

RETIREMENT Plan Trends



A benefits update

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White House Announces Initiatives For Retirement Savings

On September 5, President Barack Obama announced new initiatives designed to make it easier for Americans to save for retirement. These new programs, which went into effect immediately, were intended to complement the president's legislative proposals for increasing participation in IRAs and matching retirement savings.

The first initiative expands opportunities for automatic enrollment in 401(k) and other retirement savings plans. To help streamline the process for plan sponsors wishing to adopt automatic enrollment, the IRS will be issuing pre-approved automatic enrollment language that allows employers to add automatic enrollment features to their plans without the need for case-by-case approval. In addition, the Treasury and the IRS will release

a ruling clarifying how 401(k) plan sponsors can automatically increase employee contributions over time, and they will issue guidance to help employers automatically enroll employees in SIMPLE IRA plans.

The second initiative seeks to make it easier for Americans who receive a Federal tax refund to save all or a portion of it. While taxpayers

can already instruct the IRS to directly deposit their refunds and designate a portion to an IRA or other savings vehicle, starting in early 2010, the IRS and the Treasury will allow taxpayers to use their refunds to purchase U.S. savings bonds simply by checking a box on their tax return. The savings bonds will then be mailed directly to the taxpayer.

The third initiative allows workers to convert their unused vacation or other similar paid leave into retirement savings. The Treasury and the IRS will issue two rulings to explain how employers can allow their employees to contribute payments received for unused leave to their 401(k) accounts upon termination of employment. As an alternative, employers will be given the option of making their own

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contributions of these amounts to their employees' 401(k) or other retirement accounts.

The final initiative seeks to help workers and their employers better understand options for tax-favored retirement saving through clear, easy-to-understand language. In particular, education will focus on the advantages of rolling over retirement savings from one tax-advantaged account to another when leaving a job.

In addition to announcing these initiatives, President Obama urged Congress to take legislative action on two proposals: the creation of Automatic IRAs, which would automatically enroll workers without access to employer-sponsored retirement plans in IRAs through payroll deposit contributions at the workplace, and the expansion of the Savers Tax Credit to match half of the retirement savings of low-income families.

The Retirement Of Baby Boomers And Asset Demand

While some economists have warned of a sharp decline in the demand for assets if the baby boom generation begins to sell off stocks and other investments to finance their retirement, a study recently released by the Congressional Budget Office (CBO) has concluded that the effects of asset sales by this generation of Americans are likely to be modest, especially over a longer time frame.

"Will the Demand for Assets Fall When the Baby Boomers Retire?" is part of a series of background papers the CBO produces on the current and projected state of the U.S. economy. The study's authors observed that, over the course of most people's working lives, real income tends to peak in late middle age and then to decline as people enter retirement. According to economic theory, people will smooth their spending over time by accumulating assets during their working

lives, which they will then sell in retirement to cover their living expenses. Generally, economists expect that retirees will sell assets to finance their retirement, while younger and middle-aged workers will buy assets to save for retirement. Thus, as a population ages, the number of retired people selling assets will rise relative to the number of younger, working people purchasing them.

Researchers noted that oldest members of the baby boom generation—those born between 1946 and 1964—turned 62 in 2008, the age of eligibility for retirement benefits under Social Security, thus marking the start of a wave of retirement from the workforce. Given the large number of potential retirees, economists have expressed concern that, if the baby boom generation begins to sell off their assets to pay for retirement, a steep decline in the demand for assets, particularly stocks, could follow. According to the report, economists have predicted that the aging of the baby boomers and later cohorts over the next half century will increase the ratio of older to younger people by 75%, potentially causing a significant decline in the demand for assets.

Indeed, some economists have suggested that the volume of saving by the baby boomers during their working years might already have affected asset markets. According to these studies, the increase in baby boomers' demand for assets during their middle years explains some of the strength of the stock market over the past two decades. Thus, it follows that, "if such an unusually large cohort were to sell its accumulated assets to finance consumption during retirement, the total demand for assets in the economy could fall substantially over several decades, and the prices of those assets could decline as well," the study's authors said.

However, the authors observed, empirical evidence about the behavior of earlier groups of retirees suggests that baby boomers will not sell their accumulated assets shortly after retiring. First, retirees generally are cautious about selling assets to finance consumption out of a concern

that they might need those assets if, for example, they live longer than expected or have higher-than-anticipated medical costs. Second, retirees may wish to retain the ability to pass on wealth to heirs, rather than spending all of their assets in retirement. Finally, wealth in the United States is highly concentrated, with around one-third of the nation's financial assets being held by the wealthiest 1% of the U.S. population. These very wealthy people generally do not spend down major portions of their assets during their lifetimes, preferring instead to leave bequests to the next generation.

Moreover, the study's authors speculated that baby boomers who have lost or spent a significant portion of their retirement assets during the current economic downturn might choose to defer retirement, thus shortening the duration of retirement and reducing the amount of assets they would need to sell off to finance consumption during retirement. However, the aggregate effect of delayed retirement on asset demand might be small if the delays amounted to no more than one or two years. And, while asset demand could be affected if retiring baby boomers sell risky assets, such as corporate stocks, to rebalance their portfolios in favor of safer assets, the evidence appears to show that most investors do not substantially change the composition of their portfolios after retirement.

In addition, researchers pointed out that foreign demand is likely to help sustain the demand for U.S. assets, helping to offset the effects of asset sales by baby boomers in retirement. The authors asserted that this increase in foreign demand will likely be driven by a rising demand from investors in developing nations with emerging economies and relatively young populations.

While the retirement of the baby boomers is not likely to cause a dramatic drop in aggregate demand for assets, several economic studies suggest that the retirement and aging of baby boomers could lead to a temporary decline in asset prices, the study's authors acknowledged. The prediction of a temporary decrease "is based on the studies' theoretical prediction that

the retirement of baby boomers will cause the demand for assets to fall more rapidly than the installed stock of capital will be reduced, causing asset prices to fall while the capital stock adjusts," the authors said. However, they concluded, the empirical evidence "has not revealed much connection between demographic trends and the changes observed in financial markets."

Gender And 401(k) Investment Choices

Gender plays a role in the investment choices made by workers, with a larger fund assortment tending to reduce 401(k) plan participation and contribution levels among women, but tending to increase enrollment and contribution rates among men, according to a study published by the Networks Financial Institute at Indiana University.

"Fund Assortments and 401(k) Plan Participation: The Moderating Effect of Gender" was written by marketing professors Maureen Morrin, Susan Broniarczyk, and J. Jeffrey Inman. As more employers transition from defined benefit to defined contribution retirement plans, the authors said, employees bear a far greater level of responsibility than in the past for their future financial security, which includes making choices about whether to participate in a retirement plan, how much money to invest, and how safe investments should be.

"For many, such decisions are difficult, even daunting," researchers commented. Citing one recent survey showing that fewer than one-fifth of respondents believed they were successfully planning for retirement, they observed that "despite the importance of saving for retirement, many choose not to do so."

In part, the authors speculated, the failure to save for retirement may stem from inadequate knowledge of financial investing or low levels of financial literacy, problems that are particularly evident among women, minorities, and people without a college education. However,



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recent studies have suggested that the decision-making context, such as how 401(k) plans are structured, can also play a role in savings behaviors. For example, efforts have grown in recent years to introduce automatic enrollment and other automated features to defined contribution plans. Despite these efforts, however, most defined contribution plans continue to require employees to take action to enroll. At these companies, as many as one-third of eligible workers choose not to do so. “Thus,” the authors said, “it is of critical importance to better understand the process underlying an individual’s decision to invest in a retirement investment plan.”

According to the report, one aspect of retirement plan design that has been found by a number of studies to influence participation and savings rates has been the size of mutual fund assortments. Generally, offering larger mutual fund assortments in 401(k) plans reduces overall participation rates. To further explore this assertion, the authors addressed the question of whether women are more likely than men to be negatively affected by larger fund assortments in terms of plan participation.

Researchers asked 349 adults, 48% of them women, to complete a retirement investing questionnaire. Respondents were given a booklet that asked them to imagine they were employees of a firm that offered the opportunity to invest in a 401(k) plan. Respondents were given information describing the plan, as well as descriptions of each of the available funds. They were then asked whether they would invest in the plan, how much they would invest, and at what level of risk they would invest. The level of financial literacy of respondents was also measured.

Results showed that 249 of the 349 respondents (71.3%) chose to participate in the plan. Participation was found to increase according to income and age, with wealthier and older respondents showing

a greater interest in saving for retirement. When a large fund assortment (21 funds) was offered, 70.8% of respondents agreed to participate, but when a small assortment (3 funds) was offered, 73.5% said they would join the plan.

According to gender, women’s participation in the plan declined as the fund assortment size increased, from 86.0% when choosing from the small assortment, to 66.1% when choosing from the medium assortment (9 funds), and to 62.5% when choosing from the large assortment. Among men, however, the opposite effect occurred, with participation rates rising from 60.7% when choosing from the small assortment, to 73.3% when choosing from the medium assortment, and to 78.1% when choosing from the large assortment. Similarly, men invested more money when presented with a large assortment of funds, while women invested more when presented with a smaller number of funds.

The authors recommended that plan sponsors consider these gender differences when designing plans, but that they avoid simply paring down fund assortments in an effort to encourage greater participation by women. Instead, they advised employers to be aware of the reasons why women may be less likely to participate in a plan offering a larger number of mutual fund choices. For example, the women respondents reported being less knowledgeable about financial decisions than men, suggesting a potential explanation for why larger fund assortments may discourage women but motivate men. The authors also cited studies that found that women process information differently from men, and that changes in the way in which information about funds is presented, both in written and graphic form, could raise levels of participation among women.



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