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Retirement Savings: Big Picture, Big Opportunity

ICI President's Remarks Before the Economic Club of Chicago

Retirement Savings: Big Picture, Big Opportunity

By Paul Schott Stevens

President, Investment Company Institute

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Thanks for that introduction. It really is a pleasure to be here at the Economic Club of Chicago.

Someone once said: "The best time to start thinking about your retirement is before the boss does."

However close you may be to your own retirement, the best time to start thinking about it is now, so I am glad you are participating in this discussion on such an important issue.

As Lou noted, my goal is to give you a big-picture look at retirement savings in America. If you take one thing away from my remarks, I want it to be this: the "doom and gloom" scenario that is often portrayed in discussions about retirement savings is not warranted.

Let me take just a few minutes to explain three key points:

- First, we have more opportunities today to save for retirement than we had a generation ago.
- Second, innovations and recent changes to pension laws are helping people save more and get the best return on their money.
- And, third, we must build on the progress we have made to help more Americans take full advantage of the savings opportunities available to them.

Growth of the 401(k) Re-Defines Retirement Saving

To get a clear picture of where America stands on retirement savings today, we must first consider where we were a generation ago.

25 years ago, most Americans did not have enough in discretionary savings alone to retire comfortably. Social Security helped provide a portion of retirement income for just about everyone. Designed to be the cornerstone of retirement security, Social Security wasn't enough by itself to replace pre-retirement income. Traditional pension plans were available to only a limited portion of the workforce, and defined benefit plans dominated the landscape, covering 83 percent of workers in pension plans in 1980. Although they held the promise of additional benefits, many workers left jobs before being able to collect significant benefits.

That was the picture of retirement savings in America…until November 10, 1981.

Exactly 25 years ago today something very important happened: The IRS proposed regulations that made it possible for workers to contribute a portion of their salary on a pre-tax basis to 401(k) plans. These plans were unique. They empowered individuals to play an active part in retirement savings and planning. They provided an important tax incentive for saving, and the benefits accrued more steadily than in a traditional defined benefit plan in a portable, easily understood account.

Sounds like a great idea now, but the reality is 401(k) plans were somewhat of a "happy" accident. Congress did not have in mind a comprehensive approach to retirement savings. It originally created 401(k) to address a narrow issue about profit-sharing bonuses. Yet, because 401(k) contributions and earnings are tax deferred, concerns about lost tax revenue were a thorn in the side of this program from its inception.

As the graph illustrates, legislative and regulatory restrictions actually scaled back the defined contribution plan limits from where they were originally envisioned and held them down for decades. You can see that the limit has not yet made it back to the level it was in 1982. In other words, it was possible for an employer and employee together to contribute more to a 401(k) plan in 1982 than it is today.

Yet, even with such strong regulatory headwinds, a landmark shift in retirement benefits occurred during the past 25 years, driven by significant changes in American industry. 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.

Finally, starting in the late 1990s, Congress acted to encourage growth in 401(k) plans. In 1996, legislation reduced the compliance burden for smaller businesses. Five years later, Congress increased the amount a worker could contribute to a DC plan, as well as the total contribution from both employee and employer.

This slide illustrates how these important legislative changes made it possible for workers to increase their contributions each of the past five years. As you can see, lawmakers also allowed older employees to make catch-up contributions – important for workers nearing retirement.

Today, 401(k)s are the most common type of retirement plan offered by private-sector employers in the United States.

401(k)s have more active participants and about as much in assets as all other private pension plans combined – quite an increase from where we were in 1980. In 2005, 47 million American workers were active participants. And by the end of 2005, 401(k) plan assets totaled a remarkable $2.4 trillion, compared to $1.9 trillion in private employer-sponsored defined benefit plans.

But that's not all of the 401(k) story. Today, nearly half of all assets in Individual Retirement Accounts, or IRAs, came from employees who rolled over assets from employer-sponsored plans, including 401(k)s. That's another $1.5 trillion saved. 401(k) also has become a model for other countries, as they look to expand retirement savings.

As we mark the 25th anniversary of 401(k), we should be mindful of just how far retirement savings and planning have come.

Pension Protection Act Makes DC Plans More Effective

With that brief history, let me give you a preview of the next chapter in retirement savings.

Lawmakers in Washington recognize that 401(k)s are the way forward in retirement savings, and they are serious about making them available and accessible to more Americans.

In August, President Bush signed the Pension Protection Act. This bill will make 401(k)s even more effective. It does five key things, from a policy perspective:

- First, it permanently increases the contribution limits.

- Second, it locks in the provisions for catch-up contributions – that's key for baby boomers.
- 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.
- 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.

These changes will have a profoundly positive impact on the big picture of retirement savings in America.

Mutual funds also play an important role in shaping the retirement security "Big Picture."

Today, 51 percent of 401(k) assets are invested in mutual funds. And 72 percent of mutual fund shareholders say saving for retirement is their primary financial goal.

It is no surprise that mutual funds are attentive to ideas that help Americans make the most of their savings. Recent innovations in lifestyle and lifecycle funds are great examples. These funds invest in a mix of stocks and bonds, determined by an individual's risk tolerance or retirement date. Investors can "set it, and forget it."

Consistent participation in a 401(k) plan pays off in the long run. In fact, our data show that steady savers benefit, even in the wake of the last "bear" market – the worst since World War II.

Together, the supportive regulatory environment and industry innovations are promising even greater opportunities for retirement savings in the years ahead. That's good news for all of us here today.

More Work To Do

Now, I know what some of you are thinking: "If we have made so much progress, and there are so many opportunities to save, why aren't more Americans better prepared for retirement?" That's a fair question, with several answers.

As Lee discusses in his book, there are psychological factors that inhibit people from thinking about retirement. And as Terry notes in her book, many people need help with the "how to" of retirement planning. But even with the right tools, mindset, and expert advice, Americans still face some limitations.

Federal Reserve Board Chairman Ben Bernanke recently discussed one of the biggest challenges in a speech to the Washington Economic Club, where he said, "A failure on our part to prepare for demographic change will have substantial adverse effects on the economic welfare of our children and grandchildren and on the long-run productive potential of the U.S. economy."

If we are going to secure a bright future for the next generation of retirees, we have to move retirement savings forward at a much faster pace and consider new approaches that encourage additional savings.

We all have a part to play. Through forums like this one, we can help spread the word to consumers about the tools and resources that are available to them today. Business leaders, like you, can help make more savings options available to more employees. Finally, lawmakers and regulators must continue to innovate our policies to provide important further savings options to working Americans.

Conclusion

The big picture of retirement savings shows big opportunities.

We have more tools to expand retirement savings. We have to help more Americans use them – and do so ever more effectively.

Thank you, again, for the opportunity to be here; I look forward to taking your questions.
