TOP STORY

Four Members of the NAGDCA Executive Board Attend the 2006 Saver Summit in Washington D.C. as Appointed Delegates

The National Association of Government Defined Contribution Administrators, Inc. (NAGDCA) was honored to have four members of the Executive Board appointed as delegates for the 2006 Saver Summit ("Saving for Your Golden Years: Trends, Challenges and Opportunities"), hosted by the U.S. Department of Labor.
Appointed Executive Board Members were as follows:

- Della Williamson, President, NAGDCA
- Ralph Marsh, Vice President, NAGDCA
- Mindy Harris, Secretary/Treasurer, NAGDCA
- Edward Lilly, Member-at-Large, NAGDCA

This year's summit explored the challenges that are faced by low-income workers, small business employees, new entrants to the workforce and workers nearing retirement as they save for a stable financial future. These topics were analyzed and evaluated in four concurrent discussion groups over a two day period, in which delegates offered their expertise regarding retirement savings.

In attendance were numerous state, local, and federal elected and appointed officials including Vice President Richard Cheney, the Honorable Elaine Chao (U.S. Secretary of Labor), and the Honorable Gordon Smith (Chairman, Senate Special Committee on Aging), just to name a few. As a result of the Saver Summit the Department of Labor will prepare a final report, which will be used to develop initiatives and recommendations to present to Congress to help all Americans understand the importance of saving for their retirement. 2005 was the first time since the Depression that Americans had a negative savings rate.

According to Elaine Chao, 51% of the population hasn't calculated their retirement savings needs. Personal savings rate has been on a downward trend for the past 25 years. New entrants to the workforce (younger workers) mistakenly assume they'll have time later to prepare - what they don't realize is that time is their most essential tool/advantage.

Former Commerce Secretary Don Evans, said that a poll conducted for the lobby group found that nearly three out of five Americans between the ages of 35 and 49 are saving less than $10,000 a year. "For most, this will prove too little to support a comfortable middle-class retirement," said Evans, who is now chief of the Financial Services Forum. The poll also found that nearly a third of Americans saved nothing for retirement last year.

Mr. Ben Stein shared that the US was 16 trillion in the hole on being prepared for the baby-boomers and that we are part of the largest crisis in the making since the depression. He shared that 77 million boomers are unprepared. Mr. Stein thinks we need to use fear and scare tactics (Shock therapy) to get people saving, rather than pictures of beaches. Americans are saving too little, especially acute for women & minorities & low income.

The creative recommendations from the breakout groups will be outlined in a final report by the DOL. One suggestion that came out of several groups was to revise the Social Security statement that workers receive currently to provide actuarial amount of what a worker may need to save as supplement to their social security to provide for their retirement. There were several ideas on education starting early for children, and revising the savers credit to enhance it with increased eligibility limits and making it refundable.

"It was an honor to be appointed to be a delegate along side such an esteemed group of colleagues to discuss and work through current challenges and issues of saving in today's workforce", Della Williamson, NAGDCA President, and, Program Administrator, Employees Retirement System of Texas, stated. "Forums, like the Saver Summit, are extremely important due to interactive dialogue and a diverse group of attendees ranging from state and local governments to corporate entities as well as representatives at the federal level", said Williamson.

MARK YOUR CALENDAR

2006 Industry Roundtable
April 19-20, 2006
Washington, DC
Washington Court Hotel
https://www.nagdca.org/meetings/industryroundtable.cfm

2006 Annual Conference
September 23-27, 2006
Kansas City, Missouri
Hyatt Regency Crown Center
http://www.nagdca.org/meetings/2006annual.cfm

PRESIDENT'S CORNER

HAPPY SPRING – my favorite time of year. There is so much going on with legislation and in our retirement arena. It's an exciting but challenging time to be in the pension business. We are blessed to have Susan White to keep us abreast of all the Washington activity. The NAGDCA Board traveled to Washington DC for our annual visit on the Hill at the end of February. Four Board members were delegates at the 2006 National Summit on Retirement Savings ("Saving for your Golden Years: Trends, Challenges and Opportunities") on March 1^{st} and 2^{nd}. The timing was perfect with the Board already being in DC. The summit is part of the Savings Are Vital to Everyone's Retirement Act of 1997 (SAVER), which was enacted to advance the public's knowledge and understanding of the importance of retirement savings. It was totally awesome to be part of such an outreach. There were approximately 250 delegates from around the country in attendance. Some delegates are appointed by President Bush and others are appointed by the Republican and Democratic leaders in Congress. A primary objective of the summit was to develop recommendations for additional research, reforms and action in the field of private pensions and individual retirement savings. A listing of the agenda, delegates and other information on the summit can be found on the DOL Website at http://www.saversummit.dol.gov.

Vice President Richard Cheney spoke at the Summit and said that too often, workers are living paycheck to paycheck and are not saving sufficiently. Vice President Cheney urged Americans to do a better job of saving and challenged policymakers to strengthen pensions and fix Social Security to help people live more comfortably in their "golden years". Last year, Americans' personal savings rate dropped to its lowest point since the Great Depression. The dismal state of savings comes as a big wave of baby boomers will soon start retiring. That wave of retirees will eventually put massive strains on government resources as people draw on Social Security and Medicare benefits. Fewer workers can be counted on to help bankroll the retirement program. "With an aging population, and a steadily falling ratio of workers to retirees, the system is on a course to eventual bankruptcy," the vice president said.

The Summit also addressed the central issues facing real workers and real families. Delegates worked in one of four teams to examine the challenges facing four distinct groups by discussing ways to reach each distinct populace with retirement savings messages and recommending solutions to assist them in overcoming their savings obstacles. Creative recommendations from the following breakout groups will be outlined in a final report by the Department of Labor.

- New Entrants to the Workforce
- Workers Nearing Retirement
- Low-Income Workers
- Small Business Employees

As I organize tax information, I always think of employees that need to save for their future and what an important job we have to communicate and educate about the 3^{rd} leg of the stool called defined contribution. 2006 marks the year when the 1^{st} Baby Boomers turn 60! Since many boomers are expected to live well into their 80s, it's too early to say whether the defined contribution plans have encouraged enough savings to fund a fulfilling retirement. A recent survey found that only 1 in 5 older workers is confident of having enough money to finance a comfortable retirement, much less being able to save enough to cover medical expenses and long-term care.

The NAGDCA Board has been working very hard to create some exciting goals and challenging initiatives to help enrich our association. Some of the upcoming items you can look for are:

- NAGDCA/Arthur N. Caple Foundation – NAGDCA is setting up a foundation to receive funds and offer scholarships to further careers in retirement education. Fund raising will begin soon – Look for more information to be released in the coming months.

- Continuing Education – NAGDCA will be offering educational credits for members attending sessions at the annual conference for CPA, CFP and CFA designations.

- A new NAGDCA Code of Ethics has been developed for members to vote on at the annual meeting in September.

I want to stress the importance of completing the upcoming 2006 survey. It is a great value to our members and to the defined contribution industry. Please help us reach our goal of 100% participation!

Important features to be aware of:

- Code Section **409A -** Employers should review their bonus and other short-term deferral arrangements in light of the 409A rules and make the appropriate changes to Plan documents and rules. Post-severance compensation may be included in compensation if it's paid within 2½ months after separation from service. This is only for payments, regular compensation, overtime pay, commissions, and bonuses — that would have been paid had the participant continued in employment. Leave-related severance payments for bona fide sick, vacation, and other leave may be included in compensation only if the leave had been accrued before leaving and could have been used had employment continued. Although these regulations were issued in 2005, they are effective for plan years beginning on or after January 1, 2005.

- The U.S. Treasury Department and the IRS issued final regulations December 30, 2005, on establishing and offering Roth 401(k) s to employees. The final regulations made few revisions to rules proposed in March 2005. Plans must allocate Roth contributions and earnings to the separate Roth account within the plan, but they cannot allocate forfeitures and matching contributions to the separate Roth account. Roth 401(k) accounts present some administrative challenges. Although they are otherwise treated like pre-tax elective deferrals, Roth 401(k) contributions are treated as after-tax contributions for tax purposes. Roth 401(k) contributions and earnings must be separately accounted for in a separate Roth 401(k) account. Offering a Roth 401(k) would increase the recordkeeping requirements and likely increase record-keeping costs (plan costs) in order to keep track of these elections. From a record-keeping standpoint, the TPA would have to track, gains, losses, contributions, and other changes separately for the Roth IRA since they are after tax dollars. A modification to the agreement with record keeper would be necessary.

I encourage you to network with your fellow NAGDCA compadres and shape up your plan to create a compelling investment tool.   Because we have to wear many different hats as plan administrators and plan sponsors, we benefit from sharing with associates tasks and information you commonly manage in the retirement arena such as:

- Hardships, catch-up, distributions, RMDs loans, QDROs
- Contracts, RFPs, Plan documents and rules, legislative changes
- Communications, education, and advice
- Asset allocation models, product information, short term trading policies and redemption fees

Make a difference by helping to educate and encourage personal and retirement savings. Get involved and enjoy this awesome industry!

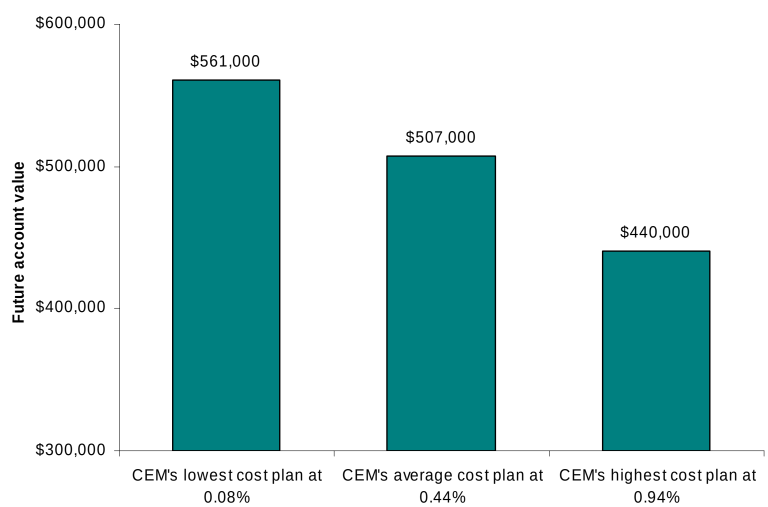
INDUSTRY VIEWPOINT

Costs Threaten Future Value

By: Hubert Lum, CFA, CEM Benchmarking Inc

How does cost impact the future value of a participant's account? Small differences in cost produce large differences in future value. In 2004, the difference in total investment and administration cost between the lowest cost plan and the highest cost plan in the CEM defined contribution performance database was 0.86%. To put this difference in dollar terms, we projected a participant's account value over 30 years with the following assumptions: an initial account value of $100,000, growing at a constant annual rate of 6%, and cost, as a percentage of account size, remaining the same. The account value of the plan with cost of 0.08%, which was the lowest cost plan in the CEM database, grew to $561,000. The account value of the plan with cost of 0.94%, which was the highest cost plan in the CEM database, grew to $440,000. This difference in cost reduced future value by 22%. The results are shown in Table 1.

Table 1:
Future Account Value in 30 Years for Plans in the CEM Database



The CEM database comprises plans that are much larger than the average pension plan. In 2004, there were 84 plans in CEM's defined contribution database. The average plan asset size was $3.4 billion. The assets of several plans exceeded $10 billion. These plans benefit from economies of scale. They are expected to be at the low end of the cost spectrum.

To observe the cost impact on future value in the typical small pension plan, we applied a representative cost from retail mutual funds to the model described above. According to Lipper, the average expense ratio for a US balanced mutual fund is 1.2%. At this cost level, the future value of our participant's $100,000 account was $408,000. Compared to CEM's lowest cost pension plan, the reduction in value was $153,000 ($561,000 less $408,000) or 27%.

Costs threaten future value. The review highlights the importance of the cost monitoring function of fiduciaries.

Hubert Lum is Research Director of CEM Benchmarking Inc., a global benchmarking company.

ICMA-RC Participation Education
By Joan McCallen, ICMA-RC

If every individual participating in his or her employer's 457 or 401 plan was beating the market every year – maybe even capturing double-digit returns – then they'd all be long-term investors, right?

Truth is, of course, investing is far more challenging. Short- and long-term market performance is only one issue for individual investors to ponder. There are also factors such as objective-setting, asset allocation, rebalancing, risk tolerance and more. When markets are choppy, directionless or declining – all conditions investors have endured at one time or another over the past few years – it can be discouraging. People tend to forget that saving and investing for retirement are decades-long pursuits.

Plan providers are taking many steps, both directly and indirectly, to keep plan participants in their plans. Industry leaders consider this to be such a high priority that they have made it a goal to establish and maintain long-term relationships with plan participants with the objective of helping them not only with retirement security, but with securing a sound financial footing overall.

In many ways, client education is an effort in which everyone is involved in some way. Whether it's maintaining an up-to-date Web site design or revamping quarterly account statements, providers are concentrating on educational efforts to maintain close relationships with their participants.

One new means of educating participants while relieving the burden of investing is through the growing use of target-based investment options. In these funds, usually composed of other fund offerings in the plans, asset allocations are preset based on the number of years until maturity. As the fund grows closer to the target date, the fund is reallocated to grow more conservative, consistent with the shorter time horizon. The actual allocation within the fund is periodically rebalanced to maintain the fund's risk level.

For example, if a person plans to withdraw funds in 2025, the allocation today may be along the lines of 21 percent fixed income and 79 percent equity, because the investor can take advantage of long time horizon to access the higher potential for equity returns, while still having time to recover from market setbacks. For someone planning to retire in 2010, the allocation might be more conservative, for example 52 percent fixed income and 48 percent equity.

These types of funds are particularly appropriate for public sector employees because often the "retirement" date – when they leave service – is not the same time that they intend to access the account. This might especially be the case for someone who is taking early retirement but may intend to continue working in a different job or have access to alternative sources of income.

Plan providers are continually developing new products, such as target-date funds, to meet the changing needs of participants. They are also continually seeking to help employers answer the question they hear so often from their participants: "How should I investment my retirement assets?"

Joan McCallen is president and chief executive officer of ICMA-RC.

Is Your Plan Ready or Retired?
By Christine Chaia
Assistant Vice President, Retirement Plans Group Marketing, The Hartford

This year, the first wave of Baby Boomers becomes eligible to begin taking distributions from their retirement programs. It is the dawn of a new era in retirement planning, when Boomers' focus will shift from wealth accumulation to wealth preservation.

In accordance with this shift, plan sponsors will have the additional responsibility of providing education to these Boomers, many of whom may not be financially prepared for what lies ahead. Experienced retirement plan providers like The Hartford can help.

A Different Generation
To address their need for education, it is important to recognize some of the unique characteristics of retiring Baby Boomers.

This generation will challenge traditional notions of retirement, redefining it as a time of new opportunities and the continuation of an active lifestyle. Their expectations for retirement exceed those of past generations, and most feel confident they will be prepared to finance their dreams. In fact, the majority of Americans -sixty five percent - are "somewhat to very confident" that they will have enough money to retire, according to the 2005 Retirement Confidence Survey conducted by Employee Benefits Research Institute.

Despite their optimism, Boomers face a number of potentially significant financial burdens, including declining social security benefits, the abolition of the traditional pension plan, and longer life expectancies that necessitate more robust retirement savings. In addition, Boomers often find themselves "sandwiched" between caring for both their elderly parents and grown children.

While this generation may be more educated about the importance of saving for retirement, many did not save enough during their working years. In fact, the number of people aged 65 and older who have filed for bankruptcy has tripled in the past decade**,** due most often to inadequate savings rates and poor planning for medical emergencies. For a population confident that it will have enough to retire, only 51% of those aged 50 and up report having accumulated $50,000 for that goal.

A New Responsibility for the Plan Sponsor
While these statistics are alarming, conscientious plan sponsors can help reduce the percentage of Boomers headed toward retirement trouble through simple education. When it comes to educating Boomers about their retirement plan options, ask yourself the following questions:

1. When is the last time we reviewed our employee education program?
2. Do we hold regular employee educations sessions that are not solely focused on enrollment?
3. Does our program focus more on participation or increasing deferrals?
4. Is our program targeted based on age or career cycles?

The number of Boomers preparing for retirement necessitates a role change for retirement plan sponsors. Employee education programs must begin to include a more comprehensive curriculum based on the various stages of the career cycle. Older employees need to understand the principles and options for wealth preservation, while younger employee populations will focus on accumulating retirement assets.

As traditional pension plans disappear and defined contribution plans become a primary savings vehicle for retirement, plan sponsors can – and must- take an active role in helping *all* employees prepare to retire comfortably.

Action Plan for Reaching Out
Step 1: Target your Audience
Consider targeting specific age groups or career levels when developing an employee education program. Offering educational content geared toward age-specific needs means employees receive relevant, actionable information.

Step 2: Customize the Presentation to Fit the Need
Boomers have specific needs and financial challenges that require real solutions. Targeted, topical seminars such as “Your Rollover Options” or “How to Help Ensure You Will Not Outlive your Assets“ can help pre-retirement Boomers take inventory of their financial situation and make informed decisions about how they will manage their assets in retirement.

The Hartford offers targeted employee education through its *Plan for Life Series*®, which includes twelve presentations on a variety of investment concepts and career cycle planning strategies. Several of these presentations are designed specifically Boomers preparing to retire.

Step 3: Be Visible at the Education Meetings
Consider attending enrollment meetings and educational sessions with employees. Your presence sends a strong message, even if your role is simply to introduce the presenter and the topic being discussed. Attending such meetings indicates that you care about

your employees and hear their concerns and questions, and can help you deliver additional programs in the future based on their needs.

Don't let your plan retire. Use these action steps to assess your employee education program and refresh it for enhanced utilization and effectiveness.

Christine Chaia is Assistant Vice President of Marketing for the Retirement Plans Group at Hartford Life, based in Simsbury, CT. Christine can be reached at Christine.chaia@hartfordlife.com.

NOT FOR USE WITH PARTICIPANTS

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The views expressed here are those of Christine Chaia. Ms. Chaia's views are not necessarily those of The Hartford and should not be construed as investment advice.

Baby Boomers - Changing the Look of Retirement
By Mary Willett, Willett Consulting

The first baby boomers turned age 60 this year. Over the next 25 years, 77 million Americans who were born between 1946 and 1964 will become the new generation of senior citizens. It shouldn't be surprising that they are once again breaking molds and traditions…opting for a retirement lifestyle that is significantly different than their parents or grandparents.

Instead of reaching for rocking chairs and golf clubs, boomers are looking for ways to become reenergized and engaged through new experiences and challenges. Planning for life after career employment is now more likely to include going back to school, starting a business or new career, or taking on new or expanded volunteer roles.

Many boomers are planning a phased approach to retirement through bridge or transitional employment for a number of years before beginning a full retirement. This may be with the same employer, or a different one, but typically involves a shorter work schedule or a job with reduced physical or mental stress.

State and local governments are already feeling the impact of the aging workforce as their employees are, on average, older and retire earlier. In order to address current and future worker shortages, some have already begun to implement new strategies to meet the needs of employees at, or near, retirement age.

Phased employment opportunities such as job sharing, telecommuting, and part-time or temporary reassignments are being established to help employers retain their skilled and experienced employees beyond a normal retirement age. Mentoring programs are also being used to provide new challenges to older workers while transferring knowledge to new employees.

According to a March 2005 report from AARP entitled *The Attitudes of Individuals 50 and Older Toward Phased Retirement*, about four in ten employees over age 50 stated they would be very or somewhat interested if their employer offered this option. Eight in ten of those expressing interest indicated that this would result in their delaying full-time retirement beyond a normal retirement age. The features of phased retirement that were most desired included:

- The average work week is reduced by 16 hours or more
- Pension benefits continue to accrue during bridge employment and the value is protected during this period
- Retirement benefits (e.g., partial payment) can be accessed during phased employment to supplement income

This report suggests that just offering bridge employment opportunities may not be enough. Employers should also examine current retirement benefit structures – both primary and supplemental programs – to determine if enhancements are possible to better meet the changing retirement needs of their aging workforce.

The public sector offers excellent employee benefits, particularly pensions and deferred compensation programs, but they were designed to fit a traditional retirement. As employers evaluate these programs in the future, it may be desirable to determine if changes can be made to address the baby boomers new phased approach to retirement.

About the author…**Mary Willett, Willett Consulting**, CRA, CRC, has more than twenty years experience in the field of public employee retirement benefits. She currently is the project manager for the InFRE Retirement Readiness Study that is being conducted with the Federal government to create a retirement readiness profile index and also serves on the InFRE Board of Standards. Willett is working with Nationwide Retirement Solutions to develop educational programs and material for the public sector plan sponsor community and chairs the Panel of Advisors of the Nationwide Retirement Education Institute.

Prior to her current role as a benefit plan consultant, Willett was Director of the State of Wisconsin Deferred Compensation Plan and the FY 2000/2001 President of the National Association of Government Defined Contribution Administrators (NAGDCA).

Boosting Contributions, Increasing Participation:
An Integrated Campaign Strikes the Right Chord for the State of Tennessee's 401(k) Participants
By: Great-West Retirement Services

Challenge
Tennessee state employees were about to get a double dose of good news in the summer of 2005. First, their paychecks were getting a little larger, thanks to a statewide 3% salary increase. At the same time, the state had decided to increase its matching

contributions to 401(k) accounts by 50%—from $20 to $30—for participants who contributed at least $30 a month.

For the sponsors of the state's 401(k) Plan, the news represented perfect timing. It offered a unique opportunity to address one of their longstanding goals: increasing contributions from participants in the lower contribution range. Because employees would have more money in their pockets each month, Plan sponsors hoped all participants would be open to the idea of increasing their contributions. But for lower-contributing participants who had other plans for their raises, the increase in the matching contribution could provide just enough incentive to nudge them up to or even a little past the $30 per month watermark.

The Plan sponsors recognized that they needed something beyond their usual communications tools to get the message out. They needed to broadcast the right messages at the right time in a way that would educate and motivate participants. So they turned to their partners at Great-West Retirement Services® for help.

Solution

Great-West Retirement Services developed a compelling, fully integrated communications campaign and precisely timed the delivery of the pieces to coincide with the salary and match increases. The strategy behind the campaign was based on the idea that an out-of-the-ordinary approach would be the best way to capture participant attention.

The Great-West Retirement Services marketing team departed from the existing look and feel of the Plan's communication materials and created new, colorful materials that emphasized Tennessee's unique musical heritage.

The campaign kicked off with an e-mail to all employees notifying them of the increase in matching contributions—and the opportunity to use the salary increase to boost their contributions and take full advantage of the match. Posters and fliers reinforcing the announcement came two weeks later, followed by a similarly themed newsletter in the next two weeks. Each communication reinforced its predecessors in both messaging and design, helping to raise awareness and create the workplace "buzz" critical to the success of the campaign.

An Integrated Campaign Strikes the Right Chord for the State of Tennessee's 401(k) Participants

- Week One: E-mail to employees
- Week Two: Promotional Posters
- Week Three: Employee Newsletter = BUZZ

Results

In the short time the campaign has been in circulation, it has generated significant results. To date, more than 10,000 participants have increased their contribution levels, with more expected as the campaign continues to gain traction. To put that in perspective, the Plan normally sees about 300 contribution increases per month. Even more impressive is the fact that 70% of the increases came from the target audience—participants contributing an amount below the newly instituted match.

The campaign also had some unintended—though equally positive—results. Participation levels increased significantly, with 767 new enrollments in July and 1,378 in August. The Plan usually adds significantly less than that, averaging 370 new participants each month.

With numbers like those, the success of the campaign generated buzz beyond the state of Tennessee.

The early results were submitted to the National Association of Government Defined Contribution Administrators (NAGDCA). As a result, NAGDCA awarded the Plan a 2005 Leadership Recognition Award for its outstanding communication and enrollment campaign.

As participants continue to take advantage of the good news they received in the summer of 2005, the Plan can join in the celebration due to the success of the campaign. Deana Hannah, with the state of Tennessee Treasury Department, summed up the effort nicely: “Great-West Retirement Services put together a fantastic effort in a short time, and it has delivered amazing results.”

WASHINGTON REPORT

By Susan J. White, Legislative Counsel

March 28, 2006

Federal Budget, Tax and Pension Matters Yet to be Addressed in Washington

President Bush sent his Federal Fiscal Year budget to Capitol Hill in early February. After a grueling battle over deep spending cuts in entitlement and domestic discretionary programs last year, the Administration proposed additional major spending cuts in programs and, as part of the Federal Fiscal Year budget plan, vowed to push tax cutting legislation.

Congressional leaders have pledged to move forward with tax cutting legislation, however the perimeters for how they will debate and vote on such legislation continue to be negotiated. Although both the Senate and House plan to move forward on tax legislation, there is not agreement between the two chambers on much of the rest of the President’s budget proposals. Specifically, the Senate has already rejected proposals to make reductions in entitlement programs—including Medicaid; while many of the other discretionary program funding matters remain undecided at this time.

As part of his 2007 budget plan, the President proposed, as in the past two years, to include the Early Retirement and Savings Accounts (ERSA) that would combine state and local government and private defined contribution plans. Even so, the pending pension legislation does not include these plans and it is unclear whether the Administration will push forward on ERSAs this year. NAGDCA has continually indicated its concern regarding such efforts, pointing out that many issues would be at stake for state and local government employees. These include the potential loss of the exemption from the 10% excise tax early withdrawal under governmental 457(b) plans and the catch-up for 457(b) plans. For NAGDCA's positions regarding ERSAs and the combination of defined contribution plans, generally, see NAGDCA's website.

Fate of Major Pension Legislation Remains Unresolved: Jurisdictional Disputes Complicate Passage

As we go to press, major pension legislation (respectively, HR 3820 and S 1783) still languishes in the House-Senate conference committee, and there remains uncertainty about whether a final measure will pass Congress and be sent to the President for his signature.

As it stands now, key congressional committees and legislators in the Senate disagree on fundamental aspects of the legislation. At issue is how much corporations and businesses must pay to cover the costs of their employee defined benefit retirement plans—and how much the federal government is willing to risk to ensure that such plans employees are protected.

Although legislation has wound its way through numerous committees in both the House and the Senate, it is now at a standstill over these disagreements. In particular, the Senate Finance Committee and the Senate Health, Education and Labor Committee or in a major dispute over the issue of the private sector's responsibility to back its pension obligations.

The development of the pension legislation has been more complicated than in years past because it deals with ERISA plans and other tax code related defined contribution plans. Therefore, it has been subject to the jurisdiction of more than one committee in both the House and the Senate. In the House the bill was marked up and reported out by the Ways and Means Committee and the Workforce and Education Committee. In the Senate the two committees with jurisdiction over the measure are the Health, Education, Labor and Pension Committee and the Finance Committee.

Key State and Local Government Interests Contained In Pending Bill

Both the Senate and House bills contain a number of provisions of interest to state and local governments, including a long supported NAGDCA provision to clarify how purchase of service credits are used and extension of the Low Income Savers Credit.

The Senate legislation contains a provision that would allow state and local governments (not grandfathered under the 1086 Tax Reform Act) to offer 401(k) plans to public employees—a change from an originally sought after provision to require state and local governments to freeze current defined contribution plans and move to 401(ks). It is unclear, at this time whether this provision would remain a part of the final legislation. As a point of interest, there had also been earlier efforts to include the Administration's ERSA proposals as part of the Senate bill—those efforts failed.

Automatic enrollment has played a major role in discussions in Congress as the current bill has been drafted. In fact, the pending bill pre-empts state laws that would prohibit automatic enrollment in non-public 401(k) plans. Still in flux is Congress' view regarding whether such pre-emptions of state law should apply to governmental defined contribution plans—possibly at state option. NAGDCA, along with other state and local public interest groups in Washington, has advocated against such pre-emptions.

For further information regarding NAGDCA positions and letters to Congress and the Department of Treasury are available on NAGDCA's website.

415 Regulations Due out this Year

NAGDCA has worked with the Department of Treasury over the past year regarding concerns about calculating vacation and sick leave under state and local government 457 plans. At issue is whether the 2003 final 457 regulations allow deferral of sick and vacation pay only if the amount deferred would have been payable before severance from employment. Section 1.457-4(d).

In the 2005 proposed regulations relating to section 415, the Department of Treasury has proposed allowing deferral of sick and vacation if it would be payable within 2 1/2 months after severance from employment. Proposed sections 1.457-4(d) and 1.415(c)-2(e)(3)(ii). The Department is trying to finalize the 415 regulations during their current business plan year that ends 6/30/06.

AROUND THE COUNTRY

COMBINED ROLE OF DB AND DC PLANS IN PROVIDING FUTURE RETIREMENT BENEFITS FOR PUBLIC SECTOR EMPLOYEES

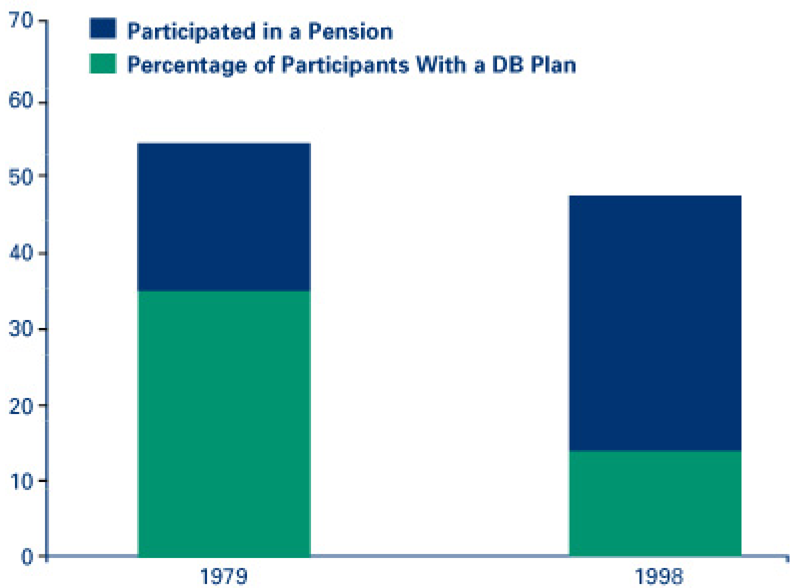
By: Jim Crockett, Denver Water

Not a day passes with out a media report of another private sector employer freezing or eliminating a defined benefit (DB) pension plan. General Motors, IBM, Verizon, Alcoa, Sears, Hewlett-Packard and Motorola are a few of the companies taking this action. The pension woes of several airlines that have had a major financial impact on the Pension Benefit Guaranty Corporation, and legislation increasing the cost to private sector employers have been covered by the Press in every form of media. This alone has led many to conclude that the traditional DB pension system will eventually disappear.

HISTORICAL BACKGROUND

One of the most striking changes over the last 25 years has been the shift from DB to defined contribution (DC) pension plans. While the share of full-time U.S. workers that participated in any pension plan edged down from roughly 55 percent in 1979 to less than 50 percent in 1998, the composition of pension coverage changed much more dramatically (Figure 1). In 1979, two-thirds of workers with pension coverage were covered by a DB plan. By 1998, only one-third of those workers had a DB plan.

Figure 1
Pension Participation Among Full-Time, Private-Sector Workers, 1979-1998



Source: "Are Firms or Workers Behind the Shift Away from DB Pension Plans?" Stephanie Aaronson and Julia Coronado, Federal Reserve Board of Governors Finance and Economics Discussion Series Working Paper No. 2005-17.

Traditional defined benefit pension plans, based on years of service and either final salary or a flat dollar benefit formula, provide a stable source of retirement income to supplement Social Security. The number of private-sector defined benefit plans reached a peak of 112,000 in the mid-1980s. At that time, about one-third of American workers were covered by defined benefit plans. The number of plans now stands at about 30,000.

Initially, defined contribution plans DC plans served mainly to supplement DB pensions. DB pensions were the dominant form of employer-sponsored retirement benefit. The law (ERISA) imposed participation, vesting, funding, reporting and disclosure requirements on plan sponsors; created a standards-setting body for actuaries; and established the PBGC. The rising cost of regulatory compliance was a key factor in the shift away from DB plans. Because many compliance costs are fixed, they impose a smaller burden on larger employers, which benefit from economies of scale. So the migration away from DB plans has been particularly pronounced among small and midsize companies**.**

DEFINED CONTRIBUTION PLAN REALITY

Despite their popularity, DC plans have not generated dollar balances high enough for most participants for retirement. Industry statistics consistently reveal that there are large numbers of plan members who are not saving enough to provide any form of adequate income in retirement years. The low level of savings, plan loans, cashed out distributions not rolled over, lack of advice and poor asset allocation have produced mediocre results for plan participants. As each year passes. They fall further and further behind their savings goals.

The Private Sector Environment

The decline in DB coverage slowed in the late 1990s, due to new plan designs that enabled DB sponsors to meet their workforce management needs and the favorable financial markets. While the number of small plans continued to decline, the number of large plans actually increased. Since 2000, however, plan sponsors have faced challenges that threaten to further weaken the DB pension system. The combination of falling equity prices that dealt a blow to pension asset values and falling interest rates pushed up current value measures of liabilities. These adverse conditions drove funding ratios down from a peak average of 122 percent in 1999 to a trough of 76 percent in 2002. Firms have regained some lost ground, with the average funding ratio climbing to 83 percent by the end of fiscal year 2004.

The majority of DC plan designs require employees to contribute before the employer matches contributions, and participation rates in DC plans have generally been disappointing. Roughly 75 percent of all eligible workers participate in 401(k) plans, but participation rates are much lower among lower-income and younger workers. The DC plan is not reaching the level of asset accumulation necessary to provide much of a retirement benefit.

DB plans provide different incentives for employees and achieve different workforce goals, encouraging employees to stay with the employer at all ages, with five-year vesting provisions and higher accrual rates. DB plans also allow significant design flexibility. Plans may use early retirement subsidies or delayed retirement incentives, and Social Security integration. While DC vesting schedules offer some early-career retention incentives, employers have fewer options for varying contributions due to nondiscrimination regulations. Survey data show that DB plans exert more influence on attraction and retention, particularly among older employees. This may become increasingly important to employers as the workforce ages and labor force growth slows.

What Is the Future for DB Pensions in The Private Sector?

Many government organizations and private firms are in the process of evaluating their retirement benefit programs. While some entities are turning away from DB plans, many are discovering good reasons to keep their DB plans. Interviews at a number of companies that decided to stay with or expand their DB programs revealed several recurring themes:

- The workforce goals of attracting, retaining and managing retirement behavior are fundamental to the decision to stay with DB pensions.
- Corporate change, notably mergers, frequently plays an important role in triggering expansions of DB coverage.
- Companies that retain or expand their DB plans almost always also offer a DC savings plan.

A survey by Hewitt Consulting indicated that a majority of employers plan to continue offering their employees some form of DB plan in 2006.

Two key workforce philosophies structured this decision. First, the company saw the retirement plan within a total compensation framework. Decision-makers wanted to ensure that the entire compensation package, including benefits, offered an appropriate mix of cash and non-cash remuneration. Second, the company wanted an optimal way of delivering this compensation within the constraints of the compensation and benefits budgets. A combination of DB and DC retirement plans emerged as the best solution.

Public Sector Pension Trends

According to the Reason Foundation Study, The Gathering Pension Storm: How Government Pension Plans Are Breaking The Bank And Strategies For Reform , Government interest in defined-contribution plans is more recent than in the private sector, and has been steadily moving in that direction for the past three decades. Currently 90 percent of state and local government employees participate in a defined benefit (DB) plan as their primary retirement benefit. Nevertheless, as private-sector plans have been forced to scale back benefits in accordance with demographic and economic trends, pressure has grown on the public sector to do likewise.

There are signs that taxpayer frustrations and fiscal realities are now boiling over. California has become ground zero in the battle over government defined-benefit plans. Governor Schwarzenegger brought the issue to the forefront when he argued in his 2005 State of the State Address. When he stated “We must move from a defined benefit to a defined contribution system. We need a public pension system that is fair to employees and to taxpayers”. California’s non-partisan Legislative Analyst’s Office has similarly called for the state to consider switching to a defined-contribution plan to limit costs to the state and offer employees a more portable pension plan option.

If California were to move to a defined-contribution pension system, it would join other States including Colorado, Florida, Louisiana, Maine, Michigan, Montana, Ohio, Oregon, South Carolina, Vermont, Virginia, and Washington who already offer defined-contribution plans to at least some of their state employees. Some states have switched completely from their traditional plans to defined-contribution plans while others offer defined-contribution plans as an option in addition to existing defined-benefit plans. Consider the following examples of government defined-contribution plans:

1. Michigan. All employees hired after March 3, 1997 have belonged to a defined-contribution plan in Michigan. The government employers (departments, agencies, etc.) contribute 4 percent of the employee’s salary to the plan and will match employee contributions of an additional 3 percent.

2. Florida. Florida began offering a defined-contribution plan in addition to its traditional plan in 2002. Employees were given the option of remaining in the existing defined-benefit plan, transferring accumulated benefits to the defined-contribution plan, or keeping their accrued balance in the old plan but directing all future contributions to the defined-contribution plan. Employees do not contribute anything to either plan.

3. Oregon. While Florida began offering its defined-contribution plan mostly to provide its employees a greater choice in their retirement plans, State employees hired after August 29, 2003, participate in both a defined-contribution and a new defined-benefit plan. All employee contributions go into the defined-contribution plans and all
employer contributions are made to a scaled-down defined-benefit plan.

4. Nebraska. Nebraska became the first state to shift to defined-contribution benefit when the State Employees' Retirement Plan was initiated as a defined-contribution plan in 1964. (Teachers, judges, and highway patrol officers remained on defined-benefit plans.) The state then switched from its defined-contribution plan to a cash-balance plan (a defined-benefit plan with some defined-contribution
plan features.

5. Alaska. Alaska is debating a switch to a defined-contribution retirement plan for new state employees.

The Reason Foundation Study concludes that Government pension systems across the country face funding crises. While the recent downturn in the stock market is often blamed for the crises by government officials—and this certainly did play a role—the market losses only unveiled the weaknesses in the system that were previously masked by the historic investment gains of the late 1990s..

Over the past several decades, the private sector has rapidly shifted away from defined-benefit plan. The government should follow the private sector's lead in transitioning to defined-contribution retirement plans that will offer employees greater freedom and choice of retirement planning options at lower, more stable costs to the employer.

The National Association of State Retirement Administrators, responds to the
Reason Foundation Study, "The Gathering Pension Storm" with the these comments.

NASRA believes the Reason study makes its case by1) distorting the true financial condition of public pensions in general; 2) mistakenly extrapolating a handful of public pension problems onto the entire public pension community; 3) failing to consider the many negative consequences that would result from terminating DB plans; and 4) advancing arguments that reflect an incomplete understanding of public pension issues.

As a group, public pension funds are in reasonably good condition:

• According to recent information, public pension plans in the U.S. have combined actuarial assets of approximately $2.48 trillion and actuarial liabilities of $2.82 trillion, for an aggregate funding level of around 88 percent.

• 70 percent of public pension plans are funded at 80 percent or higher.

Although the majority of public pensions are in fairly good financial condition, some
plans do face serious unfunded liabilities that will require corrective action. Of those public pension plans that face serious funding problems, most result from legislative failure over extended periods to remit required contributions. States that chronically failed to remit required contributions enjoyed the savings that were generated by diverting pension contributions to other priorities. Contribution rates in some states declined in recent years to unprecedented levels, including as low as zero. Combined with the decline in equity values, very low or nonexistent contribution rates contributed to the decline.

According to the U.S. Census Bureau, there are more than 2,000 public pension plans in the U.S., that provide pension and other benefits for more than 14 million active and 6 million retired
public employees.

Like other employers, public employers must compete in the labor market for a limited pool of talent, and a DB plan has long been a central component of the compensation package for most public employees. Removing the DB plan from public workers' compensation would have consequences for all stakeholders: employers, employees, and taxpayers.

A majority of public sector positions are best served when those who occupy them are career-oriented or at least remain in them for ten years or longer. Two-thirds of public employees are classified by the U.S. Census Bureau as judicial, firefighters, police officers and support, corrections, or educational.

Retention of qualified workers is a primary reason that public sector employers continue to offer a DB plan—it creates an incentive for career-oriented workers to remain in their position.

Reason's study does not acknowledge the role DB plans play in attracting and retaining public employees.

DEFINED BENEFIT / CONTRIBUTION PLAN FUTURE ROLES

Regardless of the controversy and on-going debate of the roles of DB and DC plans in the future, retirement plans should reflect the combining of DB stability and attractiveness to employees with the DC financial stability of certain contribution levels with the employer not being accountable for short falls during years of poor retirement fund performance ensuring full funding of the plan.

From the perspective of the 457, 401(k), 403(b) and the DB plan administrator, the importance of education can not be over emphasized.

Government DB plan members need to recognize the possible changes and uncertainty that may impact their DB pensions in the future. They should be encourage to accumulate funds in DC plans to supplement their DB plans.

If and when government pension reform occurs, DC plan accounts would survive in some form or other and place the employee in a good position to continue their retirement plan funding.

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.

Networking

- An Annual Conference with unparalleled networking opportunities
- An on-line Membership Directory that assists in locating other members
- Government and industry member listserves to enable open channels of communication

New Members

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

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