling.

One of these statistics is—this was done by EBRI—that individuals of all economic levels are more likely to save inside a retire-

ment plan than outside a retirement plan. And the actual statistic is workers are 14 times more likely to save in a retirement plan offered by their employer than to save through an IRA—14 times more likely.

For those of us who work with small businesses—of course, now this statistic applies across the board, so this goes to mid-size and larger businesses as well—the magic is payroll deduction.

So you have your paycheck. The contribution you are making to the plan is automatically taken out of that paycheck. There is nothing the employee is doing. It is all on automatic pilot. And not only did you not have to do anything to get the money into the retirement plan, but it is not in your pocket. So it is much harder to think of spending it because it is not there.

I think we all have walked down the street with a dollar in our pocket and without a dollar in our pocket, and we know what happens. When you do not have it in your pocket, you do not spend it.

So the retirement security of our Nation is intended to rest primarily upon three sources, and very often you may have heard this referred to as the three-legged stool. The first is Social Security. The second is the voluntary private retirement plan system. And the third is individual savings.

Today—well, we know Social Security is a defined-benefit system. It is based on an annuity type of framework. There is not that much choice on the part of the individuals with Social Security. You can pick a few different start dates, and that is about it. You cannot outlive your payments coming from Social Security.

The qualified voluntary private retirement system today is primarily based on a defined-contribution system, and methods of payment out of these plans can include annuities, installments—usually, that is coming from an IRA—lump sums or a combination of one or more of those different methods of payment.

The voluntary private retirement system is heavily regulated by Department of Labor and IRS. But even though it is heavily regulated, there is a lot of flexibility in the system so that small businesses, and mid-size and large businesses, are able to create retirement plans that fit their particular business and their particular employees the best.

Of course, individual savings is totally open-ended, and initially, it was thought that this would be done outside a retirement plan because it really was not until the 401(k) plan that it became clear that this was going to be a major vehicle for Americans to save.

The Social Security system, I think we all know, is probably in pretty good shape. I imagine with some—I do not believe great—amounts of shoring it would be made successful, but I can understand it would be painfully political to shore it up.

The private retirement system is in fairly good shape in large part due to a series of laws that were passed by Congress in the last decades that recognized that the system had become too complex and that there was not enough in the system for small business owners to join the system, and the result of that is those laws reversed it. So the cost-benefit analysis for small business owners became so that an owner would say it makes sense for my company to sponsor a retirement plan because the benefits to the owners

outweighed the costs and burdens that were inherent in that system.

Let's just talk about payroll deduction quickly because we know it is an easy and painless way to save. We know it is done automatically by the employer, and we know it is much harder to spend money you do not have. And the third thing about it is in the 401(k) area, also the 403(b) plan area, employees do not have easy access to the money.

So not only is it taken away automatically; it is sort of locked inside. You can get to it by loans and hardship, but neither of those are easy ways to get your money. So the money keeps growing, tax-free.

I hope by now you are understanding that part of what I am getting to is encouraging savings inside a retirement plan is a very good thing for all of us to do and that we should be trying to educate all employees, particularly younger employees, to take advantage of this feature in their plan.

Interestingly, what we do know is it does not matter if it is a large business, a mid-size business or a small business. Once a plan is offered to an employee, it is almost the same take-up rate by the employees regardless of the size of entities. So, once again, we know that it is to the benefit of the retirement security of our Americans to promote these plans and encourage formation of the retirement plans, particularly in the small business sector.

Two other things we know are very successful right now, and it is somewhat startling.

One is auto enrollment, and what auto enrollment means is when an employee is hired they are automatically enrolled in the plan. To get out of the plan, you have to take steps to say I do not want to be in the plan; take me out. So you are automatically enrolled.

The other is auto escalation, which means that you might start off with a 3 percent contribution being made, meaning the employee is putting 3 percent of their income—their compensation from that employer—into the plan. The next year it might be 4 percent; next year, 5 percent; next year, 6 percent. That is called auto escalation.

And you would think—I mean, I would think when I first started hearing about these is, why is this successful?

And then when I started realizing and thinking about what I know about small business employees, not only from my own business but from SBCA members, is inertia is a huge thing going out there with small business employees. And I am not sure I know why, but it is easier to be enrolled and stay enrolled than it is to take all the steps to get yourself out of the plan. And the same thing—it is easier to let the savings go in the plan than to take the steps to get out of it.

So we know that that is also a very, very effective thing.

Finally—okay. Am I way over my time here?

Okay, then I will stop here.

The CHAIRMAN. Thank you, Ms. Calimafde.

Dr. JOHNSON.

STATEMENT OF RICHARD W. JOHNSON, PH.D., SENIOR FELLOW AND DIRECTOR, PROGRAM ON RETIREMENT POLICY, THE URBAN INSTITUTE

Mr. JOHNSON. Thank you. Chairman Nelson, Ranking Member Collins and members of the Committee, thank you for the opportunity to testify today about the challenges confronting our retirement income system.

As you know, concern is growing about how well future retirees will fail. And we have been tackling this question at The Urban Institute, and we have been using our modeling capabilities to project retirement incomes for Boomers and later generations, and so today I would like to share the results from that research and some of the conclusions that I draw from them.

So, first, a bit of good news—retirement incomes will continue to increase over the next 30 years even after accounting for inflation because women are earning more than ever, productivity gains will boost average wages in the economy, and many people are delaying retirement and working longer.

But now the bad news—more Americans will see their living standards fall as they enter retirement because retirement incomes are not projected to keep pace with earnings.

Now it is not clear how much income is necessary for retirees to live as comfortably as they did, in retirement, but a common rule of thumb is that they need about 75 percent of their pre-retirement earnings. And the thinking here is that they need less money than they did while working because they do not have to cover employment costs, they do not have to pay payroll taxes, and they do not have to save for retirement.

Now we projected over the next 30 years the share of 70-year-olds who cannot meet this 75 percent replacement rate threshold will increase from 25 percent today to 30 percent. So that is a 5 percentage point increase over about 30 years. This decline in retirement preparedness may not qualify as a retirement crisis, but it certainly is a worrisome trend.

And a bigger threat to retirement security, however, is rising health care costs. Older Americans already devote a substantial portion of their incomes to health care. Although Medicare covers nearly all adults ages 65 and older, many end up paying substantial costs out of pocket because of premiums, deductibles and uncovered services. Half of all Americans ages 65 and older now spend more than 12 percent of their incomes on health care. And among those with incomes below 200 percent of the poverty level, half spend more than a fifth—more than 20 percent—of their incomes on health care.

Out-of-pocket health care spending by older Americans is projected to rise sharply in coming decades as health care costs continue to grow. A common benchmark for burdensome health care spending is 20 percent of income. Now, if health care spending grows at the intermediate rates assumed by the Medicare trustees, in 2040, about 45 percent of all adults 65 and older will experience burdensome costs, including about 70 percent of those in the bottom two-fifths of the income distribution.

Now perhaps the greatest financial risk for older Americans is the prospect of becoming disabled and needing expensive long-term

care. One estimate indicates that 7 in 10 Americans who survive to age 65 will eventually need long-term services and supports and 1 in 5 will need help for 5 or more years.

Most will receive informal help from family and friends, often creating significant financial, physical and emotional burdens for their helpers. However, increasing numbers of older Americans will receive home care from paid helpers, especially as family caregivers become less available because family sizes are falling and middle-aged women, who provide most of the informal care today, are now working more than in the past.

And as many as half of older adults may end up in nursing homes. Long-term care costs are prohibitive. A year of nursing home care in a semi-private room now averages about \$80,000 nationwide, with average costs as much as 75 percent higher in certain parts of the country.

A frail, older adult receiving 60 hours of paid home care per month—that is the median amount—would incur costs of about \$15,000 per year.

We lack a system to adequately finance these costs. Standard health insurance plans do not cover long-term care, and Medicare covers long-term care only in special circumstances. Only about 12 percent of adults 65 and older have private long-term care insurance, and there are signs that this private market is shrinking. As a result, long-term care costs can quickly deplete household savings, and many long-term care recipients, especially those with extended nursing home stays, end up going on Medicaid which requires a beneficiary surrender nearly all of their income and wealth.

Because out-of-pocket medical and long-term care costs are substantial and growing, seniors may need as much money in retirement as when they were working. But according to our projections, 45 percent of those born between 1970 and 1974 will lack enough income at age 70 to replace all of their pre-retirement earnings.

So, as Congress grapples with these issues, I would recommend focusing on protecting incomes for the most vulnerable seniors, ensure Social Security's long-term financial health and add a meaningful minimum benefit, modernize the Supplemental Security Income Program by increasing asset limits for beneficiaries, protect seniors from catastrophic medical expenses by setting a limit on out-of-pocket spending in Medicare and create a mandatory program to help families finance long-term care.

Thank you.

The CHAIRMAN. Thank you, Dr. Johnson.

Okay, we are going to get into some questions now.

Senator Collins.

Senator COLLINS. Thank you, Mr. Chairman.

Ms. Jacobsen, I want to thank you very much for coming today and sharing your personal experience. It is important that we put a human face on the issue that we are discussing, and you did just that in sharing your personal experience. So I thank you for that.

I am curious about your case because it seems like you planned. You did everything right. You were frugal. I mean, if you had a credit rating of 800, that is awfully good. You were paying your bills.

Ms. JACOBSEN. Seven seventy-seven, to be exact.

Senator COLLINS. There you go.

And, yet, here you find yourself in difficult circumstances beyond your control.

So I am wondering what happened to the pension that you were promised because if a company goes bankrupt we have the Pension Benefit Guaranty Corporation to which premiums are paid that is supposed to step in.

Now you would have gotten a lower pension amount, but you would have gotten something. So why didn't that happen in your case; do you know?

Ms. JACOBSEN. Let me clarify. I do have my pension itself because I took it as a lump sum and rolled it into an IRA because I did not know what the company was going to be called tomorrow.

It is my health care benefits and my life insurance and all the benefits that now cost us thousands of dollars a year to come up with. So that has not been factored into the retirement budget.

What Verizon is doing now is what they call de-risking, and it has sold off its pensions to another company—Prudential, in this case—to avoid paying the premiums to the PBGC.

So now it is now guaranteed to the rest of those employees. I got out when it was, and I took the money and left.

Senator COLLINS. So people after you are in even worse situations.

Ms. JACOBSEN. Right, people that are collecting on annuities now are collecting it from the mother company, Verizon. They are collecting it from Prudential, which does not guarantee, which is not covered by the PBGC.

Senator COLLINS. Very interesting. Thank you.

Ms. JACOBSEN. It is called de-risking.

Senator COLLINS. Thank you for——

The CHAIRMAN. Could I add?

Senator COLLINS. Certainly.

The CHAIRMAN. But you were nine months shy of retirement.

Ms. JACOBSEN. Full retirement, right.

The CHAIRMAN. What would that have given you?

Ms. JACOBSEN. That would have given me more dollars for my medical benefits.

Senator COLLINS. Would it have increased the size of your pension?

Ms. JACOBSEN. That, too, somewhat, yes. Correct.

Senator COLLINS. But, Dr. Mitchell, you made an incredibly important point about the potential benefits for some people of delaying claiming benefits under Social Security.

Obviously, we see a significant number of seniors collecting Social Security at age 62, and sometimes for excellent reasons. Some of them may be working in physically very demanding jobs, and they need that income and cannot continue.

But we know that minimum benefit—and Dr. Johnson touched on this—for Social Security is extremely low. I have always felt that when we look at Social Security reform we need to increase that minimum benefit, but that is a whole nother issue.

My question for you is, do you think that seniors understand what a huge difference it makes in their Social Security lifetime benefits, delaying the receipt?

I was shocked at the 76 percent figure that you gave, and I follow this fairly closely.

So what should Social Security—the Social Security Administration—be doing to make sure that seniors understand that if they choose age 62 they are going to get far less than if they are able to delay the receipt? Sometimes they cannot, or there are good reasons not to.

Ms. MITCHELL. Excellent question. Up until very recently, maybe three or four years ago, the Social Security field agents had a policy of describing this choice about when to claim your benefits in terms of a so-called break-even level.

So, for example, they might say if you claim at 62 you get \$1,000 a month, just to pick a number out of the air. If you work 1 more year, you will get \$1,127.27 a month.

But then they would say, do you realize that you would forfeit the \$12,000 plus the interest you could have earned on it—and they use the F-word, forfeit—if you do not live for sure another 14 years.

Now that, obviously, gives people the cold chills, and they think, oh, I do not want to forfeit anything, and so they tend to be encouraged to take it early.

I will say that the Social Security field agents have moved away from that presentation. Nonetheless, in surveys of financial advisors, two-thirds of the financial advisors today still use that forfeit, break-even presentation.

So you are absolutely right; we do not inform people well enough about what a good deal it might be if you can afford to delay it—maybe not until 70, but a year or 2. It is the best deal going. In terms of lifetime protection, inflation index benefits, you cannot get it anywhere else.

Senator COLLINS. Thank you.

And, finally, very quickly, Paula—I am not going to try. Could you tell us just quickly, if you could pick one policy change that you would recommend to us to encourage—not mandate, but encourage—more small businesses to provide retirement plans for their employees, what would it be?

Ms. CALIMAFDE. I think I am going to answer that in the negative. The most important thing Congress could do is not cut back on the contribution levels to retirement plans.

In the small business world, the owners are making the contributions to the plan, in effect, out of the profits of the company, which if they did not put it into the retirement plan or put it back in the business they would take out as compensation.

So they are making the contributions for themselves and for all their employees. And, if there is not enough of a benefit in the plan to encourage them to save, then it makes sense for them to take it out as compensation or put it back into the business otherwise, but not to put it in the retirement plan.

So the number one thing is with all of the policy issues you all are facing with debt reduction and tax expenditures, the tax expenditure for the retirement plan system is a huge number. And,

yet, if you look at it one way, it is not even an expenditure because the money that the government is foregoing by having people put money into the plan and having it grow tax-free comes back to the FISC at the time the people retire and the money comes back.

So the real cost is the time value of money. That is what the government is losing. But because of the way it is being shown on the budget windows, it looks like a total loss that never comes back in.

So I know there is a number of proposals trying to cut back on the retirement plan contributions, and all of those would really hurt.

Senator COLLINS. Thank you.

The CHAIRMAN. Senator Warren has done quite a bit of research on senior debt as a professor.

Senator Warren.

Senator WARREN. Thank you very much, Mr. Chairman.

Thank you and Ranking Member Collins for doing this hearing. You all show such great leadership every time in these, and getting these issues out here is powerfully important.

I think it is fundamental that we all believe that if you work hard you ought to be able to retire with dignity, and yet, Social Security provides just the barest minimum for most people. And rising costs—rising costs for food, rising costs for health care, rising costs for drugs—are really putting the squeeze on families.

The Chairman mentioned—you are right. I did a lot of research on this. I spent a lot of time talking about working on how families struggle economically.

And among the different studies I did was one that showed that in families from 1991 to 2007 we saw 150 percent increase in the percentage of people over the age of 65 who were forced to file for bankruptcy—in bankruptcy because of rising medical costs out-of-pocket, in bankruptcy because of divorce or the death of a spouse as families break up, in bankruptcy, even at that age, because they lost jobs that they needed to be able to keep their budgets together.

So I have seen this, and I know it is a terrible problem. I appreciate the work you are doing to bring this to our attention.

And thank you, Ms. Jacobsen. As Ranking Member Collins said, it is very important to have a personal face on this, and I appreciate your coming here today.

I would just like to ask a question about helping people save more for retirement—the idea of how they can best take care of themselves. And we know from the research that if there is an employer-sponsored plan, I think as you said, Ms. Calimafde, that we will see more people in that plan. I think you said 14 times as many people will get into a retirement plan if we have got employer sponsorship of those plans.

And yet, we know from the Employment Benefits Research Institute that about half of all employers offer no retirement plan of any kind, and the GAO tells us that for companies that have 100 or fewer employees the rate at which—that 72 percent offer no retirement plans of any kind.

Now, as I understand it, for small businesses, since this is obviously a problem, fewer small businesses are offering retiree plans and that one of the principle reasons they talk about are the high

administrative costs—that it is very expensive for small businesses to do this.

And so businesses have pooled together. We have the multiple employer plans so that small businesses can work together to try to get benefits for their employees.

Now today, I joined Chairman Nelson and Senator Murray in a letter to the Department of Treasury encouraging them to go forward with rulemaking to protect small businesses in the multiple employer plans by ensuring that an entire plan will not become disqualified in the event that one particular company breaks the rules—the bad apple problem.

And so what I would like to do is just ask if you could—I thought I would start with you, Ms. Calimafde—if you could just speak briefly to the question of how important it is to remove obstacles so that small businesses are more likely to participate in employer-sponsored pension plans.

Ms. CALIMAFDE. Well, that is critical, but I want to start off by saying that I think the GAO study, as far as coverage in the small business sector, is wrong and that there is a study that was done in 2011 by the Social Security Administration that relied on W2 data, rather than surveying employees.

And what they found—and I have got this exactly in my report, but basically, if you were looking at a small business—and I will just pick one side—that employs 25 employees but less than 50, 60 percent of those businesses offer retirement plans. So the numbers are much better.

And, again, those of us who work in this area are not surprised because employees very often do not even know they are making 401(k) contributions to the plan and, even more strangely, they do not even know their company is making contributions for them.

So the world is not as dark as we thought. It is much better than we thought, but that does not mean we should not encourage more formation because the more formation—and we know people take up the 401(k)s, so the savings in the plan. So that is the way to go.

MEPs—I encourage and applaud you trying to get rid of the bad apple rule. It is not a fair rule. Basically, in a MEP, where you have a group of employers coming together, if one of them has a plan that is disqualified, it disqualifies all the plans that were covered.

I think the goal of a MEP, to lower administrative costs, is a good goal. I have a feeling it would end up like a lowest common denominator type of plan. Hopefully, it would be like a starter plan because I have a feeling that the choices, as far as investment choices and whatever, would not be as good as you would normally get in a regular brokerage house or insurance company plan.

Senator WARREN. So, if I can, Mr. Chairman, can I just follow up with one more question on pensions?

The CHAIRMAN. Yes.

Senator WARREN. And then we will have this one out here because I just think it is so important.

And that is whether we are talking about 40 percent of the employees of small businesses not having any employer-sponsored plan or whether we are talking about 70 percent not having them,

it is still way too many, and we are looking for ways to try to get more people into employer-sponsored plans.

So I want to ask one more question about that, and that is that the GAO also found that small businesses pay higher fees than larger employers and that small businesses, because they lack the economies of scale of larger employers, sometimes are just left out here and that much of the increased cost comes from the lack of expertise of the small businesses in picking these plans and having to deal with these plans.

So, last year, the Department of Labor implemented new 401(k) employee fee disclosures to try to help small businesses and participants better understand the fees they are paying.

And I understand that disclosures are always enormously valuable. I am never going to object to having more disclosure. But the real question I have is, would it be more helpful if we just made these rules simpler and encouraged the Department of Labor to get simpler rules out there for the employers and for the employees?

Dr. Mitchell, would you like to speak to that?

Ms. MITCHELL. Being against simplification, I think, is un-American, but absolutely—you know, I have been working in this area for 30 years.

Senator WARREN. I am sorry Let me just say it this way. Would it make a real difference? Maybe that is the way I should put it.

Everyone is in favor of it, but do you think it would make a real difference?

Ms. MITCHELL. Well, the issue is that Congress has used tax law and a number of other laws to shape the environment in which we save for retirement. So there is a certain amount you can put in tax-qualified. There is a certain amount you can take out without a penalty. There are certain ages. It is very complicated.

I do believe that the research has shown, however, that automatic enrollment works. If you have an employer who can put in place a pension and pop everybody into it, people stay in. They know they should be saving for retirement.

There is also the issue of if you auto enroll people, what do you put them into in terms of investments?

I think Congress did the right thing and the Labor Department did the right thing in putting folks into target date funds. Again, there is a big variety of them, but by and large, it is better than holding your money in money market funds for the next 70 years.

The big question is, what happens at retirement?

So those of us that have defined-contribution plans—401(k) plans—get there with a lump sum, and then we are left adrift. How do we manage the money so we do not outspend it in retirement?

So I think that is the crucial issue—how to inform people, how to make employers comfortable with helping people through the pay-out phase.

Senator WARREN. Thank you very much.

And thank you for your indulgence, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Warren.

Senator Scott.

Senator SCOTT. Thank you, sir.

Dr. Mitchell, in the insurance business, we call that too much month at the end of the money. Unfortunately, it is an often occurrence.

Ms. Calimafde, a couple questions on the simplification process for small businesses who want to engage in finding plans—I spent, I guess, 25 years of my professional life in the insurance business, trying to find a way to create access and information as well as education to those employers, especially the smaller ones—one employee to ten. They were clueless, really, on the number of opportunities and options in the marketplace for as little as \$400 or \$500 a year to get 1 plan started.

And so my question to you is a question on time horizons and tax preferences.

One, the plans are pretty simple. You can get an age-weighted plan from one of the major mutual fund companies for a very small fee to get it started.

So the question really comes down to the knowledge horizon. With all the stuff going on in small businesses, the space for making retirement decisions seems to be eliminated because of the lack of profit being made over the last five to seven years.

Would you comment on the notion of positioning small employers to make good decisions on doing the research so they know what is available in the marketplace?

Ms. CALIMAFDE. Great question.

And I have to applaud those in the insurance industry because they have gotten it that the 30-second sound bite and a single piece of paper with charts on it and colors goes a long way with a small business owner rather than a 10-page—

Senator SCOTT. It does not work.

Ms. CALIMAFDE [continuing]. Legal document where they are going, oh, I am not going to read this today.

We do know from the Small Business Administration that half of all small businesses do not make it through the first five years.

Senator SCOTT. Right.

Ms. CALIMAFDE. So, if you are a business in that first five years, the chances you are sitting around thinking about retirement benefits for yourself or anyone else—probably not. Hopefully, you are trying to keep the business alive.

After 10 years, only a third make it through. Those are pretty sad statistics.

However, the ones that do make it through are very stable. And because the owners—most of the small businesses are not going to be able to be sold. So they cannot rely on the business for their retirement security.

And we know the nonqualified deferred compensation world, which is so important in the larger businesses, is not in the small business world because of the tax code.

So I would think one of the most important things would be for accountants and insurance people to advise the small business owners. And, in fact, we often find that it is the accountant who is the first person to talk to the small business owners and say, you know, you have got some profit this year; you can put in a retirement plan.

And I agree with you. I think plans are fairly easy to be put in, and I do not think they are that expensive. There is a number of brokerage houses out there who are very good at doing it now, and insurance companies. And I probably have missed somebody else in that world, but—trade associations are putting together plans.

I mean, the problem is not the plan, and there is some very good investment advice out there.

If you look at a typical 401(k) plan today from the employee's viewpoint, they can go on a web site. They can see their different fund choices. They see how much they have saved. They usually have a pie chart that shows them what they have done. If they do not want to do any of that, they just go into the default, which is almost always a target fund.

So the real magic is getting them to the plan.

Senator SCOTT. Yes.

Ms. CALIMAFDE. And I really think the advisors are the key.

Senator SCOTT. Okay. Dr. Mitchell, perhaps on the whole dysfunction of our tax code and how to incent more dysfunction, my next comments will help us get there quickly.

I have a notion that the long-term care component which, of course, is not covered by your health insurance plan—so the whole financial literacy concept needs to include, and fuse into it, the notion that long-term care and the activities of daily living that is a trigger for it to start are not a part of your health insurance, nor will it be.

So my question is really on a tax preference in the tax code that would provide some type of tax incentives to purchase long-term care—the impact of that.

And my second question for any of the panelists, as I run out of time here in 35 seconds, is a question about simple math. Part of the challenge that we face today for our seniors will be repeated except for it will be exasperated over the next generation. Where 50 or 60 years ago we had 16 Americans working, we had 1 retired, and the expiration happened 3 years later, today, we have 3 working with 1 retired, and the expiration happens 15 years later.

So we are dealing with a problem of math, and I would love to have someone talk about how we change the contributions that are necessary for us to sustain a system that is based on a formula that is obsolete.

And the first question being a question about tax preferences as it relates to long-term care and/or those types of things that would allow for folks to make better decisions because they have the tax incentive to do so.

Ms. MITCHELL. Well, long-term care is one of the most fraught challenges that I think we really face.

Recently, my employer decided to offer long-term care, not as a tax-subsidized vehicle, but as a payroll tax—a payroll deduction off of my paycheck. And I finally bought it. I dropped my life insurance and bought the long-term care insurance because I figured that is the next challenge.

Two percent of employees at most, in my experience, in an employer setting, buy long-term care when it is offered to active workers. And you might think, well, we could wait and do it later when

we retire, but by that point you may well be underwritten; you may be uninsurable.

And so it is a very, very big challenge.

One of the concerns also is that in an environment where we cannot predict future medical care costs very well and we cannot predict longevity very well, the insurance companies themselves—and I am sure you know this from your experience—do not really know what they are insuring.

So, as a consequence, there is a lot of passing the buck going on and a lot of people not knowing what they can afford to do when they do buy coverage. It gets more expensive.

All I can say is there are other models. It may be worth your while to go take a look at what they did in Japan. They have actually mandated long-term care insurance, which is privately provided, but everybody from the age of 40 has to pay into a pool. So you do not get any adverse selection, and everybody is covered. That has not corrected the problem, but it does mean that there is more protection.

The benefits are also means-tested, I would add. So, if turns out you are quite wealthy when you get to retirement age, you get less than if you do not.

Senator SCOTT. Thank you.

The CHAIRMAN. Thank you, Senator Scott.

You know, we passed a long-term care act, and it was so expensive that then we had to backtrack.

Senator MANCHIN.

Senator MANCHIN. Thank you, Mr. Chairman.

And, if I could ask Dr. Mitchell, the GAO has identified about 15 different agencies trying to give financial literacy service. Millions and millions of dollars are being spent, and nothing seems to be—the results have not changed.

Do you have recommendations to us about how we could help you streamline the system?

Ms. MITCHELL. I have been doing some work recently with a colleague of mine, Annamarie Lusardi, and what we have done is survey Baby Boomers as well as younger people and, in fact, people all around the world about the key, fundamental, simple financial facts that you need to know in order to be able to make smart financial decisions.

So we have asked questions, for example—and I am not putting you to a test. We will not make you answer.

Senator MANCHIN. No, I am asking you. Hold on. Hold on one second.

Ms. MITCHELL. Suppose you had \$100 in a savings account.

Senator MANCHIN. One second.

Ms. MITCHELL. Yes.

Senator MANCHIN. Let me ask you. We know the GAO has identified 15 different Federal agencies spending \$60 million to \$70 million a year. You are watching all this, and we are not seeing the results, sitting here. So, if the GAO has given us a report that there should be some consolidation, can you identify for us the overlapping agencies that maybe should be consolidated rather than individually keeping these alive?

Ms. MITCHELL. So my answer to you would be before we decide to consolidate we ought to figure out what is in the core curriculum? What is it that Americans need to know?

And then with that benchmark we can go out and say, what are these folks providing? What kind of information are they providing?

The other issue is that Baby Boomers, and people older than they are, are maybe not web friendly so that if a lot of the information is on the web they are much more likely to be going and trusting their Social Security field agency than 101 different other providers.

So we have to figure out first what they need to know, and I think interest compounding is critical, and risk diversification is critical. And then we ought to figure out who is the most trusted conduit of that information and work that route. That would be my recommendation.

Senator MANCHIN. I think we are on two different pages. I am just saying there is 15.

Have you evaluated what they are trying to educate my generation on, whether I am web friendly or not web friendly?

Do I have 15 doing the same thing? Do I have 10 doing the same thing?

Can you recommend that this should not happen; we should have maybe a portal with 1 or 2 doing what 15 are doing now? That is what I would ask you to evaluate.

I only have so much time. So maybe we will get more into that.

Ms. MITCHELL. Let's talk offline because I can give you some recommendations of useful studies.

Thank you.

Senator MANCHIN. Thank you so much.

Dr. Johnson, nursing home care—I was a former Governor of the State of West Virginia, and it is a great concern. I have an elderly population. But I just saw the inhumane treatment when a person who has been a breadwinner all their life had to divest themselves of all their money in order to become a Medicaid recipient.

Something is just not right there when you take everything away from a hardworking individual and say, guess what? Now you are going to be a ward of the state.

There has got to be a better way to do it. Have you all looked into that, or can you give us any recommendations or help on that?

I have always thought need-based sliding fee scale. So my mother or father, God forbid if they would have needed that, they could have at least felt like they were taken care of and providing for their own care a little bit. Now they have to basically—in a two-year period of time, they divest all their assets and worldly possessions in order to get down to the poverty level so Medicaid kicks in.

Eighty percent of the people in nursing homes are on Medicaid in my State. I do not know if that is the national average, but I know it is high because they have learned how to scam the system.

Mr. JOHNSON. That is certainly true, and our system of financing nursing home care is almost nonexistent. So there are kind of two approaches that have been suggested.

One is to try to get more people to purchase private insurance. Basically, get more people to save on their own. Either put lots of

money away so you can cover this nursing home expense when you need—and that is almost impossible to do because the costs are so.

And the other alternative is to get them to purchase private insurance. Right now, only 12 percent of seniors have private insurance—private long-term care insurance. We see that there is very little effect of tax incentives. It increases it a little bit but not much.

We tried to have a voluntary system in the CLASS Act that was recently repealed. That does not work because you have a whole set of adverse selection problems. Only the sickest people are going to join this program. That means the program is not sustainable.

It seems to me that one solution is to include more long-term care costs within Medicare, perhaps raising premiums, raising taxes, raising payroll taxes, having the payroll tax contribute and fund some of these future long-term care benefits. That is a way, though, that you would at least avoid this problem of people having to forego all of their assets to get—

Senator MANCHIN. I am just saying here that the nursing home industry does a great job. They take care of people and do it well, and we are very pleased in our State with mostly all the nursing home care that we are giving.

It has been brought to my attention that a person is demeaned to the point where they get an allowance, where they are allowed to have so much money and not, and this and that. And they just even would think that—and the families, too—if they could pay a certain percentage of that income towards a sliding fee scale, or a means-tested, would help an awful lot more with adding dignity and, I think, a little respect to an elderly person who has made their way or paid their way all their life.

And I do not know if you all have looked, and we will talk—I know my time is up. We will talk about that later, but that is what we are trying to find—some way with dignity and pride, as we grow older, that we can still pay our way as much as possible.

Thank you, Mr. Chairman.

The CHAIRMAN. I want to invite the members of the Committee to chime in as I do some cleanup here, and feel free to interrupt.

Ms. Jacobsen, you mentioned you see age discrimination in trying to find employment. Tell us about that.

Ms. JACOBSEN. Well, I did—I mean, when I was in between jobs, I sent out over 100 resumes, and I had several interviews.

I had one interview in a company in Sarasota, and I walked in, and there were six people there going to interview me simultaneously. And they were extremely impressed with not only my resume but the things that I said in the meeting. In fact, they were nudging each other and saying, did you hear that? That was a great idea, et cetera.

The vice president sent me an email and said the next day—it was on a Thursday—we have one more candidate, but it is just a superficial thing. We will get back to you on Tuesday. You are our number one candidate.

I have that on a written email.

Tuesday came. Wednesday came. Thursday, I did not hear from him. So I sent him an email. He said, oh—email in writing—forgot to call you. We hired somebody else.

Just enough time to do a background check—I was number one on Thursday, and on Tuesday they forgot my name.

So——

Senator MANCHIN. What did the background check show?

Ms. JACOBSEN. How old I was.

The CHAIRMAN. Her age.

Ms. JACOBSEN. My resume does not say how old I am.

Senator MANCHIN. [Inaudible.]

Ms. JACOBSEN. Well, thank you, but numbers are numbers.

Senator MANCHIN. You had a first interview?

Ms. JACOBSEN. Oh, yes, with six people in the room—vice president and several.

Senator MANCHIN. So they did not have a problem until they——

The CHAIRMAN. Find out how old you are, yes.

Ms. JACOBSEN. Right.

Oh, and may I make a comment? I am sorry I know this is interjecting.

The CHAIRMAN. Certainly.

Ms. JACOBSEN. But we have all concurred that this is a problem, and what we are lacking here is financial education.

I have told my sons, this is a do-it-yourself economy. If you do not do it for yourselves, no one else is going to do it for you.

But how are they going to learn how to do it for you?

We need financial education in high schools and in college, and it has got to be mandatory. You cannot let companies default on their pension promises and then go, ah, do it yourself.

Well, how are they going to do it themselves, if they do not know how to do it?

Let's have financial education.

Thank you. I am sorry.

The CHAIRMAN. Thank you.

Dr. Johnson had noted that the median value of retirement accounts held by households in the age range of 55 to 64 is \$100,000—retirement accounts.

The median retirement account balance for 55 to 64 for all households—believe it or not, we have a study here—\$12,000.

Median retirement account balance for 55 to 64 for households with savings—\$120,000.

So that does not go very far, does it, Dr. Johnson?

Mr. JOHNSON. No, it certainly does not. If you were to annuitize that amount at age 65 today, you would maybe get \$500 or \$600 a month. So it helps. Every little bit helps, but it is not going to allow you to live comfortably.

That really is the challenge we face—how to get those account balances larger—and that is why people have been talking about this auto escalation, auto enrollment, to get people into it.

I think part of the problem is that a lot of people do not participate at all in their 401(k) plans.

I mean, first, you have people who are not offered 401(k) plans. Then you have people who are offered them, who do not participate, people who participate but do not invest enough, people who deplete some of their assets before they retire because they dip into their assets. They take loans from this money. They take them out

when they change jobs. There are all kinds of things that can go wrong along the way to retirement, and it is a major problem.

I think we should also look at, though, that there is a lot of attention—there is this thinking that the defined-benefit world was so much better. The defined-benefit world did not work that well for a lot of people, though. You would get a lot of money if you stayed on the job for a long time. If you changed jobs frequently, either by choice of your own or because the employer went bankrupt, or because of family reasons you had to move, you did not make much in that account either.

The CHAIRMAN. Well, we are coming to some tough conclusions here. Work longer is one conclusion. This certainly was not the way it was in the previous generation.

Anybody want to offer some hope?

Ms. CALIMAFDE. Could I make a comment?

The CHAIRMAN. Please.

Ms. CALIMAFDE. We are saying work longer, but when Social Security was first formed the average life expectancy, I think, was like 65 or 66. So they were putting together a program that had a life expectancy of 10 months or 11 months for the average person.

Today—and it is too bad Senator Scott has left, but—one of the problems insurance companies are having is the life expectancy is increasing so dramatically right now that they really do not even know how to put their life insurance policies together.

So to say, gee, it is a shame you have to work longer; 65 today is not 65 30 years ago, 40 years ago. I would submit it is not even the same it was 10 years ago.

I mean, if you are going to live until you are 85 or 89 or 90, maybe we want people to keep working longer so that they can provide a function in society. But also, I would think it would be more interesting for them to keep working longer than all of a sudden—I do not think most of us are set up for 40-year retirements. That is sort of not where we are.

I was also going to quickly mention that one of the things in the tax code that I think—

The CHAIRMAN. Let me interrupt you there.

Senator Warren has a comment.

Senator WARREN. So I just want to push back on that notion, though. I understand that people are living longer, but that does not necessarily mean that someone can work longer. Living until you are 85 does not mean you can still manage a construction job at 65—

Ms. CALIMAFDE. True.

Senator WARREN [continuing]. Or that you can still take care of small children where there is lots of bending and lifting and carrying—

Ms. CALIMAFDE. Right.

Senator WARREN [continuing]. Or that you can still work as a nurse.

There are so many jobs, well, that require you to be strong, that require—or that have battered people's bodies for years.

Ms. CALIMAFDE. Well, I agree with that, Senator, but I am just saying that there is a lot of jobs out there where people are being put out to pasture at age 65 and 65 is a very vital person today.

So I am almost turning it on its head, saying these forced retirement ages that companies are coming up with are really not—they do not fit with today and who people are at 65 today.

Senator WARREN. Maybe we are just describing different parts of the problem—

Ms. CALIMAFDE. Right.

Senator WARREN [continuing]. Because I think I would say this the other way around. As I understand it, we do not have most forced retirement ages anymore.

Ms. CALIMAFDE. We do.

Senator WARREN. What we have got are people who are trying to work and who cannot get work, or people for whom it is just not possible to continue to work for years to come.

And the question is how we are going to manage longer retirement periods, and I think expecting people to work until they are 68, 70, 72 is just not realistic and, frankly, just not right.

For those who want to work, for those who can work, for those who can find the right kinds of jobs and part-time jobs, I am all for it. But, if we think the solution to dealing with the coming economic crisis around retirement is to expect people to work until 72, I just think that is wrong. I do not think we can do that, and I do not think we should be looking in that direction.

Sorry, Senator.

The CHAIRMAN. Okay. I want to raise a very contentious issue that we are going to face shortly if there is a grand bargain, and who knows in this political environment what is going to happen.

But one of the suggested parts of a grand bargain is to make Social Security more actuarially sound by not increasing the tax on higher-level income folks but, rather, altering the CPI from the existing one to what is known as Chained CPI, which is still being evaluated. But the essence is that it is a lower CPI than the existing one. Therefore, seniors' monthly payments on Social Security would be a little less.

Does anybody want to have any comment about that?

Yes, ma'am, Ms. Jacobsen.

Ms. JACOBSEN. Then you are talking life and death because it cannot get any lower and people cannot live.

Senator MANCHIN. Can I chime in?

Ms. JACOBSEN. We are talking food. We are talking—just food. People cannot live.

Senator MANCHIN. Ms. Jacobsen, I think what the Senator might have been saying is let's say that you come to retirement age, and you have done quite well in your life. But you have other people that basically have not done quite as well in their life, and they need that. That is the substance they have.

Ms. JACOBSEN. Yes.

Senator MANCHIN. Do you think this society—and this is a discussion that goes on. Would society be able to have it flexible?

Let's say my parents have done very well, and they might not need the CPI. They might not need the cost of living.

Ms. JACOBSEN. Right.

Senator MANCHIN. And they are above 250 percent of the poverty guidelines. Their income is still \$60,000, \$70,000, \$80,000 a year of investments in that.

But someone who basically needs it to adjust to their rent and their utilities and that would get it.

Ms. JACOBSEN. Okay.

Senator MANCHIN. My parents would not be upset. My parents would not be upset to say, guess what, John and Mary? You all are not going to get the COLA, but Aunt Theresa over here will get the COLA because she did not do quite as well.

They could live with that, but we cannot come to grips politically with that.

Ms. JACOBSEN. Right.

Senator MANCHIN. It is either a Chained CPI or a change in the whole COLA. You know, the amount.

Ms. JACOBSEN. Yes.

Senator MANCHIN. There are just some people that basically have done very well. They are going to get their Social Security because they paid into it, but they do not automatically have to get, nor do I think they would demand or think that it is unfair if they did not get a COLA so that we could keep COLA for the people that really need it because everybody has paid into Social Security. Right.

Does that make sense to you?

Ms. JACOBSEN. It does, and I have been paying into it since I was 15.

And you are right, but at what level? What discriminatory level?

Senator MANCHIN. I will use 250 percent of the poverty guidelines.

So take whatever the poverty guidelines are in your state—

Ms. JACOBSEN. Right.

Senator MANCHIN [continuing]. And then 250 percent above that. And, if you still had that—I am just using it hypothetically.

But these are discussions that we have, that go on, and they are not done in public, but it needs to be talked about.

Ms. JACOBSEN. Right.

Senator MANCHIN. Is there a social acceptance to it?

I know I have talked to my family members who are older, and they would say, as long as I get my Social Security back, I am okay. I am okay if I do not get the COLA. I am still in pretty good shape.

But I can tell you our neighbor over here; she has to have it. She has to have it.

Ms. JACOBSEN. Right. I am a generous person. I feel the same way you do. But is everybody else going to? Are your constituents going to?

Senator MANCHIN. Well, I do not know. That is why you have to have—around here they are afraid to have your guilt by conversation; let alone guilt by association. So they are afraid to even talk about that.

The CHAIRMAN. And that is why I said it was a contentious issue.

Now, interestingly, the flip side of that is you could solve the Social Security actuarial problem. And there is an actuarial problem, and you all have described it. We have got a lot more people that are coming into the system than are paying into it. A lot more people that are beneficiaries is what I meant.

Now you could—on the level of someone's salary, \$110,000, you could impose a Social Security tax on the amount of income above

that. I do not know the specific amount of the tax, but you could virtually solve the actuarial problem for Social Security with that.

Senator MANCHIN. I think, again, what we are talking about is if you make \$250,000 a year—or, 110. You quit taking it by 6.2 percent participation. Should that go up to at least what the value of the dollar was when we started that, when 110 went into effect, and would it be 180 or 190 today?

There has to be a reasonable way to do it, responsible and what nobody thinks is gouging, but just done in a way that this would have been the natural increments that should be today. That is where I think the cash flow might take care of itself, but there are people that say that is just raising the taxes. You know.

The CHAIRMAN. Senator Collins.

Senator COLLINS. Thank you.

I just want to point out that when the President proposed moving to a Chained CPI he also proposed increasing the minimum benefit, and I think when we have this discussion that that is really important to remember.

And the minimum benefit, as I said in my opening statement, is only about \$15,000 a year.

So I think you cannot look at just the proposal for the Chained CPI without looking at the fact that if it were desirable to move to that you have to increase the minimum benefit because, from my perspective, someone who has worked their entire life should not retire in poverty. That ought to be one of our baseline goals.

I noticed Dr. Mitchell was trying to jump in here, if we could hear from her.

The CHAIRMAN. Sure, Dr. Mitchell.

Ms. MITCHELL. With your permission, thank you.

I would only say that in the view of many economists the issue about how to correctly measure inflation is really a completely different discussion than the issue of whether we can fix poverty in old age.

And in my view, personally, if the Chained CPI is a better way to measure the cost of living for seniors, then we should do it. But we also need to focus on the issue of inadequate ability and control over resources and inadequate consumption.

And so I will only say in passing that I was on the bipartisan 2001 Commission to Strengthen Social Security, and we did propose, aside from private accounts—I am not going there. We did propose a change in the indexation of benefits prior to retirement, and that generated enough money to raise survivor benefits, which are very important, and also to raise minimum benefits to 120 percent of the poverty line.

So let's just stop there, but I wanted to bring that to your attention.

The CHAIRMAN. Senator Warren.

Senator WARREN. If I can, I just want to go back to the point, though, that Senator Manchin raised. When Senator Manchin talks about the difference between using a Chained CPI for some people and perhaps not for others, what you are really doing is just acknowledging that, at least as the Chained CPI has been laid out, we are just talking about over time a cut in benefits.

And I think that Senator Collins goes to the right point when she says the fundamental question we have to address is whether the benefits are adequate. And then we have to find the right way to grow them over time for people, but that is the baseline question.

And pretending that this is a question that somehow goes away if we use a different inflation index, I think, just misses the whole point. We have got to make sure we are paying people enough, exactly as you said, Senator Collins, so that people are not retiring in poverty.

The CHAIRMAN. Senator Manchin.

Senator MANCHIN. If I could just chime in, I have talked to enough people on the bottom of the food chain and the top of the food chain, and this is something socially that we have to come to grips with as policymakers, basically. We have to have a cost of living, or COLA, no matter what you call it. Let's say even the present formula that we are using to do our COLAs with. But there has to be one that adequately takes into account the essential living costs of people that basically the majority of their income is their Social Security check.

But, on the other hand, there are people that basically have done so well, the 110 that they have been capped at—you follow me? That Social Security check does not make or break them. They do not need and do not look for it, but they do deserve it because they have paid into it. So we do not want to take anything away, but I have found it to be more receptive for the people who have done well in the food chain.

I do not know where the breaking point would be. I use 250. It could be 300 percent. You know, we could all come to an agreement on what it should be.

But, to me, that would be a more compassionate way of doing it and making sure the people that have not done as well are able to have enough of an adjustment that they can keep lights on, food on the table and take care of themselves, and the people on the top end do not feel like you have kept a benefit away from them. That might be something we should be looking at.

We are looking at revamping and really reinventing the wheel. And you said if it really represents the purchasing power, Dr. Mitchell, then that is what should be done.

I can tell you right now it is not bought that way, as Senator Warren had said.

And I know that we have had that presentation made to us that Senator Collins spoke about—that there are certain preventions and certain stop-gaps that really help people in certain categories of the Chained CPI. It just has not been accepted that way.

So, with that being said, would they accept another approach?

That is all we are doing, and we are doing this out in the public forum as today. We need to be able to talk about this because there are certain people in my State who cannot make it. Social Security in the State of West Virginia—60 percent of retired seniors—that is their income.

Yes, ma'am.

Ms. CALIMAFDE. One comment about the idea of increasing the level at which you keep paying on Social Security is for small businesses, particularly for those who are sole proprietors, they end up

paying Social Security for themselves as an employee and then they pay for it for themselves as an employer. So, as you move that number up, that would really hit the small business community very hard.

The CHAIRMAN. Any other comments from the Senators?

[Pause.]

Well, this has been a most helpful discussion.

And I think as you, Ms. Paula, indicated, the three-legged stool—Social Security, a person's employment pension or retirement, and their private savings. We see how important it is for all of them.

And any one of them may get cut, which then, Ms. Jacobsen, gets to the point that seniors rely on that Social Security benefit because if they have the misfortune that you have chronicled today then what is the safety net.

Okay. Now we just got into today the discussion of having long-term care, and what we are going to do is in another month we are going to have a hearing on long-term care. We have scheduled that for October the 23rd.

So thank you all for participating, and the meeting is adjourned. [Whereupon, at 3:53 p.m., the Committee was adjourned.]

APPENDIX

Prepared Witness Statements

September 25, 2013 - Senate Committee on Aging –Testimony by Joanne Jacobsen

My name is Joanne (Femino) Jacobsen. I am 63 years old. I was born, grew up, raised and lived in Massachusetts until I was 56 years old. I have two sons, now ages 34, living in Massachusetts and 38, living in New Hampshire.

I have worked in some form or fashion since I was 15. I saved money, supported my sons, and planned for my retirement. Yet when I reached what should have been my retirement age, the promise that I would receive health and pension benefits for the rest of my life was broken, and so were my hopes of retiring comfortably in Florida. Like many Baby Boomers battered by the Recession, I am still in the work force and will probably remain on the job for the foreseeable future. The older people like me you see working at places like WalMart and Home Depot – a lot of us are not doing this because we're bored with retirement; we're doing it to survive.

My parents came from Italy with their parents and settled in Massachusetts. My father grew up in the Roslindale section of Boston, my mother grew up on a farm in Topsfield. We did not have a lot of money while I was growing up. My paternal grandmother became a union steward in the garment industry in Boston and instilled in me a sense that hard work pays off. She had a pension from the union – quite a feat for a woman at that time.

Work History

I started working part time when I was 15 years old and have not stopped working since. I started college, but had to drop out at age 20, because my father got sick and couldn't work anymore. So I got a "good job with the phone company," then AT&T. I got married, then divorced, raised two sons with no support, worked for the phone company for 18 years, and got my bachelor's degree at night school. That degree enabled me to get a promotion into management as the manager of Training & Education in the Information Services division of the phone company, then called NYNEX (New York/New England), where I worked for 12 more years while the company became Bell Atlantic and then Verizon. Thus, I was able to send my sons to college (again, with no financial support), while I also returned to college and got my master's degree.

In January of 2002, I was laid off at age 52, 9 months short of full retirement of 30 years. It was a time when thousands of management employees were being laid off in down-sizing measures in many industries. By luck, I was offered a job that very same month as a real estate appraiser. So I went back to school and learned a new trade. Eventually I moved on to become the town tax assessor and also worked in the Planning & Zoning Board in another town. So I worked three jobs while my youngest son finished college.

I had always planned to move and retire in Florida. Part of my dream came true in January of 2006, when I moved to Venice, Florida (20 miles south of Sarasota) and started working in real estate sales. Unfortunately the recession hit full force in 2007 and I left real estate sales because very few people were buying houses at that point. So I began working as a curriculum manager/writer of real estate training courses for a real estate training and investment company until the company went out of business in 2009. I got a job working for Sarasota County Community Redevelopment Agency, until that job was eliminated too. After a series of

unfulfilling jobs, I went back to real estate sales, where I am presently still working in order to make a living. Thankfully the economy is recovering and sales are good. Over the past few years, I tried seeking regular employment, sending out over 100 resumes. In one case, I interviewed with five people simultaneously. Everyone raved about my qualifications and about the ingenious comments I had about their business. The vice president, also there at the interview, sent me an email the next day (Thursday), saying that I was their number one candidate and that they'd follow up with me the following Tuesday. When I did not hear from him, I sent him an email that Thursday, his reply was: "Sorry, forgot to call you, we hired another candidate." So from Thursday of one week to Tuesday of the next, he had forgotten who I was; and/or he had just enough time to do a background check to find out that I was really 60 years old. There have been other similar incidents, so I decided to return to self-employment in real estate. And thus is the plight of so many baby boomers: subtle and unprovable age discrimination.

Financial Planning

While working for the Verizon, I did all the right things. Even though I was the sole supporter of two sons, in addition to being enrolled in the company's defined benefit pension plan, I also enrolled in the company savings plan, I bought a few stocks, participated in financial planning offered by the company and kept track of all of my promised/earned retirement benefits. The Company sent out our benefits enrollment packages every year, including information about our retirement benefits. I began planning my retirement while in my 30's. My goal was to retire to Florida in my 50's. All of my financial and retirement planning was centered on Verizon's promised pension and retirement health care benefits. All that was factored into the budget for my retirement.

The New Reality for Baby Boomers

When I was laid off at Verizon, I had a choice: I could take my pension earnings in a lump sum distribution or an annuity. Given the uncertain nature of the industry, I took a lump sum and put it in an IRA and other investments. After I did that, Verizon, like many other companies, began to "de-risk" its pension funds, that is it is selling them off to a third party that annuitizes the plan, allowing the company to avoid certain risks.

As I approached age 62 in June of 2012, I converted my IRA to annuities and enrolled in Social Security benefits. Just 6 weeks later, out of the blue, I received a letter from Verizon, now spun off as a new company called SuperMedia, stating that they would no longer provide health care benefits and would even discontinue our life insurance. For those people 65 and older, this rescission of benefits took place almost immediately. For those under 65, like me, health care premiums increased immediately. My health care premium shot up from \$145 per month to \$303 per month. All company subsidies for health care will stop as of January 1, 2014.

I obtained estimates for private health care which were between \$500 - \$800 per month. Estimates from Verizon/SuperMedia for group insurance are expected to be around \$600 per month. Life insurance would be extra. Buying life insurance after age 60 is an enormous expense, depending on the amount and if you add long-term care insurance as well.

I have owned my own home since I was 23. When I moved to Florida, I owned a small condo at first and kept moving up as I felt a little more comfortable about my financial situation. I bought a home in January 2010, but since then have been unable to sell the condo I moved from due to the depressed home values since the recession. In addition to these new health care expenses I also have costs associated with my home, my home owners insurance on just one home in Florida has gone from \$1,403 in 2012 to \$1,939 in 2013.

My annuities and social security barely cover my basic costs of mortgage, taxes, insurance, car payments, utilities, and daily living and business expenses. It does not cover my increase in health care premiums. So my work continues.

The Pitfalls of Social Security

Because I took Social Security before my normal retirement age of 66, I can only earn up to \$15,120 per year, before a portion of my benefits are withheld. I need to earn money to pay for all these unexpected health care costs, but I don't want to earn so much that I lose part of the benefits. I have been to my local Social Security office four times in the last year trying to figure out how this work limitation impacts my benefits, and only now, upon preparing for this hearing, have I discovered that I don't actually lose this money, but that I will get an enhanced benefit once I hit age 66. Unfortunately that does not help me now.

Because I have been living on this limited budget the past year or so, I have had to have to charge doctors and dentists visits, along with other unanticipated expenses, to my credit cards. Until now, my debt was always manageable and my credit rating near 800. Now it has swollen to five figures, my credit rating has diminished. My thoughts of ever retiring have diminished as well. So there are no vacations, new cars or luxury items for me. There will be no thoughts of ever really retiring. I will still be working into the unforeseeable future, or until my health holds out. The equation for me is: Escalating expenses (insurance and health care costs) vs. fixed income = the necessity to work

Educating the Next Generation

I now serve as financial counselor to my sons with regard to jobs, careers, investing and retirement planning. I have told them that it now a "do-it-yourself" economy and always have the proverbial Plan B and Plan C. That is if you don't do it, no one else is going to do it for you. There is no stability in today's job market and absolutely no promise of retirement benefits.

What Baby Boomers Need

We need relief. This is a life or death matter. People will die for lack of affordable and quality health care.

Statement of Olivia S. Mitchell

For the
Senate Special Committee on Aging

Hearing on

The Changing Face of Retirement Security in America

Wednesday, September 25, 2013

Dirksen 562

Good afternoon, Senators, and thank you for inviting me to discuss the changing face of retirement security. My name is Olivia S. Mitchell,¹ and I am a Professor at the Wharton School and Director of the Pension Research Council at the University of Pennsylvania. As a researcher and a Baby Boomer, I commend you for taking up this important issue. This statement consists of my prepared testimony.

This is a challenging time to be growing older in America. Thirty years ago when my parents retired, they had a secure lifetime pension along with a generous retiree medical plan. Interest rates were high enough to secure them a steady income without spending down their nest eggs too quickly. They also had inflation-protected lifetime benefits from Social Security and Medicare, and they held no debt. And their four children whom they'd saved enough to educate could always be relied on for help.

By contrast, we Boomers face a much different future. We worry that Social Security and Medicare, as well as the Disability Insurance system, are fragile. Few of us have retiree medical coverage and traditional defined benefit pensions. Some of us with defined contribution pensions have not saved enough, nor are we converting our assets into longevity-protected income streams so as to avoid outliving our saving. Interest rates are so low that holding TIPS is a losing proposition. With longer lifespans in the offing, we very much need protection for long-term care costs, but the products aren't widely available or affordable. And many more Boomers are in debt than we have seen in generations. This rising indebtedness is the focus of my comments today.

Debt and Financial Fragility Higher Among Baby Boomers

In a recent report, I compared three cohorts of people aged 56-61 in 1992, 2002 and 2008, using the Health and Retirement Study (HRS). For each group on the verge of retirement, we measured *total debt* (the value of mortgages plus other residential loans, and other debt including credit

¹ These comments represent my own views and not those of any research supporters or coauthors.

card, medical, and such), and we also compared *debt to assets*. We also focused on Baby Boomer patterns of indebtedness and financial fragility using both the HRS and the FINRA National Financial Capability Study (NFCS).²

We came to two main conclusions about older Americans' debt levels:

1. Americans are more likely to arrive with debt at retirement now than in the past. For the earlier group in 1991, about 64% held debt, whereas over 70% of the Boomers did by 2008.
2. Not only did more people have debt, but the value of this debt also grew sharply. Median debt more than quadrupled from about \$6,200 in 1992, to \$28,300 in 2008 (in 2012 dollars). Also the quarter of the distribution holding the most debt owed about \$50,000, but in the two later cohorts, this same subset of the population owed \$100,000 and \$117,300 respectively.

This is important because Boomers retiring in the next several years are more likely to carry this debt into retirement, compared to previous cohorts. Also, since debt payments typically rise faster than the interest rates that retirees can earn on their investments, they will likely be more vulnerable during retirement.

We also examined patterns of financial fragility, measured several ways including whether people had debt to asset ratios of over 50% (see Table 1). Again, things look more problematic for the Boomers, since almost a quarter (23%) had debt exceeding their total assets versus only 10% of the earliest cohort we examined.

Sources of Debt

A key reason that debt rose so rapidly for Boomers is that this group spent more on housing than earlier cohorts. As a result, Boomers are now more likely to have loans outstanding on their

² This study was funded in part by the Social Security Administration through the Michigan Retirement Research Center (MRRC) and the Pension Research Council/Boettner Center at the Wharton School of the University of Pennsylvania; see Lusardi and Mitchell (2013).

primary residences, and their mortgage values have grown faster than the values of their homes.³ Median home loans relative to assets rose from 6% to 25%, which implies that Boomers will need to service their home loans well into retirement. In other words, Boomers entering retirement are more leveraged due to housing than their earlier counterparts back in the 1990s, since they bought more expensive houses and financed them with larger mortgages.

Boomers are also much more likely to have debt equal to or greater than their liquid assets, meaning that they will likely have to sell off their less liquid assets (or borrow more) to meet their bills. Interestingly, some Boomers have both liquid assets and debt, suggesting that they may be overlooking ways to better manage their household finances.

Drilling down further using the 2012 NCFS, we found that in addition to mortgage debt, many Boomers have expensive financial habits: they do not pay off their credit card balances in full, they use their cards for cash advances, and they are charged fees for late payment or exceeding their credit limits. Medical bills are also a source of financial problems, mentioned by almost a quarter (23%). And in the five years prior to the survey, more than one-fifth of the Boomer group (age 56-61) said they had engaged in high-cost borrowing using alternative financial services (such as pawn shops, payday loans, rent-to-own stores, auto title loans, and tax refund loans). When asked to evaluate their indebtedness, 40% felt they had too much debt. Even more striking was the fact that one-third (36%) said that they were unlikely to be able to come up with \$2,000 in the next month, if an unexpected need arose. (This amount would be on the order of a medium-sized car repair or home repair bill.)

Factors Associated with Higher Debt Levels

Finally, we evaluated what factors appeared to be more or less protective against debt at older ages. To summarize our findings, the following factors stand out:

1. Higher income, better educated, and more financially literate Boomers were systematically less likely to hold high levels of debt and to be financially fragile.

³ The probability of having a mortgage in this age group rose between 1992 and 2008 from 10% to 16%, an increase of 60% (Lusardi and Mitchell 2013).

2. Nonwhite, unmarried, and less healthy Boomers, along with those who had more children, were more vulnerable.
3. People who had a large unexpected drop in income the previous year were more likely to feel that debt was a major problem for them.

Why Boomer Debt Is of Concern

It is important to focus on debt among Boomers for at least three reasons. First, financial markets have made it easier for people to access mortgages and home equity lines of credit, even when they have poor credit scores, little income, and few other assets. Second, over time, more people have gained access to alternative financial services such as payday loans, pawn shops, auto title loans, tax refund loans, and rent-to-own shops. Third, it appears that the prevalence of financially fragile and indebted household has risen over time. Our analysis of debt patterns seeks to help us avoid a repeat of past errors and assist those on the doorstep of retirement to focus specifically on debt management.

Policy Options

In the wake of the financial crisis and Great Recession, we now know that more can be done to protect Americans from the problems stemming from financial illiteracy.⁴ In particular, we have learned that there is a strong positive link between financial literacy, planning, and wealth; those who are not financially savvy are more likely to have debt and lower savings.

While protective legislation may be useful when people lack the opportunity to make repeated financial decisions so as to learn from them, it can also be useful to better inform Americans when they face potentially expensive decisions such as buying a home, cashing out their 401(k) plans, or taking out credit card loans.

Boomers could also do better with more access to financial advice, which can generate potentially important rewards in the form of lower debt for those nearing retirement. They also

⁴ For recent reviews of this literature, see Lusardi and Mitchell (2014 forthcoming) and Mitchell and Smetters (2013 forthcoming).

need more information on the benefits of delaying retirement; indeed, many have already come to this conclusion on their own.⁵ Finally, deferring Social Security claiming produces a much higher retirement income for many: for instance, delaying claiming benefits from age 62 to 70 can mean an additional 76% more in monthly payments.⁶

As we concluded in our recent review of financial knowledge and financial success, “the costs of raising financial literacy are likely to be substantial, [but] so too are the costs of being liquidity-constrained, over-indebted, and poor.”⁷

References

- EBRI (2013). Expected Retirement Age Continues to Rise. *EBRI Fast Facts* #246. September.
- Lusardi, Annamaria and Olivia S. Mitchell. (2014 forthcoming). The Economic Importance of Financial Literacy: Theory and Evidence. *Journal of Economic Literature*. March. (NBER WP 18952).
- Lusardi, Annamaria and Olivia S. Mitchell. (2013). Debt and Debt Management among Older Adults. Paper presented at the 15th Annual Joint Conference of the Retirement Research Consortium, August. Summary available at: http://www.mrrc.isr.umich.edu/transmit/rrc2013/summaries/4A_LusardiMitchellSummary.pdf
- Mitchell, Olivia S. and Annamaria Lusardi, eds. (2011). *Financial Literacy: Implications for Retirement Security and the Financial Marketplace*. Oxford: Oxford University Press.
- Mitchell, Olivia S. and Kent Smetters. (2013 forthcoming). *The Market for Financial Advice*. Oxford University Press.
- Shoven, John B. and Sita N. Slavov. (2012). The Decision to Delay Social Security Benefits: Theory and Evidence. NBER WP 17866. February.
- Shoven, John B. and Sita N. Slavov. (2013). Recent Changes in the Gains from Delaying Social Security. NBER WP 19370. August.

⁵ Over one-third of workers in a recent survey indicated that they expected to retire later than age 65, up from 11% in 1991 (EBRI 2013).

⁶ Detailed computations are provided in Shoven and Slavov (2013).

⁷ Lusardi and Mitchell (2014 forthcoming).

Table 1. Measures of Financial Fragility on the Verge of Retirement in the National Financial Capability Study (NFCS)

Source: Derived from Lusardi and Mitchell (2013)

	Age 56-61
Underwater with home value*	17.0%
Credit card fees, at least one type*	31.4%
Loan from retirement accounts*	7.0%
Hardship withdrawal from retirement accounts*	5.7%
Unpaid medical bills	23.4%
High-cost borrowing	21.2%
Too much debt	39.9%
Could not come up with \$2,000	35.5%

* Values conditional on holding the asset or debt. Statistics on hardship withdrawal and loan and retirement account reported if have a retirement account.

**Testimony to the United States Senate
Special Committee on Aging**

September 25, 2013

Prepared by Paula A. Calimafde, Esq.
Chair of the Small Business Council of America

The Small Business Council of America (SBCA) and the Small Business Legislative Council (SBLC) appreciate the opportunity to submit testimony to the Senate's Special Committee on Aging.

The SBCA is a national nonprofit organization which represents the interests of privately-held and family-owned businesses on federal tax, health care and employee benefit matters. The SBCA, through its members, represents well over 20,000 enterprises in retail, manufacturing and service industries, virtually all of which provide health insurance and retirement plans for their employees. The SBCA is fortunate to have many of the leading small business advisors in the country on its Advisory Boards, many of whom are the leading experts in employee benefits law and how that law impacts small and family-owned businesses.

The SBLC is a 35 year old permanent, independent coalition of over 50 trade and professional associations that share a common commitment to the future of small business. SBLC members represent the interests of small businesses in such diverse economic sectors as manufacturing, retailing, distribution, professional and technical services, construction, transportation, and agriculture. SBLC policies are developed by consensus among its membership.

Mr. Chairman and Members of the Committee, I am Paula Calimafde, Chair of the SBCA and a member of the Board of Directors and past Chair of the SBLC. I am also a practicing attorney who works extensively in retirement plan and employee benefits law. As Chair of the SBCA and a member of the Board of Directors of the SBLC, I am here to present our views as to how small business retirement plan coverage can be increased as well as how employees can be incentivized to increase their savings inside those plans so as to increase the retirement security of our country's employees.

Introduction:

Longer life expectancies are requiring increased retirement savings. Individuals of all economic levels are far more likely to properly save for their retirement if they participate in some form of retirement plan. According to research by the American Society of Pension Professionals and Actuaries (ASPPA), workers are **14** times more likely to save in a retirement plan offered by their employer than to save through an

IRA.¹ By using payroll deductions, these plans encourage savings because they automatically remove the money before it ever goes into the employee's pocket.

The retirement security of our nation's employees is intended to rest primarily upon three sources – often referred to as the three legged stool – Social Security, the voluntary private retirement system and individual savings. As we know, Social Security is basically a defined benefit system and payments are based upon an annuity type of framework – i.e., one cannot outlive payments from Social Security. The voluntary private retirement system is now primarily based on a defined contribution system and the methods of payments can include annuity, instalments (most often through an IRA), lump sum or a combination of one or more of these methods.

Today there is concern for the viability of the Social Security system, though most experts believe that with some relatively minor, but probably politically painful, shoring, it could be kept viable for the foreseeable future. The private retirement system is doing quite well, primarily because of a series of laws (sometimes referred to as the “Portman-Cardin” laws) which recognized that the system had become too complex and costly without providing enough upside for small and mid-size businesses to join it and largely corrected those problems. As reflected in the ASPPA statistic cited above, almost all of our individual savings are done inside a 401(k) plan, 403(b) plan or SIMPLE IRA. We also know that 71.5% of individuals who make between \$30,000 and \$50,000 contribute to an employer plan, whereas only 4.6% of individuals in the same income bracket contribute to an IRA.²

It would appear that there are at least three factors responsible for the success of employee saving in retirement plans. First, it is clear that payroll deduction is an “easy” or “painless” way to save. It is done automatically by the employer and thus, the employee does not have to do anything to get the money into the savings vehicle. Second, it is easier not to spend money or conversely to save it when one does not have it in his/her pocket. Third, with respect to the 401(k) and 403(b) plan, the employee does not have easy access to the saved money so that it continues to grow tax free.

Retirement plans are therefore central to helping employees prepare for their retirement. When an employer offers a retirement plan, most employees will participate. These high “take-up” rates are true regardless of the size of the employer. A recent study,³ which used actual data from employees' W-2 forms, found that 81% of employees working for employers with 100 or more employees take advantage of an

¹ The American Society of Pension Professionals and Actuaries, Tax Reform Shouldn't Harm Main Street's Retirement Plan (April 19, 2013), <http://www.asppanews.org/2013/04/19/tax-reform-should-not-harm-main-streets-retirement-plan/>

² The American Society of Pension Professionals and Actuaries, Save My 401(k) Fact Sheet, <http://asppa.org/savemy401kfactsheet>

³ Dushi, Iams and Lichtenstein, Social Security Bulletin, Vol. 71 No.2 2011, Assessment of Retirement Plan Coverage by Firm Size, Using W-2 Tax Records.

offered retirement plan and that 79% of employees working for employers with less than 100 employees take advantage of being able to make employee contributions into the qualified retirement plan. Although these rates are good, maintaining and continuing to increase these numbers is still important. Auto-enrollment, which automatically enrolls an employee in the plan unless they opt out, and auto-escalation, which automatically increases an employee's contribution to the plan unless they opt out, are important options that an employer can utilize to increase employee participation in a plan. The success of auto enrollment and auto escalation is somewhat startling.⁴ Those of us in the trenches believe that inertia is the key to their success – i.e., an employee would rather stay enrolled in a retirement plan because it is easier to do so than to opt out and it is easier for employees to allow the amount of their contributions to increase over a number of years than to affirmatively take steps to decrease the amount. Additionally, educating the entire workforce, particularly the younger workers, of the importance of saving for retirement is key to maintaining the high take-up rates that we see today.

Because employees save better in a retirement plan, and because employees are likely to participate in a plan when given the option, encouraging employers to sponsor retirement plans is critical in creating retirement stability.

Small businesses face particular challenges when it comes to sponsoring retirement plans. Small businesses have long been at the heart of the American economy. However, it is important to remember that small business owners are focused on the challenges of maintaining their businesses and that the relative cost of sponsoring a plan is far greater for small businesses than it is for large companies. In 2012, the Small Business Administration reported that only about half of new businesses survive their first five years and only about a third of new businesses survive 10 years or more.⁵ No matter how much a small business owner cares about his or her employees, offering a retirement plan is often a secondary concern to the survival of the business and the decision of whether to offer a plan comes down to a cost benefit analysis. Once small businesses survive the initial period of uncertainty and become more established they are far more likely to sponsor a retirement plan.

Despite the challenges, many small businesses still offer plans and make meaningful contributions for their employees. Unfortunately, there is a problematic misconception that plan sponsorship among small businesses is very low. In fact, the small business qualified retirement plan system has been very successful in providing retirement security for its workers. In the study⁶ which used actual data from employees'

⁴ Jack VanDerhei and Lori Lucas, The Impact of Auto-enrollment and Automatic Contribution Escalation on Retirement Income Adequacy, Employee Benefits Research Institute, Issue Brief No. 349 (November 2010), http://www.ebri.org/pdf/briefspdf/EBRI_IB_011-2010_No349_EBRI_DCIA.pdf

⁵ Frequently Asked Questions, Small Business Administration, Office of Advocacy (September 2012), available at http://www.sba.gov/sites/default/files/FAQ_Sept_2012.pdf.

⁶ Dushi, Jams and Lichtenstein, Social Security Bulletin, Vol. 71 No.2 2011, Assessment of Retirement Plan Coverage by Firm Size, Using W-2 Tax Records.

W-2 forms, the researchers found that 77% of all employees who work in companies with 10 or more employees are offered a retirement plan and that of these employees, 62% made 401(k) contributions.⁷ It is interesting to note that the reason why this study shows higher retirement plan coverage than is reflected in other studies is because this study relied upon actual W-2 data to determine if an employee was covered by a plan. Most other studies have relied upon surveying employees to find out if they were covered by a retirement plan. Once again, those of us in the trenches are not surprised by the marked discrepancy between employees who report they are not covered by a plan compared to the actual data. One would think that an employee would know if he/she were making employee contributions into the plan but this is not the case. Perhaps even more obscured for many employees is that their employer is making contributions for them whether through a match or by a nonelective employer contribution (aka profit sharing contribution).

In light of the cost to a small business of offering a plan and the large number of employees who are actually covered by the qualified small business retirement plan system, any changes that would make plan sponsorship more costly or burdensome, or otherwise motivate employers to freeze or eliminate the plans could have significant and detrimental long term repercussions. This is highlighted by considering the demographics of the employees who participate in retirement plans – nearly 80% of all plan participants make under \$100,000 per year and 43% of all participants make less than \$50,000 annually.⁸

What Motivates Small Businesses to Sponsor Plans?

There are a number of elements that small business owners weigh when deciding whether to sponsor a plan. Small businesses have a unique place in the qualified retirement plan system. Unlike large businesses, most small businesses are closely held and most small business owners do not anticipate being able to sell their businesses as a means of providing for their retirement. Also, the non-qualified deferred compensation plan heavily utilized for key management employees in larger businesses is not available to smaller businesses because of unfavorable tax treatment. **Because of this, one of the primary motivations for small business owners to sponsor a plan is that participating themselves is the best way to save for their own retirement. Most small business owners view the meaningful contributions that are made for the non-key employees as the price of admission to be able to save in a qualified retirement**

⁷ The size of the company makes a significant difference. W-2 data reflects that 46% of small businesses with more than 10 employees but less than 25 offer a retirement plan. The same data reflects that 60% of small businesses which employ 25 employees but less than 50 offer a retirement plan. 70% of small businesses which employ 50 employees but less than 100 offer a retirement plan. 84% of businesses with more than 100 employees offer a retirement plan. There is no further breakdown given for over 100 employees so we do not know how many small to mid-size businesses – often defined as up to 500 employees offer plans compared to the larger businesses.

⁸ The American Society of Pension Professionals and Actuaries, Save My 401(k) Fact Sheet, <http://asppa.org/savemy401kfactsheet>

plan for themselves. Employee recruitment, retention and morale are also positive factors that the owners take into account when deciding whether or not to sponsor a plan.

There are, however, significant costs for a small business to sponsor a plan. Thus, a small business owner's decision of whether to sponsor or continue to sponsor a plan often comes down to a cost benefit calculation. Some of the factors taken into account by small business owners when deciding to sponsor a retirement plan include the employees' preference for cash or health care coverage (i.e., lack of appreciation by the employees for contributions made by the employer into the retirement plan for their benefit), the uncertainty of the business' revenue from year to year, the costs of setting up the plan and the ongoing costs of administering it and the amount of the required company contributions (i.e., the top-heavy rules). When asked what could break down these barriers, the following answers are often given by small businesses: repeal the top-heavy rules, reduce administration, and change the lack of employee demand by educating employees about the need to save for their retirement now. As mentioned above, some small business owners reported that until they were more profitable and stable nothing would induce them to join the system. Almost all reported that any decrease to the owners' and key employees' level of benefits would significantly affect their cost-benefit analysis.

Some small business owners engage in this calculus on their own, while many rely on accountants and other financial advisors to help them weigh the pros and cons of sponsoring a plan. As such, the success of the small business retirement system is largely dependent on federal tax laws. The contribution limits for both employees and employers and the tax deferrals are usually central to tipping the scale in favor of plan sponsorship.

A criticism sometimes aimed at the retirement plan system is that the contributions for the non-highly compensated are not significant. Practitioners who work with qualified retirement plans know better, at least as far as small businesses are concerned. The rules governing the qualified retirement system force significant company contributions for all non-highly compensated employees if the highly compensated employees are to receive benefits. Since a major goal of a retirement plan is to provide retirement security for the owners (and in most cases, is the only way they can save for retirement through their company), it is not at all unusual for small business contributions to range between 3% and 10% of compensation for the non-highly compensated employees. This means that it is not unusual for a small business employee to, in effect, receive a bonus, albeit one given to the retirement plan, in an amount of at least 3% of their annual compensation but often equal to 5% or even 7.5%.

In the recent discussions on how to raise revenue (and conceivably lower tax rates through tax reform), the deduction for retirement plan contributions has been treated the same as other tax expenditures in the tax code. This is a mischaracterization because retirement plan contributions are eventually brought into income, along with any

earnings.⁹ There are approximately 670,000 private-sector defined contribution plans covering approximately 67 million participants and over 48,000 private-sector defined benefit plans covering approximately 19 million participants. The U.S. private retirement plan system paid out over \$3.824 trillion in benefits from 2000 through 2009 and U.S. public sector plans paid out \$2.651 trillion during the same period. All of this money was brought into income and subject to regular income tax rates (the only exception would be money that was contributed on an after-tax basis). The only loss to the government with respect to the deduction for retirement plan contributions and tax free growth inside the plan is the time value of money. But the potential detrimental impact on savings by Americans due to a reduction on contributions to retirement plans could be huge.

Simplifying the Retirement Plan System to Motivate Plan Sponsorship:

A major disincentive for a small business owner to sponsor a plan is the heavy administrative requirements (such as notice requirements, top-heavy rules and discrimination testing) which can often be very burdensome on the employer and tip the scales against sponsoring a plan. Many of these administrative requirements could be eliminated or simplified without negatively impacting the participants.

Repeal or Revise Top-Heavy Rules

One of these areas which is ripe for simple and meaningful changes is the top-heavy rules for defined contribution plans. When first enacted the top-heavy rules imposed additional minimum contributions and accelerated vesting on small and mid-size retirement plans which were almost always top-heavy due to the mathematical tests used to determine such status. Over the years, the rules have changed so significantly that the top-heavy rules are now an archaic appendage similar to that of the appendix in the human body – they do nothing but cause problems.

Nevertheless those who are not immersed in the technicalities of retirement plan law insist that the top-heavy rules still operate so as to benefit non-highly compensated employees. This outdated view has resulted in inertia on the Hill when it comes to repealing these unnecessary and complicated rules. Because this is unlikely to change, the following proposals have been developed so as to try to ameliorate the more negative aspects of the top-heavy rules. However, these ideas would not accomplish the goal nearly as effectively as outright repeal of these obsolete rules for defined contribution plans.

One way to improve the system would be to eliminate top-heavy contributions for plan participants with less than one year of service so that employees are allowed to make

⁹ A study prepared for the American Society of Pension Professionals & Actuaries reflects the value of the retirement plan tax expenditure to be roughly 55 – 75% lower than estimates by the Joint Committee and the Treasury. This study assumes that people will enjoy lower income tax rates during retirement than when contributions are made to the retirement plan. This assumption, increases the value of the “tax expenditure.” Many experts believe, however, that tax rates are going to be higher for most taxpayers in the future and that the “real” cost of the retirement plan tax expenditure is even lower than that set forth in the ASPPA report. Xanthopoulos and Schmitt, Retirement Savings and Tax Expenditure Estimates, ASPPA May, 2011.

401(k) contributions during their first year. Because of the top-heavy rules, small and mid-size plans that are top-heavy cannot allow recent employees into the 401(k) portion of their profit sharing plan without these employees receiving an employer contribution even though they have not met the requirements for the regular "profit sharing contribution." Thus, even though from a policy viewpoint we would want to encourage new hires to start saving for their retirement as soon as possible, the top-heavy rules do not allow this result. Enactment of the change above will result in more participation in the 401(k) plan sooner rather than requiring employees to be at the company for a year before being able to enter the 401(k) portion of the retirement plan. The one year wait is the "typical" wait for eligibility for entry into small retirement plans and this is because of the top-heavy rules. Eliminating the wait would allow more small business employees to start participating in the 401(k) portion of the plan sooner.

The topic of 401(k) plans is a tremendous success story. Prospective employees ask potential employers if they have a 401(k) plan and if so, what the investment options are and how much does the employer contribute. Employees meet with investment advisors to be guided as to which investments to select, employees have 800 numbers to call to see how their investments are doing and to determine whether they want to change investments. Employees discuss among themselves which investment vehicles they like and how much they are putting into the plan and how large their account balances have grown. It is probably not an exaggeration to say that the 401(k) plan brought Wall Street to main street and that it has provided employees with the education needed to effectively invest.

The forced savings feature of the 401(k) plan cannot be underestimated and must be safeguarded. When a person participates in a 401(k) plan, he or she cannot remove the money on a whim. Some retirement plans allow savings to be removed by written plan loan which cannot exceed 50% of the account balance or \$50,000 whichever is less. Savings can be removed by a hardship distribution, but this is a tough standard to meet. The distribution must be used to assist with a statutorily defined hardship such as keeping a house or dealing with a medical emergency. This is in contrast to funds inside an IRA or a SIMPLE IRA (an employer sponsored IRA program) where the funds can be accessed at any time for any reason. True, funds removed will be subject to an early withdrawal penalty (which is also the case for a hardship distribution from a 401(k) plan), but anecdotal data suggests that individuals freely access IRAs and SEPs (also an employer sponsored IRA program) and that the early withdrawal penalty does not seem to represent a significant barrier. Nevertheless, there is a distinct difference between asking the employer for a loan or a hardship distribution and having to jump through some statutorily and well placed hoops versus simply removing money at whim from your own IRA.

Another change would be to allow small and mid-sized companies to sponsor employee pay-all 401(k) plans without the 401(k) contributions made by key employees triggering the top-heavy rules. Under current IRS regulations, when a key employee makes a 401(k) contribution, that employee contribution is deemed to have been made by the company and the company is then required to make top-heavy contributions for the

non-key employees. Because of this rule, small to mid-size employers who would like to offer 401(k) plans must either commit to make company contributions to non-key employees or to exclude key employees from participation in the 401(k) plan. Many companies cannot afford to make company contributions and most owners will be unmotivated to offer plans in which they, and other key employees, cannot participate. Thus, from a policy viewpoint, employees who might have made 401(k) contributions are not given the opportunity because of the significant barriers that stand before small to mid-size company offering this type of plan. Many members of Congress seem to not understand that most small business owners are not interested in incurring additional expense and administrative burdens if there is no upside for them. Employees of small or mid-sized employers would certainly be far better off having an employee pay-all plan, in which both key and non-key employees could contribute without creating a required contribution for the company, than having no plan at all. Under such a scenario, the regular anti-discrimination tests would still apply to offer protection for non-key employees. Larger companies (which because of the mathematical tests are never top-heavy) can sponsor employee pay-all 401(k) plans. This rule unfairly discriminates against small businesses and their employees. A change to this rule would allow more small business employees access to a 401(k) plan and level the playing field between larger and smaller business entities.

Simplify ADP Testing

Another area ripe for simplification is the 401(k) discrimination testing, known as the “ADP” tests. The anti-discrimination rules for 401(k) plans (the ADP tests) are more complicated than needed. For instance, the tests set forth in the proposal referred to as the “ERSA” (Employer Retirement Savings Accounts) would satisfy the policy goals of the ADP while reducing some of the complexity currently inherent in these tests. This could be an optional ADP test so that companies who are able to deal with the current ADP tests are not required to change retirement plan documents, software and procedures.

The ERSA proposal calls for the contribution percentage for eligible highly compensated employees (HCEs) for the plan year not to exceed 200% of such percentage for the non-highly compensated employees (NHCEs) if the contribution percentage of the NHCEs does not exceed 6%. If the contribution percentage of the NHCEs exceeds 6%, then no testing would be required. The proposal also has two safe harbors to avoid the simplified nondiscrimination test which are similar to the current 401(k) safe harbors.

Eliminate Safe Harbor Notices for 401(k) Safe Harbor Match and 3% Non-Elective Safe Harbor Notices

These notices, both required by statute, are costly and burdensome. The match safe harbor notice does serve a policy purpose in that it can affect the amount of 401(k) deferrals an employee may choose to make in order to receive the match. However, rather than yearly notices, the notice could stay in effect unless and until revoked. The notice could be part of the Summary Plan Description.

The safe harbor notice for the 3% non-elective safe harbor serves no policy purpose at all and should be eliminated as soon as possible. Eliminating these unnecessary notice requirements would reduce the burdensome paperwork that pose a barrier to small businesses sponsoring a plan.

Eliminate Required Minimum Distributions (RMDs)

It makes no sense to require individuals to remove funds from an IRA or retirement plan prior to their retirement or when not needed. **Presently the law requires small business owners (and only small business owners) to start receiving RMDs while they are working.** The demographics of the group comprised of small business owners are such that money saved in a plan or an IRA will be crucial to their retirement security.

Further, all IRA owners must start removing money from their IRAs whether needed or not by the April 1st following the calendar year in which they attain the age of 70 ½. Life expectancy appears to be increasing dramatically, particularly for the oldest sectors of our population. There is no reason why the tax code should be forcing people to remove money that is intended to provide retirement security before it is needed. Worse, it is likely that the withdrawn money will be spent rather than growing tax deferred inside the IRA. It is essential that the money be available to the IRA owners when they reach the ages of 85, 90 or beyond.

Eliminating required minimum distributions and allowing participants more control after the age of 59 ½ will also help to simplify the tax code. At a minimum, the 70 ½ beginning date should be pushed back to 75. Doing so would help to ensure that individuals will have enough savings for their retirement taking into account increasing longevity so they will not have to rely upon the government for their welfare.

Modify the QPSA Rules so that the Age 35 Requirement is Eliminated

The law now provides that a plan participant subject to the survivor annuity requirements of section 401(a)(11) generally may only waive the Qualified Pre-retirement Survivor Annuity (QPSA) benefit (with spousal consent) on or after the first day of the plan year in which the participant attains age 35. However, a plan may provide for an earlier waiver (with spousal consent), provided that a written explanation of the QPSA is given to the participant and such waiver becomes invalid upon the beginning of the plan year in which the participant's 35th birthday occurs. If there is no new waiver after such date, the participant's spouse must receive the QPSA benefit upon the participant's death. This provision does not promote any particular policy goals and is exactly the type of unnecessary provision that should be eliminated.

Bring Interim Amendments Under Control

Small plans (actually all plans) have in the last five to six years been getting hit with almost yearly amendments that are costly, and by and large unnecessary. This has placed a huge burden on the small business retirement plan system. When making any changes in the retirement plan area Congress should include a direction to the IRS that no amendments are to be required on the new law, including regulations on the new law, for

a period of at least 3 years, or better until the next required restatement of the plan document. Summary of material modifications would still be required for changes requiring such notice to the plan participants. This change would make plans less expensive and burdensome to maintain while imposing no hardship on the plan participants.

Conclusion:

The sine qua non of small businesses is private ownership with any year end surplus revenues (i.e., profits) flowing to the owners of the business. Each year, the owners can choose to reduce the profits by paying themselves additional taxable compensation and/or they can retain the profits inside the company and "grow" the business and/or they can contribute all or a portion of the profits to a retirement plan sponsored by the business. It is typical for the owners to weigh the tax consequences of these various options when deciding what to do with any excess revenues.

The viability of the small business retirement system is almost uniquely dependent upon the availability of sufficient tax incentives to the owners in order to offset the administrative costs of sponsoring a plan, the mandatory contributions for the non-owner employees required under the top-heavy and anti-discrimination rules set forth in the Internal Revenue Code and the fiduciary responsibility that comes with the plan. Thus, unless the owners come out ahead by making contributions to the retirement plan (taking into account the initial deduction for contributions made to the plan, the tax free growth, the eventual distributions being subject to regular income tax rates, the costs of running the plan and the costs of making the contributions necessary for staff employees) as compared to distributing the profit to the owners as taxable income and investing the net after tax compensation as they choose (with eventual favorable capital gains and/or dividend rates), small business owners are likely to forgo the retirement plan option.

Employer sponsored retirement plans are critical to ensuring widespread retirement security. Although small businesses face greater costs and barriers to sponsoring a retirement plan, the small business retirement system has been largely successful at helping employees save. This trend should be encouraged by promoting laws which simplify the system and cut down the costs on small businesses and rejecting proposals to eliminate the tax deductions and other benefits that motivate small businesses to sponsor plans.

Retirement Income Challenges in the Twenty-First Century

Statement of

Richard W. Johnson
Director, Program on Retirement Policy
The Urban Institute

Before the
Senate Special Committee on Aging

September 25, 2013

The views expressed are those of the author and should not be attributed to the Urban Institute, its trustees, or its funders. Outstanding research assistance from Ben Southgate is gratefully acknowledged.



2100 M STREET, N.W. WASHINGTON DC 20037

Chairman Nelson, Ranking Member Collins, and Members of the Committee, thank you for the opportunity to testify today about the challenges confronting our retirement income system. As you know, ongoing social, economic, demographic, and policy changes are transforming the way Americans prepare for retirement and raising concern about the economic well-being of future retirees. One of the most important trends has been the shift away from traditional employer-sponsored pension plans in the private sector. A generation ago most people working at large firms could leave their retirement planning on auto pilot, because their employers guaranteed retirees lifetime income streams based typically on how much they earned near the end of their careers and how long they worked. Today, those traditional defined benefit pension plans have largely been supplanted by 401(k)-type plans that enable workers to set aside part of their paycheck in tax-deferred savings accounts, generally supplemented by employer contributions. These do-it-yourself retirement plans can generate substantial retirement income only if workers choose to make significant contributions to their accounts each pay period, invest the funds prudently, resist the temptation to dip into their accounts before they retire, and manage their funds wisely after they retire. The evidence suggests that for most Americans 401(k) plans have fallen short so far (Munnell and Sunden 2005). In 2010 the median value of retirement accounts held by households ages 55 to 64 totaled just \$100,000 (Bricker, Kennickell, Moore, and Sabelhaus 2012), which would generate a lifetime income stream beginning at age 65 of only about \$500 per month.

Other changes create additional challenges. The recent increase in Social Security's full retirement age effectively cut payments to all new beneficiaries. More cuts may be needed to improve the system's long-run finances. As people live longer, their retirement savings must last longer. Yet, wages for the majority of male workers have stagnated over the past few decades, leaving fewer financial resources that can be set aside for retirement. Unusually low interest rates have depressed investment returns for those who do save, and the prolonged housing slump has reduced home values, the largest asset held by most retirees. Many older people who lost their jobs during the recession are still out of work, destroying their ability to save for retirement and forcing many to dip into their savings much earlier than expected. And sharp swings in the stock market have added to the uncertainty surrounding retirement security. These developments have left many Americans unsure about whether they will be able to enjoy a comfortable retirement (Helman, Adams, Copeland, and VanDerhei 2013).

Another set of trends, however, paint a rosier picture of the long-term prospects for retirement security. Women are now working and earning more than in earlier generations, partly offsetting men's declining labor market fortunes. Women's higher earnings boost family incomes and enable women to amass Social Security credits and 401(k) accounts in their own names. Because Social Security benefits are partly tied to the growth in average earnings across the workforce, strong wage growth among the nation's top earners has boosted Social Security payments to beneficiaries at all income levels, despite the sluggish earnings growth among low- and moderate-wage workers. Americans now in their fifties and sixties are better educated than ever and healthier than in the previous generation. As a result, many older people are working longer, earning more over their careers, and saving more for retirement. And many Baby Boomers benefited from the run-up in housing values and the stock market during the 1990s and the late 1980s, so many still have substantial wealth despite the recent market setbacks.

For the past decade researchers in the Urban Institute's Program on Retirement Policy have been disentangling these contradictory trends to project the economic well-being of future generations of retirees. Our projections are based on DYNASIM3, the Institute's unique microsimulation model. It takes baseline data from a large, nationally representative survey of Americans and uses hundreds of equations describing such processes as marriage formation and dissolution, fertility and mortality, employment and earnings, savings behavior, program participation, and disability to age that data year by year. DYNASIM3 currently projects such outcomes as labor force participation, health and disability status, the components of household wealth (including home equity, retirement accounts, and other financial assets), and the components of household income (including earnings, Social Security benefits, and asset income) through 2087.¹

My testimony today highlights the following four conclusions that I draw from our projections and related analysis of other data:

- Median retirement incomes will continue to rise in inflation-adjusted terms for generations retiring through the 2030s, partly because women are earning more than ever, productivity gains will boost average wages in the economy, and many people are delaying retirement and working longer.
- However, increasing shares of Americans will see their living standards fall as they enter retirement, because retirement incomes are not projected to keep pace with the earnings received by the working-age population.
- High out-of-pocket medical and especially long-term care costs pose the greatest threat to older Americans' economic security.
- Other key challenges include the growth in income inequality at older ages and the difficulties many seniors face in turning retirement account balances into lifelong income.

The discussion below elaborates on each of these points, and concludes with some policy recommendations.

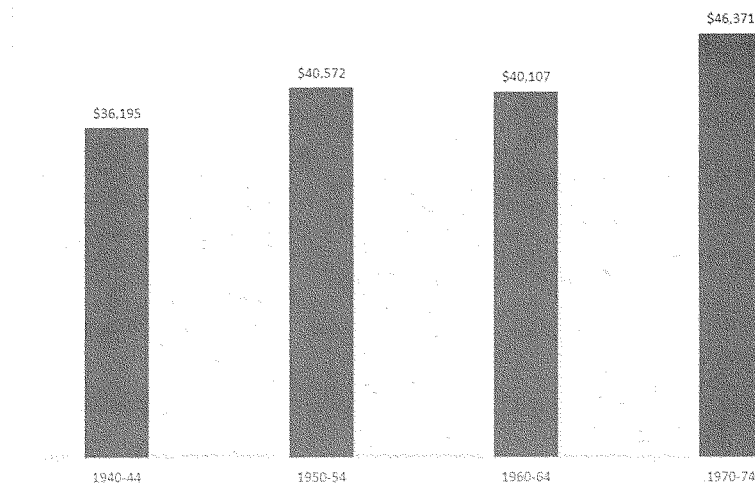
How Much Income Will Future Retirees Receive?

Our projections show that inflation-adjusted retirement incomes will generally increase over the coming decades. Median per capita household income at age 70 will total about \$46,400 (measured in constant 2013 dollars) for those born between 1970 and 1974, who will turn 70 between 2040 and 2044 (figure 1). This estimate is 14 percent higher than the corresponding projection for adults born between 1950 and 1954 and 28 percent higher than the corresponding projection for those born between 1940 and 1944.

Future retirement incomes will rise despite the much-discussed erosion in traditional employer-sponsored pension coverage. According to our projections, defined benefit pension

¹ For more information on DYNASIM3, see Favreault and Smith (2004) and Smith (2012).

Figure 1. Median Real Annual Per Capita Household Income at Age 70,
by Birth Cohort (2013 Constant Dollars)



Source: Urban Institute estimates from DYNASIM3, run 848.

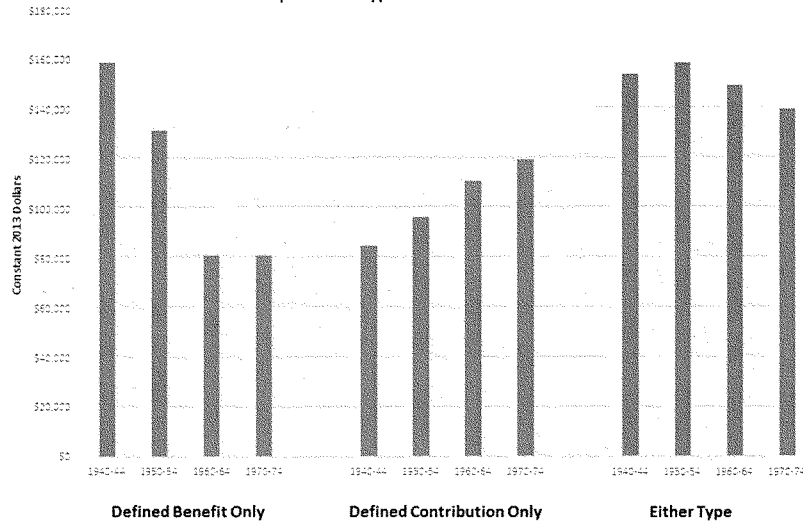
Note: Estimates assume that 80 percent of retirement accounts and other financial assets are annuitized at age 70.

wealth—the present value of the expected stream of future benefits—for those receiving payments will fall from \$158,000 (in constant 2013 dollars) for those born between 1940 and 1944 to \$81,000 for those born between 1970 and 1974 (figure 2), a 49 percent drop. This decline stems from the reduction in the number of years workers will spend in jobs providing traditional pension coverage. The loss of traditional pension benefits will be partially offset by an increase in 401(k) account holdings. The median real value of these defined contribution retirement accounts among those with accounts at age 70 will rise from \$84,000 in constant 2013 dollars for those born between 1940 and 1944, to \$119,000 for those born between 1970 and 1974, a 42 percent increase. Yet despite the growth in 401(k)-type accounts, median real wealth from both types of employer-sponsored retirement plans will drop. The share of adults with wealth from either type of plan will hold steady at about 65 percent, but median real wealth among those with some holdings born between 1970 and 1974 will fall about 19 percent below the median value of their counterparts born 30 years earlier.

Why then will retirees generally receive more income over the coming decades, even after adjusting for inflation? The improvement stems from women's movement into the labor force, productivity growth, and the increase in working lives.

Increase in women's employment and earnings. One of the most important developments in the labor market during the second half of the twentieth century was the movement of women into the labor force. Between 1948 and 2012, the labor force participation

Figure 2. Median Real Pension Wealth at Age 70 Among Those with Wealth,
By Pension Type and Birth Cohort



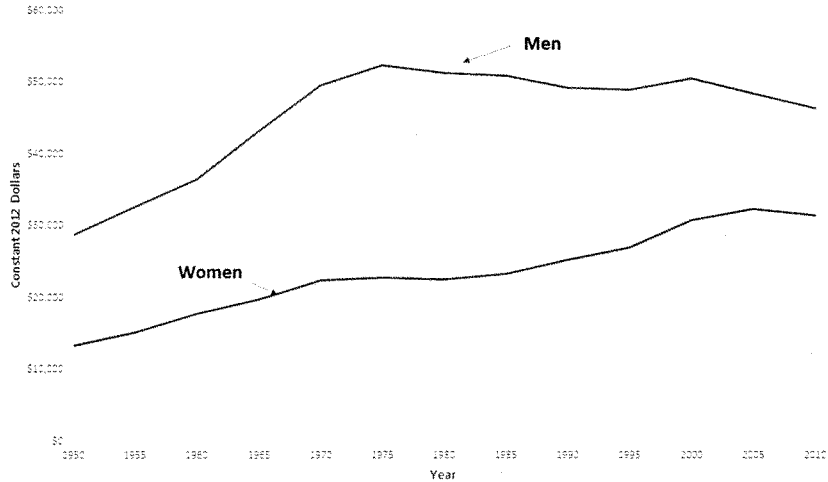
Source: Urban Institute estimates from DYNASIM3, run 848.

rate for women ages 25 to 54 increased from 35 to 75 percent.² Working women have also earned more over time. Between 1950 and 2010, median inflation-adjusted annual earnings for employed women ages 50 to 54—when wages and salaries typically peak—increased 234 percent (figure 3). By contrast, employed men’s median earnings increased only 161 percent over the same period, although working men still earned nearly 50 percent more than working women in 2010. The gender disparity in earnings growth has been particularly stark over the past 35 years. Between 1975 and 2010, real median earnings fell 11 percent for men while increasing 38 percent for women.

Women’s employment gains will substantially improve their own retirement security, which depends largely on earnings received earlier in life. As women’s lifetime earnings grow they will receive more Social Security benefits, they will accumulate more wealth in their employers’ retirement plans, and they will be able to set aside more money in other savings vehicles. In fact, we project that median real per capita household income at age 70 will be 38 percent higher for women born between 1970 and 1974 than for their counterparts born 30 years earlier. By contrast, men’s median real per capita income at age 70 will increase just 20 percent over the next 30 years. The gender gap in age-70 per capita household income will shrink to 10 percent among those born between 1970 and 74, compared with 22 percent for those born between 1940 and 1944.

² This estimate is based on the author’s calculations from the Bureau of Labor Statistics (2013b).

Figure 3. Median Real Annual Earnings for Workers Ages 50 to 54,
by Gender and Year



Source: Author's computations from Social Security Administration (2013).
Note: Estimates are restricted to men and women with positive earnings.

Productivity growth. Technological advances generally raise worker productivity over time, which typically translates into higher wages and salaries for workers. Between 1951 and 2007 (before the Great Recession began), wages (as measured by Social Security's national average wage index) increased at a compound annual growth rate of 4.9 percent, while prices (as measured by the consumer price index) increased at a compound annual growth rate of only 3.8 percent.³ As average real wages increase, incomes tend to grow faster than prices and living standards improve. Of course, some workers do not experience wage gains even when the average wage in the economy rises. Indeed, as noted earlier, median earnings for men ages 50 to 54 grew more slowly than inflation over the past 35 years. However, because the Social Security benefit formula uses changes in the national average wage to index workers' earnings over the course of their careers, overall wage growth will increase Social Security benefits even if an individual's real wages remain flat.

A simple example illustrates this point. Consider a woman born in 1951 who works every year from age 25 to 61 and begins collecting Social Security benefits in 2013 at age 62. Assume she earns \$10,000 at age 25 and that her earnings increase each year at the rate of inflation, so she would earn \$40,350 in 2012 at age 61. Measured in 2012 inflation-adjusted dollars, she earned \$40,350 throughout her career. However, the Social Security Administration uses the

³ These estimates are based on the author's calculations from the Bureau of Labor Statistics (2013a) and Social Security Administration (2013).

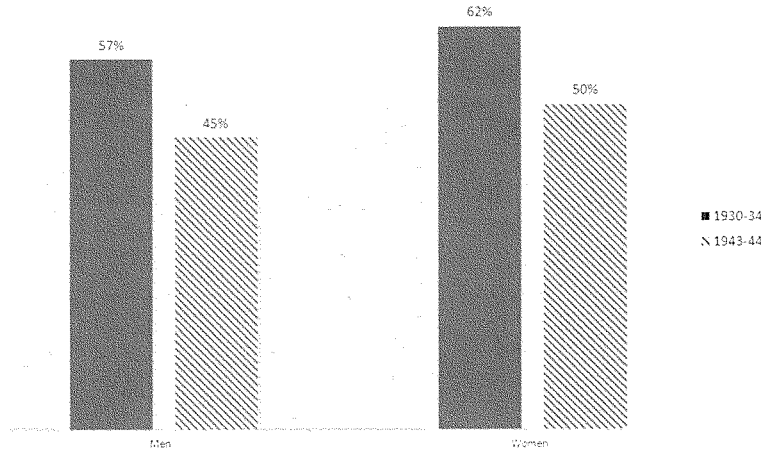
national average wage index, not the consumer price index, to adjust the earnings she received earlier in her career. Because average wages grew faster than inflation, her early career earnings enter the benefit formula at much higher values. For example, Social Security values her age-25 earnings at \$46,583 and her age-31 earnings at \$50,163. If average wages in the economy grew only at the rate of inflation, she would receive a monthly Social Security benefit of \$1,135 at age 62. Because average economy-wide earnings actually grew much faster, Social Security will instead pay her \$1,250 per month at age 62, or 9 percent more.

Longer working lives. Another reason why retiree incomes will grow over time is because people are working longer. After falling for much of the twentieth century, older men's labor force participation rates have been increasing rapidly over the past 20 years. Between 1948 and 1993, participation rates for men ages 65 and older fell from 47 to 16 percent. By 2012, however, they had rebounded to 24 percent. Participation rates have grown especially rapidly in recent years for men ages 65 to 69, increasing from 25 percent in 1993 to 37 percent in 2012, a 48 percent relative increase. . Women are also more likely now to work at older ages. Between 1993 and 2012, the share of women participating in the labor force grew from 16 to 28 percent, a relative increase of 75 percent.

As people work longer, they are collecting Social Security retirement benefits later. Only 45 percent of men born between 1943 and 1944 (who turned 62 in 2005 and 2006) began collecting Social Security at age 62, the first year benefits are available (figure 4). By comparison, 57 percent of men born between 1930 and 1934 began collecting Social Security at age 62. More women also waiting to collect their Social Security benefits. Only 50 percent of women born between 1943 and 1944 began collecting at age 62, down from 62 percent among those born between 1930 and 1934.

Working longer and delaying retirement substantially increases financial resources in old age. Extending the work life boosts lifetime earnings, increasing Social Security credits and providing workers with additional resources that they can save for retirement. Working longer also shrinks the retirement period, so retirement savings do not have to last as long. Workers who delay the age at which they claim Social Security benefits will receive higher monthly payments even if they do not work while waiting to collect. Social Security actuarially adjusts the retirement benefits it provides, reducing monthly payments for those who retire early and increasing payments for those who delay so that lifetime payments are approximately equal no matter when beneficiaries begin collecting. For example, those who collect at the earliest eligibility age of 62 now receive just 75 percent of the full benefits they would receive if they wait until age 66—the full retirement age—to begin collecting benefits. Monthly benefits increase 8 percent for each year that beneficiaries claim take-up beyond the full retirement age (up to age 70). One study found that working one additional year would increase annual retirement income by 9 percent, while working five additional years would increase annual retirement income by 56 percent (Butrica, Smith, and Steuerle 2006).

Figure 4. Percentage of Men and Women Claiming Social Security Retirement Benefits at Age 62, by Birth Cohort



Source: Johnson, Smith, and Haaga (2013).

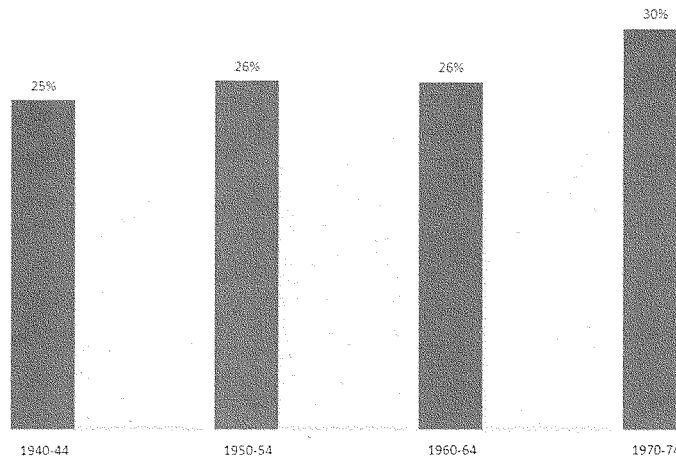
Can Future Retirees Maintain Their Pre-Retirement Income Levels?

Although we project that median income at age 70 will increase over time, will incomes grow enough to ensure that future generations have sufficient resources to live comfortably in retirement? There is much debate about how much retirement income is necessary, but a common rule of thumb is that retirees need to replace 75 percent of their pre-retirement incomes, based on the assumption that spending declines in retirement, especially since retirees do not pay payroll taxes or save in retirement accounts.⁴

Figure 5 shows the projected share of adults with age-70 incomes insufficient to replace 75 percent of their age 50 to 54 earnings. As with our income projections, these estimates assume that people use 80 percent of their retirement accounts and other financial assets to purchase actuarially fair annuities. We find that the share of adults who will be unable to replace at least three-fourths of their pre-retirement earnings will increase from 25 percent for those born between 1940 and 1944 to 30 percent for those born between 1970 and 1974. This projected deterioration in retirement preparedness may not be dramatic enough to qualify as a retirement crisis, but it is a worrisome trend worthy of careful consideration by policymakers.

⁴ See Scholz and Seshadri (2009) for a discussion of replacement rates.

Figure 5. Percentage of Adults Whose Projected Age-70 Income Will Replace Less than 75% of Their Age 50-54 Earnings, by Birth Cohort



Source: Urban Institute estimates from DYNASIM3, run 848.

Note: Estimates assume that 80 percent of retirement accounts and other financial assets are annuitized at age 70.

Will Medical and Long-Term Care Costs Undermine Retirement Security?

The adequacy of older Americans' financial resources depends critically on their retirement needs. How health care costs evolve over time will partly determine how much income older adults need and significantly influence their economic well-being. Because health care costs are likely to grow in the future as prices and health care use increase, some experts argue that retirees need as much income as they had before retirement to maintain the living standards they enjoyed at younger ages (VanDerhei 2011).

Older Americans already devote a substantial portion of their incomes to health care. Although Medicare covers nearly all adults ages 65 and older, premiums, deductibles, and holes in the benefit package leave many older Americans with substantial out-of-pocket expenses. Half of all Americans ages 65 and older now spend more than 12 percent of their incomes on health care (Johnson and Mommaerts 2009). Among those with incomes below 200 percent of the federal poverty level, half spend more than a fifth of their incomes on health care.

Out-of-pocket health care spending by older Americans is projected to rise sharply in coming decades as health care costs continue to grow. If health care spending grows at the intermediate rates assumed by the Medicare trustees, in 2040 health care costs will consume more than a fifth of household income—a common benchmark for burdensome health care

spending—for 45 percent of all adults ages 65 and older and about 70 percent of those in the bottom two-fifths of the income distribution (Johnson and Mommaerts 2010). If, instead, health care spending follows the Medicare trustees' high-cost growth rate assumptions, about 70 percent of *all* adults ages 65 and older will devote more than a fifth of their incomes to health care in 2040.

The prospect of becoming disabled and needing expensive long-term care pose perhaps an even greater financial risk for older Americans than the prospect of high medical bills. One estimate indicates that 7 in 10 Americans who survive to age 65 will eventually need long-term services and supports, and 1 in 5 will need help for five or more years (Kemper, Komisar, and Alecxih 2005). Most will receive informal help from family and friends, often creating significant financial, physical, and emotional burdens for their helpers. About 53 percent of people caring for their frail parents are employed full time, and another 10 percent are employed part time (Johnson and Wiener 2006). About 11 percent of children caring for parents are ages 30 to 39 (Johnson and Wiener 2006), a life-course stage when many people are raising young children. Another 68 percent of caregivers are in their 40s and 50s, ages when many people still have dependent children at home. Overall, 37 percent of caregivers have children under age 18 (National Alliance for Caregiving and AARP 2004). Care responsibilities often interfere with paid employment. About 57 percent of employed caregivers report that they sometimes have to go to work late, leave early, or take time off to attend to their care duties, and 17 percent said they had to take a leave of absence (National Alliance for Caregiving and AARP 2004).

However, increasing numbers of older Americans will receive home care from paid helpers, especially as family caregivers become less available because future generations of older Americans had fewer children than the current generation and middle-aged women are now working more than in the past (Johnson, Toohey, and Wiener 2007). Many older adults will also end up in nursing homes. Despite long-term declines in nursing home admission rates (Bishop 1999), a recent study concluded that the chances of receiving nursing home care at some point after age 50 still exceeds 50 percent (Hurd, Michaud, and Rohwedder forthcoming).

Long-term care costs are prohibitive. The latest estimates from the 2012 MetLife Mature Market survey indicate that a year of nursing home care in a semi-private room now averages about \$80,000 nationwide, with average costs as much as 75 percent higher in certain parts of the country (MetLife Mature Market Institute 2012). The private cost of home health aides average \$21 per hour nationally. A frail older adult receiving 60 hours of paid home care per month—the median amount (Johnson and Wiener 2006)—would incur costs of about \$15,000 per year.

The United States lacks a system to adequately finance these costs. Standard health insurance plans do not cover long-term care, and Medicare covers long-term care only in special circumstances. Only about 12 percent of adults ages 65 and older have private long-term care insurance (Johnson and Park 2011), and there are signs that this private market is shrinking. As a result, long-term care costs can quickly deplete household savings. According to one study, married women typically forfeit about \$40,000, more than one-third of their wealth, when they enter nursing homes (Johnson, Mermin, and Uccello 2006). Single women forfeit about \$20,000, or about 60 percent of their wealth. Many long-term care recipients, especially those with extended nursing home stays, end up going on Medicaid (Wiener et al. 2013), which requires

that beneficiaries surrender nearly all of their income and wealth. The Kaiser Commission on Medicaid and the Uninsured (2013) estimates that Medicaid covers 41 percent of the nation's long-term care costs, costing taxpayers about \$140 billion in 2010.

Taken together, health and long-term care costs often deplete older Americans' financial resources near the end of life, when many people receive expensive care. Out-of-pocket health and long-term care spending averages \$38,688 for individuals and \$51,030 for couples in the last five years of life (Kelley et al. 2013). One in 10 individuals incur out-of-pocket costs in excess of \$89,106 during the last five years of life. These expenses exceed total household wealth for 25 percent of cases and total non-housing wealth for 43 percent of cases.

Substantial and growing out-of-pocket medical and long-term care costs at older ages suggest that seniors may need as much money in retirement as when they were working. According to our projections, 45 percent of those born between 1970 and 1974 will lack enough of income at age 70 to replace all of their pre-retirement earnings.

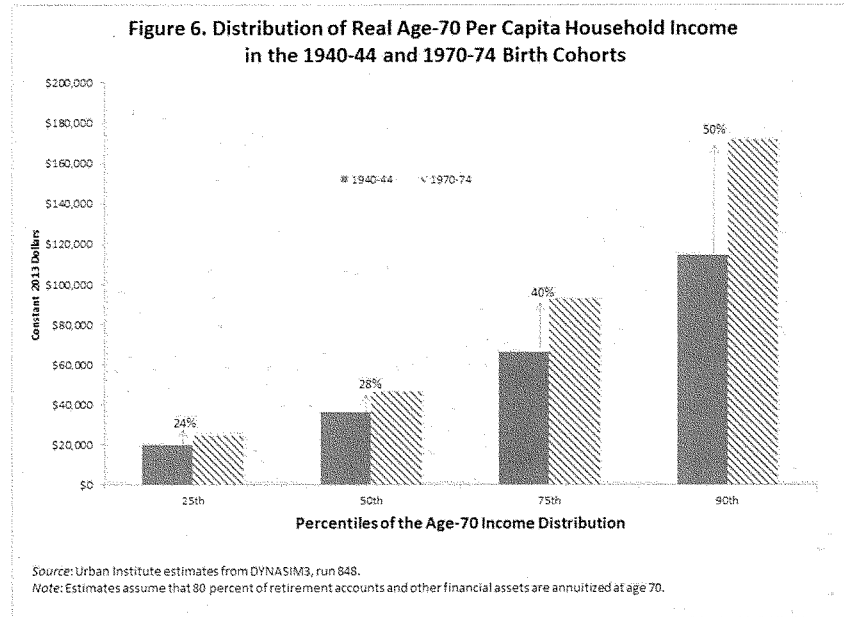
How Do Outcomes Vary across the Income Distribution?

The distribution of earnings across the labor force has become increasingly unequal over the past generation, as wages soared for those near the top of the earnings distribution while falling or stagnating for those in the middle and near the bottom. A recent study, for example, found that the top 10 percent of workers collected more than half of the nation's earnings in 2012, the highest share ever recorded (Saez 2013). These trends reverberate into old age, long after workers have retired, because retirement income depends on how much is earned at younger ages. Retirement incomes are already highly skewed. For those born between 1940 and 1944, the 75th percentile of the age-70 per capita household income distribution is more than three times higher than the 25th percentile of the distribution, and the 90th percentile is nearly six times higher.⁵ These disparities will grow over the next 30 years as retirement incomes grow more rapidly for those near the top of the income distribution than for those in the bottom half. For those born between 1970 and 1974, the 90th percentile of the age-70 per capita income distribution will be seven times higher than the 25th percentile. Over the next 30 years inflation-adjusted incomes will increase 50 percent at the 90th percentile and 40 percent at the 75th percentile, but only 24 percent at the 25th percentile (figure 6).

Health disparities at older ages contribute to unequal financial outcomes. The recent increase in Social Security's full retirement age places a premium on working longer, yet many people with health problems cannot extend their working lives into old age. Those with health problems also spend more on medical care and long-term care. Moreover, it is well known that health problems are more common among lower-income adults than higher-income adults (Cutler, Lleras-Muney, and Vogl 2008). As a result, those who most need to supplement their

⁵ Each percentile of the income distribution indicates the income level below which that percentage of the population falls. Exactly 25 percent of the population, for example, has less income than the 25th percentile of the income distribution. For the 1940-44 birth cohort, the 25th percentile of the age-70 per capita household income distribution is \$20,300, the 75th percentile is \$66,400 and the 90th percentile is \$114,400.

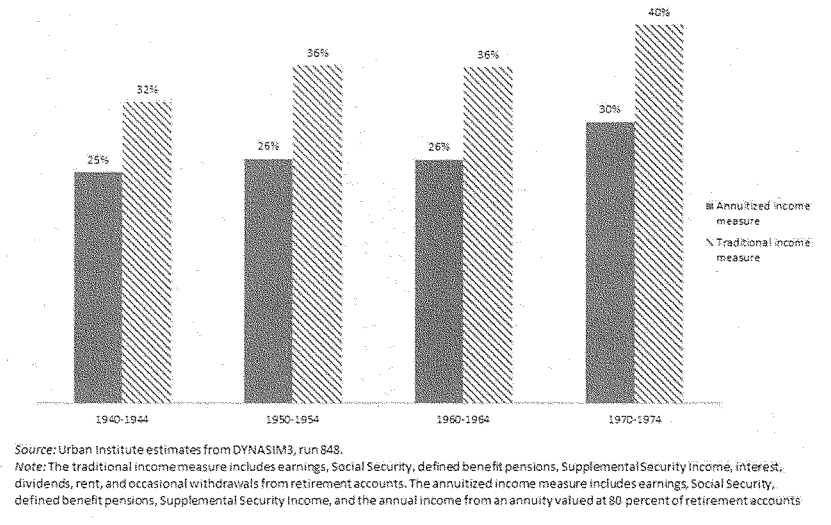
income are least able to collect additional earnings, and those with the greatest health care costs are least able to afford them (Johnson 2013).



Can Retirees Make Their Savings Last for a Lifetime?

As 401(k) plans have become increasingly common, more retirees will have to make decisions about how to spend the funds they have accumulated in those accounts. Retirees with traditional employer-sponsored defined benefit pension plans do not generally confront this problem, because most receive their benefits in monthly installments that last until they (and their spouse) die. However, few retirees convert their retirement accounts into annuities that provide fixed payments until death, partly because few employers offer retirees the option to annuitize their account balances and annuities available in the private marketplace do not generally provide favorable rates. Retirees who do not annuitize their 401(k) balances face two risks. They might deplete their accounts before they die, especially if they live until very advanced ages, leaving them with few resources near the end of their lives. Or the fear of running out of money might dissuade them from spending much from their accounts, preventing them from living as comfortable in retirement as they might otherwise (Smith, Soto, and Penner 2009).

Figure 7. Percentage of Adults Whose Projected Age-70 Income Will Replace Less than 75% of Their Age 50-54 Earnings, by Birth Cohort and Income Measure



How people withdraw funds from their retirement accounts substantially affects their economic well-being. The income projections shown so far assumed that retirees convert 80 percent of their retirement accounts and other financial assets into a lifetime annuity. Our income projections fall substantially when we assume that they do not annuitize their assets and instead take periodic withdrawals from their accounts and receive interest and dividends from their holdings (figure 7). Using this traditional income measure, we project that 40 percent of those born between 1970 and 1974 will lack sufficient income at age 70 to replace 75 percent or more of the earnings they received at ages 50 to 54. Under the annuitized income measure, we projected that 30 percent would be at risk.

Policy Options

Congress might consider several options to address the key challenges of retirement security.

Safeguarding incomes for the most vulnerable seniors: As income inequality grows, providing a safety net for older Americans with limited income becomes increasingly important. First and foremost, policymakers must ensure Social Security's long-term financial health, given the central role it plays in seniors' economic security, especially for those with limited resources. As Congress reworks Social Security, it should consider creating better protections for low-income beneficiaries. Options include creating a meaningful minimum benefit and revising the

benefit formula to increase replacement rates for those with limited lifetime earnings, perhaps paid for by reducing benefits for high-income beneficiaries. Congress should also modernize the Supplemental Security Income program, which provides cash benefits to older adults and people with disabilities. The program's asset test, for example, is woefully out of date and much too strict, restricting payments to individuals with less than \$2,000 in household wealth and couples with less than \$3,000. These limits are not indexed for inflation and have not changed since 1989.

Protecting seniors from high out-of-pocket health and long-term care costs.

Congress could take several steps to protect older adults from catastrophic medical expenses. Options include setting a limit on out-of-pocket spending by Medicare beneficiaries, combining deductibles for the various parts of Medicare, and relating deductibles or out-of-pocket spending limits to income. It is also time to create a program to help families finance long-term care. An obvious option is to include these services as part of Medicare's benefit package.

Encouraging lifetime income. Older adults should be encouraged to annuitize some of their retirement accounts and savings when they retire to boost their incomes and produce a guaranteed income stream until death. Policymakers should consider reforms that make annuities more attractive and increase trust in these products.

Promoting work at older ages. Americans should be encouraged to work as long as they can. Policymakers and employers need to recognize the importance of jobs for older adults, promoting retraining and flexible work schedules that can accommodate their needs. The federal government might be able to encourage some workers to delay retirement simply by designating age 70 the full retirement age, without changing the way benefits are computed, because many people appear to respond to such signals from the government (Johnson, Smith, and Haaga 2013).

References

- Bishop, Christine E. 1999. "Where Are the Missing Elders? The Decline in Nursing Home Use, 1985 and 1995." *Health Affairs* 18(4): 146–55.
- Bricker, Jesse, Arthur B. Kennickell, Kevin B. Moore, and John Sabelhaus. 2012. "Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances." *Federal Reserve Bulletin* 98(2): 1-80.
- Bureau of Labor Statistics. 2013a. "Consumer Price Index: All Urban Consumers (Current Series)." Washington, DC: U.S. Department of Labor. <http://www.ssa.gov/oact/cola/AWI.html#Series>
- . 2013b. "Labor Force Statistics from the Current Population Survey." Washington, DC: U.S. Department of Labor. <http://data.bls.gov/pdq/querytool.jsp?survey=ln>.

- Butrica, Barbara A., Karen E. Smith, and C. Eugene Steuerle. 2006. "Working for a Good Retirement." Washington, DC: The Urban Institute.
http://www.urban.org/UploadedPDF/311333_good_retirement.pdf.
- Cutler, David M., Adriana Lleras-Muney, and Tom Vogl. 2008. "Socioeconomic Status and Health: Dimensions and Mechanisms." NBER Working Paper No. 14333. Cambridge, MA: National Bureau of Economic Research.
- Favreault, Melissa M., and Karen E. Smith. 2004. "A Primer on the Dynamic Simulation of Income Model (DYNASIM3)." Washington, DC: The Urban Institute.
<http://www.urban.org/publications/410961.html>
- Helman, Ruth, Nevin Adams, Craig Copeland, and Jack VanDerhei. 2013. "The 2013 Retirement Confidence Survey: Perceived Savings Needs Outpace Reality for Many." EBRI Issue Brief No. 384. Washington, DC: Employee Benefit Research Institute.
http://www.ebri.org/pdf/briefspdf/EBRI_IB_03-13.No384.RCS2.pdf.
- Hurd, Michael, Pierre-Carl Michaud, and Susann Rohwedder. Forthcoming. "The Lifetime Risk of Nursing Home Use." In *Discoveries in the Economics of Aging*, edited by David A. Wise. Chicago: University of Chicago Press.
- Johnson, Richard W. 2013. "Income and Wealth of Older Adults Needing Long-Term Services and Supports." Testimony before the Federal Commission on Long-Term Care. Washington, DC: The Urban Institute. <http://www.urban.org/publications/904599.html>.
- Johnson, Richard W., and Corina Mommaerts. 2009. "Are Health Care Costs a Burden for Older Americans?" Washington, DC: The Urban Institute.
<http://www.urban.org/publications/411924.html>.
- Johnson, Richard W., and Corina Mommaerts. 2010. "Will Health Care Costs Bankrupt Aging Boomers?" Washington, DC: The Urban Institute.
<http://www.urban.org/publications/412026.html>.
- Johnson, Richard W., and Janice S. Park. 2011. "Who Purchased Long-Term Care Insurance?" Washington, DC: The Urban Institute. <http://www.urban.org/publications/412324.html>.
- Johnson, Richard W., and Joshua M. Wiener. 2006. "A Profile of Frail Older Americans and Their Caregivers." Retirement Project Occasional Paper No. 8. Washington, DC: The Urban Institute. <http://www.urban.org/url.cfm?ID=311284>.
- Johnson, Richard W., Karen E. Smith, and Owen Haaga. 2013. "How Did the Great Recession Affect Social Security Claiming?" Program on Retirement Policy Brief No. 37. Washington, DC: The Urban Institute. <http://www.urban.org/publications/412875.html>.
- Johnson, Richard W., Gordon B.T. Mermin, and Cori E. Uccello. 2006. "When the Nest Egg Cracks: Financial Consequences of Health Problems, Marital Status Changes, and Job

Layoffs at Older Ages.” Washington, DC: The Urban Institute.
<http://www.urban.org/publications/411265.html>.

Johnson, Richard W., Desmond Toohey, and Joshua M. Wiener. 2007. “Meeting the Long-Term Care Needs of the Baby Boomers: How Changing Families Will Affect Paid Helpers and Institutions.” Washington, DC: The Urban Institute.
<http://www.urban.org/publications/311451.html>.

Kaiser Commission on Medicaid and the Uninsured. 2013. “Medicaid’s Role in Meeting the Long-Term Care Needs of America’s Seniors.” Washington, DC: The Henry J. Kaiser Family Foundation.

Kelley, Amy S., Kathleen McGarry, Sean Fahle, Samuel M. Marshall, Qingling Du, and Jonathan S. Skinner. 2012. “Out-of-Pocket Spending in the Last Five Years of Life.” *Journal of General Internal Medicine* 28(2): 304–309.

Kemper, Peter, Harriet L. Komisar, and Lisa Alecxih. 2005. “Long-Term Care over an Uncertain Future: What Can Current Retirees Expect?” *Inquiry* 42(4): 335–50.

MetLife Mature Market Institute. 2012. “Market Survey of Long-Term Care Costs: The 2012 MetLife Market Survey of Nursing Home, Assisted Living, Adult Day Services, and Home Care Costs.” New York: Metropolitan Life Insurance Company.

Munnell, Alicia H., and Annika Sunden. 2005. *Coming Up Short: The Challenge of 401(k) Plans*. Washington, DC: Brookings Institution Press.

National Alliance for Caregiving and AARP. 2004. “Caregiving in the U.S.” Bethesda, MD and Washington, DC: National Alliance for Caregiving and AARP.

Saez, Emmanuel. 2013. “Striking it Richer: The Evolution of Top Incomes in the United States (Updated with 2012 preliminary estimates).” <http://elsa.berkeley.edu/~saez/saez-UStopincomes-2012.pdf>.

Scholz, John Karl, and Ananth Seshadri. 2009. “What Replacement Rates Should Households Use?” MRRC Working Paper 2009-214. Ann Arbor: University of Michigan Retirement Research Center.

Smith, Karen E. 2012. “Projection Methods Used in the Dynamic Simulation of Income (DYNASIM3).” Washington, DC: The Urban Institute.
<http://www.urban.org/publications/412512.html>.

Smith, Karen E., Mauricio Soto, and Rudolph G. Penner. 2009. “How Seniors Change Their Assets during Retirement.” Washington, DC: The Urban Institute.
<http://www.urban.org/publications/412006.html>.

- Social Security Administration. 2013. *Annual Statistical Supplement to the Social Security Bulletin, 2012*. Washington, DC: Social Security Administration.
- VanDerhei, Jack. 2011. "A Post-Crisis Assessment of Retirement Income Adequacy for Baby Boomers and Gen Xers." Washington, DC: Employee Benefit Research Institute.
- Wiener, Joshua M., Wayne L. Anderson, Galina Khatutsky, Yevgeniya Kaganova, Janet O'Keeffe, Anne Tumlinson, Eric Hammelman, and Elana Stair. 2013. "Medicaid Spend Down: Implications for Long-Term Services and Supports and Aging Policy." Long Beach, CA: The Scan Foundation.
http://www.thescanfoundation.org/sites/thescanfoundation.org/files/tsf_ltc-financing_medicaid-spend-down-implications_wiener-tumlinson_3-20-13_0.pdf.

Additional Statements for the Record



Statement of William K. Zinke
President, Center for Productive Longevity
 to the
Senate Special Committee on Aging
Hearing on "State of the American Senior:
The Changing Retirement Landscape for Baby Boomers"
September 25, 2013

Chairman Nelson, Ranking Member Collins, and other members of the committee, as you examine the changing retirement landscape for baby boomers in the United States, I encourage you to consider that Americans who are near or past "retirement age" may choose not to retire but instead remain actively engaged in society for a myriad of reasons, including personal interest or fulfillment, financial need, and/or healthier and longer life expectancies,

I am William Zinke, president of a 501(c)(3) non-profit, the Center for Productive Longevity (CPL), whose mission is to stimulate the substantially increased engagement of people 50 and older (50+) in productive activities, paid and volunteer, where they are qualified and ready to continue adding value.

With today's high unemployment and low economic growth projected to continue for the foreseeable future, CPL has focused on entrepreneurship as one of the most viable options not only for Baby Boomers but for all Americans 50+ who want to continue earning in productive activities. Entrepreneurship makes sense for this age group and for our country as well because new-business creation enables people 50+ to remain productively engaged while also contributing to increased employment and economic growth.

Governments, schools, businesses, and non-profit organizations should be encouraging and enabling Americans 50+ to "Start Anew" as entrepreneurs of the 21st century for the following reasons:

1. Approximately 99 million people, almost one-third of the total U.S. population, are 50 years of age or older.
2. This population segment represents a large and growing talent pool with experience, expertise, seasoned judgment and proven performance; millions of them are sitting on the sidelines but wanting or needing to continue working.
3. Contrary to popular thinking, the Kauffman Index of Entrepreneurial Activity for 1996-2012 reports that people 55-64 created 8.7% more new businesses on average per year than did people 20-34, and their success rate was better.
4. Few other options beyond entrepreneurship actually exist for people 50+.
5. Entrepreneurship has been the backbone of the U.S. economy since the country began, serving as the driver for increased employment and economic growth.

In furtherance of its mission, last year CPL held four meetings in different parts of the United States spotlighting entrepreneurship opportunities for Baby Boomers: At the Kauffman Foundation (Kansas City, MO), Babson College (Wellesley, MA), Northwestern University/Kellogg School of Management (Chicago, IL), and the University of Denver-University College. More than 400 people participated in these meetings, and 74% of the participants who provided written evaluations said they were more likely to create a new business as a result of their experience.

As a logical progression of these events, more than 200 thought leaders from the public, private, non-profit and academic sectors will gather in Washington, DC November 7-8 at a *National Conference on the Entrepreneurship Imperative for Engaging People 50 and Older*, where they will discuss what actions the four sectors can take separately and where they can collaborate to stimulate substantially more new-business creation by people 50+. CPL is committed to facilitating implementation of those actions within 12 months of the conference to stimulate a substantial increase in new-business creation.

Among the actions we anticipate being discussed and recommended are:

- federal and state governments create an environment that encourages and supports increased entrepreneurship for people 50 and older such as adopting laws, regulations, tax structures, financial incentives, and other measures promoting new-business creation by people 50+;
- colleges and business schools focus on entrepreneurship courses and programs that educate and train people 50+;
- organizations conduct more research and development on how to encourage and support increased entrepreneurship for people 50+;
- many more large companies encourage and support intrapreneurship and entrepreneurship; and
- the private, non-profit, and public sectors work together more effectively to develop an increased emphasis on innovation and creativity.

As someone who is well beyond the Baby Boomer generation, I would be happy to discuss with you how our nation can expand entrepreneurial opportunities for Americans 50+ and thus contribute to the nation's economic health and well-being.

William K. Zinke
Center for Productive Longevity
Boulder, CO
<http://www.ctrpl.org/>
info@ctrpl.org

September 24, 2013

