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Hearing, "Can We Do More to Keep Savings in the Retirement System"

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Chairman Harkin, Ranking Member Alexander and Members of the Committee on Health, Education, Labor and Pensions, thank you for inviting me to testify today about the opportunity to help Americans improve their retirement security.

My name is Matt Fellowes, I am the founder and CEO of HelloWallet, a Washington, D.C. based Software Company that helps firms improve their benefit and compensation outcomes by providing independent guidance to workers about their benefits and finances. Prior to founding HelloWallet in 2009, I was an academic at The Brookings Institution, and also taught at Georgetown and George Washington Universities here in Washington. I decided to leave Brookings when I discovered new technology and behavioral psychology insights that can be used to democratize access to independent, personalized financial guidance. This was during the mortgage foreclosure crisis when I was advising Governors and the Bush administration about how to respond to the fact that 5 million people had willingly bought homes that they never were going to be able to afford. I saw an opportunity to create a proactive solution to a systematic problem, so I decided to become an entrepreneur and founded HelloWallet.

I'm here today because of conversations I had through out 2012 with numerous plan sponsors about the health of their defined contribution plans. Among the things I learned in those conversations, is that there are plans today where a majority of participants will cash-out their entire 401(k) balance within 5 years of signing-up, even though in each of those cases the savings deferral rates had increased, the participation rate had increased, and the assets under management had increased. But, in fact, those data were just a mirage of retirement savings success because underneath those numbers, there was a massive amount of turnover and churn – the majority would not actually be using all or some of their savings for retirement.

I decided to figure out whether the story that these data were telling me were generalizable to the entire defined contribution market, or just isolated to those plans. So, I put my academic hat back on and examined Federal Reserve, Census Bureau, and IRS data so I could better understand the problem these plan sponsors were encountering.

Mr. Chairman, what I learned is that a large and growing number of defined contribution participants are using their defined contribution plans for non-retirement spending needs. In particular, I learned that for every $1 that is annually deposited into 401(k) and other defined contribution plans; approximately $0.25 is now withdrawn for non-retirement spending. Among participants that are younger than 55, up to $0.45 of every $1.00 deposited is withdrawn prior to retirement every year for non-retirement spending. Now, about 15 percent of that withdrawn money is in the form of temporary loans, the bulk of which will be repaid. The majority of withdrawn funds, however, are in the form of lump-sum cash-outs, which are permanent withdrawals of retirement savings. And, no short-term spending needs should ideally be addressed by relying on a long-term savings vehicle like the 401(k).

Now, since I left Brookings I am no longer working in the day-to-day policy details of the subject for today's hearing nor other public policy issues that I used to be involved in for that matter. Nonetheless, large employers ask me weekly for practical business ideas to keep savings in the retirement system, outside of policy. They also ask me how to increase savings into those plans. So, Mr. Chairman, I thought it would be useful for you to hear what I tell them they can do to keep more savings in the retirement system.

First, my advice is to accumulate more data about their plans. If these plans are supposed to be about improving retirement readiness, than the measure of success should not be confined to just 401(k) savings data. The median household near retirement has ten accounts, and the 401(k) is just one of those. So, I stress that the measure of success should include data on the actual retirement readiness of the workers and the ROI that the company is getting from that retirement investment. That helps sponsors understand what participants the plan is helping, what participants it is not helping, and what specific, and personalized, steps need to be taken to improve program outcomes. Sponsors, in short, need a management dashboard to understand their employees' retirement readiness, not just their retirement program performance.

Second, when participants are not saving enough or, worse, taking money out of their plans for non-retirement spending needs, my advice is to address the underlying causes. In our research, we found that the strongest predictors that a participant will use their retirement savings for non-retirement purposes is if they do not actively budget – which is approximately 80% of U.S. households - and if they do not have three or more months of emergency savings – which is approximately 85% of U.S. households. Both findings make sense. If workers are not budgeting, its not realistic for us to expect to progress on retirement readiness.

To see why this is the case, I find that a ladder is an effective metaphor. Today, we have a large percentage of workers that are saving for retirement, which I consider a top rung of the ladder that individuals reach because it occurs at the end of a worker's career. But, underneath that top rung, there are missing rungs that people lack, which are fundamental to retirement security. Few people have budgets, for instance, which is a critical step on the ladder because it helps workers control their debt, spend less than they make, and save for other things in life that they need. Likewise, few have adequate emergency savings, few have college savings, few have savings for home ownership and many have high interest credit card debt, all of which are rungs on the ladder that people reach before they retire. What has happened as a result is that you have a large share of U.S. workers that are dangling from the top of the ladder with retirement savings, but they lack any foundation underneath them because they don't have the other rungs of the ladder to stand on. This is why the 401(k) is losing so much money every year to non-retirement spending. It's not a matter of insuring against the risk of falling off the ladder; it's that there are not enough rungs on the ladder to begin with.

Companies can address this market dynamic by giving more attention to the foundations of retirement success, which include making good day-to-day financial decisions, managing debt in a healthy manner, saving for other goals, and so on. In short, I advise that as much attention is given to how the entire paycheck is allocated as companies currently give to retirement investment allocation. Effectively allocating monthly income, after all, has many, many times greater an effect on retirement security than even the best investment allocation.

The bottom line of my advice, Mr. Chairman, is that we have learned that sponsors can automate higher 401(k) and defined contribution plan balances, investment decisions, and savings deferral rates. But, we cannot automate retirement readiness. For that to happen, we need to engage workers in their day-to-day decisions, and provide independent solutions to help them make more optimal choices for their own retirement security.

Mr. Chairman, I'm including a copy of the aforementioned research, "The Retirement Breach in Defined Contribution plans" and a one-page summary with my written testimony. Thank you for your leadership on this issue and thank you for the opportunity to participate in today's panel.