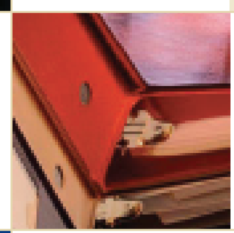
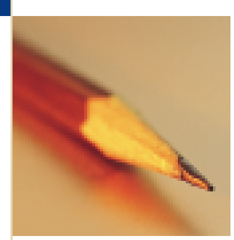
America's Retirement

voice

Public Sector Retirement
Yesterday, Today, and Tomorrow





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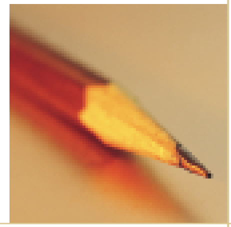


There has been little research into how well state and local government employees are preparing for retirement through their supplemental deferred compensation plans.

Information is frequently in the news about companies' 401(k) plans and their participants, but the public sector segment is often overlooked.

The Nationwide Retirement Education Institute and its Panel of Advisors have been established to investigate the nature of public sector retirement and to report back to plan sponsors, policy makers, industry leaders and others. Their objectives are to promote understanding, improvement of current plans and associated tools and services to help public employees successfully invest for secure retirements.

Understanding the Public Sector

While there are key similarities among the issues faced in public and private sector retirement, there are also substantial differences. Areas more clearly associated with the public sector include:

- Continued strong presence and influence of defined benefit (DB) plans
- Emergence of hybrid DB/DC (defined contribution) plan types
- Adoption of phased or transitional retirement programs and new DB plan distribution choices (deferred retirement option plans/DROPS and partial lump sums)
- Challenges in keeping growing numbers of older, skilled workers in the workforce (larger percentages in public sector)

Like private sector employers, public sector employers are dealing with a host of challenges brought on by constricting budgets and the rising costs of funding employee benefits. For years private sector employers have been dealing with the increased benefit costs by eliminating DB plans and focusing on 401(k) plans.

Public sector employers are dealing with a host of challenges brought on by constricting budgets and the rising costs of funding employee benefits.

In contrast, government employers have generally continued to offer these plans. The strength of DB plans is illustrated by the fact that while public sector plans comprise only 5% of the total number in the U.S., they hold 53% of all DB assets.

Other public and private sector differences are evident in the characteristics of employees. For example, the public workforce is more likely to be:[1]

- Female—58% are female versus 49% for private
- Older—74% are over 35 versus 61% for private
- Middle income—Average annual earnings of $40,228 versus $38,322 in private[2]
- Working longer with the same employer and retiring at a younger age than private employees

Positive Trends in 457 Plans

The analysis of 457 plan data[3] provided evidence of some positive trends:

- Average deferrals increased over the past few years with the most dramatic increases among older participants.
- While males continued to contribute more than females, females are showing increases and the gap has narrowed in recent years.
- Participants are also demonstrating more diversification in their accounts. The number of participants investing in three or more asset classes has increased. This result has been aided by the increased popularity of asset allocation funds, especially among the youngest participants.

In general, public sector education programs around planning, investing, and asset diversification are receiving increased emphasis; however, these programs have not yet been able to demonstrate success.

[1] Bureau of Labor Statistics, unless otherwise noted.

[2] Statistical Abstract of the United States, No. 607, 2002.

[3] Analyses largely based on Nationwide® public sector data. The 2003 Nationwide database included information on over 8,200 plans, more than 1.75 million participants and over $31 billion in assets.

457 vs. 401(k) Plan Data

While there are similarities between the features of 457 plans for government entities (states, counties, municipalities, townships, special districts) and the 401(k) plans of private sector employers, there are also differences in the ways the plans are being used. Most public sector employees will have a significant portion of their retirement income provided through their DB plan and can therefore use their 457 plan assets to supplement this income. In contrast, for most employees in the private sector the 401(k) plan will serve as their primary retirement benefit. This distinction is important when examining the 457 plan data and how employees are structuring their retirement investments.

A look at 457 participants versus 401(k) private sector participants indicates those in the public sector on average earn less and contribute a smaller percentage of their pay than their private sector counterparts. And as might be expected, the average account balance for 457 participants is less. In fact the average 457 account balance is less than half that of the average 401(k) balance. Employees in larger governmental plans or plans in which the employer provides a match (much less likely in public than private sector) are more likely to have higher balances than other public sector participants.

Regarding the investment activity of 457 participants, they tend to demonstrate somewhat more conservative investment patterns than their 401(k) counterparts, having less of their assets in equities. In addition, public sector participants tend to be less active traders. In 2003 only 11% made fund exchanges during the year versus 17% of 401(k) participants.[4]

Future Solutions

A variety of factors are converging to threaten the success of retirement plans in the public sector:

- Increasing percentages of aging employees with inadequate savings
- Increased longevity, use of early retirement, and the need to fund longer retirement periods
- Declines in DB plans coupled with low enrollment in DC plans
- Poor understanding of investment principles among employees and inadequate diversification of their 457 plan accounts
- Employers facing shrinking budgets and increasing costs for funding employee benefits

Plan sponsors, policy makers, and industry supporters are urged to use the data and analyses to understand today's plans and help shape the future. They are encouraged to focus on creative solutions that include customized approaches for employers and employees and define success by measurable results. Understanding today's employer-sponsored plans and how employees are using them provides insights into changes or enhancements to help ensure public sector employees can enjoy financially secure retirements in the coming years. ■

[4] "How Well Are Employees Saving and Investing in 401(k) Plans?: 2002," Hewitt Universe Benchmarks, Business Wire, 17 June 2003.

Objectives

This is the first in a series of reports designed to examine the nature of retirement in the public sector. Unlike other documents that concentrate solely or primarily on the private sector, this work is devoted to governmental retirement plans. It is focused on state and local government employers and employees. This series is designed to provide comprehensive information about how this segment of the United States workforce is preparing for and transitioning to retirement.

The material is intended to assist plan sponsors, policy makers, industry leaders, and others to better understand public sector retirement issues. It is hoped that these materials will serve to generate discussions on retirement plan design, education, and policies to help employees better prepare for this life phase.

Topics

The report begins with a view of the public sector—briefly what it is, whom it includes, and how it is changing. Next, there is an overview of employer-sponsored retirement plans. The overview is followed by in-depth examinations of Section 457 deferred compensation plans[5]—plan composition and issues for employers and employees. Throughout the document there are references to private sector retirement plans. These references are used to round out the discussion and elucidate characteristics of the public sector through private sector comparisons. The document closes with some thoughts regarding the implications of the study results for public sector retirement.

Sources and Methods

Experts agree that the "best" conclusions are based on studies that employ sound research methods—and multiple studies of this type give the confidence of both valid and reliable findings. However, because such studies are rare in the public sector retirement literature, this report was developed using converging operations—collecting information from a variety of sources, weighing the soundness of the research and looking for patterns in the results. The conclusions reflect this approach.

This series is designed to provide comprehensive information about how this segment of the United States workforce is preparing for and transitioning to retirement.

Much of the data on which the conclusions are based is from Nationwide® Retirement Solutions (NRS), a division of Nationwide Financial[6] dedicated to the public sector. Nationwide has been a market leader in providing 457 retirement plans since these plans began in the mid-1970s.

[5] Eligible Section 457 plans of governmental employers are typically offered to supplement primary retirement benefits and are funded through voluntary employee pre-tax deferrals from earnings.

[6] Nationwide Financial Services, Inc. (NYSE:NFS), based in Columbus, Ohio, is a leading provider of annuities, life insurance, retirement plans and other financial services for individuals and institutional clients. The parent company, Nationwide, is a leading provider of diversified insurance and financial services and is ranked No. 111 on the Fortune 500 based on revenue.

The Nationwide data includes current and historical plan analyses, attitudinal and behavioral studies, and participant information collected over a span of more than 25 years. The current (2003) Nationwide database includes information on over 8,200 plans with more than 1.75 million participants and over $31 billion in assets. These rich data sources have been combined with secondary analyses from both published and unpublished sources to create snapshots, identify trends, and develop conclusions about public sector retirement.

Our Commitment

This report is the first in a series of studies to be conducted by Nationwide focusing on public retirement. These research efforts are supported through the work of the Nationwide Retirement Education Institute and its Panel of Advisors. The panel has provided valuable input regarding the information and conclusions detailed in this first study and will provide guidance regarding additional research to be conducted over the next year. These reports and other activities of the Institute are designed to establish a forum for thought and action associated with public sector retirement.

While each report will be comprehensive in its findings and conclusions, the analysis will also identify new questions and issues for examination. Each investigation will be more advanced than previous ones in terms of the available data, analyses, conclusions, and new hypotheses.

This effort is the first step on a journey of learning and, in conjunction with the efforts of industry leaders, policy makers, and others, is designed to positively impact the nature of public sector retirement. ■

The views of the Nationwide Retirement Education Institute and its panel of advisors do not necessarily reflect those of Nationwide or its affiliates and subsidiaries.

Who, What, and How Large

The United States retirement market is comprised of both private and public sector employers as retirement plan sponsors. Public sector employers can be divided into three groups:

- State and local government employers
- Educational institutions and non-profit employers—colleges, universities, hospitals, foundations, and other charitable groups
- Federal government employers

Private sector contains for-profit corporations and multi-employer retirement plans (a.k.a. Taft-Hartley plans).

In addition to the 50 states, there are almost 88,000 local governments.[7] The breakdown of local governments is as follows:

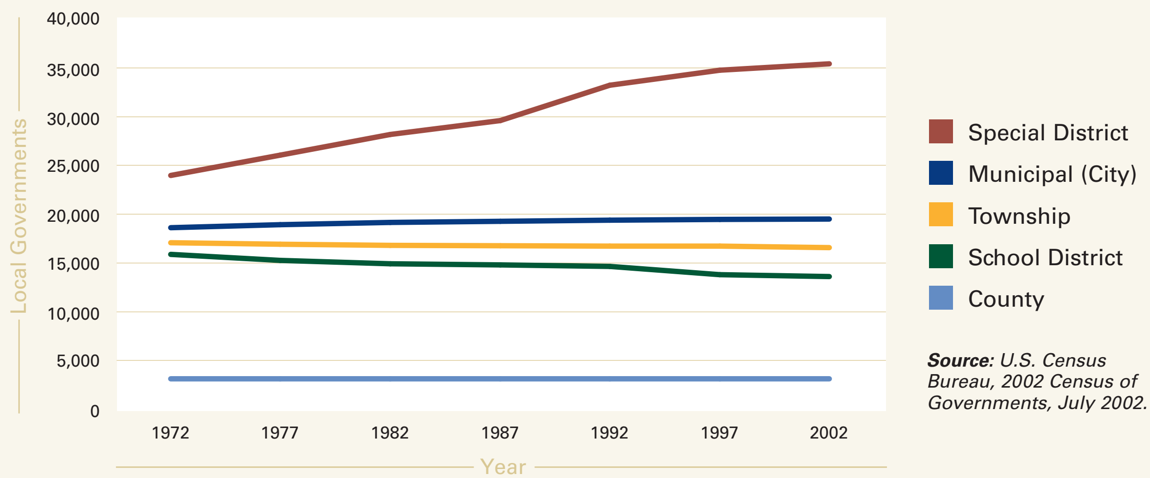
- County = 3,034
- Township = 16,506
- City = 19,431
- School Districts = 13,522
- Special Districts = 35,356*

Over the past thirty years, while some jurisdictions have been consolidated, the number of county governments has remained relatively constant (3,034), decreasing less than 1% (see figure 1).

Township governments have decreased by 3% in the same period, primarily due to jurisdictions being dissolved or folded into nearby municipalities. Municipal (city) governments have increased by 5% as the result of new incorporations.

Figure 1: Growth of Local Government Jurisdictions

Only special districts show significant growth, at 48% over 30 years.



Source: *U.S. Census Bureau, 2002 Census of Governments, July 2002.*

[7] U.S. Census Bureau, *Statistical Abstracts of the United States 2002*, Table 405. Includes entities with unknown number of employees.

* Includes special districts with no employees as reported by the U.S. Census Bureau. These "non-people" special districts hold funds assigned to a specific project such as highway construction. There are approximately 15,000 "non-people" special districts.

School districts decreased by 14% due to school district consolidation and reorganization. Also, many "dependent" school districts have been classified as agencies of other state/county/city government units.

Special districts are the only units to have shown significant growth, at 48%. Most special districts (91%) have been established to perform a single function. Some examples include: natural resources, fire protection, water supply, housing, and community developments. Special districts generally are very small and specialized. The higher growth rate in the number of small government jurisdictions is comparable to small business growth in the private sector.

Focusing on Employees

There are approximately 12.3 million state and local government employees (full- and part-time) and another 5.6 million public school district employees.[8] The number of state and local government employees grew by 12% from 1996 to 2001, compared to all jobs (total non-farm), which grew at 9% for the same period. As the economy faltered, local government job growth slowed to a 1% growth rate while all (private and public sector) jobs remained flat (-0.25%).[9]

Compared to private sector employees, government employees are:

- More likely to be female—58% vs. 49% of private sector non-farm labor force[10]
- Older—74% of government workers are over age 35 versus 61% of private sector workers[11]
- Longer tenured and more likely to retire younger—Government workers' average tenure with the current employer is 6.7 years, a figure almost double that of the private sector. As of 1998 (most recent data available), 97% of workers in government defined benefit pension plans were in plans allowing full retirement benefits prior to age 65.
- Middle-income earners—State and local government employees have an average salary of $40,228.[12] This figure compares favorably with the $38,322 average for private sector full-time wage and salaried workers in the U.S. If total annual compensation[13] is compared, government employees extend the difference with annual compensation of $52,820 vs. $41,318 for private industries. One explanation for this apparent difference could be the higher proportion of white-collar workers in public versus private sector jobs.

Employee Attitudes and Behaviors

In a 2003 investigation conducted by AON, employees of small private sector businesses ranked retirement plans as the third most important employee benefit, following only medical insurance and paid time off.[14]

[8] U.S. Census Bureau, *Statistical Abstracts of the United States 2002*, Table 441.

[9] U.S. Census of Governments 2002 (data as of 2000).

[10] Bureau of Labor Statistics.

[11] Bureau of Labor Statistics.

[12] *Statistical Abstracts of the United States*, No. 607, 2002.

[13] Includes in addition to wages and salaries, employer contributions for social insurance, employer contributions to private and welfare fund, directors fees, jury and witness fees, etc.

[14] AON Small Business @ Work Study, from Benefit News.com 2/18/2003.

In another study addressing employee priorities, private sector employees continued to focus on issues regarding retirement plans. Evaluating current investment options was identified as the top concern by 64% of respondents (see table 2).[15]

While these results are relative to private sector employees, the results reported in the following discussion suggest generalization to public sector is warranted.

In a recent survey of all consumers[16] that examined ownership and attitudes about many subjects including financial services and products, results indicated 457 public sector participants (relative to all individuals across the nation) were more:

- Likely to indicate retirement as an important savings goal (63% vs. 34%)
- Interested in tax-exempt or tax-deferred investments (89% vs. 61%)
- In need of help in selecting products best suited to help meet their financial goals (75% vs. 67%)
- Willing to spend time making investment decisions (71% vs. 53%)

In a national 2003 study conducted by Nationwide regarding public sector attitudes, 457 plan participants reported interest and satisfaction with 457 retirement plans—with 77% reporting a willingness to recommend their employer-sponsored plan to a co-worker.[17] Clearly voluntary 457 retirement plans are an important topic for public employees.

Ongoing Challenges

There are significant challenges and issues facing employers in the public sector, such as dealing with budget pressures, keeping older skilled workers, and providing healthcare and pension benefits.

Facing Budgetary Concerns

A stalled economy, falling revenues, and continued pressures to increase spending (particularly with Medicaid programs) continue to plague state budgets. A June 2003 report by the National Governors Association[18] indicated fiscal 2003 general fund spending growth of only 0.3% above fiscal 2002. Thirty-seven states reduced

Table 2: Top Five Private Sector Employee Priorities, 2003

Priority	% Citing Priority as within "Top 5"
Evaluate current investment options	64%
Evaluate adequacy of current level of retirement savings	61%
Identify additional ways to save for retirement	44%
Learn more about health care risks and how to control them	40%
Make greater use of Internet tools and manage financial and security programs	36%

Source: *Deloitte & Touche Survey, IOMA Report—Managing Benefit Plans, May 2003.*

[15] Deloitte & Touche Survey, IOMA Report—Managing Benefit Plans, May 2003, p. 7.
[16] SRI Consulting MacroMonitor, 2000–2001.
[17] Nationwide Plan Sponsor Research, July 2003.
[18] National Governors Association, "The Fiscal Survey of States," June 2003.

fiscal 2003-enacted budgets by more than $14.5 billion—the largest spending cut since 1979. States have relied heavily on specific strategies to reduce budget gaps:

- 33 states enacted a combination of across-the-board cuts and use of rainy day funds
- 17 states laid off employees
- 8 states used early retirement incentives
- 10 states reorganized programs
- 10 states imposed new fees

For local jurisdictions, similar budget challenges exist. A recent survey of U.S. counties revealed that nearly three-fourths (72%) are facing budget shortfalls. Some counties (25%) plan to decrease public health services, and over half (56%) face reductions in state aid for state-mandated programs. Of those facing state aid reductions, almost four in ten (37%) will reduce services to offset the funding reductions and 17% of counties will increase taxes.[19]

Cities face similar challenges. Four out of five (79%) city financial officers say their city is less able to meet financial needs in 2003 than in 2002. State aid to cities is expected to decline 2.1% in 2003. Responses of cities are similar to those of other governmental entities—raising user fees for services, drawing down reserves, laying off city personnel,and reducing investments in infrastructure and maintenance.[20] Although these tactics have provided some relief, many of these budget-balancing actions are one-time-only remedies that cannot be used repeatedly.

Retaining Older Skilled Workers

In state and local governments, 40% of employees will be eligible to retire between 2000 and 2015. Because public sector employees are older, have longer tenure with their employer, yet often retire younger, they are contributing to the extreme pressures on funding defined benefit plans.

At the same time the workforce is aging and the annual growth rate of the labor force is slowing, there is also a need to retain older workers.[21] Many governments are trying to retain skilled older workers through phased retirement programs. The U.S. Department of Labor defines phased retirement as “a gradual change in a person’s work arrangements as a transition toward full retirement.”[22]

Various retire-rehire plans are being tested by school districts, city, county, and state government jurisdictions in efforts to retain skilled personnel. One type of program being tried is Deferred Retirement Option Plans (DROPs—discussed in more detail later in this document). Despite the cyclical downturn in employment after 2000, isolated labor shortages remain in certain parts of the country and those areas have helped keep the phased retirement trend alive.

[19] National Association of Counties, “Counties in Crisis,” February 2003, pages 1–17.
[20] National League of Cities, “Cities Confront Tough Choices as Fiscal Conditions Decline,” February 2003.
[21] The Evolution of Public Sector Pension Plans, National Conference of Public Employee Retirement System, May 2002, p. 7.
[22] Please Don’t Go! Why Phased Retirement May Make Sense for Your Government, Government Finance Review, October 2002.

Providing Costly Benefits

State and local government employers, like private sector employers, face challenges managing the cost of various employee benefits. As a percentage of total compensation costs, health insurance and defined benefit pension plans are the two most costly employee benefits for state and local governments at 8.6% and 4.8% respectively (excludes wages/salaries).[23] The costs of these two benefits have outpaced various types of paid leave (vacation, sick), other types of insurance (disability, life) and even legally required benefits such as workers compensation coverage.

Similarly, private sector employers' two most costly employee benefits are health insurance (5.9%) followed by Social Security contributions (4.9%, excludes Medicare). It is important to recognize that some government employers use their DB plan in place of Social Security coverage and this is a factor in the higher benefit costs compared to private sector plans.

Given the proportion of health insurance and retirement benefit costs that are part of a total compensation package, it is not surprising that the management of these two benefits is a focus of state and local government officials. Current cost issues are exacerbated in this difficult economic environment in which state and local governments are facing extremely difficult budget issues such as large employment cost increases (12 months ending 9/2003 increases: compensation = 3.6%; benefit costs = 6.7%).[24]

Table 3: Top Five Private Sector Employer Priorities, 2003

Priority	% Citing Priority as within "Top 5"
Control health and welfare costs	86%
Comply with privacy requirements	50%
Expand employee self-service technology for communication and / or administration	38%
Evaluate / implement / expand use of Internet / intranet applications	36%
Provide financial / retirement planning tools and information	33%

Source: *Deloitte & Touche Survey, IOMA Report—Managing Benefit Plans, May 2003.*

[23] McDonnell, Ken, Benefit Cost Comparisons Between State & Local Governments and Private-Sector Employers, EBRI Notes, October 2002, Figures 7, p. 7.

[24] Bureau of Labor Statistics, Employment Cost Index (ECI).

Demographic and cost factors—aging workers, a higher ratio of retirees to active employees, and longer life expectancies—put pressure on funding employer health care plans. Healthcare costs for employers due to larger numbers of retirees (pre-Medicare) are increasing at a faster rate than costs for active employees. Rising prescription drug outlays and worker trends toward early retirement also contribute to rising healthcare costs. As state and local government employers face major healthcare funding challenges and funding for benefits becomes scarce, it becomes increasingly difficult to maintain the robust benefits contained within traditional government DB plans.[25]

Similar to government employers, private sector employers cite their top priority for 2003 to be controlling health and welfare costs (see table 3, page 10). Controlling these costs was also the top priority last year. These costs increased 5% since 2002 and outpaced the second most important priority by a wide margin.[26]

The heavy use of defined contribution plans in the private sector (now emerging in the public sector) has been one response to the retirement plan cost issue for employers. However, increased reliance on DC plans has spawned a new issue—making sure employees have resources to properly manage their own retirement accounts and understand how to use their retirement assets to last throughout their lifetimes. ■

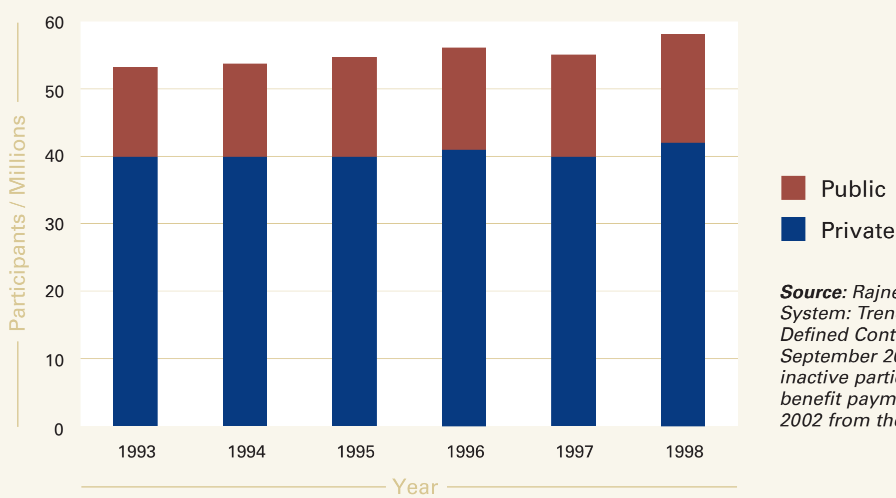
[25] EBRI Retirement Confidence Survey, 2003.
[26] Deloitte & Touche Survey, IOMA Report—Managing Benefit Plans, May 2003, p. 7.

Defined Benefit (DB) Plans Overview

DB plans provide retirement benefits to 58 million participants in the private and public sectors. The number of private sector DB plan participants has remained steady at approximately 42 million. In contrast, the number of public sector participants has grown an average of 4% per year, from just over 13 million participants in 1993 to more than 16 million in 1998 (see figure 4).[27] Since 1998, public sector participant growth has continued and has risen to over 17.2 million members in 2002 (comparable private sector participant data not available).

The total number of private and public sector defined benefit plans has declined to approximately 58,000 plans in 2002 (55,000 private plus 2,670 public). (See figure 5, page 13.) The number of private sector DB plans has declined dramatically since 1985.[28] The decline in private sector DB plans has been primarily among small employers. Reasons for the decline include legislative and regulatory changes that made the plans more costly and less tax advantageous for these employers. The number of public sector plans has changed very little over the past 20 years (see figure 5, page 13). There are far fewer public sector plans relative to private sector plans, though the public sector plans tend to be larger.

Figure 4: Total Number of DB Participants



Source: *Rajnes, David, An Evolving Pensions System: Trends in Defined Benefit and Defined Contribution Plans, EBRI Issue Brief, September 2002. Includes active and inactive participants but not those receiving benefit payments. Public sector data for 2002 from the U.S. Census Bureau.*

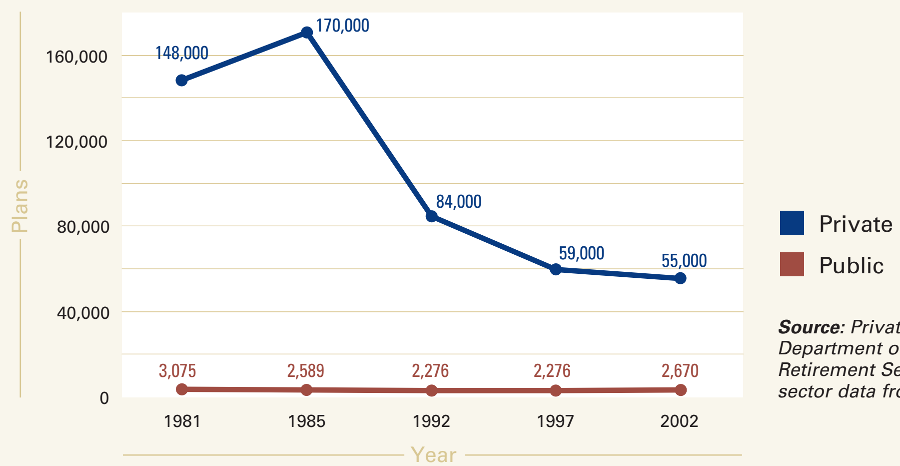
[27] Rajnes, David, An Evolving Pensions System: Trends in Defined Benefit and Defined Contribution Plans, EBRI Issue Brief, September 2002, Figures 2 and 16. Includes active and inactive participants but not those receiving benefit payments. Public sector data for 2002 from the U.S. Census Bureau.

[28] Private sector data from Department of Labor, PBGC, and Retirement Services Roundtable. Public sector data from the U.S. Census Bureau.

DB plan assets have declined from $4.8 trillion in 2000 to $4.0 trillion in 2002 (see figure 6). For both public and private sectors, asset declines are due to several factors:[29]

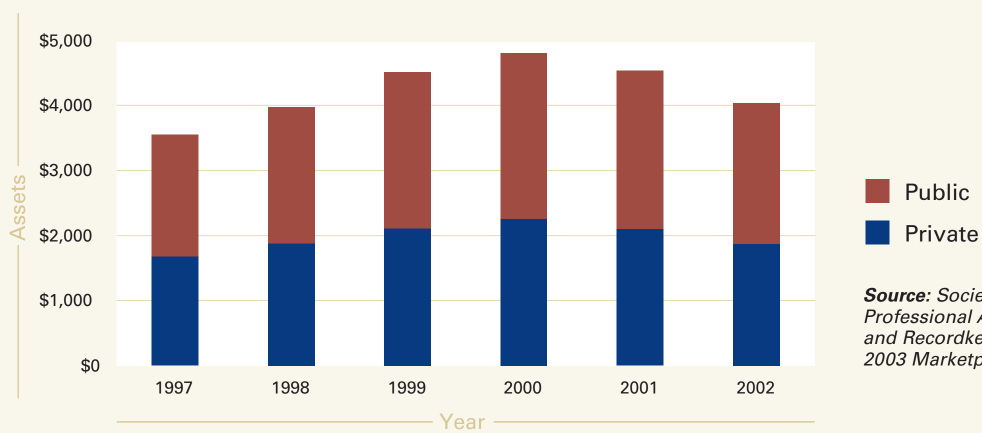
- Reduced investment returns combined with record-low interest rates
- Economic problems facing more U.S. states
- Rising unemployment
- Slower job growth

Figure 5: Total Number of DB Plans



Source: *Private sector data from Department of Labor, PBGC, and Retirement Services Roundtable. Public sector data from the U.S. Census Bureau.*

Figure 6: Defined Benefit Plan Assets Have Declined



Source: *Society of Professional Administrators and Recordkeepers (SPARK), 2003 Marketplace Update.*

[29] Society of Professional Administrators and Recordkeepers (SPARK), 2003 Marketplace Update.

Public Sector DB Plans

Government defined benefit pension plans have existed since World War II. While not subject to ERISA regulations as in the private sector, these plans are subject to Internal Revenue Code provisions and state-level regulations. Over time the plans have evolved into more valuable plans relative to private sector plans, with favorable features including disability and cost-of-living adjustments. Factors contributing to the development of public sector DB plans include:

- Issues related to competing with private sector employers for skilled workers and the absence of Social Security coverage among some employers
- Strong union presence among public sector employees

Most government DB pension plans were established within large governmental units, mainly states and large cities. However, some large counties and townships also have plans, and a few plans exist with special districts and school districts (see figure 7).

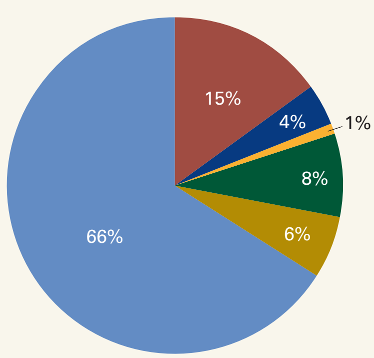
Many state plans are multi-employer plans, in which the various local governments have adopted the state DB plan. In addition some states have more than one DB plan serving specific groups—for example, separate plans for public education employees or state law enforcement personnel.

The 2,670+ public sector DB plans:

- Comprise less than 5% of all DB plans in the United States
- Cover approximately 12% of the U.S. workforce (state and local government employees)
- Hold over 53% of all DB plan assets in the U.S.

Overall, nearly 90% of state and local government employees participate in some type of employer-funded retirement plan (see figure 8). Public sector access to DB retirement plans is far more prevalent compared to private sector employers. In contrast, private sector employees are more likely to have access to employer-funded DC plans than public employees.[30]

Figure 7: Number of State and Local Government DB Plans

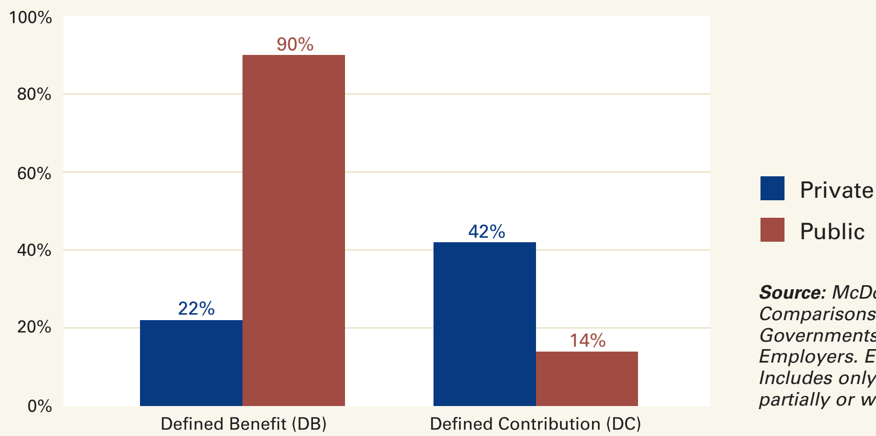


Townships	404
Special Districts	108
School Districts	14
States*	219
Counties	164
Cities	1,761

Source: *U.S. Census data, 2001–2002.*
**States can have multiple plans.*

[30] McDonnell, Ken, Benefit Cost Comparisons Between State and Local Governments and Private Sector Employers. EBRI Notes, October 2002, Figure 7, p. 7. Note: Includes only benefit plans that are partially or wholly paid by the employer.

Figure 8: Percent of Full-Time Employees Participating in Plan



Source: *McDonnell, Ken, Benefit Cost Comparisons Between State and Local Governments and Private Sector Employers. EBRI Notes, October 2002. Includes only benefit plans that are partially or wholly paid by the employer.*

Defined Contribution (DC) Plans

In the 1990s, government defined contribution (DC) plans, specifically employer-funded 401(a) plans, began to surge in popularity due to increased worker mobility. These plans were attractive to employees in that they were easy-to-understand, portable and offered individually controlled accounts. Many of these plans grew as a response to increases in funding pressures.

There are three basic variations of employer-funded DC plans:

1. A hybrid plan that combines certain features of both DB and DC plans, offered as a replacement for a DB plan
2. An optional DC plan, offered as a replacement for, or as a second choice, alongside a DB plan
3. A match plan, offered to encourage participation in voluntary supplemental plans, such as 457 plans or 401(k) plans

Table 9 illustrates how some state DB plans have responded to DC plan growth using hybrid and optional DC plans.

Table 9: DB Plan Changes Based on DC Influences

Plan Change Made	Year—States(s)
Set up new DC plan, closed, or replaced existing DB plan	1999 - North Dakota 1991 - West Virginia 1998 - Virginia
Set up hybrid DB-DC plan	2001 - Idaho 2000 - Washington 1996 - Michigan 1995 - Washington & Colorado
Added new eligible classes of employees for DC plans	1999 - Louisiana 1998 - Maine
Shifted to cash balance DB plan or offered new benefit schedule within current DB plan	2002 - Nebraska 1999 - Missouri & North Dakota 1996 - California
Set up optional DC plan, DB plan remained intact	2000 - S. Carolina, Utah, Ohio, California, Florida 1999 - Colorado, Montana, Arizona 1998 - Illinois, Vermont, Ohio

Source: *Rajnes, David, An Evolving Pension System: Trends in Defined Benefit and Defined Contribution Plans. EBRI Issue Brief, September 2002.*

Public Sector DC Plans

Unlike the employer-funded 401(a) DC plans discussed above (match, hybrid, optional), voluntary DC plans are considered supplemental plans and are funded when an employee elects to defer a portion of his/her salary for retirement. These plans include 457(b), 403(b), and 401(k) plans.

Section 457 plans were legislated into existence in the public sector in the mid-1970s. State and local governments as well as public university and school district employers are eligible to offer these plans. Section 403(b)s (or tax-sheltered annuity plans) are more frequently offered by universities and school districts in lieu of, or in addition to, 457 plans. Section 401(k) plans are offered by government employers who adopted this plan type on or before May 1986.

Supplemental 457 DC plans grew because they allowed employers to compete more effectively with the private sector for qualified employees—without having to fund the plans. The employer-funded match plans arose in the 1990s to help public sector employers compete with match plans offered by private sector employers in 401(k) plans.

In the private sector, 401(k) plans have achieved strong growth, offsetting to some extent the decline in the number of DB plans among small employers. The private sector relies heavily on employer matching with 401(k) plans, an estimated 77% of all plans provide matches.[31] Other 401(a) DC plans options offered in the private sector, include profit sharing plans, stock option plans and ESOPs.

Ongoing Issues

There are a number of key issues affecting public sector retirement plans. These include financial concerns for underfunded DB plans, momentum for the popularity of phased retirement arrangements, continued impact to pension reform from the 2001 Tax Relief Reconciliation Act, and new savings options for deemed IRAs, as well as employers' top priorities for plans.

DB Funding Shortfalls

Just as large numbers of employees are beginning to retire, many traditional government DB pension plans are facing funding shortfalls due to poor investment returns. The 2002 State Retirement Funding Report issued by Wilshire Associates indicated that 51% of all plans are now underfunded (defined as less than 100% funded) and further declines of 10% to 15% are predicted in the next reporting cycle.[32] The actuarial funding assumptions indicate it may take years before the underfunding crisis eases and increased employee contributions may be required to mitigate funding shortfalls. It is hoped, however, that investment returns may improve enough to avoid this change.

State and local governments continue to struggle with budget issues. Employee groups lobby for enhanced benefits and oppose employer efforts to reduce costs through benefit reductions. Severe budgeting constraints increase the financial motivation to use the pension system to satisfy short-term budget imbalances and affect a pension system designed for the long term.

Phased Retirement Solutions

The long-term trend toward earlier retirement is slowing due to declining labor force participation and the aging workforce. Employees find phased retirement more attractive than ever due to inadequate retirement savings and the need to sustain a longer retirement period (due to longer life expectancies). Aside from financial necessity, many employees voluntarily extend their employment to remain active and involved.

To address the related issues of an aging workforce and a reduction in skilled labor, some state and local governments are beginning to develop formal retirement arrangements that allow for flexible work options. These "bridge jobs" include reduced hours or schedules, special assignments, temporary work, and consulting relationships.[33] Phased retirement is gaining the most momentum in the public sector as a tool to retain employees, especially in professions where early retirement commonly takes place, such as law enforcement, teaching, and firefighting.

[31] Society of Professional Recordkeepers and Administrators (SPARK) Marketplace Update 2003, p. 24.
[32] "Public Sector Retirement System: What Does The Future Hold?" *Employee Benefits Journal*, June 2003.
[33] "Phased Retirement" Catching on …, EBRI, September 24, 2001.

One example of a formal phased retirement arrangement is the “Deferred Retirement Option Plan” (DROP). DROP is a type of distribution in DB plans that is being established in governmental plans. Private sector plans are unable to adopt similar provisions because ERISA constraints limit this flexibility. There are no specific federal tax laws that govern DROPs, and governmental employers are finding many creative ways to establish these plans to meet the unique needs of their workforce.

A DROP can allow eligible state and local government employees to “retire” for pension plan purposes but continue working for a specified period of time. Typically the retirement benefit is calculated at the time a DROP is elected and the value of the monthly pension benefit is recorded into a separate account. This approach is the most common type of DROP, also referred to as a trustee-directed DROP. Far less common are DROPs that have been set up as a 401(a) DC plan with a limited funding period. These plans are often referred to as self-directed DROPs.

Instead of offering a DROP, some states have begun to offer a partial lump-sum option from their DB plan to provide employees more flexibility. The retiree can choose the traditional pension income stream or take an initial lump sum and a smaller payment stream. While it is not the same as a DROP, this option duplicates an attractive feature of DROPs—the lump sum distribution at retirement.

2001 EGTRRA Pension Reform Impact

In 2001, the Tax Relief Reconciliation Act (EGTRRA) became law. It marked a departure from pension-related legislation of the 1980s, which dramatically cut benefits that could be provided through pension plans and added layers of complex rules.[34] EGTRRA

- Expanded portability of retirement benefits among private, nonprofit and governmental sectors[35]
- Provided common provisions for 457, 403(b) and 401(k) plans such as maximum annual deferrals and catch-up contributions

We have not yet seen the full impact of this legislation. Just over 1% of participants used the new portability provisions (illustrated later in this report) in 2002. While 11% of participants currently maximize their 401(k) contributions,[36] only an estimated 3% maximize contributions in 457 plans.[37] Although there has been a decrease in the percentage of employees who are actually deferring the maximum annual amount, the fact that the limit has been increasing for the past few years (due to EGTRRA) may be responsible. Overall, average deferral amounts that individuals are contributing to their accounts are increasing.

[34] Editorial: More pension reforms necessary, *Business Insurance*, April 21, 2003, Vol 37, Number 16.
[35] Editorial: More pension reforms necessary, *Business Insurance*, April 21, 2003, Vol 37, Number 16.
[36] Sommer, Jeff, “401(k) Contributions Not All They Could Be,” *The New York Times*, March 16, 2003.
[37] Nationwide research, 2003.

Deemed IRAs Provide New Options

Within EGTRRA, Congress created deemed IRAs because of concerns about the low rate of retirement savings in the United States. Deemed IRAs give plan sponsors the ability to offer employees a payroll-deducted IRA with the characteristics of a Roth IRA or traditional IRA. The IRS recently issued important proposed guidance to clarify how the qualified plan and the IRA rules impact any plan offering deemed IRAs.

It remains to be seen whether employers and/or employees will value this product. Employees often find it financially prudent to maximize their pre-tax retirement plan contributions before contributing to an IRA and employers may be slow to add this option to their plan because of some outstanding regulatory issues. Regulatory requirements include having a separate trustee for IRA assets. This guideline appears to suggest that governments will not be able to self-trustee as they often do with their primary and supplemental retirement plans. Additional guidelines suggest issues around fiduciary obligations, having accounts meet IRA federal tax requirements and employee communication/education requirements. Collectively, such requirements may deter employers from offering new IRA options.

Employer Priorities

When asked to list their top priorities for 457 plans over the next twelve months, employers cited goals that revolved around employee satisfaction, employee education, and employer fiduciary/plan management.[38]

Priorities cited most often were:

- Improving awareness of plan and participant satisfaction to increase participation and deferrals
- Improving investment education to allow better asset allocation and diversification
- Implementing fund performance reviews
- Developing investment policy statements
- Updating plan documents based on regulatory changes ■

[38] Nationwide Large Plan Sponsor Research, February 2003 (C&A)

Marketplace Overview

An overview of the marketplace shows that six financial institutions administer the vast majority of 457 plan assets, there is little new plan growth, and plan sponsor trends are moving from multiple provider and plan options toward one or two providers administering several types of plans. A view of the "average" plan is also included below.

Market Leaders

The public sector marketplace is dominated by a handful of well-known financial services companies that have a long history in the 457 market. Six financial service companies (CitiStreet, Great-West Life, Hartford, ICMA-RC, ING, and Nationwide Retirement Solutions) manage the administration of approximately 80 to 90% of all 457 plan assets.[39]

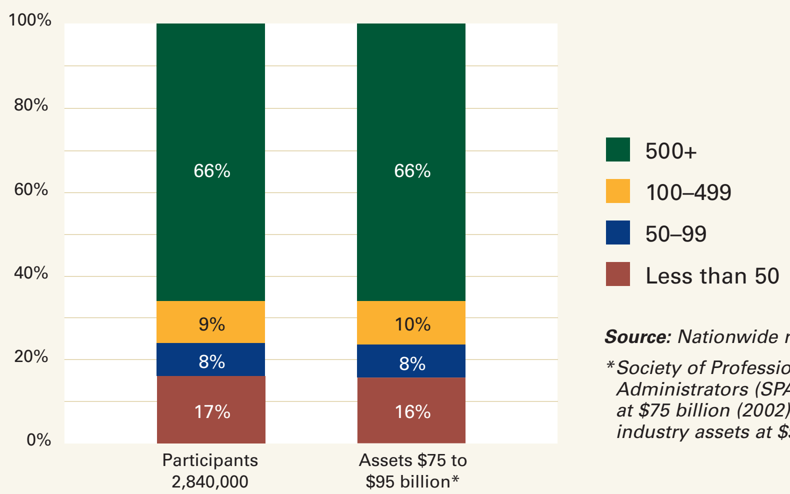
The majority of 457 plan participants and assets are concentrated in a few large plans (see figure 10). It is estimated that these large plans account for:[40]

- approximately 2% of all 457 plans
- two-thirds (66%) of all participants
- two-thirds (66%) of the plan industry assets

Limited New Growth

The governmental 457 plan market is estimated to contain 31,450 plans. These voluntary plans grew fast in the 1980s, analogous to private sector 401(k) plan growth in the 1990s. Most, if not all, large and mid-size cities and counties and all 50 states already have a plan in place. A notable number of small government jurisdictions use their state's 457 plan rather than set up their own plan—Ohio is one example of this shared approach. Remaining new plan formation is limited primarily to small special districts (e.g., water districts) and some small townships.

Figure 10: 457 Plan Participants and Assets by Size of Plan



Source: *Nationwide research, 2003.*

**Society of Professional Recordkeepers and Administrators (SPARK) industry assets estimated at $75 billion (2002); Spectrem Group estimated industry assets at $95 billion (2000).*

[39] Based on analysis of various RFP bids, news releases and interviews by Nationwide staff.

[40] The Section 457 Retirement Plan Market, Spectrem Group, December 2000, p. 5, Society of Professional Recordkeepers and Administrators (SPARK) Marketplace Update 2003.

Multiple Plan and Provider Trends

Many plan sponsors allow employees a choice by offering more than one 457 plan provider. A review of mid-size and large plans suggests there is a prominent level of multiple plans, estimated to be 60%.[41] This percentage declines among the largest (i.e., mega) and the smallest plans. Less than half of these latter groups are likely to offer multiple plans.

Recent trends suggest plan sponsors are moving from multiple providers for multiple plans to one or two providers administering several types of plans (457, 403(b), etc.). Several market factors are influencing this trend:

- Increased IRS audits of 401(k), 457, and 403(b) plans, leading plan sponsors to prefer a single provider to manage all plans in order to improve cross-plan coordination on provisions such as maximum deferrals and catch-up provisions.
- Consolidated statements—combining information on several plan types from one provider—becoming popular with employers as well as employees. Some providers are beginning to offer common remittance services as a response to this trend.
- Convenience, accountability, and interest in using DC retirement plans (and more recently health savings plans) as a depository for unused sick and vacation pay.[42]
- Desire for cost-cutting opportunities.
- Increased emphasis on fiduciary responsibility by plan sponsors.

In some instances plan sponsors will unbundle specific services to acquire expertise or to control costs. Plan education services, investment advice, and plan investment reviews are some examples of services sometimes provided by a firm other than the provider administering the plan.

The "Average" Plan

Relative to industry information described earlier, Nationwide's base of 457 plans includes a higher percentage (8%, see table 11) of large and mega plans relative to industry estimates of 2%. However, the overall pattern of a few plans (8%) holding the majority of assets (66%) is similar for both market and Nationwide plan data.

Table 11: 457 Statistics by Plan Size

Plan Size (Assets)	Average Number of Participants	% of All 457 Assets	% of All 457 Plans
Mega ($1 billion+)	115,000	46%	4%
Large ($100 million–$1 billion)	15,000	20%	4%
Medium ($5 million–$100 million)	750	22%	5%
Small (<$5 million)	50	12%	94%

Source: *Nationwide research, 2003.*

[41] Large Plan Market Information, Nationwide, 2002.
[42] IRS Audit Reports, RFP's and Industry Reports compiled by Nationwide personnel, June 2003.

Assets, Deferrals, and Participation Rates

This section provides details on participant activity involving account balances, deferral rates and asset diversification. Challenges of fund ownership, including the use of single funds, and asset allocation of ongoing contributions are also discussed.

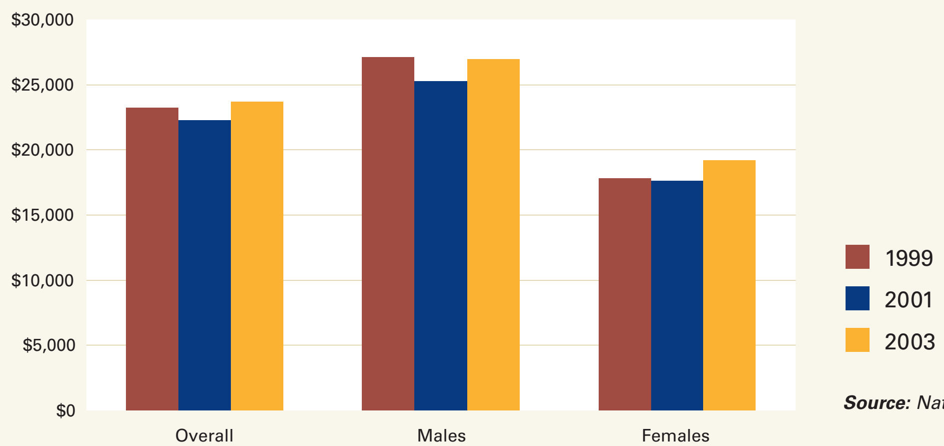
Influences on Account Balances

The account balance of the average participant decreased by 14% during the recent market decline, but is rebounding. The overall current average balance is still increasing from earlier years—currently it is about $24,000 (see figure 12).

While males and females have tended to defer at different rates, the difference between their total account balances is narrowing. The average balance of male participants is $27,000, and the average female participant account balance is $19,000. Historically, the male/female difference was almost $10,000 but decreased to $8,000 in 2003.

As expected, older participants have larger balances than younger ones. All age groups, except those 18–25, have recovered from market declines and are above 1999 average balances (see table 13).

Figure 12: Average 457 Participant Account Balances



Source: *Nationwide research, 2003.*

Table 13: Average Participant Account Balance by Age Range (Public Sector)

Age Range	1999	2001	2003
18–25	$3,400	$2,000	$2,600
26–35	$5,200	$5,300	$6,900
36–45	$13,600	$12,700	$14,900
46–55	$24,400	$23,900	$26,900
56–65	$28,600	$38,500	$41,000
65+	$48,700	$51,600	$53,000

Source: *Nationwide research, 2003.*

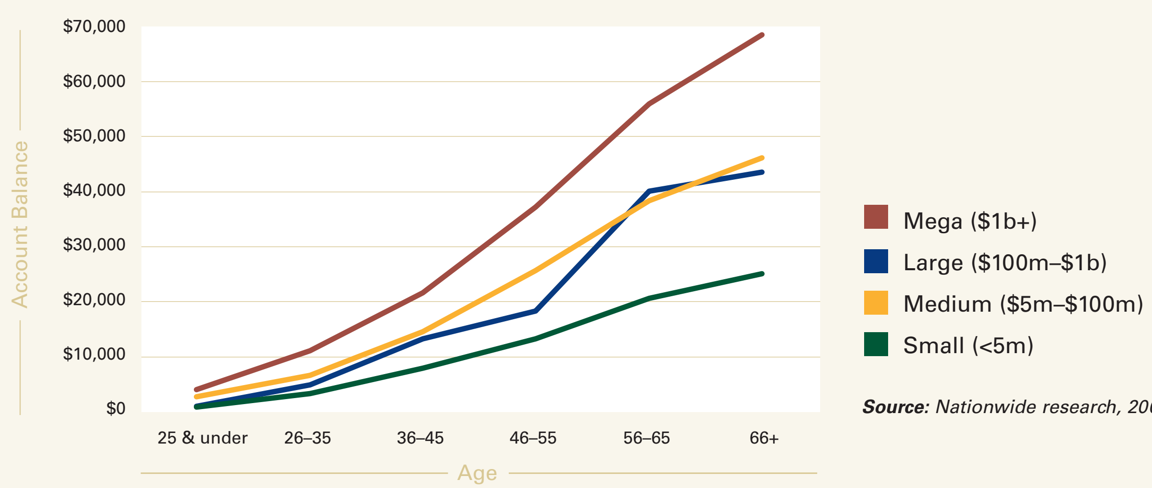
Large Plans Have Edge

When we examine account balances based on total assets in a plan, we note that larger plans have larger average account balances. This is true for all age groups (see figure 14).

Mega sized plans (over $1 billion in assets) double and triple the average account balances for similar age groups in small plans (less than $5 million).

Results for medium and large plans lie between those of mega and small plans. The gaps are consistent among all age groups.

Figure 14: Average Account Balance by Plan Size



Source: *Nationwide research, 2003.*

Table 15: Average Participant Account Balance by Plan Size (Private Sector)

Selected Plan Size (number of participants)	Average Participant Assets
2–99	$20,900
500–999	$25,400
1,000–4,999	$31,800
20,000+	$60,600

Source: *Retirement Industry Update: Trends in 401(k) and IRA Markets, Cerulli Associates, 2002.*

Results for the private sector illustrate this same phenomenon, with average participant assets increasing with entity size (see table 15). The average balances in the largest plans are typically almost triple those of the smallest plans.[43]

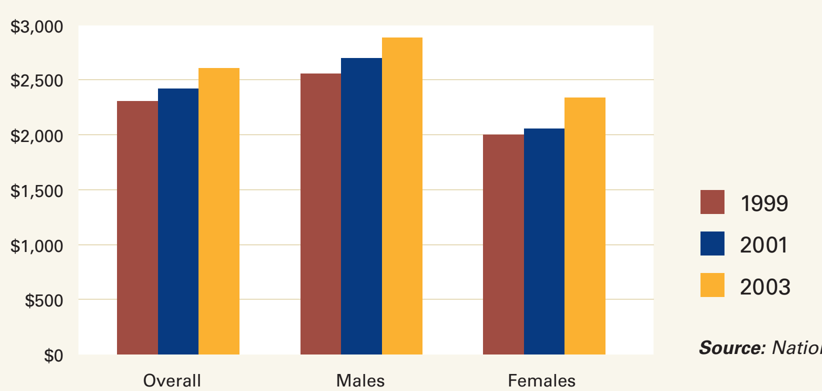
Reasons for this difference could be due to the longevity of the plans, length of employee plan participation, salary differences, management support of the plans, or other factors. Future research will be necessary to identify the root causes for the difference.

Deferrals Rising

Average annual deferral amounts have increased every year, with a notable jump in the past two years (see figure 16). The overall average 2003 deferral rate was $2,600, an increase from $2,300 in 1999. As noted earlier, changes in maximum deferral limits and catch-up requirements may have influenced this increase.

The average male deferral was $2,890. This amount represents an increase of $330 since 1999. The average female deferral rate was $2,340, with an increase of $340 since 1999. This result, males deferring more per year than females, has been relatively constant over time.

Figure 16: Average Deferral Amounts per Year



Source: *Nationwide research, 2003.*

[43] Retirement Industry Update: Trends in 401(k) and IRA Markets, Cerulli Associates, 2002, pg. 81.

Table 17: Average Deferral by Age Range

Age Range	2000	2001	2003*	% Increase 1999 to 2003
18–25	$1,320	$1,170	$1,050	-20%
26–35	$1,530	$1,640	$1,710	12%
36–45	$2,100	$2,120	$2,190	4%
46–55	$2,600	$2,700	$3,020	16%
56–65	$3,210	$3,280	$3,870	21%
65+	$3,390	$3,520	$4,690	38%

Source: *Nationwide research, 2003.*
**Annualized—may be slightly overstated.*

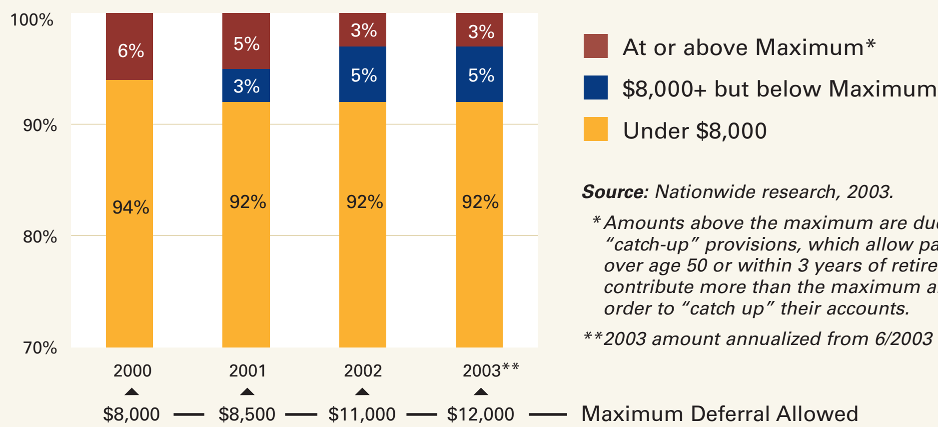
Average annual deferral amounts are increasing in all age groups except those that are ages 18–25. The most dramatic change is with those participants over age 55 (see table 17).

EGTRRA may have contributed to these changes. One could speculate that the large increase in the older ages is due to recent increases in catch-up and maximum deferral limits. One could speculate that the decrease at youngest ages may have been influenced by the addition of an income tax credit for lower-earning households leading to an increasing number of younger employees beginning to contribute into their retirement accounts.

In a 2003 national study, over one-quarter (26%) of participants reported that they had increased their 457 plan deferrals within the past year. When asked about future increases, almost half (46%) reported that they were “somewhat likely” or “extremely likely” to increase their deferral amount in the next 12 months.[44] When individuals were asked how they planned to make that change, they indicated a comfort level with both telephone (52%) and Web site (40%) changes. (See the research section, Customer Service Preferences, page 40, for more details.)

[44] 2003 Public Employee Plan Participant Satisfaction Survey, Nationwide, April 2003.

Figure 18: Percent of Maximum-deferring Participants by Year



***Source:** Nationwide research, 2003.*

**Amounts above the maximum are due to "catch-up" provisions, which allow participants over age 50 or within 3 years of retirement to contribute more than the maximum amount in order to "catch up" their accounts.*

***2003 amount annualized from 6/2003 data.*

As a result of EGTRRA, the maximum contribution limits available to participants were nearly doubled. An analysis of the impact of this legislation indicated that the percentage of participants who are at, or above, the maximum has decreased from 6% in 2000 to 3% in 2003 (see figure 18). However, results also indicated an increase in the percentage of participants who deferred $8,000 or more—increasing from 6% in 2000 to 8% in 2003.

This incremental increase is consistent with the typical "slow-to-react" behavior of participants. It can be expected that once the new maximum is in effect for several years, the percentage of participants at this level will increase to that consistent with previous results.

Asset Diversification—Slow to Take Hold

Participants choose the type of asset classes[45] in which they invest. Standard asset classes from which they may select include:

- Balanced
- Bonds
- Fixed/cash
- International
- Large cap
- Mid cap
- Brokerage
- Small cap
- Specialty
- Asset allocation

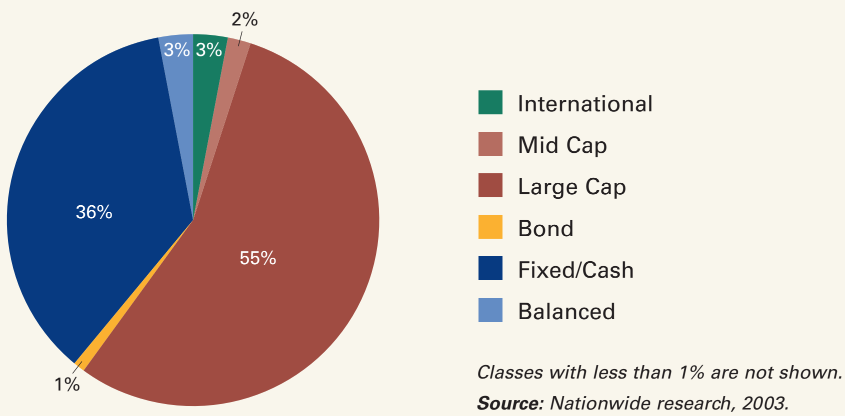
In future reports there will be an effort to understand the proportion of change due to market fluctuations versus that associated with asset transfers.

[45] Asset or fund classes are categories of investments based on company capitalization, geography, guarantees, investment philosophies, or a combination thereof.

Since the market downturn, there has been a large shift of total assets into fixed/cash asset classes—from 36% of assets in 1999 to 45% in 2003. Large cap assets were the main loser, decreasing from 55% to 38%. This shift is due to market losses in equity classes and to actual asset shifts from equity to more conservative options. In future reports there will be an effort to understand the proportion of change due to market fluctuations versus that associated with asset transfers.

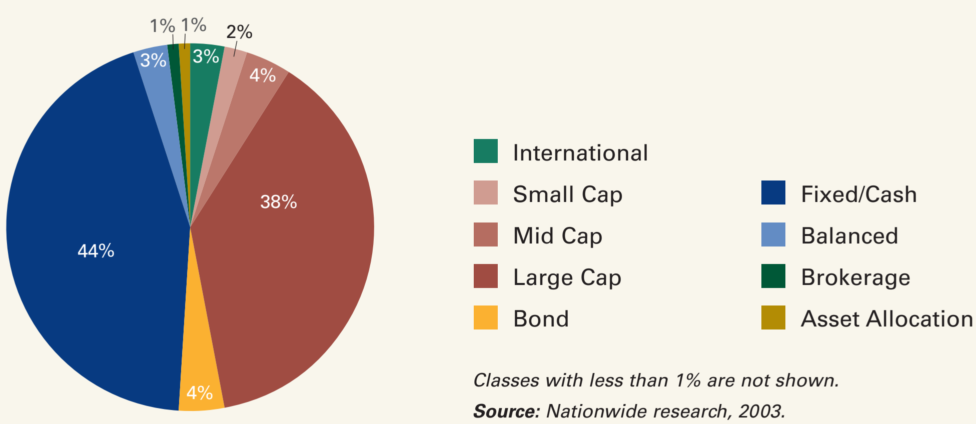
Figures 19 and 20 illustrate the change in asset classes from 1999 to 2003. Some asset classes have grown—bonds, mid cap, small cap, and fixed/cash. However, the total assets in equity classes, excluding large cap, have grown from 7% of assets in 1999 to 12% in 2003, an annual growth rate of approximately 15%.

Figure 19: 1999—Participant Assets By Class



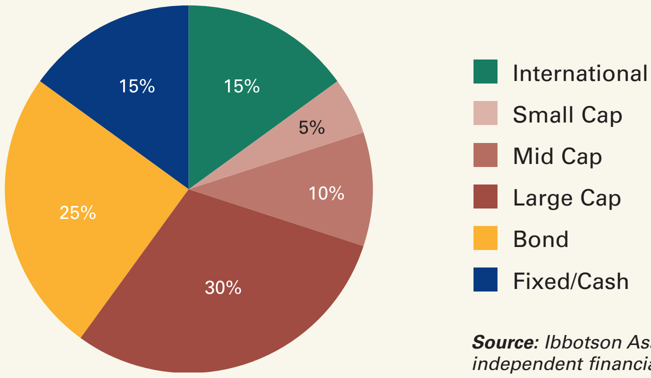
Classes with less than 1% are not shown.
Source: *Nationwide research, 2003.*

Figure 20: 2003—Participant Assets by Class



Classes with less than 1% are not shown.
Source: *Nationwide research, 2003.*

Figure 21: Ibbotson Model Allocation—Moderate



Source: *Ibbotson Associates independent financial research.*

A review of how 2003 participants' asset allocations (see figure 20, page 27) compare to the standard Ibbotson[46] model for a moderate investor (see figure 21) indicates that current 457 participants' assets are heavily weighted toward fixed and large cap asset classes. Although a portion of accounts are held in other classes such as bonds and international, there is not enough in each to provide "true" diversification. When compared to other Ibbotson models (aggressive, moderately aggressive, moderately conservative, conservative), there is a similar lack of diversification "fit."

Gender does not appear to be a factor in determining overall asset class diversification (see table 22). There is very little differentiation in asset class proportions between males and females. The overall trend away from equities exhibited from 1999 to 2003 is similar in both males and females.

Table 22: Asset Allocation by Gender, 1999 and 2003

1999	Male	Female	2003	Male	Female
Equities	61%	60%	Equities	49%	47%
Fixed	36%	36%	Fixed	44%	45%
Bonds	1%	1%	Bonds	4%	4%
Balanced	2%	3%	Balanced	3%	4%
		Exactly the same as overall totals		*Exactly the same as overall totals*	

Source: *Nationwide research, 2003.*

[46] Ibbotson Associates is an independent firm that develops recommended asset allocation models.

Table 23: Asset Allocation by Age, 1999 and 2003

Age Range	All Equities		Fixed	
	1999	2003	1999	2003
18–25	32%	61%	68%	35%
26–35	85%	80%	15%	17%
36–45	78%	68%	22%	28%
46–55	69%	54%	30%	41%
56–65	59%	43%	40%	53%
66+	40%	29%	59%	67%

Note: *Bond assets excluded, so may not add to 100%*
Source: *Nationwide research, 2003.*

Whereas the overall asset make-up between males and females is similar, the deferral choices of females are generally more conservative. This result will be discussed in more detail later in the report.

Since 1999, all age segments, with the exception of 18–25-year-olds, have reduced assets in equities and increased assets in fixed options (see table 23).

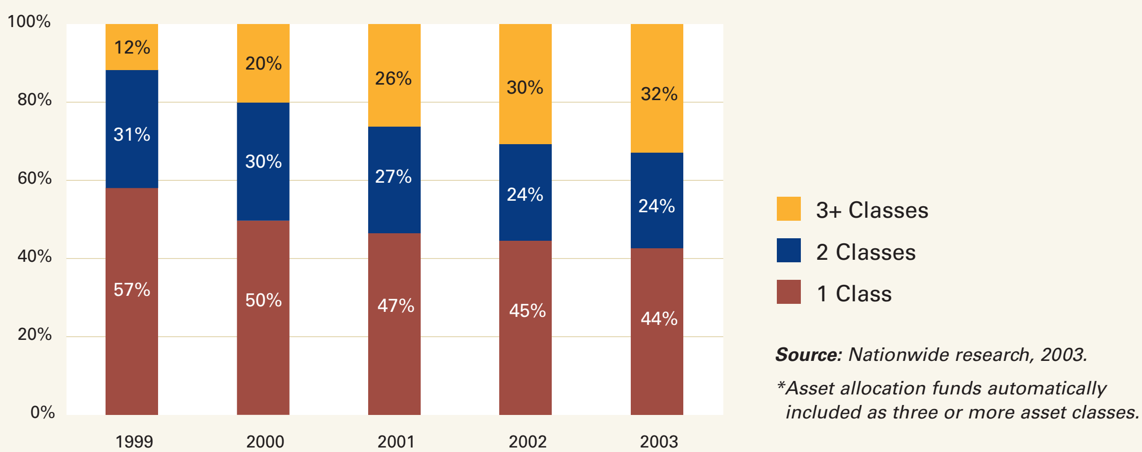
The market downturn is likely a major factor influencing this change. Also note that the change is more pronounced at older ages. These shifts are consistent with standard financial planning guidelines—more equities at younger ages and more fixed holdings at older ages.

Participants' assets are invested in an average of 2.0 asset classes (up from 1.6 in 1999). New enrollees (those enrolled from 1/2003 to 6/2003) have a similar average, with 2.2 asset classes.

There has been an increase in the number of asset classes in which participants are invested. The percent of participants investing in three or more classes has grown from 12% in 1999 to 32% in 2003 (see figure 24). This increase in asset classes is, at least partially, due to the increase in the number of participants investing in asset allocation funds. In 1999, only 1% of all participants selected asset allocation funds. In contrast, this figure rose to 8% in 2003. In spite of this change, however, nearly half of all participants (44%) are still invested in a single asset class.

While an examination of all participant assets (including 457 plus other outside-the-plan holdings) could indicate adequate diversification when all holdings are considered, it is unlikely that participants in a single investment class have other financial holdings that are substantial enough to offset such limited diversification in their 457 assets. Therefore, it is assumed that many participants need assistance in adequately diversifying their accounts. A similar lack of diversification is evident with private sector 401(k) participants. Nearly 40% are invested in only one or two asset classes, down significantly from 75% in 2000.[47]

Figure 24: Percent of Participants by Number of Asset Classes*



Source: *Nationwide research, 2003.*

**Asset allocation funds automatically included as three or more asset classes.*

[47] "Hewitt Associates Study Shows Economy, Market Volatility Has Taken a Toll on US Employee's Interaction with 401(k) Plans," Business Wire, 17 June 2003, referencing "How Well Are Employees Saving and Investing in 401(k) Plans?: 2002," Hewitt Associates.

Table 25: Diversification by Age Group, 1999 and 2003*

Age Group	1999	2003
18–25	6%	39%
26–35	10%	36%
36–45	12%	33%
46–55	14%	33%
56–65	14%	27%
66+	9%	14%

**Asset allocation funds automatically included as three or more asset classes.*
***Source:** Nationwide research, 2003.*

As described earlier, there has been a modest increase in the percent of participants investing in three or more asset classes. This shift has been most notable with the youngest age group (ages 18 to 25, see table 25). The oldest participants (over age 65) made the smallest shift, with only 14% of this group invested in three or more asset classes in 2003. In general all age groups have made diversification changes that may be attributable, in part, to concerns over the stock market downturn.

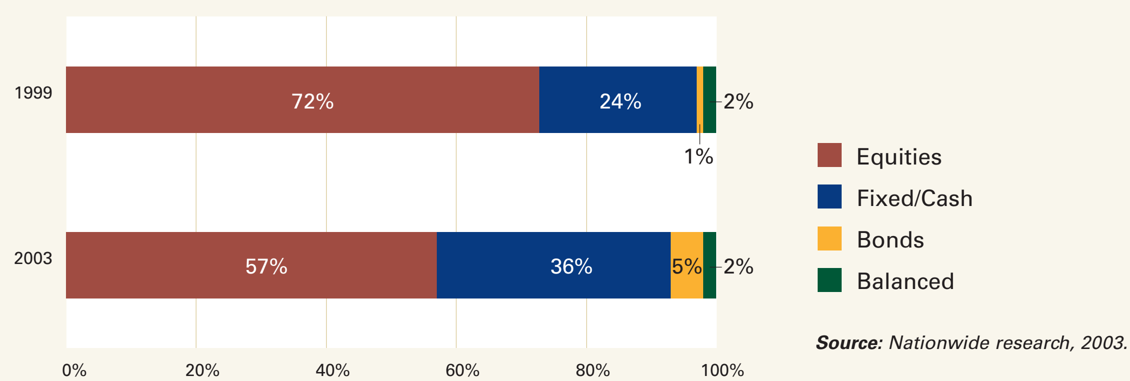
From Total Accounts to Deferrals

An analysis of ongoing deferral allocations (defined as new payroll deduction dollars going into the plan) indicates that they are also changing in a variety of ways. Deferral percentages to large cap funds are decreasing, but are still 40% of all new deferral dollars in 2003. Overall, equity fund deferrals have decreased from 72% in 1999 to 57% in 2003 (see figure 26). Fixed fund deferrals have increased from 24% to 36% of new money. These shifts are likely responses to equity market losses and the desire to preserve wealth and assets.

There are some slight differences in deferral allocations based on gender. Generally, females demonstrate a slightly more conservative investment outlook. This conservatism is illustrated in a slightly higher percentage of deferral dollars marked for fixed/cash asset classes in 1999 as well as in 2003. Both genders have a notable decrease in the percentage of deferrals going to equity asset classes in 2003 (see figure 27).

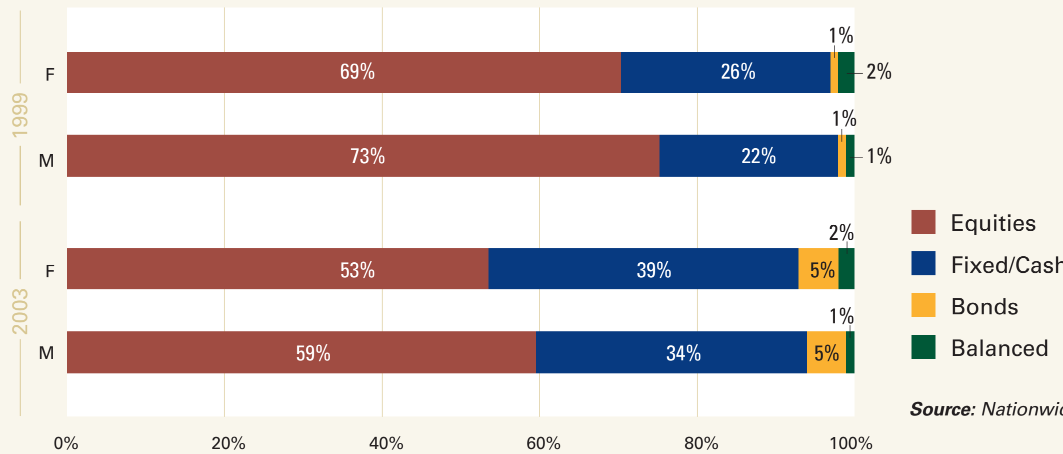
Except for the youngest participants, increased interest in the security of fixed investment

Figure 26: Percent of Deferral Allocation by Class



Source: *Nationwide research, 2003.*

Figure 27: Deferral Allocation by Gender and Asset Class



Source: *Nationwide research, 2003.*

Table 28: Percent of Deferrals to Fixed Options by Age, 2000 and 2003

Age Group	2000	2003
18–25	60%	36% ⌄
26–35	10%	18% ⌃
36–45	14%	25% ⌃
46–55	19%	40% ⌃
56–65	27%	52% ⌃
66+	46%	70% ⌃

Source: *Nationwide research, 2003.*

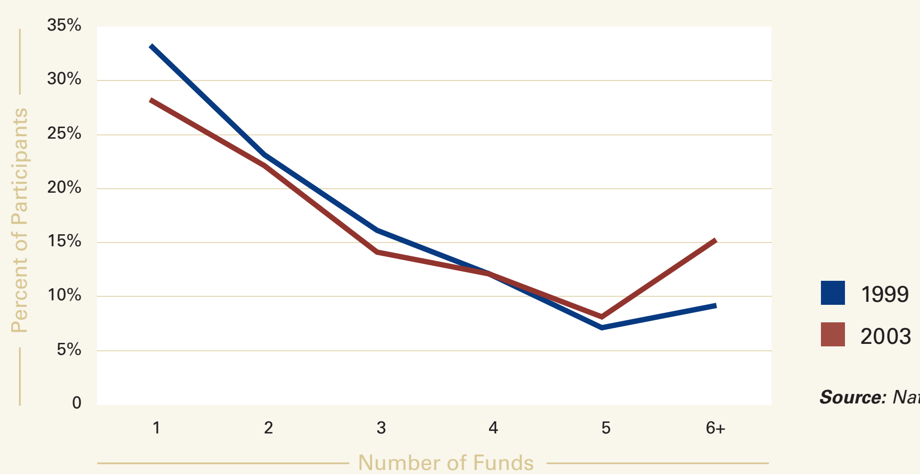
alternatives is clearly evidenced in the 2003 allocations as compared to those in 2000 (see table 28).

Fund Ownership Shows Change

The average number of 457 plan fund options held by participants has increased from 2.9 in 1999 to 3.3 in 2003. The number of funds held by new enrollees (those who enrolled in 2003) is slightly lower at 3.2. In comparison, the average 401(k) participant invested in 3.6 funds.

The percent of 457 participants who invested in only one fund decreased slightly from 33% in 1999 to 28% in 2003 (see figure 29). Most participants, 64%, owned three or fewer funds, down from 72% in 1999. Ownership of four funds was unchanged (12%) and those owning five funds decreased minimally over the same time period. The most notable change in ownership was for those participants owning six or more funds. This percent increased from 9% in 1999 to 15% in 2003.

Figure 29: Participant Fund Ownership



Source: *Nationwide research, 2003.*

Forty-five percent of participants ages 18–25 and 50% of those who are ages 66 and older own only one fund (see figure 30). For both age groups, the majority (≈70%) of those invested in one fund are invested in the fixed fund. Participants ages 46–55 have the highest percentage of ownership of six or more funds (17%).

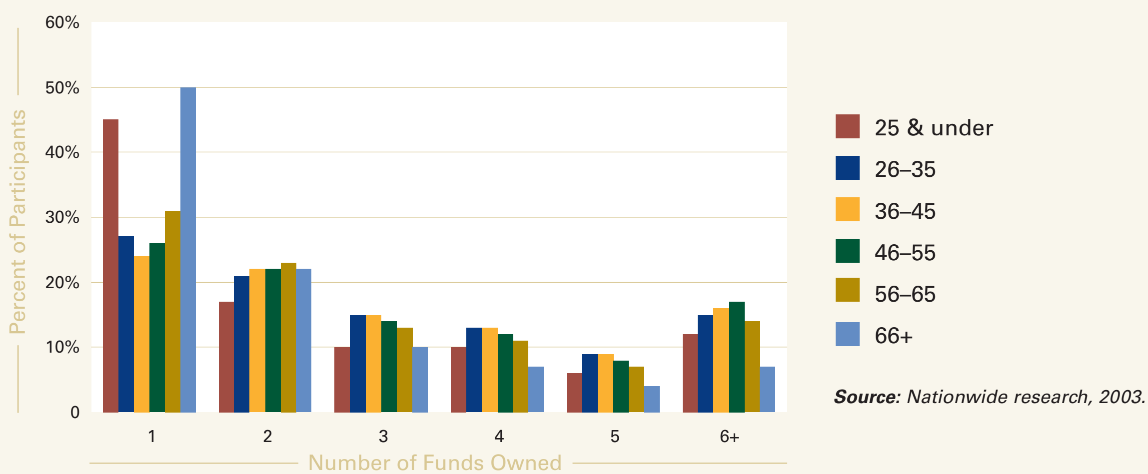
These trends are also reflected among private sector 401(k) participants. The first, and often only, asset allocation decision is made by most participants at enrollment.[48] 401(k) participant assets are still heavily weighted in equities (52%+), and most retirement sources assert that the shift in the equity/fixed balance is mostly due to market losses versus asset rebalancing efforts.[49] This assertion is reinforced by private sector results indicating that only one in six participants took any action to adjust the mix of investments in their 401(k) plans in the last year.[50]

Single Fund Diversification Challenges

A special analysis was conducted for those participants whose accounts were invested in only one fund (28% of all participants). For both genders and among all age groups, a fixed fund or a large cap fund were the fund options most likely to be selected.

As shown in figures 31 and 32 (page 35) the fixed fund was the most popular choice for most age groups who chose to invest in a single fund. The preference was most pronounced with the oldest participants (over age 65: 87% of females, 82% of males). This fixed fund percentage tended to decline with decreases in age. However, this trend was not evident with the youngest participants. The 18- to 25-year-old group demonstrated a strong preference for the fixed option (62% of females, 55% of males).

Figure 30: Fund Ownership by Age Group

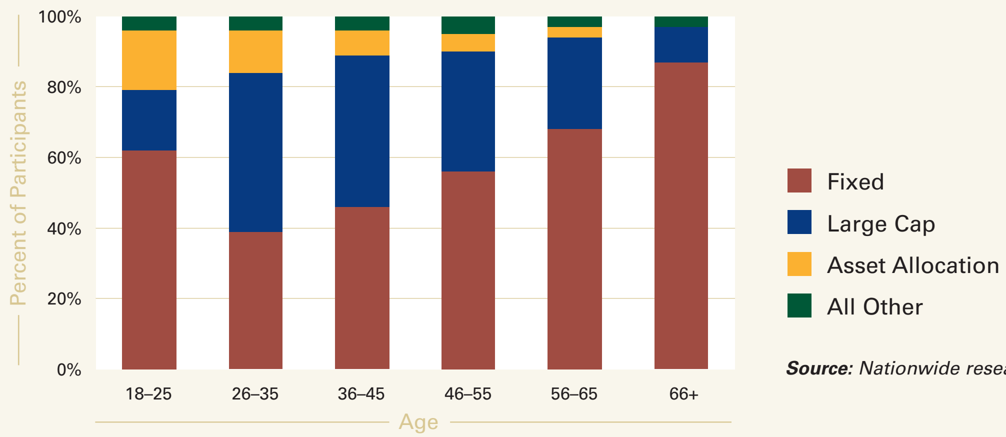


Source: *Nationwide research, 2003.*

[48] "401(k) plan education not working, surveys suggest," *Business Insurance*, 24 March 2003.
[49] 2003 SPARK Marketplace Update, Watson Wyatt Worldwide (*Business Insurance* 3/24/03).
[50] "Make your 401(k) plan as good as it can be," *Courier-Post*, August 24 2003 (EBRI reference).

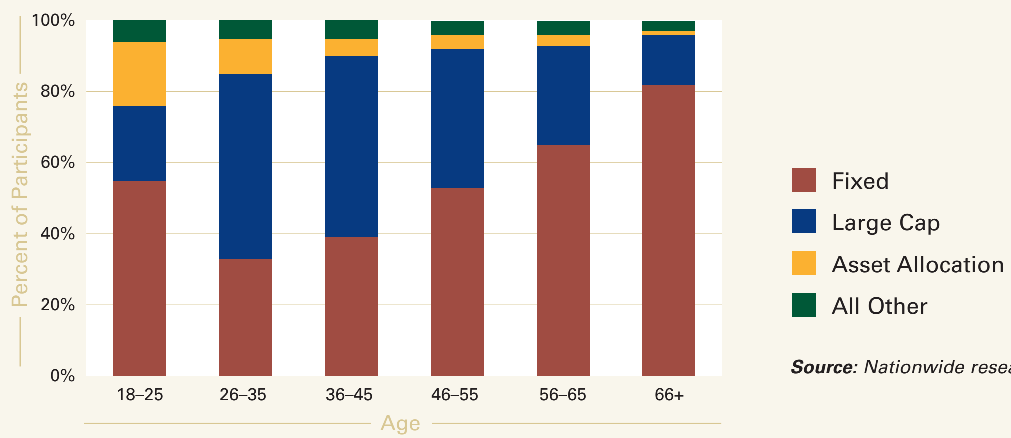
Among all age groups, females were more likely to demonstrate a preference for a fixed option than were males. The following figures illustrate the asset classes for those whose accounts were invested in only one fund.

Figure 31: Single Fund Option Participants—Females



Source: *Nationwide research, 2003.*

Figure 32: Single Fund Option Participants—Males



Source: *Nationwide research, 2003.*

Asset Allocation Fund Use Is Rising

A special analysis was also conducted for those participants who selected an asset allocation fund. In 2003, 8% of all participants selected this type of fund. Between 1999 and 2003 there has been substantial growth in the use of these funds. This growth has been most pronounced for the younger participants (see table 33).

In some cases participants have chosen these funds as their only option (a single fund), and in others, asset allocation funds have been used in combination with other options. Figures 34 and 35 (page 37) illustrate these two approaches by age and gender. The graphs demonstrate the fact that the two youngest age groups are more likely to elect an asset allocation fund as their only option than are those at older ages. The graphs also illustrate the slight preference among females at all ages to use an asset allocation fund as their only fund selection.

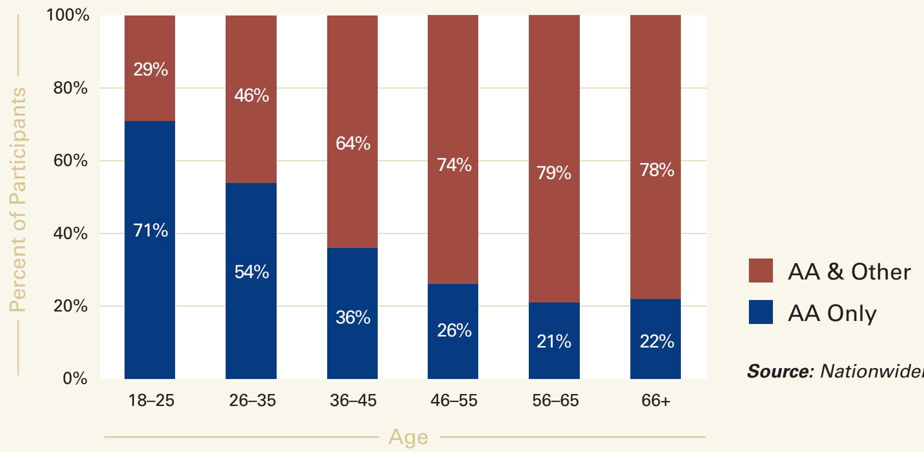
With the current analyses it is not possible to determine whether participants who were using asset allocation funds in combination with other funds are using them appropriately. For example, within a participant account, diversification could have been achieved with asset allocation funds for a portion of the assets, and a collection of funds could have been used to provide diversification for another portion of the account assets. In contrast, asset allocation funds may have been selected as just one other fund option within a participant account and have promoted a lack of appropriate diversification for the account. Future analyses at an account level will be required to make this distinction.

Table 33: Deferrals to Asset Allocation Funds by Age Group

Age Group	1999	2001	2003
18–25	2%	10%	14% ^
26–35	2%	7%	10% ^
36–45	1%	7%	8% ^
46–55	1%	8%	8%
56–65	1%	6%	6%
66+	>1%	2%	2%

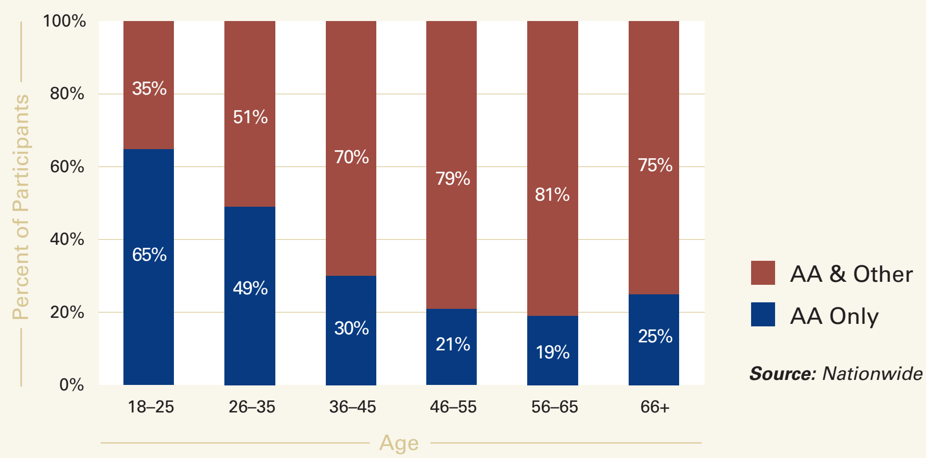
Source: *Nationwide research, 2003.*

Figure 34: Use of Single Asset Allocation (AA) Fund by Age—Females



Source: *Nationwideresearch, 2003.*

Figure 35: Use of Single Asset Allocation (AA) Fund by Age—Males



Source: *Nationwide research, 2003.*

Average Participation Rates—Match Makes a Difference

State cases tend to have smaller participation rates for two important reasons:

- Many local government units have their own 457 plans; however, their employees may be counted as eligibles in the state plan that is also available to them. This double counting of eligibility contributes to lower participation rates for state plans.
- Many state plans also count personnel of public education employers as eligible employees. Similar to the local government units, these employers typically have their own plan, in this instance a 403(b) plan. Historically 403(b) plans have been more attractive to this group of employees relative to 457 plans, so adoption or use of 457 plans among public education employers and employees has been infrequent.

Based on these two reasons, state participation rates tend to be depressed, having an average of 27%, and ranging from 11% to 50%.[51] If a state provides a match plan,[52] the participation rate almost doubles.

Local plans have higher participation rates with almost one-third having a 50% or higher participation rate. Local plans benefit from less geographic dispersion and higher salaries (among urban jurisdictions). As with state plans, match plans almost double participation rates.

Although having a match plan appears to create higher participation rates, some employers have enhanced participation without using a match. Some "best practices" include:

- Strong grassroots support among middle management to encourage participation—for example, allowing plan providers frequent access to employees
- Allowing participant access to saving and retirement planning seminars, benefit fairs and other educational programs during work hours
- Actively communicating about the plan and encouraging referrals among employees
- Partnering with plan providers and treating the 457 plan as an employee benefit similar to the employers pension and health benefits

If a state provides a match plan, the participation rate almost doubles.

Overall, the mean (average) participation rate in a 457 plan is 30%. When a match is present, the

Table 36: 457 Plan Participation Rates

	Mean (average)	Median* (50th percentile)	Mode** (most frequent)
State	27%	28%	28%
Local	33%	38%	38%
All Plans	30%	38%	38%

** Median is the middle or midpoint in a range of ordered values. 3 is the median for: 1 2 3 4 5.*
*** Mode is most frequent value within a given range of values.*
***Source:** Nationwide research, 2003.*

[51] Internal data, using NAGDA survey results to test for reasonableness.

[52] Match plans involve the employer "matching" some or part of a participant's 457 contribution.

average rate rises to 51%. If no employer match is available, the average participation rate drops to 29% of eligible employees. When best practices, such as those described earlier, are present, the participation rate can exceed 70%, even without the benefit of a match.[53]

Three measures of central tendency (mean, median and mode) were calculated in order to determine whether the means or averages were skewed by a few extreme scores. The results (see table 36, page 38) indicate a wider range of scores with local plans than is present with state plans.

Participant Preferences

This section provides a snapshot of participant preferences, including an outline of needs for improved educational materials, how participants are contacting plan sponsors to complete various tasks, and analyses of withdrawal activities.

Meeting Education Needs

The increasing shift in responsibility for funding retirement from employers to employees leads to increased needs for participants to understand their employee-directed retirement plans and know how to use them appropriately.

The financial needs that consistently emerge with public sector participants are:[54]

- Pre-retirement planning
- Transition into retirement
- Successful investing concepts to maximize 457 plan value
- Ways to increase wealth while decreasing debt

Research with participants has also suggested best ways to provide education and advice:[55]

- The number one preference is face-to-face, one-on-one counseling when learning more about financial topics (44% would use)
- Short workshops during the day are the second most preferred method (38% would use)
- On-line advice is the method most participants said they definitely would not use (47% would not)

This last result is also consistent with private sector results indicating that employees are dissatisfied with on-line education and advice tools and that most do not use them.[56] In interpreting these last results, one should exercise caution. For example, it may be that on-line advice is rejected due to the types of programs that currently exist on-line.

Future research with new methods may indicate that participants find on-line options acceptable when they are presented in more intriguing or user friendly formats. Currently there is very little information regarding the impact of educational methods and/or tools delivered either face-to-face or on-line. Given the preference for face-to-face options, it is possible that these methods (more prevalent in the public versus private sector) may be more effective. However, we do not have enough data to support this assumption. Future reports will continue to address the assessment of education and advice alternatives.

[53] City of Chicago 457 Plan.

[54] 2003 Public Employee Plan Participant Satisfaction Survey, Nationwide, April 2003.

[55] 2003 Public Employee Plan Participant Satisfaction Survey, Nationwide, April 2003.

[56] Will Financial Engines' New Aggressive Advice Approach Make Participants Proactive? IOMA's DC Plan Investing, December 2002.

Customer Service Preferences

There are several ways for participants to contact their plan provider: on-line (Web), voice response units (VRU), calling the customer service area (CS), and in some plans calling/meeting with a local retirement specialist. The average participant has 4.3 contacts with the provider each year with this combination of methods.[57] The most frequent reasons for these contacts include an address change, a fund exchange, account balance lookups, or more sophisticated actions such as income planning or goal setting.

Figures 37 and 38 (page 41) reflect some usage trends and indicates that while overall usage of on-line/Web services account for the majority of contacts, customer service calls are still the preferred method for certain transactions such as fund exchanges or allocation changes.

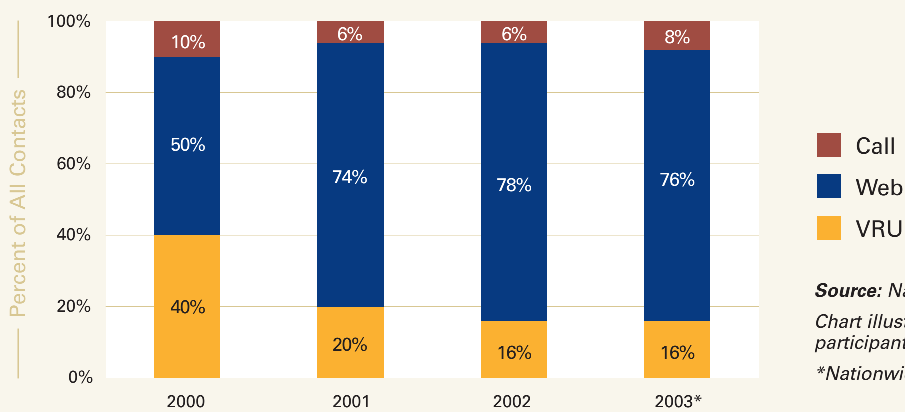
Participant Web Usage[58]

- Thirty-three percent (33%) of all participants have visited their 457 plan Web site at least once; of those, 80% accessed their account information.
- 25% of participants have visited the Web site in the last year.
- 39% of participants in smaller plans (less than $5 million in assets) say they are likely to increase usage of the Web in the next two years; 28% of participants in larger plans ($5 million and greater) say they are likely to increase usage.
- 22% say they were either extremely likely or very likely to use the Web the next time they increase their deferral amount.

Participant Customer Service (CS) and Voice Response Unit (VRU)[59]

- 24% of participants called a toll-free 800 number and spoke with a customer service representative in the last year.
- 13% of 457 participants used the VRU in the last year.
- 38% of participants in smaller entities (less than $5 million in assets) say they are likely to increase usage of CS in the next two years; 23% of participants in larger entities ($5 million and greater) say they are likely to increase CS usage.

Figure 37: Customer Service Contacts



Source: *Nationwide research, 2003.*

Chart illustrates total contacts to provider—participants may have multiple contacts.

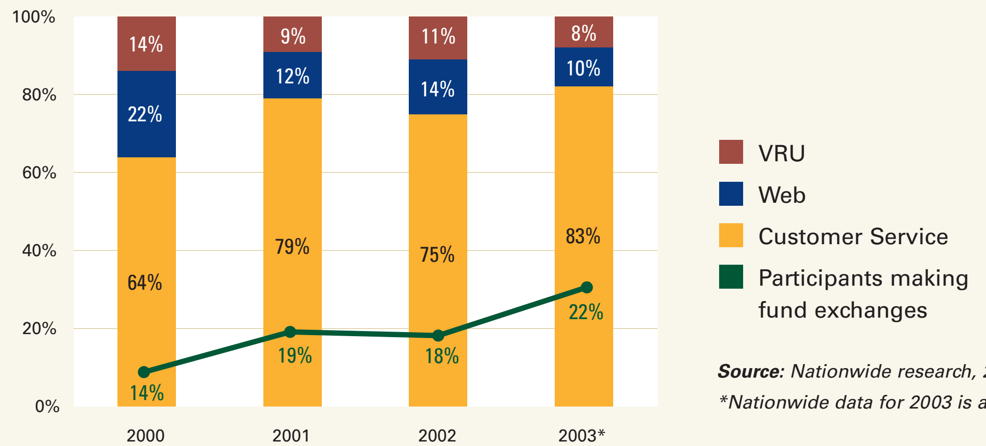
**Nationwide data for 2003 is annualized.*

[57] 2003 Public Employee Plan Participant Satisfaction Survey, Nationwide, April 2003.

[58] 2003 Public Employee Plan Participant Satisfaction Survey, Nationwide, April 2003.

[59] 2003 Public Employee Plan Participant Satisfaction Survey, Nationwide, April 2003.

Figure 38: Methods Used for Fund Exchanges



Source: *Nationwide research, 2003.*
**Nationwide data for 2003 is annualized.*

When contacting the provider, one frequent participant activity is fund exchanges. When examining how participants make these changes, it is interesting to note that the percentage of participants making fund exchanges, relative to all participants, has increased over time and the method used most often is calls to customer service.

The percent of participants making a fund exchange has increased slightly from 14% of all participants in 2000 to 22% in 2003 (see figure 38). One explanation for the increase is participants' shifting funds in response to market downturns in an attempt to better diversify assets and preserve account balances.

The majority of fund exchanges has been, and continues to be, executed via phone calls to customer service. Customer service calls increased from 64% of all exchanges in 2000 to 83% in 2003. VRU exchanges declined from 14% of exchanges in 2000 to 8% in 2003, and Web exchanges declined from 22% in 2000 to 10% in 2003.

This trend is consistent with research indicating that consumers tend to do research using technology (checking balances), but elect to actually speak to a person when they make a purchase (or a change) that involves a financial decision.[60] There may be a greater level of psychological confidence that comes from actually speaking with another individual in these circumstances.

For fund exchanges, there was very little variation in customer service access based on age. All age groups demonstrated a preference for calling customer service (CS) to execute transactions. The percentage of customer service calls for transactions was over 80% in 2003. Surprisingly, the younger age groups used calls to customer service the most often. The percentages of calls to CS actually dropped slightly (see table 39, page 43) with increases in age.

Withdrawal Activities

Withdrawals from a 457 account can only be made when an employee separates from service (job change or retirement), encounters a financial emergency (e.g., catastrophic property/casualty losses, family member death, etc.) or has a small/inactive account ($5000 or less). Participants are typically allowed to leave their assets in the plan after termination until the mandatory age to begin a distribution, age 70½. A variety of options are typically available to participants for distribution of their account balances. The box on the right includes descriptions of withdrawal options and figure 40 (page 43) shows frequency of use.

Types of Distributions

- Systematic withdrawal activity appears to have declined slightly in 2003. A likely explanation for this change is the availability of new distribution flexibility resulting from EGTRRA legislation, i.e., a participant can now change a distribution once it begins without restriction. Previously, only one distribution change was permitted.
- Emergency withdrawals and annuitizations have fluctuated little over the past 5 years.
- Lump sum distributions of the entire account balance have decreased slightly over the years, another result likely attributable to the increased flexibility resulting from EGTRRA.
- The percentage of annuity purchases has been and continues to be quite small. However, in recent months income annuities have been increasingly featured as a topic in the popular press and are being described as a valuable option for many individuals at retirement. Also in recent months we have seen increases in the number of individually sold immediate income annuities. If we continue to see increases in consumer acceptance of income annuities, decreases in the value of DB plans, proposed tax advantages, and increased concerns about lifetime income, we are likely to see this annuity percentage grow in coming years.
- Rollovers out of the 457 plan to other plan types (like IRAs) first became available in 2002. Compared to other withdrawal options, there is a relatively small percentage of participants making this choice.

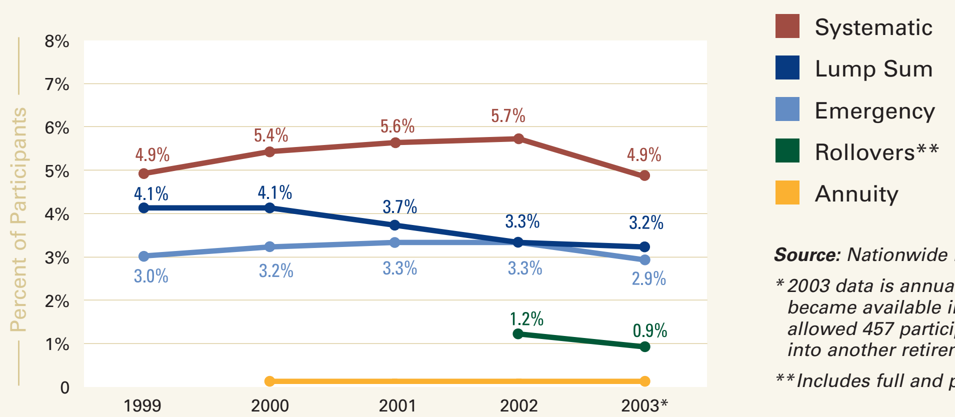
[60] Which Channels Financial Consumers Use, Forrest Research, March 2003.

Table 39: Percent of Participants Using Customer Service for Fund Exchanges

Age Group	% Using Customer Service for Fund Exchange
18–25	88%
26–35	86%
36–45	84%
46–55	81%
56–65	80%
66+	84%

Source: *Nationwide research, 2003.*

Figure 40: Withdrawals by Year



Source: *Nationwide research, 2003.*

**2003 data is annualized. Rollover withdrawals became available in 2002 and for the first time, allowed 457 participants to roll their assets into another retirement plan.*

***Includes full and partial rollovers.*

457 vs. 401(k)

Earlier in this document, we described the differences between a typical state and local government employee and a private sector employee. In the following section, the differences between the **participants** of 401(k) and 457 plans are highlighted. See table 41 (page 45) for a summary of public/private differences.

Some notable distinctions are that public sector participants are slightly older, earning less, and contributing less to their voluntary DC plans than their private sector counterparts. While the average contribution rate of 6% for public sector participants is lower than the private sector rate of 7.8%, the public sector rate is a very strong result. Given the infrequent use of match by government employers and the lower average salaries of public sector participants relative to those in the private sector, one might expect an even wider gap between private versus public average rates.

Another public/private difference is the fact that most long-term government employees will receive a significant portion of their retirement income from their DB plan (the 457 plan serving as a supplemental plan). This result contrasts with that of the private sector. Fifty-five percent of private sector participants indicated that their 401(k) plan would be their primary source of retirement income.[61]

Public sector participants have been shown to be more conservative and less active investors in their respective supplemental plans than private sector participants. Future research is required to determine the explanation for this difference. ■

[61] Key Plan Benchmarks Hewitt Study Defines Plan Structure, Asset Classes, Matches & Advice, IOMA's Managing 401(k) Plans, October 2003, p. 14 referencing Hewitt's *2003 Trends and Experiences in 401(k) Plans.*

Table 41: Comparison of Selected 401(k) and 457 Plan Statistics

401(k)[62]	Measurement	457[63]
43	Average age of participant	47
$57,000	Average annual salary of participant	$40,000
68%*	Average % of workers participating in plan	30% 51% w/ match
2.5%[64]	Average match %	<1%**
7.8%	Average % of pay contributed to plan	6%[65]
$49,000	Average total balance in plan	$24,000
13	Average number of funds available in plan	41
3.6	Average number of funds held by participant***	3.3%
66%	% Assets in equity investments	52%
17%	% Participants who made trade (last 12 months)	11%

**77% of 401(k) sponsors provide a match.[66]*

***Tends to be a flat dollar amount vs. percent of salary.*

****Actual funds—not to be confused with asset classes, which were discussed earlier.*

62 How Well are Employees Saving and Investing in 401(k) Plans: 2002 Hewitt Universe Benchmarks, Business Wire, 17 June 2003.

63 Nationwide 457 plan data on plans and participants unless otherwise noted.

64 Geller, Adam, "Companies Cut Contributions to 401(k) Plans," Associated Press; Charleston.net, April 4, 2003.

65 Calculated from Statistical Abstracts and Nationwide Internal Data.

66 Society of Professional Recordkeepers and Administrators (SPARK) Marketplace Update 2003, p. 24.

As state and local governments continue to face increasing budget pressures, plan sponsors will continue to look for alternatives to control costs—particularly in the high cost areas of healthcare and retirement plans. The dilemma for sponsors is the desire to reduce costs while preserving the most valuable features of these benefits.

As was demonstrated in the private sector, increases may be expected in:

- Sharing costs with employees and providers
- Shifting benefit risks to employees
- Examining plan alternatives and
- Outsourcing employer responsibilities

As the risks for retirement financing increase and are shifted from employers to employees, there will be increases in fiduciary concerns among employers and in the need for education for employees. At-retirement issues will continue to escalate in line with the constriction of plan-sponsored retiree benefits and the rising percentage of aging employees.

Some of the recent trends evident in the private sector that are also likely to occur in the public sector include:

- Increased demands on providers of employee benefits to help provide more for less
- Exploration of options for outsourcing plan tasks to provide cost savings
- Restriction and consolidation in the number of providers offering employee benefit plans
- Plan providers offering more support and tools to help employers meet fiduciary responsibilities
- Additional options for employees to gain education to manage their own accounts
- New voluntary benefits offered in the worksite to offset declines in employer-sponsored benefits

With regard to 457 supplemental plans, the number of participants and amount of assets in 457 plans will continue to rise. There is clearly still substantial room for growth in the numbers of participants, average participation rates, and contribution amounts. Since state and local government employees—relative to the general U.S. population—tend to be older, stay longer with their employer, and retire at younger ages, special attention devoted to keeping skilled older workers is likely to continue.

To promote better employee and participant education, there is likely to be increased attention to segmenting groups (both private and public sectors) in order to deliver quality education programs that are better suited to information needs and delivery preferences.

Both the public and private sectors are beginning to explore the costs and benefits associated with various types of planning, enrollment and investment education methods. New best practices will emerge around examining the effectiveness of the various methods. These approaches are likely to be particularly apparent with the at-retirement segment.

Employers

Employers who are continuing to look for alternatives to deal with constricting budgets and methods of controlling costs should exercise caution. It is important not to lose sight of the significance of certain employer-sponsored benefits—particularly health and retirement plan benefits—in attracting and retaining employees. In looking for efficiencies, it is important to insist on quality plans to meet employee needs. Low-cost plans that fail to appeal to employees and do not attract participants are not a bargain.

Public sector employers compete with private sector businesses for the best employees. As employee benefits are altered in the private sector, the competitive environment changes. Employers should examine the appeal of public versus private sector benefits on an ongoing basis.

Employers will be presented with a new breed of education, advice, and product options (e.g., managed accounts) to better meet participant needs. As employers shift more responsibility to employees for funding their own retirements, it will be increasingly important to help employees make good decisions when enrolling and selecting investments. Employers should look for examples of behavior-based measures of these tools and focus on "show me" results when evaluating the array of options offered by providers.

Employers should also look to providers for assistance in helping them perform their fiduciary responsibilities associated with retirement plans. This support has become critical in the private sector and will become increasingly important in the public sector. This is another example of an area that employers can use to influence their decisions regarding the selection and retention of providers.

Public sector employers should continue to monitor the legislative changes—actual and proposed—and focus on those provisions that are advantageous to public sector employers and employees. For example, supporting the removal of early distribution penalties on certain public safety officer benefits, part of the Portman-Cardin (H.R.1776) proposal, could be an area for public employer support.

It is important not to lose sight of the significance of certain employer-sponsored benefits—particularly health and retirement plan benefits—in attracting and retaining employees.

Other proposals such as those for plan convergence continue to be discussed and require close scrutiny. Most recently President Bush supported a proposal that would merge 401(k), 403(b), and 457 plans into a single plan type called Employer Retirement Savings Accounts (ERSAs). The proposal is far-reaching and controversial. While it was not passed in 2003, it is likely to resurface in 2004. Because previous convergence proposals have modeled the popular 401(k) plans, the potential impact for 457 plans could include more restrictive limitations regarding early withdrawal penalties and catch-up provisions. Such changes could significantly change the nature of public sector retirement plans and participation.

Employees

As DB plans are altered, employers are beginning to share more responsibility for retirement with their employees. That sharing is becoming more apparent with all DC plan types—401(a), 401(k), 457 and 403(b). Although employees have increased responsibility, many clearly do not have the knowledge required to make good investment decisions. Education continues to be a major concern for both employers and employees. The recent market downturn has focused more attention on this concern.

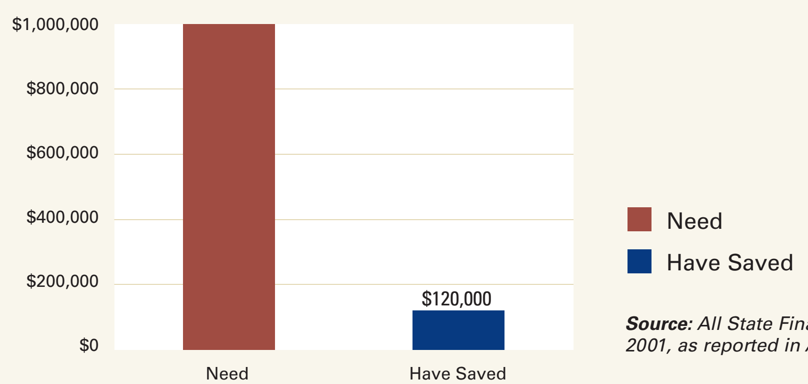
The passage of EGTRRA in 2001 gave participants more flexibility—i.e., portability. However, this change also created a new decision for participants—"Should I move my money somewhere else and if so, when and where?" Participants are being asked to make difficult financial decisions that have long-term consequences, often with little or no training and education. Lawmakers continue to tweak pension laws and regulations that may add to the complexity of participants' decisions.

457 plans have substantial room for growth and enhancement.

- Many employees do not participate—average participation rate is 30%
- Many participants do not contribute the maximum allowed—97% do not
- Many participants are not adequately diversified—43% are invested in one asset class

There is a gap between what many individuals are saving and what they will need to fund their retirement years. In a 2002 study of baby boomers, study participants indicated that they anticipate needing approximately $30,000 per year in retirement.[67] However, a look at their savings suggests they are not prepared. Figure 42 illustrates the gap between the amount needed to fund retirement and their actual savings.

Figure 42: Baby Boomers' Retirement Savings



Source: *All State Financial Retirement Reality Check Survey, 2001, as reported in ABA Banking Journal, July 2002.*

[67] "Retirement Survey Highlights Boomers' Need for Insurance Products," ABA Banking Journal, July 2002, p. 62.

In another study conducted to understand retirement readiness, a similar demonstration of inadequate preparation emerged. Fewer than one in four respondents between the ages of 40 and 59 had saved—even as much as 25%—of the amount they needed for retirement.[68]

Despite increased access to education, advice and tools, most are not being used. For example, one private sector study found that only 31% of participants utilize online investment tools and advice options when offered.[69] In another study, 47% of study participants responded that they either do not trust the advice that is available or are skeptical of it.[70]

Employees have the responsibility to make their preferences known regarding the products and services that can best meet their needs. In turn, employers and providers should be looking for ways to get employee and participant input to identify best practices and shortcomings. Those who actually use the programs need to be involved in shaping the next generation of products and services.

Employees also have the responsibility to establish their personal or household investment and retirement objectives. Once established, it is possible to take advantage of advice tools, products and services to help them achieve these objectives.

For those who are not interested in, or capable of, defining their objectives and establishing appropriate investment plans, there should be other options available. Some examples include managed accounts, asset allocation funds, or some other type of passively managed program.

Fewer than one in four respondents between the ages of 40 and 59 had saved—even as much as 25%—of the amount they needed for retirement.[67]

Although some employers have established automatic features to help employees save in spite of their inertia (termed opt-out or negative election programs), most employers have not been willing to take such an aggressive stand. In addition, recent history has suggested that the success of these programs is limited. Employees should be encouraged to be involved—and to act responsibly. That is, they should enroll, elect deferral amounts, and perform investment selections—on their own or through passive programs—in order to take advantage of employer-sponsored programs.

Industry Providers and Supporters

The nature of retirement is changing:[71]

- More than two million Americans turn 65 every year.
- For every couple turning 65—there is an 80% likelihood that at least one spouse will live into his or her 80s and a 63% chance that one will live into the 90s.
- Over 30 million baby boomers will turn 55 over the next 10 years.

[68] GE Financial's Wealth & Income Management Division Study, March 2003.

[69] Will Financial Engines' New Aggressive Advice Approach Make Participants Proactive? IOMA's DC Plan Investing, December 10, 2002, Figure 2, p. 7.

[70] What Kind of Investment Advice Is Best For Sponsors and Participants, IOMA's Report on Managing 401(k) Plans, October 2002, p. 7.

[71] Rich, Marvina C., The Changing Nature of Retirement, LIMRA Marketfacts Quarterly, Winter 2003.

In a survey of state and local government employees, 60% indicated strong interest in learning how to effectively prepare for, and transition to, retirement.[72] Retirees are living longer and facing a host of new challenges, including finding income and funding health care—not just for themselves, but for family members as well. There is general agreement that there will be many new issues facing these retirees. To date, the financial services industry has not rushed in to meet these needs.[73] Ensuring adequate lifetime income and financing health care costs, including long-term care, are the two biggest concerns of pre-retirees and are not being addressed.

Providers need to focus more on retirement and distribution throughout the savings process. A recent report issued by the GAO[74] indicated concerns that retirees are at substantial risk of outliving their pensions and savings assets and of being unable to maintain an acceptable standard of living. The findings of the GAO report reinforce the conclusion that more should to be done to help individuals prepare for retirement. Alternative product options, increased educational efforts, and interactive planning tools are some obvious options to help individuals prepare.

Some other solutions to be explored include:

- Linking enrollment (and accumulation) with discussions about future distribution considerations
- Providing at-retirement workshops beginning at age 50 (giving enough time for catch-up and other planning options)
- Encouraging the use of income planning tools to help employees address the number-one retiree concern of outliving their available incomes

Providers also need to improve their ability to respond appropriately to employer and employee needs regarding retirement plans. Employers of various sizes and employee populations have different needs. For example employees differ based on their:

- Ages (particularly youngest versus oldest)
- Income levels (middle market versus affluent)
- Family structure (multi-generational, single, nuclear, one-parent households)
- Ethnic groups
- Financial sophistication levels
- Occupations

[72] 2003 Public Employee Plan Participant Satisfaction Survey, Nationwide, April 2003.
[73] Rich, Marvina C., The Changing Nature of Retirement, LIMRA Marketfacts Quarterly, Winter 2003.
[74] U.S. General Accounting Office; Private Pensions—Participants Need Information on Risks They Face in Managing Pension Assets at and during Retirement; July 2003.

The needs of these groups translate into differing requirements—messages for enrollments, support for decision-making, asset allocation, etc. To successfully meet employee needs, providers must become adept at tailoring approaches to a variety of employee segments. For example:

- Working to increase lagging female participation rates
- Encouraging those who are younger to begin deferring
- Helping those who are approaching their retirement years

These are all areas needing segmentation and targeting approaches for success.

Future reports in this series will serve as an information source for plan sponsors, policy makers, industry leaders, and others.

Other recommended actions for providers and industry supporters include continuing to support legislation that promotes the best interests of public sector employers and employees, and understanding and replicating best practices.

Stay Tuned

Future reports in this series will serve as an information source for plan sponsors, policy makers, industry leaders, and others. Like this report, each will include statistics, analyses, conclusions, and examples of best practices to be presented to the Panel of Advisors of the Nationwide Retirement Education Institute. These reports and other activities of the Institute are intended to facilitate better understanding, enable discussions, and promote informed and enlightened actions for shaping the nature of public sector retirement. ■

The views of the Nationwide Retirement Education Institute and its panel of advisors do not necessarily reflect those of Nationwide or its affiliates and subsidiaries.

Primary Author

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Marvina C. Rich, Ph.D., ChFC is currently a Marketing Officer with Nationwide. Trained as a social psychologist, throughout her career she has focused on the business applications of individuals' attitudinal and decision-making processes. She has worked within financial services organizations and as a consultant to both private corporations and public sector entities in the areas of consumer behavior, marketing, research and segmentation, strategic planning, and business management and growth. She holds a Ph.D. from Vanderbilt University, completed a postdoctoral fellowship at Northwestern University, and is a Chartered Financial Consultant. She is currently focused on strategy and development activities for Nationwide's private and public sector institutional businesses.

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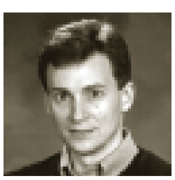
Robert K. Moore

Robert K. Moore (Bob) is currently a Director of Institutional Markets Development for both private and public sector retirement programs with Nationwide. Bob's background includes 20 years of experience with employer-provided health and retirement products and services. He has held a variety of marketing positions encompassing market planning and strategy, market research, product development, and competitive analysis, as well as risk management and operations management roles. Bob earned his bachelor's degree in marketing with a minor in finance from Ohio State University and his MBA from the University of Dayton.

Lucy Snodgrass

Lucy Snodgrass has worked as a Marketing Specialist for over 5 years in the Strategic Marketing department of Nationwide doing project management, research, and statistical analysis. She also has experience in marketing and sales support, relationship marketing, and database management.



Bob Longfellow

Bob Longfellow is Management Information Director in the Finance and Actuarial Department at Nationwide Retirement Solutions. He has been an actuary with Nationwide Retirement Solutions since 1996 and with Nationwide since 1990. He is an Associate in the Society of Actuaries and has an MBA from Capital University.