

# **The Case For Employer-Sponsored Retirement Plans**

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**Coverage, Participation and Retirement Security**

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THE  
**SPARK**  
Institute, Inc.

SHAPING  
AMERICA'S  
RETIREMENT

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## **ABOUT THE SPARK INSTITUTE**

The SPARK Institute represents the interests of a broad based cross section of retirement plan service providers and investment managers, including members that are banks, mutual fund companies, insurance companies, third party administrators and benefits consultants. Our members include most of the largest firms that provide record keeping services to employer-sponsored retirement plans, ranging from one participant programs to plans that cover tens of thousands of employees. The combined membership services more than 62 million employer-sponsored plan participants.

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# The Case For Employer-Sponsored Retirement Plans

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## Coverage, Participation and Retirement Security

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### INTRODUCTION

This white paper is the second installment in a series developed by The SPARK Institute to demonstrate that employer-sponsored retirement plans, particularly 401(k) plans,<sup>1</sup> are the most effective, secure and viable way for American workers to save and invest to reach their retirement goals. The first installment examined the “Benefits and Accomplishments” of employer-sponsored plans<sup>2</sup> and the third installment will examine “Fees and Expenses.” This installment examines issues related to coverage of American workers by employer-sponsored retirement plans and certain tax benefits associated with these plans. The paper also examines the retirement security and readiness of workers who save through employer-sponsored plans. The SPARK Institute will release additional installments in order to address new issues and developments as appropriate.

*Our series of white papers examines the myths and demonstrates the value, benefits, effectiveness, security and viability that make employer-sponsored retirement plans the best way for American workers to save and invest to reach their retirement goals.*

<sup>1</sup> Employer-sponsored and workplace retirement savings plans are defined herein as any workplace retirement plan, including 401(k), 457, 403(b) or retirement savings plans offered through collective bargaining (e.g. Taft-Hartley). Employer-sponsored and workplace retirement savings plans, as used herein, do not include Individual Retirement Accounts.

<sup>2</sup> The first installment of our white papers titled, “The Case for Employer-Sponsored Retirement Plans – Benefits and Accomplishments,” is available on The SPARK Institute website at [www.sparkinstitute.org/comments-and-materials](http://www.sparkinstitute.org/comments-and-materials).

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## EXECUTIVE SUMMARY

There are many myths, misperceptions and misunderstandings about the employer-sponsored retirement plan system and its accomplishments and effectiveness in helping American workers save and invest for retirement. The SPARK Institute's series of white papers examines the myths and demonstrates the value, benefits and effectiveness that make employer-sponsored retirement plans the best way for American workers to save and invest to reach their retirement goals.

### The SPARK Institute believes that:

- ▶ The employer-sponsored retirement plan system is a fundamentally successful, sound, competitive and innovative system that (1) provides the best way for American workers to invest and save to reach their retirement goals, and (2) provides high quality services and good value for the cost, including more affordable investment options than retail investment products.
- ▶ Plan sponsors play a critical role in providing a valuable and cost-effective way for employees to save for retirement.
- ▶ Employer-sponsored retirement plans afford American workers a number of features that both encourage participation and deliver education and advice. Many of these features are not available through other savings vehicles.
- ▶ Opportunities to improve employer-sponsored retirement plans remain, and improvements can be readily made without abandoning the current system. Refinements to plan designs, features, rules and regulations are the best way to leverage the existing employer-sponsored retirement plan system in order to meet the changing needs of American workers.

*Opportunities to improve employer-sponsored retirement plans remain, and improvements can be readily made without abandoning the current system.*

### Recommendations

The SPARK Institute believes that all American workers should have access to retirement savings accounts through employer-sponsored plans. The current voluntary system should be maintained so that employers, particularly small businesses, can devote their resources to starting and maintaining their businesses and creating jobs before they are forced to provide certain employee benefits. If policy makers conclude, however, that a mandatory retirement program is necessary, then The SPARK Institute recommends that employers offer 401(k) plans as the primary savings vehicle with IRAs as alternatives for smaller employers that may not meet the requirements for qualified plans.

**The SPARK Institute recommends that:**

- ▶ Employer-sponsored plans should be designed to help working Americans (1) save more, (2) avoid taking distributions of the money they have in their accounts before retirement, (3) appropriately diversify their savings through asset allocation, (4) protect their savings from market volatility, particularly as they get closer to retirement, (5) provide a steady stream of income throughout their retirement, and (6) minimize the risk of outliving their savings.
- ▶ Mandatory automatic enrollment of employees and automatic escalation of employee contributions should be used as methods to increase participation in workplace savings plans and the rate of savings. Employee contributions and escalation rates should be set so that, when combined with Social Security, they will provide appropriate income replacement at retirement.
- ▶ Legislators and regulators should adopt new laws and regulations that limit participants' ability to cash out their retirement savings when they change jobs, while maintaining portability attributes.
- ▶ Employers, the retirement plan and investment industries, and government should continue to assist employees in establishing appropriate diversified portfolios for their retirement account balances. The longstanding principles of diversification and appropriate asset allocation are proven techniques for achieving success over the long term.

*Employer-sponsored plans should be designed to help working Americans (1) save more, (2) avoid taking distributions of the money they have in their accounts before retirement, (3) appropriately diversify their savings through asset allocation, (4) protect their savings from market volatility, particularly as they get closer to retirement, (5) provide a steady stream of income throughout their retirement, and (6) minimize the risk of outliving their savings.*

In conjunction with a robust employer-sponsored retirement plan system, a strong Social Security system is needed to ensure that workers have a secure retirement and meet the promise of a public retirement benefit they expect to receive after contributing to the system for their entire working lives.

Throughout this document we examine and dispel the myths, misperceptions and misunderstandings about employer-sponsored plans. Recommendations for improving the current system are also discussed in greater detail.

## DISCUSSION AND RECOMMENDATIONS

The historic financial markets' collapse of the past year is wider, deeper, and more unsettling than any other downturn in generations. Companies in the Standard & Poor's 500 have lost almost \$6 trillion in market value. Nearly all investors, including American workers saving for their retirement through any type of retirement plan, have seen their account balances decline substantially. These recent events and other issues have led some policy makers, academics and other industry critics to question whether the employer-sponsored retirement plan system can adequately prepare American workers for retirement. It is necessary to separate the market crisis from the retirement crisis and make improvements to the retirement system and continue to leverage what is working today.

While the media and some members of Congress have raised questions about 401(k) plans, and despite the recent decline in account balances (in line with general market declines), a recent study revealed that the vast majority of American workers continue to value their retirement plans.<sup>3</sup>

- ▶ The survey found that slightly more than 40% of those surveyed said they probably wouldn't be saving for retirement if it weren't for their employer-sponsored plan.
- ▶ Additionally, 87% of those surveyed, regardless of whether or not they participated in an employer-sponsored plan, said they didn't want the government to take away their ability to make investment decisions in their accounts or to replace their accounts with either a government promise or a government bond.

The employer-sponsored retirement plan system is fundamentally sound – and has continued to adapt and support the changing needs of the American worker. Changes incorporated in the Pension Protection Act of 2006 (“PPA”) and other legislation and regulation over the years are examples of how the system has been modified. The SPARK Institute believes that it is essential to continue to adapt to changing needs, and that opportunities to improve employer-sponsored retirement plans remain.

*The number of defined contribution plans sponsored by American employers has grown steadily over the past 25 years to over 700,000. These plans now provide savings accounts for nearly 92 million workers.*

On the following pages, we discuss specific points about coverage, participation and retirement security and outline our recommendations in greater detail.

### A. Over 90 Million Americans Save Through Employer-Sponsored Plans

The power of defined contribution plans as a vehicle for empowering American workers to save for their retirement years can be seen in the way millions of Americans have embraced these plans. The number of defined contribution plans sponsored by American employers has grown steadily over the past 25 years to over 700,000. These plans now provide savings accounts for nearly 92 million workers.<sup>4</sup>

<sup>3</sup> Investment Company Institute (“ICI”) report, “Retirement Saving in the Wake of Financial Market Volatility,” December 2008

<sup>4</sup> “Retirement Market in Focus,” RG Wuelfing & Associates, Inc. and Retirement Research, Inc., May 2009.

For a number of reasons, however, workplace savings plans cover only approximately 50% of working Americans,<sup>5</sup> including part-time employees.<sup>6</sup> Clearly, any discussion of coverage issues and recommendations for improvement must start by looking at the reasons that certain employers do not offer retirement plans. Only 30% of employers with a workforce of between 10-24 employees offer a workplace retirement plan and 45% of employers with a workforce between 25 and 99 employees offer a plan.<sup>7</sup>

Among the various reasons small employers do not offer workplace savings plans are fiduciary liability and cost.<sup>8</sup> Personal characteristics of employees also play a role in whether an employee will have access to an employer-sponsored retirement plan. One study suggests that “the probability that an employee works for a firm that sponsors a plan is highly related to the employee’s characteristics. In particular, employees who work for firms that sponsor plans are more likely to be older, have higher earnings and work full-time for a full year.”<sup>9</sup>

***If policy makers conclude that a mandatory retirement program is necessary, then The SPARK Institute recommends that employers offer 401(k) plans as the primary savings vehicle.***

***The SPARK Institute Recommendation*** – The SPARK Institute believes that all American workers should have access to retirement savings accounts. The SPARK Institute believes, however, that the current voluntary system should be maintained so that employers, particularly small businesses, can devote their resources to starting and maintaining their businesses and creating jobs before they are forced to provide certain employee benefits. Workplace savings plans offer the most convenient and effective way for workers to save for retirement – with tax-deferred contributions invested through payroll deduction and, in many cases, the added benefit of a company match.

If policy makers conclude, however, that mandatory retirement benefits are necessary, then The SPARK Institute recommends that:

- ▶ Employers have the flexibility to choose whether to offer either a 401(k) plan or an IRA.
- ▶ 401(k) plans should be the primary savings vehicle for American workers.
- ▶ IRAs should be offered as an alternative to an employer-sponsored savings plan for smaller employers that may not meet the requirements for qualified plans.
- ▶ No proposal should give preferred status to the use of IRAs as a substitute for employer-sponsored retirement plans.

Additionally, The SPARK Institute believes the benefits of employer-sponsored plans outweigh those of IRAs

<sup>5</sup> Employee Benefit Research Institute (“EBRI”) Issue Brief: “Employment-based retirement plan participation: Geographic differences and trends 2007,” October 2008.

<sup>6</sup> The Department of Labor defines part-time as an employee that works less than 34 hours in a week.

<sup>7</sup> “Who Gets Retirement Plans & Why,” ICI, January 2009.

<sup>8</sup> “Online 401(k) Plans Warrant Consideration By Small Companies,” Mark Gutrich, Resource Nation. Even a statement by Rep. Kind echoes the same concerns, “as I dug into the issue I discovered that the majority of small businesses don’t offer any retirement savings plans to employees because it is often a complicated, costly, and a somewhat risky endeavor.” Statement of Rep. Ron Kind to House Committee on Ways and Means, June 26, 2008.

<sup>9</sup> “Online 401(k) Plans Warrant Consideration By Small Companies,” Mark Gutrich, Resource Nation.

for many other reasons including, but not limited to, the following:

- ▶ As more robust retirement savings programs, they help companies retain workers.
- ▶ Their higher contribution limits allow employees to save more for a secure retirement.
- ▶ They offer employer matching and profit sharing contributions.
- ▶ They have the ability to use vesting schedules for employer contributions to incentivize retention.
- ▶ Employer oversight is provided.
- ▶ Employer education and vendor tools are offered.
- ▶ Potential economies of scale emerge as plans grow.

The SPARK Institute is alarmed by any proposal that appears to give IRAs preferential treatment based on misconceptions about them and, in some instances, based on the successes of 401(k) plans. For example, the proponents of mandatory automatic IRAs cite the successes of automatic enrollment arrangements developed and adopted by the 401(k) industry in order to support the possible success of automatic IRAs.<sup>10</sup> As is demonstrated throughout this white paper and others in this series,<sup>11</sup> employer-sponsored retirement plans are the most valuable, effective, secure and viable way for American workers to save and invest to reach their retirement goals.

#### **Mandatory IRAs and the Prior 403(b) Plan System Analogies**

The proposed mandatory IRAs would appear to create a system similar to the “403(b) plan system” prior to the IRS and Treasury adopting rules and regulations requiring greater employer involvement in the operation of those plans. For decades before January 1, 2009, under 403(b) arrangements, employees could open up retirement savings accounts with virtually any investment provider of their choosing. As a result, there were challenges in monitoring 403(b) plans which resulted in violations with respect to contributions and withdrawals. The use of a mandatory IRA would result in some of the same issues that faced 403(b) plans prior to January 1, 2009, including a lack of education for participants, higher fees and the inability to monitor compliance with regulations because of the limited role of the employer. This would lead to outcomes that are in direct contrast to many of the objectives of policy makers.

After years of proposed rulemaking, 403(b) plan regulations were changed effective January 1, 2009 and now require greater employer/plan sponsor involvement in the oversight and operation of a plan and treat the employer as a plan sponsor. Congress and regulators made 403(b) plans more like 401(k)s with respect to oversight and monitoring.

However, the proposed mandatory IRA system would likely create the next unsupervised, loosely managed and hard-to-regulate retirement system, and mimic the concept that was just fixed in the 403(b) world. In order to prevent these potential problems, the employer must play a greater role in the arrangement and will have more responsibility. Once you go down the path of increasing the employer role with respect to such IRA arrangements, it begs the question why, then, would IRAs be better than 401(k) arrangements? As is demonstrated herein and in the other white papers on these topics, The SPARK Institute believes the answer is that mandatory IRAs cannot be justified when compared to 401(k) plans, whether voluntary or mandatory.

<sup>10</sup> Congressional Testimony, Pursuing Universal Retirement Security Through Automatic IRAs, before the Subcommittee on Select Revenue Measures of the U.S. House of Representatives’ Ways and Means Committee, David John (The Heritage Foundation) and Mark Iwry (The Brookings Institute), June 26, 2008.

<sup>11</sup> The first and third installments of our white papers cover “Benefits and Accomplishments” and “Fees and Expenses,” respectively.

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In order to overcome certain employers' reluctance to offer a retirement plan, The SPARK Institute recommends that lawmakers and regulators adopt new laws and regulations that would allow employers to offer a simplified "mandatory K" plan with the following changes:

- ▶ Fewer and simpler plan features.
- ▶ Pre-selected or fewer investment options.
- ▶ Limited fiduciary responsibility and exposure to potential claims by participants.
- ▶ Simple plan documents that are provided by service providers.
- ▶ No compliance testing (e.g., non-discrimination and coverage testing).
- ▶ Limited regulatory reporting.
- ▶ Eligibility requirements limited to either 3 months or 501 hours, thereby reducing the number of small accounts created due to high employee turnover.
- ▶ No employer-contribution requirements.

Workplace savings plans were never intended to be the primary source of private retirement savings. It is evident that workplace savings plans are becoming an essential pillar, along with Social Security and private savings, in the effort to achieve retirement security for working Americans. The time is right to focus on ways to improve the existing system and expand coverage so more Americans can save for retirement. Having employers offer a workplace savings plan to their employees is the first step in helping achieve retirement security.

## **B. Employers Proactively Encourage Plan Participation**

The top priority of most defined contribution plans is to increase participation rates. Today, the average participation rate is 77%.<sup>12</sup> The increasing adoption of automatic enrollment programs is expected to raise the participation rate even further. Yet some workers are almost always likely to refrain from enrolling in defined contribution plans. The reasons usually have more to do with personal circumstances – such as the inability to put money aside for retirement when current financial needs appear more pressing – than with the type of plans being offered.

Critics of employer-sponsored retirement plans argue that they are inadequate because too many employees choose not to participate or save in them. However, the reasons that individuals may not participate in a plan have more to do with human nature and personal circumstances than the type of plan that is offered. For example, many of those who do not participate are younger or lower-paid workers.

***The reasons that employees don't participate usually have more to do with personal circumstances – such as the inability to put money aside for retirement when current financial needs appear more pressing – than with the type of plans being offered.***

<sup>12</sup> "DCP 2008," Boston Research Group.

The non-participating workers can be segmented as follows:

- ▶ 80.7% of the age 21-24 population of eligible employees do not participate in the workplace retirement plan.
- ▶ 92.4% of the eligible employees who earn less than \$10,000 do not participate in the workplace retirement plan.<sup>13</sup>

The SPARK Institute believes the PPA was a major step toward strengthening the retirement system by allowing employers to automatically enroll employees, raise their contribution rates over time, and default them to lifecycle funds, managed accounts or balanced funds. Auto enrollment has had a positive impact across employers of all sizes, including smaller employers. However, more should be done to increase utilization of automatic enrollment, especially among smaller employers. In 2008, only 16% and 37% of micro (plan assets <\$5 million) and small (plan assets \$5-50 million) employers, respectively, reported using automatic enrollment.<sup>14</sup>

***The SPARK Institute Recommendation*** – The SPARK Institute recommends mandatory automatic enrollment of employees as a method to increase participation in workplace savings plans. The SPARK Institute also recommends mandatory automatic escalation of employee contributions so that, when combined with Social Security, they will provide appropriate income replacement at retirement.

### C. Roadblocks to and Solutions for Retirement Security

Some critics contend that many American workers will not have enough money saved in their employer-sponsored retirement plans to provide them with adequate retirement income. This often has to do with the fact that many employees either enrolled in plans late in their working careers or did not contribute sufficient levels of their income toward their defined contribution plan retirement accounts. Efforts are being made to rectify these concerns through automatic enrollment and automatic deferral escalation programs, as well as education programs directed at encouraging participants to build their retirement accounts to meet their post-work financial needs. Additionally, plan participants may be allowed to make additional catch-up contributions when they reach age 50.

Supporters of the current system, as well as critics, have expressed concerns that the current laws and regulations governing such plans create too many opportunities for participants to withdraw their savings before retirement. Critics argue that financial market volatility, poor investment decisions, and inadequate participation and contribution rates are also reasons to consider these plans to be failures.

The SPARK Institute believes that some of the concerns can and should be addressed through modifications in the current retirement plan laws and regulations and through plan design changes. Additionally, The SPARK Institute is very concerned that the employer-sponsored retirement plan system is being wrongly

***Any discussion regarding the amount of money Americans have been able to save as a result of the employer-sponsored retirement system must look at the combined savings figure of \$6.51 trillion in order to provide an accurate picture of the success of such plans.***

<sup>13</sup> Copeland, Craig. "Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2007." EBRI Issue Brief No. 322 (Employee Benefit Research Institute, October 2008).

<sup>14</sup> *Plan Sponsor Defined Contribution Survey*, 2008.

blamed for issues that are not unique to such plans, such as the decline in account balances due to market volatility. As will be discussed more fully below, almost every investment vehicle that was designed to provide long term-growth for long-term investors, including retirement plan participants, has been adversely impacted by the historic collapse in the financial markets.

Many of the other reasons that contribute to the possible inadequacy of savings in employer-sponsored plans are based on the actions or inaction by employees, which are beyond the control of plan sponsors and the retirement plan and investment industries. Additionally, critics of these plans ignore the fact that employer-sponsored plans have, in large part, acted as a feeder program for a significant amount of money invested in rollover IRAs. As of December 31, 2008, approximately \$3.6 trillion were held in IRAs, of which approximately \$2.39 trillion or 66% were rollovers from employer-sponsored retirement plans.<sup>15</sup> The total amount saved in employer-sponsored plans (excluding defined benefit (“DB”) plans) at the same point was approximately \$4.12 trillion.<sup>16</sup> The SPARK Institute believes that any discussion regarding the amount of money Americans have been able to save as a result of the employer-sponsored retirement system must look at the combined savings figure of \$6.51 trillion in order to provide an accurate picture of the success of such plans.

*Studies suggest that almost all of the eligible employees who currently do not participate in their employer-sponsored plans would remain participants if they were automatically enrolled.*

While some recent changes in the retirement plan laws, such as automatic enrollment and qualified default investment alternatives (“QDIAs”), have helped to address some of the concerns above, The SPARK Institute believes that more can still be done to improve on the current system.

***The SPARK Institute Recommendation*** - In order to address these concerns, workplace retirement plans should be designed to help working Americans (1) save more, (2) avoid taking distributions of the money they have in their accounts before retirement, (3) appropriately diversify their savings through asset allocation, (4) protect their savings from market volatility, particularly as they get closer to retirement, (5) provide a steady stream of income throughout their retirement, and (6) minimize the risk of outliving their savings.

**1. Employers Encourage Workers to Start Saving Earlier and to Defer More** – One argument leveled against employer-sponsored retirement plans is that employees do not join plans early enough and that their contribution rates are too low. But, again, these issues have more to do with personal circumstances, habits and attitudes than the type of plans that are offered by employers. Both employers and the retirement plan industry are initiating programs to encourage workers to enroll in plans as soon they begin employment and to increase their deferral rates so that they can accumulate sufficient assets to see them through their retirement years. Automatic enrollment is meant to enroll workers in defined contribution plans as soon as they begin employment. And automatic deferral escalation programs generally increase the percentage of income that workers contribute to their accounts every year until they reach a desired level. Employers report that these programs are meeting with widespread satisfaction from workers. Already, average participation rates in 401(k) plans have reached 77%, while the average deferral rate is 6% of pay.<sup>17</sup>

<sup>15</sup> The SPARK Institute data.

<sup>16</sup> Ibid.

<sup>17</sup> DCP 2008, Boston Research Group.

The criticisms about lack of participation and low contribution rates also single out and blame employer-sponsored retirement plans for issues and realities that have more to do with other factors than with the employer-sponsored retirement plan system.

These include the tendency of young workers to avoid thinking about retirement, economic realities (including the costs associated with near term priorities for many such as health insurance and housing), and the fact that Americans generally have not been good savers. Prior to the recession, the savings rate for Americans from 2005 until September of 2008 averaged less than 1%.<sup>18</sup> Employers, with the assistance of their retirement plan service providers, however, have devoted significant resources to educating American workers about the importance of starting

to save as early as possible, about participating in their plans and about saving as much as possible (especially to take advantage of employer matching contributions).

***If policy makers conclude, however, that more must be done to force employees to begin saving for retirement at an early age and to save more, The SPARK Institute recommends mandating that all employer-sponsored plans include automatic enrollment and automatic escalation of employee contribution features.***

It is undeniable that employer-sponsored plans, particularly 401(k) plans, have, since their inception, helped tens of millions of American workers save for retirement. Many years ago, however, the retirement plan industry recognized the need to increase participation and the levels of contributions and to overcome the obstacles that prevent employees from enrolling and contributing to their plans as early as they can. To that end, the concepts of automatic enrollment and automatic savings rate escalation were developed. While some employers were early adopters of these concepts, the majority did not adopt the automatic features because of regulatory hurdles and potential fiduciary liability.

Recognizing the importance and success of these arrangements, Congress resolved some of the roadblocks to employer adoption by passing the PPA, which The SPARK Institute applauds. More time is needed, however, to allow employers to adopt these features and for them to work. Studies have shown that these features work and are successful. In fact, the proponents of automatic IRAs cite and rely on the success of automatic enrollment in 401(k) plans as a basis for assuming similar success may be achieved if applied to IRAs.

If policy makers conclude, however, that more must be done to force employees to begin saving for retirement at an early age and to save more, The SPARK Institute recommends mandating that all employer-sponsored plans include automatic enrollment and automatic escalation of employee contribution features. Studies suggest that almost all eligible employees who currently do not participate in their employer-sponsored plans would remain participants if they were automatically enrolled.<sup>19</sup>

Under automatic enrollment, according to research by The Vanguard Group,<sup>20</sup> the participation rate for new hires was 86%. Only 14% of automatically enrolled employees opted out. In contrast, 45% of

<sup>18</sup> Personal Savings Rate, U.S. Department of Commerce: Bureau of Economic Analysis, Personal Income and Outlays, March 27, 2009.

<sup>19</sup> James Choi, David Laibson, Brigitte Madrian, Andrew Metrick, Defined Contribution Pensions: Plan Rules, Participant Decisions, and the Path of Least Resistance, 2001; Brigitte C. Madrian, Savings in America: Helping Individuals Provide for Their Own Retirement, 2001; James Choi, David Laibson and Brigitte Madrian, Plan Design and 401(k) Savings Outcomes, 2004.

<sup>20</sup> Vanguard: "Measuring the Effectiveness of Automatic Enrollment." V 31. December 2008.

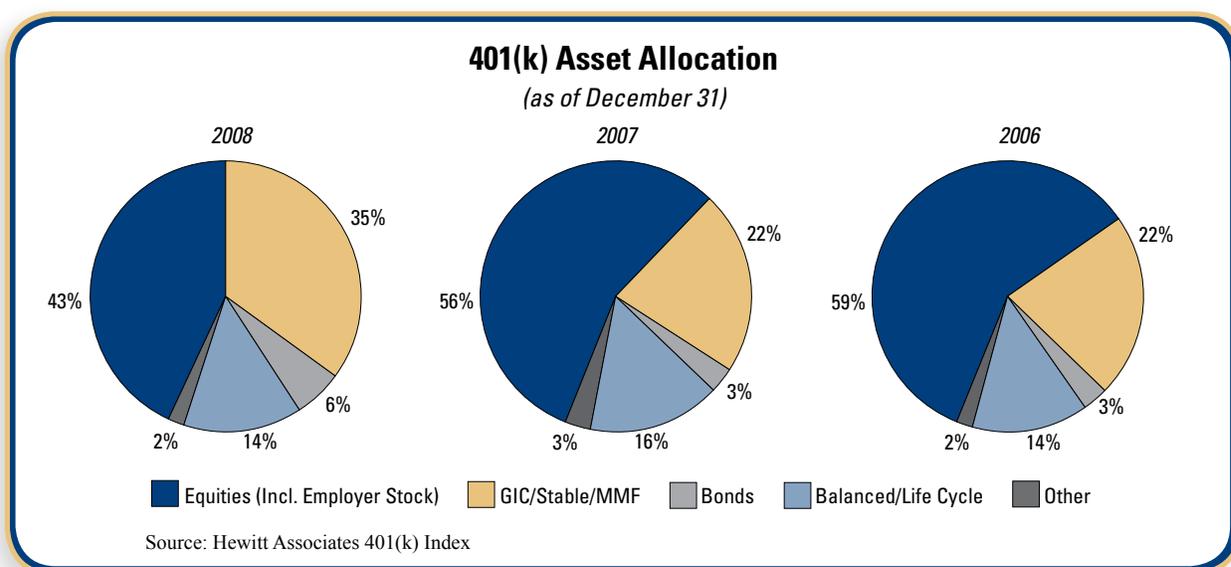
employees hired under voluntary enrollment initially joined their 401(k) plans. Automatic enrollment has its strongest results among low-wage and younger employees. After 30 months, 57% of the employees who automatically enrolled also contributed more than the default contribution amount.

Additionally, as noted previously, The SPARK Institute recommends mandating the inclusion of automatic contribution rate escalation features. Research suggests that the introduction of automatic escalation features in employer-sponsored plans will result in a significant increase in participant account accumulations – especially for low-income workers. The automatic escalation feature is likely to increase overall accumulations between 11% and 28% for participants in the lowest-income quartile.<sup>21</sup>

**2. Developing the Tools to Make Workers Savvier Investors** – The vast majority of employer-sponsored plans provide tools and resources to help participants appropriately diversify their accounts and optimize their investment allocations. When participants fail to take advantage of these tools, their reluctance generally stems from personal circumstances and their own outlook and habits rather than from any issue relating to the nature or structure of the employer-sponsored retirement plan system.

Employers, retirement plan service providers and investment advisors have spent significant resources and developed countless tools to help participants understand investment concepts and how to allocate their retirement savings. Even though employees often have different approaches and attitudes towards investing and making investment decisions, the goal is to offer workers the education and tools they might need to make prudent choices when it comes to investing their plan assets.

Some employees prefer making decisions entirely on their own, some prefer to have someone tell them what to do, and others want some guidance but will ultimately want to make their own decisions. Some participants are risk averse and do not want to lose money due to market fluctuation and others can accept significant market volatility. Overall, participants in employer-sponsored retirement plans tend to invest across asset classes. The following charts illustrate the asset mix for participant accounts in 2006 - 2008, according to data from Hewitt Associates.<sup>22</sup>



<sup>21</sup> VanDerhei, Jack, et al. “401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2007.” EBRI Issue Brief No. 324, December 2008.

<sup>22</sup> Hewitt Associates 401(k) Index, December 2006-2008.

While individual participant asset allocations cannot be determined from this data, clearly, participants diversify their assets and invest in long-term growth vehicles regardless of market conditions. As expected with the market turmoil in 2008, many participants moved out of equities and into more stable investment funds.

Retirement plan service and investment providers, as well as investment advisors, have recognized the different participant needs and have developed a number of tools, products and services to help employees enhance the investment potential of their retirement accounts. Among these are basic investment education materials supplied to participants in written and electronic form and through enrollment and in-person education meetings; online tools that perform retirement savings and investment allocation modeling; investment options with pre-set asset allocations designed for a participant's risk tolerance and/or target retirement date; and access to actual advice in helping establish an appropriate asset allocation strategy. When offered, this guidance is made available through third party providers via one or more of the following channels: web sites, call centers, and in-person sessions. The SPARK Institute

***Distributions taken by plan participants when they change jobs create a serious threat to retirement savings and security. Legislators and regulators should adopt laws and regulations that limit participants' ability to cash-out their retirement savings when they change jobs.***

observes that concerns regarding plan participant investment allocations will likely be compounded under a mandated IRA savings structure because of the limited employer role and the limited availability of many of the resources made available by service providers to participants in employer-sponsored plans.

The SPARK Institute recognizes, however, that improvements can be made in order to further assist employees in making better investment decisions.

***The SPARK Institute Recommendation*** – The SPARK Institute recommends that the retirement and investment management industries continue to develop and improve tools, products and services that are available to plan participants to help them appropriately diversify their accounts. Additionally, it is recommended that policy makers and regulators create a legal and regulatory environment that permits service providers to offer the assistance, guidance, investment advice, and investment products that participants need to achieve retirement security. The SPARK Institute believes that participants who take advantage of the tools, products and services that are available to them will be significantly more likely to reach and sustain their retirement goals.

- 3. Discouraging Early Withdrawals** – Some plans allow participants to withdraw loans from their accounts or take distributions before retirement. Loan programs initially were launched to help encourage employees to participate in defined contribution plans. But today, that enticement is seen by many employers as an unnecessary tool, and an increasing number of plans no longer offer loan programs. At the same time, the vast majority of participants in plans with loan programs do not

<sup>23</sup> VanDerhei, Jack, et al. "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2007." EBRI Issue Brief No. 324, December 2008.

borrow from their plans. And those that do tend to take out very small loans.<sup>23</sup> When it comes to early distributions, plan design rules always can be changed to limit participants' ability to cash out their retirement savings when they change jobs.

Another criticism of employer-sponsored plans is that participants may have too easy access to their savings prior to retirement through loans and distributions, particularly when they change jobs. The vast majority of plan participants (82%) do not borrow from their retirement plan accounts. Despite this data, however, it is recognized that taking a loan from a retirement plan account has the potential to reduce a participant's account at retirement by upwards of 17%.<sup>24</sup>

Given the successes of employer-sponsored plans and American workers' better understanding of the need to save for retirement, however, liberal loan provisions now may be potentially more harmful than beneficial.

***Participants in employer-sponsored plans, unlike investors in other retirement plan programs, are educated to diversify their investments to blunt the impact of market volatility.***

Distributions taken by American workers when they change jobs create a more serious threat to retirement savings and security. Employees age 25 and older stay at each job for about five years.<sup>25</sup> According to recent research, when employees in employer-sponsored retirement plans move to a new employer, 40% of them "cash out" their account balance and don't roll it over to their new employer's retirement plan or to a rollover IRA. While most of those who cash out have low balances (56% have less than \$5,000), when employees continually cash out, they do lose "savings momentum".<sup>26</sup>

***The SPARK Institute Recommendation*** – The SPARK Institute recommends that legislators and regulators adopt new laws and regulations that limit participants' ability to cash-out their retirement savings when they change jobs. New rules and regulations should require plan participants that no longer work for the plan sponsor to either leave their accounts in their former employer's plan, transfer their savings to their new employer's plan, or to transfer their account balances to an IRA.

- 4. Promoting Investment for the Long Term** – Market volatility can cause participants to lose large amounts of their retirement savings, as can be seen during the recent stock market decline. Yet employer-sponsored retirement plans are not unique in that sense. All investments, regardless of how or where they are made, are subject to market volatility. Participants in defined contribution plans are encouraged to save for the long term. And history shows that equity investments provide consistent returns to those who stay invested for the long term, and that long-term risk of losses is minimal. Participants in employer-sponsored plans, unlike investors in other retirement plan programs, are educated to diversify their investments to blunt the impact of market volatility. They also receive education that promotes long-term investment strategies and argues against simply reacting to recent market returns.

Some critics of employer-sponsored retirement plans incorrectly point to the recent historic decline in the financial markets and the resulting decline in participant account balances as the basis for claiming that such plans are flawed. The current financial crisis was caused by many factors, including aggressive and

<sup>24</sup> Great-West Retirement Services data.

<sup>25</sup> U.S. Department of Labor, Bureau of Labor Statistics news release, September 26, 2008.

<sup>26</sup> Brightwork Partners "Distributions from Qualified Plans Projected Through 2008."

abusive lending practices, over-use of debt and over-spending by Americans, inflated real-estate prices, the lack of saving by Americans, and lax government enforcement. These factors impacted individuals' savings, regardless of the type of savings vehicle – IRA, 401(k) or profit sharing plan. No one was spared from the financial crisis. The SPARK Institute points out that the retirement plan industry and employer-sponsored retirement plans are not to blame. In fact, American workers have likely saved more money in their employer-sponsored retirement plans than they have anywhere else. Clearly, such plans have encouraged important savings practices and should be recognized for having done so.

Employer-sponsored plans should not be judged, and policy makers should not make knee-jerk changes to the current employer-sponsored retirement plan system, based on unprecedented negative circumstances that were caused by unrelated events. History shows that equity investments provide consistent returns to investors who stay invested for the long term, and that the long-term risk of losses is minimal. Accordingly, plan participants with long-term time horizons who do not panic in market downturns and stick to consistent, diversified, long-term investment strategies generally have their account balances recover and then increase when the markets recover.

***Participants who have followed and continue to follow the investing principles for long- and short-term investing will likely see their accounts recover and then increase.***

Many critics of the current system point to the fact that some participants who may have been closer to retirement and had a short-term time horizon have seen their account balances reduced in the current economic crisis. While such situations are disturbing, it's important to note that even participants close to retirement may need some allocation in equities in order to realize their long-term retirement needs. The life expectancy for Americans today is 78 years,<sup>27</sup> and there is a 50% chance that a spouse will live to at least 85.<sup>28</sup>

Participants need help in understanding their overall needs and risk characteristics to make the most informed decisions. Investment education materials routinely provided to plan participants by employers and retirement plan and investment providers point out those critical needs and investing risks. Participants who have followed and continue to follow the investing principles for long- and short-term investing will likely see their accounts recover and then increase.

All investors, regardless of the type of investment account they used, have seen their account balances reduced in the current financial crisis. Since the unprecedented market decline affected all investments, not just those in employer-sponsored retirement plans, it is misleading to single out these plans for criticism and doing so ignores the realities of the economic crisis.<sup>29</sup> Even DB plans, for example, which are supposed to provide guaranteed benefits to participants, were affected. As a result, until the financial markets recover as expected, employers will have to increase their contributions to the plans when they are most likely already struggling in a difficult business environment. What's more, if a DB plan sponsor were to declare

<sup>27</sup> Central Intelligence Agency, The World Factbook, April 2009.

<sup>28</sup> Annuity 2000 Mortality Table; Society of Actuaries. Figure assumes a person is in good health.

<sup>29</sup> For example, funds within the Federal Thrift Savings Plan ("TSP") saw significant declines in 2008. The TSP's C Fund, which attempts to track the S&P 500 index, was down 37% in 2008. The TSP's indexed I Fund, which attempts to track the Morgan Stanley Capital International EAFE Index, was down 42%.

bankruptcy, the amount of each participant’s benefits could be jeopardized even with the backstop of the Pension Benefit Guaranty Corporation (“PBGC”).

While there are certainly no guarantees in a market-based approach to investing, rejecting the concept of investing in equities as a long-term strategy is tantamount to rejecting the basic concepts of capitalism under which the United States has thrived. It also flies in the face of generally accepted investment principles that have been proven over decades of market ups and downs.

***The SPARK Institute Recommendation*** – The SPARK Institute believes that the longstanding principles of diversification and appropriate asset allocation are proven techniques for achieving success over the long term. In addition, employer-sponsored retirement plans, by providing participant education, access to an array of pre-screened investment options, and professional investment guidance and advice, offer American workers the best way to save and invest to reach their retirement goals. Based on the foregoing, The SPARK Institute recommends that employers, the retirement plan and investment industries, and government continue to assist employees in establishing appropriately diversified portfolios for their retirement account balances.

- 5. Providing Steady Income for Retirement** – Research data demonstrate that American workers who save and invest properly through their employer-sponsored retirement plans should have adequate income to maintain their standard of living in retirement. Social Security benefits, IRAs and personal savings outside of retirement accounts must all be taken into account in evaluating the adequacy of a family’s or individual’s retirement savings. Education programs and new tools incorporated into employer-sponsored retirement plans have been designed to help workers maximize their defined contribution plan investments and savings so that they all can accumulate a sufficient level of assets to see them through their retirement years.

***American workers who save and invest properly through their employer-sponsored retirement plans should have adequate income to maintain their standard of living in retirement.***

Some opponents of the current system claim that because employees do not start saving early enough or do not save enough they will outlive their retirement savings. That claim, however, is misleading because it overlooks several critical facts and realities.

Research has concluded that nearly 80% of households with residents aged 50 to 61 who had employer-sponsored plan accounts should be able to maintain their pre-retirement living standards in retirement, yet only 47% of households without an employer-sponsored plan account would be able to maintain their pre-retirement standards of living.<sup>30</sup> The data clearly contradict the broad claims made by critics that American workers who save and invest properly through employer-sponsored retirement plans will not have adequate income to maintain their standard of living in retirement.

***The SPARK Institute Recommendation*** – The SPARK Institute recommends that, in conjunction with a robust employer-based retirement plan system, a strong Social Security system is needed. That system should ensure that workers have a secure retirement that will meet the promise of a public retirement benefit they expect to receive after contributing to the system for their entire working lives. Americans

<sup>30</sup> Civic Ventures, Fact Sheet on Older Americans.

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also should include the promised Social Security benefits in their retirement planning. In fact, because of the limit on Social Security benefits, the need to rely on the security of the system and the payment of benefits is more important for lower and middle income workers because such payments represent a higher percentage of their pre-retirement income. Social Security benefits represent a lower percentage of pre-retirement income for higher paid workers who must, therefore, save more through other means, such as an employer-sponsored retirement plan.

**D. Equitable Tax Treatment** – Employer-sponsored savings plans are governed by rules and regulations to ensure equitable benefits and contributions, including tax benefits and credits, for all salary ranges. While recent studies suggest that higher paid workers may reap greater tax benefits from saving through employer-sponsored retirement plans, they typically incur a higher portion of the plan’s expenses. Employer-sponsored plans, however, will benefit any workers who participate, regardless of their salary range. The SPARK Institute believes the ability to save while having taxes deferred, as well as the potential for employer matching contributions, serve as incentives to participate. It is also important to consider all means through which an individual can save for retirement. One cannot disregard the need to address the viability of other sources of retirement savings, such as Social Security and personal savings, the other two legs of the “retirement stool.”

*The ability to save while having taxes deferred, as well as the potential for employer matching contributions, serve as incentives to participate.*

In short, the success of each of these three sources of retirement savings has been debated over the years, and all have had their capacity to successfully position workers for retirement questioned: (1) personal savings for such reasons as difficult financial situations and the self-control to forgo consumption; (2) employer-sponsored retirement plans for such reasons as accessibility, market volatility and expenses; and finally (3) Social Security, for the anticipated disproportionate benefits paid as compared to taxes collected.

Having said that, The SPARK Institute maintains that:

- ▶ All Employees Benefit - The SPARK Institute believes that workplace savings plans benefit employees of all income ranges.
- ▶ Improvements Can Be Made - Improvements to the private sector retirement plan system, coupled with Social Security, should help working Americans achieve a certain level of retirement security.

Following is a more detailed discussion expanding on The SPARK Institute’s comments introduced above.

**1. Equitability of Employer-Sponsored Retirement Plans** – Although some studies may suggest that higher paid workers earn greater tax benefits from employer-sponsored plans, they typically pay a higher share of plan expenses. In addition, these plans are subject to rigorous nondiscrimination testing requirements that act to ensure that benefits and contributions are shared equitably among all eligible employees of a company. That is, as a percentage of pay, higher paid workers’ contributions (employee and employer) to employer-sponsored retirement plans are limited by the average contribution percentages of the lower paid workforce. In addition, all eligible participants are subject to the same Internal Revenue Code-

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imposed contribution limits, such as the Section 402(g) pre-tax deferral limit of \$16,500, or \$22,000 for those 50 or older (indexed for 2009). In short, the rules governing the operation of qualified retirement plans are structured to ensure that higher-paid workers do not receive disproportionately higher benefits than the lower-paid workforce.

Some studies find that lower-paid and younger workers have an untapped potential for increased retirement savings from employer-sponsored retirement plans.<sup>31</sup> Limited participation indicates the need for increased efforts targeted at the younger and otherwise lower-paid workforce, which today are primarily delivered via employer-sponsored retirement plans. New strategies being adopted by many employers, including automatic enrollment and safe harbor plan designs, also help to increase plan participation among all salary and age ranges.

***The SPARK Institute Recommendation*** – The SPARK Institute supports continued enhancements to employer-sponsored savings plans and further believes that they are an integral component of an individual’s retirement security. They offer benefits, including retirement education and the potential for employer matching contributions, not available through other retirement savings alternatives. The SPARK Institute recommends that the issue of more widespread accessibility be addressed and further supports the adoption of automatic enrollment and safe harbor plan designs, potentially eliminating nondiscrimination requirements.

**2. Income Replacement Ratio** – In addition to accessibility and participation in employer-sponsored retirement savings vehicles, another factor that impacts an employee’s retirement readiness is the actual percentage of earnings set aside for retirement. A Government Accountability Office (“GAO”) report found that some pension professionals consider income available at retirement to be adequate if it replaces 65% to 85% of pre-retirement income.<sup>32</sup> Other studies indicate that, after inflation and medical costs are factored in, it is recommended that retirees strive to replace, on average, over 125% of their pre-retirement income.<sup>33</sup>

Whatever the income replacement ratio, it is traditionally achieved via the three-legged stool consisting of Social Security, personal savings and employer-sponsored retirement plans. While those taking advantage of employer-sponsored plans tend to be higher paid employees, studies show that Social Security provides a higher income replacement ratio to lower paid employees. Aon Consulting analyzed replacement ratios and found that workers earning \$50,000 a year benefit from a Social Security replacement ratio of 51%, whereas workers earning \$250,000 realize only a 14% replacement ratio.<sup>34</sup> Given this disparity, it is not unreasonable to expect that higher-paid employees seeking to achieve a similar rate of replacement income in retirement would take advantage of the tax-favored savings opportunity offered by qualified retirement plans and save more of their income in these vehicles than their lower-paid counterparts. Nor is it unreasonable that the provisions of the tax code should be designed to encourage savings for retirement by offering tax incentives to those who contribute to these plans, since accumulating sufficient savings to provide for a reasonably secure retirement promotes a number of socially desirable outcomes.

<sup>31</sup> Vanguard, “How America Saves 2008: A Report on Vanguard 2007 Defined Contribution Plan Data.”

<sup>32</sup> GAO, “Report to Congressional Requesters, Private Pensions: Improving Worker Coverage and Benefits,” April 2002.

<sup>33</sup> Hewitt Associates, “Research Highlights - Total Retirement Income at Large Companies: The Real Deal,” June 2008.

<sup>34</sup> AON Consulting, Replacement Ratio Study, press release August 12, 2008.

Social Security was designed as a foundation upon which individuals could build retirement through additional savings. It was never designed to replace 100% of pre-retirement income. According to the Social Security Trustee's Report to Congress, in 2017 Social Security benefits paid will exceed what is collected in taxes. Without changes, by 2041 the Social Security Trust Fund will be exhausted, reducing scheduled benefits to about 78 cents on the dollar.<sup>35</sup> An additional concern is the impact of Medicare deductions on future Social Security checks. These dire predictions related to the future viability of the Social Security system serve to highlight the importance of a healthy private retirement system.

The success of employer-sponsored retirement plans is also being debated. Recent surveys indicate, however, that Americans want Washington to focus on strengthening Social Security and preserving employer-sponsored retirement plans.<sup>36</sup>

***The SPARK Institute Recommendation*** – The SPARK Institute believes that employer-sponsored retirement plans benefit all employees regardless of their salary ranges. Improvements to the private sector retirement system, coupled with Social Security, should help working Americans attain an adequate income replacement ratio. Eliminating workplace savings plans introduces further risk that higher-paid employees will not have sufficient means to replace the recommended percentage of pre-retirement income. Conversely, the future viability of Social Security could put the lower-paid workforce at significant risk of retirement readiness, as this “leg of the stool” tends to represent a sizeable portion of their retirement nest egg.

***The SPARK Institute believes that employer-sponsored retirement plans benefit all employees regardless of their salary ranges.***

The SPARK Institute believes that enhancement opportunities exist for all three legs of the retirement stool. The SPARK Institute further believes that employer-sponsored retirement plans encourage personal savings. They also serve as a means to educate the work force on the significance of retirement readiness. Currently, no other savings vehicle promotes this valuable lesson.

**3. The Savers Credit** – The Savers Credit, formally known as the “Retirement Savings Contribution Credit”, is available to low and moderate income workers whose 2009 Adjusted Gross Income (“AGI”) is no more than:

- ▶ \$55,500 if the filing status is married filing jointly,
- ▶ \$41,625 if the filing status is head of household, or
- ▶ \$27,750 if the filing status is single, married filing separately, or qualifying widow(er).

This tax credit serves to encourage tax payers in lower income brackets to save for retirement. Salary reduction contributions made to employer-sponsored retirement plans, or contributions made to traditional or Roth IRAs, are eligible contributions. The amount of the Savers Credit is dependent upon the worker's filing status, AGI, and eligible retirement contributions. The credit is calculated as a percentage of the qualifying contribution amount, with the highest rate, or percentage, benefiting taxpayers with the lowest income. The Savers Credit is in addition to other tax benefits that may result from retirement

<sup>35</sup> Sample Social Security statement, updated Feb. 18, 2009, [www.ssa.gov](http://www.ssa.gov).

<sup>36</sup> ICI, “Retirement Saving in the Wake of Financial Market Volatility,” December 2008.

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contributions. The Savers Credit serves as both a benefit and incentive to lower-paid workers, in order to bolster participation and therefore assist low and moderately paid workers prepare for their retirements. The credit is not made available to workers whose AGI is more than the income outlined above.

***The SPARK Institute Recommendation*** – The SPARK Institute supports continued enhancements to employer-sponsored retirement savings plans and further believes that they are an integral component of an individual’s retirement security. The SPARK Institute also supports incentives that encourage American workers to save for retirement and incentives that bolster participation among younger and lower-paid workers who have historically been the least active in participating in employer-sponsored plans. The tax code should be designed to encourage retirement savings by offering tax incentives to those who contribute, since accumulating sufficient savings for a reasonably secure retirement promotes a number of socially desirable outcomes.

