Written Testimony of C. Robert Henrikson
to the House Education and Workforce Committee

February 25, 2004

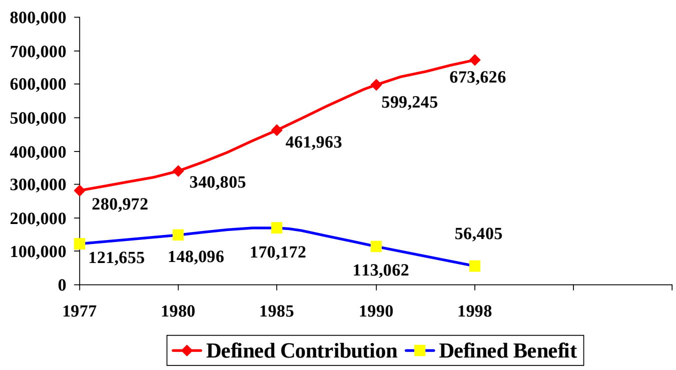
By now most of us are aware that many Americans have not saved enough for retirement. Though there are signs of recovery, the recent stock market decline has added to this problem by wiping out a significant portion of retirement assets. There are other factors at work that are compounding the problem. First, we are living longer than at any time in our nation's history. Second, fewer and fewer people will be able to rely on the security and guarantee of a fixed level of lifetime income afforded by traditional pension plans. The convergence of these factors has created the real possibility that many retirees will outlive their retirement assets or needlessly adjust their lifestyles and standard of living.

To better understand the magnitude of the problem we face, we will begin with a discussion of the demographic and market forces that have gotten us to this point. We'll highlight research results that speak to people's overall retirement preparedness and review some of the risks that are unique to retirees. And finally, we'll describe in some detail one important solution to the need for lifetime retirement income - - annuities.

The Impending Retirement Crisis

The looming crisis facing us today is not one that happened overnight. We have slowly been evolving to this point over the last 20 years as the burden of saving for retirement has been steadily shifting to the individual. Over that time the number of defined contribution plans (DC) plans, such as 401(k)s, has been accelerating rapidly while the number of defined benefit programs (DB), with their guarantee of lifetime income, has been steadily decreasing.

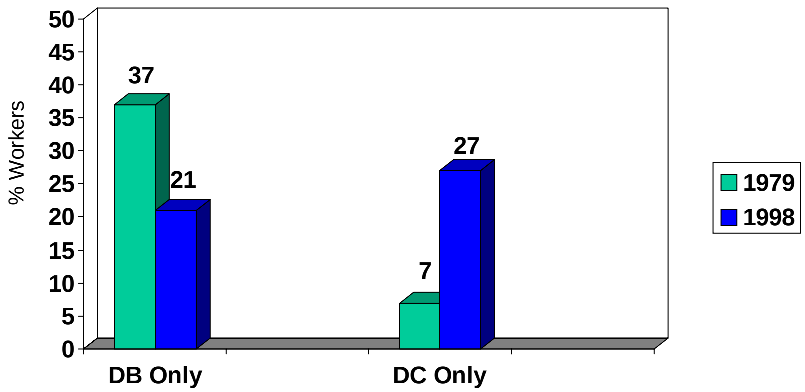
Number of Defined Contribution
&
Defined Benefit Plans
1977-1998



Source:Department of Labor

In the period 1979 to 1998, the Department of Labor reported that the percentage of workers who participated in a primary defined benefit plan fell by 16 percentage points while the percentage participating in a primary defined contribution rose by 20 percentage points.

Worker Participation
by
Plan Type
1979 vs. 1998

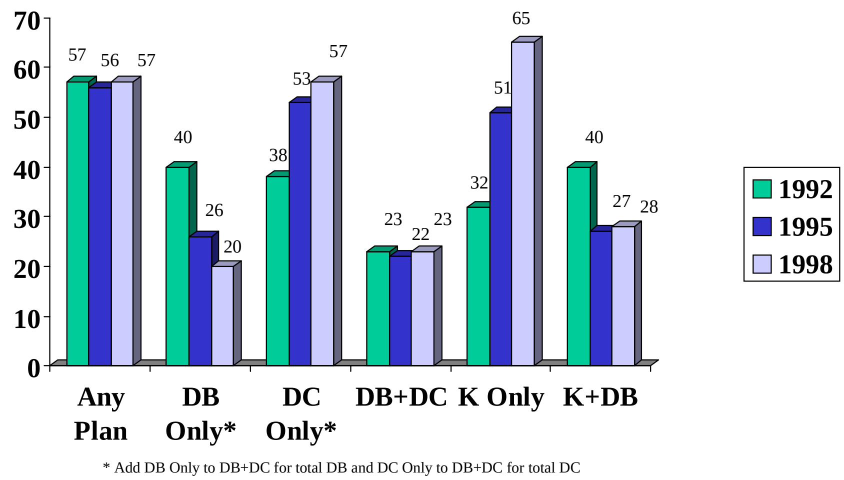


Source: Department of Labor; GAO report on private pensions July 2003

Today, only 23 million workers are covered by a traditional pension plan, with half of those plans allowing employees to take their distribution in a lump sum rather than as a lifetime monthly check. We believe that this movement away from traditional pension plans will have a significant adverse impact on individuals' retirement security, especially for the Baby Boom generation.

The shift away from traditional defined benefit plans has put increasing pressure on retirement savings plans such as 401(k)s to be the primary source of retirement income. With it comes a tremendous challenge for our citizens as they are being asked to determine on their own **how much** to save, **how to invest** that money wisely and **how to prudently draw down** their savings so they are not depleted prematurely.

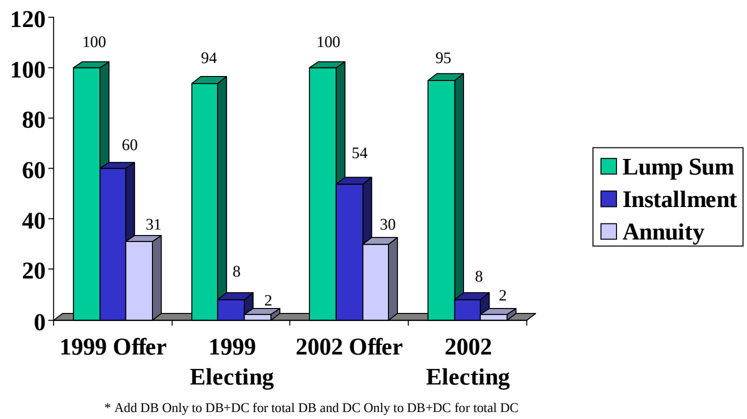
Percentage of Families with Pension Coverage Through a Current Job that Participated



Source: EBRI Analysis of 1992,1995 and 1998 Survey of Consumer Finances

So what choices are people making at the point of retirement? In its report on private pensions, the General Accounting Office (GAO) analyzed the types of pay-out workers actually received at retirement from defined benefit and defined contribution plans. The analysis covered the period 1992-2000. They found that retirees in greater numbers are selecting benefits in a form other than a guaranteed lifetime payment (i.e., annuities). An increasing proportion of more recent retirees chose to directly roll over lump sum benefits into an IRA or to leave their assets in the plan. Between 1992-1994 retirees choosing either of these options represented about 32% but grew to 47% by 1998-2000. Clearly, much of this can be explained by the shift toward defined contribution plans, less than one-third of which offer an annuity option. But the report went on to state that a growing percentage of retirees who reported having a choice among benefit pay-out options chose pay-outs other than annuities. An analysis conducted by the Employee Benefit Research Institute (EBRI) would support the GAO findings:

Payment Forms and Selection



Source: EBRI Analysis of 1992,1995 and 1998 Survey of Consumer Finances

All indications are that when given the choice to replicate the benefit provided by a traditional pension - i.e., an annuity, few individuals are making that choice.

We applaud the Committee for introducing defined benefit plan reforms that will help to maintain and perhaps even reverse the decline of these plans. In particular, 30-year Treasury interest rate relief is desperately needed today, as many defined benefit plan sponsors are now freezing or terminating their plans because they cannot meet funding requirements. Beyond that, more fundamental DB funding reforms must be put in place to ensure responsible funding of these plans while preserving employers' flexibility to make additional contributions during profitable periods. We encourage Congress to pass legislation on these issues and others quickly so that we can maintain the viability of these critical retirement income plans.

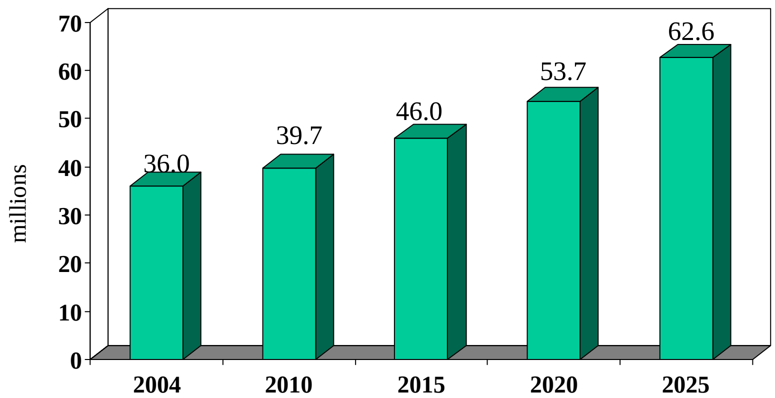
Given the clear trend away from traditional pensions, people are largely left to rely on programs such as 401(k) plans that do not provide the same guarantee of benefits. They will be left on their own to replicate the security previously provided by defined benefit plans - - security that was created by teams of actuaries, pension experts, investment professionals, benefit consultants, accountants, attorneys and by the government through the protection offered by the Pension Benefit Guaranty Corporation. Stripped of this expertise and protection, today's employees need our help.

Consumer Preparedness

With continued increases in life expectancy, the continuing shift from employer managed and funded traditional pension plans to individually controlled defined contribution plans, and the financial challenges faced by government supported programs, we are entering a period of great risk with regard to retirement security. This triple threat is magnified exponentially when you factor in that the 36 million Americans over the age of 65 will grow to 62 million 20 years from now. With its projected growth, the 65+ segment of our society will represent 20% of the population (compared to 12% today). Furthermore, Cerulli

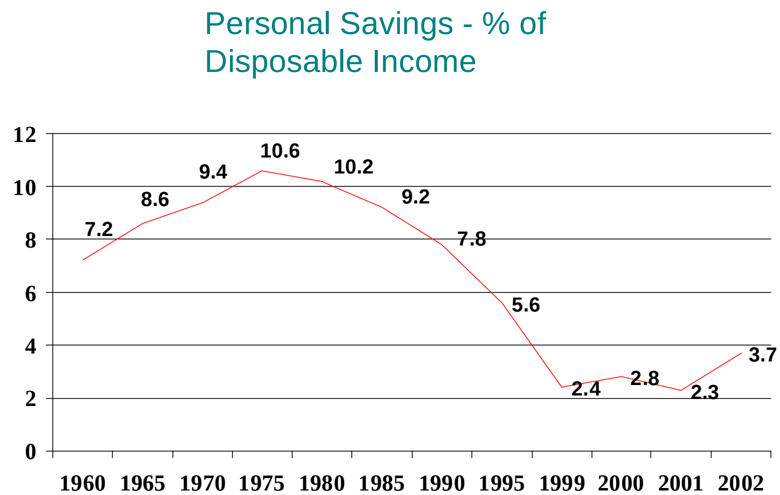
Associates estimates that 25% of current 401(k) participants will retire by 2015. If that sounds far off, consider that the first Baby Boomers will reach the traditional retirement age of 65 in 2011.

The 65+ Population is Growing Rapidly



Source: U.S. Census Bureau

So how prepared for retirement are these millions of people? The savings rate in the country remains low. Though the rate increased by approximately one and a half percent between 2001 and 2002, the fact remains that the personal savings rate in our country is one of the lowest among the industrialized nations.



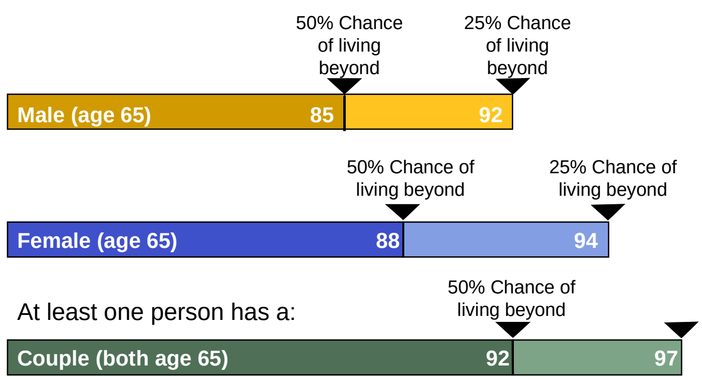
Source: Dept. of Commerce, Bureau of Economic Analysis, June 2003

In January of 2002, EBRI released its Retirement Risk Survey. When the accumulated savings and investments for retirees and pre-retirees were compared, the results were similar:

- Almost three in ten (28%) say they have saved less than $50,000.
- Between one and two in ten report having saved $50,000-$99,999 (12% of retirees and 17% of pre-retirees).
- Roughly two in ten claimed to have saved between $100,000 and $250,000 (20% of retirees and 24% of pre-retirees).

Last June, MetLife created the Retirement Income IQ. 1200 men and women between 56 and 65 years of age and within five years of retiring were asked 15 questions to assess their level of retirement preparedness. 95% of the respondents scored 60% or less; the average score was 33 on a grading scale of 100 points. Perhaps most disturbing was the misunderstanding surrounding how long people will live. A 65 year-old man has a 50% chance of living beyond his average life expectancy. That's what average life expectancy means - about half the population will live past that point and the other half won't. Yet when we posed that question to 1200 individuals, the majority of them thought there was only a 25% or less likelihood of living beyond average life expectancy. Only 16% of respondents replied correctly that a couple consisting of a 65 year-old man and woman have a 25% chance that one of them will live beyond age 97.

People Underestimate the Time Spent in Retirement



When you combine underestimating longevity with other findings, the picture gets even more unsettling. Respondents also *underestimated* how much money experts recommend they need for retirement and they *overestimated* the rate at which experts recommend they can safely withdraw from savings to help make their money last throughout their retirement. Over one-third believe they can safely withdraw 7% from their savings annually, even though planning professionals suggest limiting annual withdrawals to no more than 4%.

Our findings from the Retirement Income IQ are corroborated by many other industry studies. EBRI's 2003 Retirement Confidence Survey asserts that little more than one-third (37%) of workers have even done a basic retirement calculation. Other results of note from this survey include:

- One-third of respondents are not confident of having enough money to live comfortably in retirement (up from 29% in 2002).
- The percentage of those who are not at all confident of having enough money to meet basic expenses in retirement jumped from 6% in 2002 to 11% in 2003.
- Almost one-half (49%) believe they will need less than seventy percent of their pre-retirement income while retired.
- 71% of all workers have given little or no thought as to how they will manage their money in retirement so that it doesn't run out.

MetLife's 2003 Employee Benefits Trend Study found that nearly half of workers rank "outliving their assets" as their greatest fear. Among employees in the 41 to 60 age group, only 4% have reportedly reached their goals. What's worse is that employers are signaling less intent to offer retirement planning and 401(k) investment education in the future. Other results from the survey of note include:

- More than half (52%) of all those surveyed report that they manage their finances by living paycheck-to-paycheck. 51% of those in the 61 to 69 age cohort responded accordingly.

- Less than one-third (30%) of those surveyed are confident in their ability to make the right financial decisions for themselves and their families. One-quarter have done no specific financial planning.
- Lack of retirement planning explains why more than one-third (39%) of employees cannot estimate their annual income needs for retirement and do not know how many years they need to plan for living beyond retirement (44%).

Survey results are very enlightening but we sometimes tend to forget that there are real people with real concerns behind the numbers. We have all heard or read disheartening stories about retirees losing their entire life savings and, where possible, returning to work in order to make ends meet. It is also not uncommon to see retirees needlessly adjusting their lifestyle for fear of running out of money in retirement. They spend too little, often denying themselves many of the things they had planned to do or buy in their Golden Years. Following are a few quotes taken from a number of focus groups MetLife has conducted surrounding this issue of retirement security:

- "I would say no, I don't have a plan. I don't sit down on a monthly basis and see what I have spent and where it's going…I don't plan for the future" (female worker, New York)
- "I don't know but that is a fear of mine. I fear that I will become a burden" (female retiree in Tampa when asked how she plans to not run out of money)
- "I'd get a job at Wal-Mart as a greeter" (female pre-retiree in Tampa when asked what she would do if she started running out of money in retirement)

- “I never even figured that out” (male retiree in Tampa when asked what his monthly expenses were)
- “Those are questions you don’t deal with…you block them out” (female worker in New York when asked how long she thought she would live)

What is the answer? Individuals must receive better retirement planning education. MetLife believes the most effective delivery mechanism for that education is in the workplace. Beyond that, we believe individuals must receive investment advice so they understand how to maximize their retirement dollars. Our 2001 Retirement Crossroads study found that retirees who received retirement education and investment advice were more satisfied in retirement than those who did not. MetLife believes that H.R. 1000 takes an important step in ensuring that individuals receive the investment advice they need to succeed. We also support the provision contained in the bill that would allow employees to set aside pre-tax money to pay for retirement planning services. This is another important step in encouraging individuals to seek the critical retirement planning services they need.

We also need to shift the conversation from retirement *assets* to focus on retirement *income* and offer tools to make this happen. Even those who have built a relatively large nest egg do not know how much income that nest egg will produce throughout their retirement. In short, Americans don’t know what their savings are really worth.

Risks in Retirement

Once they reach retirement, there are certain risks people face that they did not have to confront during their working years.

In its Retirement Risk Survey, EBRI reports that the biggest financial concern for retirees and pre-retirees alike is **inflation**.

Income Required to Keep Pace With Inflation

Based on 3.5% rate

Over half of retirees and nearly two-thirds of pre-retirees are *very* or *somewhat* concerned that they will not be able to maintain the value of their savings and investments relative to inflation. In addition, pre-retirees expressed a greater concern than retirees over the possibility of not having enough money to pay for good health care (58% of pre-retirees are *very* or *somewhat* concerned as opposed to 43% of retirees). Pre-retirees are also more concerned with their ability to pay for quality nursing care.

Market volatility is another risk that can have a unique impact on retirees. Recent stock market experience has taught us all how quickly and how adversely our savings can be affected when exposed to a bear market. But for people who are still saving they have the benefit of time on their side and have a reasonable expectation of seeing their assets return to or even surpass pre-downturn levels. But for retirees, market downturns, especially early on in their retirement years, can have a devastating impact.

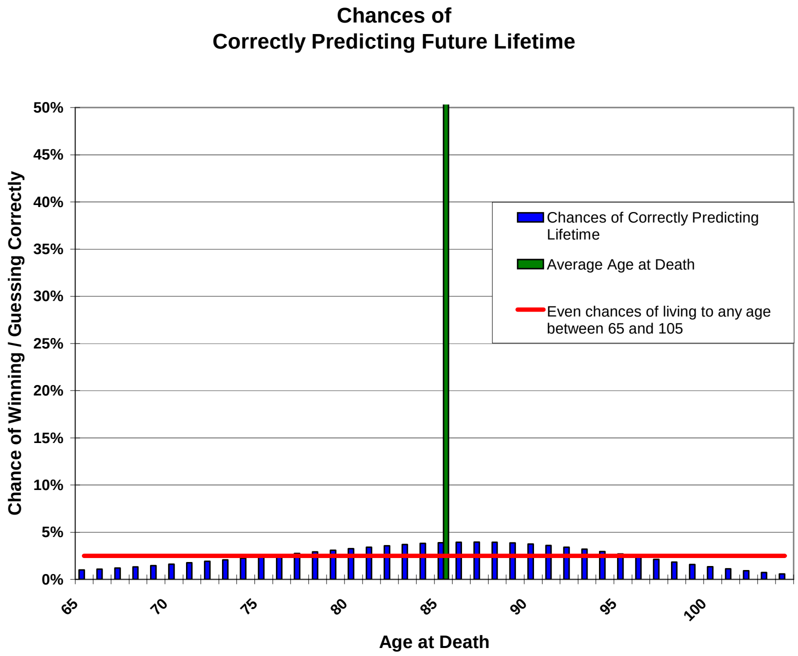
Too often people rely on averages and base their planning (if any) on the assumption that their account will return the average. They research the historical market returns, plan to withdraw an amount less than the historical average return and then feel confident their money will last them well into their retirement years. However, a market downturn in retirement can have a much greater impact on a retiree's nest egg if they are taking withdrawals than if they are simply saving and still have time to recover from any stock market losses. Using average returns while planning is dangerous because the market does not earn averages in any given year and once you withdraw in a down market, you realize losses never to be recovered.

But the biggest risk facing retirees is **longevity.** An earlier graph illustrated the average life expectancies for males, females and couples. When we have shared these statistics with consumers most expressed shock and some even disbelief. But the numbers are accurate and as we continue to make advances in medicine and adopt healthier, more active lifestyles the chances are the life expectancy tables will stretch out longer.

The reason we believe longevity is the greatest retirement risk we face is because it is the only one an individual cannot manage on his or her own. Market risk can be alleviated somewhat through asset allocation and inflation risk can be addressed by investing in growth equities. But longevity risk only serves to exacerbate these other two risks by increasing the length of time an individual is exposed to them.

Managing Longevity Risk

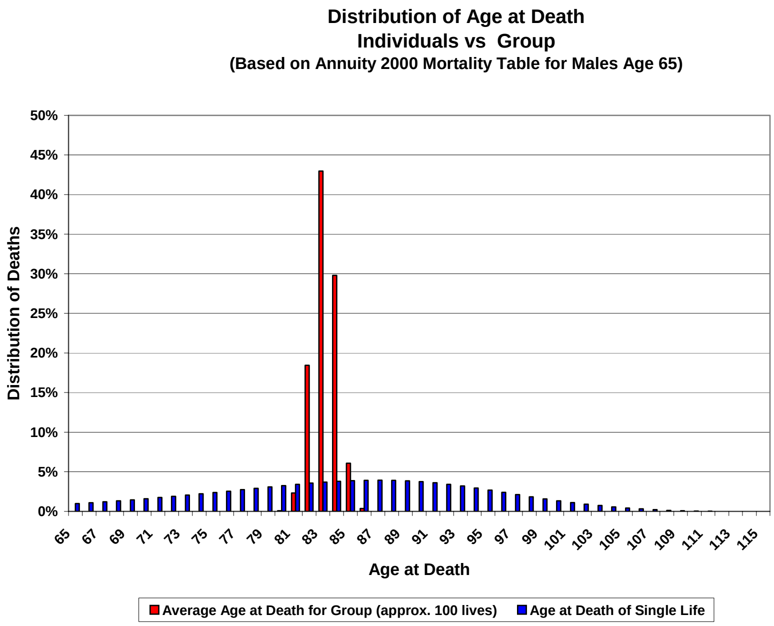
How long one individual will live is extremely uncertain. The following graph, which was prepared by MetLife, shows that the chances are close to a sweepstakes in which you pick a number between 1 and 40 (the red line).



If you choose age 85 you have even odds of not outliving your assets. In order to get 10 to 1 in your favor you must choose age 97 and live on a lot less. People can take a guess as to how long they are going to live…plan so that their retirement assets last the right amount of time…and then pray that they haven't underestimated their life expectancy. But there is a better way than trying to win at life expectancy roulette. Join a mortality pool and ensure that you will not outlive your assets.

The pooling concept is a powerful one that's at the heart of all insurance products (as well as the mortality element within defined benefit plans). Individuals cannot self-insure the risk of outliving their money because they cannot accurately predict how long they will live. Longevity creates a much smaller risk for large defined benefit pension plan sponsors since the "law of large numbers" permits them to fund for the average life expectancy of the entire group of retirees. When a large group of retirees are pooled together, the retiree who lives a long time is offset by the retiree who dies early. The following chart, also prepared by

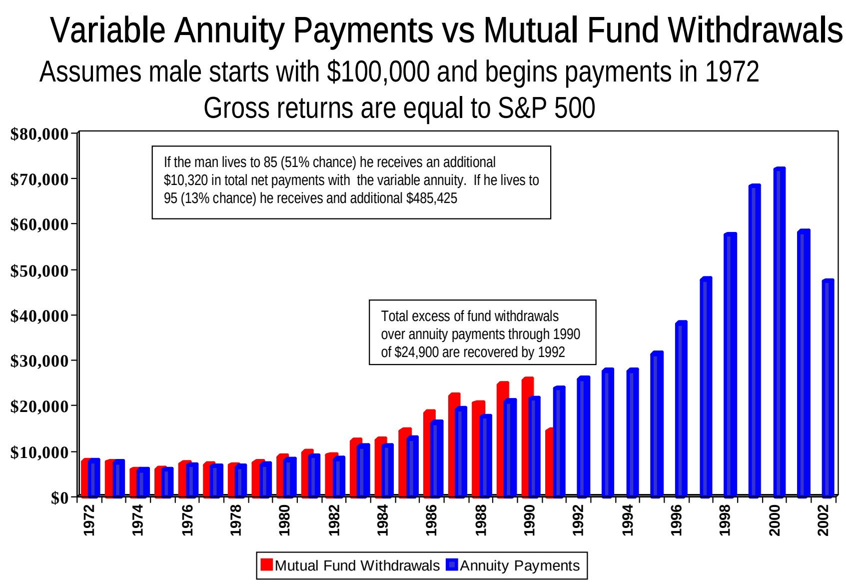
MetLife, depicts how by pooling even a small group of slightly over 100 individuals, the uncertainty of the age at death **on average** for the entire group is greatly reduced.



The longevity risk faced by an individual retiree is comparable in magnitude, but not in nature, to the investment risk that he or she faces at retirement. Whereas an individual can decrease his investment risk by changing his investment strategy, there is no way that an individual can, on his own, reduce his longevity risk. The only way that an individual can manage this risk is by converting his savings to an annuity. Annuities, like a large plan sponsor, use the averaging effect created by pooling together the mortality experience of a large number of annuitants. Through annuities, a retiree can manage longevity risk and may choose to keep some portion of investment risk (along with its potential return) through a variable income annuity. Or a retiree can manage both longevity and investment risk with a fixed income annuity. An income annuity, also known as an immediate or payout annuity, is an insurance product that converts a sum of money into a stream of income that is guaranteed to last throughout the lifetime of the policyholder. It is, in effect, a personal pension plan and it works because the insurance company pools the lives of many individuals.

<u>The Value of Annuities</u>

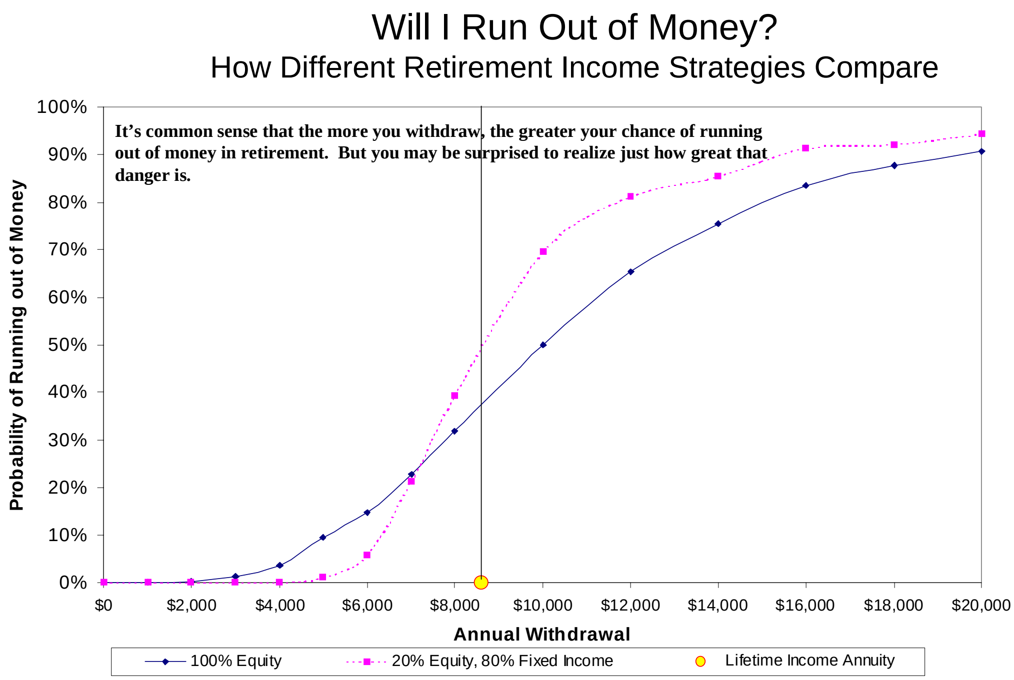
The core value of an annuity is its guarantee of lifetime income. To demonstrate this benefit, we compared it to another popular method of generating income in retirement -- systematic withdrawals from an investment portfolio.



Annual fund withdrawals are equal to annuity payments made before the reduction of a 95 basis point separate account fee. Other charges and expenses apply to a continued investment in mutual funds and annuities. If these charges and expenses and applicable taxes had been factored into the above example, the value of the payments would be reduced. Opening balance of the IRA mutual fund account is $100,000 with returns equal to those of the S&P 500. Annuity payments are based on an initial purchase amount of $100,000 for a single life male age 65 and assume a 100% variable option using an AIR of 4% and investment returns equal to those of the S&P500. Should the annuitant die before age 84 in this hypothetical example, annuity payments would cease whereas the balance in the mutual fund would pass to the accountholder's beneficiary or estate. Certain income or lump sum options are available for designated beneficiaries of annuity contracts. Costs for these options will reduce income payments to the annuity holder. The above example is hypothetical and does not represent the income stream of any MetLife product. Actual income will fluctuate and there is no guarantee they will increase in value. Past performance is not a guarantee of future results.

The graph compares the results of systematic withdrawals from a fund with an opening balance of $100,000 versus a variable immediate annuity purchased with this same amount. The fund withdrawal is equal to the payments generated from the annuity before the reduction of the fees associated with the annuity. We assume the return on both the fund and the annuity is equal to the S&P 500 and the payments and withdrawals started in 1972. The fund would have been depleted by 1991 (age 84 in this example), whereas the annuity will continue income payments for as long as the annuity owner lives. Considering that a 65 year old man has more than a 50% chance of living beyond this age, there is a very good chance that he will run out of money without an annuity.

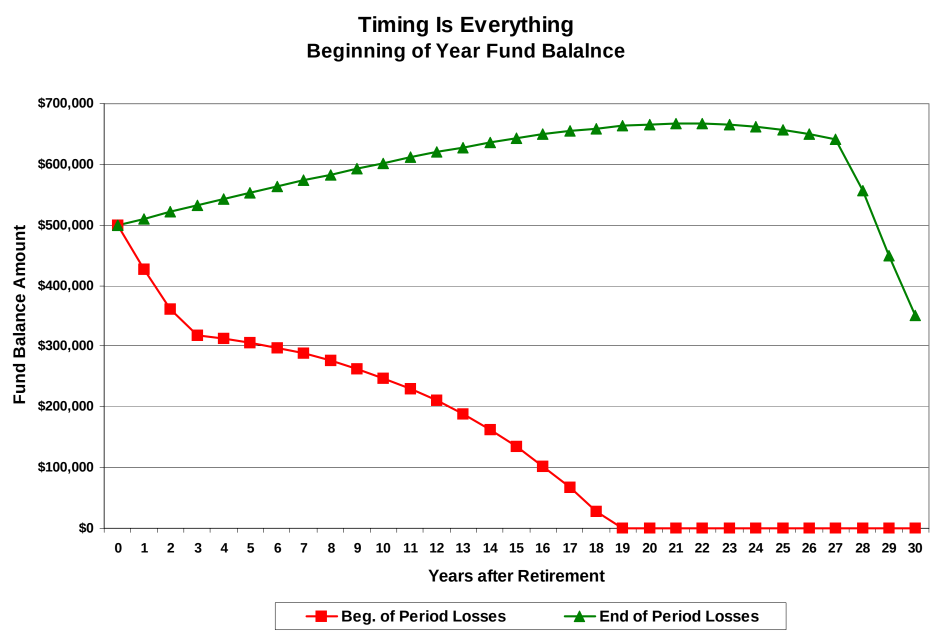
We have seen enough evidence, factual and anecdotal, that people are concerned about running out of money and are looking for strategies to minimize this risk. The following graph, prepared by MetLife, compares different strategies and measures the probability of running out of money. It compares two strategies involving a $100,000 investment. In the first strategy the entire amount is allocated to equity funds and in the other, the allocation is 20% to equities and 80% in fixed income. If you withdraw $8,600 each year, there is a 38% and 48% chance respectively of running out of money. If the withdrawal amount is raised to $10,000 those probabilities jump to 50% and 70%. That same $100,000 would purchase a fixed income annuity that guarantees an annual payment of approximately $8,600 for the rest of your life.



Lifetime fixed income annuity for a male age 65, purchased at $100,000 with assumed 6% interest rate. Equity returns normally distributed, with 10% mean average return and 20% standard dev. Fixed income account normally distributed, with mean return 6% and standard dev. 5%. Combined equity/fixed income is assumed constantly instantaneously rebalanced. Mortality table: Annuity 2000 male (no projection).

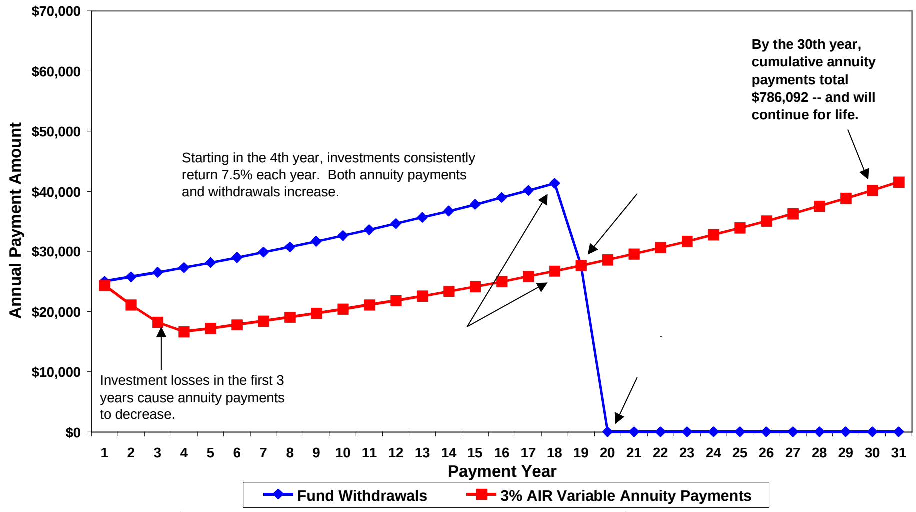
On January 4, 2004 the New York Times ran an article entitled "For Boomers Near Retirement, Toolboxes Aplenty". The gist of the article dealt with the wave of sophisticated online financial calculators intended to help investors solve the often confusing problems involved in building a nest egg and then safely consuming it. The article discussed the long-term impact of just a few years of negative returns early into retirement. To illustrate this point, it contained a graph entitled "Timing is Everything" that shows how a $500,000 retirement account that has losses in the first few years of retirement will run out of money faster than one with the same losses in later years.

In this example, one account has losses of 10 percent in the first two years and 5 percent in the third year. The other account has losses of 5,10 and 10 percent in the last three years. Both accounts have annual returns of 7.5 percent in every year in which they do not have losses. In both, $25,000 is taken out in the first year, increasing by 3 percent each year to account for inflation. The graph from the article is duplicated below.



We thought it would be interesting to see how a variable income annuity would behave given the same performance assumptions. We assumed that the $500,000 was used to purchase an annuity with a 3% Assumed Investment Return for a fifty-five year old man and we then plotted the resulting annuity payments against the fund withdrawals where the losses occur early.

The Lifetime Income Advantage:
How Early Losses in Retirement Affect Fund Withdrawals and Annuity Payments



Opening balance for mutual fund is $500,000. Withdrawals are assumed to be taken at the beginning of each year, starting at $25,000 and increasing each year thereafter by 3%. Annuity payments are based on a $500,000 purchase payment for an immediate life income annuity with an AIR of 3%, with annual payments at the beginning of each year. The annuity is assumed purchased at the beginning of the period, by a male annuitant aged 55. Mortality is based on 75% of the GAM94 Basic Male Table, with mortality improvement to 2004 and thereafter based on Projection Scale AA for males. * Based on Annuity 2000 Mortality Assumptions.

Clearly, the real benefit to the annuity is seen in this scenario. Even though the returns bounced back to a constant 7.5 percent in years 4 and later, the early losses coupled with the withdrawals result in the fund balance being depleted in the twentieth year. Keep in mind this individual would be 75 years of age with every expectation of living another 10 to 15 years. On the other hand, the annuity keeps on generating income payments even though the losses in the early years caused its payments to decrease initially and lag behind the fund withdrawals.

The conclusion is that fund withdrawals during a down market significantly increase the risk of outliving your income by locking in your losses. But with a variable income annuity, losses are not irreversible - - payments bounce back when the market does and bring with them the valuable benefit of continuing for life.

The Outlook

We believe annuities can be an important part of the solution to helping people secure guaranteed lifetime income in retirement. Market research indicates that there is greater receptivity to annuities once their benefits are explained. Furthermore, we are beginning to see more in the way of innovative product design that is intended to meet the needs of today's retirees. For example, we are seeing more products offer liquidity options that allow purchasers to access money in an emergency. In addition, products are offering features (such as, more investment choices, transfers and rebalancing) that provide individuals with the flexibility and control that they are used to seeing within their 401(k) plans.

H.R. 1776 takes an important step in educating individuals about the value of income annuities by including a limited income tax exclusion for retirement plan distributions taken in the form of annuity payments. The bill also contains an important fiduciary safe harbor for employers that offer a specific annuity or IRA at the time of distribution, which will encourage employers to offer annuities to 401(k) plan participants. We believe that a concentrated effort to educate consumers on the benefits of annuities, coupled with the legislative proposals now in Congress will go a long way in helping us meet and overcome the retirement crisis facing the country.