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INCREASING SAVINGS FOR RETIREMENT

HEARING

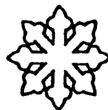
BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

FEBRUARY 24, 1999



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INCREASING SAVINGS FOR RETIREMENT

WEDNESDAY, FEBRUARY 24, 1999

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:23 a.m., in room SD–215, Dirksen Senate Office Building, Hon. William V. Roth, Jr. (chairman of the committee) presiding.

Also present: Senators Hatch, Moynihan, Baucus, Graham, Kerrey, and Robb.

OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will please be in order.

I am going to proceed with my opening statement, I know, to the loss of those present, but they can watch it on video.

Today, first of all, let me welcome each and every one of you. It is a pleasure to have you here.

Today the Committee will hear testimony about the various types of tax-favored savings vehicles available to taxpayers and how well they are working. We will also hear testimony on how we can increase savings in these vehicles and how actual taxpayers and small businesses make decisions on how to save.

One of the concerns of many Americans is will I have enough to live on when I retire. According to a study published by the Employee Benefit Research Institute, about one third of Americans are not confident that they will have enough to live on in their retirement years. Social Security is an important component of an individual's retirement income, but savings—whether through personal accounts or through employer-provided retirement plans—will help provide for a better life at retirement. There must be ways to get more Americans interested in providing for their retirement years and I hope that today's witnesses will give us some answers.

Our tax system provides for various tax incentives for savings. For savings through the workplace, there are 401(k) plans, 403(b) plans and 457 plans, each that can be sponsored by different types of employers. For individual savings, there is either the traditional IRA or the Roth IRA. And all these different savings vehicles have different limits on how much individuals can save. Quite frankly, I believe that our current system can do more and that the limitations that we placed on retirement savings in times of budgetary restraints should be re-examined now.

I should also note that issues relating to retirement are not only a concern of mine, but they are the concerns of many of the members of this Committee. The Administration also has ideas on how to increase retirement savings. I look forward to working on a bipartisan basis to providing needed improvements to this country's retirement system.

While our current system for retirement savings has gotten more complicated over time, I am sure that our witnesses today can lead us through our system and tell us what works and what doesn't work. I look forward to their insights.*

The CHAIRMAN. Senator Moynihan, would you like to make a statement?

OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, A U.S. SENATOR FROM NEW YORK

Senator MOYNIHAN. Very brief, sir, to thank you for holding this hearing on this central subject of our economy just now. It is a bit of a mystery how our savings rate has just dwindled to the vanishing point. There may be some speculation about whether the stock markets have so increased family worth, that they do not see the need of savings, which could turn out to be a great mistake.

That is why Senator Kerrey and I have proposed that we use part of the Social Security surplus, which is to say, take 2 percentage points of the payroll tax that is not needed to maintain the present system, and turn it into an optional thrift savings plan so that families and individuals can start, early in life, acquiring what will be a retirement fund, what my radical friend down at the end of the table calls wealth. [Laughter.] Let us talk more.

Thank you, sir.

The CHAIRMAN. We are already very late getting started, so I would like to proceed.

OPENING STATEMENT OF HON. J. ROBERT KERREY, A U.S. SENATOR FROM NEBRASKA

Senator KERREY. Mr. Chairman, first of all, let me just try to be brief. You deserve a great deal of credit and commendation for calling this hearing. I think it is a very important question, what can we do to help American working people save more money. Myself, I am especially concerned about people who are earning less than $30,000 a year. Median family income in Nebraska is about $28,000, which means we have got half below and half above that number.

If you start with Social Security, Mr. Chairman, for somebody who is making $1,500 a month, let us say, average indexed monthly earnings, you can see the need for this kind of reform, and the reform that Senator Moynihan alluded to in our Social Security proposal. Because Social Security, for all of its vaunted generosity, is not very generous to that low-wage worker.

One of the things that is not typically told by people who are supporters of the current defined benefit, and opponents of many changes, is that Social Security only replaces 90 percent of the first

* For further information on this subject *see also* "Present Law and Background Relating to Tax Incentives for Savings," Joint Committee on Taxation report, February 23, 1999 (JCX-7-99).

$505, and then it replaces 32 percent of everything up to about $3,000 a month.

So for somebody making $1,500 a month, they find themselves acquiring from Social Security substantially less than what they need to survive over a longer period of post-employment life. So, Social Security itself is not very generous.

One of the reasons we are struggling with that program, it seems to me, is that fact. I hope this hearing will help us to answer some questions about, what we can do, especially at that lower wage, to help individuals to increase their contributions to 401(k)s or other kinds of pensions that will provide them with supplemental income for Social Security.

Senator MOYNIHAN. And do not forget, Roth IRAs.

Senator KERREY. The Roth IRAs.

The CHAIRMAN. Senator Hatch, do you have a statement?

OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH

Senator HATCH. Mr. Chairman, I will put my statement in the record. I am happy to welcome all four of you here, especially Mr. Smail. You have businesses in Utah. We are very grateful. We want all of the rest of you to have businesses in Utah. [Laughter.]

But I am grateful to be with you. I want to compliment you, Mr. Chairman, and also Senators Moynihan and Kerrey for the work that they are doing. I do agree that we need to do something about having some modicum of private investment to just see if it works.

And it will work. I am convinced that, once that becomes a part of our lives, it will become a major part of our lives. I just appreciate the leadership you are providing, both you, Mr. Chairman, and you, Mr. Vice Chairman, of this committee. So, thank you.

The CHAIRMAN. Thank you, Orrin.

[The prepared statement of Senator Hatch appears in the appendix.]

The CHAIRMAN. We will now proceed with individuals representing the four different types of retirement saving vehicles. We, first, have Mr. Matthew Fink, president of the Investment Company Institute, who will address the current status of IRAs. Next, will be, for the Association of Private Pension and Welfare Plan, Mr. Peter Smail, who is president of Fidelity Institutional Retirement Service Company. He will talk about 401(k) plans.

Mr. McCormack, after Mr.—how do you pronounce your name, is it Smail?

Mr. SMAIL. It is Smail, Mr. Chairman.

The CHAIRMAN. Smail. All right. I apologize for mispronouncing it.

Mr. SMAIL. No problem.

The CHAIRMAN. Mr. John McCormack, who is president of TIAA/CREF Enterprises. He will tell us about 403(b) plans.

Finally, Mr. Ray Pool, who will testify about 457 plans, on behalf of the National Association of Government Deferred Compensation. Mr. Pool is currently the administrator of the Oklahoma State Deferred Compensation and Savings Incentive Plan.

Thank you, gentlemen, very much for being here. We will begin with Mr. Fink, and then proceed down the table.

STATEMENT OF MATTHEW FINK, PRESIDENT, INVESTMENT COMPANY INSTITUTE, WASHINGTON, DC

Mr. FINK. Thank you, Mr. Chairman. I am Matthew Fink, president of the Investment Company Institute, which is the mutual fund industry's trade association.

I would like to commend the committee for holding these hearings and for recognizing the Chairman's leadership in this area.

As each of the Senators has indicated, Americans face a very profound challenge today in saving for retirement. This has always been a problem, but it is now exacerbated by two factors, the coming retirement of the huge baby boomer's generation, and, second, the fact that, hopefully, we all are living longer so we will have more years in retirement. That puts even greater pressure on Social Security.

Today I would like to emphasize two points. First, based on the evidence that my association has gathered during 1998, it appears that both the new IRA, the Roth IRA, and the new simple plans are successful in creating new savings and extending pension coverage to millions of new people.

In the second part of my testimony I will try to identify some initiatives that we think would increase retirement savings in the country.

Let me, first, talk about the new Roth IRA and simple plans. They are both creating new long-term investors and encouraging people to save. Time has not yet allowed us to collect comprehensive data, so I would like to give some anecdotal evidence that we have collected.

First, let me talk about the Roth IRA. First, based on a survey we have done, we estimate that 3 percent of all American households opened a Roth IRA within the first 5 months of the program.

Second, and this is very interesting, 30 percent of all of the people who opened Roth IRAs—we surveyed in May—indicated that the Roth IRA was the first IRA they had ever opened. So 30 percent were completely new to the IRA program.

Third, and also quite interesting, during 1998, in early 1998, traditional IRA activity, the old IRA, increased by about 12 percent. From what we can tell, that happened because all of the media and industry talk about the Roth IRA actually promoted IRAs more generally. So even the traditional IRAs went up. That was data we collected in early 1998.

At year end, we also got some anecdotal evidence which also showed that the Roth IRA stayed successful through the remainder of the year. For example, one mutual fund firm who we talked to said that, by April 15, it had 142,000 Roth IRAs on its books. That more than tripled to over half a million by year-end 1998. So it looks to us, from the early anecdotal evidence, that the new Roth IRA has been quite successful.

We also took some evidence on new simple plans, which Congress designed 2 years ago to try to reach that core of small employers who seemed very reluctant to open up plans. We also have some interesting data there.

First of all, it looks to us that, when you look at the employers who opened simple plans, they are, indeed, the small employers.

Ninety percent of the simple plan employers have 10 employees or less. So the program does seem to be reaching down.

Second, the formation of simple plans seemed to continue in 1998, as it did in 1997. For example, one mutual fund firm we contacted said that, by year end, it had 23,000 simple plans and 219,000 accounts. That was more than double the number of plans, and four times the number of simple accounts it had a year earlier.

This might give me a segue into the legislative changes we would recommend. One question is, why has the simple plan been so successful, even though it has only been around for 2 years, in reaching this very hard market? I think the reason is given by its name: the plan is simple. It is not complex. It is very easy for both employers and workers to understand. I would suggest, simplicity has to be the cornerstone of further changes we make.

So let me talk about three simple measures that are contained in the proposed legislation that we think would help. First, the legislation would restore the universal simple IRA that we knew in this country from 1981 to 1986.

The current IRA rules are extremely confusing and complex. If I am right, we have deductible IRAs, non-deductible IRAs, Roth IRAs, and so on, each with different eligibility limits.

The confusion to the consumer is very difficult. The confusion and lack of universality can be shown. To go back to one of Senator Kerrey's questions, how can you reach the lower paid? One advantage of the universal IRA, which we had for those 5 years, is it was reaching down more and more each year to the lower paid.

I think, at its height, 75 percent of people in the universal IRA made less than $50,000, and each year the income level of participants dropped. It started at $42,000 and dropped, I think, to $29,000 when the program was ended.

When the program was ended it not only knocked out IRAs for people who could no longer take the deduction, but, because of the confusion, 40 percent of people who were still eligible to have deductible IRAs stopped having them because the program just confused everybody.

So I think the lesson of the simple is clear, and the IRA experience is clear: when rules are complicated, individuals stop investing. So I think the first thing in the bill I would like to commend, is the universal IRA. I will be brief on the second two, Senator.

Second, is we think the IRA limit should be raised. The IRA started as $1,500 in 1974 in ERISA. If you indexed it for inflation, it would be about $5,000 today. I think that would be a worthwhile change.

Third, the legislation establishes catch-up provisions. We have a lot of people, like my wife and others, who go out of the work force to have children, stay home. When they come back in the work force, I think it would be fair to let them put in catch-up contributions to make up for the years they missed. You have a similar provision in existing law in the 403(b) area. We think the catch-up provision in the bill is very good.

So I would say, in conclusion, that the two new programs, the Roth IRA and the simple plan, seem to be working, from the evidence we can gather. The bill contains three very good measures

which I think would encourage more people to save for their retirement.

Thank you.

The CHAIRMAN. Thank you, Mr. Fink.

[The prepared statement of Mr. Fink appears in the appendix.]

The CHAIRMAN. Mr. Smail?

STATEMENT OF PETER J. SMAIL, PRESIDENT, FIDELITY INSTITUTIONAL RETIREMENT SERVICES COMPANY, BOSTON, MA, ON BEHALF OF THE ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS (APPWP), WASHINGTON, DC

Mr. SMAIL. Mr. Chairman, Senator Moynihan, and other distinguished members of the Finance Committee, I am Peter Smail, president of Fidelity Institutional Retirement Services Company, which is a division of Fidelity Investments.

We are the Nation's largest mutual fund company, with over $700 billion in assets under management. We are also the Nation's leading provider of 401(k) services, with over $340 billion in assets, and we are servicing over 5 million 401(k) plan participants today.

Today I am presenting testimony on behalf of the Association of Private Pension and Welfare Plans, which is a public policy organization representing principally Fortune 500 companies and other organizations that assist plan sponsors in providing benefits to employees. APPWP's members either sponsor directly, or provide services to retirement and health plans that cover more than 100 million Americans.

It is a pleasure and an honor, quite frankly, for me to testify before you today on the success of employer-sponsored retirement plans.

Retirement income adequacy depends on three sources: Social Security, individual savings, and employer-sponsored plans. The wide range of employer-sponsored plans ensures income security for America's retirees and provides much of the capital to fuel our economy.

Today, however, I am focusing my testimony on 401(k) plans, which are working exceptionally well for millions and millions of Americans. We applaud Chairman Roth for preparing a bill that helps the employer-based retirement system, especially 401(k) plans, keep pace with our aging population.

401(k) plans, as you know, were created by Congress in 1978. Today, over $1 trillion is invested in 401(k) plans by over 25 million participants. This is projected to grow to close to $2 trillion by the year 2002.

Today, 79 percent of eligible employees participate in their employer's 401(k) plan. That is an all-time high, and is up from 62 percent in 1985. For 401(k) plans administered by Fidelity Investments, the participation rate is actually 82 percent.

Contributions to 401(k) plans are also growing at impressive rates. The average contribution rate today is 7.1 percent of pay. But if you look more closely at the numbers, we find that about 32 percent of 401(k) participants contribute more than 10 percent of pay, and another 29 percent contribute between 6 and 9 percent of pay.

As you might expect, the overall size of the 401(k) account balances varies primarily by age. For 401(k) plans administered by Fidelity, the average account balance for all participants at all ages is $52,000.

According to a recently released Employee Benefit Research Institute and Investment Company Institute study of 1996, 401(k) plan participants in their 60's with over 30 years of service have an average account balance in excess of $156,000.

401(k) plans work well for several reasons. First, the tax incentive. Employees are motivated to save by the tax-deferred feature of contributions and earnings in 401(k) plans.

Second, the portability. Today's workers can be expected to change jobs five to seven times during their work life. 401(k) plans allow employees to take their benefits with them from job to job and to consolidate them into a 401(k) plan with the new provider, or with an individual retirement account. This type of portability, as you know, is not available in traditional defined benefit types of programs.

Third, in addition to the obvious attractiveness of a matching company contribution, employers provide three very important services that translate into higher savings in 401(k). The first, is administrative efficiency. Employees collect employee contributions to the 401(k) through payroll deduction. It is painless, and very seamless as well.

Investor education. Employers often provide customized investment education materials to 401(k) plan participants. These materials are critical in educating workers about the importance of saving for retirement, and also on how to invest those savings.

Trust and confidence. Employees trust their employers to administer their retirement plan correctly and to also safeguard their assets. A recent study indicates that employees have greater trust in their employers on retirement planning matters than any other source available to them.

Last, employees enjoy the benefits of plan features such as choices among several diversified investment options, as well as access to the accounts through toll-free 800 numbers, and also along with the Internet.

Chairman Roth, the legislation that you are preparing will build on the success of today's 401(k) plan and provide more Americans with the opportunity to save for retirement.

For example, your bill recognizes that saving enough for retirement will be a particular challenge to the baby boomers. Millions of baby boomers in their 50's are now empty-nesters. Many have depleted their savings raising children and sending them to college, and now want to do the catch-up provision. This certainly allows that.

In addition, we believe the repeal of the law limiting 401(k) contributions to 25 percent of a worker's pay, as proposed by Senators Grassley, Graham, Roth, and others, would give middle income families the ability to maximize their 401(k) contributions.

Many Americans cannot contribute the 401(k) maximum of $10,000 because their contributions, when added to the employer's contributions, exceed the 25 percent of pay. When this happens, their own 401(k) contributions are cut back.

So we would encourage you, Mr. Chairman, to work with the bipartisan group of members led by Senators Graham, Grassley, and Hatch to incorporate proposals that they have advanced to enhance pension portability, streamline a number of onerous pension rules, and to also modify the minimum contribution requirement on small plans, the so-called top-heavy rules.

The top-heavy rules, in particular, preclude many small employers from offering retirement plans. Combining the Roth and bipartisan members' proposals offers a truly comprehensive agenda to strengthen our Nation's employer-provided retirement system.

This concludes my testimony, and I thank you for the opportunity to be here. I request that my written statement be included in the record.

The CHAIRMAN. Without objection. All statements will be included as if read. Thank you, Mr. Smail.

Mr. SMAIL. Thank you.

[The prepared statement of Mr. Smail appears in the appendix.]

The CHAIRMAN. Now we call on you, Mr. McCormack.

STATEMENT OF JOHN McCORMACK, PRESIDENT, TIAA/CREF ENTERPRISES, NEW YORK, NY

Mr. MCCORMACK. Thank you. Good morning, Mr. Chairman, Senator Moynihan, and other members of the committee. I am John McCormack from TIAA/CREF. We are the Nation's largest private retirement funding system. TIAA/CREF provides pension products to almost two million educational employees and pays retirement benefits to some 300,000 retirees. Most of these individuals participate in 403(b) defined contribution plans offered by colleges, schools, hospitals, and other tax-exempt organizations.

The fact that TIAA/CREF has operated well for the last 80 years is testament to the success that a defined contribution plan can achieve. I commend you for holding these hearings and for your leadership in introducing a pension bill that builds on a system that works well.

First, let me share some data about 403(b) participants and plans. For many decades, the educational community has achieved remarkable success in expanding pension coverage using 403(b) annuity contracts for both employer-sponsored retirement plans and for voluntary pre-tax retirement savings on the part of individuals. These plans are important to more than 6 million employees covered in one of 33,000 organizations sponsoring 403(b) plans. Nationwide, these pension plans hold assets of $422 billion.

According to the current population survey, broad coverage in 403(b) retirement plans and public retirement systems results in 95 percent of full-time employees who work in higher education having the option to participate in a retirement plan.

This helps improve the overall coverage rate for women as well. Women comprise a majority of 54 percent of TIAA/CREF participants, who are mostly in the higher education community. Women comprise 74 percent of the work force in the public K-12 marketplace, another major 403(b) marketplace.

403(b) plans play a dual role, working as defined contribution, money purchase, basic retirement plans, as well as encouraging employees to contribute their own additional savings. Retirement

plans in the higher education community seek to replace two-thirds of pre-retirement income.

To reach this benchmark, higher education institutions make substantial contributions, most to at least 10 percent of pay, to their employee's 403(b) plans. In fact, many colleges pay the full cost of these plans. About one-third of the educational employers sponsor a contributory pension plan with a dollar-for-dollar match for each contribution the individual makes.

The average contribution to TIAA/CREF's basic pension plans during 1997 was $5,866. The supplemental retirement annuities exclusively fund voluntary employee savings and had an average premium in 1997 of $4,538.

Immediate vesting of both employer and employee contributions available to almost all 403(b) encourages full pension portability. This concept of portability remains a cornerstone of TIAA/CREF, as it has been since 1918.

Another longstanding principle that TIAA/CREF strongly believes in is the importance of guaranteed lifetime income for participants. In fact, 79 percent of our retirees choose a lifetime income option.

Before participants start to save, they often ask a simple question: how much can I contribute? The current answer is complex and based on a maximum exclusion allowance, limited to the total of 25 percent of pay, then further restricted by a $10,000 limit on employee contributions that can sometimes be increased to $13,000 for a small group of long-service employees. So, as you can see, 403(b) plan contribution requirements are ripe for simplification.

The Retirement Savings Opportunity Act of 1999 represents an important step forward. Several aspects of your bill will have a positive impact on 403(b) plans. Allowing employees to make their contributions to 403(b) retirement plans in a manner similar to the tax treatment for Roth IRAs introduces a new choice that can help lower paid workers and will broaden the appeal of savings in a 403(b) plan.

Over the last 20 years, changes in the Tax Code have placed increasingly lower dollar limits on employee-elective contributions to 403(b) annuities, due, in part, to the $9,500 cap on employee tax-deferred savings.

Our participants' average annual voluntary contribution—the number I mentioned earlier, $4,583 in 1997—did not increase in real dollars from the amount being contributed 10 years ago.

Increasing the dollar limit under Section 402(g) to $15,000 should have a positive impact on savings. But for most TIAA/CREF participants, the $4,150 limit that is based on the 25 percent of compensation restricts the amount that they can save.

After paying for a child's education and a home, a family may finally be actually able to save for retirement. But a teacher who could save more than 25 percent of his or her $30,000 salary cannot contribute more than $7,500 unless Congress repeals the 25 percent limit, and the corresponding repeal of the maximum exclusion allowance.

Finally, creating a new, broadly available savings catch-up provision is just simple good pension policy. Using an age requirement

assures that all employees have an opportunity to make up for missed contributions during their early years of employment.

I want to thank you for the opportunity to testify. I would be happy to respond to questions when that time comes.

The CHAIRMAN. Thank you, Mr. McCormack.

[The prepared statement of Mr. McCormack appears in the appendix.]

The CHAIRMAN. Now, Mr. Pool.

STATEMENT OF RAY POOL, ADMINISTRATOR, STATE OF OKLAHOMA DEFERRED COMPENSATION PLAN, OKLAHOMA CITY, OK, ON BEHALF OF THE NATIONAL ASSOCIATION OF GOVERNMENT DEFERRED COMPENSATION ADMINISTRATORS, LEXINGTON, KY

Mr. POOL. Thank you. Good morning, Mr. Chairman and members of the committee. My name is Ray Pool. I am administrator of the State of Oklahoma Deferred Compensation Program.

I am here today as chairman of the National Association of Government Deferred Compensation Administrators', NAGDA, legislative committee. Seated behind me are John Barry, assistant attorney general for the State of Maryland and also a NAGDA board member, and Susan White, NAGDA's legislative counsel.

NAGDA supports the legislation you are preparing to enhance public and private employee retirement plans. We want to thank you for your efforts to enhance public employee retirement plans over the last several years as well. Most notably, for protecting over $75 billion in employee assets in State and local government 457 programs, a necessary safeguard against municipal bankruptcy or other workplace disruptions.

NAGDA members administer State and local government plans that are regulated under Section 457 of the Internal Revenue Code. Section 457 came about as a result of the Revenue Act of 1978, which contained a provision for public employers to offer deferred compensation programs. The provision was later codified into Section 457 of the Internal Revenue Code.

These plans supplemental local and State defined benefit programs. They provide a convenient vehicle for public employees across the country to save for retirement.

A snapshot of membership would show that social workers, road crew workers, fire fighters, police, all the way to Governors of States, participate in these programs. These 457 plans are funded by employees who contribute a portion of their salary into these deferred compensation programs.

In a limited number of cases, we are seeing States also making contributions and encouraging people to save for their retirement through a match. In the State of Oklahoma, recently we introduced a match program for anyone that saved for their retirement at any level. The State would put in a nominal amount of $25 a month. Over 2 years, this quadrupled participation in our State plan and encouraged people, with that small amount, to make sure they were financially secure for retirement.

States also implement educational programs that are aimed at increasing employee contributions and educating participants about their investment options. NAGDA, I am proud to say, is currently

working with the International Foundation of Retirement Education, a nonprofit organization, to provide standards and certifications for the professionals who work in the retirement arena.

It is important to remember that 457 plans are the only employer-sponsored retirement savings plans available to the majority of public sector employees. Private sector 401(k)s are not allowed in the public sector as a result of the Tax Reform Act of 1996. A few States and local governments who already had 401(k)s were grandfathered in by the legislation.

457 and 401(k) differ in many ways. A few of the differences will be illustrated shortly, but, first, I would like to mention some important measures that can be taken to enhance these plans.

One, would be increasing contribution limits. It will ensure employees that they are able to save to their maximum potential in these tax-deferred savings environments.

Typically, what we see in our plans is people are raising families, saving for college. They are not able to save at their maximum potential. As they approach the retirement years and become emptynesters, that is when they start bumping up against the maximum contribution limits. An increase in those limits would allow them to save to their potential.

My written testimony provided to the committee outlines other recommendations, but I just want to touch on two today. One, would be to allow public employees to purchase service credits in their defined benefit program with their defined contribution plan dollars.

Remember, 457 plans supplement these defined benefit programs and, at retirement, many times participants are eligible to purchase additional service credits in the defined benefit programs.

Second, implement less restrictive rules for 457 retirement plans to allow employees to change the time and amount of their retirement distributions. An example best illustrates the dilemma some of our 457 retirees face.

Let us assume a 457 retiree likes to receive $250 a month from his plan. Under current law, they are prohibited from changing that amount, even in the event of changing life circumstances such as an unforeseeable increase in health insurance premiums.

In comparison, 401(k) and other retirees can adjust their distributions at any time, within certain parameters. NAGDA supports a change that would put government workers on a more equal footing with employees in the private sector.

As mentioned earlier and talked about today, the rules for these plans are different. In 457, there are no Federal excise tax penalties for withdrawal prior to 59 and a half. You simply must retire to be eligible to have access to your retirement funds.

This seems appropriate, since the public sector includes fire fighters and police, many of whom retire prior to 59 and a half, and need access to their retirement savings. 401(k) plans, in certain circumstances, impose the penalty for withdrawal prior to 59 and a half.

In closing, Mr. Chairman and members of the committee, NAGDA members realize the myriad of issues that must be addressed when changing these retirement plans.

We support the increase in contribution limits to public plans and look forward to working with you and your staff on these and other issues. We will continue to encourage public employees, through education, to take responsibility for their future by participating in these deferred compensation plans.

The enhancements that your proposed legislation will provide, along with other measures that are under consideration, should move us toward our goal of a financially secure retirement for our members. Thank you for the opportunity to testify today, and I will be happy to answer questions when that time comes.

The CHAIRMAN. Thank you, Mr. Pool.

[The prepared statement of Mr. Pool appears in the appendix.]

The CHAIRMAN. Let me emphasize, the whole purpose of the legislation and program is to provide retirement security. I think that is a key issue for this country today, as people live longer, find other expenses increasing, whether it is education, buying a house, or whatever. So I do think it is a problem that needs to be addressed.

Now, some of you have mentioned the catch-up rule, which I think has definite advantages, that at age 50 you can contribute more. But I would like to get the reaction of all of you.

First, does the panel think that the step-up contribution is needed? Should we limit this to people returning to the work force, like women who take time off to care for children? Alternately, should we limit this to only amounts that would have been contributed if they had worked all the way through?

Mr. Fink?

Mr. FINK. Senator, in an ideal world you might try to make do with precision. But if you do, I am afraid, again, you will confuse people. So I think a simple, rough justice rule would be better. Just to say, people after a certain age can contribute more. I do not know how many taxpayers will save their returns to go back 10 or 15 years. So, I would argue for a simple age additional amount rule.

The CHAIRMAN. Mr. Smail?

Mr. SMAIL. I would agree with Mr. Fink wholeheartedly, Mr. Chairman. I think the easier you can keep this, the more you can simplify it to make it easier for employers, employees and the service providers to allow this type of provision, I think you get your biggest bang for the buck.

The CHAIRMAN. Mr. McCormack?

Mr. MCCORMACK. I would agree. But I would also suggest that there is probably a simple formula that you could apply. You could take the age at which the contribution was missed, apply some reasonable factor in terms of earnings, be it 6, 7, or 8 percent, and then determine, at age 50, what it would cost to buy back that prior service.

For example, a $2,000 contribution missed at age 30 would cost you $9,000 at 8 percent at age 50. So you can keep some control in terms of the amount of dollars that are actually being used in the program that way.

The CHAIRMAN. That is an interesting suggestion. But that is somewhat complex in itself, is it not?

Mr. MCCORMACK. Yes, it is a little bit. But it is really a basic present value calculation based on 20 years of not participating at 8 percent for $2,000.

The CHAIRMAN. I am not sure I could figure it out.

Mr. Pool?

Mr. POOL. Chairman Roth, Section 457 plans currently contain a catch-up provision. It allows for participants that are within 3 years of being eligible to retire to basically double, or contribute up to $15,000 a year.

It is a cumbersome calculation. It is only allowed for contributions that they could have put in when they were eligible but, for whatever reason, did not. We do see more and more people starting to take advantage of that, but we would support a simpler formula to come up with the catch-up amount.

The CHAIRMAN. Mr. McCormack, I will direct this at you, but I would be interested in comments from others as well. 403(b) plans are available for other tax-exempt organizations as well as educational institutions. In the Small Business Job Protection Act, we permitted tax-exempt organizations to establish 401(k) plans.

Now, some have suggested that all these different types of plans are too confusing and that the confusion stops employers from establishing retirement plans. Should we try to limit the number of plans that are available to employers or maybe to employees, or do different types of plans appeal to different kinds of groups that make it desirable?

Mr. MCCORMACK. I think it is clear, from our vantage point, that different types of plans appeal to different types of groups. In my oral comments, I mentioned that we have had 80 years of success with 403(b) programs in terms of establishing them and administering them.

I think there is a level of comfort on the part of employers in terms of their responsibilities from an administrative standpoint that they feel good about because, as you mentioned, there was a provision recently enacted that would have allowed the educational institutions to establish 401(k) programs.

To the best of my knowledge, not one single institution—certainly educational institutions that we deal with—changed from a 403(b) to a 401(k) program. There were absolutely none.

That, basically, is based on the history of having a successful program for their employees under Section 403(b), a familiarity with the 403(b) provisions. There would be tremendous disruption and expense that would be incurred if those 33,000 programs had to be changed to some other format. So I would say that the proof is in the history.

The CHAIRMAN. Mr. Fink?

Mr. FINK. I guess I would slightly disagree with that. I think, if we could ever have a clean piece of paper, it would be good to have one universal DC plan, perhaps with a series of changes different organizations could adopt.

You might have one format. It may be hard to get that, but I think it is a thing we ought to strive for. I might say, we are an opposite example. That is my broad view on it, that we ought to try to get them to look alike as much as possible.

Just as an employer, I am president of a company. With the new law change, we did change. I do not know what our plan was before. It was some kind of thrift savings plan. But when Congress allowed 401(k) plans for nonprofits, as a trade group, we did it. So we are a case of somebody who did switch over, to the benefit of our company and our employees.

So I would say, I do not want to make a foolish consistency the only touchstone, but the more consistency, the better, I think.

The CHAIRMAN. Thank you.

Mr. Smail?

Mr. SMAIL. I tend to agree with that. I am not sure wholesale types of change are certainly necessary, but I do think that some of the rules have grown up through the different types of organizations that sponsor the various plans. Sometimes there is not a whole lot of rationale between what the limits are on 403(b) versus 401(k), versus 457.

So as long as it is not something that is onerous and requires a lot of back-doing of systems and processes and things like that. Again, if we could keep the word simplified in there, I think we would be going in the right direction.

The CHAIRMAN. Mr. Pool?

Mr. POOL. We do support simplification. I think it would, as mentioned, be difficult to go from where we are now all of a sudden to one universal plan. But we do support simplification and making some of the rules more compatible, and that would include portability between some of the plans as well.

The CHAIRMAN. Senator Moynihan?

Senator MOYNIHAN. Yes. Gentlemen, all. May I welcome, in particular, Mr. McCormack, who is a graduate of St. Bonaventure, who looks after me. I noticed that these various places I taught, they had this TIAA/CREF. The next thing I know, I am on easy street. Well, sort of. [Laughter.]

Mr. MCCORMACK. Thank you, Senator.

Senator MOYNIHAN. Almost, after 40 years, we have almost paid off the mortgage on the farm which we bought for $10,000 in 1964. The mortgage gradually rose to $80,000. I do not know how that happened. [Laughter.]

The portability. I would just make the point, Mr. McCormack, the Teachers' Insurance and Annuity was founded by Andrew Carnegie as a nonprofit organization, and it transformed American education by enabling university and college teachers, professors, to move anywhere they wished in the system.

They did not get caught in one organization. If their interests changed, their talents were recognized, they could move. It has been hugely important to American education. I mean, it is one of those little hidden things that matters so much, for which we thank you.

I would like to ask, as I mentioned earlier, Senator Kerrey and I have proposed reducing the Social Security payroll tax and return to a pay-as-you-go basis. In 1977, no one noticed this. We put Social Security on a partially-funded basis, anticipating the things you have been talking about in retirement. That budget surplus has been used for heaven knows what for the last 22 years. It has certainly not been used for Social Security.

Our proposal would return Social Security to a pay-as-you-go and reduce by one percentage point both the employer and employee payroll tax rate. It would be an $80 billion a year tax reduction. Much of it, we think, would go into thrift savings plans, which would be the idea that, over 60 years, or 50 years of employment, starting very early—I mean, I got my Social Security card at age 16, a long time ago . It would have accumulated by now.

Some of our critics are saying that the cost of administering small private accounts exceeds their benefits. I wonder if we could have your collective judgment on that. I mean, you may not have an answer.

Mr. Fink?

Mr. FINK. I think the administrative costs will be large, but the cost when the Social Security system was set up in 1936, I am sure some people said, boy, you will never administer it. You are going to have every employer in the country that will have to disburse money every payroll. So I think, like most things, it can be done if the country wants to commit money to it. The government may have to set up the railroad, but I think it can be done.

I might say, my own organization has taken a position on it that, whether it is done or not, is really not a question we are experts on. That is a public policy issue for the Congress.

But if you do it, I would recommend three things, Senator. One, is you are going to need a massive public education campaign because for the first time tens of millions of people who never invested are going to have to make investment decisions.

Second, you are going to have a good regulatory system, because we have seen in other countries, when you partially privatize and have not protected the public. I think the U.K. has had problems that way.

Senator MOYNIHAN. Yes. We understand that.

Mr. FINK. Third, we would recommend that, while people start in something like the thrift plan, after some time or dollar amount they be able to opt out into private investments, as they do in IRAs or 401(k)s. That would be my view, Senator.

Senator MOYNIHAN. Thank you. Perhaps you would follow that up with a letter.

Mr. FINK. Certainly.

Mr. SMAIL. I think, obviously, that a little more time to study exactly what the benefit versus the value of something like that would be. But, on the surface, I would definitely be concerned with the cost of administering small balance accounts for a large group of people over a long period of time.

Senator MOYNIHAN. Does our thrift savings plan in the Federal Government not do that pretty well?

Mr. SMAIL. Sure it does. I do not know what the contribution levels are to something like that and the contribution levels of something like this, Senator.

Senator MOYNIHAN. Not that different, I do not think.

Well, Mr. McCormack, you are the expert.

Mr. MCCORMACK. Well, I do not know about expert. I think you are in a unique position, however, in terms of the proposal to challenge the industry and basically have the industry come up with

a response that basically addresses the question of, can this be done at a reasonable cost.

The Federal thrift program, I think, has worked pretty well. I do not know how much of the reason it has worked real well is because of some supplement going on through some Federal budget.

Senator MOYNIHAN. Do you not get a lot of small accounts from high school teachers at Southern Tier.

Mr. MCCORMACK. We have a fair number of small accounts. We have a fair number of fairly small institutions that have small programs as well. Yes, we have been very effective. We are still probably the lowest cost pension provider around. But that is why I think challenging the industry to come to those kinds of expense levels would be important.

Senator MOYNIHAN. Mr. Chairman, perhaps we could ask all four of our witnesses if they could give us their comments in writing on this subject. Not today. I mean, take the weekend to think about it.

The CHAIRMAN. I think that would be helpful. Let me say, we will keep the record open so that if people have additional questions beyond those they are able to offer, they will have the opportunity to do so. So we will keep the record open until 7:00 tonight.

Senator MOYNIHAN. Thank you, sir.

The CHAIRMAN. Senator Kerrey?

Senator KERREY. Thank you very much, Mr. Chairman. I am going to continue along the line of questioning that Senator Moynihan had. I like, in general terms, Mr. Chairman, what you are trying to do with this legislation, a lot. Specifically, what we are doing, in addition to improving the catch-up rules, is we are raising the limit on 401(k)s.

I believe Mr. Yakoboski, who is going to be in the later, second panel, says that right now people are not running up to their full limit of 401(k). Indeed, one of the central questions for us is how to best spend tax dollars.

Current pension deductions, net of taxes paid on that income, is about $100 billion a year, against what Senator Moynihan is talking about, which is $80 billion a year, of some kind of defined contribution for that lower wage worker. We get Treasury numbers that show that about 60 percent of the work force only gets about 10 percent of that $100 billion, for obvious reasons.

I really am very much concerned about that 50 percent of the work force, that lower half. I am looking at numbers right now in Nebraska for roughly half of the work force.

I am not going to go through all these wage categories, but these are very important jobs that need to be done. And if we are going to keep the right trade policies and keep America competitive, we have got to figure out a way for those individuals to get their share of the American dream and acquire a little financial wealth and security. What we are hearing, instead, is people saying, it cannot be done. It is too small of a contribution, it cannot be done. Administratively a nightmare. Cannot be done. Too much education effort.

I must tell you, I buy my groceries from Hi-V in Omaha, Nebraska, and the check-out guy has got a 401(k) account. He knows a lot better than I do the difference between a stock and a bond, a high school graduate. So, especially when you look at the ease of

the thrift savings program at the Federal level, it is not a difficult program to administer. Most of us who are elected to office hardly are financial experts, otherwise we would not have run in the first place.

So one of the things that, again, as I look at this thing, the highest benefit that I get in Social Security for half of my work force in Nebraska is about $1,200 a month. Increasingly, they are taking early retirement. 1.1 million of 1.3 million beneficiaries in 1997 took the old age benefit. It is not really a retirement benefit any longer. They took it at 62, 63, 64. The reason is, if you live to be 72, you are money ahead than if you take it at 62.

Well, that means they take a 20 percent reduction off of that, so they are getting $700 or $800 a month, tops. If you drop down into the service industries, they are getting $400 or $500 a month. So I think there is a real compelling need for the industry.

I hope that you will take the Chairman and the Vice Chairman's request here seriously. Help us solve this administrative problem. We have got a wealth gap that is widening in America and it is not good for liberal democracy to have that. It is going to threaten our capacity to get Normal Trade Authority passed through this Congress. There are all sorts of other problems that are going to be created if we do not answer the question.

It may be that opponents of doing it inside the Social Security system will win, and we do it outside the Social Security system. But, either way, we are going to have relatively small accounts for these lower wage workers.

I mean, if you are making $1,000 a month it is impossible to bump up to the 401(k) limit now. You are just not going to do it. I would appreciate, Mr. Fink, or Mr. Smail, you probably have more experience in this, if you could comment as to why you think people are not using the full limit of 401(k)s now.

I appreciate that we need to change the catch-up rules, but what benefit will we get from raising the limit if one of the concerns that we have got is half the work force out there right now is only using only about 10 percent of the current benefits?

Mr. FINK. Well, Senator, I come more as an IRA expert. I will not dodge the question. Let me answer, first, because IRAs are a parallel situation. I think universality and simplicity, the IRA experience shows you can reach those people.

When we had universal simple IRAs, I think 75 percent of the IRAs were contributed by people below $50,000, and each year the income of people contributing dropped from $42,000, as I recall, to $29,000, or probably would have dropped further.

But what you need, at least in the IRA market where it is individual, not employer, is sustained advertising by financial institutions, sustained media, and over time you will get more and more lower paid.

It is not just a dollar issue, it is an educational issue. If we make retirement savings a big deal in this country, you will reach more people. But if we turn the spigot on, change the program, put it back on, take it off, you will break that flow.

Senator KERREY. But people like me, I mean, I want to change the law. And I think it is the only answer, by the way, to the most rapidly growing mandatory program we have, Medicare, is to

change the law so people are less dependent, when they head towards their nonworking retirement years, on the government for income and health care needs. If you want to do that, it seems to me you have got to start early.

You have really got to aggressively answer the question: how do you make it work for that lower wage worker, who is very important to this economy? They are very important for us. It is not likely that the market, all by itself, is going to bid their wages up much higher than they currently are.

Mr. FINK. Well, Senator, I tried to answer at least in the IRA experience, where it is direct, one-on-one, non-employer. I think if you keep a program year after year, each year you will reach down into more and more lower paid people.

Senator KERREY. Well, again, I take the Chairman and Senator Moynihan's request seriously, and I will ask the second panel to do so as well, because what is making it possible right now, or making it most difficult, is to take $80 billion a year—and we can go back to pay-as-you-go today. We are generating in excess of $80 billion a year surplus with the payroll tax. We could do it today. The biggest barrier is the education issue and the administrative costs of small accounts.

So what is happening is, all these individuals who would benefit from a generation of wealth are not going to benefit because we are sitting here saying, administratively, we cannot figure out how to do it, we cannot figure out how to educate them to be able to determine the difference between a stock and a bond.

The CHAIRMAN. Thank you, Senator Kerrey.

Senator Graham?

Senator GRAHAM. Thank you, Mr. Chairman. Thank you for holding this hearing, which I think raises the right question. The issue is not Social Security reform, the issue is retirement security reform, recognizing that Social Security, as several of our panelists have already mentioned, represents a foundation, but is not the totality of what most Americans are going to be satisfied to live on once they retire.

The numbers that I have heard are that most Americans can expect to get about 45 to 50 percent of their last level of earnings through Social Security. If they wish to retire at a higher percentage of their last earnings, let us say 75 percent, then they have to have a plan to supplement Social Security in the range of 25 to 30 percent.

Using those numbers as our standard, what proportion of Americans today are in a program which will supplement their Social Security to the point that they would be able to retire at 75 to 80 percent of their last earnings?

Mr. MCCORMACK. Certainly in our case, we know that 95 percent of the people in the higher education community are eligible to participate in retirement programs. Two-thirds of those retirement programs are paid for by employers.

Senator GRAHAM. The question I am asking is a somewhat more macro question. If our goal is to provide Americans with the opportunity to have a foundation in a defined benefit plan called Social Security that will provide them approximately 45 to 50 percent of their last earnings, and then on top of that we want to give them

a series of inducements and encouragements to take self action, either through private savings or in cooperation with their employer, to be able to supplement Social Security to the point that they can retire at 75 to 80 percent of their final earnings, what proportion of Americans today have a plan in effect which will provide that 25 to 30 percent, beyond Social Security, of final income?

Mr. MCCORMACK. I do not know.

Mr. SMAIL. I am not sure exactly what that number is, Senator.

Mr. FINK. I do not know the exact number, but I know it has been a constant problem going all the way back to ERISA. And I am going to make up a number, that something like half the work force, as I remember, does not have supplemental retirement. I do not know if it is 40 percent or 50 percent, but a large percentage does not.

Senator GRAHAM. Well, it seems to me that looking at the interplay between Social Security and those other forms of retirement, that it is critical that we, first, have some idea of how close we are to achieving that goal, and then how many Americans are taking advantage of those. And if there is a significant gap—and I suspect there is—then what can we do in terms of public policy to make it more attractive for Americans to take self-help, either individually or in cooperation with their employers. Yes?

Mr. FINK. Senator, I sound like a broken record. I think we found two devices that work. I think a universal IRA reaches people, and I think the new simple plan. I think the hard nut is the small employer, which has tended over the years not to install a plan.

The simple seems to have been the first device that I am aware of that seems to be getting those small employers to install plans. That may be much smaller than you are looking for, but I think they are two devices that I think history would show have worked and ought to be encouraged.

Senator GRAHAM. Who has done some empirical research on this question of, what are Americans doing to supplement Social Security in order to have a retirement income which is what most people set as their goal in the 75 to 80 percent of last earnings level?

Mr. FINK. I would suspect the Department of Labor, probably arms of the government have it. I think we could probably provide it based on other sources. I do not know if we on our own do it, but I think we can provide it.

Mr. SMAIL. I also think, Senator, the Employee Benefit Research Institute, EBRI, has done some work in that regard. I am not exactly familiar with what the research shows, but I know they have done some analysis around that and we would be happy to get that to the committee as well.

Senator GRAHAM. Let me take that broad question and narrow it to a specific, immediate focus. That is, the President's proposal for a universal savings account. The concept is to create another encouragement through Federal participation for Americans to save. There are concerns, some of which are those that have been expressed already by Senator Moynihan and Senator Kerrey's proposal relative to the administrative costs of large numbers of relatively small accounts.

There also is concern about the unintended consequence of discouraging small businesses, which currently have a retirement sys-

tem, to continue if they are able to save; I do not need to provide this savings vehicle because now we have the Federal Government with this universal savings account doing it.

Mr. Smail, do you have any comments about the President's proposal, and maybe any variations on his proposal that might better achieve the objective of increased savings, and therefore security, in retirement?

Mr. SMAIL. Senator, I am sorry. I have not read that proposal in a great amount of detail to the point where I think I can offer anything that is qualified in that regard.

Mr. MCCORMACK. I would just offer a comment. It goes back to the numbers you mentioned earlier, that I think are probably rather conservative. One of the things that we have always tried to focus on in terms of designing programs was to make sure that the lower paid people had a higher percentage of their final years' earning than the moderate or higher-paid people.

Consequently, anything that can be done that is going to give a lower paid person a greater supplement in retirement over and above Social Security, the better off that individual is going to be and the more likely they are going to be able to maintain their standard of living. I think it is important just to recognize the difference between percentage returns.

Senator GRAHAM. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Graham.

Senator Baucus?

Senator BAUCUS. Thank you, Mr. Chairman.

This is a very important hearing. Obviously, we want to increase personal savings rates. I have two general, broad questions. First, and it has been touched on by most members here, I am very concerned that, for some people in this country, savings for retirement is much less of an option than it is for others. The some I am talking about are middle and lower income people and people who work for small business.

I think the national figure is that 20 percent of employees who work for small business do not have a pension plan. My guess is, in a State like Montana, it is a lot less. I would guess it is about 1 in 10 employees who work for small business have a pension plan.

There are States like mine, which are small business States. We do not have big business. We do not have a Motorola plant, we do not have a HP plant, we do not have a Citibank operation. We are just a bunch of small, little businesses in my State. There are a lot of other communities like that in the country. I am wondering, and I would like you to dig a little more deeply, and tell me how those people are able to save.

It is nice to increase limits for people who already can afford it, but I think a lot of people at the lower end of the private saving side just do not have the income right now to save. And we also in a very consumptive society at the moment.

Second, on the pension side, the administrative costs of starting up a pension plan are very high, the top-heavy rules are quite difficult. Two suggestions that I have that direct small business and potential pension plans for small business, and I think the administration may have proposed it too, is a credit for the administra-

tive costs for starting up pension plans, particularly for small business, maybe.

Second, is another credit for small business employers who match their employees' contribution as an incentive, up to certain limits. I am wondering whether that would make any difference.

So I would just appreciate it, whoever wants to take a crack at it and thinks he has a good answer, to advise us as to how we can tailor our retirement programs to include more small business employees, particularly on the pension side.

Mr. SMAIL. I have got a couple of thoughts I may be able to share with you. I think a lot of progress, Senator, is being made in the area of the small market end of the business, if you will. I do think, though, the numbers are not anywhere near where they need to be, I believe, on the small end of the market. It is probably in the vicinity of 18 to 20 percent of small employees offer a retirement plan, as opposed to 98 or 99 percent of the very large end, the top corporations in the country.

I think some of the focus on the small end of the market that would help, things like a continuing relaxation of some of the onerous rules that we have talked about here, like the top-heavy rules, anti-discrimination testing rules, things like that, will continue to allow employees, if it is a simple plan, if it is relatively inexpensive to administer, a small corporation will start up a new plan.

I think, in addition to that, there are other ideas that those of us in the industry are thinking about every day. For instance, we are coming out with a product that is going to be a very, very low-cost, simple administration plan that is offered exclusively over the Internet.

So for a relatively small, small amount of money, we can completely set up a fully bundled product to the small end of the market and make something very attractive to them, where in the past it has not been made available.

I think your idea about a credit for employers who start plans and make a matching contribution is very, very intriguing, quite honestly. The single biggest ingredient to getting participants to join plans, is the availability of a company match. So I think that is a very, very key point.

Senator BAUCUS. Thank you. And my second question is, why are we not saving as Americans? I mean, it is interesting. There is a chart here. In 1980, our personal saving rate, as a percent of GDP, was 6 percent, American. Now it is zero. It has been negative the last 2 months.

In 1980, I remember sitting in this committee, the supply side economics, it is going to increase savings. The actual results were the opposite: it has decreased savings. I will not say it has decreased savings, but savings have decreased in America down to zero, and it has been negative the last several months.

So what is going on here? We talk about increasing the amounts, we talk about catch-up rules, and all that, and our qualification, because we want to save. But the experience in our country is that we are not saving.

I think part of it is because some Americans just do not have money to save, and part of it is they want to spend it for current consumption, not salt it away. Even though, and we talked about

this earlier, the private savings availability is not being used, and the 401(k) ability is not being used totally, as near as much as it could be in America today.

So why are we not saving? I mean, this is a bit surrealistic, this whole conversation. What is going on here? We keep talking about this subject and all these incentives to save.

The Joint Tax Committee did a great study on this and said the data was inconclusive, whether all the things we do have any effect on saving. We know it is inconclusive. We also know that, for whatever reason, private saving has gone down.

Does it not make sense for us to kind of ask this basic question, to some degree, and try to answer it as a basic question before we decide how we are going to change the law here?

Mr. POOL. Senator, I think there are actually probably many answers and many opinions on that subject. I think, clearly, people feel like they cannot afford to save, so many millions of Americans.

I also think there is some perception, at least of some Americans, that they feel like someone will come in and take care of them at the end, so they get into this conception of——

Senator BAUCUS. On that, let me just carry on that. All around my State, people have very little faith that that is going to happen. In fact, they think the opposite is going to happen. They think that Social Security, forget it, it is not going to be there when they retire. There is not anybody coming in, at least at the Federal level, to save them.

Mr. POOL. I would agree that you do see less and less of that. I think part of the problem is the education, educating people that they are going to need something more than Social Security, whatever amount that may be, or their defined benefit program, if they have one, through their employer.

Going back to your comment, though, on the match, I certainly do not know if a credit for a match would work for employers. I am not qualified to speak about that area. But I do have some experience with a nominal match in a program that, in less than a year, more than quadrupled the savings for the lower income end of our population.

So, as far as some type of incentive to get people to save for their retirement, it does not have to be a lot, but just something to let them know that they are putting up some of their money, but their employer is also helping them out as well.

Senator BAUCUS. I read an interesting article on this subject, it was in The New Yorker about three, four, or five weeks ago. As I recall, the basic conclusion, and the answer to my question, is it is partly just that the Americans like to keep up with the Joneses, they like to spend.

Second, and this is a minor part but I thought was more honest than a lot of stuff I have generally heard on the subject, is people see all these TV commercials, and all TV commercials are all upscale, living rooms, bathrooms, kitchens. People think, that is part of America, so I have got to have that, too. So people like to spend.

It is a society today where people tend to want to live in the present, I think, more than at other times. And the Depression generation is no longer with us as much any more. Boy, my father,

he did not borrow anything. He earned it and he saved. He knew that sometimes you have to in life. Someone else said that human experience is based on 70-year cycles.

History repeats itself basically every 70 years, so we have to go through maybe a huge correction in the market, or something, just to knock some sense into people's heads a little bit; oh, yes. I guess I had better save a little bit. I do not know. But I just think it is important to try to answer that question the best we possibly can.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Baucus.

Well, that brings us to the end of this panel. I want to thank each of you for your contribution. We will submit further questions.

And we would like to work further with you because I think we have to find some answers to the questions that have been raised by the panel.

Thank you very much for being here today.

Senator MOYNIHAN. Thank you, gentlemen.

The CHAIRMAN. It is now my pleasure to introduce our second panel. First, we will hear from Mr. Joseph Votava, a certified financial planner who is a partner in the Rochester, New York law firm of Nixon, Hargrave, Devans & Doyle. He will discuss issues that an individual confronts when determining how to structure his or her financial future.

Next, we are very pleased to have Paula Calimafde, an attorney and small business advisor in Bethesda, Maryland, on behalf of the Small Business Council and the American Society of Actuaries, who will discuss how a small business decides whether to offer a retirement plan for employees.

Finally, Dr. Paul Yakoboski will give an historical overview of participation in the various retirement savings vehicles.

We would ask you each to limit your statement to five minutes. Your full statement will, of course, be included.

We will start with you, Mr. Votava.

STATEMENT OF G. JOSEPH VOTAVA, ESQ., CPA/PFS, NIXON, HARGRAVE, DEVANS & DOYLE, LLP, ROCHESTER, NY

Mr. VOTAVA. Thank you very much, Mr. Chairman and members of the committee. My name is Joe Votava and I serve as a volunteer president for the International Association for Financial Planning, the IAFP.

I practice as an attorney, but also possess a CPA background, as well as a certified financial planner licensee, and I manage a financial planning practice at the law firm of Nixon, Hargrave, Devans & Doyle in Rochester, New York.

I appreciate very much this opportunity to testify on savings and investment issues. It is an extremely important issue for those following, or at the end, of the baby boom. Your initiatives are important to the future of the financial health of all Americans.

The IAFP is the Nation's oldest and largest organization of professionals who believe that the financial planning process is the foundation for smart decision making. Our organization comprises more than 17,000 members that use this process to help over 1.5 million Americans achieve their life goals.

A primary goal, is savings for retirement. IAFP strongly supports incentives which encourage Americans to increase their personal savings. We believe that public policy should enhance opportunities for Americans to meet their financial goals through their own initiatives and prudence.

Tax and economic policy should promote savings, investment, capital formation, and a vigorous free enterprise system. The need for motivation to address the issues of savings cannot be underestimated.

Our organization regularly conducts studies of Americans' attitudes and concerns about financial matters and has found that retirement planning is one of the most misunderstand needs for most families. Far too few are investing sufficient dollars to secure their retirement.

This is true, in part, because of the current limits on contributions to tax-deferred vehicles, limits that are often well below the amount many people should be saving to retire comfortably.

This problem is exacerbated by the confusion over the many rules and restrictions governing the diverse vehicles currently available for retirement planning. As traditional pension plans have given way to a variety of self-funded plans, financial advisors have seen that their clients at all income levels are uncertain about how to best invest for retirement.

These clients repeatedly ask, how much should I save? What are the differences between the various IRAs? What are the contribution limits? Can they save through an employer-sponsored plan and also an IRA? What are the risks and opportunities of the investment options available through these plans?

We understand that Senator Roth plans to introduce legislation that would address some of these problems. We also understand that this legislation would eliminate some of these problems.

The restrictions on participation and contributions to IRAs, Roth IRAs, 401(k) plans, and other retirement savings options are very important. The IAFP strongly supports such changes as a much-needed catalyst for individuals to begin to save more of their own earnings.

IAFP is also concerned about the high percentage of Americans who appear to be over-confident about their preparedness for retirement. Our recent study suggests that most people who say that they are confident of their ability to support themselves in retirement have not done the planning necessary to know whether their current rate of savings is sufficient, especially in view of the many expenses that can reduce the savings of middle-aged adults as they approach retirement, such as children's college education costs, or the long-term care of a parent or another loved one.

Today, the challenge of retirement planning is underscored by the fact that our retirement years are likely to be dramatically longer than were our parents'. This is true not only because we are living longer, but also because most of us hope to retire earlier.

One recent IAFP study conducted by the Wirthlin Group found that more than 70 percent of Americans with household incomes of at least $30,000 expect to retire before the traditional age of 65.

This same study found that, even among families that say they have planned for financial retirement, only 44 percent of those with children under age 18 are saving for their children's education.

More important, fewer than 1 in every 10 Americans with at least $30,000 in household income have developed a comprehensive goal-oriented financial plan, either with the help of a financial advisor or on their own. These findings suggest that millions of Americans have worthy financial goals, but are not taking the steps to achieve them.

While employer-sponsored plans like the 401(k) make it easy to save for retirement through payroll deductions, too few Americans understand the vital importance of financial planning to realistically determine the amount of savings and type of investments that will help them achieve their life goals.

Financial advisors find that many people see their participation in the 401(k) as equivalent to enrollment in the employer pension plans in the past. But in most cases, the amount they are currently saving is grossly inadequate to meet their lifestyle needs.

The International Association for Financial Planning is convinced that every American needs to understand that planning does pay off. The right approach to planning, aided by practical initiatives like those proposed by Senator Roth, will go a long way towards preparing this and future generations for a more secure retirement.

Thank you for inviting me to speak to you today about these very important issues.

The CHAIRMAN. Thank you.

[The prepared statement of Mr. Votava appears in the appendix.]

The CHAIRMAN. Ms. Calimafde?

STATEMENT OF PAULA CALIMAFDE, ESQ., PALEY, ROTHMAN, GOLDSTEIN, ROSENBERG & COOPER, BETHESDA, MD, ON BEHALF OF THE SMALL BUSINESS COUNCIL OF AMERICA, WASHINGTON DC, AND THE AMERICAN SOCIETY OF PENSION ACTUARIES, ARLINGTON, VA

Ms. CALIMAFDE. It is a privilege to be here this morning. I am representing the Small Business Council of America, the Small Business Legislative Council, ASPA, and the Profit-Sharing 401(k) Council.

I am a practicing tax attorney and I specialize in the qualified retirement plan area, and have been doing it for more than 20 years. I work with small businesses and I work with them to design, and I actually draft, retirement plans, which means that I actually have to work with these rules, such as the top-heavy rules, the 401(k) anti-discrimination rules, on an almost daily basis.

I am the chair of the Small Business Council of America. I am a member of the board of directors of the Small Business Legislative Council. I was a commissioner of Payroll Costs at the 1986 White House conference on small business, which covered retirement plans.

I was a Presidential delegate at the 1995 White House conference on small business and worked on the retirement plan issues. I was a delegate appointed by Senator Lott to the National Summit on Retirement Savings this summer here in Washington.

Today, you have asked me to discuss what factors are taken into account by small business to determine whether to sponsor a retirement plan or not. Fundamentally, small business owners, and quite often the key employees of the business, undertake a cost benefit analysis.

They assess the costs. They look to the cost of administration, they look to the cost of mandatory contributions such as those in the top-heavy rule, they look to the internal time factor, what will be lost, in sponsoring a retirement plan.

Then they assess the benefits. How much will the retirement benefit be appreciated by the staff employees? How much will the key employees be allowed to save? Then the factor in the profitability of the business, the stability of the business.

They factor in whether the employees even want a retirement benefit. Sometimes they find the employees prefer cash, more company contributions toward health insurance. They do not value the retirement plan contribution. All these things come into their decision making factor process, and then they decide whether they should sponsor the retirement plan or not.

I would say, in the last 15 years or so, the cost benefit analysis was out of whack. The costs were too high, the benefits were too low. In the last 3 years or so, Congress has taken active steps to reverse that process, that cost benefit analysis, and you reversed the devastating retirement laws that were taking place in the mid-1970's and 1980's. These laws literally left small business out of the retirement plan system.

Why is this issue so critical? Well, clearly, small business is where all the new jobs are. It appears it is where the retirement coverage is lowest. So, clearly, we have got to work on the small business area.

You hear statistics that 80 percent of the workers employed by small business—and this is usually considered companies with fewer than 100 employees—do not have retirement coverage. I personally do not think I believe that statistic.

I think it is out of line. It is not taking into account the last two pieces of legislation Congress enacted, which were very positive. So, for instance, those numbers would not take into account any of the people covered by simple, it would not take into account the growing popularity of the 401(k) plan.

As I mentioned to you, the last two bills passed by Congress began pension reform and simplification in earnest. We believe a bill which combined the new Roth bill, the Graham-Grassley bill, and Portman-Cardin, would revitalize the retirement plan system for small business and would dramatically increase access to the system for small business.

I want to give you an example of this. The 401(k) plan is cherished by employees. The energy generated by a 401(k) plan is nothing short of astounding. Unless you are around it and you see it, you really cannot believe it.

We put one into our law firm 8 years go, and I am always surprised to hear employees in the hallway talking about how much they are putting into the plan, talking about what investments they are in, talking about, are their statements understandable.

It is clearly a tremendous savings vehicle and they are really into it, and enjoy it. In fact, prospective employees often will ask small businesses, do you have a 401(k) plan? That is how important it is to employees today.

Recognizing that many small businesses did not want to go into the 401(k) area because of the 401(k) discrimination testing, Congress passed the 401(k) safe harbor rules a couple of years back. We believe that these rules will go a very long way towards making the 401(k) plan even more popular with small business.

Basically, these rules provide that the company either has to make a 3 percent contribution on behalf of every non-highly compensated employed, or there has to be some prescribed match in order to get out of the 401(k) testing.

Unfortunately, IRS has just put a significant road block to adopting the safe harbor this year for many small businesses. Back in November, they came out with a notice which said small businesses must give written notice to their employees by March 1. It is a very extensive notice, and I do not believe most small businesses will even know that they are supposed to give notice by March 1, so they are going to miss the safe harbor this year.

If you think about it for a minute, the notice, in the context of the 3 percent mandatory contribution, is sort of meaningless. It is not going to change anyone's behavior. So, I am hoping IRS will loosen that standard.

Let us turn to this year. The Roth bill, by increasing the $10,000 limit up to $15,000, would be a very welcome change. I heard Senator Baucus say people are not going up to the $10,000 limit. I guess, if you look at all the data out there, that is probably true. But I can tell you, in my office alone, every year for the last three or 4 years I have had employees say, I cannot go above $10,000? And these are staff employees, not highly compensated employees.

Senator MOYNIHAN. I wonder if we could keep to our five-minute rule. Senator Roth will be back and will be very interested to hear what you have to say about the Roth legislation.

Ms. CALIMAFDE. All right. Then do you want me just to close quickly here?

Senator MOYNIHAN. Yes.

Ms. CALIMAFDE. All right. The changes in the Graham-Grassley and Portman-Cardin bill, in the small business area, would greatly help in the top-heavy area of the 401(k) plan.

The Roth-plus concept in the 401(k) area, I think, would be really embraced by small business and I think it is a dramatic improvement. And the catch-up provisions would greatly assist small business in this area, because I have a feeling their employees are older than most of the rest of the labor pool.

I could apply this kind of analysis to almost any change contemplated in the Graham-Grassley and in the Roth bills, and could show you how it really assists small business.

[The prepared statement of Ms. Calimafde appears in the appendix.]

Senator MOYNIHAN. Fine. Why do we not just leave it there and go to Dr. Yakoboski.

STATEMENT OF PAUL YAKOBOSKI, Ph.D., SENIOR RESEARCH ASSOCIATE, EMPLOYEE BENEFIT RESEARCH INSTITUTE, BETHESDA, MD

Dr. YAKOBOSKI. Thank you. I am pleased to appear before you this morning to discuss issues regarding worker's saving behavior and 401(k) plans, in particular, the contribution levels and account accumulations.

I am with the Employee Benefit Research Institute, a nonpartisan public policy research organization based here in Washington.

EBRI has been committed, since its founding in 1978, to the accurate statistical analysis of economic security issues. Through our research, we strive to contribute to the formulation of effective and responsible health and retirement policies. Consistent with our mission, we do not lobby or advocate specific policy recommendations.

Are covered workers taking full advantage of the savings opportunities presented by their 401(k) plans? Are they contributing the maximum amount permitted to their 401(k) account? What determines the amount that they do contribute?

Our research indicates that most workers with a 401(k) plan do not contribute the maximum amount permitted to their plan. At the same time, our research provides stark evidence of the effect that plan features, such as matching provisions and legal limits, can have on workers' decisions regarding their contribution levels.

Findings indicate that older workers have their contributions constrained by maximum limits, be they plan-specific or legal limits, probably because they tend to be more focused on retirement and, thus, more likely to contribute at higher levels.

Many younger workers recognize the value of the employer match in their plan and contribute just enough to take full advantage of that match feature, but no more.

As an example, in one plan we studied, the younger the participant, the more likely he or she was to contribute just enough to receive the full company match. Close to 30 percent of workers in their 20's in this plan contributed that amount, compared with 21 percent for those in their 40's, and 10 percent for those 60 and older.

At the same time, as ages increased, there was a sizeable increase in the portion of participants maxxing out in their contribution rate. Forty-one percent of participants aged 20——

Senator MOYNIHAN. Sir, you surely do not categorize that as a new finding of social science, do you, that young people do not think much about old age?

Dr. YAKOBOSKI. Would I characterize it as new or surprising? No.

Senator MOYNIHAN. All right.

Dr. YAKOBOSKI. At the same time, as ages increase, there was a sizeable increase in the proportion of participants maxxing out in their contribution rate. Forty-one percent of participants ages 20-39 contributed the maximum amount permissible, compared with 44 percent of participants in their 40's, 58 percent for those in their 50's, and 62 percent for those 60 and older.

Plan features also appear to interact with worker earnings in determining contribution levels. Lower earning participants are more

likely to contribute the maximum amount that is matched, taking advantage of all the free money that is available in their plan. Higher earners are more likely to contribute the maximum amount allowed by the plan, or the Tax Code.

These findings indicate that, while legal and plan-specific contribution limits do not constrain most plan participants, they do constrain the amount that some individuals, particularly older individuals, actually save for retirement through their 401(k) plan at a point in time when many are just focusing on the need to save.

This leads to the question, how much are workers accumulating in their 401(k) accounts? The average account balance for all 401(k) participants is roughly $37,000. The median balance is $11,600.

Reported account balances do not reflect additional retirement savings that individuals may have in predecessor plans or rolled over into IRAs, nor do the balances indicate what savings would be in a "mature" 401(k) program.

Nearly one-half of the participants have account balances with their current employer of less than $10,000, while nearly 10 percent have balances in excess of $100,000. Those individuals with balances of less than $10,000 are primarily young workers or workers with short tenure with their current employer.

In contrast, those with balances in excess of $100,000 are older workers with long tenure. Approximately 1 out of every 4 participants in his or her 60's has an account balance with their current employer in excess of $100,000. Similarly, 31 percent of participants with 20 or more years of tenure with their current employer had balances in excess of $100,000.

The average balances of older workers with longer tenure at one employer indicate that a mature 401(k) plan program will produce substantial account balances. For example, an individual in their 60's with at least 30 years of tenure have average balances in excess of $156,000.

With that, I will conclude my oral comments. Thank you very much.

[The prepared statement of Dr. Yakoboski appears in the appendix.]

The CHAIRMAN. Thank you. I apologize. I got a telephone call I had to answer, so I missed much of your testimony. I hate to miss testimony, particularly when it is favorable.

Senator MOYNIHAN. Well, Ms. Calimafde was saying something about the Roth IRA. I said she could repeat it.

The CHAIRMAN. Thank you, Pat.

My first question is for Mr. Votava. We had previously heard testimony that there was an increase in savings due to the Roth IRA. Did financial planners experience an increase of business during the last year with the new availability of the Roth IRA? Do you think the level of complexity has made people too confused to start using these savings vehicles? And do you believe that the proposed changes to the rules on limitations on savings vehicles will mean that people will save more?

One further comment I receive every once in a while is that people are very nervous that we will do what we did in the 1980's, we went ahead with it and then we canceled out the IRA for many. Has that had a significant impact today?

Mr. VOTAVA. First of all, yes. The introduction of the Roth IRA and all of the media hype that came along with that really did encourage many clients to come forth and ask questions and begin to participate in the process.

Unfortunately, due to the complexity of the integration with employer plans and the various income limits, many of these folks were not able to secure more than perhaps one of the incentive accounts. So, finally, after a lot of discussion and working through the complex rules, you find that it has a fairly limited applicability to their situation.

Needing easier access to savings is clearly the path that needs to be followed. Simpler rules for individuals to understand what applies to them would be very, very helpful. Simpler access, by using employer-sponsored plans to facilitate payroll withholding and so forth, would be very, very helpful. People need a simpler approach.

The increase in limits, while very necessary because it is very easy when you run the calculations to see the difference between the gap of what Social Security will provide and what will be needed, clearly, more savings is needed. Will the increased limits themselves motivate people? That is difficult.

We find that, really, what motivates people is a true understanding of their picture, a true understanding of what it is they have, how much they are saving in relation to how much they are spending, and getting that equation in order as they go forward. That is an education process which needs to be applied next to the tools, the tools being the various accounts, in order to bring the desired result.

The CHAIRMAN. Thank you.

My next question. I note with much concern the fact that employees who work for small businesses are much less likely, as you point out, to be covered by pension plans. But, Ms. Calimafde, in your testimony you noted that there were many issues that made it less likely to establish a retirement savings plan. What impact do you think would result from increase of the 401(k) limits and the SIMPLE plan?

Ms. CALIMAFDE. I think that it would be very beneficial. I was explaining the cost benefit analysis. When the costs are too much and the benefits are perceived as too low, a company will not go with it.

The 401(k) plan is so popular, employees are constantly bumping up against the $10,000 limit. And when I say employees, I do not mean just highly compensated employees. Very often, you will see couples who both are working, and they will make a decision that one of the spouses, they want a lot of that spouse's income sheltered in the 401(k) plan. So you would be surprised who is saving in these 401(k) plans.

And an increase up to $15,000, I think a lot of these people would do it, and be happy to do it. I think it needs to be coupled with an increase in the defined contribution limit, which is set forth in Portman-Cardin, and I think maybe will be in Graham-Grassley, because you do not want to increase what the employee can put in, and then the employer cannot put in as much as they would have put in.

I think, in the simple area, the simple plan looks like it is working. So if you increase the limit, I do not see any reason why it would not even be more beneficial. I think it is important to keep the 401(k) and simple in line with each other, because you do not want the simple to be considered better than the 401(k).

The CHAIRMAN. Thank you.

Senator Moynihan?

Senator MOYNIHAN. First of all, thanks to this panel. It has been very helpful.

Just one note. Dr. Podoff, who works for the committee staff, as you know, handed me a note that says, the thrift savings board for the Federal Government reports administrative costs of one-tenth of a percentage point, but they readily admit that the costly work, distributing forms, providing information, is done by personnel offices of the respective agencies. So, there is a Federal subsidy in there, but how big, we probably could find out.

Could I ask a question? First of all, welcome to a graduate of Sienna College.

Mr. VOTAVA. Thank you, Senator.

Senator MOYNIHAN. You were much closer to St. Bonaventure, but you probably wanted to venture forward all the way to Albany. And of Nixon, Hargrave, Devans & Doyle in Rochester. I have friends that work there.

You said, Mr. Votava, that a recent study done for you by the Wirthlin Group found that more than 70 percent of Americans with household incomes of at least $30,000 expect to retire before the traditional retirement age of 65. Indeed, we find in Social Security, that 75 percent will have taken benefits before age 65, as I am sure Dr. Yakoboski knows.

Why is that? Is it, you just do not want to work in the mine any more, or you have that house in Phoenix, or both? It is obviously a mix of things. Could I ask all three of you what you think, because it is a very important question. If things are so difficult for the older citizens, why are they retiring so early? Did I say Phoenix? I meant Florida. [Laughter.]

Senator GRAHAM. It is acceptable for some to go to Phoenix. [Laughter.]

Dr. YAKOBOSKI. I would like to answer that by saying that the finding is really that 70 percent of Americans expect to retire, not that they can retire. When clients first come into our office and we sit down and we develop the expectation, I want to take an early retirement, I want to get out of the mines, that is their expectation. They see these things on television, they see the ads. They expect a lifestyle of a condo in Phoenix up here, because it appeared for those ahead of them.

That is why I started my own testimony by describing the real problem of those either in the middle or behind the baby boom, because I can tell you that those in the front of it, from a financial point of view, have done reasonably well without any planning; their houses appreciated, their portfolios appreciated.

Those that come behind do not enjoy that same rise of money and power around them. They have to sit down and realistically do the math. And when you do that with them, you find very quickly

that they cannot retire before age 65. In fact, the charts will show you you must work to age 85 in order to provide enough savings.

Senator MOYNIHAN. And yet, sir, and let me ask the other members in my limited time, they do retire on Social Security. I mean, that is a fact. Hard-headed Nixon, Hargrave might say you ought not, but they do.

Ms. CALIMAFDE. I am not an expert in this area. The clients I work with, people I am around, are not retiring early. In fact, people seem to be working forever. I do not know how they can retire. So I would be interested in that, too. Did they retire too early without sufficient savings?

Senator MOYNIHAN. In Social Security, as I noted, 75 percent of recipients retire before 65, and most at 62. Sir, what do you think?

Dr. YAKOBOSKI. No, that is correct. That is where the clusters are in where people retire. Retirement ages have historically been dropping over time, though I would note that there is evidence that that trend has leveled off.

I would second the previous comment. Many of today's workers do expect to retire, what I would label, unrealistically early. I think that is because most have absolutely no idea how much they need to fund their retirement.

As a final point I would also make, especially when thinking about today's workers, what does it mean to be retired? It is not a simple, cut-and-dried answer. My dad hit age 65 and went to the garden and the donut shop and that was it. Now you have workers who segue into a full retirement. They leave career jobs and set up their own shop, or they work part-time, or they work as a consultant. If you ask many of those people, are you retired? They would say, yes, I am retired. I am doing what I want. So we have a truly evolving definition——

Ms. CALIMAFDE. That is a good definition.

Dr. YAKOBOSKI [continuing]. Of what it means to be retired.

Senator MOYNIHAN. I fear I would not have any contradiction from you, sir, if I suggested, we really ought to have more research on this, do you not think?

Dr. YAKOBOSKI. As a professional researcher, I always think more research is called for. [Laughter.]

Senator MOYNIHAN. But there is such a thing as going out and surveying, asking people what is on their minds.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Graham?

Senator GRAHAM. I would like to continue that line of discussion. I am concerned that the Federal Government has a certain amount of foregone tax revenue that it can commit to encouraging people to act in a way different than they would without that Federal inducement to save and prepare for their retirement.

I am not satisfied that we know whether we are using that amount of foregone Federal income in the most cost-effective manner. Are we getting the biggest bang for the buck in terms of how we are deploying our incentives?

What is your comment about how much we know about the effectiveness of the different current Federal programs, and what can we do to increase our knowledge level? Specifically, we are about to consider passing some reform bills.

Is there anything that we could incorporate in the architecture of the reform bills that are currently under discussion that would result in us having better information about them than we have about their predecessors in terms of effectiveness?

Dr. YAKOBOSKI. I would start by noting that there has been a wealth of research devoted to the question of, how well do savings incentive programs, i.e., 401(k), IRAs, et cetera, work in terms of generating additional new savings.

Honestly, you have economists, not surprising, come out with varying answers. Some would argue that these programs truly do generate significant new savings, others who would argue the contribution is marginal that, in some sense, people who would have saved anyway simply reallocate their savings.

In my reading of the literature, my conclusion would be that the programs do generate new savings, although it is not clear exactly what the magnitude is, be it dollar for dollar, or some fraction less than that.

As regards the Federal tax expenditure issue, I would just make two quick points to keep in mind when we look at the tax expenditure figure for retirement plans, one, is that that figure includes both private and public sector plans.

The last time we analyzed the issue, most of the dollars were actually accounted for by public sector plans, given, by and large, the very healthy funded status of private plans, and also more the tax expenditures accounted for by defined contribution arrangements than defined benefit arrangements.

Ms. CALIMAFDE. May I try that one, Senator?

Senator GRAHAM. All right.

Ms. CALIMAFDE. I have two answers, completely different. One, is the National Retirement Savings Summit, at which you were there and spoke very eloquently, a lot of the thrust of that summit was on education.

I think we have already seen some of the spots that I think ASEC and/or EBRI, I am never sure which one, is doing. But you can see them on TV, and I think they are very interesting.

I think, if we can educate the public, and particularly younger people, to the benefits of saving earlier and what happens with tax-free growth, we will be way ahead of the game. I think we are just starting to do that. I think the Roth IRA generated a whole media blitz on savings again. So I think one answer is, some money should go into education, and I think it will be well spent.

The other answer is going to be totally anecdotal. Not only do I do retirement planning, but I also do estate planning. Over the years, 23 years ago when I started, most people who came in and sat down, their biggest asset was a house, almost always.

Now when people come in and sit down, their biggest asset is often a retirement plan, and then the house. It is not that there are funds over here that are outside of the plan, it is the retirement plan or an IRA. What I have decided over the years is that there is a forced savings feature to the qualified retirement plan system that should not be underestimated.

People look at the money going into a qualified retirement plan as untouchable. They look at all of their other savings as things they can spend, for prom dresses and whatever. So I think that the

qualified retirement plan system is working very well in ways that we are not even looking at, as far as really being forced savings.

Senator GRAHAM. Can I ask one other question? I recently spent some time with the Raymond, James firm, a financial planning firm, in St. Petersburg, Florida.

Senator MOYNIHAN. That is your weekly stint?

Senator GRAHAM. Yes. That was my last job. [Laughter.] And one of the issues that was raised was what was called hollowing out of retirement plans because of the opportunity to release money for non-retirement purposes. Good purposes, like buying a home, sending a child to school, when you have been unemployed for a certain amount of time. But the effect of that is to hollow out the plan so that, when you get to retirement, it is not as extensive as you had thought. How significant an issue is that?

Ms. CALIMAFDE. Do you think they are talking about hardship distributions?

Mr. VOTAVA. No. They are talking about people that need to access it for different reasons. I would say that that is a concern. That is a growing concern. There were questions and testimony earlier about individuals who want to consume, or need to consume, and take the money.

Ms. CALIMAFDE. But, wait. How are you getting to the plan asset? You cannot get to that plan asset unless you retire, become disabled, die, or you quit, or a hardship distribution, which is a very significant standard, you are losing your house, medical bills.

So there has got to be, other than the world of IRAs. But if you are in a qualified retirement plan, you cannot just go in and say, I want money now. You are going to have to meet some statutorily defined reason to have money.

Mr. VOTAVA. Today life goes on very strongly past age 59 and a half.

Ms. CALIMAFDE. Right.

Mr. VOTAVA. So at that point in time, you may have a long retirement horizon left in front of you, yet the fact that you are no longer employed at your primary employment or the fact that you want to buy the condo in Phoenix, or something along that line, will lead one to a conclusion to use the money in that plan. So that is there, and that is a danger because you have left that money in the hands of the individual.

Dr. YAKOBOSKI. I would add two things. One, is people do take loans out of their plans. And what we do not know exactly is their behavior as they pay those loans back. By definition alone, you pay back to yourself, to your 401(k) account.

By the same token, as I am paying that loan back, do I scale back my regular contribution amount that I had been making out of my salary to my account as I pay the loan back and, therefore, in some sense have this hollowing out effect? Definitely a possibility.

One other issue that continues to be of concern is, what do workers do when they change jobs and they have access to the money? And there are significant penalties, income tax and a penalty cash, to cashing out a distribution upon job change. But the data continues to show that most workers will still take the cash, pay the income tax and pay the penalty tax.

Those tend to be workers with smaller distributions, smaller dollars, but they may be the people that need it the most. If we are also living in a world where individuals will change jobs six or eight times, by definition, that means a number of small distributions. So, the issue is even more crucial.

But I would also note there that the good news is, rollover behavior is moving in the "right direction," that while there is still definitely room for improvement, the improvement has been showing up over the years.

Ms. CALIMAFDE. I would say that is probably due to a lot of the changes on the eligible rollover rules, where you made it much easier in the last couple of years to roll from one account to another without any tax consequences.

The CHAIRMAN. Senator Kerrey.

Senator KERREY. Thank you very much, Mr. Chairman.

Just briefly, you all were sitting in the audience when Senator Moynihan, earlier, asked this question. I do not know if the Senator had the chance, in your questioning, to do a follow up. If you did not, I will.

Senator MOYNIHAN. The answer is, maybe. [Laughter.]

Senator KERREY. All right. Well, I will try to do it.

Basically, what Chairman Roth is trying to do is improve the opportunity for people to save so they can generate a sufficient amount of wealth and supplement Social Security in their retirement, which I think is a first-rate idea. I am on Senator Graham's bill to try to accomplish that as well. I think it is a first-rate idea.

But underneath that, we have got a question. How do we spent our tax dollars? We have got $100 billion, net of taxes, that come in from pension income that we have right now for all of our pensions, 401(k), et al.

As I understand it, there is a problem for those lower wage people. They are not buying up to the full limit right now of 401(k). It may be reasonable to raise the limit for people who currently would like to do more than 25 percent, but we are struggling to try to get that lower wage person who is enormously important in our economy.

Earlier, I was looking at the Nebraska numbers. We have about half of our workers that are in that manufacturing/service industry. If you look at their Social Security benefit, it is inadequate to support them in their post-working years, so they need something else. That is why Senator Moynihan's and my proposal takes $80 billion a year, up against $100 billion a year.

I understand that the Treasury tell us that that lower half of the work force gets about 10 percent of that $100 billion, so figure they get about $10 billion right now of tax benefits.

Senator MOYNIHAN. Could I ask my friend, do you mean the current tax expenditures of $100 billion?

Senator KERREY. Yes, sir. One hundred billion.

Senator MOYNIHAN. How much goes to the lower half?

Senator KERREY. Actually, the lower 60 percent, they estimate 10 percent.

Senator MOYNIHAN. Ten percent.

Senator KERREY. So it is roughly, just my numbers, they are getting about $10 billion a year.

The question is, how can we design this proposal of ours to meet the administrative concerns and the educational concerns that are out there? I just do not believe that we ought to say, no, we are not going to do it. We are not going to give them $80 billion a year of wealth-generating power because we cannot figure out how to do the administrative side, and we cannot figure out how to do the educational effort.

I mean, we know that they have a difficult time right now because their payroll taxes are higher than the income taxes. These incentives that we use on the income tax side are not very attractive to them anyway, as a consequence.

But what is vitally important for us to answer, why it is vitally important, in my judgment, is that if we are going to keep our current trade policies, educational policies, and so forth in place, we have to make certain that everybody has a shot at the American dream in terms of accumulating these financial assets.

Again, the starting point is, if you look at what they are going to get with Social Security, given their average indexed monthly earnings, it is inadequate. It is not enough. They have got to have something else.

So I wonder if you have given this some thought. Dr. Yakoboski, I have seen some comments that you have made on both the administrative problems and the educational problems.

I hope, in addition to criticizing it, you will give us some answers as to how to do it, because otherwise they are not going to get the opportunity. They are going to be left out. We are going to see a continuing widening of the gap of wealth in this country which, as I say, is very unhealthy for a liberal democracy.

Dr. YAKOBOSKI. Well, it is obviously a hard and difficult question. That is why the problem persists. What we do see, is evidence that lower wage workers do respond to incentives when they have the plans available.

The data that we have available, when we look at 401(k) plans, lower income persons, younger persons know they are not contributing the maximum amount that the plan or the law will allow them. But, yes, in many cases they are contributing the maximum amount that their company will match. They are reacting to the economic incentive there and at least maximizing fully leveraging that opportunity.

The simple fact is, yes, there are some people who cannot afford to save. The money simply is not there. In other cases, education is a crucial issue. When we ask individuals in survey work that we do, individuals who are not saving for retirement, could you save $20 a week, which is a little over $1,000 a year? You will have 50 percent of savers say, yes, I could come up with $20 a week.

Well, why are they not currently? Many probably just do not appreciate a seemingly small amount of money, done on a regular basis, compound that over 20 or 30 years, actually making a significant contribution to their retirement security. So it is going to be an attack on numerous fronts which is needed, educating these workers as well as giving them incentive opportunities.

Senator KERREY. Specifically, I would invite all of you to respond, as both the Chairman and the Ranking Member offered the first panel to respond, specifically to, if you have $80 billion that you

can use of the payroll tax to distribute to savings, how do we solve this education and administrative problem? That is really the most important barrier right now.

The surpluses that we are generating for the next four or 5 years are all coming from Social Security taxes. The President is talking about 62 percent to save Social Security, but, as Senator Graham said very eloquently yesterday in a meeting I attended, a significant portion of that in the early years is all Social Security.

So we have got an opportunity to help these lower wage people who are enormously important to America and to our economy. It is likely to be inflation adjusted. Their wages are going to stay relatively low. So I hope you will take the offer that was extended to the first panel in earnest and give some consideration to this education and administrative problem that is being, I think legitimately, pointed out to our proposal.

The CHAIRMAN. Senator Robb?

Senator ROBB. Thank you, Mr. Chairman. I will be very brief. I had to spend my morning on Y2K problems across the way and I did not hear the first panel. I look forward to taking their testimony.

My question, really, builds on and was very similar to the one just asked by the Senator from Nebraska, and obviously a part of the conversation this morning. It seems to me that we have been fairly successful in generating incentives for savings within the middle income and the upper-middle income folks, but less so with respect to those that are downscale, economically. Obviously, those at the very bottom, it is always going to be very difficult, if they are living in essentially a hand-to-mouth existence.

But for those who could in any way, shape or form generate some saveable income, my basic question is, is there some essential ingredient? Does it mean inverting the whole incentive scale so we put even more incentive for the very low wage earning savers and take away something that otherwise might be available to those as you get into the upper levels in order to generate the kind of savings in the group that is most in need of having some degree of savings, even though it may pale by comparison to those who are fortunate enough to be a little higher on the food scale?

Mr. VOTAVA. I would like to respond. Those who are at the lower level obviously have more pressure on their expenses. So not only are they thinking that they need to live at a higher lifestyle or need to spend every dollar, the reality is, they do need to spend those dollars.

So perhaps increasing a company match for 401(k) at that level would be an appropriate way. They need ways in which the system will help them because they feel that they cannot help themselves. Education will help them to a certain degree, but reality will keep them in check.

We just heard testimony to the effect that people, even at the bottom of the scale, will match the company matching share, they just will not use the additional amount that they could put into a 401(k).

Do we need to somehow sweeten the incentive at that level, perhaps at the cost to some incentive at the higher level? I think expanding it at the lower level would help. Now, whether you take

it away from the higher level, I am not sure that that would necessarily help.

Senator ROBB. I understand it is difficult.

Ms. CALIMAFDE. Senator Baucus mentioned tax credits for matches for small business, and that is a very interesting idea. Graham-Grassley already would have a tax credit for start-up for small businesses.

To the extent that some of these lower paid people were employed by small business, that would encourage small business to sponsor a plan. Almost every small business plan has to give a 3 percent benefit right across the board, so right there you have started savings for them. Then with the match, maybe that is a good incentive. Give a tax credit for a match. That would bring the person inside to let them also save. It is an intriguing idea. I had not thought of it until today.

Senator ROBB. Has anyone scored that, just out of curiosity? We are talking about fungible dollars here. If we have $80 billion, if that is the number that is in play, if I picked up that number from the conversation, what would a plan like that cost, just hip pocket?

Senator MOYNIHAN. Why we do not ask the Joint Committee on Taxation?

The CHAIRMAN. Nothing really has been scored at this stage.

Senator ROBB. I just meant, if there was any sort of a sense, is this a deal-breaker or is it in the range of the doable.

The CHAIRMAN. No one knows at this stage.

Senator ROBB. Thank you, Mr. Chairman. I thank the panel, and will look forward to reviewing their testimony.

The CHAIRMAN. I would point out that, over a year ago, I introduced what I call the private savings account, whereby the surplus, half of it, would be used to set up private accounts and there would be a minimum contribution to each of $250 a year. The idea being that this would, for the first time, get many of the people on the lower end of the economic scale to invest in America, and hopefully start a new trend and interest in savings. So I would suggest you might want to look at that.

Thank you very much for being here. We appreciate it. As I said to the earlier panel, we will undoubtedly submit some questions to you, but, more importantly, call on you as we develop the legislation.

Thank you very much.

Senator MOYNIHAN. Very much.

The CHAIRMAN. The committee is in recess.

[Whereupon, at 12:29 p.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Prepared Statement of Paula A. Calimafde

The Small Business Council of America (SBCA) is a national nonprofit organization which represents the interests of privately-held and family-owned businesses on federal tax, health care and employee benefit matters. The SBCA, through its members, represents well over 20,000 enterprises in retail, manufacturing and service industries, virtually all of which sponsor retirement plans or advise small businesses which sponsor private retirement plans. These enterprises represent or sponsor well over two hundred thousand qualified retirement plans and welfare plans, and employ over 1,500,000 employees.

The Small Business Legislative Council is a permanent, independent coalition of nearly one hundred trade and professional associations that share a common commitment to the future of small business. SBLC members represent the interests of small businesses in such diverse economic sectors as manufacturing, retailing, distribution, professional and technical services, construction, transportation, tourism, and agriculture. Because SBLC is comprised of associations which are so diverse, it always presents a reasoned and fair position which benefits all small businesses.

The American Society of Pension Actuaries (ASPA) is an organization of over 4,000 retirement plan professionals who provide services to small businesses who maintain retirement plans for their employees. The purpose of ASPA is to educate pension actuaries, consultants, administrators and other benefit professionals, and to preserve and enhance the private pension system as part of the development of a cohesive and coherent national retirement income policy.

Profit Sharing/401(k) Council of America (PSCA) is a non-profit association that for the past fifty years has represented companies that sponsor profit sharing and 401(k) plans for their employees. It has approximately 1200 company members who employee approximately 3 million plan participants. Its members range in size from a six-employee parts distributor to firms with hundreds of thousands of employees.

I am Paula A. Calimafde, Chair of the Small Business Council of America and a member of the Board of the Small Business Legislative Council. I am also a practicing tax attorney (over 20 years) who specializes in qualified retirement plans and estate planning. I can also speak on behalf of the Small Business Delegates to the 1995 White House Conference on Small Business at which I served as a Presidential Delegate. At this conference the Pension Simplification and Revitalization Recommendation received the seventh highest ranking in terms of votes. Interestingly, the Portman-Cardin and the Graham-Grassley legislation introduced last year incorporates almost all of the recommendations made by the delegates to the 1995 White House Conference on Small Business.

Why did the Delegates consider this recommendation to be so important as to vote it as the seventh out of the final sixty recommendations? The reason is simple small business owners want retirement to be a viable option for them. For small business, the qualified retirement plan is the best way to save for retirement. Based in part on the current tax law, most small businesses do not provide nonqualified pension benefits, stock options and other perks. Unfortunately, many small businesses perceive the qualified retirement plan area to be a quagmire of complex rules and burdens. It is perceived as a system which discriminates against key employees. The Conference Delegates understood that if the retirement system became user friendly then they would want to use it. By doing so, they could provide for their own retirement security, while at the same time providing valuable retirement benefits for their other employees.

As a delegate appointed by Senator Trent Lott to the National Summit on Retirement Savings, I was able to share information and concerns with fellow delegates in break out sessions. Even though small business retirement plan experts, administrators and owners were not well represented, their ideas came through loud and clear in the break out sessions. Calls for repeal of the top heavy rules, increases in contribution limits, particularly the 401(k) limit, elimination of costly discrimination testing in the 401(k) area, and a return to the old compensation limits, were repeated across the break out sessions. There were even individuals calling for support of a particular piece of legislation—the Portman-Cardin retirement plan bill. Of course, many ideas were discussed particularly in the educational area, but an impartial observer would have noticed that the small business representatives were very united in their message—increase benefits, decrease costs. In other words, when undertaking a cost/benefit analysis, the costs were perceived as too high for the benefits to be gained.

At the Summit, the following problems facing small businesses in the retirement plan area were brought up: staff employees' preference for cash or health care coverage, the revenue of the business beings too uncertain, the costs of setting up the plan and administering it being too high, required company contributions (i.e., the top heavy rules) being too high, required vesting giving too much to short term employees, too many governmental regulations, and benefits for key employees being too small. When asked what could break down these barriers, the following answers were given: reduce the cost by giving small businesses tax credits for starting up a plan, repeal the top-heavy rules, reduce administration, allow key employees to have more benefits, and change lack of employee demand by educating employees about the need to save for their retirement now. Some small businesses believed that until they were more profitable nothing would induce them to join the system.

Our focus today is on increasing savings for retirement. My particular focus will be on setting forth the factors that are most often considered by a small business in determining whether to sponsor a retirement plan as well as what type of plan to sponsor. I will briefly review the ERISA Advisory Council report which was issued on November 13, 1998. I will also discuss the new 401(k) safe harbors and some of the problems small business is having with the IRS notice requirements. Finally, I will quickly discuss some of the outstanding pension legislation in the Senate and the House from the viewpoint of small businesses.

Why is this issue so critical? Small business is where most of the new jobs are for today's workforce. According to the Small Business Administration 75% of the 2.5 million new jobs created in 1995 were created by small business. Unfortunately, way too many small businesses do not sponsor retirement plans. Since the enactment of ERISA, layer upon layer of complex rules and regulations have been adopted which seriously retard the ability of small business to maintain retirement plans for their employees. The effect of these costly rules and regulations on small business retirement plan coverage has been significant. Some estimate that as many as 80% of workers employed by small businesses with fewer than 100 employees have absolutely no retirement plan coverage. In contrast, at least 72% of workers at larger firms (over 500 employees) have some form of retirement plan coverage.

SBCA, SBLC, ASPA and PSCA strongly believe that legislation which combines the higher IRA and Roth IRA limits and the new Plus concept along with reforms to IRC Section 404 from the new Roth legislation, the increase in limits and compensation from Portman-Cardin along with the tax credits, top heavy reform and elimination of user fees set forth in Graham-Grassley, will bring the retirement system to small businesses.

On November 13, 1998, the ERISA Advisory Council on Employee Welfare and Benefit Plans released its Report of the Working Group on Small Business: How to Enhance and Encourage The Establishment of Pension Plans. This report provides eight recommendations for solving the problems facing small businesses today in the retirement plan area. Interestingly, these recommendations mirror many of those that came out of the National Summit on Retirement Savings.

The Advisory Council report calls for a Repeal of Top-Heavy Rules, Elimination of IRS User Fees, an Increase in the Limits on Benefits and Contributions, an Increase in the Limits on Includable Compensation, the Development of a National Retirement Policy, Consider the development of Coalitions, Tax Incentives and the Development of a Simplified Defined Benefit Plan.

The Report explains the legislative development of the top-heavy rules and then summarizes the layers of legislation that occurred subsequent to their passage which made them obsolete. The Report states, "The top-heavy rules under Internal Revenue Code Section 416 should be repealed. . . . Their effect is largely duplicated by other rules enacted subsequently. . . . They also create a perception within the small business community that pension laws target small businesses for

potential abuses. This too discourages small business from establishing qualified retirement plans for their employees."

It is important to note that the Graham-Grassley legislation as well as the Portman-Cardin legislation dramatically improve the top-heavy rules and significantly reduce administration expenses associated with them.

The Report calls for the elimination of User Fees imposed by IRS. The Report in part states, "The imposition of user fees adds another financial obstacle to the adoption of qualified retirement plans by small business. Although user fees apply to all employers—large and small—the cost of establishing a plan is more acutely felt among small employers. User fees do not vary by size of employer. . . . Now that the budget deficit has become a budget surplus, the economic justification for user fees is much diminished. User fees should be repealed."

The Graham-Grassley legislation addresses the user fee issue to assist small businesses in sponsoring retirement plans.

The Advisory Council Report calls for increasing the limits on benefits and contributions:

"The defined benefit and defined contribution plan dollar limit were indexed by ERISA and were originally established in 1974 at $75,000 and $25,000 respectively. From 1976 to 1982, the indexing feature was allowed to operate as intended and the dollar amounts grew to $136,425 and $45,475. Under the Tax Equity and Fiscal Responsibility Act of 1982, the dollar limit on defined benefit plans was reduced to $90,000 and the dollar limit on defined contribution plans was reduced to $30,000. . . .

"These reductions in the dollar amounts are widely believed to have been revenue driven. These reductions had the net effect of adjusting downward the maximum amount of benefits and contributions that highly-paid employees can receive in relationship to the contributions and benefits of rank and file employees. . . .

"In order to give key employees the incentive needed to establish qualified retirement plans and expand coverage, we recommend that the $30,000 dollar limit on defined contribution plans be increased to $50,000 which will help partially restore the dollar amount to the level it would have grown to had the indexing continued without alteration since the dollar limit was first established in 1974.

"Second, we recommend that the $90,000 dollar limit on defined benefit plans be increased to $200,000 which will restore the dollar amounts lost through alterations in the dollar amount since 1974, while maintaining the 1:4 ratio established in 1982 as part of TEFRA.

"Third, we recommend, that in the future, indexing occur in $1,000, not $5,000 increments which has had the effect of retarding recognition of the effect of inflation."

And finally the report concludes, "we recommend, that actuarial reductions of the defined benefit plans dollar limit should be required only for benefits commencing prior to age 62. This was the rule originally enacted in 1974 as part of ERISA."

The Roth legislation, the Graham-Grassley legislation as well as the Portman-Cardin legislation all raise the contribution limits with respect to some or all of the retirement plans. As discussed in more detail below, this is perhaps one of the most important changes that can be made to the system to increase small business access.

The Report also calls for a corresponding increase in the limit on includable compensation for similar reasons. "Under ERISA, there was no dollar limit on the amount of annual compensation taken into account for purposes of determining plan benefits and contributions. However, as part of the Tax Reform Act of 1986, a qualified retirement plan was required to limit the annual compensation taken into account to $200,000 indexed. The $200,000 limit was adjusted upward through indexing to $235,843 for 1993. As part of the Omnibus Budget Reconciliation Act of 1993, the limit on includable compensation was further reduced down to $150,000 for years after 1994. Although indexed, adjustments are now made in increments of $10,000, adjusted downward. In 1998, the indexed amount is $160,000." "We recommend that the limit on includable compensation be restored to its 1988 level of $235,000 be indexed in $1,000 increments in the future."

The Portman-Cardin legislation, (and hopefully the Graham-Grassley legislation), will return the compensation limit back to where it stood in 1988. The system is perceived by many small business owners as discriminatory against key employees; this type of change will allow it to be perceived as more fair to all employees.

The Report develops a number of recommendations in the area of education, including using public service spots on television, radio and in the printed media to educate the public and raise the awareness of the need to prepare and save for retirement. Virtually all of the Report's recommendations in this area also were made at the National Summit on Retirement Savings. This is a critical area for small

business. Clearly, more small businesses will want to sponsor retirement plans if retirement benefits are perceived as a valuable benefit by their employees.

One of the direct benefits to come out of the National Retirement Summit is the educational spots being put on the air by ASEC and/or by EBRI. It is critical for the public to become educated about the need to start saving for their retirement and the benefits of starting early.

The Report also discussed the possibility of developing coalitions to offer pooling vehicles for small employers. Absent a great deal of persuasive testimony, it would seem that the idea of multiemployer plans should not be extended to small businesses without a collective bargaining agreement. While certainly no expert in the area, the multiemployer plans are not well liked by small business and often provide horrendous problems when a termination occurs. Further, it is quite simple for a small business to adopt a prototype 401(k) or SIMPLE plan sponsored by a financial institution or an insurance company. It's hard to see how a coalition could make this process simpler, but we would be willing to see where this idea could lead.

The Report calls for tax credits that could be used as an incentive for a small business to adopt a qualified retirement plan or to offset administration costs or even retirement education costs.

The Graham-Grassley legislation focuses on the idea of tax credits providing an incentive for small businesses to adopt retirement plans. Some of the Senators who are sponsoring this legislation are even considering the use of a tax credit to encourage a small business to start matching employee 401(k) contributions.

Finally the Advisory Council calls for a Simplified Defined Benefit Plan.

Graham-Grassley and Portman-Cardin both call for a simplified defined benefit plan which will assist small business.

The graying of America, and the burden that it will place on future generations, should not be ignored. The American Council of Life Insurance reports that from 1990 to 2025, the percentage of Americans over 65 years of age will increase by 49%. This jump in our elderly population signals potentially critical problems for Social Security, Medicare and our nation's programs designed to serve the aged.

While we must shore up Social Security and Medicare, it is clear that the private retirement system and private sources for retiree health care will have to play a more significant role for tomorrow's retirees. The savings that will accumulate for meeting this need will contribute to the pool of capital for investments that will provide the economic growth needed to finance the growing burdens of Social Security and Medicare. The policy direction reflected by the Roth, Graham-Grassley and Portman-Cardin legislation will ensure that sufficient savings will flow into the retirement plan system so as to provide a secure retirement for as many Americans as possible.

The last two bills passed by this Congress, dealing with the retirement plan system, began the process of simplifying the technical compliance burdens so that small businesses are able to sponsor qualified retirement plans. The retirement plan bills we are discussing today represent another huge step forward. Indeed, if this legislation becomes the law, only a few and relatively minor changes remain to fully restore the system to its former health prior to the onslaught of negative and complex changes of the 1980's.

SBCA, SBLC, ASPA, and PSCA strongly support the following items in the Pension legislation which will greatly assist small businesses in sponsoring retirement plans:

401(K) CHANGES

The 401(k) Plan is a tremendous success story. The excitement generated by this plan is amazing. Prospective employees ask potential employers if they have a 401(k) plan and if so, what the investment options are and how much does the employer contribute. Employees meet with investment advisors to be guided as to which investments to select, employees have 800 numbers to call to see how their investments are doing and to determine whether they want to switch. Employees discuss among themselves which investment vehicles they like and how much they are putting into the plan and how large their account balances have grown.

The forced savings feature of the 401(k) plan cannot be underestimated and must be safeguarded. When a person participates in a 401(k) plan, he or she cannot remove the money on a whim. Savings can be removed by written plan loan which cannot exceed 50% of the account balance or $50,000 whichever is less. Savings can be removed by a hardship distribution, but this is a tough standard to meet. The distribution must be used to assist with a statutorily defined hardship such as keeping a house or dealing with a medical emergency. This is in contrast to funds inside an IRA or a SIMPLE (which in reality is nothing more than an employer sponsored

IRA program) where the funds can be accessed at any time for any reason. True, funds removed will be subject to a 10% penalty (which is also the case for a hardship distribution from a 401(k) plan), but preliminary and totally unofficial data suggests that individuals freely access IRAs and SEPs (also nothing more than a glorified IRA) and that the 10% penalty does not seem to represent a significant barrier. In fact, this is why the SIMPLE IRA starts off with a 25% penalty for the first two years an individual participates in SIMPLE in hopes that if a participant can accumulate a little bit he or she will be tempted to leave it alone and watch it grow. Nevertheless, there is a distinct difference between asking the employer for a loan or a hardship distribution and having to jump through some statutorily and well placed hoops versus simply removing money at whim from your own IRA.

- Increasing 401(k) contributions from $10,000 to $15,000 is a significant, beneficial change which will assist many employees, particularly those who are getting closer to retirement age.
- Opening up the second 401(k) Safe Harbor, the "Match Safe Harbor" to small businesses by exempting it from the Top-Heavy Rules is a valuable change which places small businesses on a level playing field with larger entities.
- We believe that the voluntary safe harbors will prove to be the easiest and most cost effective way to make the 401(k) plan user friendly for small businesses. If a small business makes a 3% contribution for all non-highly compensated employees, or makes the required matching contributions, then the company no longer has to pay for the complex 401(k) antidiscrimination testing (nor does it have to keep the records necessary in order to do the testing). We recognize that many companies will choose to stay outside the safe harbor because the 3% employer contribution or required match "cost of admission" is too high and because it is more cost-effective to stay with their current system (including software and written communication material to employees). We believe that small business will embrace the voluntary safe harbors that do away with costly complex testing. Legislation which allows small businesses to use either safe harbor could very well prove to be enough of an incentive for companies to begin sponsoring a 401(k) retirement plan.
- Unfortunately, IRS is imposing a Notice Requirement which is very restrictive and will probably cause most small businesses not to be able to use the safe harbor this year. IRS in Notice 98-52 which was published November 16, 1998 requires that a business adopting either safe harbor give notice (in the case of a calendar year plan) by March 1st. Now let's examine the rationale behind the notice requirement and see whether this type of restriction is justified. Remember there are two safe harbors—one is a prescribed company match to employee 401(k) contributions, the other is a non-elective 3% contribution. A non-elective 3% contribution means that every eligible employee receives this contribution whether or not he or she makes 401(k) contributions. The rationale for notice in the context of the match safe harbor is self evident. An employee may very well change his or her behavior and contribute more 401(k) contributions knowing that a match is going to be made. There appears to be no rationale for notice in the context of the non-elective 3% contribution—no employee is going to change any behavior on knowing that a contribution will be made for them at the end of the year. The problem of course is compounded when dealing in the small business world. Unless an outside advisor has informed a small business that it must give a fairly extensive notice by March 1st and the company complies, it will not be able to take advantage of the safe harbor for this entire year. My guess is that there will be many, many small businesses this year who would have taken advantage of the 3% non-elective safe harbor but will not be able to do so because they had not been informed of the requirements of this overly restrictive notice requirement. Thus, they will not be able to rid themselves of the complex and costly 401(k) anti-discrimination testing.

SBCA, SBLC, ASPA and PSCA suggest that the notice requirement be changed to within 30 days of the close of the plan year for those companies selecting the 3% non-elective contribution safe harbor. This change will allow word to get out to small business about this option and give them time to comply with the notice requirement.

- The Voluntary Plus Contribution set forth in the Roth legislation is an exciting concept which will be embraced by the small business community.
- Excluding 401(k) contributions made by the employees from the IRC Section 404 15% deduction limit will make these plans better for all employees. Today, employee 401(k) contributions are included in the Section 404 limit. Section 404 limits a company's deduction for profit sharing contributions to 15% of eligible participants' compensation. This limit covers both employer and employee 401(k) contributions. This limitation now operates against public policy; either

employer contributions are cut back which works to the detriment of the employees' retirement security or employee pre-tax salary deferred contributions must be returned to the employee. Thus, employees lose an opportunity to save for their retirement in a tax-free environment. This is particularly inappropriate since the employee has taken the initiative to save for his or her retirement, exactly the behavior Congress wants to encourage, not discourage.

- Repeal of the complicated "Multiple Use Test" is a very welcome change and will benefit the entire retirement plan system. This test was nearly incomprehensible and forced small businesses (really their accountants or plan administrators) to apply different anti-discrimination tests to employer matching contributions than what may have been used for the regular 401(k) anti-discrimination tests.
- Allowing employee-pay all 401(k) plans for small business is fair. Portman-Cardin would allow a key employee to make a contribution to a 401(k) plan sponsored by a small business without triggering the top-heavy rules were triggered so that the small business was required to make a 3% contribution for all non-key employees. Not only is this a trap for the unwary since many small businesses, including their advisors, are unaware of this strange rule, but it is also unfair since a larger company would be able to sponsor an employee-pay-all 401(k) plan and not have to make any employer contributions to the plan. The regular 401(k) anti-discrimination tests are more than sufficient to ensure that the non-highly compensated employees are treated fairly vis a vis the highly compensated employees.
- The so-called "Catch-Up Contributions" for people approaching retirement set forth in the Roth bill will be very helpful for small business employees.

CHANGES TO PLAN CONTRIBUTION LIMITS

Perhaps the most important change in the retirement legislation is increasing the dollar limits on retirement plan contributions, removing the 25% of compensation limitation and increasing the compensation limitation.

- Increasing the $150,000 compensation limit to $235,000 is an important change which will bring the plan contributions back into line with 1998 dollars. The $150,000 limit in 1974 (ERISA) dollars is about $46,500 (assuming 5 percent average inflation). This is far below the $75,000 that represented the highest amount upon which a pension could be paid under then-new Code Section 415 (back in 1974). This cutback has hurt several groups of employees—owners and other key employees of all size businesses who make more than $150,000 and mid-range employees and managers (people in the $50,000 to $70,000 range) who are in 401(k) plans and in defined benefit plans. This cutback was perceived by owners and other key employees of small businesses as reverse discrimination and as a disincentive in establishing a retirement plan.
- Increasing the defined contribution limit from $30,000 to $45,000 and the defined benefit limit from $130,000 to $180,000 are strong changes which will increase retirement security for many Americans. These numbers are in line with actual inflation.

TOP HEAVY RULES

These rules are now largely duplicative of many other qualification requirements which have become law subsequent to the passage of the top-heavy rules. They often operate as a "trap for the unwary" particularly for mid-size businesses which never check for top-heavy status and for micro small businesses which often do not have sophisticated pension advisors to help them. These rules have always been an unfair burden singling out only small to mid-size businesses. The changes made in the Graham-Grassley and the Portman-Cardin legislation will significantly simplify the retirement system with little to no detriment to any policy adopted by Congress during the last decade. The top-heavy rules have required extensive record keeping by small businesses on an ongoing 5 year basis. They also have represented a significant hassle factor for small business—constant interpretative questions are raised on a number of top-heavy issues and additional work is required to be done by a pension administrator when dealing with a top-heavy plan, particularly a top-heavy 401(k) plan.

SBCA, SBLC, ASPA and PSCA support the repeal of the family attribution for key employees in a top-heavy plan, as well as finally doing away with family aggregation for highly compensated employees. These rules require a husband and wife and children under the age of 19 who work in a family or small business together to be treated as one person for certain plan purposes. They discriminate unfairly against spouses and children employed in the same family or small business.

We also support the simplified definition of a key employee as well as only requiring the company to keep data for running top heavy tests for the current year rather than having to keep it for the past four years in addition to the current year.

SIMPLE PLANS

It is exciting to see that the SIMPLE is attracting so many small businesses. We believe, though, that the SIMPLE plan should be viewed as a starter plan and that all businesses, including the very small, should be given incentives to enter the qualified retirement plan system as quickly as possible. The SIMPLE is an IRA program, as is the old SEP plan and in the long run true retirement security for employees is better served by strengthening qualified retirement plans rather than SIMPLES and SEPs. This is simply because employees have a far greater opportunity to remove the money from IRAs and SEPs and spend it—the forced savings feature of a qualified retirement plan is not present. While we appreciate that for start-up companies or micro businesses, a SIMPLE or the proposed salary reduction SIMPLE is the best first step into the retirement plan system, the company should be encouraged to enter the qualified retirement system as soon as possible. By making the SIMPLE rules "better" than the qualified retirement system, the reverse is achieved. Thus, we hope that the "gap" between the 401(k) limit ($15,000) and the SIMPLE limit ($10,000) and the salary reduction SIMPLE limit ($5,000) is carefully preserved so that the system does not tilt in the wrong direction.

We do not believe that any other new plans than those discussed here are needed. We now have a very good mix of plans—from those which provide flexibility and choice to very simple plans for the companies who do not want administration costs.

REQUIRED MINIMUM DISTRIBUTION RULES

We support moving back the required beginning date for receiving retirement plan benefits from 70-1/2 to 75. We would encourage the Committee to consider whether the rule which delays receiving distributions for all employees, other than 5% owners, until actual retirement, if later, should be extended to 5% owners. There seems to be no policy rationale for forcing 5% owners to receive retirement distributions while they are still working.

We also respectfully suggest the following:

1. Allow direct lineal descendants of the participant, in addition to a spouse, to have a roll-over IRA. Today, if a participant dies and names the spouse as beneficiary, the spouse can "roll-over" the retirement plan assets into an IRA, rather than receiving payments from the retirement plan. On the other hand, if a participant dies and names his or her children as the beneficiaries, the children cannot roll-over the assets into an IRA and will in most cases be forced to take the distribution in one lump sum. This triggers the problem set forth in 2 below.

2. Provide an exemption of retirement plan benefits from estate taxes. As mentioned above, if the children are forced to take a lump sum distribution (and assuming they have no surviving parent), the entire retirement plan contribution is brought into the estate of their parent who was a plan participant and is subject to immediate income tax. This is the fact pattern where the plan distribution is reduced by up to 85% due to taxes—federal and state income taxes and federal and state estate taxes. This is why people often say they don't want to save in a retirement plan because if they die the government takes it all and the children and grandchildren receive way too little.

PLAN LOANS FOR SUB-S OWNERS, PARTNERS AND SOLE PROPRIETORS

This is a long overdue change to place all small business entities on a level playing field. We support this change.

REPEAL OF 150% OF CURRENT LIABILITY FUNDING LIMIT

This is a very technical issue, but basically defined benefit plans are not allowed to fund in a level fashion. Code Section 412(c)(7) was amended to prohibit funding of a defined benefit plan above 150 percent of current "termination liability." This is misleading because termination liability is often less that the actual liability required to close out a plan at termination, and the limit is applied to ongoing plans which are not terminating. This provision is particularly detrimental to small businesses who simply cannot adopt a plan which does not allow funding to be made in a level fashion. The changes made to this law by the Roth bill are critical for small businesses to be able to sponsor defined benefit plans.

We also applaud the change in the variable rate premium which will assist small businesses which are not allowed to fund in a proper fashion because of this limitation.

A small business will go through a cost-benefit analysis to determine whether to sponsor a qualified retirement plan. A number of factors are analyzed including the profitability and stability of the business, the cost of sponsoring the plan both administratively as well as required company contributions, whether the benefit will be appreciated by staff and by key employees and whether the benefits to the key employees and owners are significant enough to offset the additional costs and burdens. The legislation being contemplated by the Senate Finance Committee will dramatically improve the existing retirement plan system. By making the system more user friendly, more small businesses will sponsor retirement plans. Easing administrative burdens will reduce the costs of maintaining retirement plans. The changes would revitalize the retirement plan system for small business as it is perceived by small businesses as more fair to them. Finally, most of the substantive changes made by Congress in the 1980's would be retained and the time tested ERISA system would stay in place. Ultimately, it is essential for this country to do everything possible to encourage retirement plan savings so that individuals are not dependent upon the government for their retirement well-being.

PREPARED STATEMENT OF MATTHEW P. FINK

A. INTRODUCTION

The Investment Company Institute ("Institute"),[1] the national association of the American investment company industry, appreciates this opportunity to testify at today's hearing on the "Retirement Savings Opportunity Act of 1999." This bill would expand the opportunities for Americans to save for their retirement in IRAs, 401(k)s and other retirement saving vehicles, simplify rules that have inhibited many Americans from taking advantage of the IRA program, and provide a way for older Americans who may have been unable to save when younger, to "catch up."

Retirement savings are of vital importance to our nation's future. We commend the Committee for holding hearings on this topic, and recognize the Chairman's continued leadership on this issue.

The challenge facing Americans today is to ensure that they prepare adequately for their financial needs in retirement. This challenge is particularly pressing in light of two demographic events. First, members of the "Baby Boom" generation are rapidly approaching their retirement years. Evidence from recent studies strongly suggests that, as a generation, they have not adequately saved for their retirement.[2] Second, Americans today are living longer. These demographic trends will place an enormous strain on the Social Security program in the near future.[3] In order to ensure that individuals have the financial resources to support themselves in their retirement years, they will need to actively save for these years. Much of this savings will need to come from individual savings and employer-sponsored plans. Providing additional opportunities for Americans to save for retirement and removing barriers that limit the ability of many individuals to save are, therefore, very important policy goals.

The U.S. mutual fund industry serves the needs of American households investing for their retirement and other long-term financial goals. By permitting millions of individuals to pool their investments in a diversified fund that is professionally managed, mutual funds perform an important financial management role for middle-income families. An estimated 66 million shareholders, representing about 37 percent of all U.S. households, owned mutual funds at year-end 1997.[4] Many shareholders invest in mutual funds through their retirement plans. Approximately 35

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[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 7,408 open-end investment companies ("mutual funds"), 449 closed-end investment companies and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about $5,468 trillion, accounting for approximately 95% of total industry assets, and have over 66 million individual shareholders.

[2] The typical Baby Boomer household will need to save at a rate 3 times greater than current savings to meet its financial needs in retirement. Bernheim, Dr. Douglas B., "The Merrill Lynch Baby Boom Retirement Index" (1996).

[3] The Social Security program is projected to run fiscal shortfalls by 2021. By 2032, the Social Security trust funds will be depleted. 1998 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds.

[4] *See* "U.S. Household Ownership of Mutual Funds in 1997," Fundamentals, Vol. 7, No. 1 (Investment Company Institute, February 1998).

percent of all mutual fund assets are held in tax-qualified retirement plans, of which an estimated $822 billion are IRA investments and $444 billion are 401(k) plan investments. These amounts, measured at year-end 1997, constituted approximately 42 percent of all IRA and 401(k) plan investments.[5]

These programs have been enormously effective for millions of Americans. As I will explain further below, the two newest retirement saving vehicles, the Roth IRA and the SIMPLE plan, also have been successful programs. They are creating new investors saving for retirement and expanding retirement plan coverage. Nevertheless, even with the success of each of these programs—the Roth and traditional IRAs, the 401(k) and SIMPLE plans—specific legislative initiatives would make them even more effective.

The "Retirement Savings Opportunity Act of 1999" contains several of these important initiatives. In particular, the Institute strongly supports those provisions that would (1) eliminate complicated IRA eligibility requirements by restoring the universal IRA, (2) raise IRA contribution limits to account for inflation, and (3) create a "catch-up" rule that would accommodate the actual savings patterns of Americans, many of whom must balance retirement saving activity with the financial obligations of raising a family. These measures would increase IRA and employer-sponsored plan participation and contribution rates and greatly assist individuals seeking to obtain adequate retirement income security.

My testimony will address each of these initiatives in greater detail. I would also like to give some background information on the use of existing retirement savings programs including, in particular, Roth IRAs and SIMPLE plans.

B. UTILIZATION OF EXISTING RETIREMENT SAVINGS PROGRAMS

1. Traditional IRAs and 401(k) Plans

The IRA and 401(k) plan programs have proven to be enormously effective for millions of Americans. A 1998 Institute survey found that an estimated 26 percent of American households now own a traditional IRA, the median account balance of which is $17,500. In those households where the head of household is sixty years old or older, the median account balance is $30,900.[6] In 1993, the most recent year for which comprehensive, aggregate data (based on tax return information) is available, 52% of all IRA owners earned less than $50,000.[7] This same group made about 65 percent of all IRA contributions in 1993 (measured in dollars).

An estimated 35.4 million Americans are eligible to participate in 401(k) plans. Based upon accounts of 6.6 million participants in over 27,700 401(k) plans in 1996, the average account balance of a 401(k) plan participant was in excess of $37,300, and the median balance was about $11,600. More than one out of every four participants in their sixties had an account balance in excess of $100,000.[8]

Evidence shows that Americans choose long-term investments for their 401(k) plans and IRAs. For instance, a review of the investment allocations in 6.6 million 401(k) plan accounts indicates that 401(k) plan participants, on average, had invested two-thirds of their account balances in equity securities in 1996.[9] And according to the Institute's household survey, two-thirds of traditional IRA owners invested a portion of their IRA in equities, including mutual funds and individual stock.[10] More specifically, of those IRA assets invested in mutual funds, about two-thirds are in stock funds.[11]

2. Roth IRA Formation Has Exceeded Expectations And Created New Savers

The Roth IRA, established by the Taxpayer Relief Act of 1997, became available on January 1, 1998. Comprehensive year-end 1998 data on the mutual fund industry's share of Roth IRA activity, which the Institute presently is collecting from its members, are not yet available. (We will share the data with the Committee as soon

[5] *See* "Mutual Funds and the Retirement Market," Fundamentals, Vol. 7, No. 2 (Investment Company Institute, July 1998).

[6] Investment Company Institute Household Tracking Study, May 1998 (unpublished).

[7] Another 33% of IRA owners had no earned income and the remainder had earned income of $50,000 and above. See Paul Yakoboski, "IRAs: Benchmarking for the Post-TRA '97 World," EBRI Notes Vol. 19, No. 12 (Employee Benefit Research Institute, December 1998).

[8] *See* "401(k) Plan Asset Allocation, Account Balances, and Loan Activity," Perspective, Vol. 5, No. 1 (Investment Company Institute, January 1999); EBRI Issue Brief No. 205, (Employee Benefit Research Institute, January 1999).

[9] Perspective, Vol. 5, No. 1, January 1999, supra at note 8.

[10] Investment Company Institute Household Tracking Survey Study, May 1998 (unpublished).

[11] Investment Company Institute data series, 1998 (unpublished).

as it becomes available.[12]) We nonetheless can provide evidence of robust use of the Roth IRA from two "snapshots" over the past year. First, Roth IRA account establishment at mutual fund firms in the first quarter of 1998—at the outset of the program—was quite strong. Second, in the final weeks of 1998, when a deadline to convert traditional IRAs to Roth IRAs approached[13], members reported unusually heavy volume.

Evidence From First Quarter, 1998. As noted above, the Institute conducted a household survey in May 1998. Based on that survey, we estimate that less than five months after the Roth IRA became available, about 3% of all American households owned a Roth IRA.[14] Two-thirds of these accounts were established with new contributions; the remainder were conversions from traditional IRAs. Most significantly, the survey found that the typical Roth IRA owner was 37 years old, significantly younger than the traditional IRA owner, who is about 50 years old, and second, that 30 percent of Roth IRA owners indicated that the Roth IRA was the first IRA they had ever owned. The survey also found that Roth IRA owners typically expected to contribute $2,000—the maximum IRA contribution—to their Roth IRAs in the 1998 tax year.[15]

The Institute also polled some of its members to gauge the number of Roth and SIMPLE IRAs established by April 15, 1998. We can share with you examples of individual member responses. One fund complex reported that individuals opened approximately 157,000 contributory Roth IRAs and 95,000 conversion Roth IRAs in first quarter 1998; another fund group reported over 110,000 contributory accounts and 36,000 conversion accounts for this period.

We also found that traditional IRA activity increased in early 1998 by an estimated 12% over the prior year in the period January 1998 through April 15, 1998. This increase can be attributed to three facts. First, financial services organizations have conducted intensive education campaigns about the Roth IRA in all media outlets—TV, radio, print and internet—and this has raised substantially the public's awareness of IRAs generally. Second, as noted above, the Roth IRA is attracting many new investors, and there has not been any substantial substitution of the Roth IRA for traditional IRAs. Third, there is a general increase in the public's awareness of the need to accumulate retirement savings.

Evidence From Year-End 1998. Similar reports indicate that activity in December 1998 was strong. In the absence of comprehensive year-end data, we have collected data from specific firms and obtained an anecdotal impression of the strength of consumer interest in this time frame. Based on these data, it appears that the rate of Roth IRA establishment continued through year-end. For instance, one firm, which had reported 142,000 Roth IRA accounts as of April 15, 1998 had more than tripled that number to 512,000 accounts as of year-end 1998. Similarly, another fund complex reported $655 million in Roth IRAs under management as of April 15 and reported $3.7 billion, more than five and one-half times that amount, at year-end. Seven fund groups that have reported year-end data to the Institute themselves have about $12 billion in Roth IRA assets. In addition, one research consultant has estimated that $47 billion flowed into Roth IRAs at mutual funds and other financial institutions in 1998.[16]

Consistent with first quarter 1998 findings, firms continue to report that new customers represent a substantial portion of the individuals establishing Roth IRAs. Indeed, one large Institute member indicated that 50% of its Roth IRAs were established by new customers. Similarly, members with both 401(k) and IRA businesses report that it does not appear that individuals are reducing their 401(k) contributions in order to fund Roth IRAs.

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[12] This data will provide an indication of the extent to which individuals are funding their Roth IRAs with mutual funds. Mutual funds, however, represent only about 42% of the traditional IRA market, and the data, therefore, will not reflect all Roth IRA activity.

[13] Taxpayers converting IRAs in 1998 may pay related income taxes over four years, rather than entirely in the year of the conversion.

[14] By comparison, the survey estimated that about 26% of American households own a traditional IRA.

[15] Similarly, a Fidelity Investments survey of its Roth IRA customers, which also was conducted in early 1998, found that about 40 percent of the individuals establishing Roth IRAs either had not contributed to a traditional IRA within the past three years or had never contributed to an IRA. Furthermore, this group indicated it would not have contributed to an IRA in 1998 had the Roth IRA not been available. Finally, consistent with Institute findings, this survey found that 42 percent of Roth IRA investors were "Generation-Xers." "Fidelity Investments Reports Unprecedented IRA Season: Research Shows Roth IRA Driving Sales Volume," Bloomberg Business Wire, April 16, 1998.

[16] R.G. Wuelfing & Associates, Marketplace Updates, unpublished presentation, November 1998.

In brief, although information is anecdotal at this time, it consistently points to the success of the Roth IRA program and provides an important sign that, although still in its infancy, the Roth IRA attracts new savers and new retirement savings.

3. SIMPLE Plan Formation Remains Strong Among The Smallest of The Nation's Employers

Congress established the SIMPLE plan program in the Small Business Job Protection Act of 1996 to make available a simple, easy to use, low-cost retirement plan for the nation's smallest employers, i.e., those with less than 100 employees.[17] The Institute has found a continued pattern of strong small employer interest in SIMPLE plans over the program's two-year history. Available data[18] demonstrates two things. First, the SIMPLE plan has been especially popular with the nation's smallest employers. Institute surveys have indicated that about 90% of those employers establishing SIMPLE plans had 10 or fewer employees. Employers with 25 or fewer employees constitute nearly the entire market.[19] These figures have remained constant across two informal Institute polls, one identifying SIMPLE plan formation as of July 31, 1997 and the other identifying SIMPLE plan formation as of December 31, 1997 and March 31, 1998.

Second, data from this informal polling and more limited year-end 1998 information suggests that new SIMPLE plan formation has continued unabated in the second year of its availability. A comparison of available, firm-specific data indicates that there has not been any decline in the rate at which small employers are establishing SIMPLE plans and, in fact, suggests an increase in the rate of plan formation. For instance, although our poll was not intended to produce scientific estimates, the number of plans reported between year-end 1997 and first quarter 1998 increased over 45 percent; the number of accounts increased by over 60 percent.

More specifically, one firm had almost 10,000 SIMPLE plans and 47,000 SIMPLE accounts as of December 31, 1997. This increased by about 50 percent over the next quarter to about 14,000 plans and 72,000 accounts. By year-end 1998, the firm had an estimated 23,000 SIMPLE plans and 219,000 accounts. Thus, over one year the number of SIMPLE plans had more than doubled and the number of SIMPLE accounts had more than quadrupled. Other firms for which data is available demonstrate similar growth. For instance, for six mutual fund groups reporting year-end 1997 and year-end 1998 data, SIMPLE assets increased four times over the year. An Employee Benefit Research Institute study published in October 1998 similarly demonstrates the effectiveness of the SIMPLE, finding that 12% of small employers with a defined contribution plan report having established a SIMPLE plan over a period of less than 2 years. By comparison, only 9% of small employers surveyed sponsored a SEP, a program that has been available since 1979.[20]

The success of the SIMPLE program is extremely significant, because the lack of retirement plan coverage in the small employer population has been stubbornly nonresponsive to previous policy initiatives and industry efforts. Under 20 percent of employers with less than 100 employees provide a retirement plan for their employees, as compared to about 84 percent of employers with 100 or more employees.[21] Among the reasons for this discrepancy are that small businesses often have limited resources to identify appropriate retirement plan products and to establish and manage these plans.[22]

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[17] The Savings Incentive Match Plan For Employees (SIMPLE) is a salary reduction plan under which employees may choose to make salary reduction contributions of up to $6,000 annually. Employers are required to provide either a specific matching or nonelective contribution for eligible employees. The SIMPLE plan, which typically is formed by establishing IRAs for each employee, entails none of the complex nondiscrimination rules, including top-heavy rules, that are associated with traditional salary reduction plans, such as the 401(k). Additionally, reporting and administrative requirements are minimized, making the plan less administratively burdensome for small employers to maintain.

[18] The Institute is currently compiling comprehensive year-end 1998 data on SIMPLEs and will provide the Committee with that information when it becomes available.

[19] Institute informal survey results suggest that SIMPLE plan formation is negligible for employers of more than 25 employees.

[20] Paul Yakoboski and Pamela Ostuw, "Small Employers and the Challenge of Sponsoring a Retirement Plan: Results of the 1998 Small Employer Retirement Survey," EBRI Issue Brief No. 202 (Employee Benefit Research Institute, October 1998).

[21] EBRI Databook on Employee Benefits (4th edition), Employee Benefit Research Institute (1997).

[22] One recent survey found that 35% of small employers who do not sponsor retirement plans cited the high cost of establishing and administering plans as a major reason why they do not sponsor a retirement plan. Similarly, 35% said there are too many government regulations, and 27% said retirement plans require too much paperwork. Employee Benefit Research Institute, 1998 Small Employer Retirement Survey.

The SIMPLE plan appears to be the solution for many of our smallest employers, because it is easy to explain to employers and employees and inexpensive to establish and maintain. Indeed, simplicity is the key to the SIMPLE's success. That should be kept in mind as Congress reevaluates the complex eligibility requirements for IRA and Roth IRA participation under current law.

C. LEGISLATIVE INITIATIVES WOULD INCREASE RETIREMENT SAVINGS OPPORTUNITIES

1. Restore The Simple, Universal IRA

We fully endorse proposals in the "Retirement Savings Opportunity Act of 1999" that would simplify the IRA rules by restoring the universal IRA through the elimination of the income limitations on deductibility and substantially raising the income limit applied to Roth IRA conversions. These changes will result in more individuals being eligible for deductible and Roth IRAs. More importantly, these changes will raise participation among those already eligible, but not participating in these programs.

The IRA's extremely complex eligibility rules continue to be a source of confusion for many Americans and a significant deterrent to program participation. Notwithstanding the success of Roth and traditional IRAs, we believe that the IRA program would be much more effective—even among those now eligible—if these complicated rules were eliminated and the Roth and deductible IRAs were made universally available. Our long experience with the IRA and the SIMPLE teach that saving incentives work best if the rules are simple and consistent.

The original deductible IRA, established in 1974, was available to individuals not covered by an employer-sponsored retirement plan. When Congress introduced universal deductible IRAs in 1982 for all wage earners, IRA contributions grew, rising from less than $4 billion in 1980 to approximately $38 billion in both 1985 and 1986. Remarkably, at the IRA's peak in 1986, about 29% of all families with a head of household under age 65 had IRA accounts, and 75% of all IRA contributions were from families with annual incomes less than $50,000.[23] Moreover, the median income of those making IRA contributions (expressed in 1984 dollars) dropped by 24 percent, i.e., from over $41,000 in 1982 to below $29,000 in 1986.[24] Thus, it is clear that the simple, universal IRA program increasingly was reaching middle-class Americans, and in our view would have continued to do so.

When Congress restricted the deductibility of IRA contributions in the Tax Reform Act of 1986, the level of IRA contributions fell sharply and never recovered. For example, contributions fell to $15 billion in 1987 and $8.6 billion in 1996.[25] As a result of the 1986 restrictions, many families no longer are able to deduct their IRA contributions, and many may deduct only a portion of their contributions. Even among those families retaining eligibility to fully deduct IRA contributions, IRA participation declined on average by 40% between 1986 and 1987, despite the fact that the change in law did not technically affect them.[26]

The lesson is clear. The universal IRA worked, but confusing rules can undermine even the powerful incentive of deductibility. When the tax rules are not simple, individuals are confused. A few years ago, American Century Investments surveyed 534 "savers" with respect to the rules governing IRAs. The survey found that "changes in eligibility, contribution levels and tax deductibility have left a majority of retirement investors confused."[27]Simply put, individuals, even eligible individuals, stop investing when a savings vehicle cannot be easily explained and readily understood.

The IRA program's complexities continue to undermine its effectiveness. The IRS Publication 590, which explains the IRA program rules to lay persons, now has 82 pages, up from 12 pages in 1981. The numerous income limitations within the IRA program, which are different for the deductible IRA, the nondeductible IRA, the con-

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[23] Venti, Steven F., "Promoting Savings for Retirement Security," Testimony prepared for the Senate Finance Subcommittee on Deficits, Debt Management and Long-Term Growth (December 7, 1994).

[24] Hubbard, R. Glenn and Skinner, Jonathan, "The Effectiveness of Savings Incentives: A Review of the Evidence" (January 19, 1995).

[25] Internal Revenue Service, Statistics of Income.

[26] Venti, supra at note 23.

[27] American Century Investments asked survey participants, who were self-described "saver," ten general questions regarding IRAs. One-half of them did not understand the current income limitation rules or the interplay of other retirement vehicles with IRA eligibility. "American Century Discovers IRA Confusion," Investor Business Daily (March 17, 1997). Similarly, even expansive changes in IRA eligibility rules, when approached in piecemeal fashion, require a threshold public education effort and often generate confusion. See, e.g., Crenshaw, Albert B., "A Taxing Set of New Rules Covers IRA Contributions," The Washington Post (March 16, 1997) (describing 1996 legislation enabling non-working spouses to contribute $2,000 to an IRA beginning in tax year 1997).

tributory Roth IRA and the conversion Roth IRA, are extremely confusing for lay people and undermine the ability of financial institutions to effectively explain the various types of IRAs to consumers.

The "Retirement Savings Opportunity Act of 1999" solves this problem by restoring the universal IRA. We strongly support this measure.

2. Adjust The IRA Contribution Limit For Inflation

The Institute endorses the proposal in the bill to raise the IRA contribution limit to $5,000 and to index future increases for inflation. (Similarly, the Institute endorses proposals in the bill that would permit individuals to defer more income into employer-sponsored retirement plans, including 401(k)s, SIMPLEs and 403(b)s.)

Personal saving, including saving through the IRA program, is a core component of this nation's retirement income security policy and plays an important role in assuring that individuals have adequate levels of income when they retire. Congress should assure, therefore, that meaningful contribution amounts can be put aside in the IRA program.

Unfortunately, the real value of IRAs has declined significantly over time. The IRA's initial annual contribution limit was set in 1974 at $1,500 and increased to its current $2,000 level in 1981—eighteen years ago. If adjusted for inflation, the $1,500 IRA of 1974 would be about $5,000 today. The failure of the value of the IRA to keep pace with inflation has disabled many Americans, especially those with no employer-sponsored plan alternative,[28] from accumulating retirement savings that they will need to have a secure retirement.

Moreover, of those individuals actively contributing to an IRA in 1997, the median contribution was close to the $2,000 maximum.[29] This suggests that if the limit were raised, many individuals would take advantage of it.

3. Adopt Catch-Up Rules For IRAs And 401(k)s

Many Americans cannot always take full advantage of the IRA and employer-sponsored retirement saving programs for which they may be eligible. In particular, many Americans find it difficult to save for the long-term goal of retirement income security when they have more pressing financial obligations, including purchasing a home, raising a family and providing college education for their children. Additionally, because of the demands of child-rearing, individuals often leave the workforce for extended periods. All these circumstances reflect the need to create a "catch-up" rule for employer-sponsored plans and IRAs whereby individuals age 50 and older can increase their annual contributions. The idea is to allow individuals who may have been unable to save during their early working years to "catch up" for lost time during their remaining working years.

The catch-up proposal is an excellent idea, because it responds directly to the needs of today's workforce and the actual savings pattern of many Americans. The laws governing retirement saving vehicles must be flexible enough to permit working Americans to make additional retirement contributions when they can afford it. The bill contains such a provision, which the Institute strongly supports. Importantly, the proposal is commendable in that it provides a simple rule that will be easy to understand and administer.

D. CONCLUSION

Today's targeted individual retirement vehicles, such as IRAs and 401(k) plans, help millions of Americans secure their future retirement through long-term investment. The new Roth IRA program is extremely popular. It has encouraged younger individuals, who have never before contributed to IRAs, to begin to accumulate personal retirement savings. Moreover, the successful appeal of the Roth IRA appears to have also had a positive effect on traditional IRA participation. Similarly, the IRA-based SIMPLE plan continues to be successful among the nation's smallest employers. The SIMPLE has been successful because it is easy to explain, simple to establish, and inexpensive to maintain.

Lessons learned from the SIMPLE's success and from the impact of complex eligibility limitations on all IRAs should encourage Congress to eliminate these confusing rules in order to encourage IRA participation. In addition, IRA contribution limits should be adjusted to keep pace with inflation and reflect the fact that the average IRA contribution is now close to the maximum limit. Adjusting this and

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[28] For many individuals, the IRA is the only available retirement saving program: only about two-thirds of IRA owners have defined contribution plans and less than one-half participate in a defined benefit plan. Investment Company Institute Household Tracking Study, May 1998 (unpublished).

[29] Investment Company Institute Household Tracking Study, May 1998 (unpublished).

other similar retirement plan limits will encourage individuals to save adequately. Finally, Congress should enact a "catch-up" rule that would respond directly to the needs of today's Americans.

We are pleased that the "Retirement Savings Opportunity Act of 1999" contains all of the foregoing provisions, and we therefore enthusiastically support its enactment.

INVESTMENT COMPANY INSTITUTE

MATTHEW P. FINK
PRESIDENT

March 19, 1999

Hon. William V. Roth, Jr.
Chairman, Committee on Finance
Room 219
Dirksen Senate Office Building
U. S. Senate
Washington, DC 20510

Dear Senator Roth:

I am writing in response to a March 1 letter in which Committee Tax Counsel asked two questions that you did not have the opportunity to ask at the February 24 hearing on retirement savings vehicles. The first question concerned the nature of current educational efforts to assist individuals in determining how to invest their retirement savings. The second addressed the use of technology in the administration of 401(k) plans.

Investor Education

Both the Institute and its members actively seek to assure that individuals investing in mutual funds – whether retail or retirement plan investors – understand the fundamentals of investing and the nature of market risk.

Member Activity. Many mutual fund companies provide substantial educational programs for retirement plan participants. Often these programs take the form of group meetings at workplaces. Other programs are in the form of interactive software available on computer disc or at company websites, or are available as part of paper-based retirement planning and education "kits." Similar programs and materials are available for individuals investing or considering investing in one of the IRA programs.

Typically, these programs and materials are designed to help individuals determine the retirement vehicles they may be eligible for; explain the fundamental principles of long-term investing, including dollar-cost averaging; and help individuals to identify their investment time horizon, personal risk profile and asset allocation preferences. Many programs also include "calculators" that help people to estimate the savings they will need for retirement and develop an appropriate investment strategy.

In addition to materials, programs and websites targeted specifically to 401(k) participants or IRA investors, many mutual fund company websites offer more general information and guidance covering areas such as planning for retirement, retirement plan issues that arise when changing jobs, and financial issues that individuals should consider when entering retirement.

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Institute Activity. The Institute has long supported the full disclosure of relevant, material information to all shareholders, including retirement plan investors. Most recently, the Institute has supported the recent Security and Exchange Commission's (SEC) "plain English" prospectus and fund profile initiatives. The Institute also is an original sponsor of and active participant in the SEC's Investor Town Meeting program, and will be participating in the SEC's Saving and Investing Week (April 25-May 1), which will target students and retirement plan participants. The Institute participated in the first of three National Summits on Retirement Savings in June, 1998, and is a charter partner of the American Savings Education Council (ASEC), an organization the purpose of which is to increase public awareness of the importance of retirement saving. Many Institute members also are members of ASEC.

Additionally, the Institute publishes educational brochures for investors. These include, for example, a guide to understanding mutual funds and a brochure explaining the nature of mutual fund fees and expenses. The Institute also posts these publications and related information on our public website. With specific regard to retirement savings and investment, the Institute plans to publish this year a brochure on retirement savings vehicles.

The Institute also played a key role in seeking Department of Labor guidance, issued in 1996, that clarified the extent to which employers and plan service providers may provide investment-related "education" to plan participants without the provision of such information giving rise to liability concerns under the Employee Retirement Income Security Act (ERISA). As a result of that guidance and market demand, there has been a substantial increase in the amount and quality of educational materials and programs -- including software-based programs -- available to retirement plan participants. We have also provided assistance to the Department in the development of a DOL information booklet describing 401(k) plan fees. Under current DOL guidance, not all investment products are required to automatically disclose all relevant fees to plan participants. The Institute has raised this issue with the Department and, additionally, has been working with the Department to develop an easy-to-use form which employers that sponsor 401(k) plans or that are considering establishing a plan can use to identify 401(k) plan services and the fees that are paid for them.

The Institute also is engaged in on-going research on investment choices made by retirement plan participants. Together with the Employee Benefit Research Institute (EBRI), we have assembled a database that includes information from more than 6.6 million 401(k) plan participant accounts and 27,000 plans. This is an on-going, multi-year project that will examine participants' asset allocation behavior and will hopefully provide information that can be used when identifying the role of educational programs and materials in assisting participants in their investment decisions. We have attached a copy of the initial paper based on project data.

The Use of Technology In 401(k) Plans

Service providers, including Institute members, increasingly use advanced technologies in the administration of 401(k) plans. These technologies include voice response systems ("VRS"), electronic mail ("e-mail") and websites. Using these technologies, plan participants can obtain significant information about their retirement plan and access to (or request paper copies of) plan literature, such as descriptions of a plan's investment and distribution options,

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summary plan descriptions ("SPDs") and prospectuses for a plan's mutual fund investment options. In addition to using these technologies to request and receive plan-related information, plan participants can use VRS, e-mail and website technology to enroll in their employer's plan, make salary deferral, contribution and investment elections, change prior elections, request loans or distributions, and obtain account statements and information regarding recent activity in their accounts. For example, participants are able to easily confirm that recent contributions were properly credited to their accounts.

These technologies have proven to be efficient, secure and accurate and, thus, beneficial to retirement plan investors. All indications are that such technologies are popular with both employers sponsoring plans and employees participating in plans.

Section 1510 of the Taxpayer Relief Act of 1997 directed the Department of the Treasury and Department of Labor to issue guidance that would both facilitate the implementation of technologies in plan administration and assure that plan participants remained adequately protected. Both agencies have issued proposed guidance that would clarify that certain statutory notices, elections and consents may be provided via VRU, internet, or other electronic media. Such guidance, when finalized, will facilitate increasing use of these technologies, much to the benefit of plan participants.

Your letter asked if there are legal changes that might be made to increase the availability of technological advances to retirement plan participants. One such issue concerns IRA account establishment. IRAs, despite being vehicles created under federal tax law, are formed as custodial or trust agreements under state law. Many states have yet to recognize the validity of electronic signatures. Thus, it can be difficult for investors to establish an IRA account on-line. Federal legislation could resolve this issue in a manner that could result in increased IRA formation. For example, legislation clarifying that IRAs could be opened via the Internet would enable individuals to open an IRA immediately after reviewing IRA or retirement savings information on a financial institution website. Similarly, a 401(k) participant who is terminating employment with his or her employer and making distribution decisions "on-line" might want to immediately roll the 401(k) account assets directly into a new IRA. Enabling legislation, thus, would facilitate the preservation of retirement assets, benefit portability and retirement asset management.

Respectfully,

Matthew P. Fink

December 3, 1998

Investment Company Institute
Statement on Social Security Reform

The Investment Company Institute is the national association of the American investment company industry. Its mutual fund members have assets of about $4.5 trillion, accounting for approximately 95% of total industry assets, and have over 62 million shareholders. About 35% of these assets under management are held in retirement savings vehicles, including Individual Retirement Accounts (IRAs), 403(b) accounts and 401(k) plans.

The nation's retirement income policy rests on three programs – the Social Security system, individual savings (including traditional and Roth IRAs) and employer-sponsored retirement plans. These programs are designed to work in concert to enable Americans to enjoy a reasonable standard of living in retirement. Lawmakers should continue this three-pillar approach, ensure that each program continues to be effective and consider ways to increase the effectiveness and reach of each program. Assuring that Americans have available all necessary tools and avenues to save for their retirement is especially important in light of our nation's changing demographic profile. As a result of increases in longevity coupled with the aging of the baby boom generation, it is vital that the retirement needs of the population be adequately addressed.

The number one goal of lawmakers should be to ensure the long-term health of Social Security. The program's status as a universal system should be maintained, because it assures a floor benefit to the many Americans who have not had the benefit of an employer-sponsored retirement plan nor the ability to accrue substantial individual savings. Moreover, the restoration of fiscal soundness and fairness will renew Americans' faith and support of the program.

Many Social Security reform proposals would include an "individual savings account" component. Among the reasons offered in support of such an approach are that it would (1) increase the benefit the system could deliver to many individuals, and (2) introduce many individuals to the basic principles of savings and investing, which could have positive effects on the two remaining retirement income program -- individual savings and employer-sponsored plans.

If lawmakers determine that individual accounts contribute to the overall fiscal stability of the Social Security system and to improved retirement income and thus includes them as part of Social Security reform, they also should ensure that appropriate investor protections, similar to those found in the securities laws, are put in place. In addition, many participants in the Social Security system may have little or no experience with long-term investing. Thus, the creation of an individual account program needs to be preceded and accompanied by a significant public education campaign about the principles of investing, markets and risks, and product disclosure.

To assure an orderly transition to a new system, all individuals upon entering the system should first have their individual accounts invested in a government-sponsored fund or funds.[1] At some designated point in time, however, individuals should be given the option of electing investments in addition to government-run funds.[2] There are several reasons why this is an important feature. First, and perhaps most importantly, the additional choices will enable participants to select investments that meet their own objectives, taking into account factors such as age, income, and risk tolerance. Second, in the absence of such an option, government-managed pools quickly would become extremely large and, as a result, have unintended impact on the markets. Third, private managers would compete against the government funds on cost, performance and service, thus improving the system. Fourth, many private managers already have well-established infrastructure to handle similar accounts. It is important that the system be designed at the outset to accommodate privately managed accounts and that additional legislative or regulatory action not be required to permit them as options.

Finally, in considering Social Security reform in the context of improving retirement security, lawmakers also should assure that the other retirement programs are expanded and the rules governing them are simplified. The success of these programs, such as IRAs and employer-sponsored plans, will reduce the strains placed on Social Security. Enhancing these programs would be even more important if lawmakers determine not to establish an individual account component to Social Security.

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[1] Such a system, might, for instance, be modeled upon the Federal Thrift Savings Plan, which offers a limited number of government-managed investment options.

[2] Such an option could be made available after, for example, an individual has participated in the system for a specified number of years, has worked for a specific number of consecutive quarters, or has accumulated a specific minimum dollar amount in his or her account.

INVESTMENT COMPANY INSTITUTE

MATTHEW P. FINK
PRESIDENT

March 15, 1999

The Honorable Daniel Patrick Moynihan
United States Senate
464 Russell Senate Office Building
Washington, DC 20510

Dear Senator Moynihan:

At the Finance Committee's February 24 hearing on retirement savings issues, you requested that we provide you with a letter addressing retirement savings opportunities for Americans with modest incomes. You asked generally how such Americans could most effectively be encouraged to save for retirement. More specifically, you asked about the feasibility of establishing accounts for individuals in a new program.

Encouraging Americans to save for retirement is an important public policy objective. The mutual fund industry has been extremely successful at providing middle-class Americans with the opportunity to participate in the capital markets and invest their savings. The median annual income of the typical household that owns mutual fund shares is $55,000. Many moderate and lower income households typically save and invest in mutual funds through retirement plan programs.

Current Programs

Current programs, such as the IRA and 401(k) programs are successful in encouraging moderate and lower-income individuals to accumulate retirement savings. For instance, 52% of IRA owners, according to 1993 data, had incomes of less than $50,000. Similarly, about 80% of eligible employees participate in their 401(k) plans at work. Furthermore, according to Employee Benefit Research Institute testimony, employer-matching contributions provide a powerful incentive for lower-earning participants to increase their contribution rates up to the maximum amount matched. In short, currently available retirement programs have been successful in encouraging Americans of all income levels to save for retirement.

Nonetheless, more can be done to increase the success of these programs. The simpler the rules and more universal the program, the more effective it is. As we stated in our testimony, when the deductible IRA was available to all Americans, it was attracting increasing numbers of Americans at modest income levels. **Between 1982 and 1986, the median income of those making IRA contributions dropped by 24 percent, from over $41,000 to below $29,000 (measured in 1984 dollars). With the introduction of complicated eligibility rules, IRA participation declined among those families who**

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actually retained eligibility by about 40% between 1986 and 1987, despite the fact that the change in law did not technically affect them. We attribute this drop solely to the confusion surrounding the change in the law. It is our strong view that the IRA remains the single best opportunity outside the workplace to encourage lower and middle-income people to save. Our more recent experience with the SIMPLE plan, discussed in our testimony, provides a similar lesson – simplicity works.

Education About Retirement Savings Opportunities

Education remains an important factor in IRA and 401(k) plan participation. The intensive education campaign conducted by financial services organizations about the Roth IRA substantially raised the public's awareness of the Roth IRA and of IRAs in general. As a result, early indications are that all IRA activity has increased. This was also the case in the early years of the universal IRA. Similarly, studies have indicated that employers that provide retirement planning and investment education to their employees (or hire financial services institutions to do so) increase plan participation and contribution rates and positively affect investment allocation behavior.

These programs, of course, do not provide a complete solution to the retirement savings problem, but they certainly can be a bigger part of the solution if legislation is designed bearing in mind the cornerstone principles of universality and simplicity.

Personal Savings Accounts In Social Security

You also asked more specifically about proposals that would enable individuals to establish separate accounts with either a small portion of current FICA taxes or outside of the Social Security system. The priority of Congress should be to assure the fiscal soundness of the Social Security program. We can well understand why the Congress might wish to consider individual investment accounts within social security, which could hold the promise of producing higher retirement income for participants. As you consider whether or not to include an individual account program in which individuals direct investments, a number of issues would need to be addressed. I will mention three: market risk; education; and administrative feasibility.

- Understanding Market Risk. First, if Congress were to decide to provide all Americans the opportunity to establish an individual retirement savings account, it must do so fully aware of the market risk assumed by each individual. Markets go up and down, and the 20% returns of the last several years should not be regarded as "normal." The historical average hovers near 11%. While that is better than that which is earned today by the social security trust fund's investment in U.S. Treasury bonds, no one – neither policy makers nor individuals – should have unrealistic expectations about account investment returns and their subsequent impact on retirement security.

  Likewise, even in a situation where there is limited investment choice, individuals will make different investment decisions that will impact on their overall return. Although historical data suggests that over long periods of time the stock market offers higher returns than other investment alternatives, there is

no guarantee of better returns for each individual. Congress should ensure that individuals understand this aspect of individual account investing. The government should not be in the precarious political position of being required, at some point in time, to guarantee a certain return on account investments. This brings us to our second point.

- Education. As we stated at the hearing, a program with millions of novice investors must begin with education about the markets, asset allocation, risk, and investment product costs. Because of this concern, we have suggested that individuals initially participate in a uniform investment program with limited investment options, similar to the federal Thrift Savings Plan program. After a few years of investment experience, however, individuals who voluntary choose to do so should be able to move their account balance into a privately managed environment. (We have attached a more complete description of our general position, which was prepared for the White House's December summit on social security reform.)

- Administrative Feasibility. There remains the question of administrative feasibility. Building an administrative system to manage millions of small accounts is certainly technologically feasible. Determining economic feasibility, however, is difficult because it depends on many different factors and parameters yet to be established. Two ways to design this program that may result in lower costs are first, to start the program with only limited investment options, as mentioned above, and second, to build on existing processing, procedures and programs. By using regulatory structures already in place, such as existing securities laws and IRA or 401(k) accounts and rules, start-up costs may be minimized and unnecessary duplication avoided.

Respectfully,

Matthew P. Fink
President

Enclosure

CONGRESS SHOULD ENACT WORKING GROUP'S RECOMMENDATIONS

The ERISA Advisory Council on Employee Welfare and Benefit Plans Working Group on Small Business issued its report - How to Enhance and Encourage the Establishment of Pension Plans - on February 8, 1999. **The undersigned organizations urge Congress to enact legislation in the 106th Congress that will implement the recommendations included in the report.** This is a good start to strengthening and expanding small business pension plan participation. We will continue to share additional ideas about encouraging small business pension coverage with Congress.

The ERISA Advisory Council is a statutorily-established entity designed to advise the Secretary of Labor and to submit recommendations regarding the Secretary's functions under ERISA. It consists of 15 members appointed by the Secretary: three representatives of employee organizations (including at least one member representing a multiemployer plan); three representatives of employers; one representative each from the fields of insurance, corporate trust, actuarial counseling, investment counseling, investment management, and accounting; and three representatives of the general public, including one member who represents those receiving benefits from a pension plan. Members are appointed to three-year terms.

The Small Business Working Group conducted four hearings in 1998 that included testimony from eighteen witnesses. The Group's objectives were to evaluate the reasons for the low level of pension coverage in the small business community; make recommendations to the Department of Labor; and suggest a methodology to enhance and encourage the education of workers and employers about the need for greater pension coverage.

The Working Group made the following recommendations. Some are included in one or both of last year's bipartisan pension proposals or in recent Administration proposals.

- ***Repeal of the top-heavy rules*** - The report concluded that the top-heavy rules no longer provide significant protections to employees; are duplicated by subsequent legislation; are an additional and unnecessary cost; and create a perception in the small business community that they are unfairly targeted for pension abuse.

- ***Elimination of user fees*** - Internal Revenue Service fees can constitute a significant cost for small businesses.

- ***Increasing limits on benefits, contributions, and includable compensation*** - The report recommends the restoration of limits that were reduced since the passage of ERISA for revenue-driven, not pension policy, reasons. It noted that the erosion of limits has resulted in the "de-linking" of retirement plans of management from rank-and-file employees; which acts as a disincentive to pension growth.

- ***Develop a national retirement policy*** - The Department of Labor should facilitate and encourage public education programs designed to increase pension saving by American workers.
- ***Coalitions*** - Coalitions should be promoted to offer pooling vehicles for small employers.
- ***Tax Incentives*** - Additional tax incentives should be offered to encourage employers to establish qualified pension plans.
- ***Simplified defined benefit plans*** - The working group restated its 1997 support for creating a simplified defined benefit plan for small businesses.

American Council of Life Insurance

American Society of Pension Actuaries

Association for Advanced Life Underwriting

Employers Council on Flexible Compensation

National Association of Manufacturers

Profit Sharing/401(k) Council of America

Small Business Council of America

U. S. Chamber of Commerce

PREPARED STATEMENT OF SENATOR ORRIN G. HATCH

Thank you, Mr. Chairman. It is probably an understatement to say that the topic of retirement security is a very important one. The demographics of our country are changing. We are living longer, having fewer children, and watching our work force shrink. The average American today will spend one-third of their lifetime in retirement.

This is not just an American phenomenon. Countries all over the world are finding that the numbers just don't add up anymore. We are standing at the same crossroads and struggling with the same issues: How do we redefine our retirement policies to reflect these new 21st century scenarios?

These new realities are forcing all of us to realize that we may not be able to do things the way we have always done them in the past. But, change is not always bad, and I believe that the future holds great promise if we approach these challenges positively.

The way I see it, our retirement policy of the future hinges on three elements: the public Social Security system, the private pension system, and individual savings. Each of these three elements is an important piece of the puzzle. You cannot discuss changing any one of them without taking into account the effects of the other two.

We have heard a lot lately about reform the Social Security system. Reform of the Social Security system is essential to ensure its long-term solvency; and it is imperative that we soon move beyond talk and into action. Social Security revenues will be insufficient to cover benefits being paid out in the year 2013. This is real—it is not a scare tactic. We must look beyond band-aid measures and accounting gimmicks as a way of addressing these problems. The President's budget does not propose reform that would deal with the core problems of the system.

But the Social Security debate often seems to ignore the bigger picture. Americans need more than just Social Security when they retire. Social Security was designed to be a safety net for retirees, not to set the standard of living for the elderly.

Congress is not the only group that needs to keep in mind that retirement security is more than Social Security; the public must change their habits as well. Social Security is the only source of income for 16 percent of its beneficiaries. It is the major source of income for an additional 66 percent. We cannot approach the broader subject of retirement security with a one-track mind. Our discussion must include the other elements of retirement security as well: private pensions and individual savings. I am glad to see that the Chairman has done just that in this hearing today to examine ways to save for retirement.

The situation out there regarding retirement savings is grave. Polls have found that 30 percent of Americans have not yet started to prepare for retirement in any way; 47 percent of them take a casual approach to retirement savings; and, only 23 percent save systemically for retirement. In a broader sense, we have seen the savings rate fall drastically from 1992, when it was 5.7 percent of income. Now, we find that it is zero.

We cannot ignore the importance of private pensions and individual savings on retirement security. We must all look toward the future and take steps to augment our retirement incomes. In the long run, low U.S. saving and investment rates will inevitably result in a lower growth rate for our economy—and an even greater burden on other forms of retirement unless we can encourage more individual effort.

If we are to find true retirement security for the 21st century, we cannot ignore the second and third legs of this three-legged stool. We must find ways to enhance employers' ability to provide pension and savings plans. And, we must stimulate growth in personal savings, which includes making the American public more aware of the need to plan, save, and invest for retirement.

The witnesses today will be able to give us important and helpful information on the ways that Americans are utilizing the programs currently available and ways that we can improve the rules to make pension saving more attractive and more feasible for Americans. I thank the witnesses who have taken time to be here today and look forward to their testimony.

PREPARED STATEMENT OF JOHN MCCORMACK, JR.

Good morning Mr. Chairman, Senator Moynihan and Members of the Committee. I am John McCormack, President at TIAA-CREF. Founded in 1918, TIAA is a non-profit life insurance company offering annuities and insurance products. CREF is a companion organization, which issues variable annuities and manages mutual funds. Together they manage over $249 billion in assets. As the nation's largest pri-

vate retirement funding system, TIAA-CREF provides pension savings products to almost two million educational employees and pays retirement income benefits to almost 300,000 retirees. Most of these individuals participate in defined contribution plans that operate under Section 403(b) of the Internal Revenue Code (the Code).

I am pleased to testify at this hearing and help explain how this long-standing section of the tax code has helped individuals who work for the colleges, schools, hospitals and other tax-exempt organizations described in Section 501(c)(3) of the Code to achieve an adequate retirement income. The American Council on Education, College and University Personnel Association and the National Association of College and University Business Officers join TIAA-CREF in support of our statement. Over twenty-five years ago, the senior Republican Senator from New York, Senator Jacob Javits cited TIAA-CREF as a role model in testimony before he introduced ERISA. Senator Javits said:

> "We need to learn something from the success of the college teachers retirement system—TIAA-CREF—which would be a real model for private industry."

Like the educators we serve, TIAA-CREF continues to learn how to make retirement more financially secure. We commend you for holding this hearing to explore the success that employer-sponsored pension plans already have achieved, as well as your leadership in introducing a pension bill that builds on what already works well. Americans will face a number of demographic challenges as baby boomers start to retire. Now is the time to set bold, new goals for increased retirement savings.

403(B) PLANS WORK FOR EMPLOYEES IN EDUCATION

First, let me share some data on who are the participants in 403(b) plans and how both types of 403(b) plans operate. For many decades, the education community has achieved remarkable success in expanding pension coverage using 403(b) annuity contracts for both employer-sponsored retirement plans and employee voluntary pre-tax retirement savings. These plans are important to more than six million employees, many of whom rely upon 403(b) annuities as their primary source of retirement income. At the end of 1997, more than 33,000 organizations (20,000 of which had less than 100 employees) sponsored a 403(b) plan and nationwide these pension plans held assets of $422 billion.

An analysis of April 1993 Current Population Survey Data indicates that 95% of the full-time employees who work in higher education have the option of participating in a retirement plan. 403(b) retirement plans together with public retirement systems are responsible for this significant achievement. This high rate of pension availability and coverage helps improve the overall pension coverage rate for women. Women comprise a majority (54%) of TIAA-CREF's participants, who are mostly from the higher education community. While I do not have data on the exact percentages of employees in the public K-12 sector who save their own funds in 403(b) annuities, over and above their public teacher's retirement system benefits, 74.4% of the public K-12 workforce are females. The education sector accounts for 60% of all 403(b) plans and 70% of all 403(b) participants.

403(b) plans play a dual role working as defined contribution money purchase basic retirement plans, as well as encouraging employees to contribute their own additional savings for retirement. The higher education community has a long-established goal for an adequate retirement plan together with Social Security—replacing two-thirds of pre-retirement income on an inflation protected basis—which is set forth in a joint statement of principles by the American Association of University Professors (AAUP) and the American Association of Colleges and Universities (AAC&U). To reach this benchmark, higher education institutions make substantial contributions (most do at least 10% of compensation) to their employees' 403(b) plans and, in fact, many of the colleges pay the full cost of these plans. About one-third of the educational employers sponsor a contributory pension plan with a dollar-for-dollar employer matching contribution available in the large majority of such plans. Also, employees can make additional voluntary contributions to 403(b) annuities by salary reduction within limits provided in the tax code.

According to the 1998-1999 AAUP Salary Survey, the average faculty salary across all types of institutions and ranks was $56,282. Based on our survey research panel data, 59% of our participants have household incomes under $75,000. The average retirement contribution to a participant's TIAA-CREF annuity from their basic pension plan during 1998 was $5,866. TIAA-CREF's Supplemental Retirement Annuities (SRA) exclusively fund voluntary employee additional tax-deferred savings and had an average premium during 1998 of $4,538. The average accumulation in these two types of accounts by year end 1998 equaled $99,500 for the retirement annuities and $39,000 for SRA products.

Immediate vesting of both employer and employee contributions, available to almost all 403(b) plans, encourages full pension portability. This concept of portability remains a cornerstone of TIAA-CREF as it has been since 1918. Another long-standing principle TIAA-CREF espouses is the importance of a guaranteed lifetime income for participants. 403(b) plans both basic retirement plans and voluntary tax-deferred plans provide annuities as the primary form of benefit. Each year, TIAA-CREF sends a projection of retirement income to all two million participants which helps them to focus on retirement throughout their careers. In 1998, 79% of those individuals starting to draw out an income from their contracts chose a lifetime income option.

LIMIT ON CONTRIBUTIONS TO 403(B) PLANS

The amount that can be contributed to a 403(b) annuity was a complex calculation in 1958 when the Congress created the maximum exclusion allowance (MEA) under Section 403(b) of the Code. The underlying concept looks at pension contributions over the span of a career with an employer. The MEA formula allows an individual to tax defer 20% of compensation multiplied by years of service less prior contributions to a retirement plan. When Congress crafted ERISA in 1974, it introduced Section 415 of the Code and added to the MEA calculation an annual limit on contributions of 25% of compensation or $25,000. Over the next 20 years, Congress changed the pension law several more times often adding more restrictions over and above the MEA and the Section 415 calculations.

For example, Congress established a new limit on employee before-tax contributions in the 1986 tax act under Section 402(g) of the Code. In recognition of the long-standing nature of 403(b) plans and reliance of the educators on the old limits, Congress froze their 402(g) limit at $9,500. Only when the indexed amount for 401(k) plans exceeded $9,500 two years ago did this limit increased to $10,000 and now both limits will increase together. In 1986, because of the career perspective built into the 403(b) exclusion allowance, Congress also created a 402(g) catch-up option which applied to employees who had completed 15 years of service allowing them the potential of adding $3,000 more pre-tax dollars to their retirement savings in a year, but no more than $15,000 overall.

I may have confused you by now. From our experience with our participants, I know this happens. In fact, that is why financial providers like TIAA-CREF assume a large share of the administrative burdens, such as preparing what we call tax-deferred annuity (TDA) calculations to help participants under the 403(b) plan limits. In fact, working with colleges, universities, schools and other organizations TIAA-CREF has created a broad array of financial education for participants to help them understand not just the MEA calculation, but more importantly, the benefits of pre-tax savings, compounding of interest, and investment diversification. The success of this educational effort is evidenced by the three-fold growth (over the last ten years) in the numbers of participants who are making voluntary contributions to Supplemental Retirement Annuities (SRAs). Also, our investment educational efforts are showing good results. A study completed by two economists, Zvi Bodie and Dwight Crane, rated the investment decisions and the asset allocation selections of our participants on a par with professional money managers.

THE "RETIREMENT SAVINGS OPPORTUNITY ACT" WILL INCREASE SAVINGS

Americans know that they need to save for retirement, but getting started can be a challenge. Your "Retirement Savings Opportunity Act of 1999" represents an important step forward. Having spent many years helping participants and plan administrators understand the complex changes made to their retirement plans that often reduced their savings opportunities, we look forward to explaining the new and greater opportunities your bill provides. Starting to defrost the contribution limits on pension plans should take the chill off our national savings rate. Increasing the contribution limit for IRAs is long overdue, since it has remained at $2,000 since 1974.

Since others will cover the bill's IRA proposals, I will focus my comments on those aspects of the bill that will have a special impact for 403(b) plans. Your pension bill creates an additional way for employees to make their contributions to their 403(b) retirement plans, in a manner similar to the tax treatment for Roth IRAs. This choice is a good one, especially for lower paid employees who can choose to pay the tax on their pension savings and receive their retirement income tax free. Creating this new option will broaden the appeal of saving in a 403(b) plan. For those currently saving, it provides the opportunity to save the same amount, pay tax on their contribution now and generate more net retirement income later.

As mentioned earlier, Congress allowed a small catch-up contribution to continue in 403(b) plans after 1986. Since the opportunity to use the catch-up election is restricted to only employees with at least 15 years of service, and since these contributions cannot exceed a total of $15,000, there is only a small group who can utilize the option. Additionally, the 15 years of service requirement tends to make the catch-up option less available to women who frequently move in and out of the work force. We believe the proposal to create a new broadly available retirement savings catch-up provision is good pension policy. Your catch-up option will be much easier to administer than the more limited one currently available under 403(b) plans. Using an age requirement means that all employees can eventually try to make up for years earlier in their career when they could not make or afford contributions to their retirement plans. Importantly, your proposal also recognizes that lost earnings are required to make individuals whole. For example, a fifty-year-old who wanted to make up for a missed $2,000 contribution when he or she was age 30, would have to contribute over $9,000 to make up lost investment earnings at an 8% rate over the twenty-year period.

Over the years, changes in the tax code have pushed these dollar limits down and kept them at low levels. TIAA-CREF participants experienced this first hand when the $9,500 cap on employee tax-deferred savings was imposed in 1987. In 1986, the average annual voluntary tax deferred contribution to our SRA accounts was $4,272. When compared to the 1997 amount of $4,583, average SRA premiums have not risen in real dollars, due in large part to the dampening effect of the $9,500 cap. Increasing the dollar limit under Section 402(g) to $15,000 from its current $10,000 amount should have a positive impact on savings.

Another important change in your bill that could help workers and families save more for retirement are the proposed changes that would eliminate the Section 415 limit that is based on 25% of compensation and correspondingly repeal the maximum exclusion allowance. For many lower paid individuals, these limits restrict the dollar amount of their retirement savings at levels well below the current $10,000 cap. Consider the teacher in an independent school (or public K-12) earning $30,000. If this is a second income in the household he, or more likely she, may be able to save more than the $7,500 which represents 25% of compensation. In fact, if this woman was returning to teach after staying home to care for her children, the 403(b) maximum exclusion allowance would impose an even lower percentage limit. In general, the multiple layering of limits on top of the MEA calculation has restricted the amount of pre-tax elective contributions at a level much lower than the MEA amount and repealing the maximum exclusion allowance would greatly simplify the administration and record keeping needed in 403(b) plans.

CONCLUSION

403(b) plans provide educators and others who work for tax exempt organizations adequate income. The pension reforms contained in the "Retirement Savings Opportunity Act" should further expand retirement savings for educators and all Americans.

Teachers Insurance and Annuity Association
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John J. McCormack, Jr.
President
TIAA-CREF Enterprises
(212) 490-9000

March 17, 1999

The Honorable William V. Roth, Jr.
United States Senate
Committee on Finance
219 Senate Dirksen Office Building
Washington, DC 20510-6200

Dear Chairman Roth:

Thank you for the opportunity at the Senate Finance Committee hearing on February 24th to share TIAA-CREF's views on how 403(b) plans can help increase the nation's savings rate. I am pleased to respond to the Committee's follow-up questions.

While financial education has always been an important task for TIAA-CREF, over the last decade we have greatly expanded our efforts to encourage participants to save — in employer-sponsored retirement plans and tax-deferred annuities — and to invest wisely for their long-term retirement needs. Today we use a variety of tools, techniques and media to carry out our financial education mission. In format, publications range from one-page stuffers, to single topic pamphlets, to newsletters for participants and plan administrators and special reports covering key issues. TIAA-CREF materials cover topics such as investment options, calculations of retirement income needs, and explanations of various tax issues. These educational efforts are supported by group seminars and one-on-one counseling by TIAA-CREF employees and TIAA-CREF uses technology to deliver information and service that our participants rate as superior.

As I mentioned in my written statement, two outside economists — Zvi Bodie and Dwight Crane — evaluated the investment behavior of TIAA-CREF participants. Their detailed analysis looked at TIAA-CREF participants' asset allocation choices based on age and net worth and compared their investment behavior with the recommendations financial experts would make to individuals. Their conclusion, published in an article (copy attached) from *Financial Analysts Journal*, November/December 1997:

> "that the TIAA-CREF respondents, on average, appear to follow the generally accepted investment principles recommended by experts. Although TIAA-CREF participants are probably better informed and more experienced at making their own investment choices than the general population, our findings suggest that, given enough education, information, and experience, people will tend to manage their self-directed investment accounts in an appropriate manner."

shows that TIAA-CREF's financial education efforts are effective. While we cannot protect participants from the volatility of the stock market, we help them understand the various

components of risk and access their level of risk tolerance so they find the right, long-term balance between the financial gains available in the stock market and market risk.

A key aspect of Bodie and Crane's assertions about financial education concerns what is enough. TIAA-CREF provides an impressive amount of education on saving and investing. Our experience suggests that effective investment education targets all levels of sophistication. Our goal is to convince our participants to save enough to ensure an adequate retirement income and our message focuses on four key concepts:

- Start participating in your employer's retirement plan as early as possible to take full advantage of compounding.
- Appropriately allocate your assets to achieve a long-term rate of return.
- Preserve your pension assets for retirement and roll over any lump sum distributions, and
- Supplement your pension with personal savings.

Print materials guarantee that a consistent message is delivered to all participants. Research from the Employee Benefit Research Institute (EBRI) suggests that employees read the financial education materials provided to them through their employer's plan. According to the results of EBRI's retirement confidence survey, workers often take an investment action after learning more about saving and investing from employer provided education: 43% changed their allocation; 43% changed their contributions and 41% started to contribute. Attached to this letter are examples of how TIAA-CREF communicates to participants. They include:

- Enrollment materials include a booklet on *Building Your Portfolio with TIAA-CREF* which helps participants understand diversification, investment risk and how to put it all together with model investment portfolios. *The Guide to Your Personal Finances* covers how to save, building risk tolerance into asset allocation and the Roth IRA.
- We mail our quarterly *Participant* magazine to two million participants. The August 1998 *Participant* featured two articles on checking asset allocation to help individuals respond to the stock market volatility. Our Fall 1998 *Investment Forum* covered this topic in more detail and featured a discussion by two noted economists on using bond investments in tax-deferred accounts.
- TIAA-CREF Annuity Benefit Report enables each participant to annually evaluate their benefit adequacy and investment strategy with a personalized projection of future retirement income. These illustrations help participants understand how inflation may impact their retirement savings since they illustrate benefits under inflation adaptive payouts.

- Statement stuffers, such as the enclosed "Five Principles of Investing that Experts Use Every Day," are one-page information pieces that convey targeted messages.

- We use advertisements to build on these key messages, such as the "Please Check Your Asset Allocation Seat Belt" advitorial and special inserts in newspapers that reach our target market.

- Also, TIAA-CREF has hosted a nationwide satellite teleconference in each of the last three years. Our Reaching Your Financial Goals broadcast occurred last October and reached 50,000 viewers in live audiences at almost 1,000 sites. It featured noted financial experts, including Jane Bryant Quinn. 27 local and educational TV stations downlinked the broadcast and TIAA-CREF subsequently distributed over 2,000 video tapes of the show.

TIAA-CREF supports these efforts with a human dimension of service. Our community seminars enable TIAA-CREF to deliver face-to-face investment education to our participants. At the same time, we offer plan administrators support in explaining their pension plans to employees through the Financial Education Series (FES), toll free telephone response centers, one-on-one counseling, and videos. We use technology to expand these efforts with financial planning software and Web-based education and transaction capabilities. Let me share with you some information on the magnitude of these services.

- During 1998, TIAA-CREF consultants conducted 5,475 group seminars using our Financial Education Series (FES) at 1,462 institutions. Over 168,000 people attended these FES seminars which focused on the four key financial education concepts. The programs feature visual aids and engage the audience with various support materials. 96% of the attendees surveyed by Roper Starch Worldwide (Roper) reported that the program met their expectations. More than half changed or planned to change their financial behavior as a result of participating in the FES seminar.

- The Telephone Counseling Centers responded to 1.7 million calls over the course of the last year. About 70% of these calls related to saving for retirement, investment choices or retirement benefit projections. In addition, TIAA-CREF's Automated Telephone Service (ATS) extends our customer service to cover 24 hours a day, seven days a week. In 1998, calls to our ATS hit a record high of 3.9 million and 70% of ATS callers surveyed by Roper rated the quality of this service as excellent. Checking accumulations was the most popular reason for calling ATS.

- Since TIAA-CREF introduced asset allocation guidance for retirement savings in 1997, we have expanded the principles and model portfolios to also cover mutual funds and IRA products. Participants answer questions designed to identify risk tolerance. After their investment preferences are evaluated using a software application, a suitable investment portfolio for each individual is recommended.

These model portfolios provide an appropriate balance between the potential growth in equities and the certainty of a guaranteed account. The investment education software is used by our consultants either on the telephone or in person at meetings on campus. The participant receives a report on the recommended portfolios with a letter of explanation.

- TIAA-CREF *At Your Service* plays an increasingly important role in our education and customer service efforts. With more than 200,000 different individuals signing on every month, the TIAA-CREF Web site is already being used as much as the long-established ATS system. The financial educational dimension of the Web site is multifaceted. Individuals can obtain from the home page the same information available in most of our publications. They can also use special programs like our new IRA calculator, test their retirement planning knowledge, listen to audio clips from our teleconferences, and download software for a retirement savings game. The menu on the Web is ever changing and we can now use the home page to schedule counseling appointments and seminars. You can find our Web site at www.tiaa-cref.org if you want to see how it works first hand.

This array of financial education has resulted in a gradual shift in the investment allocation patterns of TIAA-CREF participants. As you can see from Table 2, our participants have gradually shifted their asset allocation patterns putting a greater focus on equity investments. In 1986, 66% of our participants allocated at least 50% or more to equities while in 1998, 70% of participants allocated at least half of their contributions to equities with over a quarter choosing a 100% allocation to the stock market. Looking at the allocation patterns by age groups shows that younger investors have higher equity allocations recognizing that over their longer time horizon they can ride out swings in the stock market.

I described above how TIAA-CREF uses technology to support our financial education efforts. In response to your second question, we have also integrated technology into the administration of our retirement products. Through our corporate workflow system, all requests are processed electronically. Incoming mail and calls generate electronic files that phone counselors can access at any time to check on progress. Also, the Inter/Act area of our Web site enables participants to access their account balances and transfer among investment funds via the internet. We offer a number of administrative services to our plan administrators through a direct Interface system. For tax-deferred annuity plans, we provide software to prepare maximum exclusion allowance calculations and we do numerous institution-wide calculations to determine how much employees can contribute.

A large number of our participants have access to the internet at home or at work and those who have used our Inter/Act system rate our effective use of technology as 9.16 on a scale of 1-10 (highest). As with the ATS, checking on accumulation is its most popular use and 45% of surveyed respondents use Inter/Act to transfer among funds or change investment allocations. Many of those individuals surveyed choose Inter/Act over calling or writing because they find it convenient and easy to use.

Financial education is a crucial service component our participants expect from TIAA-CREF. As you can tell from this letter and materials attached, we have made a firm commitment to delivering financial education as part of all of our products. Over time, these efforts have yielded positive results — increased savings and appropriate investment selections.

Please let me or Diane Oakley (at 202-637-8915) know if you have any questions about these materials. We will both be happy to answer them.

Sincerely,

President
TIAA-CREF Enterprises

Enclosure

List of Attachments to John McCormack's Response:

- Article by Bodie and Crane from Financial Analysts Journal, November/December 1997
- Building Your Portfolio with TIAA-CREF
- The Guide to Your Personal Finances
- Participant (August 1998)
- Investment Forum (Fall 1998)
- Five Principles of Investing that Experts Use Every Day
- Please Check Your Asset Allocation Seat Belt — advertisement
- Reaching Your Financial Goals — video and kit
- Test Your Retirement Savings Knowledge game board from the TIAA-CREF Web site
- Table 2: Premium Allocations to TIAA and CREF Accounts, 1986-1998
- Table 4: Premium Allocations by Age, 1997 and 1998
- Communications Guide

PREPARED STATEMENT OF RAY POOL

Good morning, Mr. Chairman, and members of the committee.

My name is Ray Pool. I am the Administrator of the Oklahoma State Employees Deferred Compensation Program.

I am here to today as chairman of the National Association of Government Deferred Compensation Administrators' (NAGDCA) Legislative Committee. With me are John Barry, Assistant Attorney General for the State of Maryland and NAGDCA board member, and Susan White, NAGDCA's Legislative Counsel.

NAGDCA commends you Mr. Chairman, on your recently introduced legislation to raise annual contribution limits for public and private employee retirement plans. We also thank you and the committee for your efforts to enhance public retirement plans over the last several years. Most notably, you passed legislation in 1996, as part of the small business/minimum wage bill (SBJPA), that protected over $75 billion in employee assets in State and local government 457 programs. The SBJPA of 1996 required that 457 assets be placed in trust for the exclusive benefit of participants. This was an important and necessary safeguard against municipal bankruptcy or other work place disruptions.

You have also passed other key measures that have enhanced retirement plans for millions of public employees across the country. We have been pleased to have the opportunity to work with you and your staff, who have always been extremely knowledgeable and accessible.

NAGDCA represents 48 States and State plans. These States have, under their auspices, over 5,000 local government deferred compensation plans. NAGDCA also represents approximately 100 industrial members such as insurance and annuity companies, mutual fund companies, brokerage firms and money managers. Both the public and private sector members of NAGDCA work together to improve governmental retirement plans through sharing of information on investments, marketing and administration.

Our members administer State and local government plans that are regulated under section 457 of the Internal Revenue Code (IRC). These plans, which supplement State and local defined benefit programs, provide a convenient vehicle for public employees across the country to save for retirement. In all cases, full time employees of the entity offering the plan are eligible to participate. (And in many cases, part time employees are eligible to participate.) A snapshot of membership would show that social workers, road crew workers—all the way to the Governor—participate.

Governmental 457 plans are fully funded because employees contribute a portion of their salary into these deferred compensation plans. In a limited number of cases States also make contributions through a match. States also design and implement educational programs aimed at increasing employee contributions to these supplemental plans. Over the past nine years plan assets have nearly quadrupled.

In short, 457 deferred compensation participants have taken the responsibility to provide additional retirement income for themselves and for their families.

The 1986 Tax Reform Act prohibited States and local governments from offering 401(k) plans. However, the act grandfathered those plans already in existence. Ten States and numerous local governments have 401(k) plans, in addition to 457 plans. These plans differ in several ways which I will summarize shortly. I would first like to mention some important measures that can be taken to enhance these deferred compensation plans, while maintaining their basic structures.

In addition to your recently introduced legislation, Mr. Chairman, which would increase the maximum contribution limits for public and private plans, NAGDCA supports the following changes to allow for portability of plans between employers, simplification of the administration of public plans, and the enhancement of overall retirement savings for employees nationwide:

- allow for rollovers between public and private sector defined contribution plans, including 457, 401(k), 403(b), 401(a) plans and IRA's upon separation from service;
- allow for indexation of catch-up provisions for any plan that currently has a catch-up option;
- simplify the calculation for determining the maximum contribution limit for 457 plans;
- allow public employees to purchase service credits with any of their defined contribution plan dollars;
- implement less restrictive rules for 457 retirement plans to allow employees to change the time and amount of their retirement payments. For example, a 457 retiree elects to receive $250 a month. Under current law they are prohibited from changing that amount, even in the event of changing life circumstances—

such as an increase in insurance premiums. In comparison, 401(k) and other retirees can adjust their distributions at any time. NAGDCA supports this change that would put government workers on a more equal footing with employees in the private sector.

In closing, NAGDCA would like to emphasize that:

The rules for various governmental compensation plans are different. As money begins to move more freely from plan to plan, employees must understand the differences between the plans and how their dollars may be affected. for example, 457 money is virtually impossible to access prior to retirement. Hardship withdrawal provisions require that an employee experience an "unforeseen or unbudgetable event" in order to withdraw funds prior to retirement. 401(k) plans with loans and less restrictive hardship rules, generally provide easier access to retirement money than do 457 plans.

Additionally, there is no early retirement penalty for 457 plans. An employee must simply retire to begin taking distributions. However, there is a 10% Federal excise tax penalty if a participant withdraws 401(k) or other plan money prior to age 59-1/2. Firefighters and police, who are major 457 plan participants, typically retire well before 59-1/2. Any possibility of an early distribution penalty tax should only depend on whether they choose to roll their money into an IRA or 401(k) plan.

NAGDCA continues to encourage public workers everywhere to take responsibility for their future by participating in deferred compensation plans. The enhancements that your bill provides, along with other measures that are under consideration, should move us toward this goal.

Thank you for the opportunity to testify today.

I would be pleased to answer any questions from the committee.

Prepared Statement of Peter J. Smail

I. INTRODUCTION

Mr. Chairman, Senator Moynihan and other distinguished members of the Finance Committee, I am Peter Smail, President of Fidelity Institutional Retirement Services Company, a division of Fidelity Investments. Fidelity Investments is the nation's largest mutual fund company with over $700 billion in assets under management and is also the nation's largest 401(k) plan provider administering over $340 billion in retirement assets representing over 5 million 401(k) plan participants.

Today, I am presenting testimony on behalf of the Association of Private Pension and Welfare Plans, a public policy organization representing principally Fortune 500 companies and other organizations that assist plan sponsors in providing benefits to employees. APPWP's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

It is a pleasure and honor for me to testify before you today on the success of employer-sponsored retirement plans.

Retirement income adequacy depends on three sources: Social Security, individual savings, and employer-sponsored plans. The wide range of employer-sponsored plans ensures income security for America's retirees and provides much of the capital to fuel our economy. Today, however, I am focusing my testimony on 401(k) plans, which are working exceptionally well for millions of Americans. We applaud Chairman Roth for preparing a bill that helps the employer-based retirement system, especially 401 (k) plans, keep pace with our aging population.

II. 401(K) PLANS TODAY

401(k) plans were created by Congress in 1978. Today, over $1 trillion is invested in 401(k) plans by over 25 million participants.[1] This is projected to grow to $1.9 trillion by the year 2002.[2]

Today, 79 percent of all eligible employees participate in their employers' 401(k) plan. This is up from 62 percent in 1985. For 401(k) plans administered by Fidelity, the participation rate is 82 percent.

Contributions to 401(k) plans are growing at impressive rates. The average contribution is about 7.1 percent of pay.[3] Looking more closely at the numbers, we find

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[1] Spectrem Group © 1998.
[2] *Ibid.*
[3] EBRI Databook on Employee Benefits, 4th cd., 1997.

that 32 percent of 401(k) participants contribute more than 10 percent of pay and another 29 percent contribute 6 to 9 percent of pay.[4]

As you might expect, the overall size of 401(k) account balances varies primarily by age. For 401(k) plans administered by Fidelity, the average account balance for participants of all ages and length of service is $52,000. According to a recently released Employee Benefit Research Institute and Investment Company Institute study of 1996 data, 401(k) plan participants in their sixties with over 30 years of service have an average account balance of over $156,000.[5]

III. WHY 401(K) PLANS WORK—SUCCESS FACTORS

401(k) plans work well for several reasons:

- *Tax Incentive*: Employees are motivated to save by the tax-deferred feature of contributions and earnings in 401(k) plans.
- *Portability*: Today's workers can be expected to change jobs five to seven times during their work life. 401(k) plans allow employees to take their benefits with them from job to job and consolidate them into a 401(k) plan with a new employer or into an individual retirement account. This type of portability is not available from traditional defined benefit plans.
- *Employer Role*: Employers provide three very important services that translate into higher savings in 401(k) plans.
  - *Administrative Efficiency*: Employers collect employee contributions to the 401(k) plan through payroll withholding. It's painless and seamless. In fact, 79 percent of Americans prefer to save through payroll deduction as opposed to saving on their own.[6]
  - *Investor Education*: Employers often provide customized investment education materials to 401(k) plan participants. These materials are critical in educating workers on the importance of saving and on how to invest. In fact, 86 percent of workers expect their employers to provide descriptions of their investment options including information on how well investments have done.[7]
  - *Trust and Confidence*: Employees trust their employers to administer their retirement plan correctly and safeguard their assets. A recent study indicates that employees have greater trust in their employers on retirement planning matters than in any other source.[8]
- *Plan Features*: Employees enjoy the benefits of plan features such as a choice among several diversified investment options, daily valuation of their accounts and access to their accounts through toll-free 800 numbers.

IV. IMPROVEMENTS ARE NECESSARY

Chairman Roth, the legislation you are preparing will build on the success of today's 401 (k) plans and provide more Americans with the opportunity to save for retirement. For example, your bill recognizes that saving enough for retirement will be a particular challenge for the baby boomers. Millions of baby boomers are in their 50's and some are now "empty-nesters." Many have depleted their savings raising children and sending them to college, and now want to catch-up on their retirement savings. These people need the opportunity to make larger retirement plan contributions. The current rules prevent this. In plans that Fidelity administers, one-third of all 401(k) participants are at least age 50. Mr. Chairman, your 401(k) "catch-up" proposal, which APPWP has long supported, would remedy this problem. Under the bill, workers over age 50 would be permitted to contribute an extra $7,500 per year to their 401(k) plan.

In addition, we believe the repeal of the law limiting 401(k) contributions to 25 percent of a worker's pay, as proposed by Senators Grassley, Graham, Roth and others would give middle income families the ability to maximize their 401(k) contributions. Many Americans cannot contribute the 401(k) maximum of $10,000 because their contributions, when added to their employer's contributions, exceed 25 percent of their pay. When this happens, their own 401(k) retirement contributions are cut back.

[4] Spectrem Group © 1998.
[5] EBRI/ICI Participant Directed Retirement Plan Data Collection Project, 1999.
[6] Public Agenda, Promises to Keep • 1994.
[7] EBRI Retirement Confidence Survey, 1998.
[8] Public Agenda, *supra*.

APPWP also believes your proposal to increase the savings limits for 401(k) plans will provide an added incentive for small business owners to offer a retirement plan for the first time.[9]

We would also encourage you, Mr. Chairman, to work with a bipartisan group of Members led by Senators Graham, Grassley and Hatch to incorporate proposals they have advanced to enhance pension portability, streamline a number of onerous pension rules, and modify the minimum contribution requirement on small plans—the so called "top heavy" rules. The top-heavy rules in particular preclude many small employers from offering retirement plans. Combining the Roth and bipartisan Members proposals offers a truly comprehensive agenda to strengthen our nation's employer-provided retirement system.

This concludes my testimony and I thank you for the opportunity to be here. I request that my written statement be included in the record.

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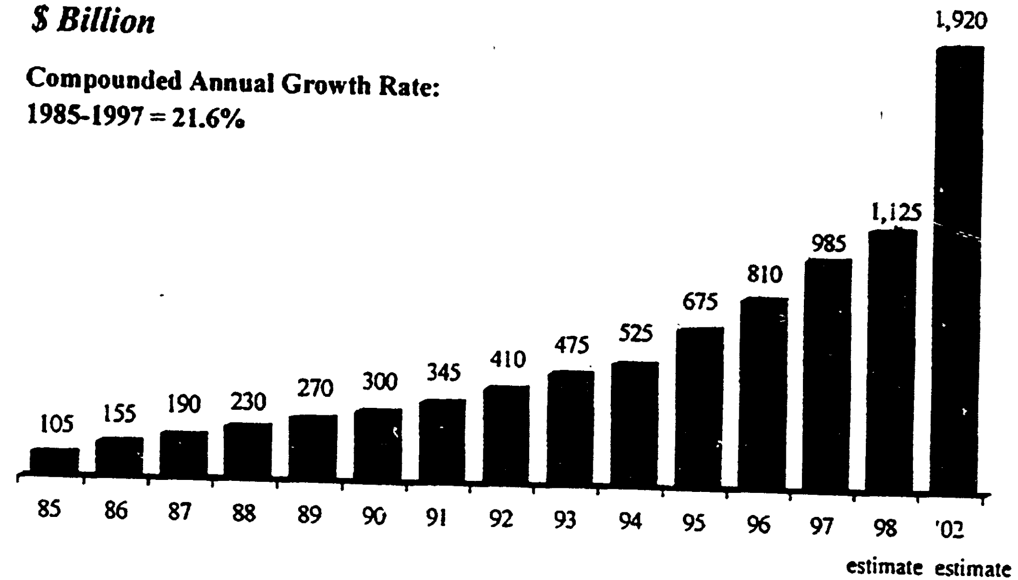
[9] Senator Roth's proposed legislation will include several proposals set forth in APPWP's Marcdh 1997 report, "Preparing for the Future: The Road to an Improved Employer-Based Retirement System."

Growth of U.S. 401(k) Market

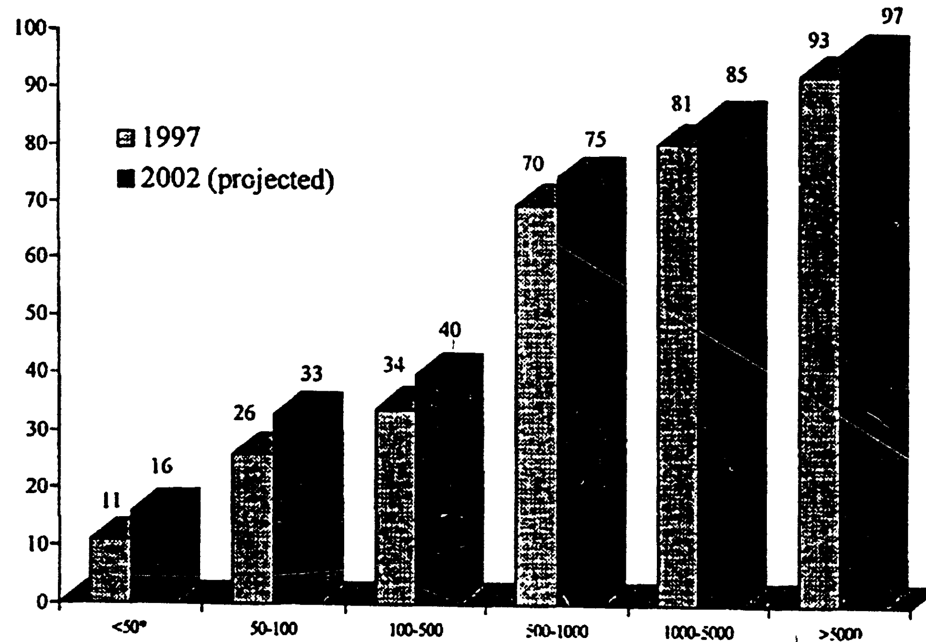


Source: Spectrem Group© 1998

401(k) Sponsorship by Employer Size

% of Companies with a 401(k) Plan

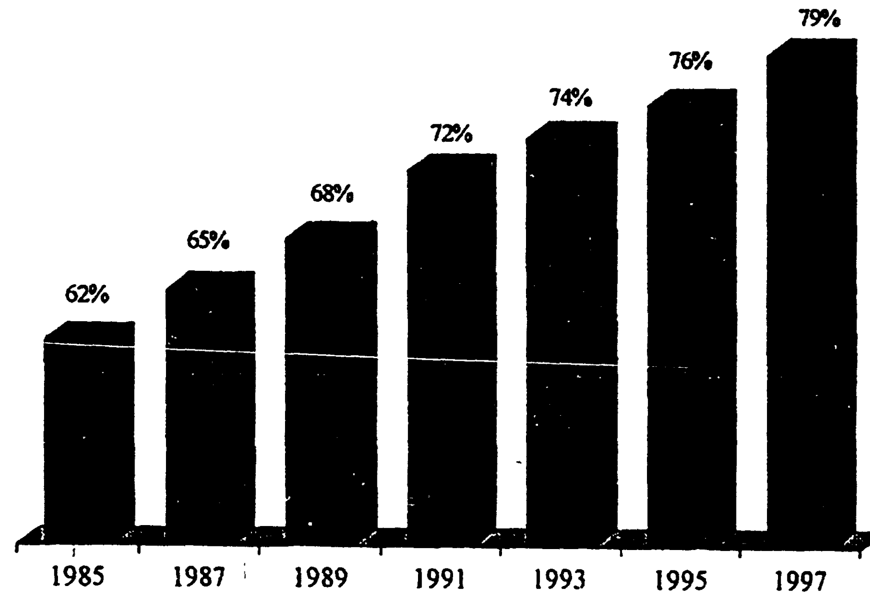
Percent



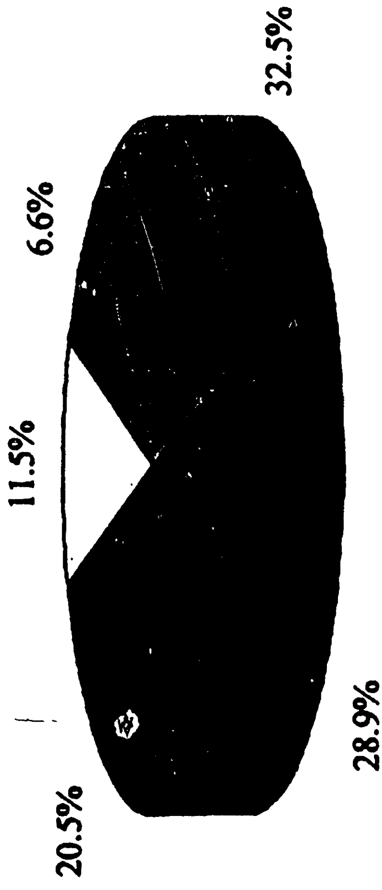
*** Includes companies with five or more employees**

Source: Spectrem Group© 1998

Average 401(k) Participation Rates



Source: Spectrem Group© 1998



PREPARED STATEMENT OF G. JOSEPH VOTAVA, JR.

Mr. Chairman and members of the committee, my name is Joe Votava and I serve as volunteer president of the International Association for Financial Planning (IAFP). I am also an attorney, CPA, and Certified Financial Planner licensee managing a financial planning practice at the law firm of Nixon, Hargrave, Devans &

Doyle in Rochester, New York. Thank you for this opportunity to testify on savings and investment issues.

IAFP is the nation's oldest and largest organization of professionals who believe the financial planning process is the foundation for smart decision making. Our organization comprises more than 17,000 individuals and institutions that use this process to help over 1.5 million clients achieve their life goals, which normally include long-term savings for retirement. What's more, we are dedicated to the idea that objective, professional advice supports successful financial planning.

IAFP strongly supports incentives which encourage Americans to increase their personal savings. We believe that:

- public policy should enhance opportunities for Americans to meet their financial goals through their own initiative and prudence;
- tax and economic policy should promote savings, investment, capital formation and a vigorous free enterprise system.

Our organization regularly conducts studies of Americans' attitudes and concerns about financial matters, and has found that retirement planning is one of the most misunderstood needs of most families. Far too few are investing sufficient dollars to secure their retirement. This is true, in part, because of the current limits on contributions to tax-deferred vehicles, limits that are often well below the amount many people should be saving to retire comfortably.

This problem is exacerbated by the confusion over the many rules and restrictions governing the diverse vehicles currently available for retirement planning. As traditional pension plans have given way to a variety of self-funded plans, financial advisers have seen that clients at all income levels are uncertain of how best to invest for retirement. These clients want to know: How much should they save? What are the differences between the various IRAs? What are the contribution limits? Can they save through an employer-sponsored plan and also an IRA? What are the risks and opportunities for the investment options available through their 401(k)s?

We understand that Senator Roth plans to introduce legislation that would address some of these problems. We also understand that this legislation would eliminate restrictions on participation in and contributions to IRAs, Roth IRAs, 401(k) plans and other retirement savings options. IAFP strongly supports such changes as a much-needed catalyst for individuals to begin to save more of their own earnings.

IAFP is also concerned about the high percentage of Americans who appear to be overconfident about their preparedness for retirement. Our recent studies suggest that most people who say they are confident of their ability to support themselves in retirement have not done the planning necessary to know whether their current rate of saving is sufficient—especially in view of the many expenses that can reduce the savings of middle-age adults as they approach retirement, such as children's college education or the long-term care of a parent or other loved one. It would only take a short stay in a nursing home to consume many Americans' retirement savings.

Today, the challenge of retirement planning is also underscored by the fact that our retirement years are likely to be dramatically longer than were our parents'. This is true not only because we are living longer, but also because so many of us hope to retire earlier. One recent IAFP study, conducted by the Wirthlin Group, found that more than 70 percent of Americans with household incomes of at least $30,000 expect to retire before the traditional retirement age of 65.

The same study found that even among families that say they have planned financially for retirement, only 44 percent of those with children under age 18 are saving for their children's education. More important, fewer than one in every 10 Americans with at least $30,000 in household income have developed a comprehensive, goal-oriented financial plan—either with the help of a financial adviser or on their own. These findings suggest that millions of Americans have worthy financial goals but are not taking the steps required to achieve them.

While employer-sponsored plans, like the 401(k), make it easy to save for retirement through payroll deductions, too few Americans understand the vital importance of financial planning to realistically determine the amount of savings and types of investments that will help them achieve their life goals. Financial advisers find that many people see their participation in a 401(k) as equivalent to enrollment in the employer pension plans of the past. But in most cases, the amount they are currently saving is grossly inadequate to meet their retirement lifestyle needs.

The International Association for Financial Planning is convinced that every American needs to understand that Planning Pays Off. The right approach to planning, aided by practical initiatives like those proposed by Senator Roth, will go a long way toward preparing this and future generations for a more secure retirement. Thank you.

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April 5, 1999

William V. Roth, Jr., Chairman
United States Senate
Committee on Finance
Washington, D.C. 20510-6200

RE: Response to Question from Hearing - 2/24/99

Dear Chairman Roth:

Thank you for allowing me to testify before your committee on the issues of savings and investment strategies to increase retirement savings. There is no question in my mind that the American public is woefully underprepared to meet that challenge. Additional legislation aimed at resolving this problem, such as your proposed legislation, would help provide a much needed catalyst for individuals to begin to save more of their own earnings.

In response to your follow-up question regarding the opportunity for individuals to make increased contributions to their tax-deferred retirement accounts after they attain age 50, there are very good reasons for doing so. There is no question that individuals who have accomplished the task of paying off their home mortgage, and in many cases college tuition, find that they finally have excess income which could be saved for retirement. At the same time, however, their income tax deductions for mortgage interest and exemptions for dependents are no longer available in their tax equation, and thus they pay a higher rate of tax on this excess income, leaving less real dollars to be saved. Allowing these individuals the opportunity to increase their savings through tax-deferred vehicles would certainly help.

In my experience, tax incentives for savings are carefully considered by taxpayers and are often the primary motivating reason for setting funds aside. Unfortunately, not all Americans have considered what their retirement picture will look like, and absent that knowledge, will not understand the importance of increasing savings. By providing incentives which they will consider each year, more will be saved. The structure of the retirement accounts, which limit distributions until retirement age, help protect these funds in a way not possible with regular savings accounts.

I do not believe that increased limits for savings in these tax-deferred plans should be limited only to those returning to the work force or to an amount which could have been

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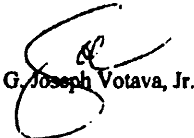
contributed in earlier years but was not for various reasons. As a practical matter, this would introduce more complexity into the tax code than is warranted. The fact patterns involving those who "have worked part time" and are "returning to the work force" would be difficult to analyze and apply with certainty. Accounting for the different annual limits, and the amounts actually set aside, to determine the carryforward available balance would require a burdensome recordkeeping regime.

Simplicity would argue for an expansion of the limits of the existing tax-deferred retirement plans for all individuals. Perhaps there could be different limits at different ages, but anything more complex than that would generate more confusion. Your proposals to increase the IRA and 401(k) dollar limits, as well as raising the income caps for participants, would go a long way towards increasing savings and reducing complexity.

I hope these comments assist you with this important work. Your leadership in helping Americans address their retirement savings needs is greatly appreciated and will help strengthen our country for generations to come.

Thank you for the opportunity to assist you in your efforts. Please feel free to contact me at any time for further assistance.

Very truly yours,



G. Joseph Votava, Jr.

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cc: William F. Sweetnam, Jr.
Tax Counsel

PREPARED STATEMENT OF PAUL J. YAKOBOSKI*

SUMMARY

- Are covered workers taking full advantage of the savings opportunity presented by their 401(k) plain? Are they contributing the maximum amount permitted to their 401(k) account? What determines the amount that they do contribute?
- Our research indicates that most workers with a 401(k) plan do not contribute the maximum permitted amount to their plan. At the same time, our research provides stark evidence of the effect that plan features (such as matching provisions) and legal limits can have on workers' decisions regarding their level of contribution to a plan.
- Findings indicate that older workers tend to have their contributions constrained by maximum limits (plan or legal), probably because they tend to be more focused on retirement and thus more likely to contribute at higher levels. Many younger workers recognize the value of the employer match, contributing just enough to take full advantage of that plan feature—but no more.
- As an example, in one plan studied, the younger the participant, the more likely he or she was to contribute just enough to receive the full company match avail-

*The views expressed in this statement are solely those of the author and should not be attributed to the Employee Benefit Research Institute, or the EBRI Education and Research Fund, its officers, trustees, sponsors, or other staff, or to the EBRI–ERF American Savings Education Council. The Employee Benefit Research Institute is a nonprofit, nonpartisan, public policy research organization which does not lobby or take positions on legislative proposals.

able. Close to 30 percent of workers in their 20s in the plan contributed this amount, compared with 21 percent for those in their 40s and 10 percent for those 60 and older. At the same time, as ages increased, there was a sizable increase in the proportion of participants "maxing out" in their contribution rate. Forty-one percent of participants ages 20 to 39 contributed the maximum amount permissible, compared with 44 percent of participants in their 40s, 58 percent for those in their 50s, and 63 percent for participants ages 60 and older.

- Plan features also appear to interact with worker earnings in determining contribution rates. Lower-earning participants are more likely to contribute the maximum amount that is matched, taking advantage of all the "free" employer money that is available. Higher earners are more likely to contribute the maximum amount allowed by the plan or the tax code.
- These findings indicate that while legal and plan-specific contribution limits do not constrain most plan participants, they do constrain the amount that some individuals (particularly older and higher-earning individuals) actually save for retirement through their 401(k) plan at a point when many are just focusing on the need to save.
- The average account balance (net of plan loans) for all 401(k) participants is $37,323, and the median balance is $11,600 (1996 data). Reported account balances do not reflect additional retirement savings held in predecessor plans or rolled over into individual retirement accounts (IRAs). Nor do the balances indicate what savings would be in a "mature" 401(k) plan program.
- Nearly one-half of the participants have account balances with their current employer of less than $10,000, while nearly 10 percent have balances in excess of $100,000. Those individuals with balances less than $10,000 are primarily young workers or workers with short tenure with their current employer. In contrast, those with balances in excess of $100,000 are older workers with long tenure. Approximately one out of every four participants in his or her 60s had an account balance with the current employer in excess of $100,000. Similarly, approximately 31 percent of workers with 20 or more years of tenure with their current employer had account balances in excess of $100,000.

Mr. Chairman and members of the Committee:

I am pleased to appear before you this morning to discuss issues regarding worker saving behavior in 401(k) plans, and in particular their contribution levels and account accumulations. My name is Paul Yakoboski. I am a senior research associate at the Employee Benefit Research Institute (EBRI), a nonprofit, nonpartisan, public policy research organization based in Washington, DC.

EBRI has been committed, since its founding in 1978, to the accurate statistical analysis of economic security issues. Through our research we strive to contribute to the formulation of effective and responsible health and retirement policies. Consistent with our mission, we do not lobby or advocate specific policy recommendations. I ask that my full statement and attachments be entered into the written record.

CONTRIBUTION LEVELS IN 401(K) PLANS

EBRI has analyzed the contribution levels in three large 401(k) plans that had approximately 200,000 participants combined. These plans were sponsored by IBM, AT&T, and New York Life for their employees, and all have employer matching provisions to encourage employees to participate and contribute. There are constraints placed on employees' maximum contribution levels, set by both the specific plan and federal law.[1] These plans also have well-developed educational programs designed to assist workers in making appropriate decisions regarding their participation in a 401(k) plan.

COMPANY A

The maximum contribution allowed under the Company A savings plan was 9 percent of earnings. The match rate in the Company A plan was 30 cents on the dollar for the first 5 percent of earnings that an employee contributed. Company A also had a defined benefit plan in place for its employees.

There were two notable points of cluster in the distribution of contribution rates in the Company A plan: 21 percent of participants contributed 5 percent of pay to the plan and 45 percent contributed 9 percent of pay (table 1). Two different phenomena appear to be at work in determining participant contribution levels in the Company A plan. First, close to one-half of participants appear to have "maxed out" in terms of contributing as much as the plan allowed. Second, one-fifth of workers

appear to have contributed just enough to take full advantage of the company match.

These findings indicate that the rates at which workers decide to contribute to the plan are directly dependent upon and constrained by the specific features of the plan. Furthermore, plan features appear to interact with participant demographic characteristics in determining contribution rates. In the Company A plan, the younger the participant, the more likely he or she was to contribute just enough to receive the full company match available. Close to 30 percent of workers in their 20s contributed 5 percent of earnings to the plan (table 1). The percentage contributing 5 percent of earnings dropped to 21 percent for those in their 40s and to 10 percent for those 60 and older.

Corresponding with this, there was a sizable increase in the proportion of participants "maxing out" in their contribution rate as ages increased. Forty-one percent of participants ages 20-39 contributed 9 percent of earnings to the plan, while 44 percent of participants in their 40s maxed out. This jumped to 58 percent for those in their 50s and 63 percent for participants 60 and older (table 1).

This same relationship also applies to contribution rates and participant earnings. In the Company A plan, lower-earning participants were relatively more likely to contribute the amount corresponding to the maximum match (i.e., 5 percent), than were higher-earners. The percentage of participants contributing 5 percent of pay to the Company A plan decreased steadily from 28 percent of participants earning $10,000-$19,999-13 percent of those earning $100,000 or more (table 1). Correspondingly, higherearners were relatively more likely to max out their contribution at 9 percent than were lower-earners. Twenty-nine percent of participants earning $10,000-$19,999 contributed 9 percent of pay to the plan, and this proportion increased steadily to 60 percent of those earning $75,000-$99,999. Only 13 percent of those earning $100,000 or more contributed the maximum 9 percent of pay allowed by the plan, but this is explained by another constraint faced by plan participants. In 1994, the maximum legal 401(k) pretax employee contribution was $9,240, and 43 percent of Company A plan participants earning $100,000 or more contributed this amount to the plan (table 1). They were therefore also maxing out in terms of their allowable contribution to the plan.

COMPANY B

Highly compensated employees for Company B were allowed to contribute up to 10 percent of salary to the saving plan, and non-highly compensated employees were allowed to contribute a maximum of 15 percent to the plan. Employee contributions were matched by the plan sponsor dollar-for-dollar for the first 3 percent of earnings contributed. Company B also had a defined benefit plan covering its employees. Given that highly compensated employees and non-highly compensated employees faced different contribution constraints, their contribution rates were analyzed separately.

Among non-highly compensated employees participating in the Company B plan, there was again evidence of specific plan features or provisions driving contribution rate decisions. Twenty-one percent of all nonhighly compensated participants contributed 3 percent of pay to the plan (the maximum amount matched by the plan) (table 2). This effect was more likely among younger workers than older workers and it was more likely among lower-earners than among higher-earners, analogous to the Company A findings. Twenty-five percent of participants in their 20s contributed 3 percent of salary, compared with 10 percent of those ages 60 and older. Twenty-seven percent of participants earning $20,000-$29,999 contributed 3 percent, compared with 17 percent of those earning $60,000 or more. Like the Company A findings, there was evidence among non-highly compensated participants in the Company B plan of clustering at the maximum contribution amounts, particularly among older participants. Ten percent of non-highly compensated participants contributed 15 percent of pay (the plan maximum), and essentially no one was constrained by the legal maximum of $9,240 (table 2). While 31 percent of workers in their 60s or older and 22 percent of those in their 50s contributed the maximum allowable of 15 percent, only 3 percent of participants in their 20s did likewise. The fraction of non-highly compensated participants contributing 15 percent increased from 5 percent among those earning $10,000-$19,999, to 15 percent among those earning $50,000-$59,999.

Among highly compensated participants in the Company B plan, there was evidence both of clustering at that maximum match amount (3 percent of pay) and significant clustering at the plan-imposed contribution limit (10 percent of pay) or the legal contribution limit. Twenty-seven percent of highly compensated participants in their 20s and 17 percent of those in their 30s contributed 3 percent of pay to the

plan (table 3). This fell to 3 percent of those ages 60 and older. A noticeably larger fraction of those with earnings under $75,000 also contributed 3 percent to the plan.

Twenty-five percent of all highly compensated plan participants contributed either 10 percent of pay or $9,240 to the plan. Not surprisingly, for highly compensated employees the legal maximum was most often the binding constraint rather than the plan maximum. Fifteen percent contributed $9,240 to the plan and an additional 10 percent contributed 10 percent of pay. Older workers were much more likely to "max out" even among the highly compensated. No participants in their 20s and 15 percent of those in their 30s contributed either 10 percent of pay or the legal maximum of $9,240, compared with 56 percent of those ages 60 and older who were constrained either by the plan limit or the legal limit. Thirty-nine percent of participants earning $100,000 or more were constrained by the legal maximum, while 27 percent of those earning $75,000-$99,999 and 12 percent of those earning less than $75,000 were constrained by the either the plan maximum of 10 percent or the $9,240 legal limit (table 3).

COMPANY C

The maximum contribution allowed under the Company C management plan was 16 percent of compensation. The match rate in the plan at that time was 66-2/3 cents on the dollar for the first 6 percent of earnings that an employee contributed. Participants in this plan are allowed to make pretax contributions to a 401(k) plan as well as contributions to a 401(a) plan that requires after-tax contributions. Although there is a tax differential at the time of contribution for the employee, both types of contributions are eligible for the employer match. Table 4 provides information on 401(k) contributions while table 5 provides similar information for total contributions (both pre- and post-tax). Company C also had a defined benefit plan in place for its employees.

There were four notable points of cluster in the distribution of 401(k) contribution rates in the Company C plan: 16.8 percent made no contributions during the year; 29.6 percent of participants contributed 6 percent of pay to the plan; 6.9 percent contributed 16 percent of pay; and 11.6 percent were limited by the 402(g)(1) maximum limit on 401(k) contributions (table 4). However, when total contributions are analyzed, those who made no contributions drops to 4.0 percent while those who contributed just enough to maximize the employer match increased to 38.4 percent. A total of 8.9 percent of the participants made the maximum combined contribution of 16 percent of compensation (table 5).[2]

Two different phenomena appear to be at work in determining total contribution levels in the Company C plan. First, close to one-fifth of participants appear to have "maxed out" in terms of contributing as much as is allowed by the plan and/or current legal limits. Second, slightly more than one-third of workers appear to have contributed just enough to take full advantage of the company match.

These findings indicate that the rates at which workers decide to contribute to the plan are directly dependent upon and constrained by the specific features of the plan. Furthermore, plan features appear to interact with participant demographic characteristics in determining contribution rates. In the Company C management plan, the younger the participant the more likely he or she was to contribute just enough to receive the full company match available. Over 46 percent of workers in their 20s contributed 6 percent of earnings to the plan (table 5). Those contributing 6 percent of earnings dropped to 37.9 percent for those in their 40s and to 24.7 percent for those 60 and older. Corresponding with this was a sizable increase in the proportion of participants "maxing out" in their contribution rate as ages increased. Less than 11 percent of participants ages 20-49 contributed 16 percent of compensation to the plan. Twelve percent of participants in their 50s maxed out, compared with 21 percent for participants 60 and older (table 5).

The relationship between contribution rates and participant earnings in the Company C management plan is somewhat unique, in that participants earning $40,000-$50,000 annually were relatively more likely to contribute the amount corresponding to the maximum match (i.e., 6 percent), than were either lower- or higher-earners. However, once this threshold level of compensation was obtained, the percentage of participants contributing 6 percent of pay to the Company C management plan decreased steadily from 42.6 percent of participants earning $40,000-$50,000 annually to 25.9 percent of those earning $100,000 or more (table 5).[3]

Higher-earners were relatively more likely to max out their contribution at 16 percent than were lowerearners, until the 402(g)(1) limit becomes binding. Approximately 12 percent of participants earning under $40,000 a year contributed a combined 16 percent of pay to the plan, and this proportion increased steadily to 13.1 percent of those earning $50,000-$59,999 (table 5). Less than 6 percent of those

earning $60,000 or more contributed the maximum 16 percent of pay allowed by the plan. In 1994, the maximum legal 401(k) pretax employee contribution was $9,240, which means that anyone earning in excess of $57,750 a year would be prevented from putting the entire 16 percent of compensation into the 401(k) plan.

IMPLICATIONS

These findings provide stark evidence of the dramatic effect that plan features, i.e., the matching formula and maximum allowable contribution levels, and legal limits can have upon workers when they are deciding how much to contribute to a plan. While most workers do not "max out" with their 401(k) contributions, in the three plans analyzed, 30 percent or more of the participants have their contribution rate directly affected by plan design (maximum matches or contribution limits) or legal limits on contributions.

In addition, these features can affect different workers in different ways. More specifically, participants of differing age and earning levels will respond to different features of the plan (matching formula versus contribution limits) in deciding how much to contribute. Older workers tend to be more focused on retirement and thus are more likely to contribute to a plan at higher levels and are more likely to be constrained by maximum limits (plan or legal). Many younger workers at least recognize the value of the employer match and contribute enough to take full advantage of that plan feature. In fact, the matching formula seems to effectively determine the contribution rate for many participants, particularly younger ones. The maximum contribution limits imposed by the sponsor or the tax code, however, serves to act as a constraint more often for older employees.

Plan features also appear to interact with worker earnings in determining contribution rates. Part of this effect could be attributed to a correlation between earnings and age, i.e., older workers tend to have greater earnings. However, there is also surely a separate effect attributable to earning levels. Lower-earning participant may feel that they cannot afford to contribute the maximum amount allowed by the plan, but they at least want to take advantage of all the "free" employer money that is available and therefore they are more likely to contribute the maximum amount that is matched. Higher-earners likely do not feel as constrained regarding the amount of money they have available to save, and therefore they are more likely to contribute the maximum amount allowed by the plan or the tax code.

The 402(g) limit imposed by law is a binding constraint for some workers that effectively restrains the amount of their earnings that they are able to save for retirement on a tax-deferred basis. It is older, higher-earning participants who are most often constrained by this limit. However, it is precisely at this point in a career, i.e., when one is older and earning levels have risen, that many workers start devoting serious attention to planning and saving for retirement.

ASSET ACCUMULATION IN 401(K) PLANS

EBRI and the Investment Company Institute (ICI) have collaborated in assembling the largest 401(k) database currently available that has detailed information on demographic information, annual contributions, plan balances, asset allocations, and loans. Figures cited in this section are 1996 information on 6.6 million active participants in 27,762 plans holding nearly $246 billion in assets. Measured against the universe of 401(k) plans, the 1996 database accounts for 9 percent of all plans, 18 percent of all participants, and 31 percent of all assets.[4]

The average account balance for all participants in the EBRI/ICI database is $37,323.[5] There is, however, wide variation around the average. For example, 47.2 percent of participants have an account balance of less than $10,000, while 9.8 percent have an account balance in excess of $100,000 (chart 1).

A participant's account balance, and thus the variability across participants, depends upon a number of factors. Some of these are specific to the individual and others reflect features of the plan. At the participant level are income, contribution rate, age, length of plan participation, asset allocation, rollovers from other plans, withdrawals, and borrowings. Plan features include age of the plan and employer contributions. These determinants of account balances complicate the interpretation of average balances.

The relationship between account balances and two of the determinants can be examined using information in the EBRI/ICI database. One of these is participant age and the other is tenure of the participant with employer, which serves as a proxy for length of participation in the plan. Age and account balance should generally be positively related, as younger workers are likely to have either lower incomes or shorter periods of plan participation than older workers. In line with this observation, nearly 60 percent of those participants with account balances less than

$10,000 are in their 20s and 30s, while less than one-fifth are in their 50s or 60s (chart 2). Similarly, of those with account balances greater than $100,000, more than one-half are in their 50s or 60s, while one in 10 are in their 30s and virtually none are in their 20s.

Tenure and plan balances also have a positive association, as long-term employees likely have had a longer period in which to accumulate assets. In fact, nearly 60 percent of those with balances less than $10,000 have five or less years of tenure, and almost 90 percent of those with balances of more than $100,000 have at least 10 years of tenure (chart 3).

The effect of participant age and tenure is revealed more clearly by examining the effect of the interaction of the two variables on account balances. For a given age group, the average balance should increase as tenure increases: A 30-year-old participant, for example, with 10 years of tenure should, on average, have accumulated a larger plan balance than a 30-year-old with two years of tenure. This positive relationship is shown in chart 4, which plots the average account balance by tenure for each age group. The average account balance for each age group increases, almost without exception, as tenure increases. The increase is present for all age groups but is especially large for those in their 50s and 60s. In addition, for each tenure group, the average balance rises with age.

An examination of the distribution of account balances underscores the effects of age and tenure. For example, overall, approximately 85 percent of all participants in their 20s have account balances of less than $10,000 (chart 5). However, only 62 percent of those in their 20s with five to 10 years of tenure have account balances less than $10,000; the remaining balances exceed this figure (chart 6).

The effect of tenure and age is even more pronounced for older workers. For example, 30 percent of those participants in their 60s have account balances less than $10,000 (chart 5). However, among those with short tenure (zero to two years), 77 percent of these older participants have account balances under $10,000 while less than 20 percent of those with long tenure (more than 20 years) are in this range (chart 6). One explanation for the low account balances among this 20 percent may be that their employer's 401(k) plan was only recently established.

Chart 7 shows the effect of age and tenure on account balances for those participants with balances more than $100,000. Although approximately 25 percent of participants in their 60s have account balances in excess of $100,000 (chart 5), less than 10 percent of those with 10 years of tenure or less have account balances of this magnitude. However, more than 30 percent of participants in their 60s with 20-30 years of tenure with their current employer have account balances of this size, and the percentage increases to 43 percent for those with more than 30 years of tenure.[6]

The average balances of older workers with long tenure at one employer indicate that a mature 401(k) plan program will produce substantial account balances. For example, individuals in their 60s with at least 30 years of tenure have average account balances in excess of $156,000; those in their 50s have balances in excess of $117,000.

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ENDNOTES

[1] In 1994, the year for which data were available, the maximum legal 401(k) pre-tax employee contribution (the 402(g) maximum) was $9,240.

[2] Since 401(a) contributions are not counted as part of the 402(g)(1) limit, the percentage of participants hitting the limit on elective deferrals will not change between tables 4 and 5.

[3] Note that the lower percentage of those with compensation in excess of $100,000 can not be explained by the 401(a)(17) limits, since the 402(g)(1) limit of $9,240 for the year is more than $150,000 times 6 percent.

[4] Plans and participants represent 1997 estimates from Cerulli (1998), while assets are for 1996.

[5] Reported balances are net of plan loans. There is an extremely wide range of estimates of average account balances in 401(k) plans. The Department of Labor (DOL, p. 85) provides an average account balance per active participant for 1994 of $26,766. However, the Goodfellow and Schieber (1997) study of 24 plans found an average balance of $38,234, and a recent study by the Profit Sharing/401(k) Council of America indicated that the average balance for participants in their survey was $75,000 in 1996 (Bureau of National Affairs, 1998). The latter number could be considered as an upper bound since it includes profit-sharing and combination plans as well as 401(k) plans.

[6] In one important respect, however, the average balance of the 60s age group with over 30 years of tenure may understate the potential balance because participants in this group could actually have been in a true 401(k) plan for no more than a fraction of that time, given legislative and regulatory chronologies. However, some of these balances are undoubtedly conversions from pre-existing profit-sharing plans.

A more appropriate way to examine this issue is to project account balances over participants' working lifetimes under a variety of assumptions. Poterba, Venti and Wise (1997) have investigated the magnitude of 401(k) account balances at retirement age. To judge the relative importance of potential 401(k) contributions, they compare projected 401(k) assets of future generations with the 1992 assets of the Health and Retirement Survey (HRS) sample. The mean of 401(k) assets for the entire sample was only $10,808, but this was significantly affected by the majority of the respondents having had no 401(k) accounts. Using historical experience to project future contributions, the authors find that, on average, a 37-year-old in 1996 would have a 401(k) balance upon retirement at age 65 of $91,600, and a 27-year-old in 1996, retiring at age 65; would have $125,000 (measured in 1992 dollars). The calculations assume that one-half of the 401(k) money was invested in stocks and one-half in bonds, and that average returns experienced since 1926 would be realized.

Table 1

PARTICIPANT DEFERRAL RATES, A RETIREMENT SAVING PLAN, 1994

	Zero	1 Percent–2 Percent	3 Percent–4 Percent	5 Percent	6 Percent	7 Percent	8 Percent	9 Percent	402(g) Maximum	Deferral Percentage[a]
Total	3.5%	5.5%	5.7%	21.4%	7.7%	3.2%	6.9%	45.1%	1.1%	6.7%
Age										
20–29	3.1	5.2	6.5	28.8	8.7	3.0	3.7	41.1	0.0	6.5
30–39	4.1	6.3	6.5	24.0	8.5	3.5	6.0	40.9	0.2	6.5
40–49	3.6	5.9	6.0	20.7	7.5	3.2	7.6	44.3	1.1	6.7
50–59	2.0	2.8	3.1	14.2	5.6	2.5	8.5	58.1	3.3	7.6
60 and over	0.5	0.7	1.6	9.7	5.3	2.4	12.3	63.0	4.5	8.1
Salary (base, not W-2)										
$10,000–$19,999	9.6	9.1	8.3	28.2	7.6	3.5	5.3	28.5	0.0	5.5
$20,000–$29,999	6.3	7.7	9.1	27.2	8.6	3.5	6.2	31.3	0.0	5.9
$30,000–$39,999	4.6	7.7	7.9	24.4	8.2	3.4	6.6	37.1	0.0	6.2
$40,000–$49,999	3.5	6.0	6.3	23.0	8.5	3.3	6.4	43.0	0.0	6.6
$50,000–$59,999	3.1	5.1	5.2	21.5	7.4	3.1	6.8	47.8	0.0	6.8
$60,000–$74,999	2.5	4.0	4.3	18.7	7.2	2.9	7.0	53.4	0.0	7.1
$75,000–$99,999	2.1	3.1	2.9	16.1	5.8	2.4	7.7	59.9	0.0	7.5
$100,000 or more	1.7	2.5	2.5	13.1	7.5	6.4	10.3	13.3	42.8	7.5
Tenure										
2 years or less	1.4	4.7	6.5	30.8	9.8	3.3	2.4	39.5	1.6	6.5
2+ years to 5 years	2.3	5.6	6.3	26.6	8.3	2.7	3.2	44.7	0.4	6.6
5+ years to 10 years	3.4	5.3	5.9	24.1	8.1	3.2	6.1	43.7	0.2	6.6
10+ years to 15 years	4.1	6.0	6.1	22.3	8.0	3.4	7.0	42.7	0.3	6.6
15+ years to 25 years	4.0	6.2	6.5	21.0	7.6	3.2	7.5	43.1	0.9	6.6
Over 25 years	2.3	3.4	3.2	14.9	6.1	2.9	8.1	55.6	3.6	7.4
Gender										
Male	3.3	5.6	5.6	21.9	8.1	3.3	6.8	44.2	1.3	6.7
Female	4.0	5.2	6.2	20.3	6.6	3.0	7.1	47.2	0.4	6.8
Marital Status										
Single	3.9	5.6	6.0	21.4	7.0	3.1	6.7	45.8	0.5	6.7
Married	3.4	5.4	5.7	21.5	7.9	3.2	6.9	44.8	1.2	6.7
Unknown	2.5	4.4	4.4	17.0	7.6	2.1	8.7	52.2	1.1	7.2
Race										
White	3.2	5.2	5.5	21.6	8.0	3.3	6.8	45.4	1.1	6.8
Nonwhite	4.8	6.7	6.8	20.9	6.2	2.8	7.5	43.6	0.7	6.5

Source: Employee Benefit Research Institute.

[a] Includes participants constrained by the 402(g) maximum contribution limit.

Table 2

PARTICIPANT DEFERRAL RATES, COMPANY B RETIREMENT SAVING PLAN, 1994: NONHIGHLY COMPENSATED EMPLOYEES

	Zero	Less Than 3 Percent	3 Percent	4 Percent–6 Percent	6 Percent–9 Percent	10 Percent	11 Percent–14 Percent	15 Percent	402(g) Maximum	Deferral Rate[a]
Total	15.1%	9.7%	21.4%	22.1%	11.2%	5.1%	5.6%	9.8%	0.1%	5.4
Age										
20–29	20.7	18.7	25.0	19.2	7.4	3.9	2.4	2.7	0.0	3.6
30–39	17.5	10.9	23.7	24.1	10.7	4.7	4.7	3.7	0.0	4.4
40–49	14.1	9.2	21.6	24.4	11.1	5.1	5.1	9.3	0.1	5.1
50–59	9.3	3.8	16.5	17.9	13.9	6.1	10.1	22.3	0.1	7.7
60 and over	10.5	2.0	10.0	14.0	16.5	8.5	7.0	31.0	0.5	8.7
Salary										
$10,000–$19,999	24.3	17.9	20.8	17.6	9.5	2.6	2.6	4.6	0.0	3.7
$20,000–$29,999	18.3	10.9	27.3	20.0	9.4	3.7	4.3	6.1	0.0	4.4
$30,000–$39,999	14.6	9.1	19.1	24.6	11.0	5.3	5.7	10.6	0.0	5.5
$40,000–$49,999	13.2	8.0	19.0	21.2	14.6	6.3	6.0	11.5	0.0	5.9
$50,000–$59,999	9.4	7.0	18.1	24.3	11.3	6.8	7.6	15.4	0.0	6.6
$60,000–$74,999	7.1	7.7	16.6	26.0	10.1	7.7	10.7	11.8	2.4	6.9
$75,000 or more	0.0	0.0	0.0	0.0	100.0	0.0	0.0	0.0	0.0	8.0
Tenure										
1 year to 2 years	9.6	20.6	26.1	21.6	10.4	3.0	5.1	3.6	0.0	4.3
2+ years to 5 years	16.0	11.2	27.9	22.9	9.3	4.0	2.7	5.9	0.1	4.4
5+ years to 10 years	16.5	7.7	23.4	21.9	11.1	4.8	5.4	9.3	0.0	5.2
10+ years to 15 year	15.7	8.9	16.0	24.8	12.9	5.7	6.8	9.2	0.0	5.5
15+ years to 25 years	16.2	9.4	16.2	20.7	12.1	5.4	7.2	12.9	0.1	5.7
Over 25 years	10.8	3.5	15.5	20.1	12.3	9.3	8.0	20.1	0.5	7.4
Gender										
Male	13.9	9.3	21.2	25.0	11.5	5.3	5.0	8.6	0.1	5.3
Female	15.6	9.9	21.4	20.8	11.0	5.0	5.8	10.3	0.1	5.4
Marital Status										
Single	16.8	12.1	22.6	20.5	10.1	5.4	5.1	7.3	0.0	4.9
Married	14.0	8.4	20.5	23.1	12.1	5.0	5.6	11.1	0.2	5.6
Unknown	13.0	6.0	20.9	23.3	9.8	3.7	9.3	14.0	0.0	6.2
Race										
White	13.0	8.9	21.6	22.4	11.4	5.3	6.1	11.3	0.1	5.7
Nonwhite	20.5	12.0	20.7	21.1	10.8	4.8	4.3	5.9	0.0	4.5

Source: Employee Benefit Research Institute.

[a]Includes participants constrained by the 402(g) maximum contribution limit.

Table 3

PARTICIPANT DEFERRAL RATES, COMPANY B RETIREMENT SAVING PLAN, 1994: HIGHLY COMPENSATED EMPLOYEES

	Zero	Less Than 3 Percent	3 Percent	4 Percent–6 Percent	6 Percent–9 Percent	10 Percent	402(g) Maximum	Deferral Rate[a]
Total	5.1%	7.0%	15.0%	23.1%	25.0%	9.7%	15.1%	5.9%
Age								
20–29	0.0	18.2	27.3	27.3	27.3	0.0	0.0	4.6
30–39	5.9	10.8	16.7	24.8	26.3	7.4	8.0	5.4
40–49	5.4	6.1	16.6	23.8	24.4	7.6	16.2	5.8
50–59	3.7	4.2	9.3	18.6	26.0	18.1	20.0	6.6
60 and over	3.1	0.0	3.1	21.9	15.6	15.6	40.6	7.0
Salary								
$10,000–$74,999	8.0	10.0	20.2	28.5	21.1	11.1	1.1	5.0
$75,000–$99,999	3.9	3.9	12.8	20.6	32.3	20.6	6.0	6.7
$100,000 or more	2.4	5.8	10.2	18.4	24.4	0.0	38.8	6.2
Tenure								
1 year to 2 years	2.8	15.9	14.0	21.5	32.7	4.7	8.4	5.5
2+ years to 5 years	5.3	7.6	14.7	21.8	25.3	11.8	13.5	6.1
5+ years to 10 years	4.3	7.2	19.1	27.8	24.9	6.2	10.5	5.4
10+ years to 15 years	7.5	9.8	16.1	24.1	20.7	8.0	13.8	5.3
15+ years to 25 years	4.6	4.3	14.4	22.6	22.3	11.9	19.9	6.1
Over 25 years	5.9	2.2	9.6	18.4	30.9	13.2	19.9	6.6
Sex								
Male	5.3	7.4	16.2	22.6	23.1	9.4	16.0	5.7
Female	4.3	5.6	10.3	24.9	32.2	10.7	12.0	6.3
Marital Status								
Single	6.1	6.5	13.5	20.0	31.8	11.0	11.0	6.1
Married	4.8	7.2	15.5	24.2	22.6	9.3	16.5	5.8
Unknown	3.7	7.4	11.1	14.8	40.7	11.1	11.1	6.6
Race								
White	4.9	6.9	14.9	22.5	24.9	9.9	16.0	5.9
Nonwhite	6.7	8.4	15.1	27.7	26.1	8.4	7.6	5.5

Source: Employee Benefit Research Institute.

[a]Includes participants constrained by the 402(g) maximum contribution limit.

Table 4

PARTICIPANT DEFERRAL RATES, COMPANY C RETIREMENT PLAN, 1994: PRETAX CONTRIBUTIONS

	Zero	Less Than 6 Percent	6 Percent	More Than 6 Percent But Less Than 16 Percent	16 Percent	402(g) Maximum	Deferral Rate[a]
Total	16.8%	10.1%	29.6%	25.0%	6.9%	11.6%	6.3%
Salary							
$10,000–$19,999	18.2	14.3	37.8	19.4	10.4	0	6.3
$20,000–$29,999	22.9	13.1	34.7	19.2	10.0	0.1	5.9
$30,000–$39,999	26.1	14.0	30.7	19.2	9.9	0	5.7
$40,000–$49,999	21.9	13.0	31.9	21.9	11.2	0	6.2
$50,000–$59,999	19.4	11.5	30.2	25.3	11.0	2.6	6.6
$60,000–$74,999	14.2	8.5	29.8	29.5	3.3	14.8	6.4
$75,000–$99,999	10.7	6.8	27.2	28.0	1.6	25.7	6.4
$100,000 or more	6.8	5.1	21.9	11.0	2.0	53.1	5.6
Tenure							
2 years or less	4.9	9.3	43.0	26.0	12.7	4.0	7.8
2+ years to 5 years	8.7	11.7	37.7	23.8	10.9	7.2	7.2
5+ years to 10 years	13.3	10.3	33.7	24.8	8.0	9.9	6.7
10+ years to 15 years	17.6	10.8	29.2	24.2	5.9	12.3	6.1
15+ years to 25 years	21.0	10.8	26.9	24.2	5.3	11.7	5.8
Over 25 years	19.2	7.5	23.9	27.4	6.2	15.7	6.3
Age							
20–29	12.1	11.2	40.6	23.8	8.8	3.5	6.7
30–39	15.9	11.6	33.2	24.1	6.3	8.9	6.2
40–49	19.7	10.5	27.7	24.6	5.5	12.1	5.9
50–59	14.7	6.1	22.5	28.2	9.6	19.0	7.2
60 and up	11.5	2.8	18.3	28.2	16.3	22.9	8.5
Sex							
Male	16.4	9.4	30.2	25.0	5.7	13.3	6.2
Female	17.6	11.2	28.6	25.0	9.0	8.7	6.5
Race							
White	16.2	9.7	30.5	25.5	6.7	11.4	6.4
Nonwhite	19.8	12.0	25.5	22.7	7.7	12.3	6.1

Source: Employee Benefit Research Institute.

[a]Includes participants constrained by the 402(g) maximum contribution limits.

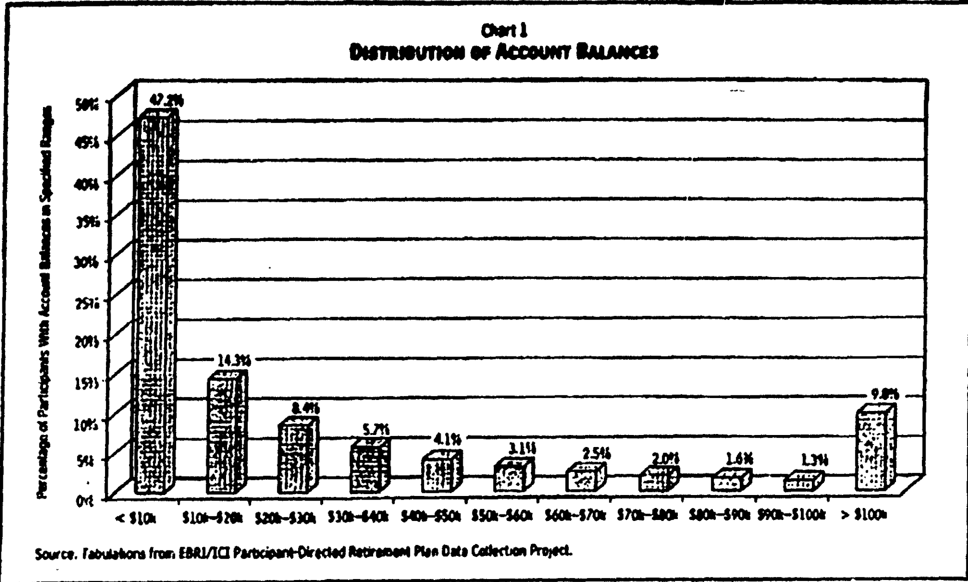
Table 5

PARTICIPANT DEFERRAL RATES, COMPANY C RETIREMENT PLAN, 1994: PRETAX AND AFTER-TAX CONTRIBUTIONS COMBINED

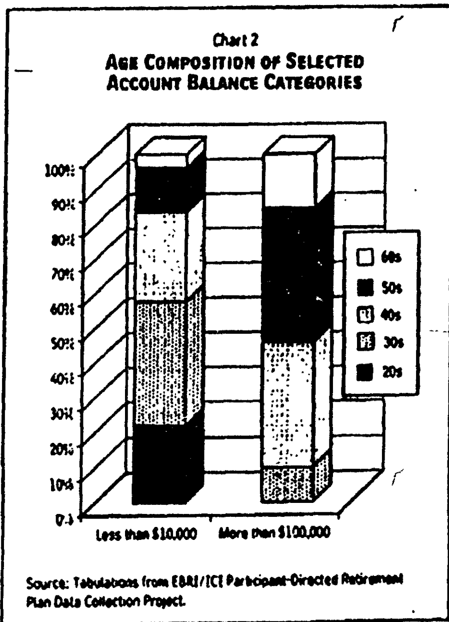
	Zero	Less Than 6	6 Percent	More Than 6 But Less Than 16	16 Percent	402(g) Maximum	Deferral Rate[a]
Total	4.0%	9.4%	38.4%	27.7%	8.9%	11.6%	7.6%
Salary							
$10,000–$19,999	11.2	13.2	40.7	22.2	12.6	0	7.1
$20,000–$29,999	12.9	13.7	40.1	21.3	11.9	0	6.8
$30,000–$39,999	10.2	15.0	41.0	22.1	11.6	0	6.9
$40,000–$49,999	5.5	14.0	42.6	25.2	12.8	0	7.5
$50,000–$59,999	4.3	11.3	40.5	28.2	13.1	2.6	7.8
$60,000–$74,999	2.3	7.0	38.1	32.1	5.6	14.8	7.7
$75,000–$99,999	1.7	4.7	34.0	29.8	4.1	25.7	7.7
$100,000 or more	0.9	2.5	25.9	14.6	3.0	53.1	7.0
Tenure							
2 years or less	1.7	7.8	45.0	27.2	14.3	4.0	8.3
2+ years to 5 years	3.3	10.0	41.1	26.0	12.5	7.2	7.9
5+ years to 10 years	4.0	8.8	40.1	27.2	10.0	9.9	7.7
10– years to 15 years	4.2	9.5	38.8	27.1	8.1	12.3	7.5
15– years to 25 years	4.9	11.2	37.6	27.4	7.2	11.7	7.2
Over 25 years	3.0	7.3	35.0	30.1	8.8	15.7	7.9
Age							
20–29	4.0	9.4	46.5	26.3	10.3	3.5	7.5
30–39	4.5	10.3	41.1	27.2	7.9	8.9	7.3
40–49	4.3	10.4	37.9	27.6	7.6	12.1	7.4
50–59	2.1	5.4	31.1	29.8	12.5	19.0	8.6
60 and over	1.0	3.3	24.7	26.1	21.9	22.9	10.0
Gender							
Male	3.6	8.6	39.3	27.7	7.6	13.3	7.5
Female	4.6	10.7	36.9	27.8	11.2	8.7	7.7
Race							
White	3.5	8.7	39.4	28.2	8.7	11.4	7.6
Nonwhite	6.3	12.5	33.1	25.4	10.1	12.3	7.4

Source: Employee Benefit Research Institute.

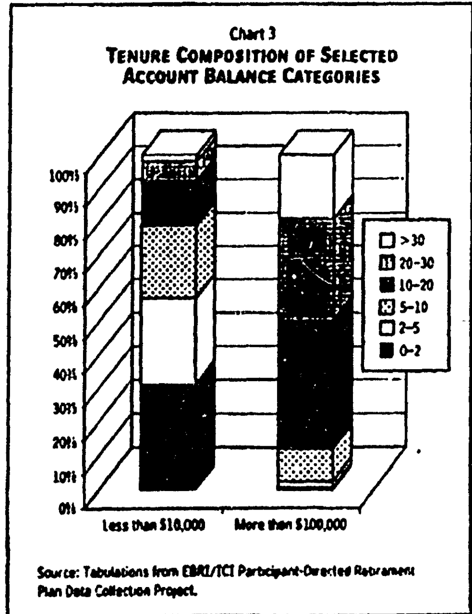
[a]Includes participants constrained by the 402(g) maximum contribution limits.



Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.



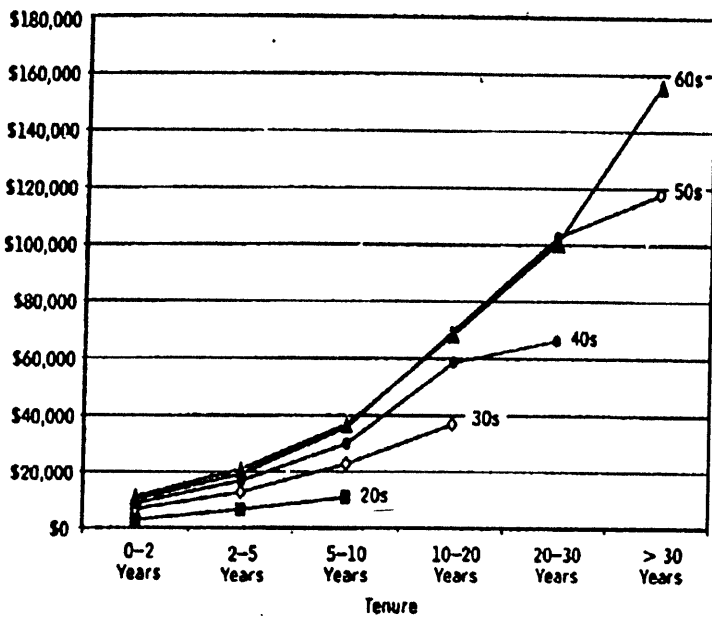
Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.



Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.

Chart 4

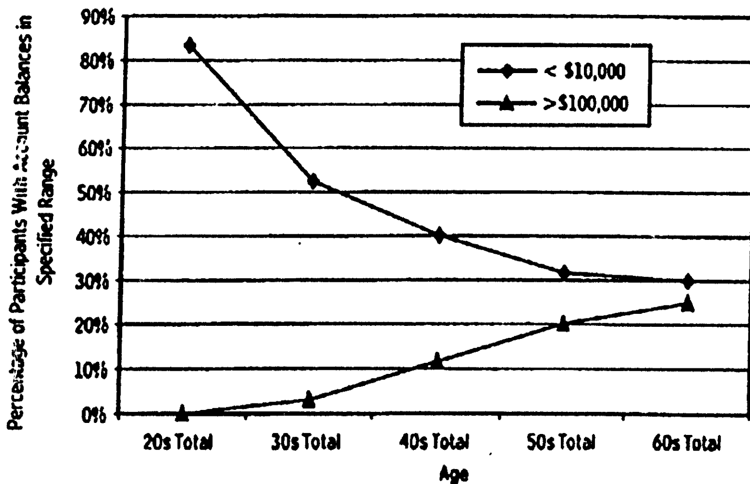
AVERAGE ACCOUNT BALANCE, BY AGE AND BY TENURE



Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.

Chart 5

IMPACT OF AGE ON ACCOUNT BALANCE



Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.

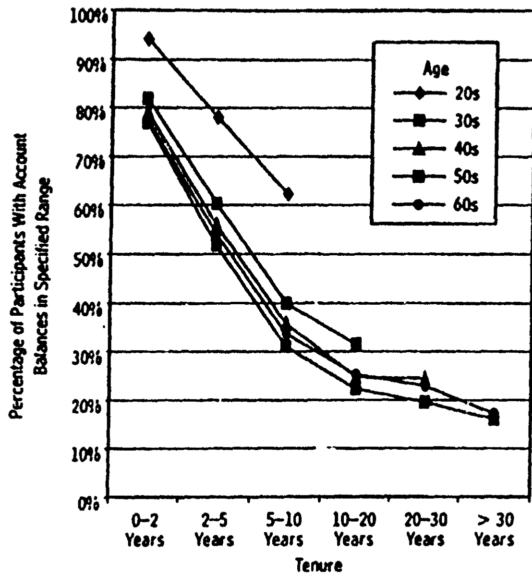


Chart 6
IMPACT OF AGE AND TENURE ON ACCOUNT BALANCE,
PARTICIPANTS WITH ACCOUNT BALANCES
LESS THAN $10,000
Percentage of Participants With Account Balances in Specified Range
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
Age
20s
30s
40s
50s
60s
0–2 Years
2–5 Years
5–10 Years
10–20 Years
20–30 Years
> 30 Years
Tenure
Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.

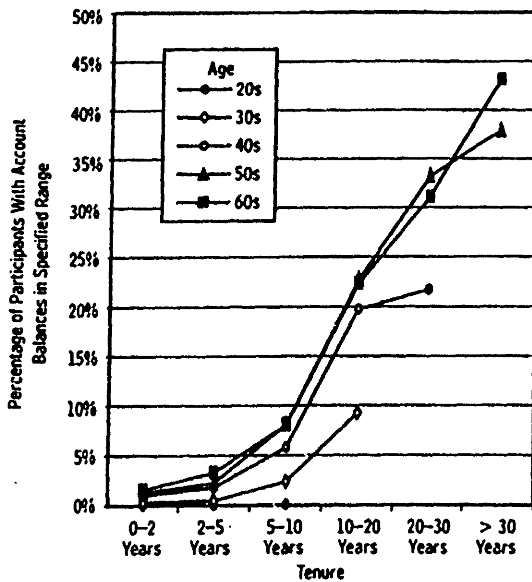


Chart 7
IMPACT OF AGE AND TENURE ON ACCOUNT BALANCE,
PARTICIPANTS WITH ACCOUNT BALANCES
OVER $100,000
Percentage of Participants With Account Balances in Specified Range
50%
45%
40%
35%
30%
25%
20%
15%
10%
5%
0%
Age
20s
30s
40s
50s
60s
0–2 Years
2–5 Years
5–10 Years
10–20 Years
20–30 Years
> 30 Years
Tenure
Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.

COMMUNICATIONS

STATEMENT OF MERRILL LYNCH & CO., INC.

[SUBMITTED BY JOHN L. STEFFENS, VICE CHAIRMAN OF THE BOARD AND HEAD OF U.S. PRIVATE CLIENT GROUP]

Mr. Chairman, we at Merrill Lynch want to commend you and the other members of the Finance Committee for your leadership in bringing the Individual Retirement Account "out of retirement." Our early experience at Merrill Lynch indicates that the new Roth IRA could be the most effective new savings generator since the successful expansion of section 401(k) plans in the 80's and early 90's.

ROTH IRAS ARE ENERGIZING NEW SAVINGS

One need go no further than the advertisements in the newspapers and other media to see that the Roth IRA changes that Congress enacted in 1997 have revitalized America's interest in the IRA. With expanded advertising, more and more people have begun asking questions about the new savings options available to them. In the process, they are becoming better educated about the importance of saving for retirement. For many, there has been a growing awareness of how far behind they are in saving for a financially secure retirement.

Although it is still early, our Financial Consultants tell us that many of our customers are responding to the pro-savings message that the Roth IRA sends. Significantly, they are increasing their savings not only through Roth IRAs, but also through traditional IRAs and other savings vehicles.

As with any new financial product, consumer interest builds over time. But, under almost any reasonable measure, the Roth IRA has been a tremendous success. Industry wide statistics are not yet available for 1998, the first year that the Taxpayer Relief Act of 1997 IRA changes went into effect, but preliminary results at Merrill Lynch show an unprecedented increase in IRA activity.

Through December 1998, we have seen an increase of more than 80 percent in the number of total IRA contributions over the same period in 1997—an astounding increase for a new savings vehicle. This includes new Roth IRAs and increased contributions to traditional IRAs.

And this is only the tip of the iceberg. Between now and April 15th—the last date to make IRA contributions for 1998—we anticipate an even bigger rush to make IRA contributions. Historically, a significant percentage of our IRA contributions (often as much as half) for a particular year are made after the close of the year. With a new concept, like the Roth IRA, this tendency to delay is probably even more prevalent as potential contributors try to use all time available to learn more. As these people begin the process of completing their tax returns for 1998, they will come to the realization that if they do not make the contribution by April 15th, their chance to make the 1998 contribution will disappear forever. We fully expect many of these "procrastinators" to make IRA contributions in the next few weeks. And we can expect contributions for 1999 and beyond to increase even more as consumer awareness grows, just as IRA contributions grew steadily between 1982 (the first year IRAs became universally available) and 1986 (when IRA access was severely restricted).

One interesting aspect of the Roth IRA expansion is that we have seen considerable spillover savings resulting from the Roth IRA advertising. For example, we have experienced a sizable increase in traditional deductible IRA contributions. To some extent that increase is attributable to the changes that were enacted in 1997 expanding the availability of deductible IRAs. However, we have seen people who were always eligible for deductible IRAs come back because they did not realize they were eligible in the past. They have called to ask about the Roth IRA, but have de-

cided to contribute to a traditional IRA or other savings vehicle. Your Roth IRA legislation deserves the credit for putting those people back in the savings habit.

To illustrate how big a success the Roth IRA and other 1997 Act IRA changes have been, one need only compare the early stages of the post-1997 Act IRA market development to the early stages of other new savings vehicles created by Congress—including earlier versions of the IRA. Once again, we won't have complete statistics for quite some time, but when you compare the IRA activity we have seen in 1998 with our early experience with other products, the success of the 1997 IRA changes becomes clear.

In calendar year 1988, Merrill Lynch has established more than two and one half times as many new IRAs than we established during the same period in 1982, the first year of universal IRA eligibility. This despite the fact that the IRA available in 1982 was simpler, available on a fully-deductible basis to most Americans, and more tax-advantaged (due to higher marginal income tax rates that were in effect in 1982). Similarly, the new Roth IRA has been extremely well received when compared with other recently introduced tax vehicles. In 1998, for example, Merrill Lynch established one hundred times more Roth IRAs than Medical Savings Accounts.

NEED FOR MORE CHANGE

Despite the Roth IRA's initial success, there is no question that current savings incentives will not be sufficient to reverse America's serious savings shortfall. The 1997 Act IRA changes were important steps in beginning the process of improving the incentives to save. But more change is needed.

In 1997, our national savings rate dipped below 4%—the lowest rate in 59 years. In 1998, preliminary data tells us it continues to trend down. It is the baby boom generation that is in the most danger. Research by Stanford University economist Douglas Bernheim, who compiles an annual Baby Boom Retirement Index for Merrill Lynch, has consistently shown that the baby boom generation has fallen as much as two-thirds behind the rate of savings that they need to maintain their current standard of living in retirement.

It is our responsibility to help the baby boom generation (and future generations) to start saving more. If we do not accomplish that goal soon, the financial burden that will be placed on our Social Security system and our economy in the next millennium could be disastrous.

While there are many causes for our national savings shortfall, one of the main reasons is that our tax system continues to penalize savings and investment. The Roth IRA was an innovative step to correct that imbalance and the additional proposals made in your legislation, Mr. Chairman, would go even further in providing every American with a meaningful opportunity to save for a secure retirement.

Let me highlight a few of the changes proposed in the Roth bill that would have the most beneficial impact.

WHY 2K?

The current $2,000 maximum IRA contribution has been in place since 1981. Your proposal to increase the maximum IRA contribution to $5,000 for both Roth and traditional IRAs (and to index for future inflation) is long overdue—at least 18 years overdue. No one can dispute that even if an individual were to contribute $2,000 in every year to an IRA, they would not have sufficient savings to ensure a secure retirement.

Interestingly, we have found that a significant percentage of our customers contribute the annual $2,000 maximum to an IRA. They save the maximum amount permitted and commit that amount to long-term retirement savings. With higher contribution limits, we fully expect that many of those individuals will save more.

Even for those who do not contribute the maximum in every year, the higher contribution limit will allow people flexibility to make IRA contributions in the years that they have the resources to make the contributions. For example, a family where one spouse remains at home to care for children will often not have disposable income for large IRA contributions. When the children are older, however, the couple may be better able to make IRA contributions. The higher contribution limit will allow that couple to make larger IRA contributions during the years they can afford to do so.

In the course of our experience with millions of IRAs we have also found that there is a very strong correlation between the size of an account and the attention and discipline that an individual affords to that account. Put simply, once an account achieves a certain "critical mass," it becomes the individual's nest egg and they become much more disciplined with respect to that account balance. They be-

come less likely to make withdrawals and more likely to continue adding to the account. Conversely, relatively small accounts have a tendency to go dormant after only one contribution and are more likely to be withdrawn. Of course, every person's "critical mass" is different, but by raising the maximum initial IRA contribution, the chances that more people will start down the savings path (and stick to it) will be increased substantially.

Your proposal to allow those age 50 and over to make additional IRA contributions of $2,500 per year will also help people who are closer to retirement to save more. This is critical because as people approach retirement age they become more focused on retirement needs. It is worth noting that many of those in today's population who are approaching or have reached age 50 did not have IRAs or 401(k) plans available through most of their working careers. They did not have the same opportunities to save that today's generations have. Instead, due to changes in the structure of the American workplace, they were caught in the transition from a relatively robust system of defined benefit pensions to the self-reliance focus of today's defined contribution landscape. Giving the baby boom generation the chance to catch-up for years they may not have saved adequately is not only fair, it is critical to helping them achieve a financially secure retirement.

ELIMINATE COMPLEXITY

The income limits that were included as part of the 1986 Tax Reform Act and extended under the 1997 Act Conference Agreement, are complex and counterproductive—doing far more harm than good. Mr. Chairman, your proposal to repeal the income limits on IRA eligibility would go a long way to increasing savings among all income classes and would also eliminate the marriage penalties that are inherent in the current income limits.

Even with the improvements included in the 1997 Act, many middle income Americans are still not eligible for a fully deductible IRA. For couples with income above $51,000 and individuals with income above $31,000, the fully deductible IRA is generally not an option. Although the Roth IRA was wisely made available to a broader segment of the population, the application of income limits on Roth IRAs remains detrimental.

To begin with, the current income limits impose a severe marriage penalty on certain couples. Take, for example two individuals who will earn $30,000 each this year. If they are unmarried, both are allowed to make fully deductible $2,000 contributions to an IRA. If they marry, however, their IRA deductions will be reduced to $200 each. Under today's tax rules, that couple faces an increase of $1,250 in their Federal income taxes just for getting married and $1,000 of that marriage penalty (about 80%) is attributable to the eligibility limits currently imposed on deductible IRAs. Your legislation, Mr. Chairman would correct that inequity.

Our experience has also shown that the people who are harmed most by the income limits are not the wealthy. To the truly wealthy, the relatively small IRA tax advantage has little affect on their overall tax burden. The people who are harmed by the income limits are those who are stuck in the middle. These are people who do not necessarily have sophisticated tax planners and accountants giving them advice. They will only proceed in locking their money into an IRA if they are confident that they will not get tripped up by the rules. Some of these people will delay contributions to make sure they will qualify, and then later forget to make the contribution or spend the money before they get around to making a contribution. Others may qualify for a full or partial IRA this year, but still will not contribute because the contribution permitted this year is too small, or because they assume they won't qualify in the future and they don't want to start contributing if they are not sure they will be able to continue the process in future years. Still others are confused and believe they may have to withdraw the funds if their income goes up in the future.

The end result of the complexity of the myriad income limits and restrictions on IRAs is that contributions are not made by those who are technically eligible (or partially eligible) under the rules in a given year. This same chilling effect occurred when Congress originally imposed income limits on deductible IRA eligibility in 1986. The year after those rules went into effect, contributions by those who remained eligible dropped by 40%.[1]

Your legislation, Mr. Chairman, by once again making all Americans eligible for IRAs—the rule that was in effect before 1986—would help all Americans to save more. By eliminating the complexity in the current rules, Americans will be pre-

[1] Testimony of Lawrence H. Summers, currently Deputy Secretary of the Department of the Treasury, before the U.S. Senate Committee on Finance, September 29, 1989.

sented with a consistent and understandable pro-savings message—a clear consensus path to follow toward retirement security. That message will be reinforced by the financial press, financial planners, and word-of-mouth. As families gain confidence in the retirement savings vehicles available to them, more and more will commit to the consensus path.

ENHANCED 401(K) PLANS

The proposals to enhance employment-based retirement plans—including your proposals to increase the maximum allowable contributions to 401(k) plans and to provide a catch-up contribution comparable to the IRA catch-up contribution—will have many of the same advantages as the IRA changes discussed above.

In particular, your concept of melding the benefits of a Roth IRA with the benefits of a 401(k) plan (creating the new "Roth 401(k)") has the potential to substantially increase the attractiveness of 401(k) plans for many employees. This idea is the kind of innovative thinking that we need to implement if we are to increase personal savings in the years ahead. By combining the attractive delayed tax incentives of the Roth IRA with the advantages of the 401(k) plan (including the ease of saving through payroll deduction and employer matching contributions), you would create a powerful new savings incentive that will draw more Americans into the savings habit.

In our experience with Roth IRAs to date, we have found that individuals react to the Roth IRA/traditional IRA choice differently and that their choices are not always based entirely on a purely mathematical analysis. It is a personal decision that is affected considerably by the individual's world view. Many people simply prefer the back-loaded incentive that the Roth IRA provides, others clearly prefer the traditional front-loaded incentive if it is available to them. Giving everyone that choice within their 401(k) plans will ensure that the savings incentive that is most attractive to that particular individual will be available. The result will be increased savings.

Significantly, we believe that many low and moderate income taxpayers—those that are currently in the 15 percent tax bracket or below—should find the back-loaded tax incentives of the Roth vehicle more attractive than the traditional 401(k), because it will be worth more to them than the current deduction.

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In the end, each American must accept significant responsibility for their own retirement security. But the government must help by reducing the tax burden on those who save while making the choices simple and understandable to the average worker. The changes enacted in the 1997 Act were a significant step forward. Your legislation, Mr. Chairman, allowing greater IRA contributions and creating the new Roth 401(k) would provide more flexible and more effective savings incentives—boosting retirement savings in the critical years ahead.