Approved: 3-22-06
Date

MINUTES OF THE SENATE FINANCIAL INSTITUTIONS AND INSURANCE COMMITTEE

The meeting was called to order by Chairman Ruth Teichman at 9:30 A.M. on March 14, 2006 in Room 234-N of the Capitol.

All members were present except:
Dennis Wilson- excused

Committee staff present:
Melissa Calderwood, Kansas Legislative Research Department
Terri Weber, Kansas Legislative Research Department
Ken Wilke, Office of Revisor of Statutes
Bev Beam, Committee Secretary

Conferees appearing before the committee:
Cynthia Smith, Sisters of Charity of Leavenworth
Dale McAllister, SBG
Robert J. Vancrum, Service Contract Industry Council, Inc.
Pam Scott, National Funeral Directors and Embalmers Assn.

Others attending:
See attached list.

The Chair called the meeting to order. The Chair said Minutes of March 7, 8, and 9 would be approved at the end of the meeting.

The Chair called Cynthia Smith, Sisters of Charity of Leavenworth Health System, to testify on (**HB 2669**) - **an act concerning automatic enrollment retirement plans; relating to the withholding of wages.**

Ms. Smith said a 403(b) retirement plan is like a 401(k) retirement plan for 501(c)(3) tax exempt organizations like Sisters of Charity. She said generally, these plans allow employees to deposit an amount of wages pre-tax into investment funds and a certain percentage is often matched by the employer. She said according to annual studies, automatic enrollment is becoming more commonly utilized by companies offering 401(k) retirement plans for their employees. Instead of employees being required to take the initiative to get enrolled in the plan and choose investment options, new employees are automatically enrolled. Generally, only one or two percent would be withdrawn from their wages and invested in one of the plan's lower risk options. Mr. Smith said Sisters of Charity requested (**HB 2669**) based on advice from legal counsel that a change to state law was necessary to offer an automatic enrollment program for employees.

Ms. Smith said Security Benefit Group supported the bill during hearings before the House Financial Institutions Committee, and spearheaded amendments to expand it beyond 403(b) plans. Leadership of Sisters of Charity believe strongly that taking this action is doing the right thing for employees and urges its favorable passage. (Attachment 1)

The Chair called Dale McAllister, SBG for his testimony. Mr. McAllister said SBG urges the committee to support national efforts to promote financial security of the Kansas workforce by supporting (**HB 2669**). He said this bill can make a big difference in the retirement prospects of a lot of people. It will cost no taxpayer money, will not require a new regulatory mandate, and will not force employers or their employees to do anything. It will simply give Kansas employers a green light to offer a new, promising retirement program that is currently being promoted by Congress and federal authorities. (Attachment 2)

The Chair closed the hearing on (**HB 2669**) and opened the hearing on (**HB 2858**) - **An act concerning service contracts; pertaining to the definition thereof.** The Chair asked Melissa Calderwood for an overview of (**HB 2858**).

MINUTES OF THE Senate Financial Institutions and Insurance Committee at 9:30 A.M. on March 14, 2006 in Room 234-N of the Capitol.

Ms. Calderwood said (**HB 2858**), as amended, would amend the requirements for service contracts provided under current law. Specifically, the bill would amend the term "service contract" to remove the phrase "handling of property damaged by power surges" and to expand the definition to allow for the accidental damage caused from the handling of any consumer good or other property. She said the proponent of the bill, the Service Contract Industry Council, Inc., indicated the amendment to the 2005 law would allow services, which include Accidental Damage by Handling (ADH), to be exempt from regulation as insurance products. There were no opponents to the bill at the House Committee hearing, she said.

The Chair called Robert Vancrum, Service Contract Industry Council, Inc., to testify. Mr. Vancrum said the Kansas Insurance Department supports (**HB 2858**). He said this bill would put Kansas in line with nearly 40 other jurisdictions that have held that service contracts which include accidental damage by handling should be exempt from regulation as insurance products. Mr. Vancrum said (**HB 2858**) would amend the language defining service contracts from last year's bill to delete the power surge limitation, which will finally resolve the issue as it will then accurately describe the contracts in the marketplace, ones that may either offer protection for failure of a product resulting from a power surge or from accidental damage from handling. (Attachment 3)

The Chair closed the hearing on (**HB 2858**) and opened the hearing on (**HB 2824**) - **An act concerning pre-arranged funeral agreement accounts; eliminating the waiting requirement.**

The Chair asked Melissa Calderwood for an overview of (**HB 2824**). Ms. Calderwood said (**HB 2824**) would amend existing requirements for pre-arranged funeral agreements by eliminating the waiting requirement. The requirement allowed the balance remaining in the individual's account which the pre-arranged agreement paid would not be paid until the expiration of at least five days after the date of death of the individual for whose services the funds were paid.

The Chair called Pam Scott, National Funeral Directors and Embalmers Association for her testimony. Ms. Scott said under current law, funds cannot be paid out of a pre-arranged funeral agreement account held by a bank, credit union, or savings and loan association until at least five days have expired after the date of death of the person for whose services the funds were paid. She said she was uncertain as to why the five-day waiting period was originally included in the statute. The result is that the waiting requirement makes it more difficult for financial institutions to compete with insurance companies to fund prearranged funeral agreements. Insurance companies often allow funds to be paid immediately to the funeral provider. She said if the waiting period is removed, protections remain in place to assure funds are not wrongfully paid of a pre-arranged funeral account. The statute would continue to require that acceptable proof of death and a verified statement setting forth that all of the terms and conditions of the agreement have been fully performed and have been provided to the financial institution. Ms. Scott urged the committee's support of (**HB 2824**). (Attachment 4)

Final Action

The Chair called for final action on (**HB 2858**). Senator Barnett moved to pass the bill out favorably. Senator Wysong seconded. The bill was passed out favorably.

The Chair called for final action on (**HB 2824**). Senator Schmidt moved to pass the bill out favorably and placed on the consent calendar, **HB 2824**). Senator Barone seconded. Motion was favorably passed.

The Chair called for final action on (**HB 2669**). Senator Barnett moved to pass (**HB 2669**) out favorably. Senator Brownlee seconded. Motion passed.

The Chair called for a motion to approve Minutes of March 7, 8 and 9. Senator Brungardt so moved. Senator Schmidt seconded. Motion passed.

The meeting adjourned at 10:30 a.m. The next meeting of this Committee is scheduled for March 15, 2006.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

FINANCIAL INSTITUTIONS & INSURANCE COMMITTEE GUEST LIST

DATE: March 14, 2006

NAME	REPRESENTING
Alex A. Kotoyantz	PIA
[illegible]	KID
Lorrie Ann Lower	KAHP

Sisters of Charity of Leavenworth Health System

Senate Committee on Financial Institutions & Insurance

Testimony in support of H. 2669
Automatic Enrollment in Retirement Plans
March 14, 2006

Cynthia Smith, JD
Advocacy Counsel
Sisters of Charity of Leavenworth Health System

We appreciate this opportunity to offer testimony on House Bill 2669. I am Cynthia Smith, Advocacy Counsel for the Sisters of Charity of Leavenworth Health System (SCLHS). I am joined today by Gene Lampe, SCLHS Manager of Compensation and Benefits.

SCLHS operates three hospitals in Kansas – St. Francis Health Center in Topeka, Providence Medical Center in Kansas City, Kansas, and Saint John Hospital in Leavenworth – as well as three safety net clinics. These facilities, as well as the Motherhouse, employ more than 3,600 people in Kansas who are eligible to participate in our 403(b) retirement plans. We requested H. 2669 so that we can offer an automatic enrollment program for our Kansas employees.

A 403(b) retirement plan is like a 401(k) retirement plan for 501(c)(3) tax exempt organizations like SCLHS. Generally, these plans allow employees to deposit an amount of wages pre-tax into investment funds and a certain percentage is often matched by the employer.

According to annual studies conducted by Hewitt Associates and anecdotal reports cited in the financial press, automatic enrollment is becoming more commonly utilized by companies offering 401(k) retirement plans for their employees. Instead of employees being required to take the initiative to get enrolled in the plan and choose investment options, new employees are automatically enrolled. Generally, a minimal amount, maybe only one or two percent, would be withdrawn from their wages and invested in one of the plan's lower risk options, such as a bond fund.

Senate FI&I Committee
Attachment 1-1
March 14, 2006

The plan is still voluntary, in that employees always have the opportunity to opt out of enrollment if they choose not to participate. The employee can also choose to increase or decrease their deduction, or change investment choices.

Currently, SCLHS provides information to employees about 403(b) retirement plan benefits, but employees must still take the initiative to enroll. The participation rate in our plans ranges from a solid 80 percent at the SCLHS corporate office, to as little as 25 percent at some of our hospitals. Our leadership is convinced that offering an automatic enrollment program would increase participation in our 403(b) program and result in more employees receiving the full benefits of the program and saving for their retirement.

SCLHS requested H. 2669 based on advice from our legal counsel that a change to state law was necessary for us to offer an automatic enrollment program for our employees.

Kansas law prescribes when employers may withhold, deduct or divert wages, under KSA §44-319. Employer 401(k) retirement plans are subject to ERISA, which preempts the state law and allows automatic enrollment programs. However, our church-based 403(b) plan is not covered by ERISA. Therefore, the change to the state law proposed in H. 2669 to allow diversion of wages into the retirement plan is necessary.

Security Benefit Group supported the bill during hearings before the House Financial Institutions Committee, and spearheaded amendments to expand it beyond 403(b) plans. We are very pleased with the amended, more comprehensive bill. You should know that it passed the full House by a unanimous vote, 122-0.

The leadership of SCLHS believes strongly that taking this action is doing the right thing for our employees. We appreciate your consideration of this legislation, and urge its favorable passage.

9801 Renner Boulevard, Suite 100 – Lenexa, KS 66219-9745 913-895-2800

Hewitt NEWS & Information

Hewitt Associates LLC
100 Half Day Road
Lincolnshire, IL 60069
Tel (847) 295-5000
Fax (847) 295-7634
www.hewitt.com

Argentina
Australia
Austria
Belgium
Brazil
Canada
Channel Islands
Chile
China
Czech Republic
France
Germany
Greece
Hong Kong
Hungary
India
Ireland
Italy
Japan
Malaysia
Mauritius
Mexico
Netherlands
Philippines
Poland
Puerto Rico
Singapore
South Africa
South Korea
Spain
Sweden
Switzerland
Thailand
United Kingdom
United States
Venezuela

For Immediate Release
January 10, 2006

Contact: Maurissa Kanter, (847) 442-7656, maurissa.kanter@hewitt.com
Kristen Polich, (847) 442-7648, kristen.polich@hewitt.com

Hewitt Survey Reveals New Employer Trends in Retirement

Automated Features Continue to Play Key Role in 2006 as Companies Lose Confidence in Workers' Ability to Save for Retirement

LINCOLNSHIRE, Ill.—Despite continued efforts to educate employees on the importance of saving for retirement, many companies do not feel workers are stepping up to the challenge, according to a new study by Hewitt Associates, a global human resources services firm. To address these concerns, an increasing number of companies are implementing automated features that make retirement saving a reactive decision rather than a proactive one.

Hewitt's study of more than 220 large U.S. companies reveals that only 6 percent are confident their employees will take accountability for their own retirement future this year, down from 12 percent in 2005. In order to encourage workers to take control of their retirement savings, 23 percent of companies are very likely to add automatic enrollment features in their 401(k) plans by the end of the year. Thirteen percent of companies are very likely to add contribution escalation features, and one in five companies (20 percent) plan to add automatic rebalancing of 401(k) accounts.

-more-

"Companies that have already implemented automatic features to their 401(k) plans have seen significant results in helping employees save and invest better for retirement. This is creating momentum and prompting other companies to consider them as well," said Lori Lucas, director of participant research at Hewitt Associates. "Automated features change the equation so that inertia around retirement saving and investing works in employees' favor: if an employee does nothing, it is ok because the 401(k) plan is on autopilot."

Link to Changes in Pension Plans

According to Hewitt's study, the majority of companies offering pension plans are not likely to make changes to them in 2006. However, 15 percent say they are very likely to close participation to new employees, 6 percent say they are very likely to freeze accruals, and 5 percent are very likely to change the design of their pension plan.

"As employers reduce their pension benefits, the 401(k) plan becomes an even more critical savings vehicle," said Lucas. "Effectively, it means that workers need to be doing a lot more when it comes to saving for retirement—and that's why it's important for companies to support workers' efforts through 401(k) plan design, delivery and communication."

Education and Communication Efforts Remain a Key Priority

In addition to automating the 401(k) plan, many companies will continue to educate workers on the value of saving in their plan this year. The majority of companies (96 percent) say they are somewhat or very likely to focus on making sure their employees understand how their 401(k) plan works and the value of it. Nearly two-thirds (64 percent) say they are somewhat or very likely to encourage long-term saving by educating workers on the advantages of preserving their retirement wealth when leaving the company.

-more-

In addition, 16 percent of companies say they are very likely to add online third-party investment advisory services to employees, enabling them to tap into financial experts who can assist them with retirement saving and planning.

Other Key Findings

- Only 13 percent of companies say they are very likely to add a Roth 401(k) in 2006. Reasons cited by employers for not offering a Roth 401(k) this year included administrative complexity, vague guidelines, concerns about lack of use by employees, and difficulties communicating the Roth 401(k).
- Six percent of companies say they are very likely to add annuities as a form of payment option in 2006.
- Sixteen percent of companies offering company stock will either limit employees' investment in company stock or eliminate it as an investment option in 2006.
- Consistent with last year, the majority of companies (79 percent) say they plan to make no changes to their company match. Eight percent say they plan to add/increase the company match, and only 1 percent say they plan to reduce or eliminate the company match.

About Hewitt Associates

With more than 60 years of experience, Hewitt Associates (NYSE: HEW) is the world's foremost provider of human resources outsourcing and consulting services. The firm consults with more than 2,400 companies and administers human resources, health care, payroll and retirement programs on behalf of more than 350 companies to millions of employees and retirees worldwide. Located in 35 countries, Hewitt employs approximately 22,000 associates. For more information, please visit www.hewitt.com.

###

THE WALL STREET JOURNAL. ONLINE

Retirement Plans Go Automatic

To Boost Returns, Employers Move Away From Money Market Funds as Default Option

By Jeff D. Opdyke, The Wall Street Journal, 1280 words
Jul 20, 2005

Document Text

Copyright (c) 2005, Dow Jones & Company Inc. Reproduced with permission of copyright owner. Further reproduction or distribution is prohibited without permission.

IN WHAT MARKS the broadest effort yet to both simplify retirement savings and get larger numbers of people to save appropriately for life after work, companies are increasingly making 401(k) choices for their employees.

In recent years, companies have been trying to boost participation by automatically enrolling employees in their plans. Those efforts have been successful, and today nearly 20% of large U.S. businesses are automatically enrolling employees as opposed to making them sign up on their own, according to new research from Hewitt Associates, a Lincolnshire, Ill., human-resources services firm. That marks the highest level ever and represents a significant shift: For most of this decade, only about 14% of companies offered autoenrollment.

But the latest efforts go beyond just enrolling people: Now many companies are taking the additional step of choosing certain funds as default options and even automatically increasing the amount employees contribute each year. In the past, the default option was typically a conservative money-market account, and employers left it up to workers to determine their contribution level. The goal now is to make sure employees invest the money in a more aggressive, but still prudent, way and thereby ultimately increase the size of their nest egg.

Many of the new default options involve so-called lifecycle funds, which automatically reallocate holdings among different asset classes as an employee ages. Last year, for example, nearly 1,200 employers added to their 401(k) plans lifecycle funds from Boston financial- services company Fidelity Investments, and 850 of those companies made the funds their default option, instead of plain-vanilla money-market funds. And already this year, more than 800 plans have adopted Fidelity's Annual Increase Program, a feature launched last summer that automatically ratchets higher the amount of money a worker saves annually. Other providers, including Charles Schwab & Co. and Vanguard Group, offer similar 401(k) plan features.

Automated 401(k) plans essentially use workers' natural inertia "for their benefit," says Doug Herron, chief financial officer of the Columbus, Ohio-based Safelite Group Inc., which automatically enrolls employees in its plan and automatically escalates their annual savings.

Automation works by essentially turning the traditional 401(k) model inside out. Typically, workers must opt into a retirement plan and then determine for themselves how much to save, where to invest, when to rebalance their account and when to increase the amount of money taken from every paycheck -- decisions they often never address.

Automated plans force workers to opt out, meaning they must tell an employer they don't wish to participate. When workers are eligible to join their 401(k) plan, they're automatically enrolled -- unless they explicitly opt out. Then, typically between 2% and 6% of their paycheck is automatically funneled into their 401(k) account. That approach aims to counteract the inertia and procrastination that often keeps employees from joining their 401(k) plan in the first place.

Workers can opt out of any or all of these automated features, but companies are finding that most employees choose not to. Retailer J.C. Penney Co. saw participation in the company's 401(k) plan surge to 85% from 71% in about 18 months after it began automatically enrolling workers. When the U.S. arm of Australian mining firm BHP Billiton Ltd. began autoenrolling employees in a 401(k) plan, nonparticipation dwindled from more than 500 workers to just two.

These moves toward automation are part of a growing realization that the biggest selling point of a 401(k) plan --

allowing workers to directly manage their retirement money -- is also its weakest link. Workers often don't have the time, the inclination or the necessary skills to invest prudently. Because of that, workers, particularly young ones, often never bother to sign up for their plan. Those who do frequently invest too much in company stock, leave their savings in a tepid money-market account or chase oversized gains in the stock market without recognizing the risk.

The groundswell of interest in automated retirement savings has captured the attention of lawmakers at a time when retirement finances are high on the American agenda. As such, several bills are winding through Congress that would exempt companies from certain 401(k) rules if they offer at least an autoenrollment feature.

Getronics NV, a Dutch firm with 3,300 U.S. employees, this month began automatically enrolling new hires in the company's 401(k) plan, and earlier this year added a program to automatically increase worker contributions by one percentage point every year. Last year it began defaulting employees into Fidelity's lifecycle funds. Getronics says it's now looking to add an autorebalancing feature in 2006 that will ensure workers' accounts remain balanced between stocks and bonds and cash.

In the last several months Vanguard has signed up about a dozen companies to a program called One Step that essentially mimics what Getronics is doing by wrapping all those automated functions -- enrollment, contribution escalation and asset allocation -- into one package. Vanguard says numerous other companies are looking to join the program.

According to Hewitt, which also administers 401(k) plans, 9% of companies already offer automatic savings escalation, and another 10% plan to add it in coming months. About 26% of companies offer autorebalancing, more than double the 2003 level. Nearly 40% of companies now default their employees into lifecycle funds or other premixed funds, up from 30% in 2003.

By going automatic, companies hope to essentially force workers into saving and investing more effectively. Currently, about 75% of eligible employees opt into their 401(k) plan. At the largest companies, the number slips to roughly two-thirds. And with new hires, the statistics are lower: Between 30% and 40% of new workers sign up for their 401(k) plan.

Fears of lawsuits may also play a role. When the notion of automating 401(k) plans began to emerge in the late 1990s, many companies felt that implementing such tactics might increase their liability from workers angered by the retirement plan's performance. Today, companies "now realize they have liability if they don't help workers, because many workers are making poor decisions because they're not sure what they should be doing," says Brooks Hamilton, a Dallas benefits consultant.

Limited numbers of companies began offering autoenrollment in the mid-1990s, but realized it wasn't enough because workers often left the money sitting in the default money-market option.

Companies are now taking the next step. Rock-Tenn Co., a Norcross, Ga., packaging firm, began offering Vanguard's One Step program in January after offering autoenrollment for about three years. The company noticed, however, "that people ended up staying where we put them, so we wanted to help them plan better for retirement," says Saba Yohannes, Rock-Tenn's senior benefits manager. The company now automatically enrolls workers at 2% of their salary, automatically invests them in a premixed retirement fund, and in October, when pay raises come, automatically increases by one percentage point the amount of money workers save each year.

"You're seeing a sea change in perspective," says David Wray, president of the Profit Sharing/401(k) Council of America, which lobbies on behalf of 401(k) plans and their participants. The 401(k) system "has spent millions and millions on educating workers, and still we don't have as many people in these plans as there should be." Automating the process, he says, "is about good outcomes for employees."

Auto Pilot

Companies are increasingly automating their 401(k) plans beyond enrollment:

-- Worker contributions are automatically invested in a premixed retirement fund of stocks, bonds and cash.

-- Worker assets are automatically rebalanced each year to keep their investments properly calibrated as employees draw closer to retirement.

-- Worker contributions are automatically increased by one percentage point or more every year.

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.

THE WALL STREET JOURNAL. ONLINE

Saving Effortlessly for Retirement

Some Companies Automate Features of 401(k)s to Help With Investment Decisions

By Jane J. Kim, The Wall Street Journal, 807 words
Apr 26, 2005

Copyright (c) 2005, Dow Jones & Company Inc. Reproduced with permission of copyright owner. Further reproduction or distribution is prohibited without permission.

For many employees, saving for retirement could soon be as easy as doing nothing.

After years of offering workers more tools and education to help them make their own investment decisions, companies are now rolling out automatic 401(k) features designed to make those choices for them.

At BHP Billiton Ltd., new U.S. employees are automatically enrolled in the company's 401(k) plan and defaulted into a managed account, where their funds are invested for them across an investment mix of the company's underlying funds. Soon, they won't even have to worry about how much to contribute. This July, the Australian mining company, which has extensive U.S. operations, will automatically boost new employees' contributions by 1% a year and give the firm's existing 1,800 workers who are eligible for the plan a chance to sign up.

The latest generation of 401(k)s pulls together all three automatic options -- enrollment, contribution increases and investing -- into one package. Although less than 1% of employers have adopted the full autopilot design, many others are adopting certain features of those plans.

At R.R. Donnelley & Sons Co., participation in the company's 401(k) jumped to 92% from 68% after the Chicago printing giant automatically enrolled all of its employees in January 2005. At J.C. Penney Co., in Plano, Texas, 401(k) participation has jumped to 86% from about 71% since the company started automatically enrolling employees in 1997. Other studies indicate that automatic enrollment boosts the rates of plan participation from a national average of about 75% of eligible employees to between 85% and 95%.

Still, some companies have been slow to embrace automatic features amid regulatory uncertainty and fears over being sued by workers if they put them into investment options that were too aggressive. In some cases, additional costs are a concern since employers would be required to shell out more, either to offer managed accounts as the default option or because the company would have to pay out more in employer matches, says Stephen Utkus of the Vanguard Center for Retirement Research, a unit of investment-services giant Vanguard Group Inc.

But new government regulations are helping to boost employers' confidence in automatic 401(k) plans. The Internal Revenue Service issued a "general information letter" in March 2004 noting that any level of contribution rates and escalation increases were allowed, and encouraged companies to use a higher automatic enrollment contribution percentage, says Mark Iwry, a former benefits tax counsel at the Treasury Department and senior fellow at the Brookings Institution. The letter also made clear that companies can escalate that percentage over time in accordance with a fixed schedule, such as 1% a year, or in response to pay increases.

Meanwhile, automatic 401(k) plans are gaining support in Congress with the introduction of a bill earlier this month by Illinois Rep. Rahm Emanuel. Similar bills are being discussed in the Senate and could be formally introduced later this year, industry watchers say. The proposed legislation would clarify some of the rules and clear away the "legislative underbrush" that would allow companies to adopt plans more widely, says Peter Orszag, director of the Retirement Security Project and senior fellow at the Brookings Institution.

A recent survey by benefits consultant Hewitt Associates LLC of Lincolnshire, Ill., says that of those employers likely to implement automatic features, nearly 60% report they may offer automatic enrollment, or automatic enrollment in conjunction with other features such as lifestyle funds and/or contribution rate increases, in the next year. Only 14% of large employers had implemented such features in 2003.

One reason for the growth: Some 401(k) plan providers are aggressively ramping up their marketing efforts. Since Vanguard introduced its "One Step" 401(k) last year, about 250 of its plan sponsors have added automatic savings

...eases as a voluntary benefit. Although only eight companies, including BHP Billiton, have signed on to offer the full autopilot design, the firm expects to have 20 firms by year's end.

At Fidelity Investments, between 6% and 7% of plan sponsors have signed up for its Annual Increase Program launched in June. And in August, Principal Financial Group Inc. launched its "Step Ahead" option, which allows workers to automatically increase their 401(k) deferrals over time. Since January, there has been a 20% increase in the number of employers using the option, while the number of participants has more than doubled over the same period, notes a company spokeswoman.

Automatic Transmission

When individuals are automatically enrolled in 401(k) plans, participation rates can jump substantially, according to a study of one large company's employees with between 3-15 months of tenure.

RATE OF PARTICIPATION

	Before Automatic Enrollment	After Automatic Enrollment
New Employees	37%	86%
Younger Employees*	25	83
High-Income Employees**	68	94

* Ages 20-29
** Earning more than $80,000 a year

Sources: Based on a 2000 study by Brigitte Madrian,Wharton School; Dennis Shea, UnitedHealth Group Inc.

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.

Sisters of Charity of Leavenworth Health System

Fact Sheet

The Sisters of Charity of Leavenworth Health System (SCLHS) is a Catholic, not-for-profit multi-institutional system dedicated to improving the health of those we serve.

Today, the Sisters of Charity of Leavenworth Health System is made up of the system office, ten hospitals, one nursing home, four stand-alone clinics for the uninsured and other related entities.

These Affiliates are located in the states of Colorado, California, Montana and Kansas, and include 3,000 licensed beds, approximately 2,200 staffed beds and over 10,000 employees.

The Affiliates are also involved in a variety of regional partnerships which are dedicated to improving the health of their respective communities.

Saint James Healthcare
Butte, Montana
Founded 1881
64 staffed beds

Holy Rosary Healthcare
Miles City, Montana
Founded 1910
151 staffed beds

Saint Vincent Healthcare
Billings, Montana
Founded 1899
257 staffed beds

Saint John Hospital
Leavenworth, Kansas
Founded 1864
36 staffed beds

Saint Vincent Clinic
Leavenworth, Kansas

Providence Medical Center
Kansas City, Kansas
Founded 1920
219 staffed beds

Providence Place
Kansas City, Kansas
90-bed Nursing Home

Duchesne Clinic
Kansas City, Kansas

Saint John's Health Center
Santa Monica, California
Founded 1942
244 staffed beds

Saint Mary's Hospital and Medical Center
Grand Junction, Colorado
Founded 1896
250 staffed beds

Marillac Clinic
Grand Junction, Colorado

Exempla Saint Joseph Hospital
Denver, Colorado
Founded 1873
379 staffed beds

Saint Francis Hospital and Medical Center
Topeka, Kansas
Founded 1909
200 staffed beds

Marian Clinic
Topeka, Kansas

SENATE FINANCIAL INSTITUTION AND INSURANCE COMMITTEE
TESTIMONY ON HB 2669
MARCH 14, 2006

By: Dale McAllister
Assistance Vice President and Counsel
Security Benefit Corporation

Good morning ladies and gentlemen. My name is Dale McAllister. I am Assistant Vice President and Counsel to Security Benefit Corporation, and have 25 years of experience working on all aspects of retirement plans offered by many different types of employers. I am here today for Security Benefit to support House Bill 2669, as part of our policy of encouraging and promoting retirement savings by the workforce of the United States in general and Kansas in particular.

Ladies and gentlemen, our workforce needs to save more for retirement. The United States Commerce Department recently reported that Americans had a negative savings rate for the 2005 calendar year. That means that during 2005, as something like 78 million baby boomers are entering into their final work years prior to retirement, we collectively spent more than we made, dipping into our retirement savings instead of adding to it. This was the first full year of negative savings in America since the Depression year of 1933. This is true even though tax advantaged savings plans, like IRAs and 401(k), 403(b) and governmental 457 deferred compensation plans, are widely available.

What can be done? Earlier this year, Michigan Governor Granholm proposed that her State encourage retirement savings by offering a State 401(k) plan for private sector employees whose employers do not offer their own plan. This is Kansas, not Michigan, and we are not here to propose that plan today. But at the federal level, the Internal Revenue Service and other agencies have been encouraging the development of what are called "automatic enrollment" 401(k), 403(b), and governmental 457 plans since 2000 and automatic enrollment IRAs since 2004.

Automatic enrollment plans encourage retirement savings by taking what we believe is the correct position that every eligible employee should want to save for their retirement and helps them do so. Under a "traditional" 401(k) plan, an employee must actually go through a process of signing up to participate in the plan and choosing an amount to contribute by a salary reduction to the plan, or they will accumulate no retirement savings—and maybe have no retirement plan at all. Although some few employees really do need every dime they earn for the problems of today, a large number of employees never sign up out of inertia or lack of concern for the future—at least until it is too late to save very much.

An automatic enrollment plan does not force an employee to save. However, in an automatic enrollment plan, employees are automatically signed up and contribute, for example, 3% of their compensation to the plan unless they affirmatively elect not to participate. Each employee is free to elect to contribute more, or less, or nothing at all. But if they do nothing, and many employees do, they will be making at least some contributions toward their own retirement security.

A recent study from the Employee Benefits Research Institute and the Investment Company Institute (attached to this testimony) found that 401(k) plan participation rates increase from an average of 66% in a traditional 401(k) up to 92% with automatic enrollment. The difference with automatic enrollment shows the power of employee inertia. When you look at the data a little closer, you see that automatic enrollment helps those at the lower end of the pay scale the most. For the bottom 25% of employees by pay, automatic enrollment increased participation from 42% to 91%--more than double. These are the ones who otherwise are not saving for their retirement. I might mention that these are also the ones who end up on our welfare and Medicaid rolls because they have no retirement savings.

On February 14, a consortium of public policy organizations ranging from the Heritage Foundation on the right to the AARP and, on the left, the Brookings Institution proposed a widely publicized program of automatic enrollment Individual Retirement Accounts (IRAs) to provide some retirement resources for the estimated 71 million American workers who have no retirement plan at all beyond Social Security. A copy of the press release announcing this proposal is attached to this testimony. According to a consortium representative, "the automatic IRA helps . . . moderate and lower-income workers who have the greatest need to save."

Congress is currently doing its part to encourage automatic enrollment. Two somewhat different retirement bills with strong automatic enrollment provisions for 401(k), 403(b) and governmental 457 plans were passed in December, HR-2830 and S-1783. Each bill would give legislative endorsement to these plans, establish some limits and relieve employers who are subject to the Employee Retirement Income Security Act of 1974 (ERISA) from fiduciary liability for some aspects of offering and operating these programs. We are confident that the final conference committee bill that will be enacted by Congress and signed into law will greatly encourage automatic enrollment plans. You will be hearing more about them.

There are a couple of problems—state law problems—that have inhibited the spread of automatic enrollment plans for employers who wish to offer them to their workers, and are likely to continue to be road blocks for at least some plans even after Congress is done with the present legislation. First, many states, including Kansas, have very specific payroll withholding statutes on the books that limit payroll deductions that can be taken without an affirmative written employee consent. In Kansas, K.S.A. 44-319 does not authorize deductions for automatic enrollment plans. Under the statute, only when an employee affirmatively signs up for a salary reduction 401(k), 403(b), 457 or IRA plan is a deduction authorized.

House Bill 2669 would change this result. We worked in the House to strengthen the original bill and extend it to all types of tax advantaged plans, including 401(k), 403(b) and 457 plans and payroll deduction IRAs. With these amendments to K.S.A 44-319, you would not be requiring any employer to change its plan. It would simply be removing a roadblock that currently holds back an employer who may wish to try this new program.

Another problem with automatic enrollment plans for some employers is the investment of contributions automatically made to their plan. When employees sign up for most traditional salary reduction plans, they normally have to choose how contributions are invested at the same time. But when contributions are made by default to an automatic enrollment plan, the employer

must chose investments, although employees are always free to change their investment elections at any time.

Although many employers are willing to accept investment responsibility, they are reluctant to do so due to the potential liability and lawsuits that can result from their actions, even when taken in complete good faith. When they accept responsibility, they often select extremely conservative investment options, like money market fund, that do not provide a reasonable prospect for growth. When the present legislation makes it out of Congress, we expect that it will relieve some employers from liability for investment decisions taken in an automatic enrollment plan, where the employer is subject to ERISA and employees can change their investments at any time. This will expand the protection already offered these ERISA employers by recent actions of the U.S. Department of Labor.

Not all employers are subject to ERISA, however. State and local governmental entities and churches and church related organizations are outside ERISA regulation and the protection that will be extended to most other employers by Congress in the pending legislation. House Bill 2669 will extend this protection to non-ERISA employers with a reasonable liability relief provision for employers making investment decisions in automatic enrollment plans, as long as participants are able to readily change investments at any time.

We urge the Committee to support present national efforts to promote financial security of the Kansas workforce by supporting House Bill 2669. The bill you have before you can make a big difference in the retirement prospects of a lot of people. It will cost no taxpayer money, will not require a new regulatory mandate, and will not force employers or their employees to do anything. It will simply give Kansas employers a green light to offer a new, promising retirement program that is currently being promoted by Congress and federal authorities.

Thank you for your time and attention this morning. I would be glad to address any questions that committee members may have.

INVESTMENT COMPANY INSTITUTE®

PERSPECTIVE

Vol. 11 / No. 2
July 2005

Perspective is a series of occasional papers published by the Investment Company Institute, the national association of the U.S. investment company industry.

Brian Reid, executive editor;
Sue Duncan, managing editor.

1401 H Street, NW
Suite 1200
Washington, DC 20005

www.ici.org

The Investment Company Institute (ICI) is the national association of U.S. investment companies. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers.

The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement

by Sarah Holden and Jack VanDerhei[1]

INTRODUCTION AND SUMMARY

Over the past quarter century, there has been a shift in the pension landscape in the United States toward defined contribution plans and, in particular, 401(k) plans. At year-end 2004, about 43 million 401(k) plan participants[2] had accumulated $2.1 trillion in plan assets.[3] Nevertheless, whether many individuals' 401(k) plan accumulations will provide significant income in retirement has become a public policy concern in recent years. The validity of such a concern cannot be assessed by looking at the 401(k) accumulations of today's retirees because these individuals have not participated in 401(k) plans throughout their working years.

The Employee Benefit Research Institute (EBRI) and the Investment Company Institute (ICI) have collaborated to develop the EBRI/ICI 401(k) Accumulation Projection Model.[4] This

TABLE OF CONTENTS

Introduction and Summary 1
EBRI/ICI 401(k) Accumulation Projection Model 5
Baseline Model Results 7
Automatic Enrollment 8
Eligible Non-Participants 9
Replacement Rates Among All Eligible Workers 10
Empirical Research on Automatic Enrollment 12
Automatic Enrollment in the Projection Model 12
Automatic Enrollment Projection Results 13
Catch-Up Contributions 15
Saving in IRAs When Not in 401(k) Plans 16
Conclusion 18
References 18

---

[1] Sarah Holden, Senior Economist, Research Department at the Investment Company Institute, and Jack VanDerhei, Temple University, Employee Benefit Research Institute Fellow. Special thanks to Luis Alonso, Research Analyst at EBRI, who maintains the EBRI/ICI database and to Craig Copeland, Senior Research Associate at EBRI, who tabulated Current Population Survey (CPS) and Survey of Consumer Finances (SCF) data for some modules of the model.

[2] See Cerulli Associates (2004).

[3] See Investment Company Institute (2005).

[4] The EBRI/ICI 401(k) Accumulation Projection Model is part of an ongoing collaborative research effort between the Employee Benefit Research Institute and the Investment Company Institute. In this ongoing research effort, known as the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project, EBRI and ICI gather data from some of their members that serve as plan recordkeepers. The data include demographic information, annual contributions, participant account balances, asset allocations, and loan balances. The year-end 2003 EBRI/ICI database contains information on 15.0 million 401(k) plan participants in 45,152 plans, holding $776.0 billion in assets (see Holden and VanDerhei (August 2004)).

2-4

model examines how 401(k) assets *might* contribute to retirement income for future retirees based on decisions workers make throughout their careers: whether or not to participate in the 401(k) plan, what amounts to contribute, how to allocate assets, whether to tap assets prior to retirement, and whether to preserve assets when changing jobs. Holden and VanDerhei (November 2002) present results from this comprehensive model, which projects the portion of pre-retirement income that retirees *might* replace in their first year of retirement with 401(k) accumulations,[5] whether the balances are held with employers or in rollover individual retirement accounts (IRAs).

The model provides a baseline scenario that ages a group of 401(k) participants in their late twenties or early thirties at year-end 2000 through a full career to retirement at age 65. The baseline scenario assumes continuous employment and 401(k) plan coverage for the group's entire working lives. It also assumes that as the group ages they behave similarly to current participants at the same age, tenure, and income levels.

Public Policy Implications

This research makes several findings that have public policy implications, including:

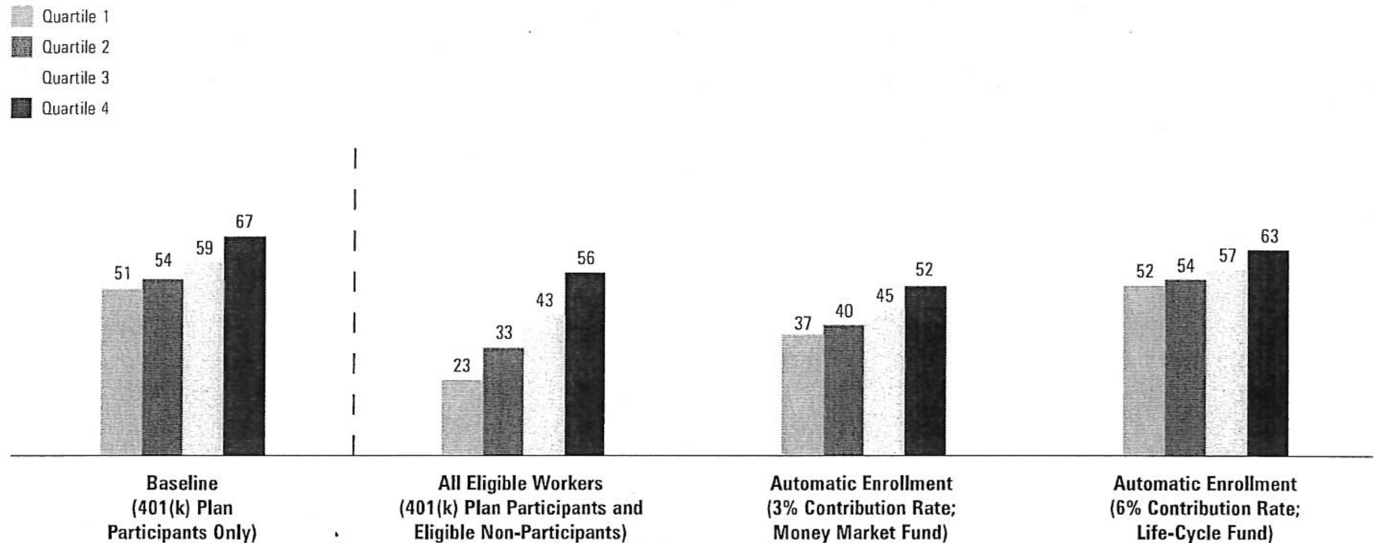
- *Under a wide range of scenarios, workers can save enough through 401(k) plans over a full career to* ***replace a significant portion of their pre-retirement income in retirement.***
- ***Automatic enrollment in 401(k) plans increases participation rates dramatically,*** *particularly among lower income workers. Increased participation improves retirement preparedness for these workers.*
- *The* ***default contribution rates and investment options*** *set by employers who offer 401(k) plans with automatic enrollment can have a significant impact on participants' 401(k) accumulations at retirement.*
- ***Catch-up contributions,*** *a tax incentive that encourages additional saving among workers age 50 or older, primarily increase replacement rates among higher income workers. However, these workers see low income replacement from Social Security, and catch-up contributions encourage them to improve their own retirement preparedness.*
- *Nearly half of all workers do not have a retirement plan at work.* ***Contributions to IRAs*** *can help fill gaps in employer-sponsored plan coverage over a career. Current IRA contribution limits allow lower income workers to replicate 401(k) contributions when their employers do not offer a retirement plan at work. Higher income workers cannot replicate their 401(k) benefits with IRAs. Breaks in higher income workers' 401(k) coverage can significantly reduce their retirement preparedness.*

[5] Retirees potentially have several sources of income in retirement, including Social Security benefits, income from defined benefit and/or defined contribution retirement plans and IRAs, income from other individual savings, and income from continued employment. The EBRI/ICI projection model in this paper only focuses on the income future retirees are projected to receive from 401(k) accumulations in their first year of retirement.

FIGURE 1

Median Replacement Rates[1] from 401(k) Accumulations[2] for Workers Turning 65 Between 2030 and 2039 by Income Quartile at Age 65

(percent of final five-year average salary)



[1] In all four simulations presented in this figure, workers experience continuous employment, continuous 401(k) plan coverage, and investment returns based on average annual returns between 1926 and 2001. In the baseline, only 401(k) participants with account balances at year-end 2000 are considered. In the other three scenarios, all eligible workers are considered.

[2] The 401(k) accumulation includes 401(k) balances at employer(s) and rollover IRA balances.

Source: EBRI/ICI 401(k) Accumulation Projection Model

With these assumptions, the baseline case produces an income replacement rate from 401(k) accumulations at age 65 for each individual and reports median replacement rates by income quartile.[6] For example, among individuals turning 65 between 2030 and 2039 whose income is in the lowest quartile for their age, the median replacement rate from their 401(k) accumulations is about half of pre-retirement salary in the first year of retirement (Figure 1). For the highest income quartile, the projected median replacement rate is about two-thirds of salary.[7]

This issue of *Perspective* builds on the model scenarios presented by Holden and VanDerhei (November 2002). It presents new scenarios that examine the role that 401(k) accumulations might play in retirement by analyzing certain factors that influence outcomes for 401(k) participants, including: *plan design*, through automatic enrollment; *tax policy*, through catch-up contributions; and *individuals themselves*, through saving in IRAs when not offered 401(k) plans.

Automatic Enrollment

Many workers do not participate in the 401(k) plans offered by their employers. Replacement rates fall significantly, especially among lower income workers, when the model considers all eligible workers because current non-participants will tend to have much lower 401(k) accumulations when they turn 65 than workers currently participating (Figure 1).

[6] The income replacement rate is the portion of pre-retirement income that a 401(k) plan participant is projected to be able to replace by drawing from his or her 401(k) accumulations at age 65. The median replacement rate is the point where half of 401(k) plan participants in a given income group will be able to replace more than this amount and half will replace less than this amount.

[7] Social Security replacement rates show the reverse pattern: for the lowest income quartile, Social Security is projected to replace about 52 percent of pre-retirement income, while the highest income quartile is projected to have Social Security replace only about 16 percent of salary. (See Holden and VanDerhei (November 2002) and discussion below.)

The difference in replacement rates at retirement between all eligible workers and the baseline (401(k) participants only) diminishes as income rises because participation rates tend to rise as income increases.

One new set of scenarios examines the effect automatic enrollment, a plan design feature, has on replacement rates at retirement. Automatic enrollment changes the worker's decision from having to choose to participate to having to choose not to participate in a 401(k) plan. If an employee does nothing, he or she is automatically enrolled in the plan. The employer sets a default contribution rate and default asset allocation. However, the employees may still choose either not to participate (opt out) or to set their own asset allocations and contribution amounts.

Automatic enrollment appears to significantly increase participation rates. Prior to automatic enrollment, 66 percent of eligible workers in the model at year-end 2000 were participants in 401(k) plans. Immediately after adding automatic enrollment to the model, the participation rate rises to 92 percent of eligible employees. The positive impact of automatic enrollment on participation rates proved even stronger among lower income workers.

The effects of automatic enrollment on replacement rates at retirement depend heavily on the default contribution rate and default investment option that the plan sponsor selects. All else equal, the higher the default contribution rate, the higher the replacement rates at retirement. Given the historical tendency of equity securities to generate higher returns than fixed-income securities, 401(k) plans that set a life-cycle fund[8] as the default investment option tend to have higher forecasted replacement rates than plans that have a money market fund as the default investment option.

Figure 1 highlights the replacement rates for all eligible workers who would have had a full career's exposure to two of the four different automatic enrollment scenarios analyzed in this paper. The first, more conservative, automatic enrollment scenario features a 3 percent default contribution rate with a money market fund as the default investment option; the more aggressive second scenario features a 6 percent default contribution rate with a life-cycle fund as the default investment option.

The conservative automatic enrollment scenario results in projected median replacement rates that are higher for lower income workers than when automatic enrollment is not available to them. Automatic enrollment has the greatest impact on this group because those in the lowest income quartile are the least likely to participate in a 401(k) plan on their own. Therefore, adding automatic enrollment creates a larger percentage of new participants from this group. The impact of automatic enrollment on higher income quartiles proves less dramatic and, in some cases, diminishes replacement rates because these workers tend to participate when left to enroll on their own. Higher income workers tend to have higher participation rates, contribute more than 3 percent of salary, and select more aggressive investments in the absence of automatic enrollment.

On the other hand, the second automatic enrollment scenario in Figure 1 highlights projected results if the plan sponsor selects as the default a 6 percent contribution rate and a life-cycle fund that invests in equities when the worker is young and rebalances to be more concentrated in fixed-income securities as the worker ages. In this scenario, median replacement rates at age 65 are projected to be higher among all eligible workers across all income quartiles than without automatic enrollment.

[8] A life-cycle "fund" is a pooled investment portfolio, such as a mutual fund, collective trust, life insurance separate account, or other pooled investment, that rebalances away from equity securities and into fixed-income securities as the target date—usually the expected retirement date of the individuals investing in the fund—approaches.

Catch-Up Contributions

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) introduced "catch-up" contributions, so that individuals age 50 or older could make additional tax-deferred contributions to qualified retirement plans and IRAs above the deferred annual contribution limits. This tax policy change encourages increased savings by individuals at a point in their lives when increased saving is possible (e.g., children are educated and grown; house has been purchased).[9]

A new EBRI/ICI model scenario captures this by assuming that all 401(k) participants age 50 or older who are projected to contribute at the limit in a given year also make the additional catch-up contribution. The model forecasts that individuals in the highest income quartile when they reach age 65 generally would have higher projected replacement rates as a result of taking advantage of catch-up contributions.

Saving in IRAs When Not in 401(k) Plans

Given that many individuals change jobs and many employers do not offer 401(k) plans to their workers, it can be assumed that many 401(k) plan participants at year-end 2000 may not always work for an employer with such a plan. Income replacement rates at retirement from 401(k) accumulations are dramatically lower when workers do not always find themselves in 401(k) plans throughout their careers. Another new scenario shows the effects of individuals' taking advantage of IRAs when they are not offered 401(k) plans. This scenario assumes participants contribute to IRAs in an effort to replicate their 401(k) contribution experience, while considering IRA contribution limits.

Although projected replacement rates at age 65 increase across all income groups when individuals not offered 401(k) plans contribute to IRAs, the results are most promising for lower income quartiles at retirement. Contribution limits for IRAs generally allow sufficient saving for lower income individuals to replicate their 401(k) experience. Higher income participants find themselves restricted by the lower IRA contribution limits, and thus do not do as well as they would if they always work for employers offering 401(k) plans.

Outline

The next section briefly describes the EBRI/ICI 401(k) Accumulation Projection Model and presents the original baseline results. For comparison, projected Social Security replacement rates in the first year of retirement are also presented. The third section adds non-participants to the model and examines the effect that automatic enrollment has on replacement rates among all eligible workers. The fourth section models the effects that catch-up contributions have on income replacement rates at retirement among 401(k) plan participants. The fifth section analyzes how IRA contributions can benefit workers when their employers do not offer 401(k) plans. Following the conclusion, references are presented.

EBRI/ICI 401(k) ACCUMULATION PROJECTION MODEL[10]

The starting point for projecting 401(k) accumulations and replacement rates at retirement is the EBRI/ICI database at year-end 2000, which contains information on actual 401(k) participant account balances at their current employers, asset allocations, loan balances, and annual incomes (Figure 2). Participants are then forecast to engage in activity in 401(k) plans over the remainder of their projected careers. As participants age, their behavior changes and reflects their own personal characteristics combined with the typical behaviors observed among millions of 401(k) participants at different ages, tenures, and income levels in the EBRI/ICI database.

In addition, the model also factors in behaviors typical at job change (Figure 2). First, the model determines whether an individual changes jobs in any given year. If he or she does, the model determines whether the individual leaves the 401(k) balance in the previous employer's plan, cashes it out, or rolls it over into an IRA. If a rollover IRA is created, then typical IRA behaviors are modeled, including asset allocation decisions and IRA withdrawal activity.

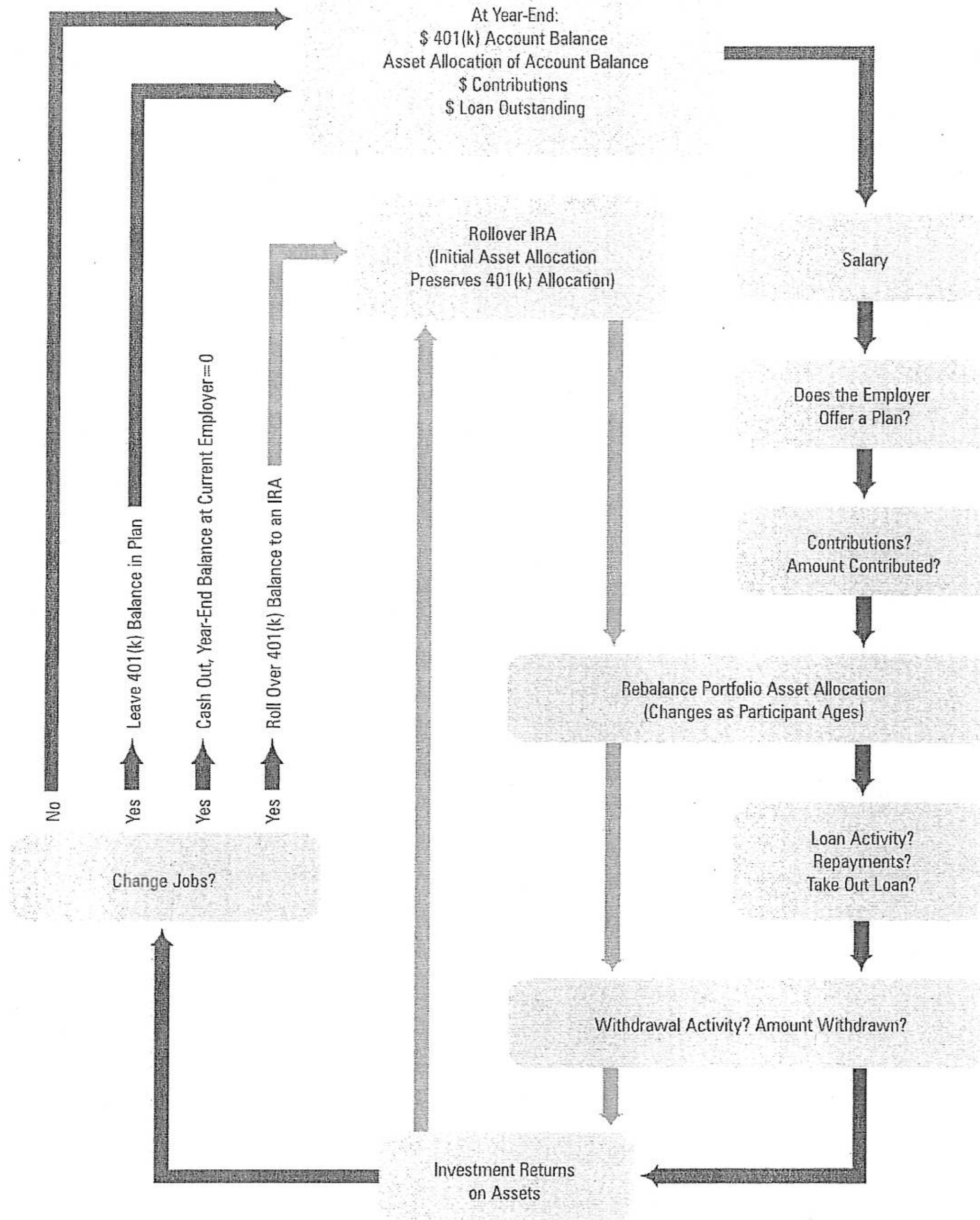
[9] The life-cycle pattern of saving suggests that older individuals are able to save at higher rates because they no longer face the expenses of buying a home and/or putting children through college. An augmented version of the life-cycle theory predicts that the optimal savings pattern increases with age. For a summary discussion of life-cycle models, see Browning and Crossley (Summer 2001). For a more extensive discussion, see Engen, Gale, and Uccello (December 1999). In addition, Mitchell and Utkus (2003) discuss life-cycle savings and behavioral finance models in the context of retirement plan design considerations.

[10] For a complete description of the model, see Holden and VanDerhei (November 2002 and November 2002—Appendix).

2-8

FIGURE 2

Diagram of Annual Growth Cycle of 401(k) Accumulations[1] in the EBRI/ICI 401(k) Accumulation Projection Model



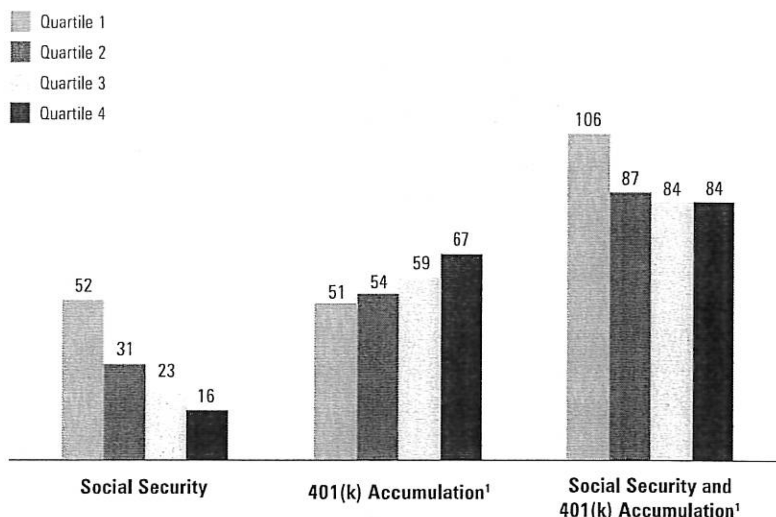
[1] In the model, both 401(k) balances at current and previous employers and rollover IRA balances are projected.
Source: EBRI/ICI 401(k) Accumulation Projection Model (See Holden and VanDerhei (November 2002—Appendix)

2-9

In order to analyze a full career working at employers with 401(k) plans, the baseline results are presented for participants who were born between 1965 and 1974 (and thus were between 26 and 35 years old in 2000) and would be turning 65 years old between 2030 and 2039. The "401(k) accumulation" at the end of the individual's career is the sum of all 401(k) balances at their employers as well as IRA balances resulting from any rollovers from 401(k) accounts. The model converts the 401(k) accumulations into an income stream—an annuity or set of installment payments—using current life expectancies at age 65 and projected discount rates. The replacement rates calculated compare the income or installment payments generated in the first year of retirement to the projected final five-year average pre-retirement income.[11]

FIGURE 3

Median Replacement Rates for Participants Turning 65 Between 2030 and 2039 by Income Quartile at Age 65
(percent of final five-year average salary)



¹ *The 401(k) accumulation includes 401(k) balances at employer(s) and rollover IRA balances.*
Source: EBRI/ICI 401(k) Accumulation Projection Model

Baseline Model Results

The baseline case of the model takes the 401(k) participants through a career with continuous employment, continuous 401(k) plan coverage, and historical financial market returns (based on U.S. financial market experience from 1926 through 2001).[12] In this baseline case, replacement rates at age 65 range from about half to about two-thirds of pre-retirement income. For example, the median individual among future retirees reaching age 65 between 2030 and 2039 in the lowest income quartile is projected to see distributions from 401(k) accumulations replace about 51 percent of pre-retirement income in the first year of retirement (Figure 3). The median individual in the highest income quartile at age 65 is projected to replace about 67 percent of pre-retirement income using distributions from 401(k) accumulations.[13]

For comparison, the model also projects the Social Security benefits in the first year of retirement.[14] By design, replacement rates from Social Security fall as income rises. The median individual in the lowest income quartile at age 65 is projected to see Social Security replace about half of projected pre-retirement income at age 65, while the median individual in the highest income quartile is projected to have a Social Security replacement rate of only 16 percent if the current benefit structure is maintained (Figure 3).

[11] The 401(k) distributions are not indexed for inflation over retirement, while Social Security payments are. In addition, if the individual elects a set of installment payments rather than an annuity, the amount that may be reasonably withdrawn each year after the first year may vary as future market fluctuations affect the account going forward.

[12] Holden and VanDerhei (November 2002) also consider projections for many different investment return scenarios including: the worst 50-year return period for U.S. equities (1929 to 1978); a bear market (three consecutive years of -9.3 percent annual returns on equities) at the beginning, middle, or end of individuals' careers; and a bull market (three consecutive years of +31.2 percent annual returns on equities) at the beginning, middle, or end of individuals' careers.

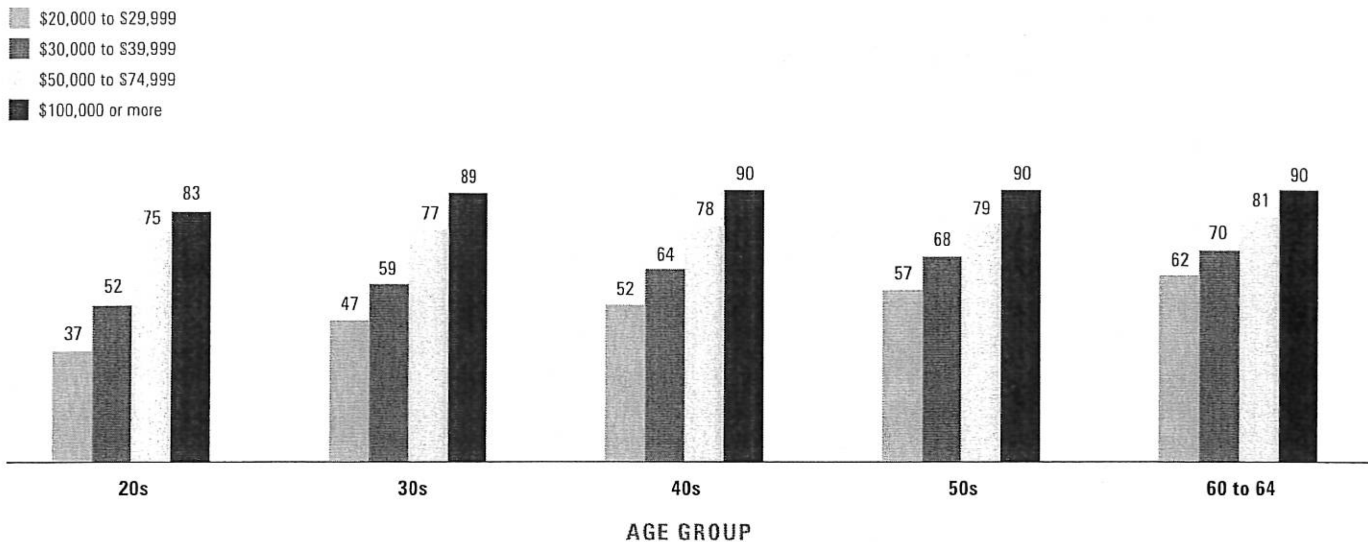
[13] Among participants reaching age 65 between 2030 and 2039, the real (in 2000 dollars) cut-off points for the income quartiles are: first quartile—$36,700; second quartile—$56,400; and third quartile—$87,200. Thus, the highest income quartile at age 65 has a real income of $87,200 or more.

[14] Technically, this is called the primary insurance amount (PIA). The PIA was calculated for the individual participant's earnings history and did not consider the possibility of a spousal benefit, which can be substantially larger than an individual's own benefit in some cases. The PIA calculated for each individual is the sum of three separate percentages of portions of their average indexed monthly earnings (AIME). The portions depend on the year in which the worker reaches retirement. For example, for 2005 the PIA was 90 percent of the first $627 of their AIME plus 32 percent of their AIME over $627 and through $3,779 plus 15 percent of their AIME over $3,779 (see the Social Security Administration's website, www.ssa.gov, for benefit formulas).

2-10

FIGURE 4

401(k) Plan Participation Rates by Selected Employee Age and Salary Groups, 2003
(percent of eligible employees participating in age and salary group)



Source: Fidelity Investments, Building Futures, Volume V: How Workplace Savings Are Shaping the Future of Retirement

AUTOMATIC ENROLLMENT

The EBRI/ICI 401(k) Accumulation Projection Model is an extension of the EBRI/ICI project's extensive analysis of millions of 401(k) plan *participants*. A significant policy concern is that many employees do not participate in the 401(k) plans sponsored by their employers (in some cases because the employees are not eligible). Participation rates are the lowest among lower income workers (Figure 4). Some of these non-participants may not join the plan because of inertia or confusion.[15] Automatic enrollment uses employees' inactivity to their advantage by making them automatic savers.

With automatic enrollment, the employer notifies the employee that a certain percentage of his or her salary will be contributed into the 401(k) plan unless the employee responds and cancels the enrollment within a certain time period. The employer sets the initial contribution rate[16] and allocates the contribution to a default investment option. Most employers pick modest contribution rates as the default, likely to lessen the burden of the automatic enrollment on the reluctant employees. Profit Sharing/401(k) Council of America (PSCA; 2004) reports that 58 percent of plans with automatic enrollment set the employee contribution rate at 3 percent of salary and another 22 percent of plans with automatic enrollment chose 2 percent of salary (Figure 5).[17] While this is greater than the zero percent contribution rate that non-participants choose, these automatic contribution rates generally are lower than average contribution rates of 401(k) participants in the EBRI/ICI database (Figure 6). In addition, in many cases the default contribution rate in the automatic enrollment plans is lower than the contribution rate needed to take full advantage of the employer match.[18]

[15] For example, Investment Company Institute (Spring 2000) surveyed households with 401(k) plans and households offered 401(k) plans but not participating. Non-participants were asked their reasons for not participating in 401(k) plans. Respondents were allowed to give multiple reasons; about a third of non-participants indicated that they were not participating because the 401(k) plan's features were confusing.

[16] Another element of plan design that may be coupled with automatic enrollment is to automatically increase the contribution rate over time. For example, Thaler and Benartzi (2004) developed Save More Tomorrow, or SMarT™. Utkus (November 2002) reports on the successful implementation of voluntary adoption of SMarT contribution rules at two divisions of one of The Vanguard Group's corporate recordkeeping clients.

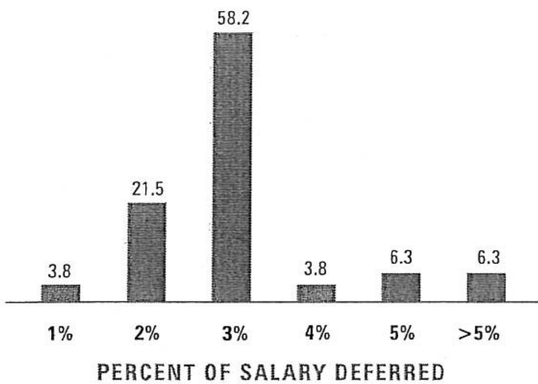
[17] Vanguard (July 2001) also reports that most plan sponsors chose a default contribution rate of 3 percent or less (while about a quarter of plan sponsors selected a default contribution rate of 4 percent or higher). Hewitt (2005) reports that about a third of plan sponsors with automatic enrollment select a default contribution rate of 2 percent or less; about half choose 3 percent; and 17 percent select a default contribution rate of 4 percent or more.

[18] Holden and VanDerhei (October 2001) find more than half of participants offered a match in 1999 were offered a match on up to at least 6 percent of salary or more.

2-11

FIGURE 5

Default Contribution Rate in Plans with Automatic Enrollment
(percent of plans)



Note: Percentages do not add to 100 percent because of rounding.
Source: Profit Sharing/401(k) Council of America (PSCA), 47th Annual Survey of Profit Sharing and 401(k) Plans, Reflecting 2003 Plan Year Experience

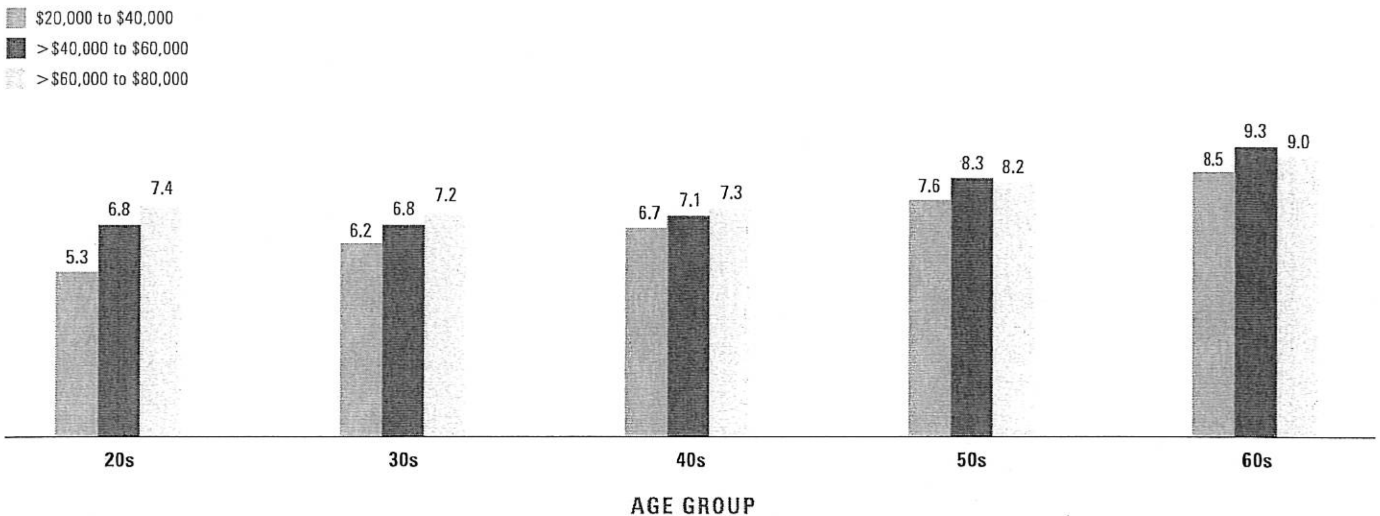
Eligible Non-Participants

To project the impact of automatic enrollment on 401(k) accumulations at retirement, the EBRI/ICI model must first produce information for non-participants. To generate non-participants, the model uses participation behavior by age and income to estimate a participation probability for a given 401(k) participant in the model.[19] For example, about half of employees in their twenties and earning between $30,000 and $39,999 participate in the 401(k) plan when eligible (Figure 4). Thus, for each 401(k) plan participant in his or her twenties with $30,000 to $39,999 in salary, an identical non-participant is created for the analysis. At year-end 2000, the total population of 3.8 million eligible employees consists of 2.5 million 401(k) plan participants with account balances and 1.3 million non-participants, which results in a participation rate of 66 percent at the start of the projection model (Figure 7, top panel).[20]

Participation rates tend to rise with age and income (Figure 4).[21] As the population of all eligible employees moves through their careers, the

FIGURE 6

Average Participant Before-Tax Contribution Rate by Selected Participant Age and Salary Groups, 1999
(percent of salary contributed)



Source: EBRI/ICI Participant-Directed Retirement Plan Data Collection Project (see Holden and VanDerhei (October 2001))

[19] See Fidelity (2004) for the full range of age and income groups analyzed.

[20] To analyze replacement rates after a full career with exposure to 401(k) plans, results for a subset of the entire model database are often highlighted in this paper. There are about 0.6 million 401(k) participants in the model database that were born between 1965 and 1974 and drawn from the EBRI/ICI year-end 2000 database. The procedure to create eligible non-participants added about 0.5 million eligible non-participants to this birth cohort in the model. The participation rate for this birth cohort is 54 percent at the beginning of the projection and 74 percent by the end when there is no automatic enrollment. With automatic enrollment, the participation rate for this group is 91 percent at the beginning of the projection and 97 percent at the end.

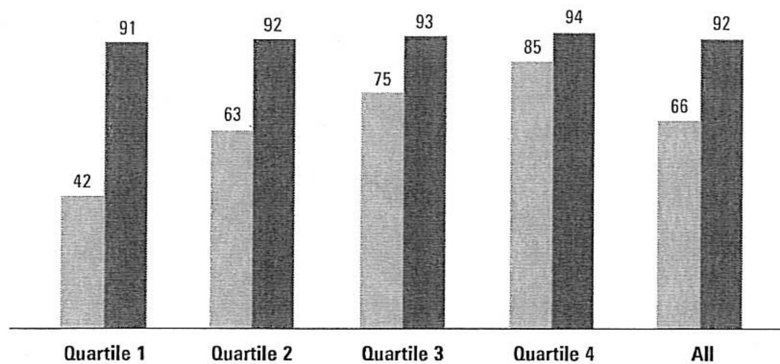
[21] Other research finds this pattern; for example, Copeland (October 2004) finds that participation rates in employer-sponsored plans (whether defined contribution, defined benefit, or both) tend to rise with income (and education) and with age through age 54. Choi et al. (2001 and 2004) also find that participation tends to rise with tenure. Although no tenure effect is modeled because the participation decision in the model is only made at job change, the model assumes that once an individual becomes a participant he or she continues to participate whenever offered a plan from that first point of participation onward.

FIGURE 7

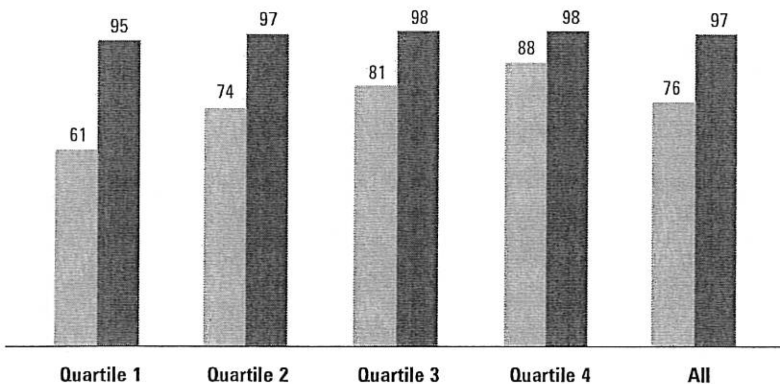
Participation Rates Before and After Automatic Enrollment at the Beginning and End of the Projection by Income Quartile
(percent of eligible workers)

Before Automatic Enrollment
After Automatic Enrollment

Beginning of Projection (Year-End 2000)



End of Projection (At Age 64)



Source: EBRI/ICI 401(k) Accumulation Projection Model

probability that an employee will choose to participate in the 401(k) plan when offered increases. Thus, each time a non-participant changes jobs, the model determines whether he or she will participate in the new 401(k) plan based on the individual's new age and new income at the time of job change. In addition, as long as the current employer offers a 401(k) plan, any employee who previously participated in a 401(k) plan continues to do so in the future.[22] By the end of the projection model, 76 percent of all eligible workers are participating in a 401(k) plan at age 64 (Figure 7, bottom panel). Next, with both participants and non-participants in the model, a range of automatic enrollment designs and participant reactions are simulated.

Replacement Rates Among All Eligible Workers

The EBRI/ICI 401(k) Accumulation Projection Model's baseline results present the median replacement rates by income quartile at age 65 for 401(k) plan *participants* who had account balances at year-end 2000. The baseline does not include the eligible workers who had not yet participated in their current employer's plan by year-end 2000. Incorporating non-participants lowers the median replacement rates for all age and income groups at age 65 (compared with the baseline) because current non-participants tend to have lower 401(k) accumulations and replacement rates at retirement

[22] Participation does not imply contributions in every year to the 401(k) plan, but that the contribution activity will be modeled after the contribution activity observed among 401(k) plan participants with account balances in any given year. Analysis of EBRI/ICI 401(k) plan participants in calendar-year 2000 finds that 91 percent of participants had contributions into their 401(k) accounts (employee, employer, or both) in that year (see Holden and VanDerhei (November 2002)). Similarly, analysis of EBRI/ICI 401(k) plan participants drawn from the 1999 database finds that 92 percent of participants made employee contributions in that year (see Holden and VanDerhei (October 2001)).

even if they begin to participate later in their careers. Including current non-participants produces a relevant measure against which to analyze the effects of automatic enrollment.

In the baseline model, the median individual among participants in the lowest income quartile at age 65 is projected to see his or her 401(k) accumulations replace about 51 percent of pre-retirement income (Figure 8, top panel). When all eligible employees are included in the model, the median replacement rate for the lowest income quartile is only about 23 percent of pre-retirement income (Figure 8, bottom panel). The reduction in replacement rates is less dramatic among the higher income quartiles because these workers tend to have higher participation rates in the absence of automatic enrollment. For example, among the highest income quartile, the projected replacement rate at age 65 is 67 percent of pre-retirement income in the baseline model and 56 percent when all eligible workers are included.

As Figure 8 also shows, there is a range of results for participants. The 25th percentile is the replacement rate that three-quarters of the individuals in a given income quartile are forecasted to meet or exceed. The 75th percentile is the projected replacement rate that a quarter of the individuals would meet or exceed.

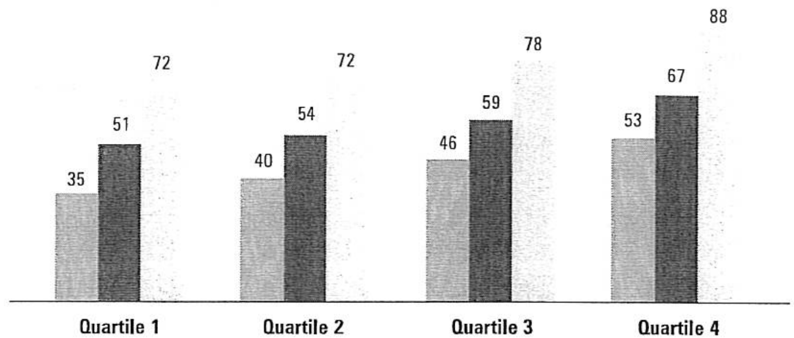
FIGURE 8

Distribution of Replacement Rates[1] from 401(k) Accumulations[2] for Participants Turning 65 Between 2030 and 2039 by Income Quartile

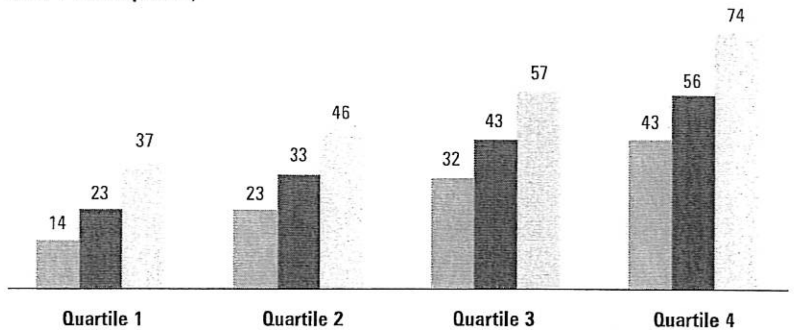
(percent of final five-year average salary)

25th Percentile
Median
75th Percentile

Baseline Model (401(k) Participants Only)



All Eligible Workers (401(k) Participants and Eligible Non-Participants)



[1] Both simulations assume continuous employment and continuous offering of 401(k) plans by employers.

[2] The 401(k) accumulation includes 401(k) balances at employer(s) and rollover IRA balances.

Source: EBRI/ICI 401(k) Accumulation Projection Model

2-14

Empirical Research on Automatic Enrollment

Automatic enrollment is relatively new and therefore only limited empirical information exists to assess how it would affect participation rates, average contribution rates, and average asset allocations over an entire career. Moreover, the model must also know how to estimate which employees and how long employees will remain with the default choices. For this set of simulations, the model's automatic enrollment assumptions are based on an analysis of data for a health services company with approximately 30,000 employees by Choi, Laibson, Madrian, and Metrick (2001 and 2004).[23]

The health services company implemented an automatic enrollment program on April 1, 1998 that applied to employees hired on or after that date. The default contribution rate was initially set at 3 percent of salary and the initial default investment fund was a money market fund. Employees were given 30 days to opt out of the plan. The employer match rate for the plan was 50 percent of up to 6 percent of pay after one year of employment.

As it is designed to do, automatic enrollment dramatically increases participation rates, especially among newer employees.[24] Automatic enrollment also has an impact on the distribution of 401(k) plan participants' contribution rates. Choi et al. (2001) find that, prior to automatic enrollment, the most common contribution rate was 6 percent of compensation, which was the maximum amount matched by the employer. Among employees with less than two years of tenure hired after the automatic enrollment program was implemented, 72 percent contributed at the default contribution rate of 3 percent.

Choi et al. (2001) find similar results with respect to asset allocation before and after automatic enrollment. Only 18 percent of participants with less than two years of tenure hired prior to automatic enrollment had all of their 401(k) balances in the money market fund (which became the default fund under automatic enrollment). This figure increased to 71 percent for those hired after automatic enrollment was installed.

While the combined impact of a lower than typical contribution rate and a conservative asset allocation will offset at least some of the benefits of the increased participation rates associated with the adoption of an automatic enrollment program, Choi et al. (2001) find that the percentage of participants hired during automatic enrollment that remained at the contribution and asset allocation defaults decreased substantially with increasing tenure. By the time employees have 46 months of tenure with this company, the percentage still at the defaults decreased to approximately 30 percent.[25]

Automatic Enrollment in the Projection Model

In order to forecast the impact of automatic enrollment on a broader population of workers over an entire career, the projection model immediately implements the automatic enrollment behaviors observed in the sample health services company analyzed by Choi et al. (2001 and 2004) in the year 2000 at all companies offering 401(k) plans. Workers have continuous employment at firms offering 401(k) plans with automatic enrollment. Automatic enrollment takes place immediately at year-end 2000, which brings many non-participants into 401(k) plans at the beginning of the projection model.

[23] Choi et al. (2001) also study two other large companies' 401(k) plans in addition to the large health services company (that was initially analyzed in Madrian and Shea (May 2000)). Choi et al. (2004) consider 11 large companies with 401(k) plans implementing a variety of changes (e.g., automatic enrollment, eligibility rules, savings survey).

[24] For example, prior to automatic enrollment, Choi et al. (2001) find that only about a third of new employees (three to five months of tenure) were participating in the 401(k) plan; after automatic enrollment, 87 percent of new employees were participating in the plan. The impact of automatic enrollment diminishes with increasing job tenure given that an increasing proportion of eligible employees would elect to participate with time in the absence of automatic enrollment. Nonetheless, the difference in the participation rates between the two groups is still 35 percentage points after 24 to 26 months of tenure.

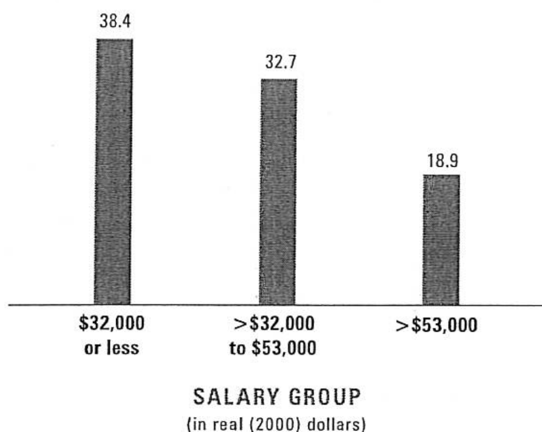
[25] See Choi et al. (2004). In addition, Choi et al. (2001) find that workers with lower incomes are more likely to select and remain with the automatic enrollment defaults.

2-15

FIGURE 9

Percentage of Participants Choosing Automatic Enrollment Defaults by Salary Group

(percent of participants in salary group)



Source: Authors' tabulations based on Choi, Laibson, Madrian, and Metrick (2001)

For eligible non-participating workers, the projection model uses a three-step process that takes place at job change after year-end 2000 to determine enrollment. First, the model determines whether the worker becomes a 401(k) participant based on the employee's age and salary (Figure 4).[26] Second, the model determines whether the participant contributes the automatic enrollment default rate or an amount based on contribution behavior observed among EBRI/ICI 401(k) plan participants. Third, the model determines whether the participant accepts the default automatic enrollment asset allocation or selects asset allocation in line with their age as observed among EBRI/ICI 401(k) plan participants. The model assumes that the percentage of participants choosing the automatic enrollment defaults (the second and third steps) depends on the employee's income (Figure 9). For example, a worker in his or her twenties with a salary of $32,000 would have a 52 percent chance of becoming a participant (Figure 4) and then a 38 percent chance of staying with the automatic enrollment defaults (Figure 9).

Automatic Enrollment Projection Results

Figure 10 compares the replacement rates of four different automatic enrollment scenarios with the replacement rates among all eligible workers without automatic enrollment. The model analyzes two different default contribution rates—3 percent of salary and 6 percent of salary—and two different default asset allocations—a money market fund and a life-cycle fund.[27]

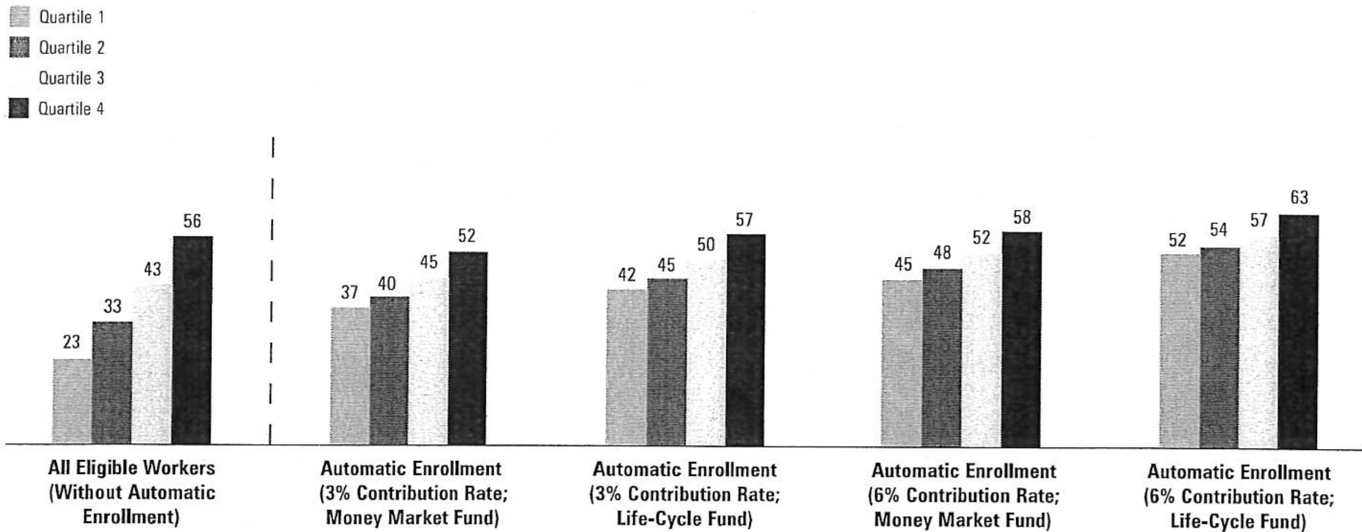
For eligible workers born between 1965 and 1974, the impact of a full career with employers offering automatic enrollment with a 3 percent of salary contribution rate and a money market fund varies from an increase of 14 percentage points in the median replacement rate for those in the lowest income quartile at age 65 to a decrease of 4 percentage points in the median replacement rate for those in the highest income quartile (Figure 10). The replacement rates rise for the lowest two income groups because the effect of increasing participation rates for these employees more than offsets the potential downside of reducing contribution rates and/or investing more conservatively. In contrast, employees in the highest income quartile already have such high participation rates even in the absence of automatic enrollment that there is very little to be gained by increasing participation. Rather, projected replacement rates are reduced by automatic enrollment's lower contribution rates and/or more conservative investment strategies.

[26] Once non-participating workers become participants, they continue to be participants and skip this first step at the next job change. However, all workers (participants and non-participants alike) experience the decision of going with automatic enrollment defaults or making their own contribution rate and asset allocation decisions at each job change. Unfortunately, at this time, there are no empirical estimates available to incorporate "learning" into the model. It is possible that employees may "learn" from their automatic enrollment experience at a previous job that they do not want to anchor their contribution rates and/or asset allocation at the defaults. In addition, one would expect that the portion of employees who have already switched out of the defaults would continue this behavior upon job change. However, the decision to remain with automatic enrollment defaults is made at job change and depends on salary, without any reflection on prior experience in 401(k) plans.

[27] The 3 percent default contribution rate and money market fund analysis is based on the results from Choi et al. (2001 and 2004). The 6 percent default contribution rate and life-cycle fund analyses assume that workers respond to these defaults as they did to the 3 percent contribution rate and money market fund defaults. In addition, the model assumes a 50 percent of salary employer match for participants automatically enrolled in the plan with the default options.

FIGURE 10

Median Replacement Rates from 401(k) Accumulations[1] for All Eligible Workers[2] Turning 65 Between 2030 and 2039 by Income Quartile at Age 65
(percent of final five-year average salary)



[1] The 401(k) accumulation includes 401(k) balances at employer(s) and rollover IRA balances.
[2] All eligible workers includes 401(k) plan participants with account balances at year-end 2000 and eligible non-participants.
Source: EBRI/ICI 401(k) Accumulation Projection Model

The automatic enrollment scenario featuring a 3 percent contribution rate and a life-cycle fund increases projected median replacement rates at age 65 across all income quartiles compared with the scenario without automatic enrollment (Figure 10). This result is driven by the equity returns in the life-cycle fund, because equity securities have historically had higher returns than fixed-income securities in the United States.[28]

Automatic enrollment with a 6 percent contribution rate, regardless of the default investment, is projected to improve outcomes for all income groups (Figure 10). The combination of the 6 percent default contribution rate and the life-cycle fund produces the highest replacement rates at retirement among the four automatic enrollment combinations analyzed.

[28] In the projection model, the future equity returns are similar to historical returns experienced by the S&P 500 between 1926 and 2001 (see "large company stocks total returns" in Ibbotson (2002)). Between 1926 and 2001, about two-thirds of the time, equity returns in any given year have fluctuated between –7 percent and 33 percent. The total return used for bonds, GICs, money market funds, and other investments in the projection is the "long-term government bonds total returns" from the beginning of 1926 to the end of 2001 (see Ibbotson (2002)). Historically, about two-thirds of the time, these returns in any given year have fluctuated between -1 percent and 14 percent.

2-17

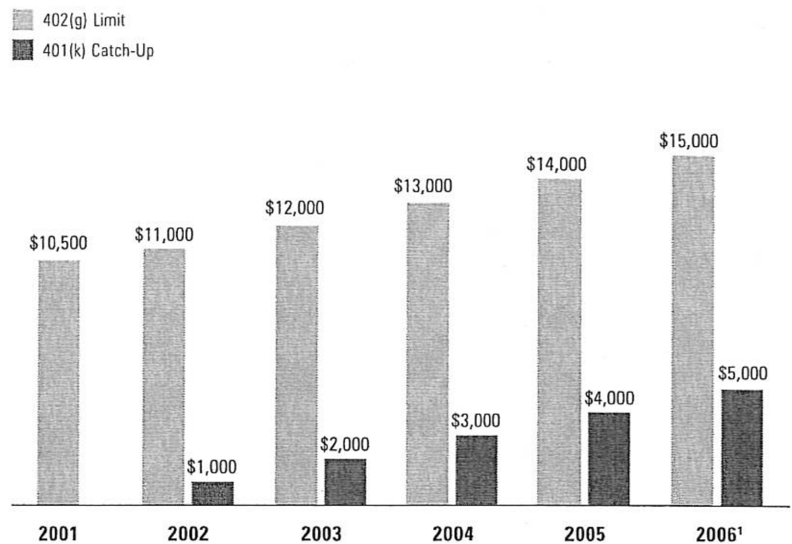
CATCH-UP CONTRIBUTIONS

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) increased annual contribution limits to 401(k) and other retirement plans (including IRAs). In addition, EGTRRA permits "catch-up" contributions by individuals age 50 or older and already contributing at the tax-deferred limit. For example, in 2005, any participant age 50 or older already contributing $14,000 (the 402(g) limit) to a 401(k) plan, could make a catch-up contribution of an additional $4,000 (Figure 11).[29] The EBRI/ICI projection model examines the impact of this increased saving opportunity.[30]

The model assumes that any individual age 50 or older who would have contributed at the 402(g) limit in the model in any given year (after 2001), will also make a catch-up contribution of the entire amount allowed.[31] Assuming that these participants make catch-up contributions of the full amount may overstate the effects of catch-up contributions. However, limiting the catch-up contributions to participants already contributing at the 402(g) limit reduces the modeled impact. This is because many 401(k) plan participants cannot contribute to the 402(g) limit because of lower plan-imposed limits[32] or nondiscrimination testing.[33] Any participants who are prevented from reaching the 402(g) limit by either plan design or nondiscrimination testing are not recognized as eligible to make catch-up contributions by the model.

FIGURE 11

Internal Revenue Code Deferred Contribution Limits in 401(k) Plans, 2001–2006



¹After 2006, these limits are indexed for inflation in $500 increments. IRA catch-up contributions are not indexed for inflation.

Source: Authors' Summary of U.S. Internal Revenue Code

The availability of catch-up contributions increases the projected replacement rate of the median individual in the fourth income quartile at age 65 by 3 percentage points compared with the model baseline, to 70 percent of pre-retirement income. Because individuals in the lower income quartiles generally are less likely to be contributing at the limit, the impact of catch-up contributions on the median replacement rates in the other income quartiles was indistinguishable from zero.[34]

[29] This assumes that the plan allows catch-up contributions. PSCA (2004) reports that nearly all member plans allowed catch-up contributions in 2003. Utkus and Mottola (April 2005) report that 86 percent of 401(k) plans in Vanguard's recordkeeping system offered catch-up contributions in 2004.

[30] Holden and VanDerhei (November 2002) and the model scenarios presented in this paper assume that the limit increases legislated in EGTRRA continue throughout the projection.

[31] ICI research into IRA catch-up contribution activity found that households taking advantage of catch-up contributions to IRAs did so to the limit (see Holden et al. (February 2005)). Thus, it was assumed that 401(k) plan participants making catch-up contributions contribute the entire amount allowed.

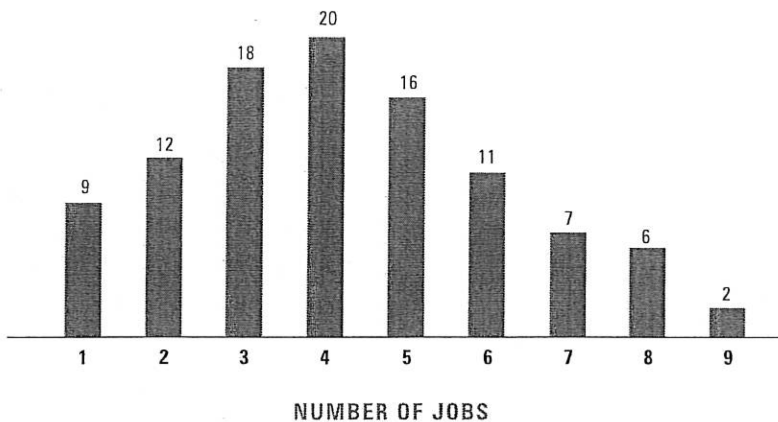
[32] For example, Holden and VanDerhei (October 2001) find that only 11 percent of participants making contributions were at the 402(g) limit (in 1999), but, among those not contributing at the limit, 52 percent could not have done so because of formal plan-imposed limits. PSCA (2004) reports that 8.6 percent of their member plans limit the contributions of highly compensated participants by plan design.

[33] PSCA (2004) reports that 9.3 percent of plans limited contributions of highly compensated employees when contributions reached the maximum allowed by the nondiscrimination tests and another 18.8 percent of plans returned excess contributions to participants after the plan year ended.

[34] Utkus and Mottola (April 2005) also find that participants with higher household incomes are more likely to take advantage of catch-up contributions. They discern catch-up contribution activity across participants who are age 50 or older in all income groups: for example, 5 percent of participants age 50 or older and earning less than $50,000 made catch-up contributions in 2004; 7 percent of those earning $50,000 to $74,999; 12 percent of those earning $75,000 to $99,999; 18 percent of those earning $100,000 to $124,999; 22 percent of those earning $125,000 to $149,999; and 32 percent of those earning $150,000 or more.

FIGURE 12

Distribution of Number of Jobs Held Over Projected Career[1]
(percent of participants at age 65 between 2030 and 2039)[2]



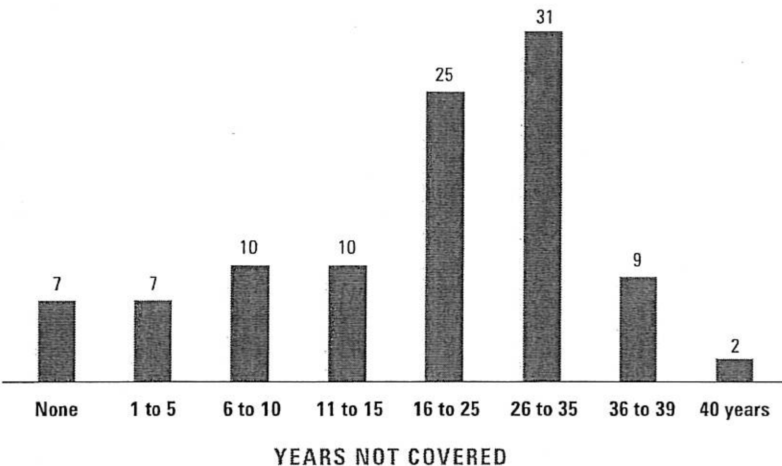
[1] *Experience from 2001 through age 65 among 401(k) participants with account balances at year-end 2000 and born between 1965 and 1974.*

[2] *Percentages do not add to 100 percent because of rounding.*

Source: EBRI/ICI 401(k) Accumulation Projection Model

FIGURE 13

Distribution of Number of Years Out of a 401(k) Plan Over Projected Career[1]
(percent of participants at age 65 between 2030 and 2039)[2]



[1] *Experience from 2001 through age 65 among 401(k) participants with account balances at year-end 2000 and born between 1965 and 1974.*

[2] *Percentages do not add to 100 percent because of rounding.*

Source: EBRI/ICI 401(k) Accumulation Projection Model

SAVING IN IRAs WHEN NOT IN 401(k) PLANS

Some research suggests that 401(k) plan participants are different from other workers because they are "savers," or individuals who are inclined to save.[35] Thus, a new projection scenario assumes that if these workers find themselves without 401(k) plans, they would attempt to replicate their 401(k) savings experience with contributions to IRAs. Based on job duration behavior observed in the Survey of Consumer Finances (SCF), participants in the EBRI/ICI 401(k) Accumulation Projection Model typically are projected to work at several different employers over the course of their careers. By age 65, only 9 percent of the 401(k) participants with account balances at year-end 2000 and born between 1965 and 1974 are projected to have had only one job their entire career; about 54 percent had three to five jobs; and about a quarter had six to nine jobs (Figure 12). As a result, because many employers do not offer a 401(k) plan,[36] only 7 percent of participants born between 1965 and 1974 were projected to have 401(k) plan coverage for their entire careers (Figure 13).

When workers do not always have 401(k) plan coverage, replacement rates fall significantly compared with the baseline model that assumes continuous coverage. For example, in the lowest income quartile at age 65, the baseline replacement rate from 401(k) accumulations in the first year of retirement is about 51 percent of projected pre-retirement income. This is about halved to 25 percent of projected pre-retirement income when 401(k) coverage is not continuous and no other plan is allowed to take its place (Figure 14). Replacement rates fall even more as income rises. For individuals in the highest income quartile, not

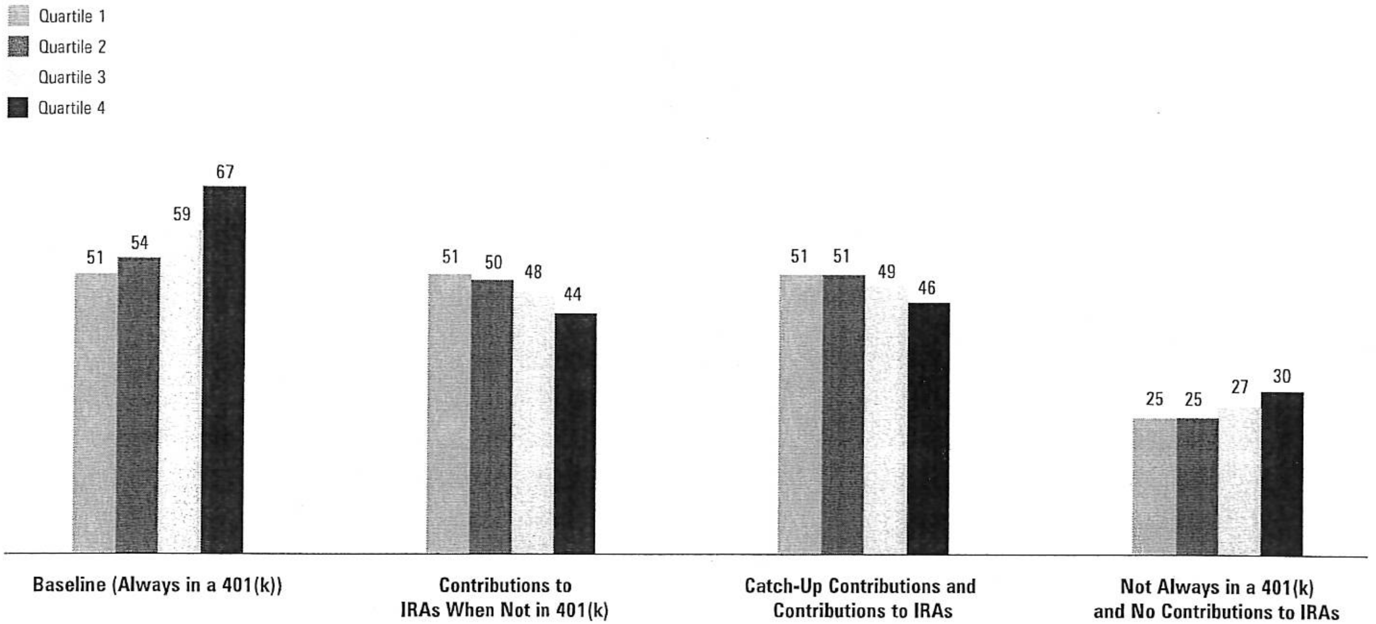
[35] For example, Pence (June 2002) finds that 401(k) plan participants have greater interest in saving compared with other workers and Ippolito (1997) argues that firms that offer defined contribution plans attract workers who are savers.

[36] See U.S. Department of Labor, Employee Benefits Security Administration (Summer 2004), which reports that 29 percent of private wage and salary workers were active participants in defined contribution plans only, 14 percent were active participants in both defined benefit and defined contribution plans, and 7 percent were in private defined benefit plans only.

FIGURE 14

Median Replacement Rates from 401(k) Accumulations[1] for Participants Turning 65 Between 2030 and 2039, by Income Quartile at Age 65

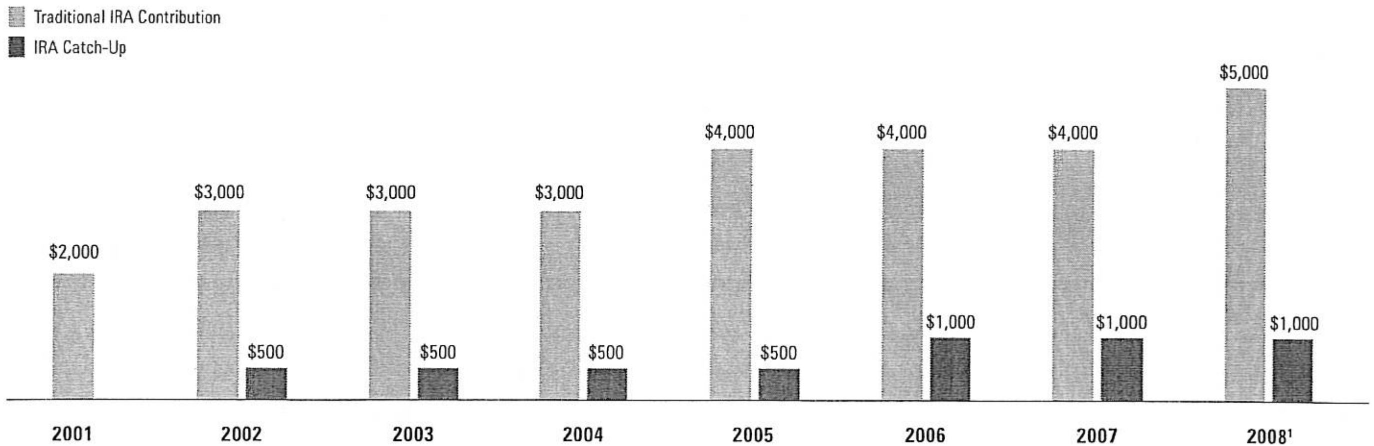
(percent of final five-year average salary)



[1] The 401(k) accumulation includes 401(k) balances at employer(s) and rollover IRA balances.
Source: EBRI/ICI 401(k) Accumulation Projection Model

FIGURE 15

Internal Revenue Code Traditional IRA Contribution Limits, 2001–2008



[1] After 2008, traditional IRA contributions are indexed for inflation in $500 increments. IRA catch-up contributions are not indexed for inflation.
Source: Authors' Summary of U.S. Internal Revenue Code

always having a 401(k) plan reduces their median replacement rate by 37 percentage points.

The question that arises is: To what extent could IRA contributions make up for a lack of 401(k) coverage? The model assumes IRA contributions only as a substitute for the 401(k) activity typically observed. Thus, the model uses the 401(k) contribution decision variables to determine whether the individual contributes to an IRA when without access to a 401(k) plan. Because IRA contribution limits are lower than 401(k) plan contribution limits (Figures 11 and 15), individuals may not be able to contribute as much as they want, or are able, to contribute. The model assumes that each individual tries to contribute to the IRA what would have been contributed by the employee and employer combined in a given year to the 401(k) account. However, if the total contribution that would have occurred in the 401(k) plan is higher than the IRA limit, then the individual can only contribute the IRA limit.

Availability of an IRA during lapses in 401(k) coverage essentially restores the lower income quartiles' replacement rates back to baseline results. This is because the 401(k) plan contribution amounts among lower income quartiles tend to be close to the IRA contribution limits. Higher income quartiles are constrained by the lower IRA limits, which prevent them from replicating their 401(k) contribution possibilities. For example, in the highest income quartile, the median replacement rate improves by about 14 percentage points when these workers make IRA contributions when without 401(k) plans, but cannot reach the baseline result (Figure 14).

CONCLUSION

Because current retirees' 401(k) accumulations are not representative of what a full career with exposure to 401(k) plans *might* generate at retirement, EBRI and ICI developed a model to simulate several projected retirement scenarios for a group of 401(k) plan participants born between 1965 and 1974 after essentially a full career's exposure to 401(k) plans. Workers' retirement savings behaviors are shaped by plan design and tax policy, as well as individuals' innate personal characteristics.

This paper examines the influence of automatic enrollment in the plan design on replacement rates among all eligible workers. Because many employees do not choose to participate in 401(k) plans, nonparticipants were added to the model to analyze the impact of automatic enrollment on replacement rates at retirement. Empirical research finds that automatic enrollment is successful at increasing participation rates, which moves many employees from a zero contribution rate to a positive contribution rate.

Lower income individuals benefit the most from automatic enrollment. However, among higher income employees, conservative default investment options and modest default contribution rates in some cases have a negative effect if the employee would have contributed at a higher rate and/or chosen a less conservative investment option without automatic enrollment.

EGTRRA changed tax policy by increasing contribution limits and allowing catch-up contributions for older participants. This paper examines the impact of catch-up contributions on replacement rates from 401(k) accumulations at age 65. The projections suggest that catch-up contributions, which are available to participants who are age 50 or older and already contributing at the limit, primarily increase higher income participants' projected replacement rates.

Finally, a new projection scenario analyzes the impact of contributions to IRAs when employees are not offered 401(k) plans. If employees use IRAs during lapses in 401(k) coverage, lower income participants do not fall behind because contributions to their 401(k) accounts tend to be close to IRA limits, which are lower than 401(k) limits. On the other hand, higher income workers are not able to replicate their 401(k) contribution experience with IRAs during periods of time when they are not offered a 401(k) plan.

REFERENCES[37]

Browning, Martin, and Thomas F. Crossly. "The Life-Cycle Model of Consumption and and Saving," *Journal of Economic Perspectives*, Vol. 15, No. 3, Summer 2003: pp. 3–22.

Cerulli Associates. "Retirement Markets 2004," *Cerulli Quantitative Update*, Boston, MA: Cerulli Associates, Inc., 2004.

Choi, James J., David Laibson, Brigitte C. Madrian, and Andrew Metrick. "Saving For Retirement on the

[37] See Holden and VanDerhei (November 2002 and November 2002–Appendix) for complete references for all components of the EBRI/ICI 401(k) Accumulation Projection Model.

2-21

Path of Least Resistance," originally prepared for *Tax Policy and the Economy 2001*, updated draft: July 19, 2004.

Choi, James J., David Laibson, Brigitte Madrian, and Andrew Metrick. "For Better or For Worse: Default Effects and 401(k) Savings Behavior," *Pension Research Council Working Paper*, PRC WP 2002-2, Philadelphia, PA: Pension Research Council, The Wharton School, University of Pennsylvania, November 9, 2001.

Copeland, Craig. "Employment-Based Retirement Plan Participation: Geographic Differences and Trends," *EBRI Issue Brief*, No. 274, Washington, DC: Employee Benefit Research Institute, October 2004.

Engen, Eric M., William G. Gale, and Cori E. Uccello. "The Adequacy of Household Saving," *Brookings Papers on Economic Activity*, Vol. 2, Washington, DC: Brookings Institution, December 1999: pp. 65–188.

Federal Reserve Board. *Survey of Consumer Finances*. Available: http://www.federalreserve.gov/pubs/oss/oss2/scfindex.html. Accessed 6/15/2005.

Fidelity Investments. *Building Futures, Volume V: How Workplace Savings Are Shaping the Future of Retirement*. Boston, MA: Fidelity Investments, 2004.

Hewitt Associates. *2005 Trends and Experience in 401(k)Plans*. Lincolnshire, IL: Hewitt Associates, LLC, 2005.

Holden, Sarah, Kathy Ireland, Vicky Leonard-Chambers, and Michael Bogdan. "The Individual Retirement Account at Age 30: A Retrospective," *ICI Perspective*, Vol. 11, No. 1, Washington, DC: Investment Company Institute, February 2005.

Holden, Sarah, and Jack VanDerhei. "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2003," *ICI Perspective*, Vol. 10, No. 2, and *EBRI Issue Brief*, No. 272, Washington, DC: Investment Company Institute and Employee Benefit Research Institute, August 2004.

Holden, Sarah, and Jack VanDerhei. "Can 401(k) Accumulations Generate Significant Income for Future Retirees?" *ICI Perspective*, Vol. 8, No. 3, and *EBRI Issue Brief*, No 251, Washington, DC: Investment Company Institute and Employee Benefit Research Institute, November 2002.

Holden, Sarah, and Jack VanDerhei. "Appendix: EBRI/ICI Accumulation Projection Model," *ICI Perspective*, Vol. 8, No. 3A, Washington, DC: Investment Company Institute, November 2002—Appendix.

Holden, Sarah, and Jack VanDerhei. "Contribution Behavior of 401(k) Plan Participants," *ICI Perspective*, Vol. 7, No. 4, and *EBRI Issue Brief*, No. 238, Washington, DC: Investment Company Institute and Employee Benefit Research Institute, October 2001.

Ibbotson Associates. *SBBI (Stocks, Bonds, Bills, and Inflation) 2002 Yearbook: Market Results for 1926–2001*. Chicago, IL: Ibbotson Associates, Inc., 2002.

Investment Company Institute. *2005 Investment Company Fact Book, 45th Edition*. Washington, DC: Investment Company Institute, 2005.

Investment Company Institute. "401(k) Plan Participants: Characteristics, Contributions, and Account Activity," *ICI Research Series*, Washington, DC: Investment Company Institute, Spring 2000.

Ippolito, Richard A. *Pension Plans and Employee Performance: Evidence, Analysis, and Policy*. Chicago, IL: The University of Chicago Press, 1997.

Madrian, Brigitte C., and Dennis F. Shea. "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," *NBER Working Paper*, No. 7682, Cambridge, MA: National Bureau of Economic Research, May 2000.

Mitchell, Olivia, and Stephen P. Utkus. "Lessons from Behavioral Finance for Retirement Plan Design," *Pension Research Council Working Paper*, PRC WP 2003-6, Philadelphia, PA: Pension Research Council, The Wharton School, University of Pennsylvania, 2003.

Pence, Karen M. "Nature or Nurture: Why Do 401(k) Participants Save Differently than Other Workers?" *Finance and Economics Discussion Series Paper*, Washington, DC: Board of Governors of the Federal Reserve System, June 2002.

Profit Sharing/401(k) Council of America. *47th Annual Survey of Profit Sharing and 401(k) Plans: Reflecting 2003 Plan Year Experience*. Chicago, IL: Profit Sharing/401(k) Council of America, 2004.

Social Security Administration, "Primary Insurance Amount." Available: http://www.ssa.gov/OACT/COLA/piaformula.html. Accessed 6/27/2005.

Thaler, Richard H., and Shlomo Benartzi. "Save More Tomorrow™: Using Behavioral Economics to Increase Employee Saving," *Journal of Political Economy*, Vol. 112, No. 1, Pt. 2, 2004: pp. S164–S187.

U.S. Department of Labor, Employee Benefits Security Administration. *Private Pension Plan Bulletin, Abstract of 1999 Form 5500 Annual Reports*. Washington, DC: U.S. Department of Labor, Summer 2004.

Utkus, Stephen P. *A Recent Successful Test of the SMarT Program*. Valley Forge, PA: The Vanguard Center for Retirement Research and The Vanguard Group, November 2002.

Utkus, Stephen P., and Gary R. Mottola. *Catch-Up Contributions in 2004: Plan Sponsor and Participant Adoption*. Valley Forge, PA: The Vanguard Center for Retirement Research and The Vanguard Group, April 2005.

Utkus, Stephen P., and Jean A. Young. *Lessons From Behavioral Finance and the Autopilot 401(k) Plan*. Valley Forge, PA: The Vanguard Center for Retirement Research and The Vanguard Group, April 2004.

The Vanguard Center for Retirement Research. *Automatic Enrollment: Vanguard Client Experience*. Valley Forge, PA: The Vanguard Group, July 2001.

The Vanguard Center for Retirement Research. *Automatic Enrollment: Benefits and Costs of Adoption*. Valley Forge, PA: The Vanguard Group, May 2001.

Back issues of *Perspective*, written by Institute staff, leading scholars, and other contributors, address public policy issues of importance to mutual funds and their shareholders. Contact the Institute's Research Department at 202/326-5913 for more information. For a complete list of back issues of *Perspective*, visit the Institute's public policy website at www.ici.org/perspective/index.html.

Title	Authors	Issue
"The Individual Retirement Account at Age 30: A Retrospective"	Sarah Holden, Kathy Ireland, Vicky Leonard-Chambers and Michael Bogdan	Volume 11, No. 1, February 2005
"401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2003"	Sarah Holden and Jack VanDerhei	Volume 10, No. 2, August 2004
"Appendix: Additional Figures for the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project for Year-End 2003"	Sarah Holden and Jack VanDerhei	Volume 10, No. 2A, August 2004
"Mutual Fund and Economic Developments in 2003"	Brian Reid, Stephen Sevigny and Bernhard Silli	Volume 10, No. 1, March 2004
"The Expenses of Defined Benefit Pension Plans and Mutual Funds"	Sean Collins	Volume 9, No. 6, December 2003
"401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2002"	Sarah Holden and Jack VanDerhei	Vol. 9, No. 5, September 2003
"Mutual Fund Independent Directors: A Model for Corporate America?"	Richard M. Phillips	Vol. 9, No. 4, August 2003
"Mutual Fund Distribution Channels and Distribution Costs"	Brian K. Reid and John D. Rea	Vol. 9, No. 3, July 2003
"401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2001"	Sarah Holden and Jack VanDerhei	Vol. 9, No. 2, March 2003
"Mutual Fund Industry Developments in 2002"	Brian Reid and Stefan Kimball	Vol. 9, No. 1, February 2003
"Can 401(k) Accumulations Generate Significant Income for Future Retirees?"	Sarah Holden and Jack VanDerhei	Vol. 8, No. 3, November 2002
"The Regulation of Operational Risk in Investment Management Companies"	Charles W. Calomiris and Richard J. Herring	Vol. 8, No. 2, September 2002
"Mutual Fund Industry Developments in 2001"	Brian Reid, Kimberlee Millar and Stephen Sevigny	Vol. 8, No. 1, February 2002
"401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2000"	Sarah Holden and Jack VanDerhei	Vol. 7, No. 5, November 2001
"Contribution Behavior of 401(k) Plan Participants"	Sarah Holden and Jack VanDerhei	Vol. 7, No. 4, October 2001
"The Potential Effects of More Frequent Portfolio Disclosure on Mutual Fund Performance"	Russ Wermers	Vol. 7, No. 3, June 2001
"Mutual Fund Assets and Flows in 2000"	Sean Collins	Vol. 7, No. 2, February 2001
"401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 1999"	Sarah Holden and Jack VanDerhei	Vol. 7, No. 1, January 2001
"The 1990s: A Decade of Expansion and Change in the U.S. Mutual Fund Industry"	Brian K. Reid	Vol. 6, No. 3, July 2000
"Mutual Fund Assets and Flows in 1999"	Brian K. Reid and Kimberlee W. Millar	Vol. 6, No. 2, February 2000
"401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 1998"	Sarah Holden, Jack VanDerhei and Carol Quick	Vol. 6, No. 1, January 2000

Copyright © 2005 by the Investment Company Institute

Although information or data provided by independent sources is believed to be reliable, the Investment Company Institute is not responsible for its accuracy, completeness, or timeliness. Opinions expressed by independent sources are not necessarily those of the Institute. If you have questions or comments about this material, please contact the source directly.

The Retirement Security Project RSP

For Immediate Release
February 14, 2006

Contact: **Laura Bos**
202.483.1397
Khris Bershers
202.608.6148

AMBITIOUS RETIREMENT SAVINGS PROPOSAL RELEASED BY HERITAGE FOUNDATION AND THE RETIREMENT SECURITY PROJECT

Automatic IRAs Would Cover Nation's Small Business Workers and Extend Benefits of Auto-Deduction to Millions

Washington, DC – A new plan for Automatic IRAs that would provide a relatively simple, cost-effective way to increase retirement security for the estimated 71 million workers without pension plan coverage was proposed today by The Heritage Foundation and The Retirement Security Project (RSP). AARP has joined forces with Heritage and RSP to lend its support.

With the looming retirement security crisis facing our country, policy-makers from both parties are focused on ways to strengthen pensions and increase savings. While reforms currently being considered would improve employer-sponsored plans, the Automatic IRA provides another way for employees of smaller businesses to choose to save for retirement. Over time, this would lead to more plans, encouraging small employers to retain and attract valuable employees by graduating to sponsorship of an actual retirement plan.

According to the proposal's co-authors Mark Iwry, Senior Adviser to The Retirement Security Project and Non-Resident Senior Fellow at the Brookings Institution, and David John, Senior Research Fellow in Retirement Issues and Financial Institutions at The Heritage Foundation, the plan works for both employers and employees: "Under our approach, those firms that aren't ready to sponsor a plan would be called upon at least to let their employees save in IRAs using the same powerful payroll deposit mechanism that drives 401(k)s. This provides an easy and effective way for individuals to take responsibility for their financial futures."

Employers would inform employees of this savings option and would have the choice to either obtain from each employee a decision to participate or not, or automatically enroll employees (allowing the employee to opt out). Automatic enrollment has produced dramatic increases in 401(k) participation, especially among lower-income and minority employees.

Small employers would receive a temporary tax credit for giving their employees access to IRAs through payroll deposit --- much like the typical direct deposit of paychecks to an employee's bank account. Small businesses with no more than 10 employees and new start-ups would not be required to provide this access to payroll deduction, but would receive the tax credit if they did so.

Under the proposal, employers would not have to maintain a plan, make contributions, determine where or how contributions are invested, or open IRAs. Additionally, they would be protected from potential fiduciary liability.

"With our aging population and changing retirement landscape, too many Americans will come up short in retirement. Congress should act now to expand this successful payroll deduction mechanism so that tens of millions of workers can more easily and effectively save for retirement," said David Certner, Director of Federal Affairs at AARP.

"The Automatic IRA helps that portion of the workforce not currently covered by employer-sponsored plans, many of whom are moderate and lower-income workers who have the greatest need to save," said Peter Orszag, Director of RSP.

The Retirement Security Project is supported by The Pew Charitable Trusts in partnership with Georgetown University's Public Policy Institute and the Brookings Institution. RSP works on a nonpartisan basis to promote common sense solutions to improve the retirement income prospects of middle- and lower-income Americans. The Heritage Foundation is a research and educational institute whose mission is to formulate and promote conservative public policies. AARP is a nonprofit, nonpartisan membership organization for people age 50 and over.

For a copy of the working paper, "Pursuing Universal Retirement Security Through Automatic IRAs," visit www.retirementsecurityproject.org.

###

Testimony to be Senate Financial Institutions and Insurance
by Robert J. Vancrum on behalf of
Service Contract Industry Council, Inc.
March 14, 2006

Dear Chairman Teichman and Honorable Members of the Committee:

You may recall Senate bill 178 of last year that originally came to you as a bill to exempt service contracts on residential property from being regulated as an insurance product. It is our understanding that the National Home Service Contract Association, sought this legislation. The legislature broadened the bill to cover many other service contracts (such as those on computers and appliances) from being treated as insurance contracts.

The member companies of the Service Contract Industry Council, the group that I represent, is a national trade association whose members together offer approximately 80% of all service contracts sold in the country. Members include companies such as GMAC, Ford, Sears, CNA, GE Financial, etc. SCIC members provide service contracts offering protection of a variety of products including motor vehicles, homes and consumer goods including cell phones and laptop computers. Many of these contracts offer a component of protection referred to as Accidental Damage from Handling, or ADH, ADH only has applicability in the consumer goods area.

Last year in Senate bill 178, while the language defining service contracts appropriately recognized this valuable component of protection for consumers, it limited the protection to instances whereby the ADH resulted from power surges. The two have no logical association in the real world.

In applying the new law to service contracts that have been brought to the attention of the Kansas Insurance Department, the DOI has applied what seemingly is the "letter of the law" and deemed service contracts offering ADH protection on property when the product failure is not associated with power surges to be insurance, and therefore, has held that the company offering such contract would have to be licensed as an insurer. Needless to say our members are very concerned that what set out to be an effort to exclude any service contracts from being regulation as an insurance product, has become a broader problem, and one that we believe was not intended by the legislature.

We have the support of the Kansas Insurance Department, the persons who asked for last year's Senate bill 178, the Property Casualty Insurance Association of America, the NHSCA and other active members of the service contract industry. This would put Kansas in line with nearly 40 other jurisdictions that have held that service contracts which include accidental damage by handling should be exempt from regulation as insurance products.

House bill 2858 would simply amend the language defining service contracts from last year's bill to delete the power surge limitation, which we believe will finally resolve the issue as it will then accurately describe the contracts in the marketplace, i.e., ones that may <u>either</u> offer

Senate FI & I Committee
Attachment 3-1
March 14, 2006

protection for failure of a product resulting from a power surge OR from accidental damage from handling.

I would be happy to answer any questions at a later time or provide copies of correspondence endorsing the legislation from any of those entities mentioned above.

807482 0002/6769960.1

1200 KANSAS AVE. | TOP..., KS 66612
785.232.7789 | 785.232.7791 FAX
WWW.KSFDA.ORG

OFFICERS

President
JERRY WITT
Fort Scott

President-Elect
CHRIS SCHWENSEN
Clay Center

Vice President
LARRY ENFIELD II
Norton

Corporate
Sec. / Treas.
ASHLEY COZINE
Wichita

Immediate
Past President
BOB STERBENS
Wichita

BOARD OF DIRECTORS

ERIC LONDEEN
Manhattan

KIRK KINSINGER
Kansas City

GARY WALL
Parsons

JUSTIN SMITH
Derby

DARIN BRADSTREET
Garden City

ROBERT GASHAW
Osborne

Policy Board
Representative
MIKE TURNBULL
Emporia

EXECUTIVE DIRECTOR

PAM SCOTT
Topeka

Testimony before the
Senate Financial Institutions and Insurance Committee
By Pam Scott, Executive Director
Kansas Funeral Directors and Embalmers Association

March 14, 2006

Madam Chair and members of the committee, I thank you for the opportunity to appear before you today on behalf of the Kansas Funeral Directors and Embalmers Association (KFDA) in support of House Bill No. 2824. The KFDA represents a membership of over 300 Kansas funeral homes.

House Bill No. 2824, which was introduced at the request of the KFDA and was passed by the House by way of the Consent Calendar. The bill amends K.S.A. 16-304 to eliminate the waiting period before funds can be paid out of a pre-arranged funeral agreement account held by a bank, credit union, or savings and loan association.

Under current law, funds cannot be paid out of such an account until at least five days have expired from the date of death of the person for whose services the funds were paid. We are uncertain as to why the five day waiting period was originally included in the statute. The result today is that the waiting requirement makes it more difficult for financial institutions to compete with insurance companies to fund prearranged funeral agreements. Insurance companies often allow funds to be paid immediately to the funeral provider. Some companies even provide the funeral home with a checkbook to write themselves a check to cover the funeral costs funded by the insurance policy.

If the waiting period is removed, protections remain in place to assure funds are not wrongfully paid out of a pre-arranged funeral account. The statute would continue to require that acceptable proof of death and a verified statement setting forth that all of the terms and condition of the agreement have been fully performed have been provided to the financial institution.

The KFDA would just like to level the playing field between financial institution funded and insurance companies when it comes to funding prearranged funeral agreements.

Your support of House Bill No. 2824 would be appreciated. I would be happy to answer any questions you may have.

Senate FI & I Committee
Attachment 4-1
March 14, 2006