TOP STORY

The 2005 NAGD*CAST* Series Begins with a Legislative Update

NAGDCA is pleased to announce the 2006 NAGD*CAST* series begins with the highly anticipated webcast, which offers an up-to-date look at Legislation which may affect Retirement Plans nationwide. Anthony Hines, Commonwealth of Pennsylvania, will serve as the moderator. Speakers include Susan White, NAGDCA Legislative Counsel, and Phillip W. Rivers, a Partner at Locke Liddell Strategies. Participants will be afforded the opportunity to ask questions at the end of the presentation via live call in or through the chat feature of the webcast.

In addition to enhancing your knowledge of defined contribution plans, NAGD*CAST*s are worth 1.5 continuing education credits through the International Foundation for Retirement Education (InFRE). NAGDCA will provide InFRE a list of all actual participants. NAGD*CAST* participants seeking continuing education credits must file appropriate forms with InFRE.

NAGDCA would like to thank the sponsors of the 2005 NAGD*CAST* series. Without their support these events would not be able to take place. Please take a moment to visit their websites: AXA, CitiStreet, Fidelity Investments, Great-West, The Hartford, ICMA Retirement Corporation, ING, Mass Mutual, Nationwide Retirement Solutions, T. Rowe Price, Vanguard. Future webcast topics will include Special Circumstances (Leaves/Absence, Loans and Military Catch-Up) and Unforeseen Emergency Provisions.

If you are interested in sponsoring the 2006 NAGDCAST series please visit the following link https://www.nagdca.org/meetings/NAGDCASTsponsor.cfm or contact Robert T. Hansel at rhansel@amrms.com or 859-514-9161.

The cost of the webcast is $75 for non-webcast sponsoring industry members and $100 for non-members. Registration will be available on the NAGDCA website soon. A password is not required to register. For more information on the 2006 NAGD*CAST* series please contact Robert T. Hansel at rhansel@amrms.com.

2006 Annual Conference (MARK YOUR CALENDAR)

September 23-27, 2006
Kansas City, Missouri
Hyatt Regency Crown Center

PRESIDENT'S CORNER

The 2006 Annual Conference, Industrial, Legislative, Market Outreach, Survey, and Publications Committees have started to work on their priority projects and issues. This year we have 3 special committees/ task forces reviewing Auto Enrollment, Redemption fees, and NAGDCA's Investment Policy. NAGDCA is very fortunate to have so many members who are willing to volunteer their time to serve on a committee or task force and support the Association's mission and goals. If you expressed an interest in participating on a committee but have not yet been selected, please don't be discouraged. We value your willingness and will do our best to see that you are placed on a task force or committee this year.

We anticipate that the first *NAGDCAST* to be a Legislative Update. It will be held in March. More information about this educational opportunity can be found on the website. We anticipate that there will be three NAGDCASTS in 2006 covering a range of defined contribution topics.

I want to remind members to visit the NAGDCA web site for brochures and information about legislative issues, as well as the clearinghouse for RFPs, forms and DC information.

This year NAGDCA will be conducting our 2006 Survey (of 2005 data). We encourage all plan sponsors to assist in our goal of 100% participation. Here are some statistics from the past.

NAGDCA – THEN & NOW

1981:

- 36 plans reported
- 136,000 participants
- Average participant in the 36 states contributed $1,962.91 per year.
- Nearly $267 million in total annual deferrals (from 36 Plans)

1997:

- 93 plans reported
- 1.1 million participants (22.3 percent of the 5.03 million eligible participants)
- Average participant in the 93 plans contributed more than $38.6 billion in total annual deferrals

2003:

- 78 plans reported, including 31 state 457 plans, 35 local government 457 plans, 8 state 401(k) plans, and 4 local government 401(k) plans
- Approximately 1.25 million active participants
- $4.85 billion in annual deferrals plus $498 million in employer contributions
- Approximately $61.5 billion in assets

Sources:
Data taken from a NAGDCA September 1981 newsletter report and from the 1997 and 2003 Survey of Plans done by NAGDCA (National Summary).

This is going to be an exciting year for those of us in the defined contribution industry, as well as NAGDCA as an association. I look forward to working with all of you as we move forward to create a stronger association that is better able to support and serve its members. As always, it is an honor to serve you and the association, and, on behalf of the Board of Directors, *all the best* for a productive and prosperous 2006.

INDUSTRY VIEWPOINT

Stable Value & Social Security: What Could the Push for Social Security Privatization Mean for Stable Value?

By Chris Tobe, CFA, AEGON Institutional Markets

For many reasons, President Bush appears to be facing an uphill battle in passing Social Security reform legislation that would partially privatize the government-run program. Nevertheless, the President continues to press his case for reform and his political will should not be underestimated. If he succeeds, what might "partial privatization" look like and how might stable value, as an asset class, fit into this paradigm?

To date, the President has not presented a specific and detailed plan; rather, he has proposed reform objectives based on certain principles. The first of these principles is to preserve the current level of benefits for retirees and near-retirees. The second is to maintain current levels of Social Security taxation; i.e., Bush would not increase the payroll tax that currently funds Social Security.

The third principle is where “privatization” comes in. The President proposes to establish voluntary “personal retirement accounts” for younger workers that would prefund a portion of their income during retirement. Individual workers could elect to divert a portion of their payroll taxes into these personal accounts, which would then grow tax-deferred. The balance in these accounts would be available to individuals at retirement, thereby reducing their need for guaranteed benefits from the government.

Critics maintain that such accounts would place retirement funds in jeopardy by shifting market risk to individual investors, while ensuring windfall profits for the Wall Street firms involved in managing these accounts. Wall Street, by and large, has adopted a “wait-and-see” approach to the President's proposals, primarily because it is far from certain yet how these personal accounts would be structured and what types of investments would be permissible.

The most likely scenario at this stage, and one floated by the Bush Administration itself, is that such personal retirement accounts would be modeled after the government Thrift Saving Plan (TSP) available to federal workers and members of Congress. According to a White House statement released on February 10, 2005:

The system of personal retirement accounts would be similar to the Federal employee retirement program, known as the Thrift Savings Plan (TSP). Contributions would be collected and records maintained by a central administrator. Personal retirement accounts would be invested in a mix of conservative bond and stock funds. Workers would be permitted to allocate their personal retirement account contributions among a small number of very broadly diversified index funds patterned after the current TSP funds.[i]

Based on this information, one could make the reasonable assumption that some form of stable value—possibly amounting to hundreds of billions in total plan assets—would be front and center in a partially privatized Social Security system. Why? Of the $141 billion in total plan assets invested in the TSP, nearly half—$65 to $70 billion—is allocated to a stable value option called the “G Fund,”[ii] which is invested exclusively in specially issued U.S. Treasury securities. Interestingly, both President Bush and Vice President Cheney have noted the returns available from the G-Fund as a way of touting the Administration's reform proposals. During a Town Hall meeting in Smyrna, Georgia on May 2, 2005, for example, Vice President Cheney had this to say about the TSP funds: “... the most conservative [the stable value G Fund], has gone up about four percent per year. ...Now compare that to the rate of return that you, in effect, get on your Social Security when you pay into the regular Social Security trust fund, that's less than 2 percent.” That is essentially the same argument the stable value industry has used for years when comparing stable value returns to money market returns.

What is the G Fund and what makes it a stable value option? The TSP website (www.tsp.gov) describes it this way:

The G Fund consists exclusively of investments in short-term, nonmarketable U.S. Treasury securities specially issued to the TSP. G Fund investments earn interest at a rate that is equal, by law, to the average rate of return on outstanding U.S. Treasury marketable securities with 4 or more years to maturity. Currently, the maturities of the securities in the G Fund range from 1 day (on business days) to 4 days (over holiday weekends). There is no credit risk (that is, risk that principal or interest will not be paid) for the Treasury securities in the G Fund. They are guaranteed by the full faith and credit of the U.S. Government. Because of the Board's current policy of investing only in short-term securities, there is also no market risk in the G Fund. Market risk is the risk of fluctuations in the value of securities due to changes in overall market rates of interest. If you are uncomfortable with market risk, the G Fund may be the most appropriate investment fund for you. However, G Fund rates of return may well be lower than those of the other TSP funds over the long term. As a result of the G Fund rate calculation and the Board's policy of investing exclusively in short-term securities, investors receive a longer-term rate on short-term securities and at the same time avoid the market risk associated with longer-term securities.[iii]

For federal employees—ranging from park rangers to SEC staff to members of Congress—invested in the option, the G Fund operates as a stable value fund because investors "receive a longer-term rate on short-term securities and at the same time avoid the market risk associated with longer-term securities." This is a concept familiar to 401(k) stable value investors, who have always enjoyed longer term returns with book value liquidity. The major difference is that, unlike 401(k) stable value options, no third-party synthetic GIC provider contractually ensures those benefits in the G Fund; rather, the U.S. Treasury subsidizes the fund by effectively acting as the GIC provider. This subsidy is potentially huge. Consider: a synthetic GIC contract achieves stable returns through a smoothing mechanism that amortizes return volatility over time. If a $70 billion fund used a conventional synthetic GIC contract, the value of the smoothing effect, based on contract fees of five to ten basis points, would be $35 million to $70 million per year. By contrast, the G fund has no such amortizing mechanism; rather, the U.S. Treasury simply guarantees long-term rates on short-term money. In effect, the government subsidy is the difference between short and long-term rates—an enormous benefit that far outstrips the value of conventional synthetic GIC fees.

The table below illustrates the historic GIC-like returns G-fund participants have enjoyed with little volatility:

Year	G Fund*	Related Securities**
1993	6.14%	6.23%
1994	7.22%	7.29%
1995	7.03%	7.10%
1996	6.76%	6.80%
1997	6.77%	6.80%
1998	5.74%	5.77%
1999	5.99%	6.03%
2000	6.42%	6.42%
2001	5.39%	5.36%
2002	5.00%	4.98%
1993-2002 compound annual rate of return	6.24%	6.27%
* These rates are stated after deducting the administrative expenses of the TSP.		
** Rates of return were calculated by the Board. These figures are based on the statutory rate of return and are stated without any reduction for administrative expenses.		
Source: http://www.tsp.gov/rates/monthly-history.html		

If the TSP model is followed for the Social Security reforms championed by President Bush, the question is: Will the U.S. Treasury similarly subsidize the entire Social Security investor population—up to 148 million participants according to the Employee Benefit Research Institute, compared to 5 million participants currently in the TSP plan[iv]—by acting as the synthetic GIC provider for personal retirement accounts? If so, no private provider could compete head-to-head with the U.S. Treasury. Given the President's focus on costs and privatization, however, it is far more likely that any reform legislation enacted would authorize a competitive bidding process among private providers for stable value funds within the accounts. Assuming this is the case, the closest analogs for how such a process might work for Social Security accounts are probably the

Federal Reserve Deferred Compensation plan (for Federal Reserve employees and the only option available at the federal level other than the TSP) and public plans offered at the state and local government levels.

The federal TSP, at $141 billion in total plan assets, is by far the largest public retirement plan—the next largest public plans dip dramatically to around $11 billion, with Texas Municipal Retirement at $11.6 billion and New York City Public & Teachers at $10.8 billion. Total plan assets go down from there with only about ten plans topping $3 billion or more in total plan assets.

Stable value funds in public defined contribution plans consist of a wide range of structures. The oldest model sometimes called an IPG is basically a general account GIC like product usually issued by one insurance company. The larger accounts mentioned in this article use either a diversified portfolio of traditional GICs or synthetic GICs (also called "wraps") or some combination.

Excluding Texas Municipal Retirement fund, at $11.6 billion, which is managed in-house with an internal guarantee like the federal Thrift Savings Plan, many of the remaining largest public plans use stable value extensively:

- The NYC Public & Teachers, at $10.8 billion in total plan assets, uses a combination of traditional and synthetic GICs, but with a majority in synthetics.

- The University of California, the next largest public plan at just under $8 billion in total plan assets, uses traditional GICs exclusively.

- The New York State Deferred Compensation plan, with total plan assets of $6.5 billion, uses a combination of traditional and synthetic GICs, but with a majority in traditional GICs.

- Washington State Board, at $5.5 billion in total plan assets, primarily uses traditional GICs.

- California Savings, at $5.1 billion in total plan assets, primarily uses synthetic GICs.

- Ohio Deferred Compensation, also with $5.1 billion in total plan assets, primarily uses synthetic GICs.

- Los Angeles County Deferred Compensation, with $4.2 billion in total plan assets, uses both traditional and synthetic GICs.[v]

- Almost seventy percent of the Federal Reserve's $3.2 billion deferred compensation plan—$2.3 billion—is invested in that plan's stable value option, comprised entirely of traditional GICs.[vi]

In summary, a stable value option within an investment platform for Social Security personal accounts is likely to be based on one of two paradigms (assuming the U.S. Treasury does not subsidize the accounts): (1) the Federal Reserve model, in which a portfolio of one-hundred percent traditional GICs are bid out on a continual basis to ensure diversification; or (2) the synthetic GIC model used in many large state/city plans. The older IPG single issuer model would probably not be considered due to credit, diversification, and transparency concerns.

Stable value is the top choice of federal employees in both the federal Thrift Savings Plan and the Federal Reserve Deferred Compensation plan because it provides attractive returns while insulating investors against short-term market swings. For precisely that reason, it is obvious that stable value, regardless of the delivery platform, should be offered as a choice if Social Security is partially privatized.

[i] http://www.whitehouse.gov/news/releases/2005/02/20050210-1.html

[ii] http://www.nelsons.com

[iii] http://www.tsp.gov/features/chapter08.html#sub1

[iv] http://www.ncpa.org/pub/ba/ba443/

[v] Pension & Investments January 24, 2005

[vi] http://www.nelsons.com

EVALUATION OF ASSET ALLOCATION FUNDS

By Chuck Sklader, Bill Tugaw and Paul Hackleman

What is asset allocation?

Asset allocation is an investment technique that provides investment diversification which can reduce risk and may improve returns for investors over a period of time. It provides for a strategic diversification of assets / paycheck contributions among the major asset classes, i.e., stocks, bonds and cash equivalents (often money market securities).

Asset allocation is initially a three step process. First, identify the asset categories or investment instruments that will compose the diversified portfolio. Next, determine what specific funds will be utilized and finally, what percentage of the assets and/or paycheck contributions will be allocated to each fund.

The appropriate asset allocation for an investor can be determined by the individual investor. However, many investors either do not have the knowledge or the inclination to develop their own asset allocation. After all, some employer sponsored portfolios offer fifty (50) or more funds and that can be intimidating to someone trying to develop an individual portfolio of funds from different asset categories. If they do develop a diversified portfolio based on asset allocation they rarely rebalance the allocation as the percentage of assets in each asset category changes over time or due to economic or market conditions.

Alternately, an investor can select a mutual fund that is designed to provide asset allocation as well as a periodic change to the asset allocation composition based a variety of conditions, often economic. Asset allocation funds are managed by investment professionals who provide diversification by allocating fund assets among multiple asset classes, equities, bonds and cash equivalent securities.

Many define contribution plans have three to five asset allocation funds ranging in risk from conservative to aggressive. Before the investor either determines their asset allocation or selects an asset allocation fund the investor must first determine how much risk they can handle. There are many risk tolerance tests that can help the investor determine how much risk is appropriate for them. The internet is one source, but a good source would be the provider, (recordkeeper).

A key tenet to investing is to evaluate investments against appropriate benchmarks to determine the quality of performance and to determine if the performance merits the risk the fund is absorbing to achieve that performance. Before we discuss the evaluative process for asset allocation funds we should first restate the value of asset allocation models for the investors (current participants and retirees) in public sector defined contribution plans.

In an article published in InFRE, volume 5, number 1, 2004 “Rethinking Public Sector Asset Allocation Models” the authors’ state the importance of taking into consideration the lifetime income that is provided by the public employers defined benefit pension in determining the investment allocation of their supplemental retirement plan(s).

The aforementioned paragraph alludes to the investors in public sector entities, but retirees of both public and private sector employers who participated in define contribution plans, should consider asset allocation funds. Through diversification, risk can be reduced and additionally, asset allocation funds allow the investor to take advantage of retaining a portion of their assets in equities. Historically, equities have produced a higher average rate of return than other commonly held investments, but also provide the most short term risk and volatility.

Evaluation of asset allocation funds

Education provided by the employer for the benefit of the participants, including retirees, is necessary and it has been affirmed that it is a fiduciary responsibility of the employer to provide the education and to encourage participants to attend educational sessions.

Another key fiduciary responsibility of the employer is to conduct investment fund evaluations on a periodic basis, (no less often than annually). The evaluation of funds is usually performed by the provider, the employer or a consultant hired by the employer, (regardless of who performs the analysis the responsibility remains with the employer). The purpose is to provide an objective analysis of each fund against a predetermined benchmark and where a particular funds fails to perform adequately against the appropriate benchmark action must be taken, i.e., watch list or de-selection.

For nearly all asset categories appropriate benchmarks are readily available. The exception is asset allocation funds. One provider of asset allocation funds compares the fund results to the Lehman Brothers Aggregate Bond Index and compares the same results to an equity index. This is done without regard for the mix of investments. In most years the asset allocation fund will outperform the Lehman Brothers Aggregate Bond Index and under perform the equity index. This type of benchmarking doesn’t provide a complete analysis of the fund(s).

Two commonly used indexes are the Dow Jones 40% US Portfolio and the Dow Jones 60% US Portfolio. The equity position, 40% or 60%, is constructed of equal weighting of six (6) U.S. equity style indexes ranging from large growth to small value. The bond and cash positions are composed of various Lehman Brothers U.S. fixed income indexes.

These indexes provide some applicability to perhaps two of the three - five asset allocation funds. However, the equal weighting of the six equity styles is a concern as typical allocations for conservative and moderate funds are more heavily weighted toward large cap and there is no inclusion of international investing in the Dow Jones models.

Morningstar, a Chicago based investment analysis firm, has developed two asset allocation indexes, Conservative Allocation and Moderate Allocation. The conservative allocation is a benchmark for funds that have 20%-50% invested in equities and 50%-80% invested in bonds and cash equivalents. The moderate allocation has 50%-70% invested in equities with 30%-50% invested in bonds and cash equivalents.

The ranges are too broad to provide an appropriate comparison for the three to five asset allocation funds typically found in employer sponsored portfolios.

A Viable Solution – Fund of Funds

The development of asset allocation funds that are composed of mutual funds already in the employer sponsored portfolio is a **fund of funds** approach. As part of the employer’s due diligence and fiduciary responsibility the funds are evaluated on at least an annual basis. The asset allocation fund need not be evaluated since the underlying funds are evaluated at least annually. If a mutual fund needs to be replaced, and is also a fund in the asset allocation model, then the replacement fund is added in the same proportion as the fund it is replacing to that asset allocation fund(s).

The cash equivalent category can be the stable value fund rather than a money market fund. Typically, the stable value fund outperforms the money market fund and is net of expenses.

The following are examples of asset composition of three asset allocation funds:

	Conservative Allocation	Moderate Allocation	Aggressive Allocation
Large Cap Value	0%	10%	10%
S & P 500 Index	20%	10%	15%
Large Cap Growth.	0%	15%	15%
Mid Cap Blend	0%	10%	20%
Small Growth	5%	10%	15%
International Growth	5%	5%	10%
Bond	20%	15%	15%
Stable Value	50%	25%	0%

An additional benefit of the **fund of funds** approach is reduced expenses. The expense of two of the three asset allocation funds of funds is considerably lower than the average expense for asset allocation funds in either of the Dow Jones 60/40, 40/60 scenarios. Accurate expense averages for the aggressive asset allocation funds are difficult to determine as the aggressive asset allocation funds typically are classified as equity funds.

	Conservative Allocation	Moderate Allocation	Aggressive Allocation
Total Expense*	0.42%	0.71%	0.98%
Average Expense**	1.20%	1.30%	Unknown

In conclusion, the value of asset allocation funds is reduced risk through asset diversification and potentially better and more consistent returns. Applying predetermined benchmarks to evaluate the asset allocation funds is an inaccurate process. The solution is to develop asset allocation models (funds) comprised of mutual funds and a stable value fund from the employer sponsored portfolio. This solution is not new; it is already used by some government entities.

Regardless of what asset allocation model or fund is used, the key is to provide education to participants, including retirees, about the benefits of the diversification process that also includes a view of the constant lifetime income that is provided through the public employers defined benefit pension plan.

***** The total expense is based on actual mutual funds used for the **fund of funds** asset allocation models in a defined contribution portfolio for a specific government entity.
******The average expense is based on the average of all funds categorized by Morningstar in the Dow Jones 40/60 and Dow Jones 60/40 indexes.

About The Authors

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Paul Hackleman is the Benefits Manager for San Mateo County, California and a consultant with I.C. Benefits Consulting with 23 years of employee benefit experience. In San Mateo County, he manages the County’s $200 million deferred compensation benefit programs. Paul is a faculty member of the International Foundation of Employee Benefit Plan’s (IFEBP) Certificate of Achievement in Public Plan Policy - Health (CAPPP) Program. Paul is a past Director with the Foundation’s Board of Directors and Chair of the Foundation’s Public Employee Board. He is the co-author of *Public Employee Benefits: From Inquiry to Strategy* published in May, 2000 and co-author of *Deferred Compensation / Defined Contribution: New Rules / New Game for Public and Private Plans* published in June, 2001 and *Defined Contribution Decisions: The Education Challenge* published in 2004.

Win By Default—the Most Important Investment Option

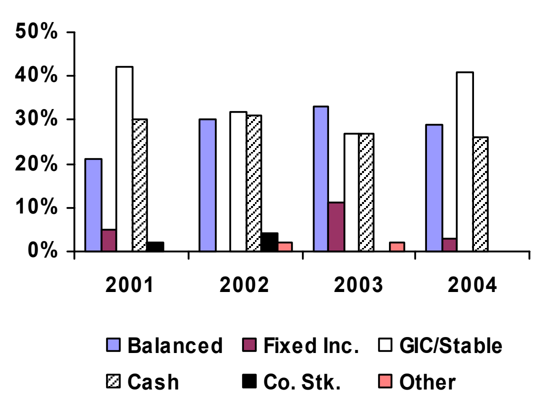
Investment Options

The dramatic growth in investment options offered by Defined Contribution plans has generated considerable and useful debate. On the one hand, the discussion encompasses participant utility via diversification, choice and enhanced welfare and, on the other hand, participant paralysis in the face of excessive choice with limited understanding and interest in asset allocation. In this discussion on investment options, it is imperative to focus on the most important investment option, the default option—the option designated by the pension plan to receive undirected contributions from participants.

Default Option Trends

A review of the Cost Effectiveness Measurement (“CEM”) database showed that the number of plans offering a default option has grown since 2001 from 54% to 78%. Further, the default option retained a high level of stability. For plans with three consecutive years of data, 90% of plans maintained the same default option. There were three principal default options: Balanced/Lifestyle Funds, GIC/Stable Value Funds and Cash. These three asset classes represented 93% of all default options offered. Use of Balanced/Lifestyle Funds recorded the greatest increase from 21% to

Types of Default Options Offered



29% from 2001 to 2004.

The Default Option and Automatic Enrolment
As expected, in 2004, 100% of plans with an automatic enrolment program also offered a default option while 70% of plans with no automatic enrolment program offered a default option. It was surprising however that almost 40% of plans with automatic enrolment offered a Balanced Fund default compared with 23% for plans without automatic enrolment. The expectation of a more conservative default option profile in plans with automatic enrolment, as suggested in research literature, was unfounded.

The Default Option and Access to Investment Advice
The default option was not a substitute for access to investment advice. On the contrary, access to advice increased at an increasing rate. In 2001, the proportion of plans which offered a default option and also offered access to advice was one-quarter. By 2004, this proportion exceeded one-half. The proportion of plans in the universe which offered neither a default option nor access to investment advice was 10%.

The Most Important Investment Option
Nobel Laureate Daniel Kahneman argues that the default option is essential to the pension plan design. It serves all the participants who lack the confidence or interest to establish their own asset allocation: “If we are going to make people fly their own planes, we should expect them to rely on the autopilot, and it must be designed accordingly”[1].

The CEM database highlights the importance of the default option. For the period from 2001 to 2004, default options increased the percentage holdings for a given asset class by a significant level. For example, as shown in the graph below, plans whose default option was Balanced Funds had 22% of total assets invested in Balanced Funds. By comparison, plans whose default option was not Balanced Funds had only 11%. The multiplier effect was 2.0x. On average, across different types of default options, the multiplier effect was 2.3x.

The strong propensity to invest in the default option is supported by research literature. In a US study, Choi found that almost one-half of study participants invested solely in the default option after three years[2]. Also, Kahneman reports that three years after the establishment of private pension accounts in Sweden, the number of participants selecting the default option rose from 33% to 93%[3]. Given the powerful impact of the default option on asset allocation, the success of a pension plan’s ability to provide suitable diversification and long run wealth accumulation will reflect the careful consideration given to the selection of the default option.

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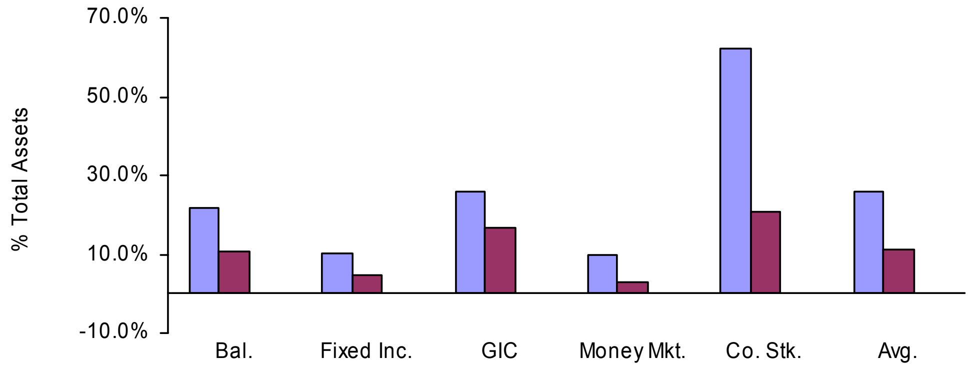
[1] Daniel Kahneman, Terrance Odean and Brad Barber, “Privatized pensions: an irrational choice,” Global Agenda 2005. 20 July 2005 <http://www.globalagendamagazine.com>.
[2] James Choi, David Laibson, Brigitte Madrian, and Andrew Metrick, “For Better or For Worse: Default Effects and 401(k) Savings Behavior,” Perspectives in the Economics of Aging, ed. David Wise (Chicago: University of Chicago Press, 2004) 81-121.
[3] Kahneman.

Asset Class Holdings vs. Default Options 2001-2004



	Bal.	Fixed Inc.	GIC	Money Mkt.	Co. Stk.	Avg.
Plans with Related Default	21.7%	10.0%	26.0%	9.6%	62.0%	25.8%
All Other Plans	10.8%	4.6%	16.6%	3.1%	20.7%	11.2%
Multiplier	2.0	2.2	1.6	3.1	3.0	2.3

Hubert Lum, CFA, is Research Director of Cost Effectiveness Measurement Inc., a global benchmarking company.

WASHINGTON REPORT

By Susan J. White, Legislative Counsel

It's been a rough and tumble year in Washington and it has not ended.

The Senate is locked in a debate over major budget legislation, Hurricanes Rita and Katrina relief funding and the Defense appropriations bill—the legislation that funds the Department of Defense.

Given all of the outstanding unresolved matters, Senate and House leaders decided not to include an extensive pension bill, as part of its final efforts this year. The Senate passed legislation (S. 1783) in mid-November and the House passed its bill (HR 2830) in early December. Both bills await a conference between the House and Senate that may well take place sometime soon after Congress reconvenes in 2006.

Key Issues Contained in House and Senate measures:

There are a number of provisions contained in both the Senate and House bills that would affect state and local government defined contribution plans and the House bill makes permanent the pension provisions in EGTRRA.

- **State and Local 401(k) Plans**

The Senate, in a manager's amendment that did not go through the regular route of the Finance Committee included a provision that would allow state and local governments to offer 401(k) plans.

- **Purchase of Service Credit**

Under the same manager's amendment, under section 1001, are amendments to the purchase of service credit provisions under current law (these are clarifications that NAGDCA has supported).

- **Automatic Enrollment**

The House passed H.R. 2830, the Pension Protection Act of 2005, and included language making it easier for employers to create automatic enrollment arrangements under defined contribution plans.

The legislation includes state preemption language meant to ease the way for states to add automatic enrollment provisions to state and local government defined contribution plans.

- **Waiving 10% penalty for early withdrawal for Public Safety Employees**

Another provision in the legislation waives the 10 percent penalty for early withdrawal by public safety employee pensioners. This provision is in both the Senate and House bills.

- **Low Income Savers Tax Credit**

The Low Income Savers Credit that had been worked on by Chairman Thomas and Representative Cardin has also been included in the House package and made permanent.

- **President's Tax Panel Reports Recommendations and the Administration's Joint Efforts on ERSA's and Save at Work Plans**

As part of his Fiscal Year 2006 budget submission to Congress, the President proposed consolidating public and private defined contribution arrangements—457(b) plans, 401(k) plans, 403(b) plans, SIMPLEs and SARSEPs—into a single plan called and "Employee Retirement Savings Account" (ERSA). The ERSA proposal was introduced as legislation in the House (HR 1161) and Senate (S 547) in March 2005.

On November 1, 2005 The President's Advisory Panel on Federal Tax Reform made a similar consolidation proposal titled "Save at Work Plans". According to the Administration and to the President's Advisory Panel, ERSAs ad Save at Work plans would generally be subject to existing 401(k) plan rules. Under the ERSA legislation (and presumably under Save at Work plans) employers with other arrangements would be required to convert these arrangements to the new plans or to freeze existing arrangements and start new plans.

Although neither of the introduced bills was included in either the Senate passed or House passed pension legislation, it is anticipated that the President, will introduce these plans again (possibly as the Save at Work Plans) as part of his Federal Fiscal Year 2007 budget, which will be sent to Congress the first week in February 2007. It is possible that these plans or aspects of the plans could be inserted into the legislation as it moves forward.

NAGDCA has been in regular contact with the Department of the Treasury regarding these proposals; as well as with Congress. For information regarding NAGDCA positions and correspondence on these matters, please contact the NAGDCA web site at:

Summary

Even thought the Federal Fiscal Year 2006 budget remains unresolved in Washington, the Administration has been putting its FFY 2007 budget together. It is highly likely that some form of ERSAs or recommendation from the President's Advisory Panel will be included in the budget.

In the meantime, Congress will have an opportunity to address the President's proposals, in hearings on Capitol Hill on the budget. Whether Capitol Hill decides to include these proposals, along with its other pending pension legislation remains to be seen.

AROUND THE COUNTRY

City of New York to Add a Roth 401(k)

The City of New York Deferred Compensation Plan will be allowing its employees to make Roth 401(k) contributions to its 401(k) plan beginning early 2006. With the Roth 401(k), employees make contributions with after-tax dollars and distributions are tax-free if the account has been held for a minimum of five years since the first contribution and withdrawn after age 59 ½.

The City of New York currently offers employees a 457 and a 401(k). The 457 started in 1986 and enrollment in the 401(k) began in 2002. There are approximately 125,000 participants in the Deferred Compensation Plan and total Plan assets as of October 31, 2005 were $6.6 billion.

With the addition of the Roth 401(k), eligible employees will have a choice of contributing on a pre-tax or an after-tax basis, or both. Recognizing that communicating the differences between the Roth 401(k) and the pre-tax 401(k) and 457 plans would be extremely challenging, the Plan, working with its consultants and recordkeeper, has created software, a video and written materials showing the differences between the different tax-favored plans.

To show employees how investing with after-tax contributions through the Roth 401(k) differs from investing with pre-tax contributions through the 457 and 401(k), the Plan has made available to employees software which can be accessed in the "Planning Tools" section of the its website, entitled "Understanding the Roth 401(k) Plan." The Plan's Investment Planning video has also been updated to illustrate the differences between investing within the Deferred Compensation Plan and how the Deferred Compensation Plan compares with outside savings vehicles.

The City of New York is anticipating that the Roth 401(k) will be a popular addition because of the tax diversification it will afford City employees who may be in a higher tax bracket during retirement.

Colorado Implements New DC Plans

Effective January 1, 2006, all new state employees, as defined in Colorado Revised Statute 24-52-202(3), will be offered three retirement plan choices. Those choices are outlined as follows:

- *Colorado Public Employees' Retirement Association (PERA) Defined Benefit* (currently available to all State employees). Effective January 1, 2006, the tax-deferred contributions are 8% for the employee (10.0% for State Troopers) and 10.65% for the employer.

- *Colorado Public Employees' Retirement Association (PERA) new Defined Contribution Plan* (C.R.S. § 24-51-1501, et seq.) will offer a similar structure as the PERA 401k Plan. CitiStreet is the service provider for both Plans.

- *The Public Officials and Employees Defined Contribution Plan* (current eligibility defined by C.R.S. § 24-52-202). This Plan -- also referred to as the State Defined Contribution Retirement Plan (State DC) -- was established in 1999 for elected and appointed officials. This defined contribution plan offers a choice of investments administered by three bundled providers: Great-West Retirement Services, The Hartford and ICMA-RC.

For additional information regarding the State DC Plan contact Suzanne Kubec, DC Plan Administrator, at 303-866-3954. Information regarding the PERA Plans please contact Katie Kaufmanis, Colorado PERA Communications Director, at 303-863-3814.

NAGDCA Member Benefit Spotlight

To remind members of benefits they receive that they may not be aware of, we will be spotlighting a benefit of membership in each edition of *The Contributor*. For more information on this or any benefit of membership, please visit our website at http://www.nagdca.org/ or contact NAGDCA staff at (859) 514-9161.

Information

- *The Contributor*, NAGDCA's quarterly newsletter that provides the latest information on association issues, members and legislative matters
- An interactive website at www.nagdca.org that provides current information on federal activities, meetings, members, RFPs, presentations and more!
- An electronic clearinghouse with resources that offer answers and perspectives on various issues by showing actual practices used by members across the country
- Legislative representation in Washington, DC

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Please visit the NAGDCA on-line directory for member's full contact information. You will need a user name and password to access the information.

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ABOUT THE CONTRIBUTOR

The Contributor is published quarterly by the National Association of Government Defined Contribution Administrators, Inc. (NAGDCA). NAGDCA encourages the submission of articles on topics relating to defined contribution/ deferred compensation retirement savings/plans. Articles that appear under the by-line of an individual express the opinions of the author and not those of NAGDCA as an organization. The deadline for submissions for the next issue is March 24, 2006. Articles should be approximately two pages in length and should be submitted in Word format. Please direct all newsletter items and questions to NAGDCA, 201 East Main Street, Ste. 1405, Lexington, KY 40507. You may also e-mail submissions to Robert Hansel at rhansel@AMRms.com. Please contact Robert Hansel at 859-514-9161 with any questions or comments.

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