America's Retirement

voice

Employee and Employer Views on Current and Proposed Retirement Plans

Spring 2004 Update

Nationwide® Retirement Education Institute

America's Retirement Voice Updates explore current public sector retirement plan issues. This first update focuses on the retirement and savings account initiatives (primarily the Lifetime Savings Account, LSA) proposed by President Bush. Attitudes of employers and employees regarding their existing supplemental defined contribution plans are also examined.

Many of these findings were presented to the Panel of Advisors of the Nationwide Retirement Education Institute, who provided input into this final report. The Institute was established to focus on public sector retirement plans and to provide information to plan sponsors, policy makers and others in the retirement industry on this important employee benefit.

Proposed Changes 2

Lifetime Savings Accounts (LSAs) 2
Retirement Savings Accounts (RSAs) 3
Employer Retirement Savings Accounts (ERSAs) 3

Reactions of Employees and Employers 4

Role of Employer-Sponsored Defined Contribution Plans 7
Current Defined Contribution (DC) Plans 8

Satisfaction 8

Savings Strategies 9

Factors Influencing Contributions—Positive Drivers 10

Factors Influencing Contributions—Negative Drivers 11

Advice and Education Needs 13

Summary and Conclusions 14

Not All Plan Types Are Created Equal 14
Special Challenges for Public Sector Plans 14
Knowing the Requirements 14
Tailoring the Language 15
Providing Education and Advice Support 15

Proposed Changes

The Bush administration has proposed a series of initiatives designed to help individuals save for retirement. Retirement readiness is an issue that cuts across both public and private sectors. As shown in **figure 1 below,** employees are expressing concerns about being financially prepared for their retirement years; however, they are typically failing to translate these fears into productive savings behaviors.

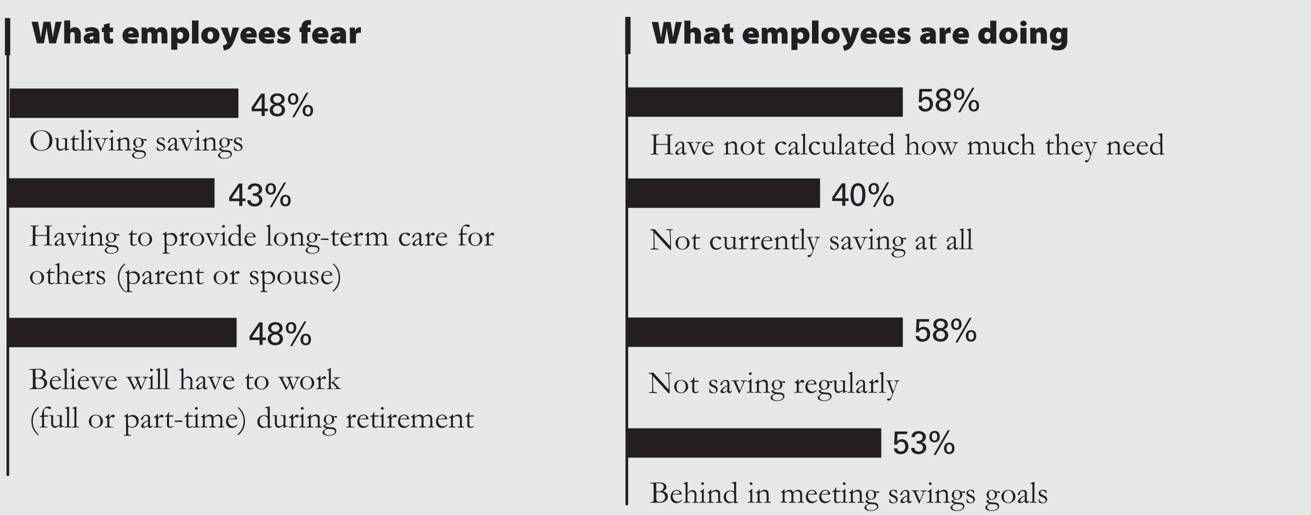
The Bush proposals include three new savings vehicles: the Employer Retirement Savings Account (ERSA), the Retirement Savings Account (RSA) and the Lifetime Savings Account (LSA). These new plans are being proposed to encourage individuals to save more and promote secure retirements.

While discussions continue regarding specific details, the proposals currently include the following:

Lifetime Savings Accounts (LSAs)

- Anyone may contribute—no age or income limits
- Individuals may convert existing tax-favored savings into these new accounts to consolidate and simplify savings arrangements
- Contribution limits=$5,000 per year indexed for inflation
- Contribution limit applies to account holder and contributions can be made into another individual's account, e.g., children, grandchildren
- Individuals may contribute the maximum to LSAs and RSAs
- Contributions not deductible, but investment earnings accumulate tax free regardless of age or purpose for which the money is used
- Individuals may convert balances from Coverdell Education Savings Accounts or Qualified Tuition Plans to LSA
- Can be used at any time, for any purpose (including education or medical savings and expenditures)
- No minimum required distribution

Figure 1: Employee attitudes and behaviors relative to retirement*



*Sources: MetLife Employee Benefits Trend Study, Press Release, Feb. 4, 2004
Cruz, Humberto & Georgina, *Baby Boomers' Lack of Retirement Plans is Alarming,* South Florida Sun-Sentinel, Jan. 18, 2004

Retirement Savings Accounts (RSAs)

- Anyone may contribute—no age or income limits
- Individuals may convert existing tax-favored savings into these new accounts to consolidate and simplify their savings arrangements
- Contribution limits=$5,000 per year, indexed for inflation; $10,000 for a married couple
- Individuals may contribute the maximum to RSAs and LSAs
- Qualified distribution after age 58 or if the account owner died or became disabled; nonqualified distribution subject to regular income tax and additional penalty taxes
- Distributions not required during the owner's lifetime; required minimum distribution rules do not apply
- Current Roth IRAs would be renamed RSAs and subject to the same rules

Employer Retirement Savings Accounts (ERSAs)

- Establishes a single employer-sponsored retirement plan type combining the array of existing retirement plans: 401(k), SIMPLE 401 (k), 403(b), Governmental 457, SARSEPS and Simple IRAs
- A single nondiscrimination test would apply to ERSA contributions for plans subject to ERISA (not government plans)
- A simple custodial ERSA (similar to the current simple IRAs) would be allowed for employers with 10 or fewer employees)
- Employee's maximum deferral from earnings (pre-tax) would be $14,000 in 2005, increasing to $15,000 in 2006
- Catch-up provisions available for those over age 50
- After-tax employee contributions would be tax-free at distribution; investment earnings accumulate tax-free
- Distributions subject to the required minimum distribution rules (i.e., must begin by age 70-1/2)
- Current 401(k) plans renamed ERSAs and continue to operate as before
- Existing SIMPLEs, SARSEPs, 403(b) and 457 plans may be frozen or converted into an ERSA: frozen plans may not accept new contributions beginning 2005

Reactions of Employees and Employers

Nationwide commissioned a special study[1] early in 2004 to understand the likely impact of these proposals on individuals' savings and investment behaviors. Harris Interactive®[2] conducted an online survey with private sector employees, public sector (state and local government) employees and private sector small business owners with 5 to 100 employees. The respondents in the study included approximately fourteen hundred employees and 200 small business owners that were selected to be representative of the various groups. The questions focused on the most flexible of the proposed accounts, the LSA.

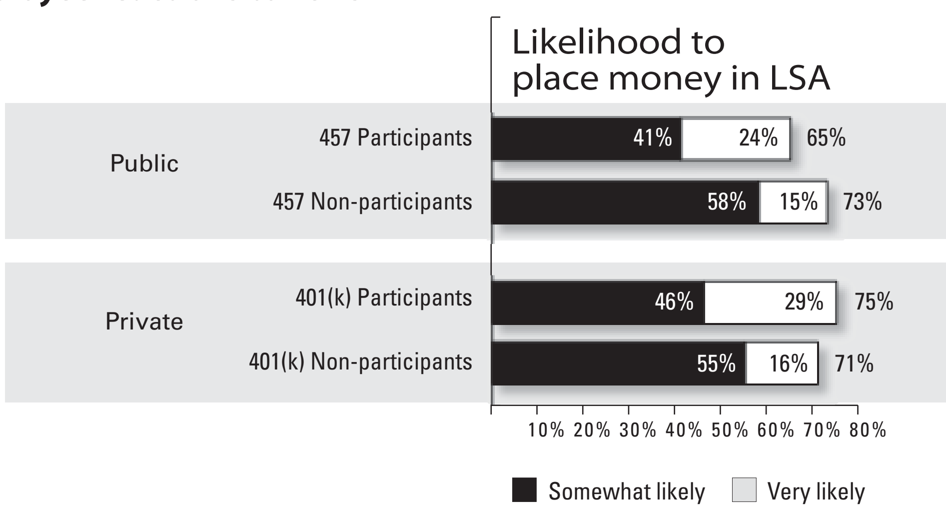
Both private and public sector employees responded favorably to the LSA. As shown in **figure 2, below,** a majority of both groups indicated that they would consider placing personal savings in this type of account. Between 65% and 75% of respondents indicated they were likely to put money into an LSA account with private sector 401(k) participants expressing more interest than public sector 457 participants.

Employee reactions to the LSA are generally favorable

Most employees reported that they would contribute from $500 to $3,000 to the LSA. The amounts reported by public sector employees were lower than those reported by private sector workers. As shown in **figure 3, page 5**, current 457 participants indicate they would contribute an average of $2,865 per year. In comparison, the 2003 average 457 contribution of $2,600 was $265 lower.[3]

It is interesting to note that the majority of employees who currently participate in 401(k) or 457 plans are not likely to redirect dollars from

Figure 2: Employee reactions to LSAs

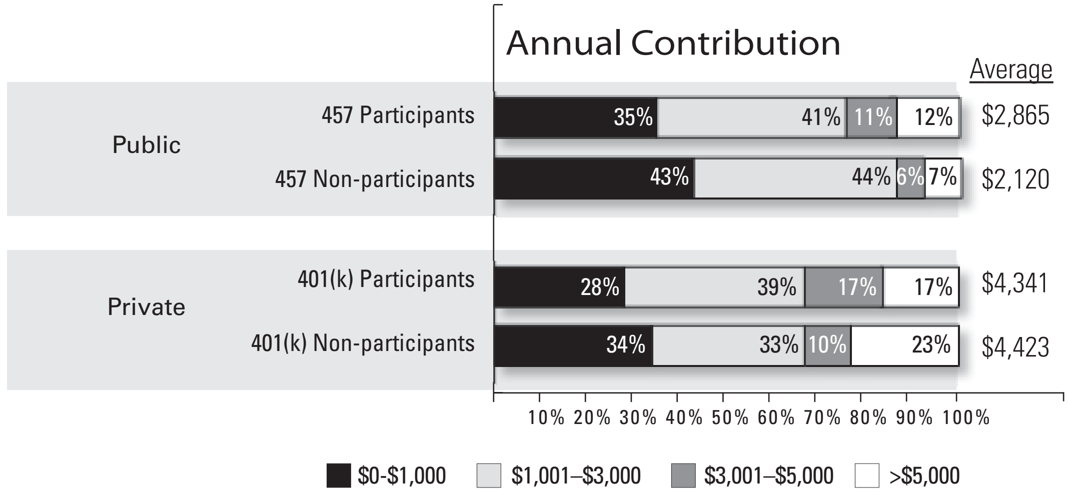


[1] **About the Study.** The survey was conducted online within the U.S. in January 2004 among adults (aged 18+), of which 845 were private sector employees and 633 were public sector employees. Figures for age, sex, race, education, region and income were weighted where necessary to bring them into line with their actual proportions in the population. Propensity weighting was also used to adjust for respondents' propensity to be online. In theory, with probability samples of this size, one could say with 95 percent certainty that the results have a statistical precision of ±5 to 6 percentage points of what they would be if the entire adult populations of private and public sector employees had been polled with complete accuracy. This online sample is not a probability sample.

[2] **About Harris Interactive®** Harris Interactive (www.harrisinteractive.com) is a worldwide market research and consulting firm best known for The Harris Poll®, and for pioneering the Internet method to conduct scientifically accurate market research. Headquartered in Rochester, New York, Harris Interactive combines proprietary methodologies and technology with expertise in predictive, custom and strategic research. The company conducts international research from its U.S. offices and through wholly owned subsidiaries-London-based HI Europe (www.hieurope.com), Paris-based Novatris and Tokyo-based Harris Interactive Japan—as well as through the Harris Interactive Global Network of independent market—and opinion-research firms.

[3] Nationwide Retirement Education Institute, *America's Retirement Voice, Public Sector Retirement; Yesterday, Today, and Tomorrow,* 2004, p. 24

Figure 3: Anticipated LSA savings levels



these plans to fund the new savings account. Less than one-fifth of the respondents expressing interest in the LSA would intend to divert contributions from employer plans. The majority of employees would be more likely to divert dollars from their bank savings accounts (see **table 1, below**).

LSAs have been described as "general" savings vehicles rather than strictly "retirement" savings accounts and employees anticipate using them this way. Almost half (48%) of public sector plan participants and 46% of private sector 401(k) participants would use an LSA for savings ***other than retirement.***

As mentioned previously, one purpose of these new accounts is to encourage individuals to save more. However, respondents are generally unsure about whether LSAs would increase their overall savings. Compared to private sector, public sector employees are even less likely to anticipate saving more. Only 35% of all public sector and 43% of private sector employees believe they would be likely to increase their current savings.

Table 1: Sources of money for LSA contributions

	401(k)/457	Bank savings*
Public		
457 participants	19%	70%
457 non-participants	N/A	76%
Private		
401(k) participants	18%	78%
401(k) non-participants	N/A	71%

**Traditional savings, CDs, money market accounts*

Figure 4: Likelihood of increasing savings

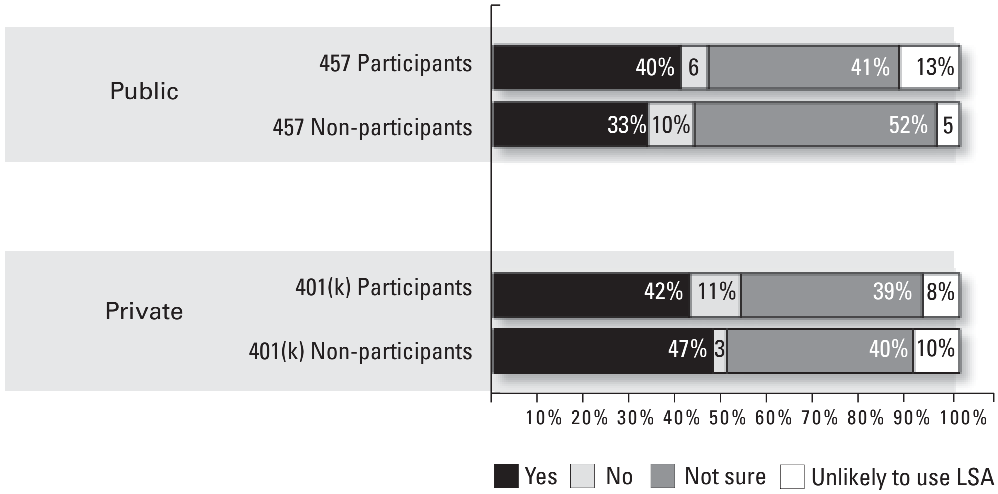
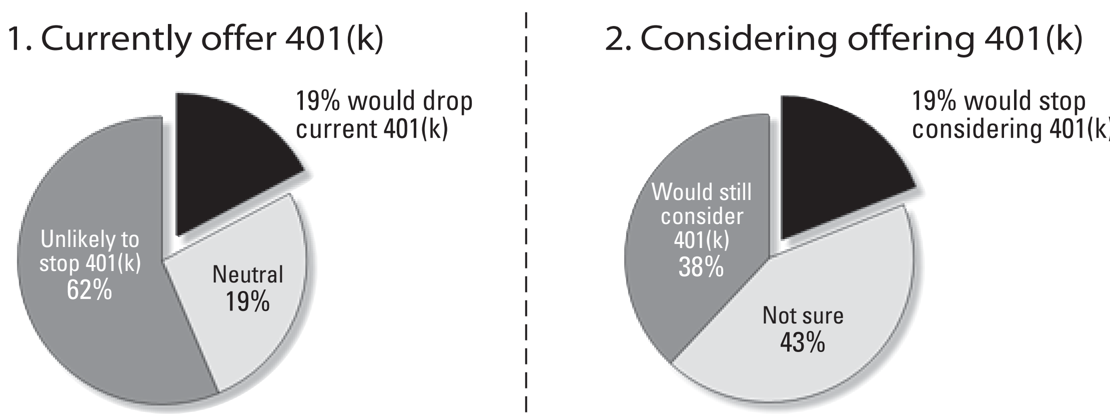


Figure 5: LSA impact—private sector employers may not offer plans



The breakdowns for responses—those currently participating and those who do not—are shown in **figure 4, above.** Current public sector participants are more likely to increase their savings than non-participants. This finding is reversed for private sector employees.

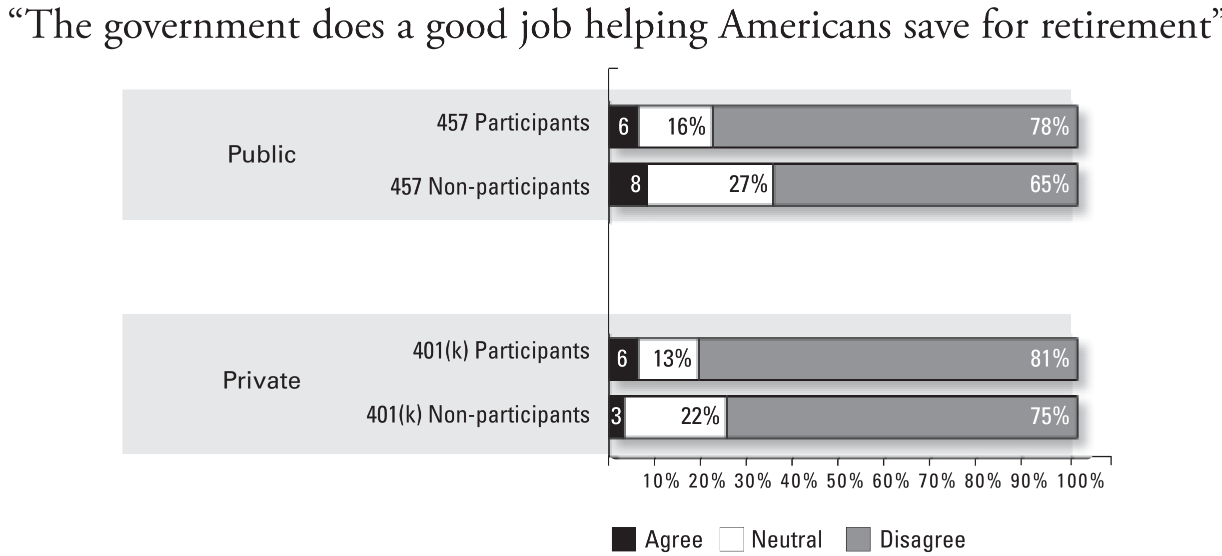
The impact of LSAs on savings is not clear

A finding from private sector employers suggests another factor may contribute to less overall savings with LSAs. Almost 20% of small business owners would discontinue the 401(k) plan that they currently offer—or stop considering adding a plan—if their employees had access to an LSA for retirement savings (see **figure 5, above**). The reasons that employers give for changing their attitudes toward offering plans include:

- Decline in employee demand
- Ability to increase other benefits
- Reduction in expenses

Regarding the objective of the Administration proposals—i.e., increasing the amount of individual savings—employees are generally negative about the government's current effectiveness in helping them save. When asked if they felt the government was doing a good job in this area, most say no (see **figure 6 page 7**).

Figure 6: Satisfaction with "Government"



Role of Employer-Sponsored Defined Contribution Plans

Employees without an employer-sponsored defined contribution plan expect Social Security or other sources to provide the majority of their retirement income. However, when a plan is available, participants see it as the primary source of retirement income. For non-participants, Social Security and other income sources increase in importance. (See **table 2, below.**) Clearly, Social Security is expected to play a greater role for private—versus public—sector workers.

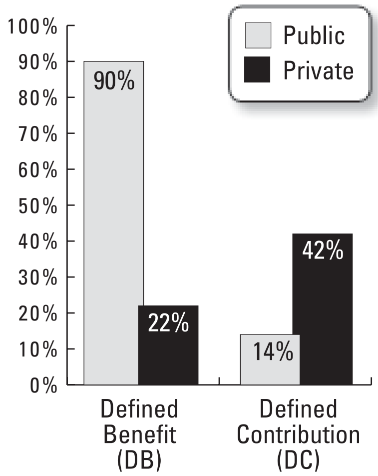
Public sector non-participants are counting on their defined benefit (DB) pension plan to be their primary source of retirement funding. Private sector non-participants are more likely to focus on income from Social Security or some other source rather than their employer's DB plan. This contrast between sectors is hardly surprising given the prominence of DB plans in the public versus private sector (see **figure 7, page 8**).

457 & 401(k) plans are very important to employees

Table 2: Primary source of retirement income

	Public		Private	
	Participants	Non-participants	Participants	Non-participants
401(k) or 457 plan	36%	6%	57%	3%
Defined benefit pension plan	28%	40%	10%	6%
Social Security	10%	8%	12%	30%
Mutual funds, stocks bonds	3%	8%	10%	10%
All other sources combined	23%	38%	11%	51%

Figure 7: Percent of full-time employees participating in a defined benefit 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.

Current Defined Contribution (DC) Plans

Moving from the likely impact of proposed tax advantaged savings plans, the following sections focus on employee attitudes regarding their employer sponsored defined contribution plans.

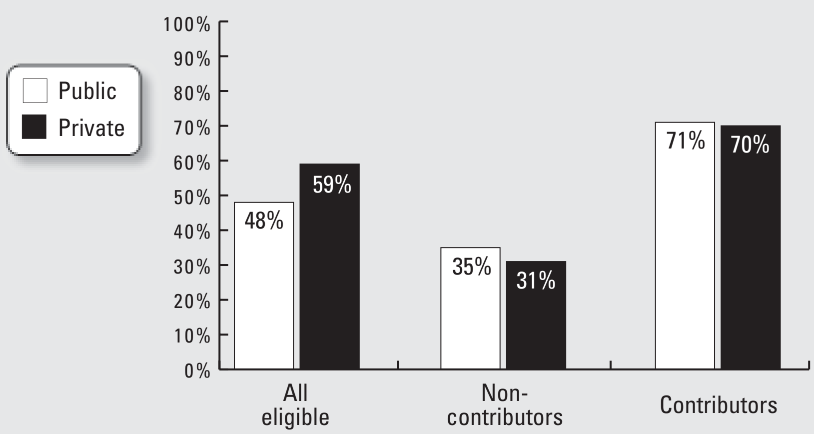
Satisfaction

Both private and public sector employees evaluated their current DC plans. In total, employees in the private sector are significantly more satisfied with their plans than are state and local government workers. Fifty-nine percent of private sector employees versus 48% of public sector employees rate their existing plans favorably. However, additional analyses indicate similar satisfaction levels for public and private sector employees when participation rates are considered.

Far more private sector employees (73%) than public sector employees (38%) participate in their employer sponsored plans. As shown in **figure 8, below**, plan ***participants*** are more likely than non-participants to rate their plans favorably. Percentages of participants, reporting satisfaction with their current plans are actually very similar for both public and private sectors, 71% versus 70% respectively.

Government workers less satisfied —or are they?

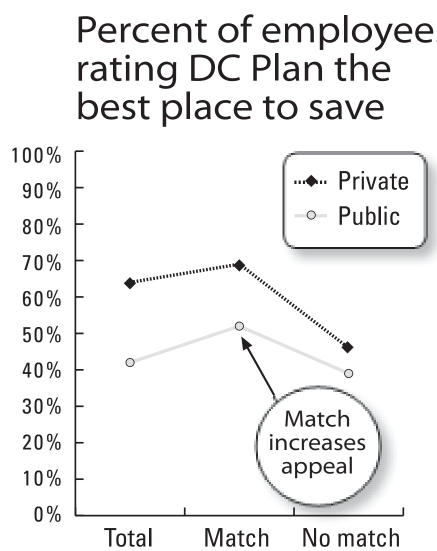
Figure 8: Satisfaction levels



To further explore employee reactions to existing plans, employees were asked whether they felt their employer's plan was **"the best place for me to put my retirement money."** Most private sector employees (64%) regard the DC plan as their best saving alternative. In contrast a significantly lower percentage of public sector employees (42%) feel their employer plan is their best savings option.

As shown in **figure 9, below**, private sector ratings are generally higher than those of government employees. This figure also illustrates that an employer match increases favorable plan evaluations for both sector groups.

Figure 9: Evaluation of current Plan



Savings Strategies

Public and private sector employees identify different savings strategies, (see **table 3, below**). While both are likely to take advantage of employer sponsored plans, public employees are almost as likely to say they **do not have a set strategy.**

It is likely that the strong presence of defined benefit plans leads government employees to develop different retirement savings approaches—including not having any savings strategy at all. The fact that public employees are significantly more likely than their private counterparts to believe that they will **"have enough money to live comfortably throughout their retirement years"** (35% for public vs. 28% for private) suggests that public employees are feeling more secure. However, public employees may be operating with a false sense of security by assuming that employer provided benefits (health care and pensions) will be sufficient to meet all their retirement income needs.

Table 3: Savings Strategies (How do you save for retirement? "First I put money into…")

	Public	Private
Voluntary (401k, 457, 403b) retirement plans	36%	67%
No set strategy	30%	17%
Traditional bank accounts	15%	6%
IRA/Roth	5%	5%
"Another" strategy	15%	5%

Factors Influencing Contributions—Positive Drivers

Both public and private sector employees would contribute more to their existing defined contribution plans if they had an employer match. Most employees who currently are not provided a match say adding one would influence them to contribute more (73% of public employees and 81% of private).

The presence of a match is far more frequent among private sector employers (approximately 77% offer)[4] than among government employers (approximately 1% make available).[5] The strong influence of an employer match has been previously reported. As noted in *America's Retirement Voice: Public Sector Retirement: Yesterday, Today and Tomorrow,* the presence of an employer match often doubles or even triples employee participation rates.[6]

Another factor associated with increased contribution rates is the employer size (see **table 4, below**). Public sector employees eligible for a defined contribution plan and working for smaller employers are more likely to contribute than counterparts working for larger entities. While future research will be needed to account for this difference, plausible reasons include more trust in the plan, easier access to benefits personnel and/or more personalized influence and communications by the employer to join the plan.

Other results suggest an enhanced role for plans offered by smaller employers. (As shown in **table 5, below**), significantly more employees of smaller firms (than those of larger firms) identify their defined contribution plan as the primary source of retirement income. While most employees (regardless of employer size) identify "other sources" as their primary income source, a significantly greater percentage of employees of larger firms (versus those of smaller) identify "other sources" as primary. Clearly, these differences associated with size of employer merit future study.

Table 5: Most Important Source of Retirement Income: Percent of Public Employees By Size of Employer

Size of employer	DC plan	DB plan	Other sources
≤ 500	28%	35%	37%
> 500	12%	35%	53%

The household income of employees is the single most important factor influencing retirement plan contributions. Eighty-four percent of public and

Table 4: Percent of public employees contributing by size of employer

	Size of Employer—Number of Employees				
	1–50	51–100	101–500	501–5000	5001+
Contribute	43%	41%	49%	34%	34%
Don't contribute	57%	60%	51%	66%	66%

[4] Society of Professional Recordkeepers and Administrators (SPARK) *Marketplace Update 2003,* p. 24

[5] Nationwide Research, 2004

[6] Nationwide Retirement Education Institute, *America's Retirement Voice, Public Sector Retirement; Yesterday, Today, and Tomorrow,* 2004

86% of private employees indicate they would contribute more if their income increased. Those with household incomes in excess of $75,000 are much more likely to contribute to their defined contribution plan than those making less than $75,000, as shown in **table 6, below**.

Table 6: Percent of public employees contributing by size of household income

Contribution status	Household income*			
	< $50K	$50K–$74.5	$75K–$99.9	>$100K
Contribute	35%	36%	83%	79%
Don't contribute	65%	64%	18%	21%

Factors Influencing Contributions —Negative Drivers

Employees indicate the ***top reasons for not contributing*** to their plan are:

- Can't afford, not enough income
- Need to pay down debt
- Have other savings priorities

Figure 10, below illustrates the relative values of these factors.

As shown in **figures 11 and 12, page 12** the reasons for failing to participate in the employer plan vary by age. For public sector employees, the youngest group (ages 25–34 years) is more likely to report **need to pay down debt** as their primary impediment. The next older group ages 35-44, is more likely to mention multiple reasons for not participating.

Figure 10: Factors influencing participation

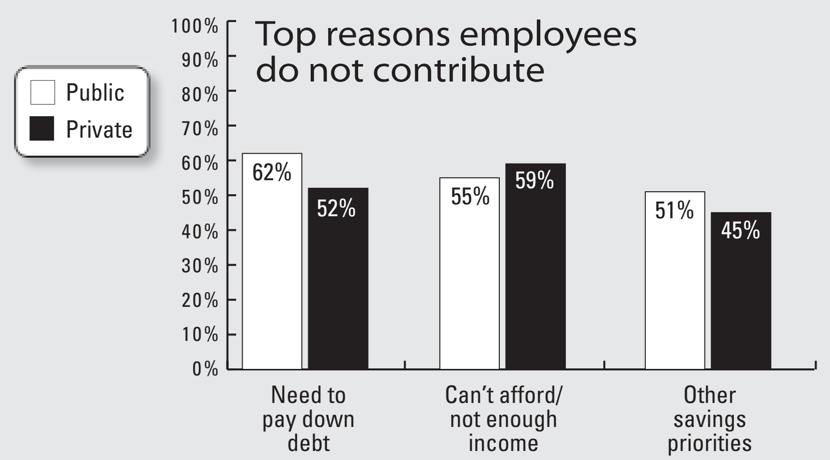


Figure 11: Negative factors by age—Public employees

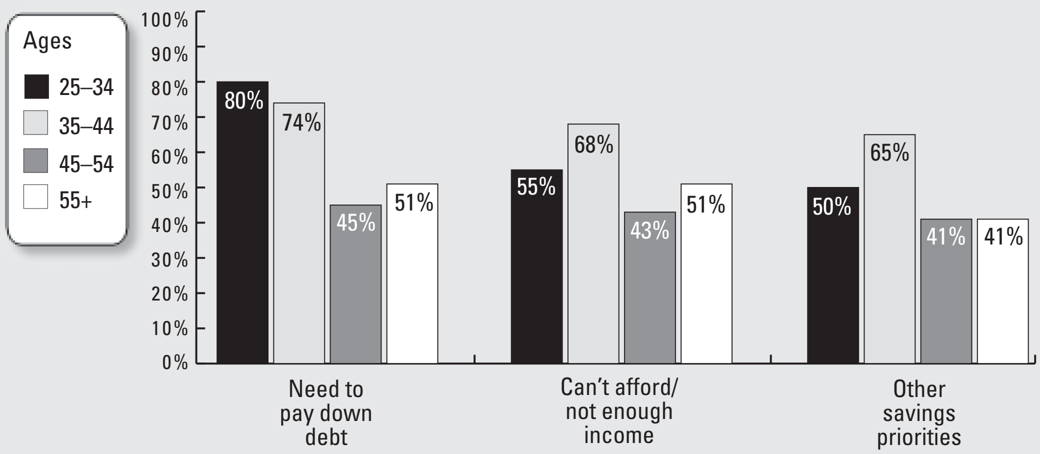
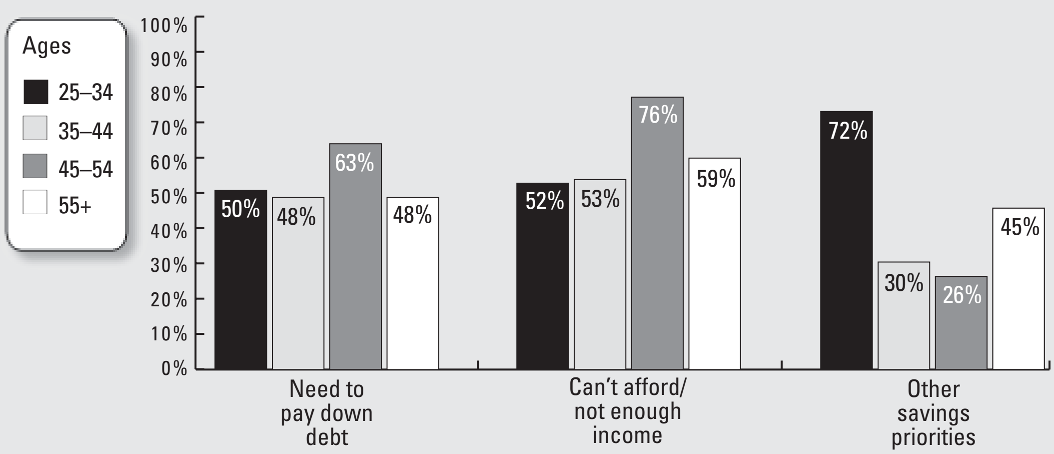


Figure 12: Negative factors by age—Private employees



Interestingly, the results for the youngest group in the private sector are different from those in the public sector. The youngest group in the private sector is more likely to identify other savings priorities as their primary reason not to contribute (see **figure 12, page 12**). This private sector result is consistent with previous private sector research indicating that individuals under age 35 are more focused on saving for a home or a car rather than saving for retirement.[7]

The reasons for not saving among the 35–44 year-old age group in the public sector are similar to those of the youngest private sector group regarding the strong influence of other savings priorities. Both of these groups were more distracted by other savings needs than were other age groups. Both of these groups were also more likely to describe themselves as "spenders" rather than "savers" and to value the forced saving feature of plan participation to aid them in saving for the long term.

As shown in **figures 11 and 12,** the reasons for failing to save vary by age and sector. Future studies should be conducted to more fully understand the rationale for the age and sector differences. Understanding these differences will help tailor education and communication messages in order to more effectively reach these various groups.

Advice and Education Needs

Both private (72%) and public (75%) sector employees agree that selecting appropriate financial products and services is complicated. Most also indicate that they are not confident in their own ability to choose the financial products and services that are best for them and their families. Only 37% of private and 35% of public sector employees agree with the statement—***"My household knows how to choose the financial products & services that are best for us."*** Employees in both sectors agreed that doing the right thing regarding investments is a challenge—and they could use some help in this process.

Employees are challenged by choices and need help

While all employees agree on the complexity associated with investments and the need for help, they disagree about how helpful their employers are in supporting their personal saving efforts. Private sector employees are significantly more likely to feel that their employer is doing a good job in making their investment choices easy to understand. Fifty-five percent of private sector employees feel that their employer is doing a good job—while only 36% of government workers feel that their employers are helping to make investment choices understandable.

Another interesting contrast between public and private sector employees is the fact that government employees report being highly influenced by personal recommendations. Public employees are significantly more likely than private sector workers to be cautious about trying new financial products without a personal recommendation from someone they knew (43% for public employees versus 34% for private employees).

[7] *Across the Divide, Retirement Solutions Roundtable,* 2003

Summary and Conclusions

Not All Plan Types Are Created Equal

Some writers have referred to the proposed Lifetime Savings Account (LSA) as the "Lifetime Spending Account"[8] due to its flexible/permissive withdrawal structure. In the current study, employees responded favorably to the LSA and its flexibility; however, they are unsure about whether these accounts will help them grow their overall savings. Current plan participants value the forced savings and limited availability of current 457 and 401(k) plan dollars and lack of these restrictions could actually decrease total savings.

Another potential threat of LSAs to retirement savings is the reaction of small private sector employers. These employers would consider discontinuing, or electing not to offer, a 401(k) plan if LSAs are available for their employees. Since private sector employees consider their employer sponsored plans as the first and best place to save, this lack of employer interest could also yield a net decrease in overall savings.

Special Challenges for Public Sector Plans

As demonstrated in this and previous research, matching contributions by employers in defined contribution plans:

- Yield higher participation rates
- Encourage larger employee deferrals
- Promote higher levels of plan satisfaction, and
- Generally facilitate better preparedness for retirement

Private sector employers are much more likely to provide a match than public (approximately 77% for private[9] versus approximately 1% for public[10] employers). When public sector employers do offer a match, the match is likely to be much lower than those offered in the private sector (average private sector match is 2.5% versus an average match of less than 1% in the public sector).[11] In order to encourage greater savings by employees, public sector employers should seriously evaluate the feasibility of adding or increasing a matching contribution when establishing employee benefit and compensation packages.

Knowing the Requirements

As reported earlier in this report, most employees do not know how much they will need for their retirement years. Helping employees with this assessment can result in an increased awareness of the need to save. Calculating income needs and relating this figure to expected income sources can help public workers. It can help them understand the expected role of defined benefit plans in meeting their needs and identify gaps.

Once income requirements are determined, then other needs can also be estimated. Collectively, these calculations help employees with understanding the correspondence between existing plan and savings resources and expense requirements. Mismatches can point to the need for other savings. Results in the recently published Retirement Confidence Survey (April, 2004) indicated that these types of need calculations encourage positive changes in retirement planning and savings by many.[12] Calculating needs can help public employees take action.

[8] National Association of Insurance and Financial Advisors, *LSAs Hurt Life Insurance, Annuities, Long-Term Savings,* February, 2004

[9] Society of Professional Recordkeepers and Administrators (SPARK) *Marketplace Update 2003,* p. 24

[10] Nationwide research, 2004

[11] Nationwide Retirement Education Institute, *America's Retirement Voice, Public Sector Retirement; Yesterday, Today, and Tomorrow,* 2004, p. 45

[12] Employee Benefit Research Institute, American Savings Education Council and Matthew Greenwald & Associates, Inc., *2004 Retirement Confidence Survey*

Tailoring the Language

The majority of public sector employees do not expect that they will be able to live comfortably in their retirement years; however, that fear is often not translated into active savings behaviors. Most public sector employees indicate that they are not disciplined about saving and most also describe themselves as "spenders" rather than "savers." This lack of connection between retirement needs and savings behaviors is a growing concern.

In order to help employees save, it is important to understand the reasons they fail to take action and then develop messages to fit. For example, the youngest public employees (ages 25–34) need help understanding that contributing a little—even if they feel they cannot afford it—can lead to big savings in later years. The next older age group (ages 35–44 years) requires messages to identify saving for retirement as a top priority relative to other types of savings objectives (car or home). Such tailored messages that directly address the reasons for failure to save can make a difference.

Providing Education and Advice Support

Public sector employees (more so than private) report challenges with their employer sponsored defined contribution plans. The majority believe that investing is complex and they are ill equipped to select the appropriate financial products for them and their families. Public sector workers clearly need help and they do not feel they are getting the support they need from their employers or the government.

Meeting the education and advice needs of public workers is a developmental objective for employers, plan providers and legislators. Employees need to set savings objectives, enroll early in available plans, determine appropriate deferral levels and employ asset allocation programs. Programs to promote and support these behaviors are needed to address the growing savings crisis and help public sector employees successfully save for secure retirements.

About the Author

Marvina C. Rich

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

Other Significant Contributor

Clayton Kie

Clayton Kie is a Marketing Specialist and Project Manager in the Primary Research Division of Markets Development with Nationwide Financial. He has a background in customer satisfaction and product development research and in quantitative analysis. He has authored numerous papers and articles and holds a Ph.D. from Ohio State University.

Nationwide®
On Your Side℠

NRS-1363-0604
pcc 16295