SAVING FOR THE 21ST CENTURY: IS AMERICA SAVING ENOUGH TO BE COMPETITIVE IN THE GLOBAL MARKETPLACE?

SENATE FINANCE SUBCOMMITEE ON LONG-TERM GROWTH AND DEBT REDUCTION

APRIL 6, 2006

STATEMENT FOR THE RECORD

SUBMITTED BY:

AMERICAN COUNCIL OF LIFE INSURERS

AMERICAN SOCIETY OF PENSION PROFESSIONALS & ACTUARIES

ASSOCIATION FOR ADVANCED LIFE UNDERWRITING

NATIONAL ASSOCIATION OF INDEPENDENT LIFE BROKERAGE AGENCIES

NATIONAL ASSOCIATION OF INSURANCE AND FINANCIAL ADVISORS

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Senate Committee on Finance
Attn. Editorial and Document Section
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Washington, DC 20510-6200

Dear Chairman Smith and Ranking Member Kerry,

We congratulate both of you for drawing attention to the nation's negative savings rate by holding a hearing in your subcommittee on April 6, 20006, titled "Saving for the 21st Century: Is America Saving Enough to be Competitive in the Global Marketplace?" As the organizations representing the life insurance and employee benefits communities, we believe that Congress should encourage sound public policy that provides efficient ways for working families not only to save, but to manage financial risks and take responsibility for their lifetime financial security.

American workers share a common goal: to create financial protection and security for themselves and their loved ones. But with the changing nature of retirement and declining personal savings, today's workers face an increasing number of risks. Whether it's the financial costs from dying, becoming disabled, having inadequate saving, or outliving savings in retirement, most individuals do not have the resources to manage risk on their own.

Attached, for the hearing record, is a white paper authored by the coalition. It carries the simple message of the importance of personal financial protection and explains how the employer-based retirement system, annuities, life insurance, long-term care insurance, and disability income insurance all are an essential part of any sound financial and retirement strategy. The current employer-provided and individually purchased protection and security products are a success story worthy of safeguarding.

Respectfully,

American Council of Life Insurers (ACLI)
American Society of Pension Professionals & Actuaries (ASPPA)
Association for Advanced Life Underwriting (AALU)
National Association of Independent Life Brokerage Agencies (NAILBA)
National Association of Insurance and Financial Advisors (NAIFA)

Pensions, 401(k)s, and IRAs: Building Retirement Savings

As our national savings rate shows, convincing Americans to save is difficult. Convincing them to save on a long-term basis for retirement is even more of a challenge, especially when retirement may be decades away.

Fortunately, most working Americans have access to an attractive assortment of retirement savings vehicles designed to help them to prepare for retirement. These vehicles include employer-provided retirement plans, such as traditional, defined benefit pensions, profit-sharing plans, and defined contribution plans, including 401(k)s, 403(b)s, and 457s. For workers without access to workplace plans or for those who want to supplement savings, there are individual retirement accounts (IRAs). At least one of these options—an employment-based retirement plan or an IRA—is available to each and every working American.

The flexibility in the current retirement system provides employers—including large and small businesses, schools, and all levels of government—with the flexibility to choose the retirement savings vehicle to best meet its operational and workforce needs. This important flexibility enables employers of all sizes to offer workplace retirement plans to American workers.

Success of the Current System: Over the years, defined benefit plans, defined contribution plans, and IRAs have been incredibly successful in helping Americans build their retirement nest egg. Over 57 percent of the nation's households have retirement savings in one of these vehicles, including 73 percent of retired households.[1] These retirement savings vehicles contain more than $10 trillion, representing 17 percent of the nation's wealth. Importantly, this is a funded pool of assets that helps working Americans afford retirement without the aid of government assistance.[2]

With the decline in traditional defined benefit pension plans, defined contribution plans have become an increasingly important part of retirement security for American workers. Employment-based retirement plans have proven to be the most effective means to get moderate income workers to save. Almost 80 percent of middle income workers making $30,000 to $50,000 participate in employee savings plans.[3]

In recent years, steps have been taken by policy-makers to enhance the current system. Thanks to legislation enacted by Congress, the number of small business workers covered by a workplace retirement plan has increased by more than 20 percent over the last decade.[4] Since 2001, workers have been allowed to contribute more to their defined contribution plans and IRAs, and workers age 50 and older may make additional annual contributions to their defined contribution plan.

Current Tax Treatment: These retirement savings vehicles provide valuable tax incentives to employers and employees to encourage long-term retirement savings. An employer's contribution to workplace retirement plans on behalf of employees is tax deductible.

A worker's contribution is excludable from income and there are no taxes due on earnings until money is withdrawn. Contributions to traditional IRAs are tax-deductible and tax on earnings in all IRAs is deferred.

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[1] Bureau of Labor Statistics, Comparing the Retirement Savings of the Baby Boomers and Other Cohorts. Sharon A. Devaney and Sophia T. Chiremba. January 2005.
[2] Derived from statistics in the 2005 U.S. Statistical Abstract, with the original source of U.S. Bureau of Economic Analysis, Survey of Current Business (Table number 704, Net Stock of Fixed Reproducible Tangible Wealth in Current and Real Dollars)
[3] EBRI, 2003. (This disparity exists notwithstanding likely eligibility for the Saver's Credit.)
[4] Congressional Research Service, Pension Sponsorship and Participation: Summary of Recent Trends. September 10, 2004.

For many moderate income workers, tax deductions and exclusions make it more affordable to save. For lower income workers, an additional retirement savings tax credit (the Saver's Credit) can further reduce their tax bill.

Restrictions and penalties apply for early withdrawal of retirement savings (i.e., before retirement or disability). These restrictions exist as a trade-off for the valuable tax incentives these retirement savings vehicles provide and are designed to help ensure savings remain and grow until workers reach retirement.

Call for Action: The current tax incentives afforded employer-sponsored retirement plans and IRAs are efficient and effective ways for workers to save. The proven track record of these retirement savings vehicles simply cannot be ignored. Maintaining and strengthening the current system is the most effective way to help working Americans achieve the dream of a comfortable retirement. Further steps can—and should—be taken to ensure that more American workers have access to, and take advantage of, retirement savings in the workplace.

Issues and Trends:

- In 2004, 75 percent of employees working for large firms (more than 1,000 employees) were offered a retirement plan; 34 percent of those in small firms (fewer than 100 employees) were offered a plan.[5]
- The number of small business workers covered by a workplace retirement plan has increased by more than 20 percent over the last decade.[6]
- The number of private-sector workers covered by a defined benefit plan decreased from 30.1 million in 1980 to 22.2 mil-lion in 2000—a decline of about 25 percent, while those covered by a defined contribution plan increased from 14.4. million in 1980 to 50.9 million in 2000—an increase of approximately 250 percent over the same period.[7]
- Active participation in 401(k) plans grew from 10 million workers in 1985 to 43 million in 2004.[8]
- More than 8 in 10 eligible workers say they participate in a retirement savings plan at work (82 percent).[9]
- Low- to moderate-income workers are 20 times more likely to save for retirement through a workplace plan.[10]

Annuities: Creating Guaranteed Income for Life

Retirement today requires more planning than in previous generations. Sources of steady retirement income have changed, as fewer and fewer workers are covered by traditional employer-provided pensions that provide a lifetime benefit. In addition, advances in medicine have resulted in increased longevity—today's retirees may spend 20, 30 or more years in retirement.

Given this landscape, workers nearing retirement face an imminent crisis: how to generate a stream of income that is guaranteed to last throughout retirement. Whether workers have access

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[5] EBRI, Issue Brief No. 286, October 2005.
[6] Congressional Research Service, Pension Sponsorship and Participation: Summary of Recent Trends. September 10, 2004.
[7] EBRI, Employment-Based Retirement Plan Participation: Geographic Difference and Trends, 2004.
[8] EBRI/ICI, 401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2004.
[9] EBRI, Encouraging Workers to Save: The 2005 Retirement Confidence Survey. April 2005.
[10] EBRI 2003.

to employment-based retirement plans or not, achieving stable and secure income in retirement is a challenge.

With the decline of defined benefit plans and increased popularity of defined contribution plans, such as 401(k)s, responsibility for managing savings has shifted from the employer to the individual. Unlike traditional pensions that provide a stream of payments to retirees for life, defined contribution plans typically offer a lump sum that the retirees then manage on their own.

Other than Social Security and the defined benefit system, the only means to create a guaranteed income stream in retirement is through an annuity. An annuity is an insurance contract that offers an efficient solution to what otherwise could be an overwhelming asset management task: creating a steady paycheck in retirement that cannot be outlived. Individuals without access to workplace retirement savings plans have an even greater challenge: to independently accumulate savings during their working years and manage those savings in retirement. An annuity can address both of those needs.

Success of the Product: Annuities offer solutions to both sides of the retirement equation: They provide ways to accumulate retirement savings, and then at retirement, to turn savings into an income stream that cannot be outlived.

The lifetime income option through annuitization allows retirees (and their spouses) to maximize retirement income without having to worry about payments stopping while they are alive. At the time of purchase, annuity owners are guaranteed that if they choose to annuitize at a later date, they will receive a benefit based on either the purchase rates at the time the annuity was issued or annuitized—whichever rate is more favorable to the annuity owner. Given the changes that can occur over time with respect to the economy, longevity, or an insurer's costs, this is a valuable consumer benefit.

Many insurers offer additional options-—such as the guaranteed minimum withdrawal benefit, which allow consumers to create and manage income flow to meet various income needs as they age—while still offering guaranteed income for life. Other income options, which do not have a lifetime guarantee, also are available.

Annuities are popular among middle-income Americans: Two-thirds of individual annuity owners have annual household incomes below $75,000; nearly half have household incomes below $50,000; and one-third have annual household incomes below $40,000.[11]

Current Tax Treatment: By encouraging long-term savings during the working years and helping individuals manage assets during retirement, the current tax treatment of annuities promotes financial discipline.

For those who are years away from retirement, or are retired and have assets that don't need to produce income right away, a deferred annuity allows savings to build up, free of current federal income tax. When payments are received, the portion that comes from earnings is taxed as ordinary income.

There are tax penalties for withdrawals from deferred annuities before age 59½, in addition to the income tax due on earnings, to encourage long-term savings for retirement. The tax penalty is not applied to certain lifetime payouts, death benefits, or payments made if an annuitant becomes disabled. Other exceptions may apply.

The current tax treatment has served as an effective savings incentive: 77 percent of individual annuity owners report that they have set aside more for retirement than they would have if the

[11] Committee of Annuity Insurers, 2005 Survey of Owners of Non-Qualified Annuity Contracts. (Conducted by The Gallop Organization and Mathew Greenwald & Associates)

tax-deferred growth of annuities was not available. A large majority cite the tax treatment of annuities as a "very" or "somewhat" important reason for their purchase.[12]

Call to Action: An annuity can help American workers meet the challenges of the changing landscape of retirement. In fact, eight out of 10 individual annuity owners say they will use their annuity savings for retirement income.[13] With the shift from defined benefit to defined contribution plans and increased longevity, policy-makers should explore ways to encourage more Americans to turn to annuities for guaranteed lifetime income.

Issues and Trends:

- Over the past 10 years, contributions to individual annuities have grown 8 percent annually.[14]
- Sixty-six percent of individual annuity owners have household incomes below $75,000; 48 percent have income below $50,000; 34 percent have incomes below $40,000.[15]
- Eight out of 10 annuity owners say they will use their annuity savings for retirement income.[16]
- During 2004, payments into annuities increased 4 percent to $301 billion.[17]
- Americans deposited $172 billion in individual annuities, up 4 percent from 2003.[18]
- Individual annuity owners received $35 billion in benefit payments in 2004.[19]

Life Insurance: Providing Financial Protection

Life insurance is a key component of Americans' ability to take individual responsibility for the financial futures of their families and businesses. It is unique in guaranteeing the delivery of financial security at precisely the moment it is needed, while contributing significantly to the nation's storehouse of savings and investment capital.

A big fear for many American families is the death of a wage-earner or provider, leaving the family unable to cope financially. Life insurance offers peace of mind through immediate financial protection for families and dependents.

Life insurance enables individuals and families from all economic brackets to maintain independence in the face of financial catastrophe, helping relieve pressure on government entitlement programs. For this reason, there has been strong public support for continuation of current tax policy for life insurance products.

By providing tools for self-protection and savings, life insurance is an efficient way to promote personal responsibility and foster less dependence on government programs. A recent survey showed that three-quarters of Americans agree that life insurance is a critical part of a financial plan.[20]

Success of the Product: According to the most recent census, there were approximately 105 million households in the United States. Life insurance data shows that in 2004, there were 167

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[12] *Ibid*.
[13] *Ibid.*
[14] ACLI, Life Insurers Fact Book 2005.
[15] Committee of Annuity Insurers, 2005 Survey of Owners of Non-Qualified Annuity Contracts. (Conducted by The Gallop Organization and Mathew Greenwald & Associates).
[16] Ibid.
[17] ACLI, Life Insurers Fact Book 2005.
[18] *Ibid*.
[19] *Ibid.*
[20] ACLI, Monitoring Attitudes of the Public. 2004.

million individual life insurance policies in force providing $9.7 trillion of protection. Fifty-six percent of the individual life insurance policies issued in 2004 were permanent policies.[21]

Life insurance protects families from financial loss from the death of a loved one. It enables families to pass on more assets from one generation to the next, providing a source of reliable liquid assets when the need arises to pay for death-related expenses or to offset estate tax and inheritance tax liabilities. Very few Americans can self-insure the risk of premature death through their own financial means. Life insurance makes managing this risk affordable through the pooling of risk.

Permanent life insurance has an additional advantage—it is guaranteed to remain in force for one's whole life, regardless of age. By design, the level premiums of permanent insurance are used to both pay for the term cost of a policy's face amount and to create a savings component (cash value), which helps cover the rising cost of insurance as one gets older. If an insured's needs change and death benefit protection becomes less acute, the policy's cash value can be used to pay various expenses, such as those for tuition or long-term care. Or, the cash value can be converted into a retirement income producing annuity that can guarantee regular payments for life or for a specified period of time, an option also available to beneficiaries of life insurance policies. Some policies allow an insured to collect all or part of the death benefit if he or she becomes terminally or chronically ill.

Businesses use permanent life insurance to protect against financial uncertainty and secure their employees' futures. By owning life insurance on key employees, businesses have a secure funding source to pay for important employee and retiree benefits and to protect jobs and families from financial loss and instability that can result from the death of an owner or key employee.

Current Tax Treatment: Policy-makers have long-recognized the important social policy served by encouraging individuals and families to protect themselves against financial risks, rather than depend on government to do so. Since its inception in 1913, the tax code has provided that death benefits—and the cash value in permanent life insurance—are not subject to income tax.

Premiums are paid with after tax dollars—there is no deduction for premiums paid. Earnings on a permanent life insurance policy's cash value are not taxed as long as the policy remains in force. However, if a policyholder gives up his or her insurance protection, earnings in excess of the total premiums paid are subject to tax.

The protection afforded by life insurance is an important societal benefit that public policy has consistently validated. This policy has been reviewed several times over the last century, and each time Congress has chosen to preserve the current tax treatment of permanent life insurance.

Call to Action: The current tax treatment of permanent life insurance encourages individuals, families, and businesses to efficiently manage risk and prepare for long-term financial needs, despite a general environment that focuses more on the short-term. Any changes to public policy must not limit or disadvantage the critical protection only permanent life insurance can provide.

Issues and Trends:

- The financial plans of 69 percent of American families include life insurance.[22]
- These families are covered by life insurance policies and group certificates that provide $18 trillion worth of protection.[23]

[21] ACLI, Life Insurers Fact Book 2005.
[22] Federal Reserve Bulletin, January 2003, "Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances."
[23] ACLI, Life Insurers Fact Book 2005.

- In 2004, there were 167 million individual life insurance policies in force, providing $9.7 trillion in protection.[24]
- Of all the individual policies issued in 2004, 56 percent were permanent insurance policies.[25]
- In 2004, beneficiaries of life insurance policies received $52 billion in death benefits.[26]

Long-Term Care Insurance: Protecting Retirement Savings

Long-term care insurance is a crucial component of retirement planning. It protects retirement savings from being depleted by the steadily growing costs of long-term care, and provides consumers with the dignity of choice by covering a wide range of services in a variety of settings. At the same time, private long-term care insurance eases the burden on public programs.

Many Americans will require long-term care in a nursing home or by an in-home provider. Of those individuals who are currently 65, about 44 percent will use a nursing home at some point. And a sizable percentage will require such services for an extended period of time—with women more at risk than men.[27]

Such care can easily deplete savings or impoverish a family. Since 1990, the price of nursing home care has increased at an average annual rate of 5.8 percent—almost double the overall inflation rate.[28] Today, the cost of a nursing home stay averages nearly $70,000 annually for a private room. Most Americans cannot save enough to cover these high costs on their own. That's where long-term care insurance comes in.

With the aging baby boomers and the increasing cost of care, total spending on nursing home care is expected to more than triple over the next 25 years and to increase more than five-fold in the next 45 years. These increases will place heavy burdens on government programs, and ultimately on taxpayers. Long-term care insurance can protect individuals and families from financial crisis and at the same time alleviate the strain on state and federal budgets.

Success of the Product: Private long-term care insurance is already meeting the needs of millions of Americans every day. Since its introduction to the marketplace in the 1980s, more than 9 million policies have been purchased.[29] In 2003 alone, carriers paid $1.6 billion in long-term care insurance benefits.[30]

Government studies show that people who bought long-term care insurance are glad they did so: claimants typically found it easy to file a claim (70 percent) and an overwhelming majority (86 percent) are satisfied with their policy.[31]

Since its introduction to the marketplace, long-term care insurance has evolved to meet the ranging needs of consumers, covering a variety of services that help individuals receive care inside or outside the home. Today's policies also handle the multifaceted challenges of family caregivers, from easing physical and emotional stress to reducing job disruptions. Hybrid products that link long-term care coverage with life insurance or annuities offer additional options to meet a wide array of financial needs.

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[24] *Ibid*.
[25] *Ibid.*
[26] *Ibid.*
[27] Spillman and Lubitz (2002).
[28] U.S. Department of Labor, Bureau of Labor Statistics.
[29] AHIP, Long-Term Care Insurance in 2002. June 2004.
[30] ACLI tabulation of 2003 NAIC data.
[31] ACLI, Passing the Trust to Private Long-Term Care Insurance. 2003.

Long-term care is available on an individual basis, or through a group plan sponsored by an employer or association. An increasing number of group employers—including the federal government and more than 20 state governments—recognize the importance of long-term care insurance in retirement planning and offer it as part of their employee-benefit packages.

Current Tax Treatment: Long-term care insurance premiums are paid after-tax; a portion of premiums and out-of-pocket expenses may be deducted from federal income taxes as part of medical expenses, but this deduction is severely limited to amounts in excess of 7.5 percent of annual income. Twenty-three states provide either a tax deduction or tax credit for long-term care insurance premiums. Long-term care insurance benefits are not taxable as long as the benefits received do not exceed certain limits.

Call to Action: In 2006, Congress paved the way for the expansion of the highly-successful long-term care partnership program, providing more Americans the opportunity to protect their assets and stay off Medicaid. With rising demand and soaring costs for long-term care services, it is crucial that policy-makers continue to encourage Americans to plan for their future long-term care needs through private-sector solutions, such as long-term care insurance.

Issues and Trends:

- Currently, about 55 percent of those 85 and older require some form of long-term care and about 19 percent of all seniors suffer some degree of chronic impairment.[32]
- By 2050, it is estimated that up to 5.4 million seniors will need the services of a nursing home—the most costly form of long-term care—and another 2.4 million will require home health care.[33]
- More Americans are buying long-term care insurance before age 65. From 1998 to 2002, the average purchasing age in the individual market fell from 72 in 1990 to 60 in 2002. The average age of employees who purchase long-term care insurance in the workplace remained fairly constant at 45 since 1990.[34]
- In 2003, carriers paid $1.6 billion in long-term care insurance benefits.[35]

Disability Income Insurance: Providing Paycheck Protection

A serious illness or injury can harm more than one's health—it can have an impact on an individual's ability to work and pay living expenses. A disability also can disrupt one's retirement planning.

The likelihood of long-term disability for persons between ages 35 and 65 is quite high—about 45 percent.[36] In the event of a serious illness or injury, the benefit from employer and government programs—such as sick leave, short-term disability, and Social Security—may not be enough to meet all of one's financial needs. Disability income insurance provides critical income protection for working-age people who are unable to work due to illness or injury.

Success of the Product: Disability income insurance enables individuals to meet ongoing living expenses—such as rent or mortgage payments and groceries—and avoid depleting long-term savings for retirement by providing a portion of earned income until they are able to return to

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32 Congressional Budget Office (2004)
33 ACLI, Long-Term Care Insurance or Medicaid: Who Will Pay for Baby Boomers' Long-Term Care, 2005.
34 AHIP, Long-term Care Insurance in 2002. June 2004.
35 ACLI tabulation of 2003 NAIC data
36 ACLI, Protectors and Investors. 2005.

work. Some policies also include return-to-work provisions, such as rehabilitation, retraining, and modifications to the work environment.

Disability income insurance can be purchased on an individual basis and is increasingly available as part of an employee benefit package in the workplace. Carriers are providing more flexibility for consumers to 'scale up' or 'scale down' benefits to meet their changing needs.

Current Tax Treatment: Benefits received from an individual disability income insurance policy typically are not subject to income taxes. Benefits are taxed, however, if an employer pays for the coverage.

Call to Action: As Americans live longer, work longer, and assume more financial obligations—such as funding education and parental care, in addition to saving for retirement—it is important to foster public education about how long-term disability income insurance can help Americans continue to support their families, maintain their independence, and avoid depleting their long-term savings for retirement should a disabling event occur.

Issues and Trends:

- People in their early 30s are three times more likely to suffer a disability lasting three months or longer than they are to die.[37]
- 36 percent of full time workers have a long-term disability policy provided by their employer—43 percent employed by medium to large firms and 17 percent employed by small firms.[38]
- Almost 1 in 7 individuals will become disabled for 5 years or more prior to age 65. This number increases to nearly 1 in 5 for individuals between the ages of 35 and 65.[39]

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[37] 1985 Commissioner's Individual Disability Table A.
[38] Bureau of Labor Statistics, National Compensation Survey: Employee Benefits in Private Industry in the United States. March 2005.
[39] 1987 Commissioner's Group Disability Table.