TESTIMONY

of

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before the

President's Commission to Strengthen Social Security

The Honorable Daniel Patrick Moynihan

and Richard Parsons, Co-Chairs

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Good afternoon, Senator Moynihan and Chairman Parsons, I am Jim Wolf, President of TIAA-CREF Retirement Services. For over 80 years, TIAA-CREF has provided a portable, defined contribution pension for educators across the country. Today, we have 2.5 million participants and pay retirement income to 500,000 retirees who have a pension through one or more of over 11,000 colleges, universities and other educational organizations. TIAA-CREF has assets under management approaching $280 billion.

We appreciate the Commission's invitation to testify today to share the insights based on our experience providing a successful, portable pension system at low cost. My comments focus on TIAA-CREF's experience. TIAA-CREF does not have a position in favor of or in opposition to creating individual accounts as part of the reform of the nation's Social Security system. As Congress expanded Social Security eligibility to the universal workforce, TIAA-CREF played an important role in ensuring that both private and public colleges could have the option of joining the system. Our experience, since the 1950s, is that the defined benefit nature and inflation protection structure of Social Security benefits provide a good balance for the participants covered under the defined contribution approach of the TIAA-CREF retirement system.

I will focus my comments this afternoon on four areas:

- Operating a national, portable retirement system
- Providing financial education
- Delivering quality service at low cost
- Distributing retirement payments.

<u>Operating a National Portable Retirement System</u>

Established in 1918 with a grant from the Carnegie Corporation of America, Teachers Insurance and Annuity Association (TIAA) has evolved over time to meet the retirement security needs of our participants and to help them take advantage of greater investment flexibility offered by the financial markets. At the time that TIAA created the College Retirement Equities Fund (CREF) in 1952, investing pension assets in common stock was a novel idea. TIAA-CREF's hallmark, fully-vested pension was cited as a model when Congress enacted the Employee Retirement Income Security Act (ERISA) of 1974. At that time, defined benefit pension plans were the corporate standard and 401(k) plans were still a decade away from gaining popularity.

As with all sectors of the economy, the pace of change involving retirement security has quickened in the last two decades. Employees today are more involved in setting the course for their retirement security and have a greatly expanded range of investment choices. For example, the retirement fund options under TIAA-CREF retirement plans have grown beyond the simple choice between TIAA's fixed income and CREF's equity-based investments. They now span a broad range of asset classes and investment objectives through ten funds. Participants in TIAA-CREF have adjusted their investment allocations based on these broader choices as well as their actual experience investing their retirement savings.

Concurrent with this greater choice and flexibility, the expectations of our participants for services, such as financial education and account transactions, have pushed the demand for customer service to span twenty-four hours a day, seven days a week. Fast rising equities markets showed participants that timing could mean big gains, but the downside can also bring losses. As a result, increasing numbers of workers today closely monitor the time it takes money deducted from their paychecks to be credited to their retirement accounts and starts to earn returns.

TIAA-CREF has worked with colleges and employee groups, such as the American Association of University Professors, to design retirement plans for the academic community that enable employees to build an adequate pension benefit over a career. The plan parameters such as contribution rate, remittances and benefit options are specifically designed for each employer. Most of the pension plans that employers in the TIAA-CREF system offer to their employees have a total contribution rate that equals at least 10% of compensation. The majority of employees participate in pensions where coverage is mandatory with about one-third of the TIAA-CREF retirement plans being voluntary. TIAA-CREF plans also cover employees at all salary levels. In 2000, the average premium to a TIAA-CREF retirement annuity was $5,600 and the average account balance in the retirement account totaled approximately $90,000 by year end.

Plan Administration

Employers who offer their employees a retirement plan play an important fiduciary role administering their plan and selecting organizations, which provide services to both their plan and employees. The workplace connection offers a convenient and crucial conduit to help build the retirement savings of all working Americans. Employers handle enrollment materials, answer basic questions, remit funds through payroll systems and verify required data. TIAA-CREF, as a retirement plan service provider, offers an array of services including: plan design, account administration, professional asset management, financial education/guidance, and payment distributions through annuities and other modes of income streams.

A number of factors impact the cost of administering a TIAA-CREF retirement plan, including employer size. About 75% of all TIAA-CREF retirement plans cover 100 or fewer employees. Retirement plans generally require employees to work a specified number of hours or to satisfy a waiting period before they become participants. Part-time, short-service and seasonal employees might not be eligible to participate in the pension plan and, as a result, it is not burdened with added administration expenses due to small accounts. Additionally, Congress extended the FICA tax exception granted for student employees at colleges to also apply to 403(b) retirement savings plans that accommodate the special requirements of the educational community.

Investing Assets

In defined contribution plans, like the TIAA-CREF system, the investment results directly impact the participant's account value. Returns from interest earnings, dividends, and capital gains increase the amount that workers will have to generate an income during their retirement years. At the same time, participants face the risk of losses in stock value when the market declines, as it has recently. While TIAA-CREF participants have control over their retirement investments, they have the help of professional money managers investing assets in the fund accounts.

TIAA-CREF's investment professionals practice a long-term diversified investment strategy designed to balance opportunity with security. TIAA's traditional annuity provides a guaranteed return to participants and focuses its investments in fixed income securities – mostly publicly traded bonds and private placements, with a smaller percentage in mortgage and real estate related assets. CREF, offering variable annuities, has developed an investment management approach that combines quantitative investment indexing and active management. Under CREF's Dual Investment Management Strategy, each equity account using this approach has Stock Selection and Enhanced Index subportfolios. The CREF Stock Account, for example, has both domestic and international components that are benchmarked to broad market indexes. For the domestic equity component, this is the Russell 3000 index, which consists of most of the tradable equities in the U.S. For the international equity component, it is the equally broad MSCI/EAFE index.

Mandates

Operating a retirement plan involves a number of statutory and regulatory requirements. The federal tax law sets limits on the amounts invested, requires complex testing of plan benefits and entails detailed recordkeeping to ensure proper tax reporting for distributions and compliance. ERISA and comparable state law specify fiduciary duties, distribution requirements and plan design parameters such as vesting or default options when workers fail to provide complete directions. Other bills like the Retirement Equity Act have created rights for spouses to share in each other's retirement income while the Age Discrimination in Employment Act protects the interest of older Americans. Meanwhile, securities laws and regulations mandate financial service firms to credit funds to accounts under a T+3 rule and to distribute quarterly reports. It is important to realize that these requirements involve costs for plan administration that go beyond complying with the requirement. For example, the distribution of TIAA-CREF quarterly reports creates a major service responsibility, since it is followed by an immediate surge in calls to our phone centers.

Providing Financial Education

According to an economic analysis of financial planning and its associated costs prepared by Professor Annamaria Lusardi, for the TIAA-CREF Institute's publication Research Dialogue, many workers may not take enough time to plan for their retirement. She found that households not planning for retirement end up having much lower savings than households that have thought a lot about retirement. Evidence from this empirical work suggests that programs that provide financial education and advice as well as information on saving, can give employees an incentive to start saving, especially women and low-income workers.

Our founding charter established financial education as an important mission for TIAA-CREF and over the last decades we have greatly expanded our financial education efforts. In fact, the workplace has become the primary delivery agent for financial education to help workers understand their investment options.

During the 1970's, TIAA-CREF representatives often conducted campus based staff meetings on behalf of plan administrators to explain the details of their pension plans and how to choose among the TIAA and CREF investments. Then, as more participants entered their 50's, we developed community-based pre-retirement seminars, which focused on the choices and options available at retirement. This has evolved to a broad spectrum of education seminars, which we call the Financial Education Series, that involve financial basics, tax issues, asset allocation, retirement options and more. In 2000, TIAA-CREF consultants conducted over 5,600 seminars.

While greater choices have challenged employees making financial decisions, many workers have at the same time become more sophisticated about investing. The questions TIAA-CREF and the employers we work with most frequently hear are: "How should I allocate my retirement contributions?", "Will I have enough when I want to retire?" and "How should I take my retirement income – as an annuity or lump sum?" TIAA-CREF believes that by providing participants with educational resources and information, we can help them make the right financial decisions about saving and investing.

Helping Participants

Today we use a variety of tools, techniques and media to carry out our financial education mission. Our publications include one-page stuffers, single topic pamphlets, newsletters for participants and plan administrators and special reports covering key issues. The attached May 2001 Participant is an example of how we communicate with our participants on a regular basis. As you can see, TIAA-CREF materials cover topics including investment options, calculations of retirement income needs, and explanations of tax issues, such as pension reform. These written materials are not only supported by group seminars, but also with individual counseling by registered representatives in our phone centers or through face-to-face meetings. In addition, TIAA-CREF uses Internet technology to deliver information and service. Our home page has evolved and now provides an interactive toolbox of financial education with numerous calculators.

To help participants apply financial education to their own situations, TIAA-CREF has developed principles that underlie our guidance. For example, we recommend that participants diversify their retirement accounts among equities and at least two other asset classes and we emphasize that diversification remains important after retirement. For the most part, general education and guidance helps participants to make their decisions. In fact, a survey by Roper Starch determined that 75% of attendees at our FES programs were "very satisfied" with the program and half of all respondents indicated that they had changed, or planned to change, their financial behavior.

The more education and guidance available to an individual, the more he or she is likely to benefit from it. The results of a 1997 study of TIAA-CREF participants and their investment allocations suggest that, given enough education, information and experience, people will tend to manage their self-directed investment accounts in an appropriate manner.

Providing Quality Service at Low Cost

TIAA-CREF believes that low expenses ensure that more of our participants' money works in their accounts to improve their retirement benefits. Because of our size and current asset base, the broad array of bundled financial services that TIAA-CREF offers employees and employers can be adequately funded by our modest asset fees. Prior to 1982, TIAA-CREF's asset base had not reached a level to benefit from economies of scale and TIAA-CREF charged participants for expenses by deducting an expense charge from each contribution.

The asset fees for each account vary to reflect the different investment expenses incurred to manage the funds in the account according to the account's investment objectives. Currently, the total annual asset charges for CREF variable annuities range from .34% for the Money Market Account to .46% for the Global Equities Account. The TIAA Real Estate Account has an asset charge of .64%. A complete listing of expense charges and investment returns is listed in the back of the attached May 2001 Participant. Included in these total annual asset charges is an amount equal to approximately one quarter of one percent of assets to cover administrative expenses for the program.

Using Technology

A great amount of technology underlies the services that TIAA-CREF provides our customers by phone, on the Internet and in person. Our technology investment is significant and totals about 25% of our expenses. The information and guidance tools available at the touch of a finger help participants make solid financial decisions, perform transactions and initiate requests quickly and seamlessly.

Over recent years, the volume of calls and participant transactions has increased significantly. In 1995, TIAA-CREF handled a total of 4.2 million phone contacts with almost 3 million handled through our automated phone service. By 2000, the total call volume increased to 6.4 million phone calls, with the TIAA-CREF Participant Call Center’s registered representatives handling over 2.5 million calls. Records of calls and service requests are placed in our corporate workflow system for response.

TIAA-CREF launched its Internet-based services in the fall of 1997, with our World Wide Web site “TIAA-CREF at Your Service.” Since its introduction, the Web site usage has surged. Services delivered include a broad spectrum of account services, investment functions, and interactive financial education and guidance calculators. The most popular Web Center feature allows participants to check accumulations and it is followed by the recently introduced income illustration calculator. During 2000, almost 9 million contacts were made to the Web Center’s Inter/ACT facility and about 400,000 transactions were handled automatically on line.

Automation and the Internet have also improved the account administration for plan sponsors, enabling electronic or on-line premium submissions. Almost 20% of our institutional premium remittances were processed automatically. Technology enables us to provide forms on-line for plan enrollment and for benefit payment selections. In addition to the Web site, TIAA-CREF also revised its computerized reporting systems to deliver combined and more comprehensive quarterly account statements. One of our most recent system improvements revamped the TIAA-CREF annual benefit report (ABR) to provide more information about participants' accounts and the estimated amount of income they might expect at retirement. In conjunction with this system change, we decided to alter the distribution schedule of ABRs and now send each individual's ABR to coordinate with the mailing of the Social Security Administration's benefit statement – an effort which Senator Moynihan was instrumental in making a reality.

Distributing Retirement Benefits

In our role as a retirement system, TIAA-CREF required annuitization from the basic retirement accounts used to fund employer and employee pension plan contributions. When we introduced new products designed exclusively for additional personal savings over and above the employer's pension program, we offered greater flexibility for lump sum payments both at and before retirement. Annuitization was mandatory for all TIAA-CREF retirement plans until 1989 when we allowed employers to amend that provision. As a result, lump sums are available at retirement or termination for most TIAA-CREF participants. At retirement, the majority of participants choose to start an on-going income stream rather than withdrawing a lump sum amount.

An important consequence resulting from the increased flexibility at retirement is a greater need for advice on how to select a retirement income option. A recent survey of TIAA-CREF participants revealed that 75% wanted advice on retirement income options with the greatest number (84%) seeking such advice among participants in the pre-retirement ages.

TIAA-CREF firmly believes that a lifetime annuity is appropriate for most people. An annuity will provide the maximum amount of monthly income with the assurance that a retiree's benefits will not be exhausted. This is especially important to TIAA-CREF retirees with limited resources to meet their income needs. For those individuals, our recommendation would be to start an annuity. Since a large percent of retired workers rely on Social Security as the major component of their retirement income, annuitization would be important for the same reason. Under certain circumstances, other payout options might be appropriate.

Selecting an Option

The once simple choice between a single-life or a joint-life retirement income annuity now has many variations. Participants can delay a decision by selection of an interest only payout or a systematic withdrawal. This allows them to defer the annuity selection until later or eventually substitute the required minimum distribution option (MDO) under Section 401(a)(9) of the Internal Revenue Code. By electing the MDO, interest-only option, or systematic withdrawal, a participant can leave the unused balance in his or her retirement account to heirs. Under all lifetime annuity contracts, the period certain guarantees (10, 15 and 20 years) enable retirees to assure that amounts will be passed on to heirs in the event of an early death. A joint life annuity enables a participant to guarantee lifetime payments to a spouse. The amount of income from a two-life payout is lower than the amount paid as single-life annuity and depends on the amount of retirement income (full, two-thirds or half) that is protected. As you know, the treatment of a spousal benefit differs under Social Security where a spouse may be entitled to a benefit up to half of the retiree's income. Federal pension law and many state statutes require that married workers obtain consent from their spouse unless they elect a joint and survivor annuity.

Helping TIAA-CREF participants manage their retirement assets to assure that they maintain an adequate income to last for their lifetime is complex. First, many people tend to underestimate their longevity. For example, few couples at age 65 realize that there is a 50-50 chance that at least one of them will be alive 27 years later at age 92 and he or she may still need an income to last more years beyond that point. When participants choose to withdraw a certain amount of income each year from their account, they can face an economic dilemma. Retirees may make too conservative a choice and try to preserve their principal, but they may find that they do not have enough income to meet living expenses and unexpected emergencies. Conversely, miscalculating by withdrawing too much early in retirement or experiencing a down market soon after retirement can deplete savings before retirees reach their final years.

Guidance

When we provide retirement decisions guidance to participants, TIAA-CREF looks at both the income needs during retirement and the various sources of income that participants have available, including benefits from Social Security. We encourage retirees to follow fundamental principles, such as “take care of a spouse and others who depend on you” as I mentioned earlier. Some other principles include:

- *Safeguard pension income against inflation.* We encourage retirees to elect retirement income options that may give them an edge over inflation. Although income from the CREF accounts is not guaranteed and can fluctuate, stocks have historically proven to be an excellent inflation hedge over the long term. TIAA also has payment options that can help achieve this goal, which I will expand on shortly.

- *Diversify – before and after retirement.* During the accumulation years, participants allocate retirement money among TIAA and/or the CREF variable annuity accounts to protect against market volatility and to benefit from the growth potential of different types of investments. These advantages can be maintained during retirement. If retirees must switch out of equities into a fixed annuity at retirement, that action could force an ill-timed investment action. So, having an option to use payout from a variable annuity is important in the transition to retirement.

- *Take it now, and you may not have enough later*. Withdrawing money from a retirement account may result in heavy taxes and a crucial loss of income for retirement. After-tax resources are usually a better choice for short-term cash needs, unless a retiree has adequate lifetime income from another source.

- *It pays to wait to retire*. The longer workers delay receiving retirement income from TIAA and the CREF accounts, the larger the payments are likely to be.

Inflation Protection

Using individual accounts means that couples and individual retirees have to adjust their initial income streams to provide inflation protection, rather than having that protection automatically provided as an additional amount of income each year as the case with Social Security benefits.

Protecting against inflation in TIAA-CREF individual accounts also means using various asset combinations that may help protect purchasing power. For example, real estate can be a good hedge against rising prices. CREF's Inflation-Linked Bond Account uses U.S. Treasury Inflation-Indexed Securities and other investments to track inflation and protect purchasing power. While this is the option with the closest relationship to inflation, the Department of Treasury may not always issue this type of bond. Equity accounts could also prove to be an excellent inflation hedge. Past performance is *not* a guarantee of future results and income from TIAA Real Estate and the CREF accounts is *not* guaranteed and can fluctuate depending on the performance of the underlying investments in the accounts. A more stable way to obtain increasing payments in retirement is under TIAA's Graded Payment Method. While it pays less income initially than the TIAA Standard Method, over time the Graded Method can be expected to produce higher income, to help preserve purchasing power.

Pricing

The pricing of annuities is a complex science that involves many variables, such as mortality risk and selection risk. While I am not an actuary, I can address only some generalizations. Moving from mandatory annuitization to a system that allows lump sums increase the risk of adverse selection, which means that those workers who are not in good health would be more likely to choose lump sums or shorter fixed payment periods. The flexibility to cash out helps such individuals preserve their assets for their personal use, but the ability to opt out of an annuity will raise the average expected lifetime of those who choose to annuitize. As a result, the cost of purchasing an annuity increases and the pension plan pays a lower the amount of retirement income. Others of my TIAA-CREF associates have more expertise in this area and I would be happy to pass on any questions you might have on annuity pricing for them to respond to your questions in writing.

Conclusion

As I close my comments, the phrase the "devil is in the details" comes to mind – and as I have learned over time, when the details involve our nation's retirement income policy they can be rather complex. As the Commission prepares its report, TIAA-CREF is willing to serve as a resource.

Let me close with one important comment, the employee benefit community has made advances to expand the voluntary employer-sponsored pension and personal retirement savings components of retirement security’s so-called three-legged stool in which Social Security is the first leg. For that reason, it’s even more important that Social Security continue to complement the private pension system that millions of Americans use to achieve a successful retirement.