

## **SPEECH**

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# **Stevens Discusses Key Strengths of 401(k)s**

Keynote Address

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Thank you, Theresa [Hamacher, President of NICSA], and let me offer my thanks to NICSA for inviting me to join you here today. This conference has been an important feature of our industry's calendar for almost thirty years. I am honored by NICSA's invitation to speak, and I welcome the opportunity to share some thoughts on issues of importance to us and to our investors.

I have been reflecting lately on the remarkable times in which we are living – full of events that are at odds with some of our basic assumptions. Massachusetts has not elected a Republican to the Senate in 38 years. Only weeks ago, would anyone have predicted the Bay State choosing Scott Brown to take the seat vacated by Ted Kennedy?

In the 43 years of their franchise, the New Orleans Saints have had only nine winning seasons. At the start of this season, would anyone have predicted that the Saints would beat the Colts so convincingly in the Super Bowl?

Then there's Washington's average yearly snowfall – 17 inches. Two weeks ago, would anyone have predicted that this winter would set a new record at 56 inches – and counting?

Unforeseen as these events may be, however, it is important not to make too much of them. I don't anticipate that the District of Columbia will be making a bid for the Winter Olympics. Massachusetts has not fundamentally changed its political orientation as a reliably "blue" state. Seven teams have put together back-to-back Super Bowl championships, but it's a very tough league. So it's way too early to declare the Saints a pro football dynasty – as appealing as that idea might be to a son of the Crescent City like myself.

In political circles, of course, there is often an ingrained tendency to over-react. That was much in evidence back in 2008, when the average account balance in 401(k) plans fell by almost one-quarter. That experience was deeply unsettling, but 401(k) savers were not alone. Literally all retirement plans, including public and private defined benefit pensions, saw their asset levels fall. It surely is fair enough, in light of this experience, to re-examine the 401(k) system and identify ways to improve it further. We have some ideas along those lines that I will share with you in my remarks.

But there were some – in public office, academia and the media – who seized on the moment to call for dismantling defined contribution plans, for retiring the 401(k) system and replacing it with new government guarantees.

That would be a profound mistake.

The American people know it, as our research shows and I will explain.

And it is important that our industry makes sure Washington understands it.

After all, working Americans have entrusted to mutual funds almost half of the \$8 trillion invested in defined contribution plans and IRAs. Our industry has a long history of providing high-quality products and services that have helped build the 401(k) system, and we have a deep and continuing interest in ensuring that Americans' means for investing for retirement security remain strong.

As the 401(k) system has evolved over the past 30 years, its defining characteristics have proved a source of great strength. Four of those features stand out.

First off, 401(k)s reflect a unique partnership – among employers, participants, service providers, investment providers, and government. Each of these groups has played a critically important role in building and enhancing the 401(k) – bolstering its legal and regulatory foundations, promoting it, designing its infrastructure, and creating innovative solutions to problems as they've arisen.

Second is the shared commitment of all of these groups to the system's continued success. They all recognize the great responsibility they have in helping provide for the financial security of millions of today's retirees – and millions more yet to come. I know that many of you here have been deeply involved in that effort.

A third characteristic of the 401(k) system is innovation. Tools like automatic enrollment and target retirement date funds emerged from efforts by employers and providers to improve plans for today's mobile American workforce. And 401(k)s have added critical services for participants, from daily balance reporting by phone or on the Internet to investment advice and education – again, with the help of many of the firms represented here today.

The fourth characteristic I want to mention is flexibility. This arises in no small part from the fact that many of the decisions in this system are made by the people who know the most about the needs and preferences of individual participants – the employers who design and offer the plans and the plan participants themselves.

There is no one-size-fits-all approach to deciding whether to offer a plan, encouraging enrollment, setting employer matches, or selecting investment options. And so those decisions are left in the hands of employers, who know the needs of their workplaces,

within a comprehensive framework of regulations.

And there is no one-size-fits-all approach to meeting a particular family's financial goals or risk tolerance, or to managing assets at job change or retirement. So those decisions are left to workers, again within the protections set by regulations.

Clearly, employers and workers need tools to help them make sound decisions, including clear disclosure on costs and other factors, as well as access to education and advice. This is an area where great efforts have been made, but there is still room for improvement.

A unique private-sector partnership operating within a framework of regulations; commitment; constant innovation; and flexibility, with key decisions in the hands of plan sponsors and participants – those are crucial features of the 401(k) system.

I hope you would agree that these features are among the strengths of 401(k).

Others, however, decry these same features as weaknesses.

But what do the American people think – and how do actual retirement savers behave?

For the last two years, ICI has made a concerted effort to answer those questions. In 2008 – in the darkest hours of the financial crisis – and again in 2009, we surveyed American households on their attitudes toward 401(k)s and government policy surrounding these plans. Both years, the results were remarkably consistent, so let me briefly describe our 2009 findings to you. I released those findings, based on a survey of 3,000 households, in early January at the National Press Club in Washington. I was joined by Jack Brennan, the former chairman of Vanguard Group, and Mellody Hobson, president of Ariel Investments, who added the perspectives of their firms and the research they had done on 401(k)s and investor education.

The results of ICI's research were quite striking. Among the households that expressed an opinion, nine out of 10 said they had a favorable impression of 401(k) and similar retirement accounts. Their No. 1 reason for this support was [QUOTE] “the ability of retirement plan accounts to accumulate significant savings,” followed by the performance of plan investments and respondents' personal experience.

That overall favorable opinion is rooted in support for the key elements of 401(k) plans. Among households that had a defined contribution plan, 85 percent or more voiced support for individual choice and control of their investments; payroll deduction; and tax-favored savings. And 85 percent of defined contribution plan account owners agreed that they were getting [QUOTE] “a good lineup of investment options.”

Given that confidence, it's probably not surprising that the households in our survey didn't agree with the ideas that some are floating to “fix” the 401(k) system. By large majorities, they disagreed with reducing contribution limits, taking away these accounts' tax advantages, or barring individuals from controlling their own investments.

What matters most, however, is whether defined contribution plans can help deliver a secure retirement for workers. The Americans who responded to our survey believe these plans can, indeed, deliver. Nearly three-quarters of all households are “somewhat confident” or “very confident” that 401(k)s and similar retirement plans can help Americans meet their retirement goals. And those who are most familiar with the plans are the most confident.

These are remarkable figures. On question after question, we see levels of support north of 70 percent – and this after the worst financial crisis in decades and months of negative press coverage and criticism of the employer-based retirement system. And this support is highly consistent. We looked across a number of questions; we looked across age, income, and account status – and the results are almost uniform.

As we all know, actions speak louder than words. So we also looked at what Americans did with their retirement accounts in reaction to the financial crisis. We have been collecting data from recordkeepers on actual account activity that has occurred since the start of 2008, and have been updating these reports quarterly. Our latest data covers activity in 24 million defined contribution plan accounts during the first three quarters of 2009. Consistently, we found that Americans didn't panic; they didn't over-react; and they didn't abandon their 401(k) plans despite their market losses. In our 2009 report:

- Only 5 percent of participants stopped contributing to their accounts.
- Only 2.6 percent took withdrawals, and hardship withdrawals were at half that level.
- And, in keeping with the fact that retirement savers are in it for the long-run, a little less than 10 percent changed the asset mix in their accounts, and a similar number changed the asset allocation of their contributions.

All of these numbers are in line with what recordkeepers have seen in typical years. Loan activity in the first nine months of 2009 was also right in line with historical experience.

This is confidence in action ... and a strong message of Americans' support for 401(k)s as these plans take a large and growing role in our employer-based system for retirement security.

Now, despite this strong public support, we recognize that the retirement system can be made to perform better for all Americans. So we want to work with Congress and regulators on ways to improve the 401(k).

Plan sponsors and participants need access to key information to help them make good decisions – and that means improving disclosure for all investment options and plan costs.

Workers saving for retirement also need help to make the best use of the innovations that 401(k) plans provide. For example, we think steps should be taken to enhance their understanding of target date funds.

Retirees need help in facing the challenge of managing assets and income in retirement.

And we need to expand the number of small employers who offer plans and the number of workers who save for retirement.

Let's look at some of those areas for improvement in greater detail, in light of the characteristics of 401(k)s that I described.

First – disclosure. The fund industry believes plan sponsors need clear information on the economics of the plan services that they buy, and workers need clear disclosure to help them make vital decisions on how to invest. The question is how to achieve those goals. We would prefer that the Department of Labor finish its comprehensive disclosure agenda, which addresses the needs of both plan sponsors and participants, because the Department is well-equipped to deal with these complex issues.

As you all know, Congress is also interested in this issue. You're no doubt familiar with the bill passed by the House Education and Labor Committee, under Chairman George Miller from California. There are two other bills in play in the House, from Democrat Richard Neal of Massachusetts and Republican John Kline of Minnesota. Chairman Miller's bill would have Congress mandate, for the first time, a specific investment option for all 401(k) plans. And it would favor a particular business model for providing plan services. The Neal and Kline bills are less likely to stifle innovation, take decisions out of the hands of employers, or impose one-size-fits-all solutions. Thus, in our view, they play to the strengths of 401(k)s.

Preserving the strengths of the system is vitally important. Consider target retirement date funds. These represent one of the most important innovations in retirement savings. They provide an efficient way for an investor to purchase a mix of asset classes through a single fund, which rebalances its asset allocation periodically and becomes more focused on income over time. They help savers meet the challenge of following a consistent investment strategy that evolves as they age. Not surprisingly, many plans, and many investors, are using these funds effectively.

Coming out of the financial crisis, however, these funds have caught Washington's attention. Both the Labor Department and the Securities and Exchange Commission are examining regulation of target date funds, and the Senate Aging Committee has raised questions about them.

It would seem that much of the controversy about these funds has been generated by certain pension consultants who have their own business interests in the debate. Target date funds are a highly efficient mechanism for allocating assets and tailoring investment risks over time. That is not lost on these consultants, who would prefer that 401(k) plans pay them for that service.

Unfortunately, some of the bombast from this quarter has been accepted uncritically.

For example, it is claimed that mutual funds using a target date strategy are "unregulated." No one remotely familiar with our industry can believe that – just ask yourself how many lawyers you encounter every day! When you point out that mutual funds are comprehensively regulated, the critics insist that only ERISA regulation is strong enough to suit them. But the "fiduciary gap" they claim is fictitious. Both the '40 Acts and ERISA impose fiduciary duties, and both have strong enforcement mechanisms to police unscrupulous operators.

There is also the notion that target date funds typically have high fees. The fact is that target date mutual fund investors incur fees that fall in the low end of the range for equity and bond funds. As of mid-2009, these fund investors paid an average expense ratio of 66 basis points – close to the 63 basis points paid by bond funds investors, and far less than the 84 basis points for equity funds.

That being said, sponsors of target date funds clearly need to redouble efforts to enhance understanding of these funds. ICI has proposed a set of disclosure principles to highlight and prominently display the key information that employers and investors need. This is not new disclosure – the information is already available in the comprehensive material that mutual funds provide. But we want to be sure that employers and workers can easily find information on the meaning of the fund's target date; the fund's assumptions about investors' intentions to withdraw at and after the target date; the age group for whom the fund is designed; its changing asset allocation or "glide path"; and the risk of losses in

target date funds.

We've given our principles to the Labor Department and the SEC, and we hope they'll use a similar approach should they decide to develop new disclosure rules. The same disclosure should apply to all target date strategies – whether they are offered as mutual funds, collective trusts, insurance company separate accounts, or customized products from pension consultants.

Another issue that needs to be addressed is the challenge of managing savings in defined contribution plans and IRAs during retirement. Extensive research by the Institute shows that, by and large, retirement savers act responsibly with their defined contribution plan account balances at retirement, and are good stewards of their IRA balances. In fact, many retirees tend to preserve their accounts until the government forces them to take a distribution, starting at age 70-1/2.

That fact points up that we can do a better job of giving workers flexibility to manage their assets in retirement – particularly in view of increased life expectancies and the challenge of meeting health care expenses. One good idea is to change the rules for required minimum distributions. Congress has tried this, temporarily waiving the RMD rules for tax year 2009 as part of its efforts to help seniors cope with the financial crisis. ICI has recommended that the age for RMDs should be permanently raised to 75.

Where we see evidence that retirees are good stewards of their assets, many policymakers see concerns that retirees need more direction in managing their accounts. The Labor and Treasury departments currently are seeking comment on whether they should encourage or require retirees to convert some of their account balances to annuities, and some lawmakers have expressed support for an annuity mandate.

Annuities play an important role in retirement security. And companies across the financial industry – including many mutual fund sponsors – are exploring innovative products to meet retirees' interest in lifetime income.

But offering products to meet a market need is one thing – mandating use of a product is another. And our survey research finds that Americans reject the notion of mandated annuities.

In our household survey last November and December, 96 percent of all households agreed that retirees should be able to make their own decisions about managing retirement assets and income.

And more than 70 percent of households disagreed with the notion of requiring retirees to buy annuities with a portion of their retirement plan accounts – whether that annuity is offered by an insurance company or by the government. In other words, opposition to a mandated annuity is overwhelming.

We don't find that surprising. First, almost all American workers start retirement with one of the best annuities available – a lifetime income program that is indexed to inflation and that fairly rewards deferring benefits until age 70. I'm speaking, of course, of Social Security, which provides lower- and middle-income Americans with a strong base of annuity income in retirement.

It's also important to remember that one key strength of the 401(k) system is its flexibility, rooted in the principle that key decisions should be in the hands of employers and workers.

Our surveys clearly indicate that Americans recognize and value that flexibility.

There is no one model for managing assets in retirement that is best for all retirees, or even for a majority. Each individual faces a different mix of factors – work history, life expectancy, health needs, family circumstances, homeownership, other assets outside of retirement accounts – to name just a few. As our research shows, participants want to maintain control of their retirement assets, and retirees should have the right to spend their hard-earned retirement savings as they see fit. Many retirees will strive to preserve their assets for emergencies, while some have a strong bequest urge. And then there are those whose emphasis is on their own retirement – the ones who have the bumper stickers that say, “I’m spending my kids’ inheritance.” I must have seen a dozen of those on my trip here from the Miami airport.

The Institute hasn’t yet responded to the request for information from Treasury and Labor. But when we do, we will make three key points:

- Americans don’t want or need a mandate to purchase annuities;
- Any incentives for annuity options should also apply to products that arrange systematic withdrawals from plan assets, and
- What Americans do need and want more of is information and access to advice that will help them make informed decisions about managing their assets and income in retirement.

Let me just touch on one last policy issue. So far, I’ve been discussing measures that would help the 65 million Americans who already participate in defined contribution workplace plans. ICI also supports efforts to expand access to retirement savings, whether through simpler plans for small employers or through payroll IRAs.

President Obama has proposed requiring firms with 10 or more workers to offer payroll-deduction IRAs, with automatic enrollment. We are studying that idea with an eye toward the key characteristics of 401(k)s. An Auto IRA should not foster the creation of a large government bureaucracy, because the private sector can meet the needs of these savers. Nor should it be burdened with highly prescriptive regulation of providers and products. And it is vital that any new savings plan does not undermine the successful employment-based retirement system by discouraging employers from offering 401(k) or pension plans.

I’ve given you a rather healthy dose of policy-speak today. You’ll have to forgive me – that’s the world that ICI lives in. And the instruments of policy – laws, regulations, interpretations – have shaped America’s approach to retirement savings and retirement security, including the 401(k) system.

But immersed as we are in Washington policy details, I often make a point of stepping back to take a larger view. No matter how familiar we are with the 401(k) system, we must never take it for granted. It is a uniquely American creation – innovative, flexible, driven by a unique private-sector partnership operating in a framework of sound policy decisions, and well-suited to the needs of an evolving American workforce. It enables workers of ordinary means to save, to share in the wealth and productivity of American business, and to enjoy a more secure retirement when their careers are complete. Its success is evident in the \$8 trillion – half of Americans’ retirement assets – that can largely be attributed to savings in defined contribution plans.

And I try always to remember the crucial contributors who design the plans ... who manage

the investments ... who efficiently and accurately process millions of transactions ... who invent the new services ... who educate the participants ... and who have created, and continue to create, this successful system. That includes many of the people here today, and the companies you represent. You have contributed to this uniquely American success story, and you continue to help build retirement security for your fellow Americans.

For that – and for the pleasure of appearing before you today – I am grateful. Thank you for your time and attention.

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