NATIONAL ENDOWMENT FOR FINANCIAL EDUCATION

Partnering for Financial Well-Being Office of the President

August 18, 2015

Testimony to the ERISA Advisory Council:
Helping Participants Make Informed Decisions in Risk Transfer Transactions

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To the U.S. Department of Labor's Advisory Council on Employee Welfare and Pension Benefit Plans:

The National Endowment for Financial Education® (NEFE®) is pleased to join with Karen Richman, Ph.D., to provide expert testimony and offer the following comments to the ERISA Advisory Council regarding the useful information that participants need to make an informed decision in a risk transfer transaction. We also include suggestions for delivering information to participants and feedback concerning the provided draft notices. Our comments are focused on low- to moderate-income individuals as well as those for whom English is a second language.

The National Endowment for Financial Education (www.nefe.org) is the only private, nonprofit national foundation wholly dedicated to improving the financial well-being of all Americans. All NEFE resources and initiatives are research-based, noncommercial, and not tied to any products or services. NEFE inspires empowered financial decision making for individuals and families through every stage of life.

Dr. Richman is principal investigator of the NEFE-funded studies: *La Tercera Edad:* Latinos' Pensions, Retirement and Impact on Families (2008) and *Confianza*, Savings and Retirement: A Study of Mexicans Immigrants in Chicago (2012). She is the director of undergraduate studies for the Institute for Latino Studies at the University of Notre Dame. Since its creation in 1999, the Institute for Latino Studies has played a vital role in fostering understanding of the U.S. Latino experience.

Executive Summary
Defined benefit plan participants may be less prepared and less confident in their retirement decision making because their involvement in managing the money is passive. To help them navigate these very complex decisions, NEFE suggests providing needed information at various touchpoints and giving them time well in advance of the 90-day notice to begin to consider their choices and decisions in the context of their overall retirement plan. NEFE also recommends that the specific needs of Latinos be considered: Research shows that Latinos are more likely to take a lump sum and spend it because they are not aware of their options upon termination of employment.

Facilitating Informed Decision Making

Much is said about the increasingly fragile retirement security of American individuals who are expected to take on complex financial decisions to ensure their financial resources last a lifetime, such as how to allocate retirement savings in defined contribution plans. For Americans fortunate enough to have a defined benefit plan, this burden of uncertainty is somewhat alleviated: They have guaranteed income for life. However, the decision of whether or not to take a lump sum when it is offered is incredibly complex. While we know that leaving one's money in a pension is often the wise choice for many people, obtaining the necessary information to make an informed decision can be difficult.

A risk transfer decision is complicated: Participants are asked to have the skills and judgment of an actuary, compliance professional, financial advisor, consumer protection specialist, and corporate finance officer. By contrast, many employers — lacking the sophisticated software needed to arrive at an estimated lump sum amount for their employees — enlist the help of actuaries and other professionals to arrive at this number. Individuals without access to these kinds of resources often are left in the dark. Without knowing the information they need and where to find the factors that go into these complex calculations — let alone their range of options, and the consequences of each — plan participants are especially at risk of giving up their lifetime income.

<u>Understand the variables</u>

To reach an informed decision, the participant is expected to know and understand a range of factors and variables: time value of money; the mechanics of discount interest rates; effects of longevity on calculations (research shows that minorities and women tend to have very inaccurate expectations of their longevity); credit risk and the financial strength of their employer and/or insurance company provider; and the value of survivor and spousal benefits in defined benefit plans.

Additionally, a participant needs to understand:

- Tax implications and penalties in various scenarios
- The potential for higher fees associated with moving money into and maintaining their own account
- The financial guarantees they are giving up by taking a lump sum
- The benefits from lower costs, the law of large participant numbers and mortality calculations

<u>Understand the participant's engagement and comfort levels with financial decision making</u>

How comfortable is the participant with managing money? Defined benefit plan participants may be less informed about financial management and less confident than those in defined contribution plans because of the active management inherently required by those accounts. Employees rely on their employer to manage the fund. But employees may not be aware of the benefits they gain from the professional management of their defined benefit plan and the large group fee schedule, or that their employer makes up any shortfall in financial performance necessary to fund benefits. Finally, the benefit of the Pension Benefit Guaranty Corporation backstop may not be understood; in fact, employees may not even be aware of its existence.

<u>Understand how people consume financial information and arrive at decisions</u>

To effectively communicate with plan participants about decisions that require action, there is a need for multiple contact points and various methods for disseminating the information. Workshops, videos, webinars, radio and audio productions, call centers/hotlines, paper notices and peer communication are all recommended.

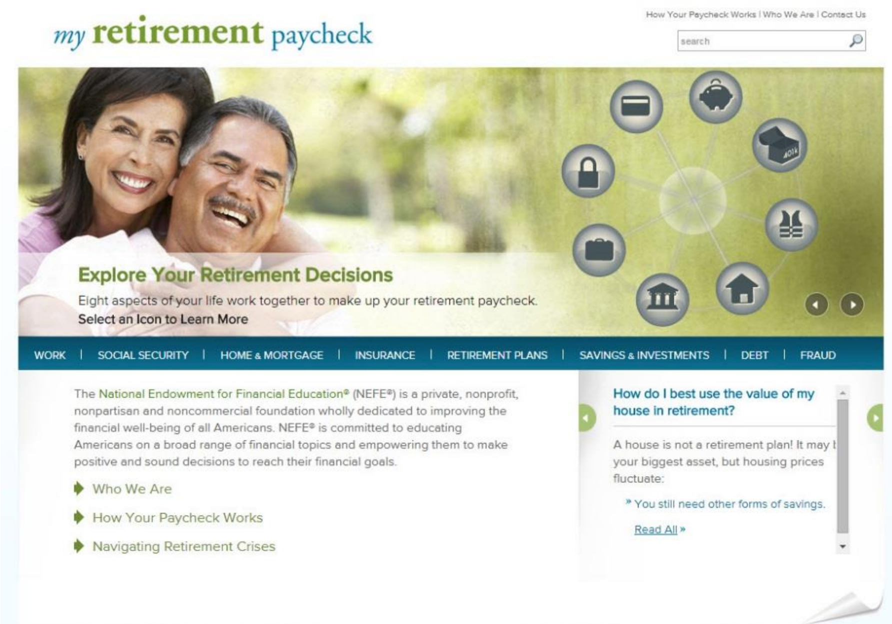
A NEFE-funded study by researchers at Dartmouth College, Increasing the Effectiveness of Retirement Saving Programs for Females and Low-Income Employees: A Marketing Approach *(2009),* explored strategies to boost employee participation in retirement savings plans, especially among vulnerable employee subsets such as women and low-income employees. By conducting focus groups and listening to these employee subsets, researchers were able to identify barriers and solutions to plan participation. They then launched a social marketing campaign involving fliers and videos in addition to a traditional informational package, which resulted in a 56 percent increase in enrollment within 30 days.

Similarly, organizations facing changes in their retirement plans communicate with employees using participant-friendly language at multiple points in various ways. For example, the University of Colorado system recently rolled out an employee communications strategy for an upcoming change to options in their retirement plan. The strategy involved emails, a paper letter and checklist, a transition guide packet and a handout to help plan participants prepare for a one-on-one financial consultation — all in addition to a website and phone support. The takeaway is that individuals need information at various touchpoints to arrive at a fully informed decision.

Finally, at key decisions or life points, people need time and repetition to internalize and validate complex decisions. Before making a decision, many employees must gather input and discuss the decision with a spouse, partner, parent, sibling, or a family/community personal finance opinion leader or acknowledged expert. Participants also may choose to consider or coordinate with the personal finance situation of someone of significance in their life who has their own health issues, employment outlook, assets, debts, Social Security benefit and other retirement and savings income sources from his or her employment or small business ownership. After all, decisions about retirement should not be made quickly, nor should they be isolated from one another. How one handles his or her pension and/or lump-sum offer is just one component of a person's retirement plan, which is composed of many interrelated decisions and varying sources of retirement income.

To really encourage sound decision making among plan participants, NEFE recommends that employers send information to plan participants well in advance of the 90-day notice. For example, information could be provided to an employee at key anniversary dates, or once an employee reaches 55 years of age. The goal is to have pension plan participants, who might be the least prepared to be an active participant in their retirement planning due to the passive nature of defined benefit plans, start thinking about their retirement choices and decisions early on. We would like to see companies empower their employees by initiating a conversation about their financial futures. This could be as simple as sending a letter to let employees know that, as they are planning their future, there a number of foundational choices and decisions they'll need to consider. Employers could then point their employees to trusted, noncommercial resources as an opportunity to get familiar with upcoming decisions and to inventory the resources they will need to create a paycheck for themselves in retirement. If employers offer a pension plan, it would be wise to let people preview the decision they'll eventually need to make about what to do with that plan and point them to reliable sources of information. If plan participants are given information well in advance, the decision will not sneak up on them and we might help people make better decisions and have better retirement outcomes.

To aid individuals in the retirement decision-making process, NEFE offers My Retirement Paycheck, an online, holistic retirement decision-making resource. In 2007, NEFE commissioned the Center for Retirement Research at Boston College to conduct a literature review and aggregate the most commonly proposed consumer guidelines within key areas where Americans make critical — and often irrevocable — decisions about initiating and paying for their retirement. The literature review was followed by NEFE's Retirement Income Decumulation Think Tank, a strategic gathering of a diverse group of retirement experts and thought leaders. The most important outcome of the event was the creation of universal retirement decumulation guidelines within eight decision areas which were consolidated, summarized and revised before producing a single, easy-to-understand set of the most important and actionable guidelines for American consumers to follow in preparing and paying for their retirement. The primary vehicle to disseminate the messages resulting from the think tank is the consumer website, My Retirement Paycheck (www.myretirementpaycheck.org).



The conventional approach to retirement decumulation emphasizes how an action taken (or not) within a specific decision area either produces or reduces retirement income. The phrase "retirement paycheck" is relevant and practical: It describes how each decision area and income stream works together to create a "paycheck." This helps individuals understand the impact of each decision, as well as have a better idea of what they can expect to pay themselves throughout retirement. The concept of a retirement paycheck provides more opportunities for optimization and better serves Americans who do not have much leeway to make mistakes with their resources.

What We Know From Research

It's important to study how various populations behave in practice and then tailor financial education materials and recommendations accordingly. Here, we present findings from NEFE-sponsored research led by Karen Richman, Ph.D. at the University of Notre Dame du Lac. The research is a unique interdisciplinary collaboration between an anthropologist and two economists, and their study integrates qualitative ethnography with statistical analysis. It has broad application beyond Latinos to illuminate how culture affects savings and retirement in diverse populations, including ethnic groups, classes, gender, ages, families and generations.

Research Findings

Latinos, especially those who are born in the United States, are embracing saving for retirement. However, while participation rates are high, low-wealth/low-income savers often see their retirement savings as a source of liquidity. In addition to the threat of "leakage" posed by current workers depleting their defined contribution funds through loans and early withdrawals, another danger looms when workers change jobs or leave work to retire. The problem appears to be a lack of good communication between employees and employers upon termination. Departing employees often are unaware of their full options as to the handling of their retirement savings, which may include leaving the funds in the current plan, transferring it to a new employer's plan, rolling it over to an IRA, buying an annuity or cashing out with a lump-sum payment. Some departing workers appear to be unaware that they can leave their savings in the plan, which may be the best way to preserve their capital. Many departing employees assume that if they want to keep a retirement savings plan, they have to rollover their funds into an IRA. These rollover plans are aggressively marketed by financial firms and banks, but IRAs often have higher fees that reduce their capital over time. However, the greatest risk to retirement savings comes from liquidating a pension as a lump-sum payment and spending it. Dr. Richman's analysis demonstrates that Latinos are at great risk of depleting their retirement savings by cashing out.

Analysis of data from The Survey of Income and Plan Participation (SIPP) shows that when they leave a job or retire, Latinos are less likely than whites to preserve their retirement savings by leaving it where it is or rolling it into their savings into other retirement savings plans. Latinos are as likely as black men and women to take a lump-sum payment and to spend it (Table 1). Latinos tend to use the funds for paying bills, paying debts, or everyday expenses.

The 2012 Health and Retirement Survey (HRS), which emphasizes retirees and only interviews people 50 years of age and older, provides more detailed data than the SIPP on what retirees do with their pension savings when they retire or leave jobs. The SIPP does not have the option for participants to indicate whether they left the money with the previous employer. Table 2 analyzes data from the HRS to show that compared to whites and blacks, Latinos do not take full advantage of the options available to them when they leave employment. Gender is a factor; as many as 75 percent of Latinas cashed out, a much higher rate than Latino men and their white and black counterparts. More than half (58 percent) of Latino men left their funds in the plan, but a third (34 percent) did not explain what they did with their savings.

Table 1. What Employees Do with Pensions When They Retire or Leave Jobs (SIPP)

	Latino Men	Latino Women	White Men	White Women	Black Men	Black Women
Rollover (including leaving money in plan or direct roll over)	19%	28%	54%	49%	26%	27%
Invest in retirement plan	0%	4%	0%	1%	0%	2%
Saving and investment	11%	0%	4%	3%	6%	2%
Spending	70%	68%	42%	47%	68%	70%

Table 2. What Employees Do with Pensions When They Retire or Leave Jobs (HRS)

	Latino Men	Latino Women	White Men	White Women	Black Men	Black Women
1. Take out the money	8%	75%	4%	38%	0%	23%
2. Rollover into IRA	0%	0%	30%	29%	5%	33%
3. Leave in the plan	58%	25%	7%	19%	50%	5%
4. Covert to/purchase annuity	0%	0%	0%	6%	0%	0%
5. Transfer to new employer's plan	0%	0%	17%	4%	0%	15%
6. Lose benefits	0%	0%	1%	0%	3%	0%
7. Receive installments	0%	0%	0%	0%	0%	13%
8. Receive benefits now	0%	0%	28%	0%	42%	10%
9. Continue collecting	0%	0%	0%	0%	0%	0%
10. Expect future benefits	0%	0%	0%	5%	0%	0%
97. Other	34%	0%	7%	0%	0%	0%
98. Don't know	0%	0%	6%	0%	0%	0%
99. Refused to answer	0%	0%	0%	0%	0%	0%

Research Recommendations

Borrowing against retirement savings plans puts the savings at risk. Those who take loans from their retirement savings have a tendency not to repay them, and when they default, workers not only deplete their savings, but are subject to penalties and taxes as well (Ariel/Aon Hewitt 2012). Blacks have the highest rates of loans and early withdrawals from their plans. Latinos are slightly more likely to borrow from pension plans than whites and Asians, and among Latinos, men are more likely to borrow from their retirement savings than women.

The greatest threat to Latinos' retirement savings plans does not come from loans against the plans, however, but from what Latinos do with their savings at the end of their employment. When Latinos leave jobs or retire they are less likely than whites, blacks and Asians to preserve their capital by leaving it in the plan or rolling it over into other retirement plans. It is important to help workers changing jobs and retiring to understand the risk of lump-sum payments and cashing out their retirement plans.

A paradox of the recruitment and termination of employment is that employers typically provide a full explanation of benefits to new hires, but departing workers do not tend to get the same degree of information — thorough knowledge of which is essential to protecting the savings they built while employed. When employees leave their jobs they do not know enough about the consequences for their retirement savings. Departing employees often do not understand the available investment options and the relative costs of their old and potential new plans. One of the reasons is that the policies vary by company and the details are not well known. And, as stated before, many employees are unaware that they are eligible to leave their retirement investment with their former employer. As a result, some departing employees withdraw their retirement savings and essentially deplete their nest egg in one stroke.

While Ariel/Aon Hewitt recommends better communications at teachable moments like hiring, etc., we suggest that termination should be another moment that employers educate departing employees with enough information in terms of how to handle their pension accounts. Many workers, including those who could have left their savings in the former employers' plan, seek the advice of investment advisors to reinvest their savings in IRAs. Unfortunately, such investment advisors are not held to the same fiduciary standards as those associated with the employer-based plan. This lower standard contributes to the pattern of offering conflicted investment advice to workers to roll their 401(k) type savings into an IRA. Lacking full knowledge about their options and a complete understanding of the detailed regulatory differences between their employer plan and an IRA, workers unknowingly subject their accumulated savings to depletion, mainly by the higher investment fees charged by IRA plans. According to a 2015 White House report, in the shift from an employer-based 401(k) type plan to an IRA, retirement savers lose an average of 1 percent of their gains and 12 percent of their total savings. The lack of portability of retirement savings plans creates an opportunity for financial industries to aggressively market the transfer of defined contribution plans to IRAs at a cost to employees. And, this is especially costly to Latinos as they tend to switch jobs more frequently.

Draft Model Notices: Review and Comments

The draft model notices are a great first step toward informing plan participants about upcoming decisions or changes. NEFE offers the following comments and suggestions to potentially further improve the drafts.

<u>Overall feedback</u>

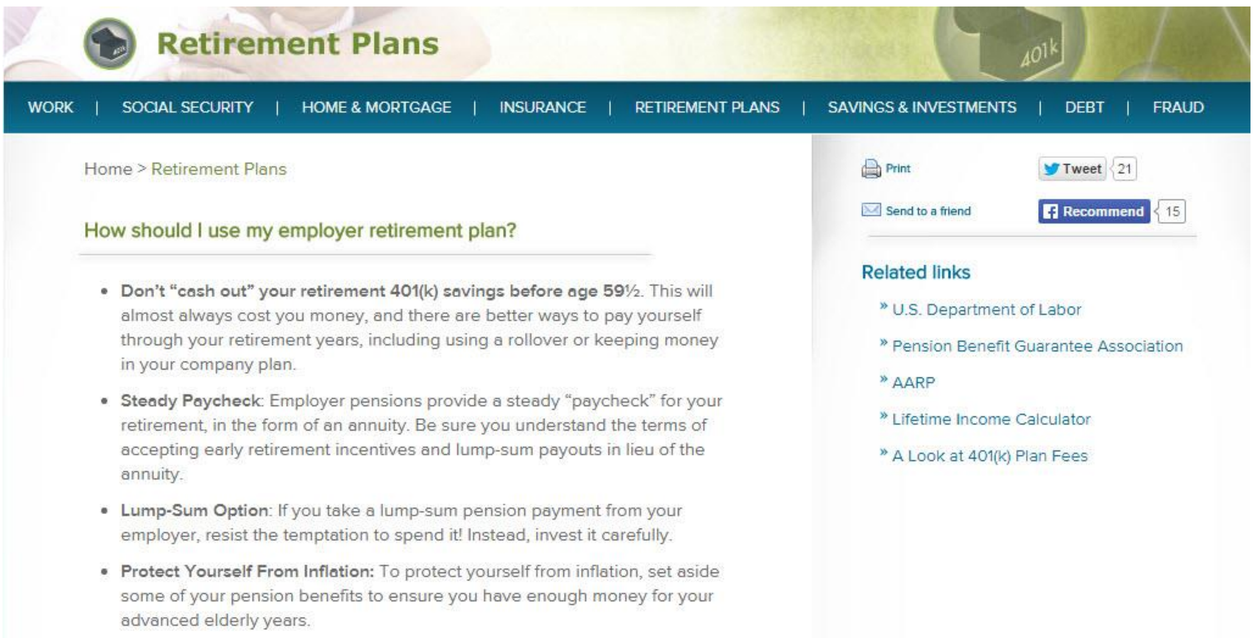
Introducing the notices, video, infographics and other visual aids for Web and mobile devices could be helpful to explain what is about to read. We recommend including context, patterns, reasons for why this happens to many people, and other general rules of thumb. This introduction would be a good place to reinforce a holistic approach to retirement decision making, including the four-legged stool of retirement income: Social Security; tax-favored employer-provided retirement savings such as pensions and 401(k) plans; personal savings; and work earnings.

Likewise, delivery of the model notices could be expanded to include other media, i.e., video and audio, which may have a broader reach. Latinos, including the foreign-born, enthusiastically embrace mobile technologies. Smartphones that support texting and apps such as Facebook have empowered low-literacy immigrants in substantial ways to transcend previous barriers to long-distance communications. These technologies are used both to extend their personal networks across national and regional borders and to gain knowledge. Therefore, educational information transmitted through social networking can be effective. In addition, Latinos often use the radio and television for continuing education. Latino women especially listen to and follow the advice of radio personalities such as Julie Stav, the financial advisor, and Doctora Isabel, the mental and physical health consultant.

In consideration of increasingly shifting demographics in the United States, especially among Latinos, NEFE recommends that the forms and notices be translated into Spanish and/or other languages of large numbers of participants. Prose should be culturally and linguistically competent — that is, conveyed in clear, respectful language. Latinos are a heterogeneous population and their vernaculars can be quite varied. All translated text should be checked to ensure that it is easily comprehensible to the main

Latino demographics: Mexicans, Puerto Ricans, Cubans and other groups such as Guatemalans, Salvadorans and Columbians.

Next, avoid explaining concepts through text-heavy and math-laden word problems. We've highlighted several instances of this in our specific feedback below and suggest using graphics or tables instead. Finally, NEFE appreciates and suggests increasing the use of rules of thumb. Government agencies rarely venture an opinion on best practices for most people, but when used here, drafters make a good point with the conditions and assumptions stated. NEFE recommends that these notices, especially the lump sum notice, offer rules of thumb that might be the best course for most people to follow. Yes, there are exceptions, but we recommend some "narrative nudging" like behavioral finance professionals might give. Rules of thumb could be stated in a separate chart and listed one by one. My Retirement Paycheck, as mentioned before, includes such rules of thumb for each decision area presented on the site (see example below).



The approach NEFE used in crafting guidelines for each decision area was to "do no harm." For the most part, these guidelines are applicable to almost any circumstance or situation, and are particularly valuable to people with limited assets. While we recognize that not all of these guidelines are achievable or available to all, most people will be able to pick out one or two guidelines in several areas to boost their confidence and build a sense of empowerment. And we've found that when a person is empowered to make even one beneficial decision, that first win often builds confidence and positive momentum that carries into other decision-making situations.

Lump Sum Notice Draft

NEFE recommends the draft begin with the summary chart, as it is clear from the beginning, and then offer prose following the chart. We found that there is no explicit discussion of fees in the text, although it appears in the summary chart. The prose should explain the effect of fees.

In taking a high level view of the draft, there should be some acknowledgement of how a pension can be a great supplement that complements monthly income from Social Security (which is inflation adjusted and lasts a lifetime). Also, pension payments can be a bridge to allow individuals and couples to delay claiming Social Security early to let that future Social Security monthly income be higher (growing 8 percent each year of delayed claiming after age 62 until age 70).

Specific feedback follows:

- In the first line of the introduction, we recommend replacing the word "option" with "opportunity" as option is a financial term that may be confusing. Similarly, in the italicized text below Point A, replace the word "benefits" with "income."

- Under A1, in the second line, change "you are eliminating" to "you will no longer have" to promote increased clarity and simplicity. Start the third sentence in this paragraph by adding clarifying language: "To duplicate the pension and its payments for the remainder of your life…"

- Under A2, in the sixth sentence, replace "get superior returns to" with "beat." The tenth sentence reads like a math word problem, which will be difficult for participants to understand. We prefer including an example graphic or table. In the sentence that follows, replace "exhaust" with "run out." Most importantly in this paragraph, the oblique reference to Department of Labor proposed guidelines on financial advisors is not enough. There should be an explanation of how and why hiring a financial advisor affects savings in contrast to how and why the employer's management of those savings works. Additionally, when calling for an outside professional opinion, do so carefully as lump sums are favored by some financial advisors as a way to gain control of client assets even when the costs are better with a pension annuitization. Also note that the Web link included is a proposal that has not yet been finalized. Other general guidance about seeking professional advice is appropriate.

- Under A3, the second line starts with the words "less than." This is unclear — less than what? Does the annuity provide less of a monthly income, or is it more costly? In the following sentence, change the word "retail" to "purchased."

- A5 includes a rule of thumb, which is effective and helpful. Similarly, A6 offers a holistic perspective, which is helpful. In the last sentence under A6, add "to avoid tax penalties" to the end of the sentence.

<u>Pension Transfer Notice Draft</u>
The notice includes appropriate warnings of what could go wrong in an insurance company's operation through insolvency or other possible failure. We recommend including some positive or at least descriptive language on normal insurance operations and how annuities are serviced and administered by an insurance company.

Also, basic issues about mailing address and direct deposit institutional changes should be emphasized. Several confusing points about state-licensed insurance agencies and their respective guarantor agencies raise issues for people who live in different states and what happens if they move. Annuity holders must stay in touch with the insurance company or its servicing surrogate for accuracy, uninterrupted payment flow and peace of mind.

Finally, a chart or graphic example of how a State Guaranty Association works would be helpful. The text regarding this information reads like an implied word problem and most readers will not grasp the concept or context being suggested through these paragraphs.

Specific feedback follows:

- In paragraph 5, we recommend restructuring the last sentence to read "Instead insurance annuities are covered by the assets of the insurance company, or in the event that the insurance company fails, state guaranty associates provide some protection."

- In paragraph 7, define "present value of an annuity." Also, the last sentence again reads like a math word problem. We recommend including an example or graphic instead.

- Paragraph 9 might be the best place to mention the information about mailing addresses and domicile issues mentioned above.

The National Endowment for Financial Education is prepared to provide more information about any of the resources included in this response. For more information, contact me at TBeck@nefe.org or (303) 224-3504; or Dr. Richman at krichman@nd.edu or (574) 631-8146. We appreciate the opportunity to provide this information.

Sincerely,

Ted Beck

Ted Beck
President and CEO
National Endowment for Financial Education