Testimony Before the Senate Finance Sub-Committee on
Economic Growth & Debt Reduction

“Saving for the 21st Century: Is America Saving Enough to be Competitive in the Global Marketplace?"

Jurrien Timmer
Director of Market Research
Fidelity Investments

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Index

Key Points

Summary

The U.S. age wave is cresting and Americans are living longer. More and more Americans will be reaching retirement in the years ahead, and as a result will need to start drawing on their retirement savings. However, millions are insufficiently prepared for retirement, either because they do not have access to a workplace savings program, or because they either under-utilize the plan that is available to them or choose not to participate at all. As a result, a record number of Americans are working at or beyond their retirement age, a trend that may well continue for some time. Steps that could be taken to better prepare Americans for their retirement include, among others, a national small business 401(k) plan, automatic enrollment in defined contribution plans, the use of life cycle funds as a default option in those plans, simplification of the IRA model, an IRA savers credit, and programs such as Kid Save.

Demographics

A Baby Boom tidal wave is underway. In 1985, the largest segment of the population consisted of 25 to 29 year olds. Currently, the largest segment consists of 40 to 44 year olds. In 2025, it will be the 60 to 64 year old group that will comprise one of the largest segments. In fact, this segment will be the largest ever recorded on a percentage basis.

Americans are living longer. In 1955, the average life expectancy in the U.S. was 66.1 years. Today it is 74.6 years. By 2050 it is expected to be 79.9 years. In 1920, Americans aged 65 and older accounted for only 3.3% of the population. Today, this group accounts for 11.8%. In 2036, this group will account for 19.0% of the population.

The Age Dependency Ratio (the number of Americans younger than 15 and older than 65, divided by the number of Americans between the age of 15 and 64) will rise from 48% in 2005 to 64% by 2036. That means that more and more children and retired Americans will need to be supported by fewer and fewer working-age Americans (on a relative basis).

The result of all this is that more and more Americans are working longer. The labor force participation rate of 55 to 64 year olds is now 63.3%, up from 53.4% in 1986. Undoubtedly, more people are working longer because they can't afford to retire, but part of the reason may also be that would-be retirees are making a lifestyle choice to work longer based on their longer life spans. With the shortage of skilled labor that is looming as a result of the rising age dependency ratio, a continuation of this trend seems inevitable.

Household Savings

The savings rate in the U.S. is about zero, and has been declining for years. However, one could reasonably argue that the calculation of the savings rate is flawed, in that (among other things) it includes the taxes on capital gains, but not the capital gains themselves. One way to adjust the savings rate is to exclude these taxes. The other is to add back the capital gains themselves. Both these series are only available until 2003, but using CBO projections we can estimate the "adjusted" savings rate as of 2005. If we exclude the taxes on capital gains, the savings rate becomes 0.71 pct. If instead we add in capital gains, the savings rate jumps to 5.75 pct. Either way, the savings rate has been in decline for years and today would be only in the mid single digits even under the best case scenario.

However, when considering household wealth, the picture brightens considerably, because American households in the aggregate have a fairly healthy balance sheet. Household net worth stands at $52.1 trillion (an all-time high), which is 5.6 times disposable income, above the average of the past 50 years. Debt service stands at 13.9 times disposable income, the highest ever recorded but perhaps still reasonable considering that it includes both mortgage and consumer debt. Assets are 6.9 times income and liabilities are 1.3 times income. Household debt has risen in recent years, in part because homeowners have extracted more equity from their homes (56%), but also because more Americans have themselves become homeowners, and therefore carry mortgage debt. But, household assets have risen more, namely through rising home prices and financial assets.

Continued on next page

Key Points (cont'd)

Why don't Americans save more? Part of the reason may be that the recent period of very low interest rates and rising home and stock prices have created a disincentive for Americans to put away much if any of their income. Consider it a wealth effect. Perhaps now that the rise in home prices is moderating and interest rates are rising again, Americans will be more inclined to save out of their income. Either way, the financial health of American households appears to depend at least in part on the housing market, and to a lesser degree on the stock market.

Retirement Security

Over the past thirty years, defined contribution plans have taken over from defined benefit plans as the primary workplace savings program for American workers. While the number of U.S. workers has increased from 62 million to 122 million since 1975, those covered by a defined benefit (DB) plan have fallen from 29 million to 21 million. At the same time, the number of employees covered by their company's 401(k) or other DC plan have grown from 11 million to 64 million.

While the rise in DC plan participation is a very positive trend, the fact is that not every company offers a DC plan, and even within those who do, many workers either under-utilize their plan's potential or fail to enroll at all. Of the 64 million workers covered by a DC plan, 22 million do not participate. Add in the 58 million workers who are not covered to begin with, and it becomes clear that a very large number of Americans are not saving as much as they should for their retirement security.

Furthermore, research studies show that many workers who do participate in their employer's DC plan do not properly manage their plan in order to maximize their future savings. To a large degree, this is understandable. Creating a retirement savings plan when you are in your twenties, picking the right investments, maximizing your deferral rate, and then rebalancing your portfolio on a regular basis over the subsequent four decades, and all this without guidance, is something that even some professional investors have trouble with.

Suggestions

More and more Americans will reach retirement in the years ahead, yet many are not financially prepared. What can be done? Specific solutions might include the following:

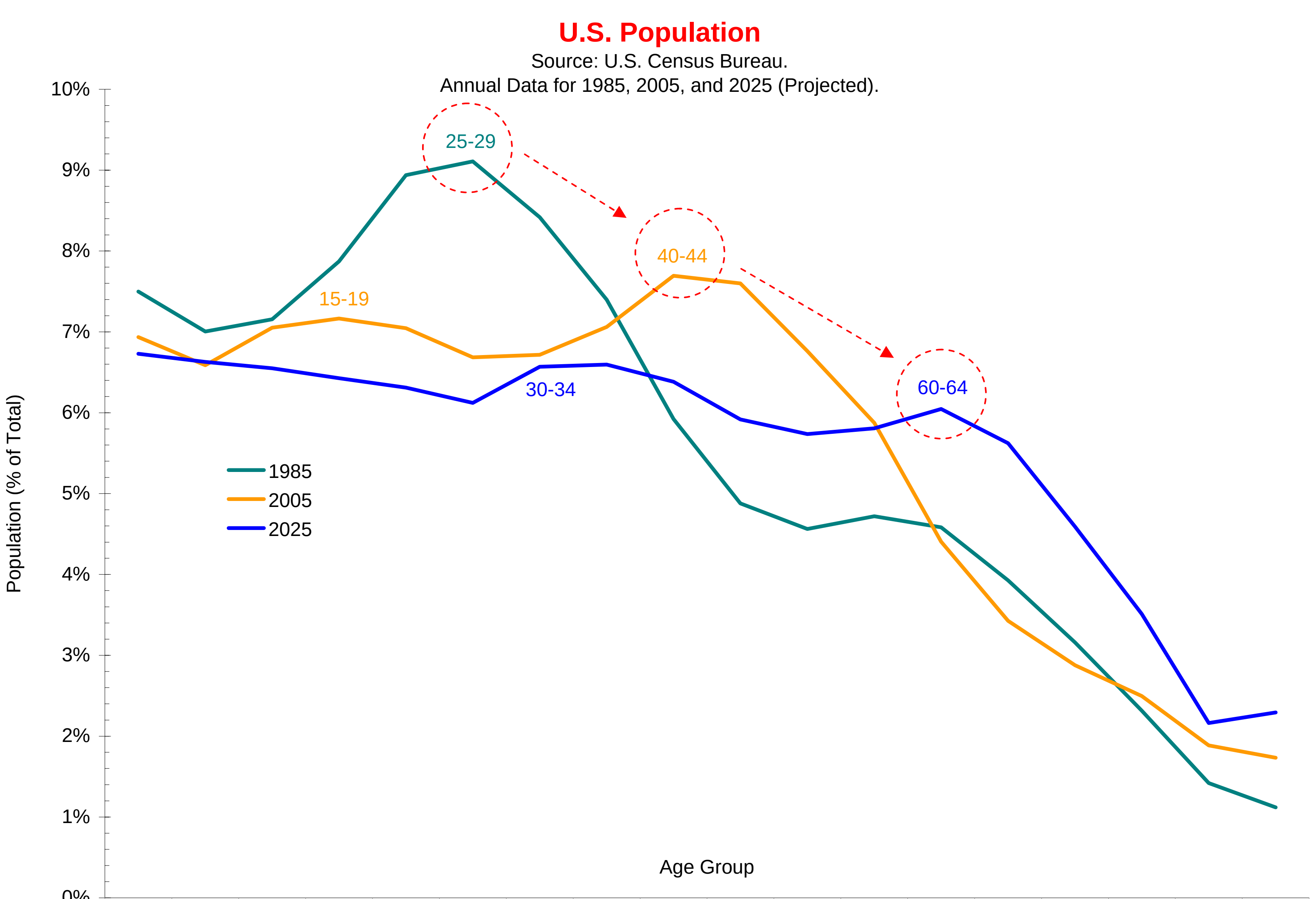
•Create a National Small Business 401(k) Plan. Many small businesses do not have a 401(k) plan because the cost of administration and reporting is too high. If these employers could outsource their plan to a central clearinghouse, their cost would be reduced while their employees would be able to access a workplace savings system.

•Encourage employers to automatically enroll their workers into their workplace savings plan. These workers could then opt-out of these plans if they so choose. Studies show that the difference in participation rates between an opt-in plan and an opt-out plan are enormous. Therefore, automatic enrollment will go a long way to helping those who are covered by a DC plan to start saving.

•Use Lifecycle funds as a default option for DC plan investors. Many workers who do participate in their company 401(k) plan do not get the most of their plan because they under-invest, don't rebalance, and don't diversify. Having these plans use lifecycle funds as a default will help workers get the most out of their plan.

•Reform and simplify the IRA system by creating fewer choices, creating saver's credits, and creating early-age programs like "Kid Save."

The Baby Boom Tidal Wave



	< 5	5-9	10-14	15-19	20-24	25-29	30-34	35-39	40-44	45-49	50-54	55-59	60-64	65-69	70-74	75-79	80-84	> 84
1985	7.5%	7.0%	7.2%	7.9%	8.9%	9.1%	8.4%	7.4%	5.9%	4.9%	4.6%	4.7%	4.6%	3.9%	3.2%	2.3%	1.4%	1.1%
2005	6.9%	6.6%	7.1%	7.2%	7.0%	6.7%	6.7%	7.1%	7.7%	7.6%	6.8%	5.9%	4.4%	3.4%	2.9%	2.5%	1.9%	1.7%
2025	6.7%	6.6%	6.5%	6.4%	6.3%	6.1%	6.6%	6.6%	6.4%	5.9%	5.7%	5.8%	6.0%	5.6%	4.6%	3.5%	2.2%	2.3%

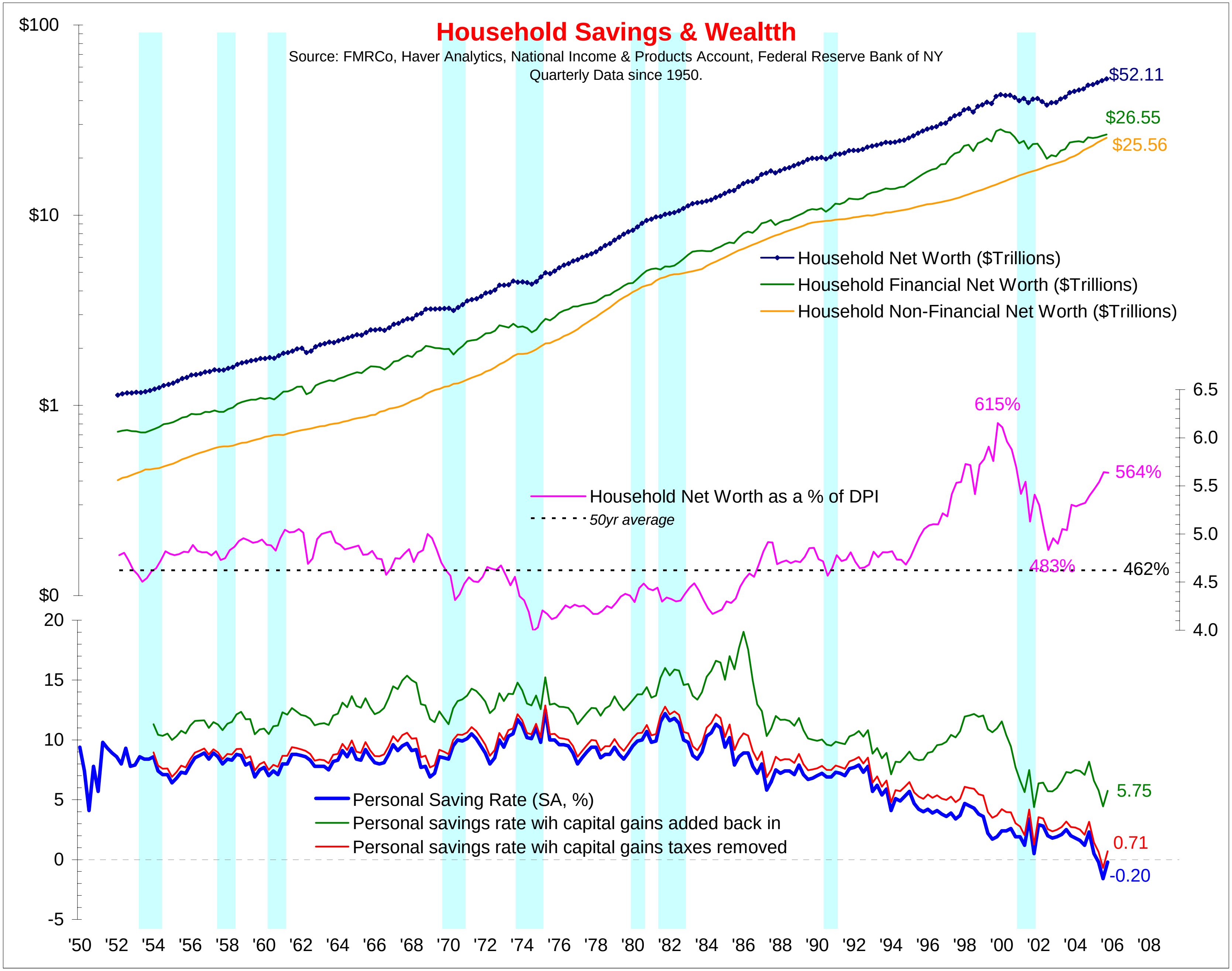
•One of the most profound demographic changes in our country's history is underway, that is, the aging of the Baby Boom generation.

•This chart shows the distribution of the U.S. population in 1985, 2005, and the projection for 2025.

•Back in 1985, the largest segment of the population was 25 to 29 years old. In 2005, the 40-44 year old segment was the largest. In 2025, the distribution from birth to 65 is about even, showing that there will be many more retiring Americans relative to the rest of the population.

•*Source: U.S. Census Bureau. Fidelity Management & Research Co (FMRCo).*

What is the True Savings Rate?



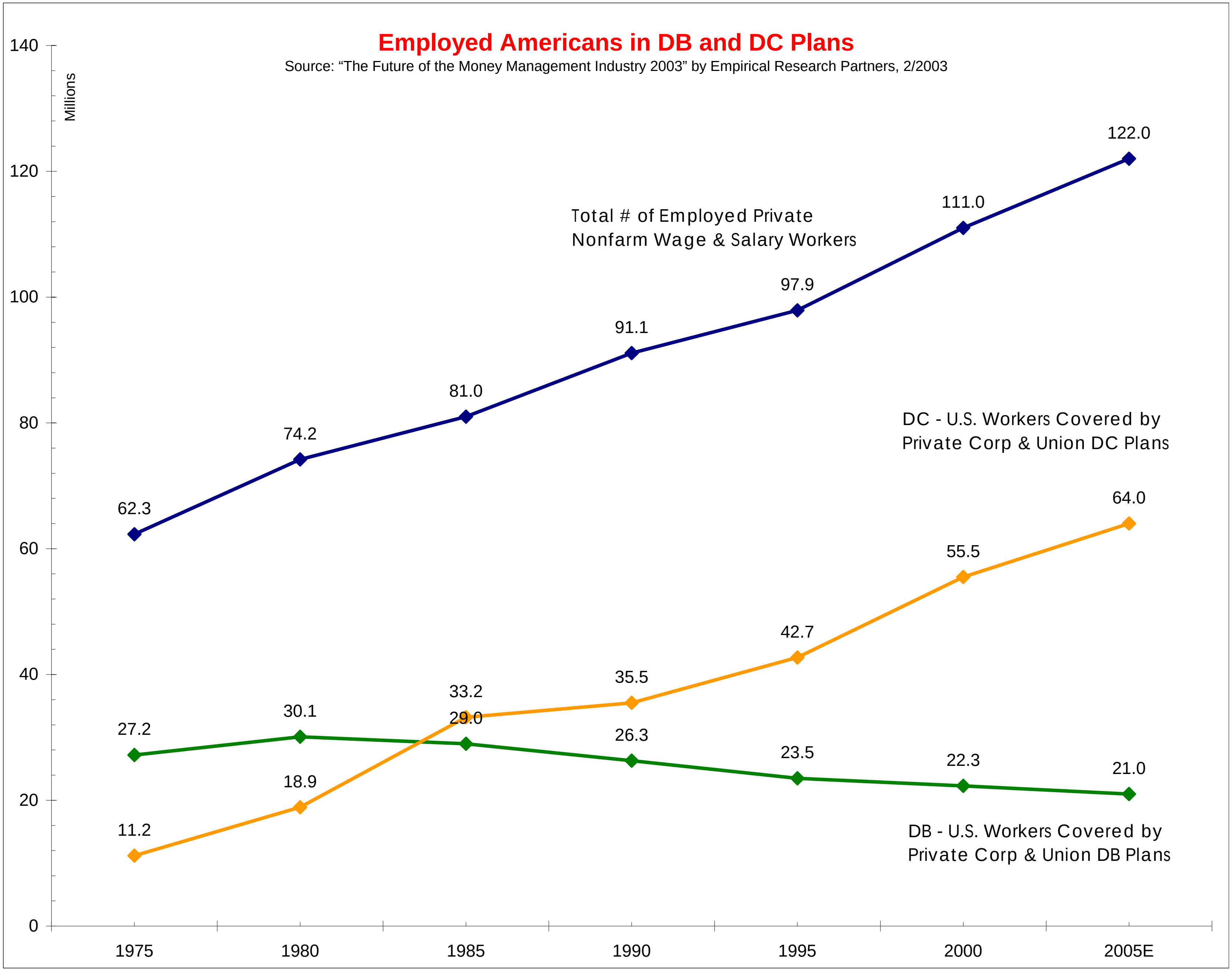
•The official savings rate in the U.S. is -0.2% and has been declining for years. However, the argument can be made that the calculation is flawed, mainly because the rate includes taxes paid on capital gains, but not the capital gains themselves.

•Furthermore, Household net worth has continued to rise, mostly as a result of rising home prices and an improving stock market.

•This prompts the question as to whether savings should only be considered as income-based or whether changes in wealth should be included as well.

•Data through 3/06. Source: Fidelity Management & Research Co (FMRCo). Based on a study by the Federal Reserve Bank of New York in 2000.

The Long Shift From DB to DC



- The longstanding trend away from defined benefit plans and towards defined contribution plans continues unabated.
- Thirty years ago, 27.2 million American workers (private non-farm) were covered by a DB plan, while only 11.2 million were covered by a DC plan.
- In 2005, only 21 million workers are covered by a DB plan, while 64 million are covered by a DC plan.
- The rise in DC plans shows that 401(k) and similar plans are the primary vehicle for many Americans to save for retirement.

•Source: "The Future of the Money Management Industry 2003" by Empirical Research Partners, 2/2003

Inadequate Savings Options

122 Million Working Americans Need to Save for Retirement

64 Million Americans are Eligible to Save through Workplace Savings Programs

58 Million Americans Must Save through other Retirement Savings Vehicles

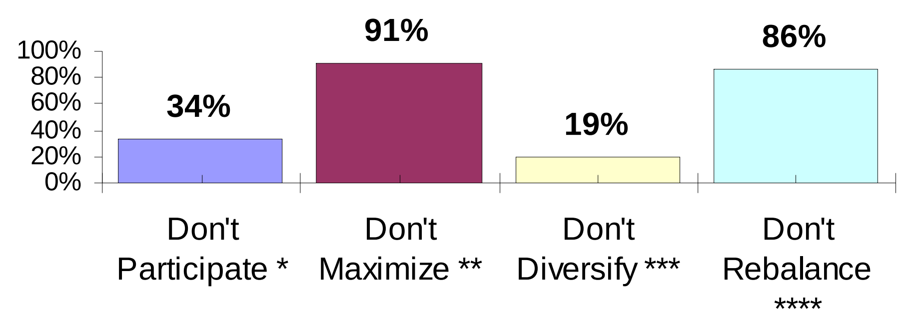
22 Million Choose Not to Participate

42 Million Choose to Save through Defined Contribution Plans

- While DC plans are now the primary retirement saving plan for many Americans, unfortunately there are still about 58 million workers who do not have access to 401(k) or similar plan. A national small business 401(k) plan might encourage more small businesses to create plans for their employees.
- Of the 64 million workers who are covered, 22 million workers have chosen for one reason or another not to enroll.
- Making matters worse, even those workers who do enroll tend to underutilize their plan's potential. Many people do not maximize their deferral, thereby leaving matching funds on the table, many people do not rebalance and some do not diversify their holdings. Education and guidance might help workers get all the benefits they can from their DC plan.

•*Sources: Building Futures Volume VI, Fidelity Investments analysis, and "The Future of the Money Management Industry 2003" by Empirical Research Partners, 2/2003*

401(k) Plans are Under Utilized



*Average among plans for which Fidelity performed nondiscrimination testing in 2004

**Pre-tax deferrals were less than $13,000 402(g) limit in 2004

***Portion of all recordkeeping participants who held a single investment option other than a blended option in 2005

****Portion of recordkeeping participants present 12/31/05 who did not make a single exchange in 2005

Sources: Building Futures Volume VI, Fidelity Investments analysis.

Supplemental Charts

Solutions to America's Savings Challenges

Needs

Break inertia, reduce complexity, and raise savings

Update workplace savings systems

Reach millions of workers without plans

Encourage health care savings

Modernize Tax & ERISA Laws

Solutions

- Raise IRA contribution limits
- Create single, simple IRA
- KidSave

- Automatic defined contribution plan
- Establish clear safe harbors
- Simplify administration

- National Small Business 401(k) Plan

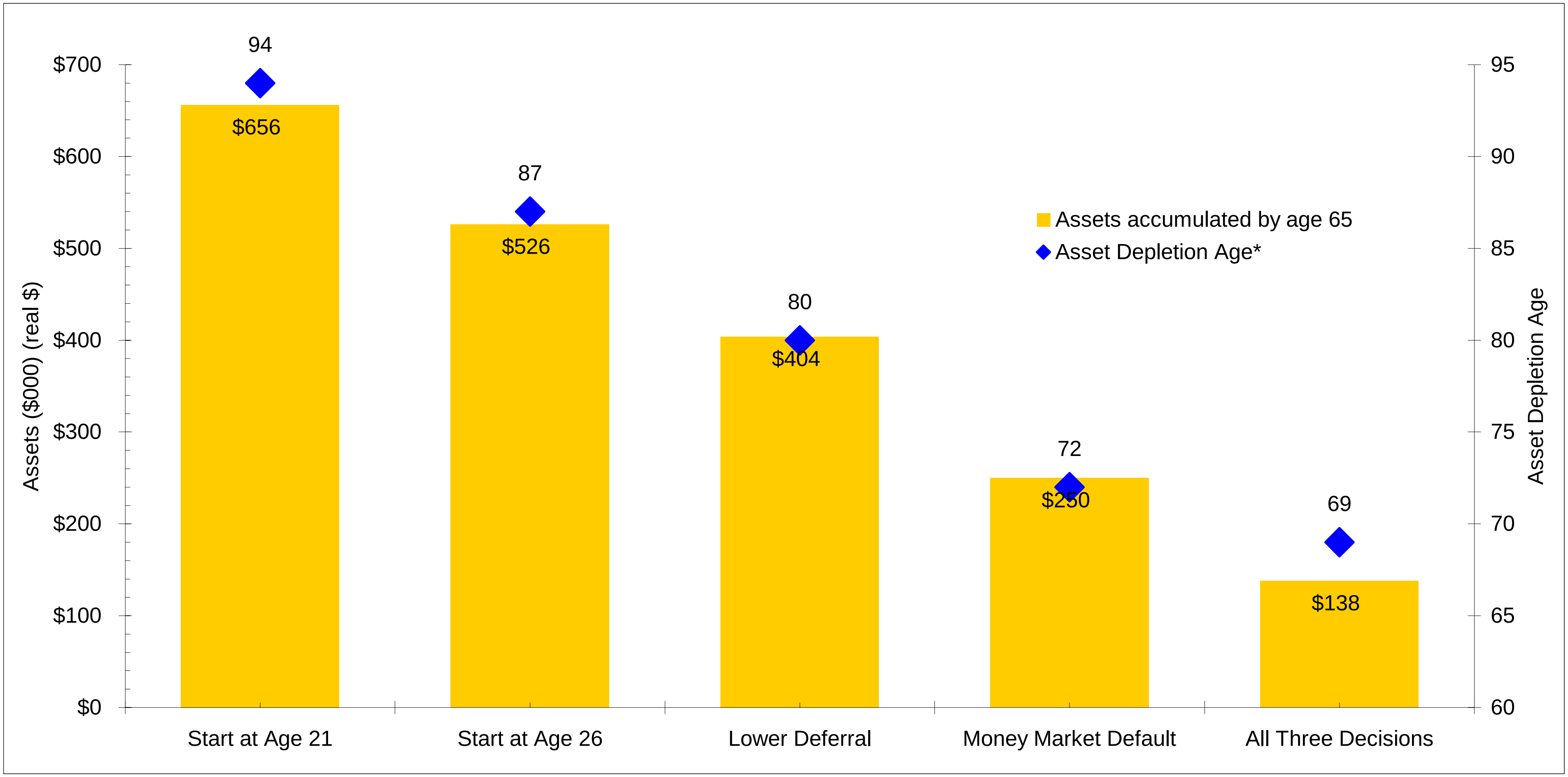
- Offer tax-free withdrawals for health care in retirement

Employees Need More Guidance

- Our studies show that many American workers do not invest appropriately according to their life cycle.
- The red line shows the ideal allocation to stocks over a person's work span, from age 20 to age 80.
- The blue dots show the actual allocation to stocks. This is based on a combination of three defined contribution plan administered by Fidelity.
- The chart illustrates the need for investment guidance as well as the need for using lifecycle funds as a default option in 401(k) plans.

•Source: Fidelity Management & Research Co (FMRCo).

The Cost of an Under-Utilized DC Plan



Hypothetical Illustration of a 21 year old participant in a tax deferred retirement plan with a starting salary of $30,000 that increases 3.5% a year (including 2.5% inflation). Retirement age is 65. Start at Age 21: The participant enrolls immediately, defers 10% of pay, receives a 3% company match, invests in a diversified allocation with annual nominal returns of 7%. Start at Age 26: Same assumptions, but participation starts 5 years later. Lower Deferral: Same assumptions as Right Start, but deferral rate is 5%. Money Market Default: Same assumptions as Right Start, but with annual nominal returns of 3% to reflect a 100% money market investment. All Three Decisions: Participation starts 5 years late, deferral rate is 5%, and annual nominal returns are 3% to reflect money market investment. Your own plan account may earn more or less than this example, and income taxes will be due when you withdraw from the account.

*Approximate age before assets are depleted, assuming an 80% pre-retirement income replacement ratio.

Fidelity Investments analysis. Past performance is no guarantee of future results. Neither diversification nor asset allocation ensures a profit or guarantees against loss.

No Enough Planning for Retirement

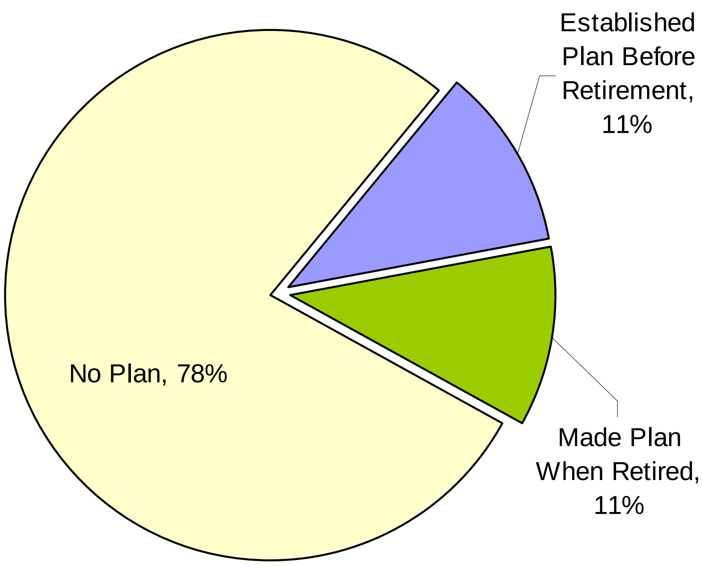
•Studies show that many people who are eligible to save through a DC plan decide not, until they get to their thirties and forties. However, in order to maximize the savings potential of DC plans, workers should start as early as possible. Automatic enrollment and better guidance could help achieve this goal.

Source: Building Futures Volume VI, Fidelity Investments Institutional Services Company, Inc., 2005

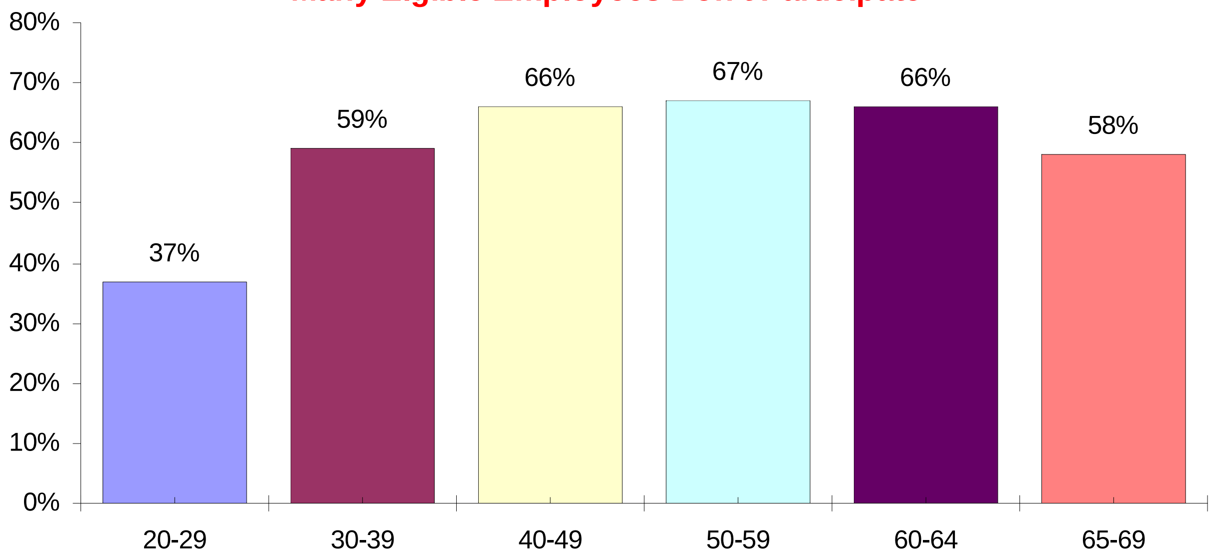
Source: LIMRA International, Inc., "Retirement Planning: The Ongoing Challenge," 2003

Retirement Preparedness

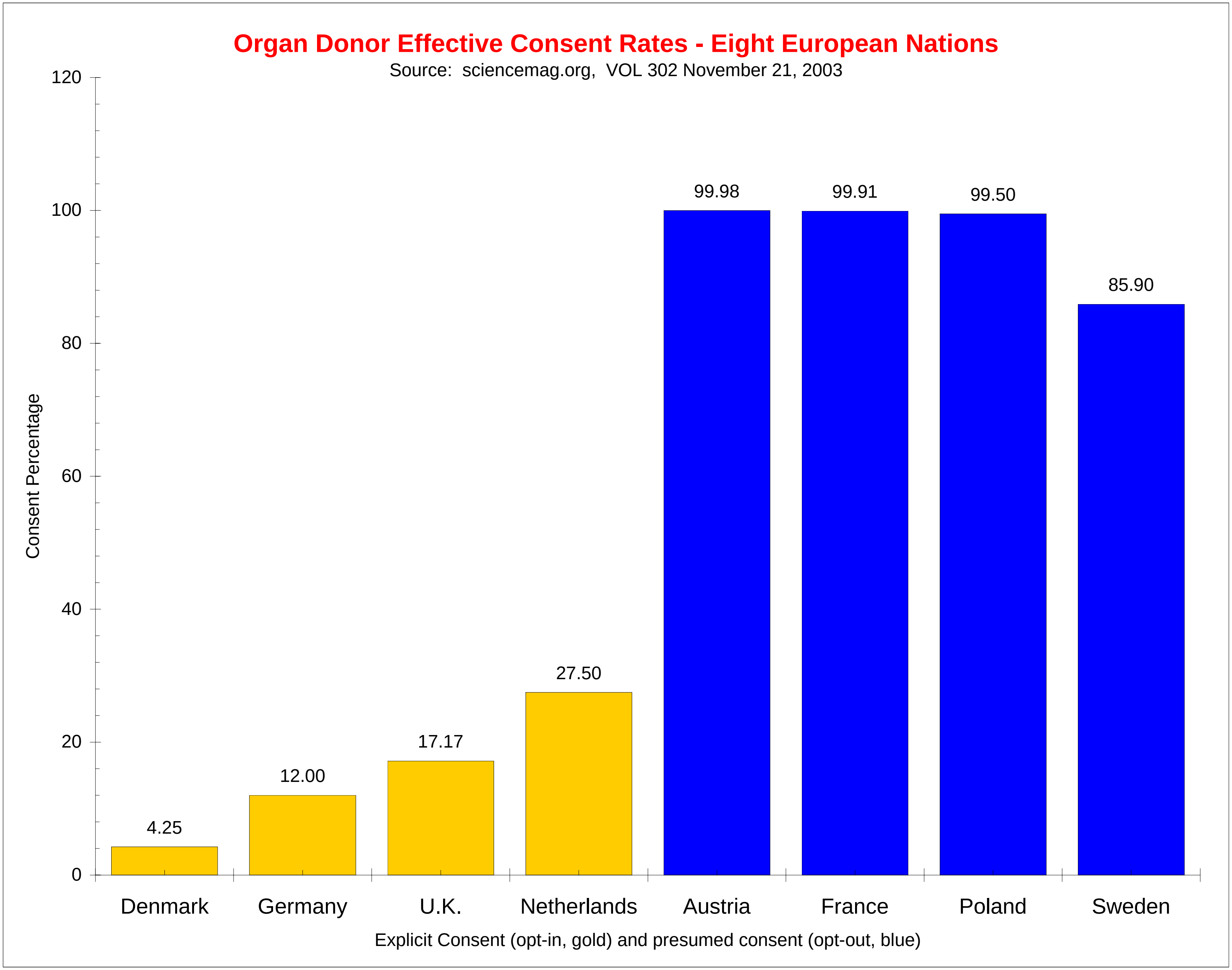
Source: LIMRA International, Inc., "Retirement Planning: The Ongoing Challenge," 2003



Many Elgible Employees Don't Participate

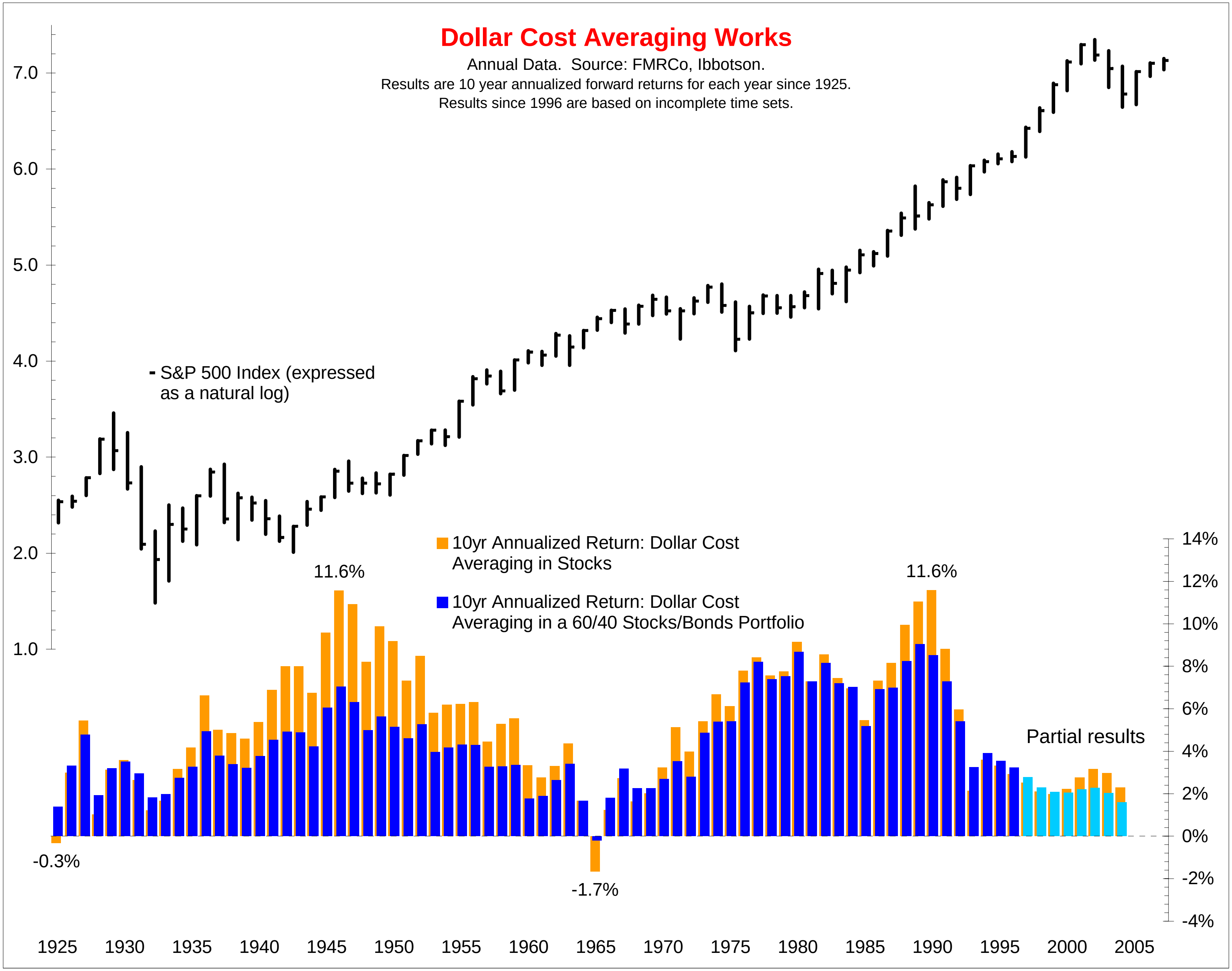


The Power of Negative Election



- Here is an illustration of the difference between an opt-in program (as 401(k) plans are currently set up) and an opt-out program (through automatic enrollment and negative election).
- In Europe, some countries have an organ donor program in which people have to opt in (gold columns, left), and some have a program where people are automatically enrolled and can opt out (blue columns, right).
- Note that Germany has only a participation rate of 12.0%, while Austria has a rate of 99.98%.
- Similar countries, totally different participation rates! Why? Automatic enrollment.
- *Source: sciencemag.org, VOL 302 November 21, 2003*

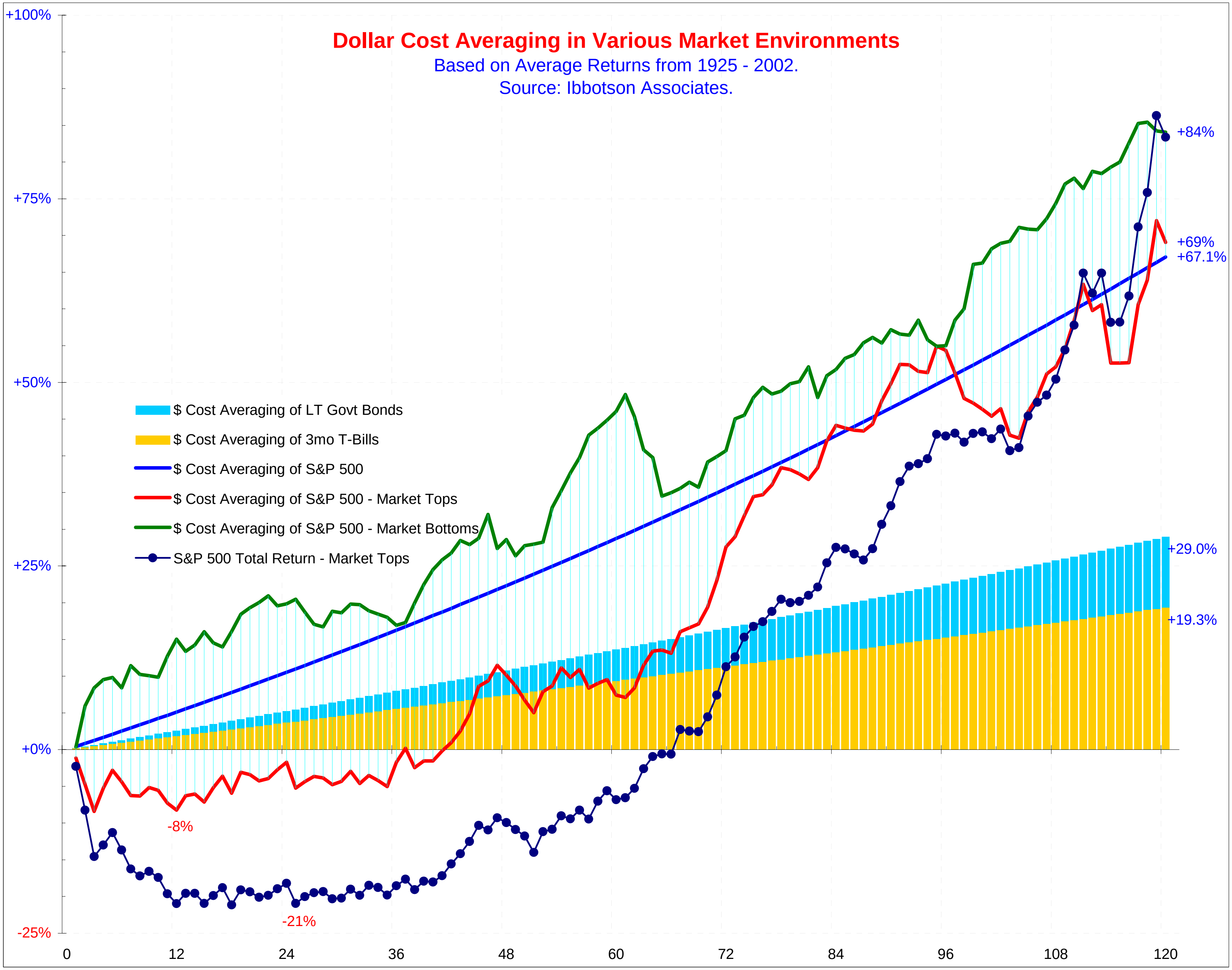
Dollar Cost Averaging Works



- The basis for any 401(K) plan is dollar cost averaging, which simply means investing small amounts of money in equal installments over a long period of time.
- Our research shows that, since 1925, a ten year dollar cost averaging plan would have netted an average annual return of 5.3% for a stock-only portfolio, and 4.4% for a 60/40 stocks/bonds portfolio.
- More importantly, the batting average over the past 80 years is 78 out of 80 (98%) and 79 out of 80 (99%), respectively.

•Data through 2004. Source: Fidelity Management & Research Co (FMRCo).

A Savings Method For All Markets

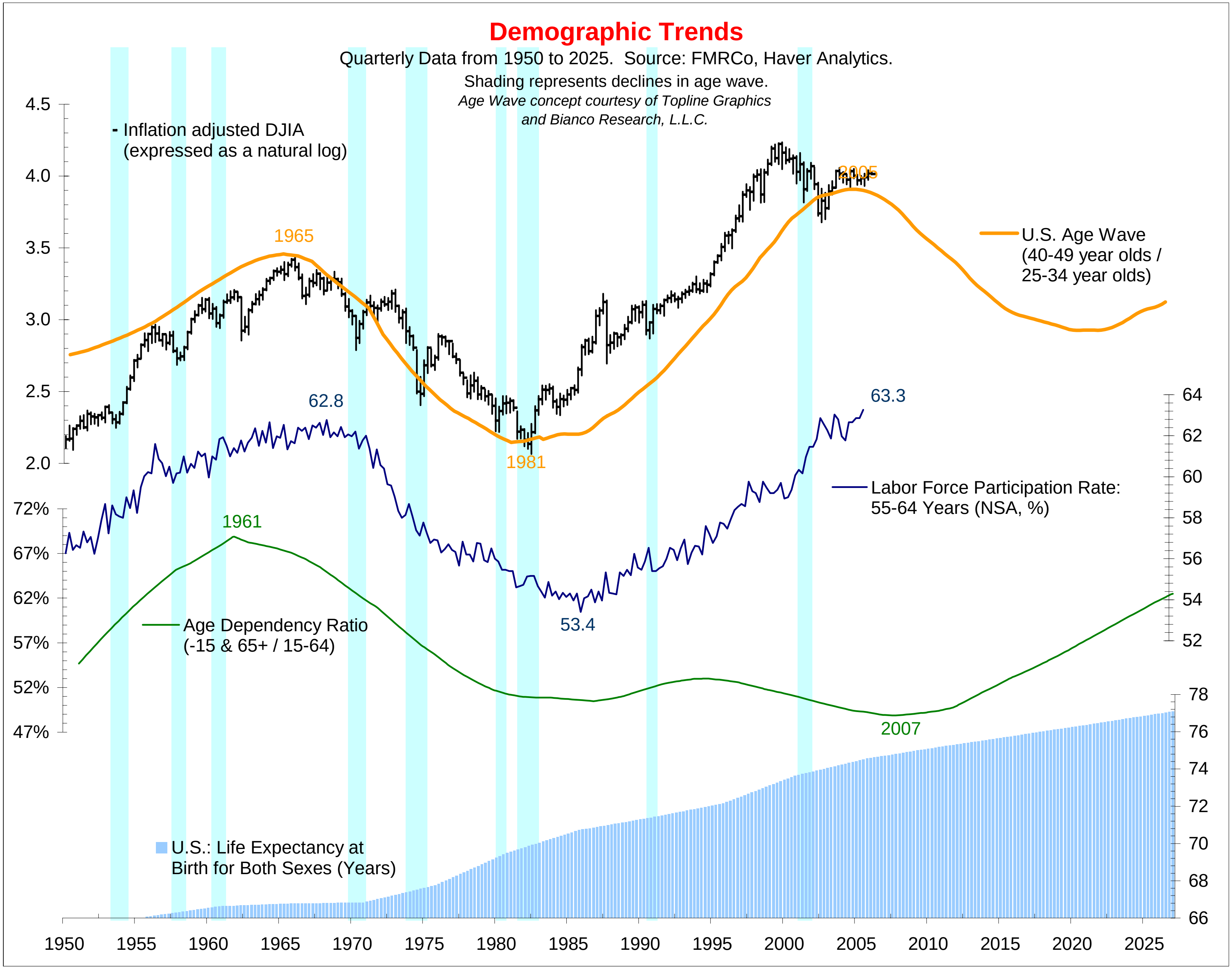


•The advantage of dollar cost averaging is that it works in most market environments, because the gradual build up of the cost basis helps to absorb market shocks.

•This chart shows that, regardless of when a dollar cost averaging program is started (typical market, top of bull market, bottom of bear market), after ten years the returns are about the same.

•Data through 2004. Source: Fidelity Management & Research Co (FMRCo).

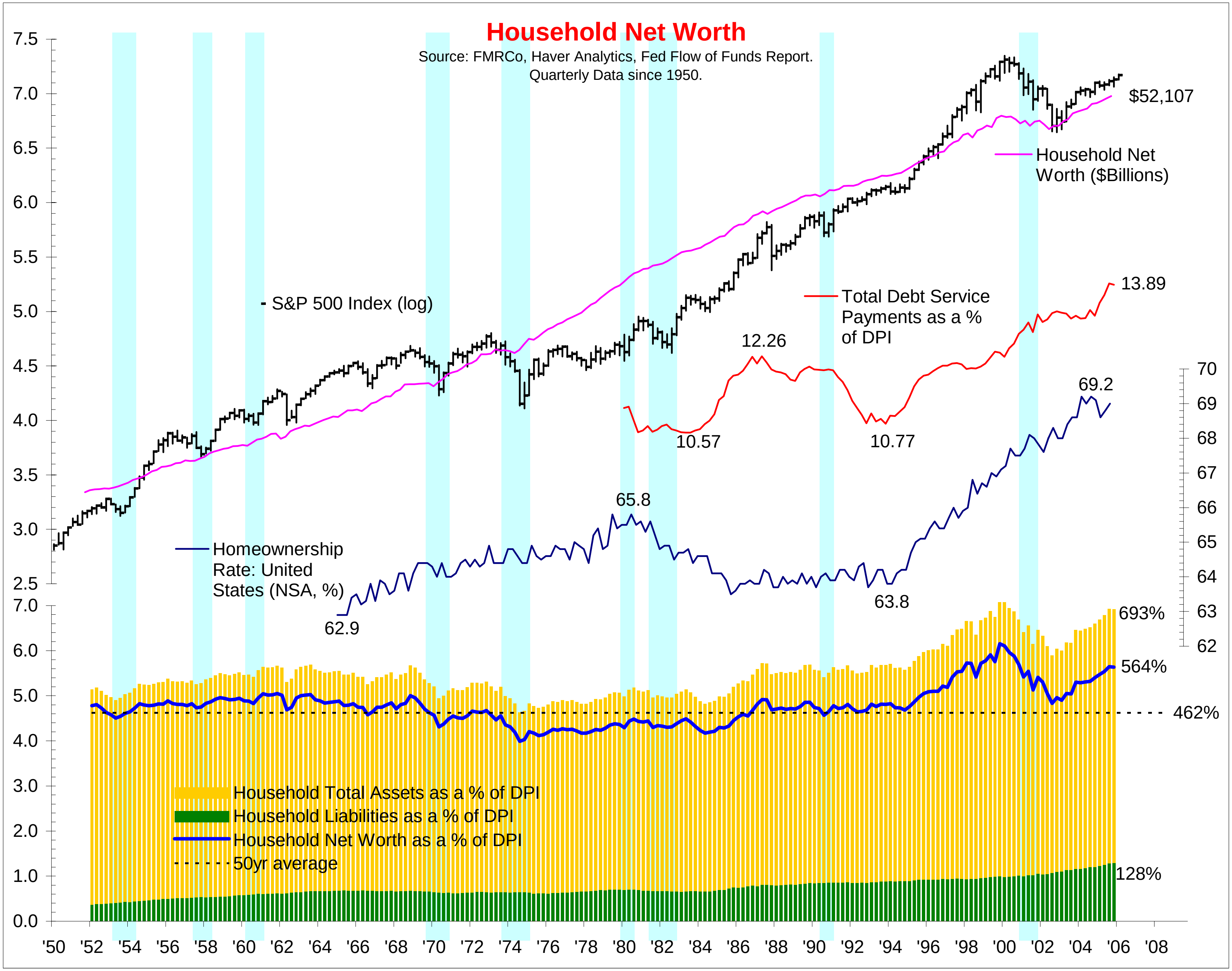
Demographic Trends



- Profound demographic changes are underway.
- Life expectancy continues to rise, and more and more Americans are working into retirement age.
- Meanwhile, the age dependency ratio will start to rise in a few years, and the age wave is peaking now.

•Data through 3/06. Source: Fidelity Management & Research Co (FMRCo), Bianco Research, U.S. Census Bureau, Haver Analytics.

Household Net Worth

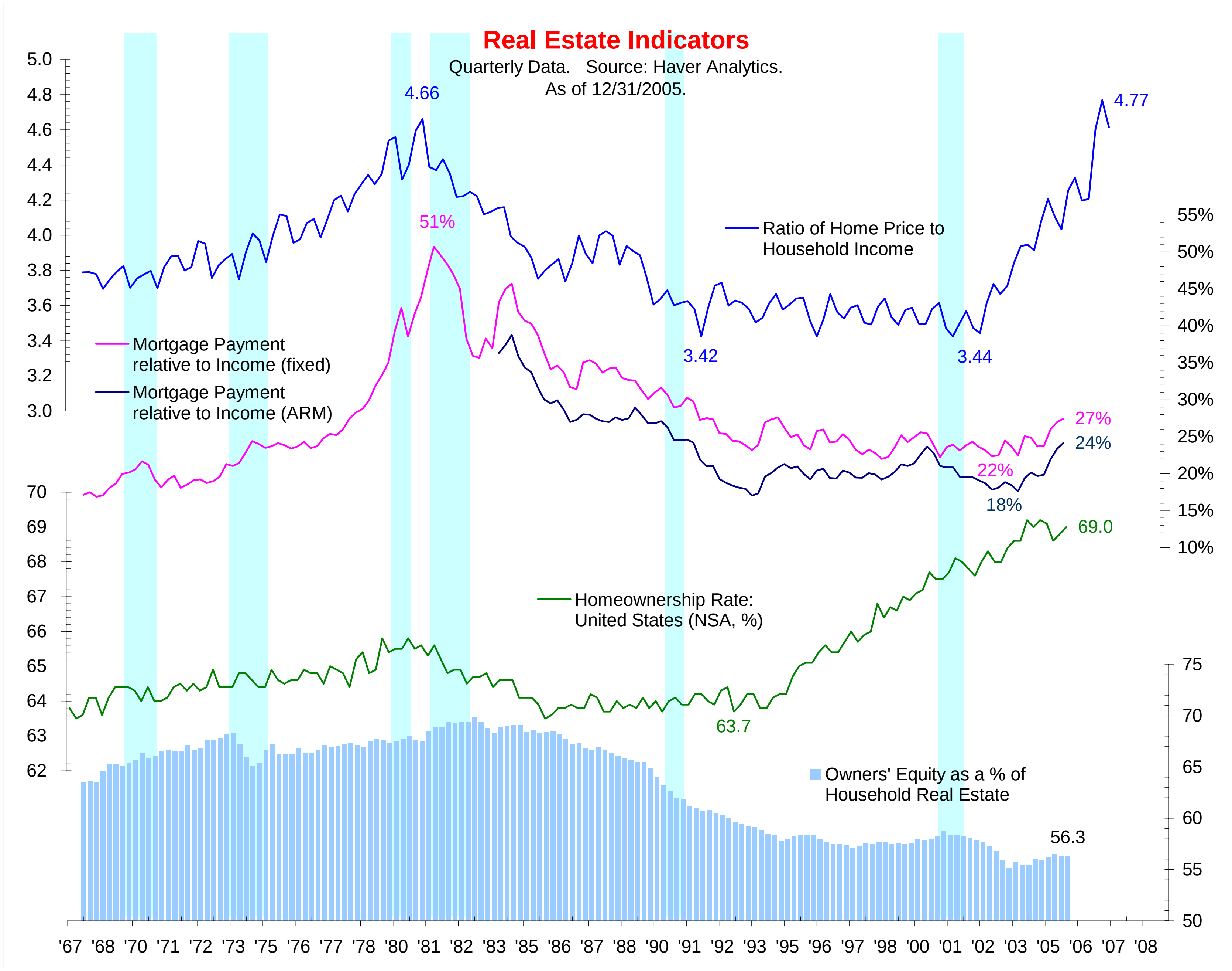


- While the household savings rate is very low, household net worth has been growing in recent years as a result of rising home prices and a rising stock market.
- Household net worth now stands at more than $52 trillion. This equates to almost six times disposable personal income (DPI).
- Debt service is at the highest level ever recorded, at 13.9% of DPI.
- Part of the rise in debt in recent years could be attributed to the rise in the homeownership rate, from 63.8 in 1994 to 69.2 in 2005.

•Data through 3/06. Source: Fidelity Management & Research Co (FMRCo).

•Based on a study by the Federal Reserve.

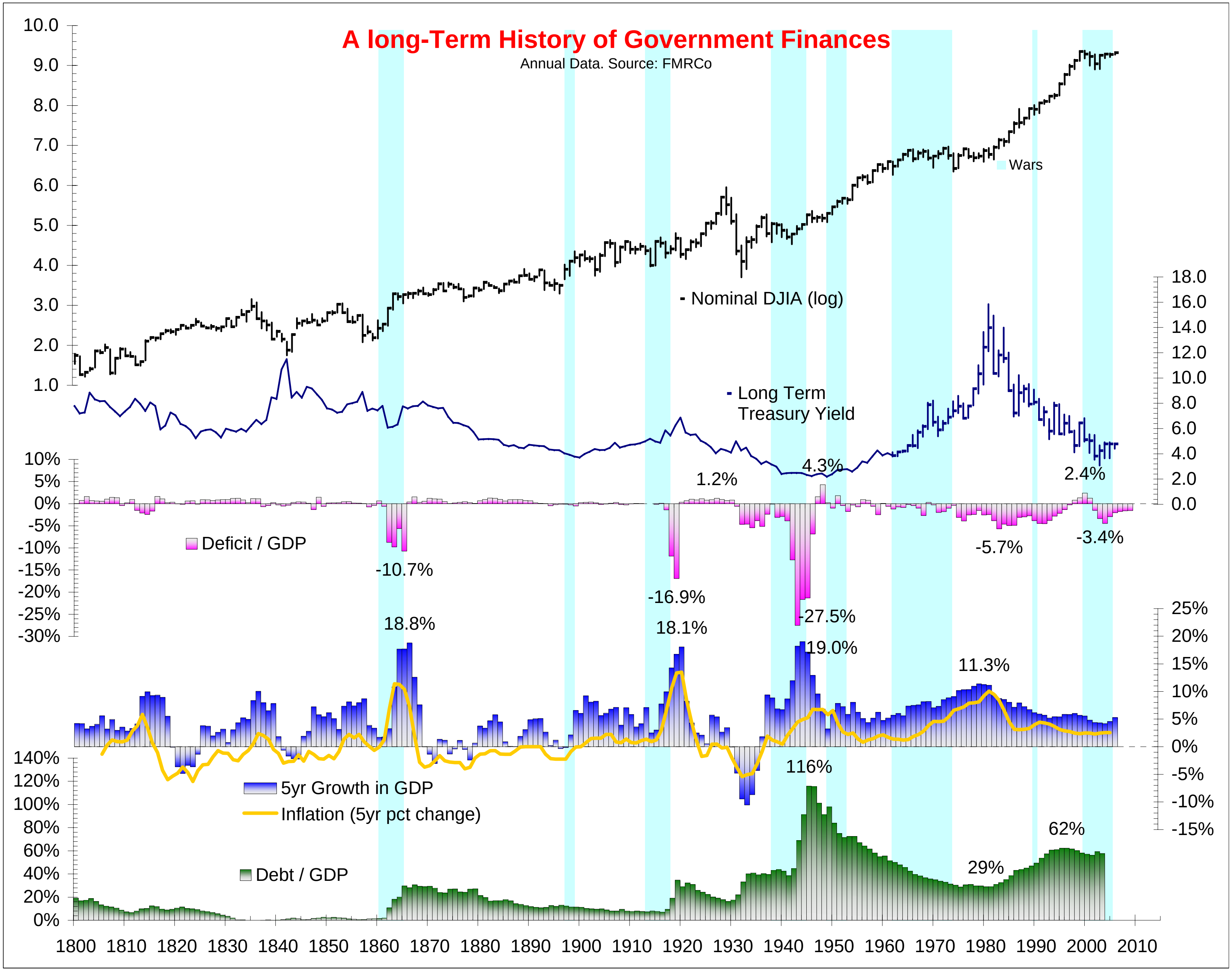
Is There a Housing Bubble?



- There is a widespread belief that the U.S. housing market is a bubble that either has burst or is about to burst. Indeed, the ratio of home prices to personal income has reached a new high at 4.77 times household income.
- However, when mortgage rates are factored into the affordability of homes, the picture is not quite as alarming.
- A mortgage payment for a new house (20% down) amounts to 27% of household income using a 30 year fixed rate, and 24% using an adjustable rate. That is higher than it has been for some time, but a far cry from where it used to be.

•Data through 3/06. Source: Fidelity Management & Research Co (FMRCo), Haver Analytics.

200 Years of Government Finances

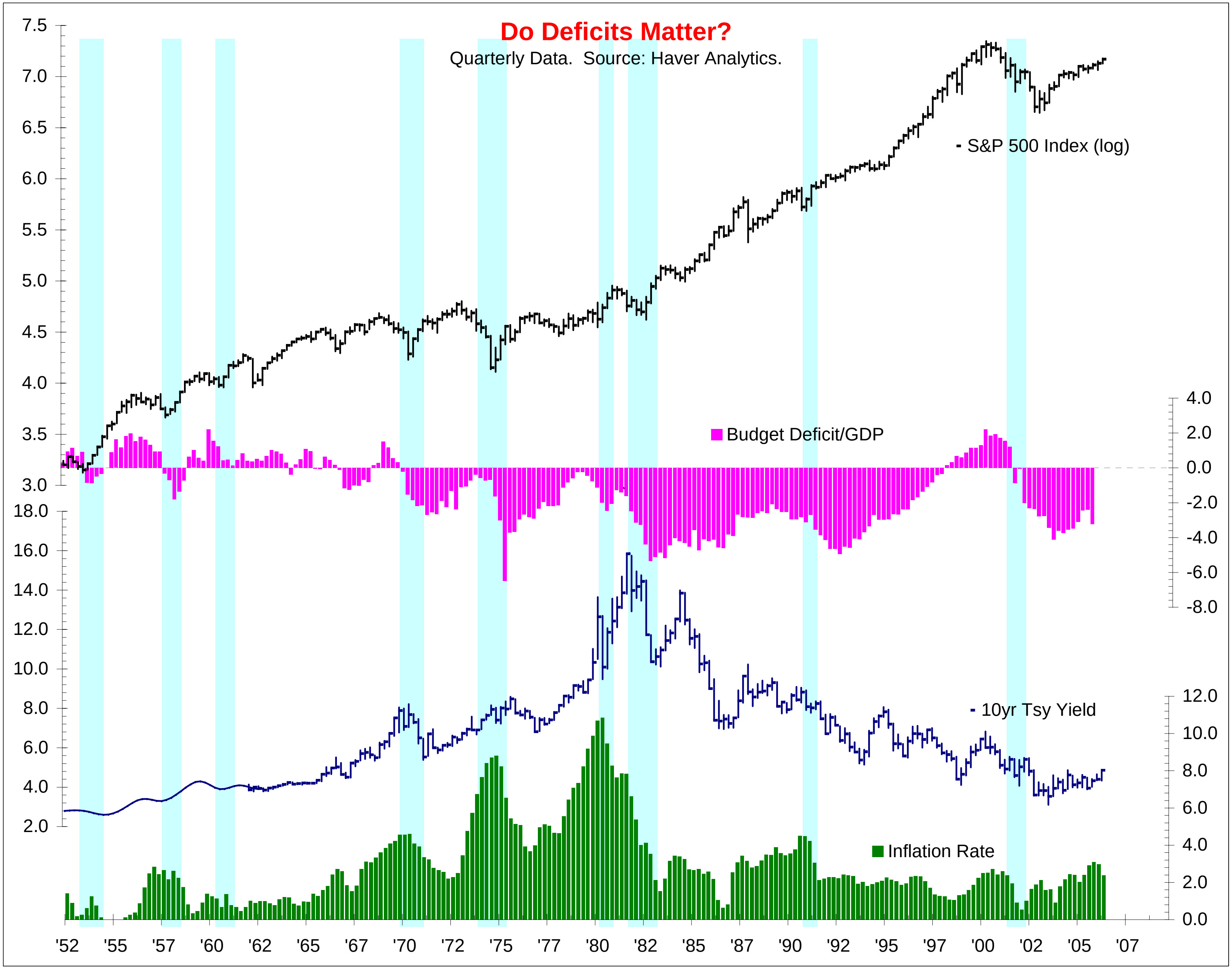


•This chart shows the U.S. Government's balance sheet since 1800.

•The vertical shadings show periods during which the country was at war. This is typically when deficits are at their highest. For example, during WWII, the budget deficit reaches 27.5% of GDP.

•Data through 2005. Source: Fidelity Management & Research Co (FMRCo), Bianco Research.

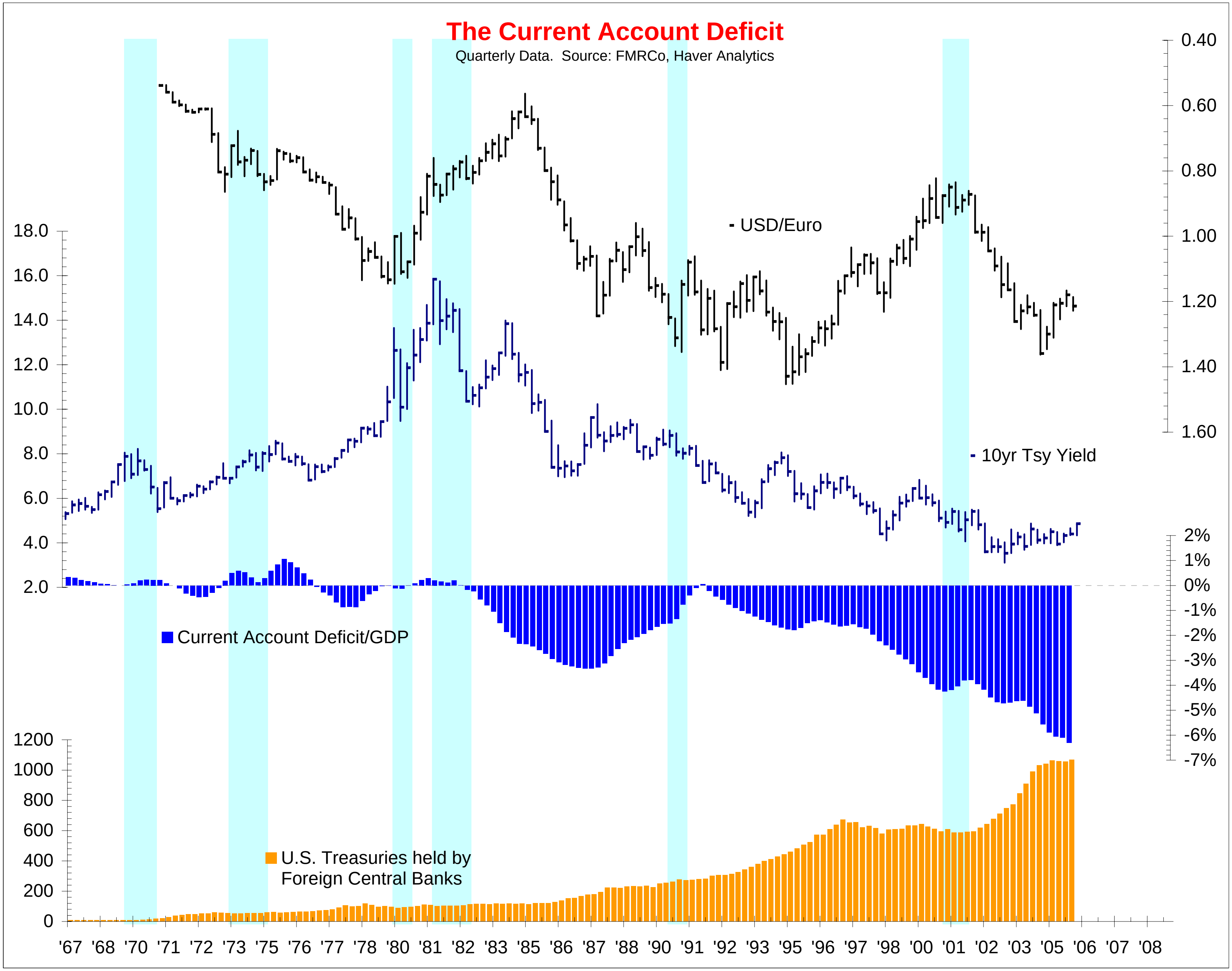
Do Deficits Affect Interest Rates or Socks?



- This chart shows a "close-up" of the budget deficit or surplus.
- While it seems clear that rising budget deficits should cause interest rates to climb (crowding out effect), it is difficult to find a consistent historical relationship.
- For instance, during the 1950's, the Government was running a consistent surplus, yet interest rates rose. During the 1980's, the Government ran consistent deficits, yet interest rates fell (and stock prices rose).

•Data through 3/06. Source: Fidelity Management & Research Co (FMRCo).

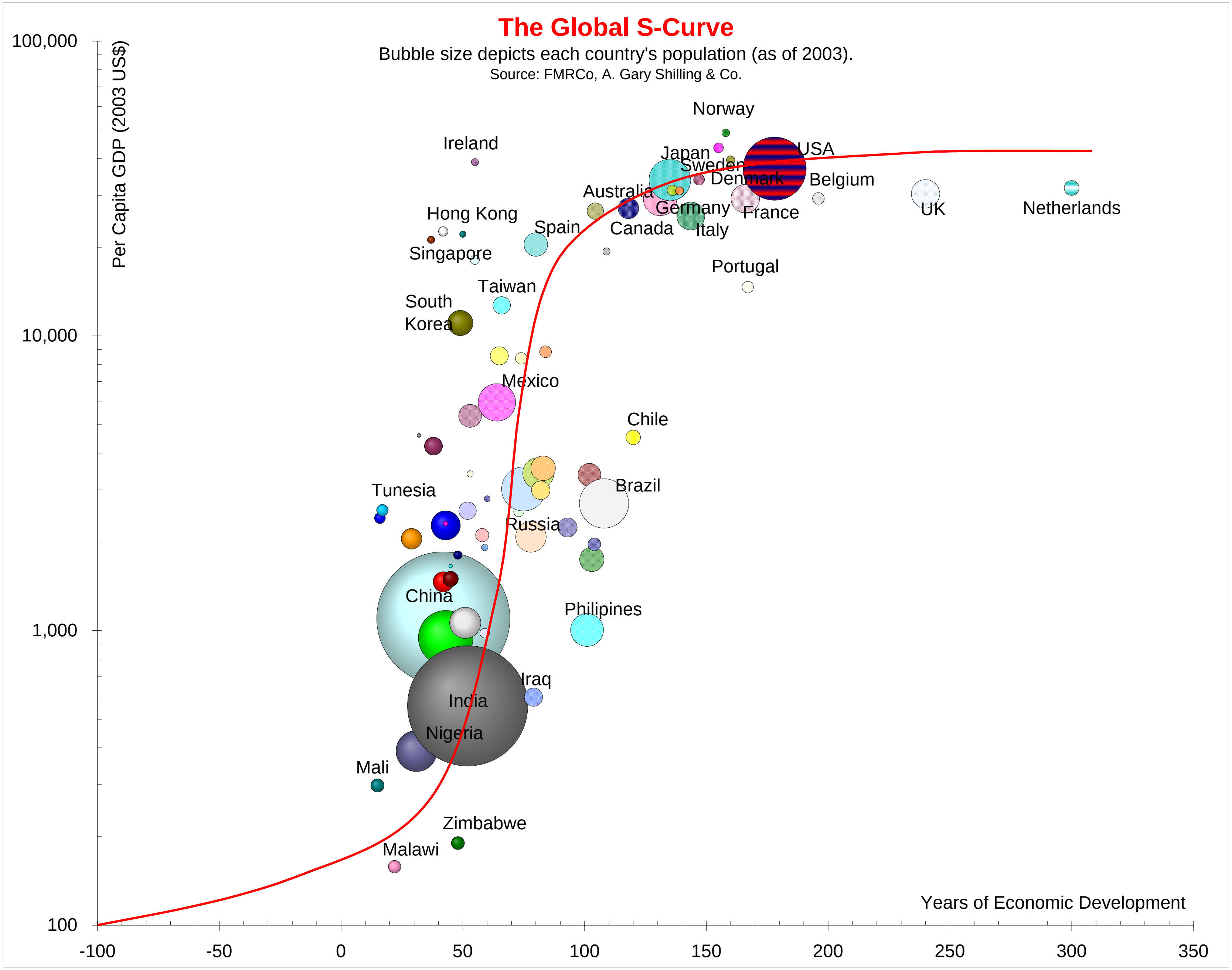
The Current Account Deficit



- In recent years, the U.S. trade deficit has ballooned ever higher (and with it the current account deficit).
- This has lead to an increased share of U.S. Government debt to be held by foreign investors, especially central banks. Foreign central banks now hold over $1 trillion in U.S. Treasuries.
- This development has lead to many predictions that either the dollar will have to fall, or interest rates will have to rise, in order to attract more investors.
- However, as the chart shows, there is little historical evidence to suggest that a widening deficit correlates with rising interest rates or a falling dollar.

•Data through 12/05. Source: Fidelity Management & Research Co (FMRCo), Haver Analytics.

Globalization: The Global S-Curve



•This chart shows where each country is on the road to economic development. This is called the “S-Curve,” which represents the growth curve of each country’s economy over time.

•The U.S., Western Europe, and Japan are among the richest and most industrialized countries.

•However, while levels of per capita GDP are high, their growth rates are not as high as those of emerging countries such as China, India, Brazil, and Mexico.

•Data Source: United Nations: The World Economy – Historical Statistics, A. Gary Shilling & Co. Per Capita GDP values are as of 2003.