

Testimony on Lifetime Income Issues
Joint Hearing before the U.S. Department of Labor (EBSA) and the U.S. Treasury Department (IRS)
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Good afternoon, my name is Edmund Murphy, and I lead the defined contribution workplace savings business for Putnam Investments in Boston Massachusetts. Thank you for inviting us to testify.

I want to begin by applauding regulators and policy-makers in Congress for the continued emphasis we're seeing on vitally important retirement security issues, notably the recently introduced legislation to provide automatic IRA coverage for millions more American workers – which we strongly support -- and this hearing itself, which reflects the very timely focus by DOL and Treasury on lifetime income policy issues.

At Putnam, we believe that providing for future income is the prime rationale for all forms of tax-deferred retirement savings, notably defined contribution plans, which have become the primary source of most American workers' future retirement income.

Yet this central goal – lifetime income – which was a key focus of most defined benefit plans -- has too often been obscured by an emphasis in most defined contribution plans on total account balances, asset allocation and investment options. These are all important metrics – and should be readily available to workplace savers. But we believe that the primary focus – or framing -- of workplace savings should change to emphasize the true goal workers are aiming for: lifetime income.

Workers should be enabled to see their job-based retirement savings plan through a “lens” that offers them a clear understanding of their account's potential for generating reliable income for life. They should also be enabled to understand – intuitively – the actions they can take to increase their retirement income potential and the cost-benefit trade-offs of taking such actions.

With those ends in mind, Putnam this January introduced a new Lifetime IncomeSM Analysis Tool. that sponsors of the workplace savings plans we administer can use with their participants.

This online tool provides workplace savers a new – and very different experience. It shows them – as the first information displayed – an estimate of their projected monthly retirement income needs – expressed in current dollars – compared with the potential monthly retirement income they are on track to create in their workplace savings plan based on current balances, their current deferral rates and asset allocation choices and their projected retirement date.

The tool thus enables plan participants to get a sense of whether they are on track to maintain their current lifestyle once they stop working – or will likely fall short. To make the analysis richer, the tool also allows participants to include projected Social Security income in these estimates, factor in other non-plan financial assets such as bank CD's or Individual Retirement Account balances and calculate how these flows and assets impact their potential income at retirement age. Participants can also see – clearly – how much of their future income will derive from any matching funds their employer may provide – a feature that makes this often invisible benefit highly visible.

Most importantly, the tool has a bias for action. That is because it has three sliding tabs that enable participants to alter their deferral rates or their projected retirement age or their asset allocation mix – and immediately see the impact of that change – measured in terms of future income potential. The tool also suggests a projected “next step” – a prescriptive recommendation on an action most likely to close any income gap their interaction has disclosed. One further click of the mouse and participants can immediately change their current deferral rate, their asset allocation or their projected retirement age.

Through this site's basic design, then, the “lens” through which participants view their workplace savings has been changed – significantly. I would note that traditional balance and asset allocation data is readily available to participants. But that data it is not primary. Instead, a lifelong income planning perspective is the first “view” participants see – along with suggestions for action to close any income gap. They are thus “educated” – persistently and simply – to measure their progress in terms of future income replacement, rather than only by raw asset accumulation.

Putnam's initial experience with this process strongly suggests that this new "view" does, in fact, influence participants' savings behavior. We are actually seeing a phenomenon that few of us in the retirement services world thought we would ever see -- impulse savings.

Preliminary data shows that of participants who visit the web and use the Lifetime Income Analysis Tool (that is, actually move the tabs to model scenarios using the sliders) roughly one third submit a change in deferral rates immediately. Four out of five participants -- over 80% -- choose to lift their savings rates by an average of more than two full percentage points -- from 6.1% before their site visit to 8.6% after. This result is a real breakthrough -- a degree of change that is rare, almost unheard of, from traditional communications and education efforts. It suggests that if you give participants a clear, easy-to-act-on understanding of the trade-off between higher deferrals today and higher income in retirement -- many of them will act, immediately.

This data comes from analysis of aggregate behavior by plan participants in July and August of this year -- amid sluggish economic growth -- and at a time when some industry surveys showed substantial increases in hardship withdrawals from workplace plans. I would note that the data I've cited reflects behavioral changes we've observed only in connection with participants' voluntary, individual use of the Lifetime Income Planning Tool. Supplemental educational efforts in the workplace -- even just e-mail reminders for participants to check up on their progress -- might well produce even more striking change.

As a veteran of an industry that has struggled for many years to raise deferral rates, I find this initial data on the impact of offering participants a clear, easy-to-act-on "income view" to be very, very encouraging.

To make an income "view" an effective motivator, however, it is vital that financial service providers be permitted to calculate estimated future income potential based not just on current account balances, but on contribution rates and potential asset appreciation to some future retirement age.

Expressing a participant's progress in terms of their account's immediate lifetime income-generating potential could actually undermine confidence and de-motivate savers. Such an approach -- immediately converting current balances into the lifelong annuity income they could purchase right now -- could be perversely discouraging for younger employees with small balances -- and would, in fact, vastly understate the future income potential they are on track to achieve at retirement age.

We believe that participants should have access to full disclosure of the methodologies used in calculating their future income needs, the income potential their savings plan are projected to have at retirement age -- and all other elements that go into providing good faith estimates of how they are faring. We do present this information on our website. We also provide clear disclosure language to ensure that participants understand that there is uncertainty associated with these projections and that it is their responsibility to visit their plan at least annually in order to accommodate changes in the market as well as changes in their own financial situation.

In terms of long-term policy impact, my sense is that participants who learn to interpret their workplace savings through the "lens" of their future income potential will be much more willing as they approach retirement age to consider products and services designed to convert their balances into lifetime income streams. This kind of experience-based "education" can -- and should -- be supplemented over time by traditional communications and information to participants about the benefits and trade-offs inherent in either annuity or non-annuity lifetime income products and strategies.

Regulatory and policy action that encourages financial service providers and plan sponsors to emphasize an "income" view of workplace savings could help speed the adoption of such an approach -- and begin changing workplace savers' mindset about their goals.

We would also support efforts to offer plan sponsors and advisors a strong legal safe harbor for advocating or adopting plan design elements that emphasize a lifetime income "view" or for offering participants education and guidance to appropriate lifetime income products and strategies. Experience with the uptake of key features of the Pension Protection Act of 2006 suggests that with clear legal guidance and safe-harbor protection, effective plan design "best practices" such as auto-enrollment, savings escalation and guidance to qualified default options can spread very swiftly. Absent such protections, progress can be glacial.

Thank you for listening.

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