The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

SPEECH

December 1, 2006

Retirement Savings: Building on Our Progress

ICI President's Remarks
Before the
Consumer Federation of America's Financial Services Conference

Retirement Savings: Building on Our Progress

By Paul Schott Stevens
President, Investment Company Institute

December 1, 2006
Washington, DC

Good morning. It's a pleasure to be here.

I want to thank the Consumer Federation of America for inviting me to be a part of this discussion on retirement security. It's an important topic – and one that is certainly top of mind for many Americans these days.

It seems like you can't open the morning paper without reading something about the challenges of saving for retirement. More often than not, we hear about what's missing: how Social Security simply can't cover the financial needs of all retirees; how health care costs are on the rise and Medicare can't cover many of the expenses; and how pension plans are no longer a sure bet.

With such a distinct focus on what's not working well, it can be difficult to get a broader picture of exactly what options are out there, what we can do to help more people save for retirement. Today, I want to talk about a few of the savings options that are working better than ever for the average American – and what we can do to improve the landscape for retirement savings by building on these successes in the years ahead.

The truth is: the glass is by no means empty – at the very least it's half full. And I believe we have the ability to fill it even more quickly in the years ahead – if we work together.

Americans Want Employer-Sponsored Plans

In the category of what's working, workplace savings is a clear leader.

Last year, CFA and the Financial Planning Association, released the results of two studies that compared how Americans and financial planners view personal wealth.

Although there are stark differences in their respective views, both planners and individuals agree that workplace saving is an important wealth-building strategy. Indeed, seven out of 10 individuals, and nine out of 10 planners, said it was very important.

ICI's analysis of the Current Population Survey data supports this finding.

In fact, the majority of Americans of all age groups and education levels are likely to participate in an employer-sponsored plan, when their employer offers one.

Clearly, people want to save, and they are looking for their employers to help them do it.

Changing Pension Landscape

Defined contribution plans have become the predominant way for individuals to save for retirement. That's a remarkable shift from where we were just 25 years ago, when many people – including lawmakers here in Washington, DC – hadn't really focused on the potential of defined contribution plans.

Twenty-five years ago, defined benefit plans dominated the landscape. Among private-sector workers participating in pension plans in 1980, 83 percent had a traditional defined benefit plan. Although these plans held the promise of additional benefits, many workers left jobs before being able to collect significant benefits.

Then, a landmark shift in retirement benefits started. On November 10, 1981, the IRS made it possible for workers to contribute a portion of their salary on a pre-tax basis to 401(k) plans. Industries that typically offered traditional pension plans declined, while industries that typically offered defined contribution plans grew. New firms tended to adopt 401(k) plans rather than defined benefit plans.

By 1999, just 42 percent of private-sector workers in pension plans had defined benefit plans; 87 percent had defined contribution plans, including 401(k)s; and 28 percent were participating in both.

Today, 401(k)s are the most common type of retirement plan offered by private-sector employers in the United States. In 2005, 47 million American workers were active participants and 401(k) plan assets totaled a remarkable $2.4 trillion. Other private-sector defined contribution plans accounted for another half trillion. That's a total of nearly $3 trillion in private-sector defined contribution plans, compared to $1.9 trillion in private employer-sponsored defined benefit plans.

Quite a change from where we were in 1980.

There are many reasons for the shift toward defined contribution plans – particularly 401(k) plans. In addition to important tax savings, the benefits in 401(k) plans accrue more steadily, which is important for today's mobile workforce. The money is in an easily understood account, which employees can take with them when they leave the company.

Recent innovations have made investing in 401(k) plans even easier.

For example, lifestyle and lifecycle funds invest in a mix of stocks and bonds, determined by an individual's risk tolerance or retirement date. In the case of lifecycle funds, investors can "set it, and forget it." The growth in these funds shows that many participants are seeking simplicity.

That's not to say there isn't room for improvement.

Last year, lawmakers in Washington recognized the need to make 401(k)s available and accessible to more Americans – and acted to remove some of the regulatory burdens that had prevented employers from making their plans more effective. The Pension Protection Act, which President Bush signed in August, does five key things:

- First, it permanently increases the contribution limits, allowing employers and employees together to contribute more.
- Second, it locks in the provisions for catch-up contributions – allowing older workers to make additional contributions every year.
- Third, it encourages employers to enroll workers automatically in a 401(k) and to increase participants' contributions over time. Both changes are especially important for younger workers, who may not yet be thinking of retirement savings.
- Fourth, for employees who don't pick their own 401(k) investments, the PPA makes it easier for the employer to put those contributions in options that are most appropriate for long-term savings.
- And, fifth, it makes it easier for 401(k) investors to get financial advice.

More specifically, our research with Dallas [Salisbury] and his colleagues at the Employee Benefit Research Institute shows that automatic enrollment will help the lowest income workers the most.

How much can it help you save? For the lowest income workers, a full career in a 401(k) plan with automatic enrollment could nearly double their income replacement rate in retirement.

Clearly, defined contribution plans have great potential to meet the retirement needs of future generations. They will work, but only if people participate.

Individual Retirement Accounts

401(k) plans are just one part of the retirement savings picture. Americans also have opportunities to save outside of employer-sponsored plans.

One option that has proven to work well is Individual Retirement Accounts – or IRAs.

Today, IRAs hold $3.7 trillion in assets, representing about one-quarter of total U.S. retirement savings.

Traditional IRAs were created with a dual purpose: as an individual tax-deferred opportunity to save for retirement, and as a vehicle for rolling over savings from employer-sponsored plans. Today, almost half of the total IRA assets resulted from rollovers.

The beauty of the IRA is that it offers a tax deduction for workers who are not eligible to participate in an employer-sponsored plan. For these workers, the savings and earnings in an IRA grow tax-deferred until they withdraw them in retirement.

In the 1980s, universal tax deductions for IRA contributions generated a great influx of savings dedicated to retirement. Financial firms devoted significant resources to making taxpayers aware of the immediate and long-term benefits of retirement savings. Americans paid attention. The result was a broader base of retirement savers.

But since 1986, the rules for IRAs have grown ever more complex. This complexity has discouraged many Americans from using IRAs; in 2004, only 17 percent of U.S. households made IRA contributions. Simply put, they are not the strong engines for additional savings that they could be – and once were.

Lawmakers need to think about simplifying these requirements so that the pension and investing worlds function seamlessly to help American families save more for their future.

I know Mark Iwry has some ideas for how we can increase IRA contributions. I look forward to Mark's presentation and looking more closely at his proposals.

Room for Improvement

401(k)s and IRAs – two vehicles that have proven potential to help everyday Americans save for the future at work and at home. Is there is room for improvement? Absolutely.

Mutual funds know we have an important role to play in realizing the potential of these and other ideas for greater retirement security. As the percentage of workers covered by traditional pension plans has fallen, and defined contribution plans have grown, workers are taking on more responsibility for their retirement savings and planning. Through employer-sponsored plans, IRAs and other savings, more than half of the households in America today look to mutual funds to help them achieve their financial goals.

Nearly 55 million U.S. households – 96 million individuals – now own mutual funds, according to ICI's annual survey. And the vast majority of all mutual fund investors tell us that retirement saving is a primary financial goal. That's a tremendous constituency. To serve that many Americans, we have to explore all ideas that will help them save. We all have a part to play.

We must work together to encourage Congress to consider tax incentives for all types of savings – both inside and outside of retirement plans.

We also must continue to innovate, creating better products and services to help meet the needs of investors at all ages and stages of life.

And as savings opportunities grow, we must do more to help all Americans understand the options available to them, so they can make the right choices to meet their financial goals. That means increasing financial understanding at all levels.

ICI's Education Foundation works to provide investors with the information they need to develop realistic goals and expectations, evaluate risk, and make informed investment decisions. Since 1989, our Foundation has partnered with government agencies and other nonprofit organizations to develop, support, and distribute investor education materials that focus on saving for retirement, college, and other long-term goals. These include programs for secondary-school teachers and students, for new and seasoned journalists, and for African-American and Hispanic investors.

For example, the Foundation's "Investing for Success" partnership with the National Urban League and Hispanic College Fund sponsors workshops in communities across the country and at Historically Black Colleges and Universities. The partnership also provides multimedia web courses in English and in Spanish.

The Institute's Foundation also works with the Foundation for Investor Education to introduce mutual fund education into secondary-school classrooms nationwide.

In addition, ICI has a website dedicated to educating consumers about the importance of long-term saving. At Funding Your Future, consumers can learn 10 steps to securing their financial futures. They'll also find links to a host of other resources, including interactive calculators and worksheets.

With your help, we can make retirement savings part of more financial education programs, especially those that focus on lower-income families.

You also can help bring new ideas to fruition. Through forums like this one, CFA and its members can help make retirement security a necessary part of the ongoing dialog on financial stability and wealth building.

And you can work with employers in both the public and private sectors to make savings plans available to more Americans and ensure they provide the right education and guidance to ensure their employees can achieve a secure retirement.

These are not easy tasks, but we must tackle them all if we are going to move retirement security forward.

Conclusion

As Thomas Edison once said: “Restlessness and discontent are the first necessities of progress.”

The fact that Americans are not content with the current level of retirement security does not mean we have not made significant progress. Rather, it means we must continue to move forward, and at a much faster pace. And that's good for everyone here today.

Thank you, again, for inviting me to participate in this discussion. I look forward to taking your questions.