From the Editor

CAT FOOD OR CAVIAR

It is looking as if a lot of Baby Boomers may need to develop a taste for cat food in their golden years. The stock market is down, only 50 percent of private sector workers participate in a retirement plan, the average 401(k) account will be enough to cover only three years of retirement and one-third of workers admit they have not saved a penny toward retirement. Nor is Social Security a reliable safety net: even in its present form, benefits will replace just half of pre-retirement income for low to moderately compensated workers and substantially less for more highly compensated employees. Clearly, we have a problem.

How did we get into this mess? The U.S. retirement system is based on the proverbial three-legged stool—voluntary employer sponsored retirement plans, Social Security, and individual savings. Starting with the Korean War and through the 1980s, defined benefit (DB) plans were the retirement vehicle of choice for most employers. DBs assured employees a steady, predictable stream of income for life, while eliminating the danger they would outlive their money. Moreover, since funding and investment decisions were handled by the employer, workers needed little financial know-how or discipline.

As evidenced by the relatively lower poverty rates among the elderly, that system worked reasonably well for most of the second half of the twentieth century. Even given periods of high inflation and growing life expectancy, the typical retiree could count on combined Social Security and pension benefits replacing fully 60 percent of pre-retirement income. Since most economists estimate that a person needs to replace about 75 percent of preretirement income to be financially secure, that meant the average worker needed to make up only about 15 percent of previous earnings through personal savings.

However, the advent of the 401(k) plan in 1981 radically altered the retirement landscape. Congress intended 401(k) plans as an easy, tax effective means for workers to set aside additional funds toward their golden years—thereby strengthening the third, individual savings leg of the retirement stool. Unfortunately, the 401(k) instead became the retirement vehicle of choice and traditional defined benefit plans began a slow but steady decline. Whereas in 1980, 64 percent of employer and employee retirement contributions went into DB plans, less than 20 years later the number had fallen to 15 percent. One can debate (and a future editorial will cover) whether the demise of DBs was caused by a more mobile work force that prefers flexibility, portability and control over their retirement assets; employers' desire to reduce benefit costs; governmental over-regulation; or all of the above.

Whatever the reason, the result is that workers retiring today typically can count on Social Security and company-sponsored retirement benefits to replace only about half their pre-retirement income and economists expect that percentage to decline further over the next twenty years. Accordingly, in order to

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live in the style to which they are accustomed after they retire, future retirees must make up that difference from personal savings.

Yet despite the clear need to be responsible for a bigger share of their retirement burden, the overwhelming evidence is that most workers are not facing up to that challenge. It is estimated that less than a third of employees have even attempted to calculate how much money they will need for a secure retirement, or have set aside any money toward retirement.

Department of Labor statistics indicate that even workers in their late fifties and early sixties—people in their prime saving years who had the advantage of a 20-year bull stock market--have an average balance in their 401(k) plans of only $57,000. That is enough to cover perhaps two to three years of retirement expenses. In fact, according to a study released by the Economic Policy Institute in May 2002 many "pre-retirees" (workers age 45 or older) actually experienced a decrease in retirement wealth between 1983 and 1998--and that's *before* the bear stock market took effect.

Aware of this looming problem, many employers have taken steps to help. Over 38 percent of companies that maintain a 401k plan also offer general investment education, covering such topics as the need to save and investment basics. (The percentage is much higher if investment questionnaires, retirement calculators and other materials in the typical enrollment kit are counted.) Finding such programs insufficient, recently some companies have established more in-depth, sophisticated investment education programs. And as Bill Schmidt's insightful article in this issue details, a recent Department of Labor interpretation makes it easier for fund managers to offer plan participants actual investment advice.

But the problems go beyond employees' inadequate savings and lack of investment acumen. According to a Society of Actuaries' study released this year, both retirees and pre-retirees display a surprising level of ignorance about the three primary risks to their future financial well being namely: inflation, outliving their savings and health and custodial care. Many individuals underestimate such critical factors as their life expectancy and the real costs of long term care. Such ignorance leads both to undersaving during their working years and possible overspending in the early part of retirement. Combine the demise of DBs, low savings rates, and financial ignorance, and many workers are in for a rough retirement.

All in all, the Government, media and investment community have failed to effectively educate and prepare employees for a financially secure retirement. By default, employers need to shoulder even more of the burden of closing the ignorance gap and convincing employees of the need to save *and* to plan for their retirement. Naturally, employers are by no means legally obligated to provide a comfortable retirement for their employees, let alone make sure they have access to financial planning. Many employers may be reluctant to assume this task, in part because it may highlight the deficiencies of their own retirement program. But doing nothing will seriously undermine company morale as employees nearing retirement face the specter of financial insecurity or witness the financial misery of retired coworkers. Since employees are clearly not doing the job

themselves, employers must jump into the fray. In the long run, employees will appreciate their employers' efforts.

We are confronted with a serious social problem. As benefit professionals we can and should do a far better job of encouraging our clients to take a more active role in helping their employees to realistically plan for their long term financial needs. Aside from Social Security, our retirement system is voluntary. While employees can't be forced to save and plan for retirement, financial education at least will increase the odds that future retirees will be able to meet their basic economic needs.

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