THE BROOKINGS INSTITUTION

GEORGETOWN PUBLIC POLICY INSTITUTE

RETIREMENT SECURITY PROJECT

AUTOMATIC SAVINGS AND PENSION PROTECTION ACT:

NEXT STEPS FOR CONGRESS

Washington, D.C.
Tuesday, November 21, 2006

MODERATOR:

PETER R. ORSZAG, Senior Fellow and Director

Retirement Security Project, The Brookings Institution

PANEL PRESENTATION:

GREG BURROWS, Vice President

The Principal Financial Group

BRIGITTE MADRIAN

Professor, Kennedy School of Government

Harvard University

MARK J. WARSHAWSKY

Director of Retirement Research, Watson Wyatt

* * * *

P R O C E E D I N G S

MR. ORSZAG: Good morning. I think we will get started. My name is Peter Orszag and I am the Director of the Retirement Security Project. Thank you for joining us this morning.

We are here to discuss both what has happened and what we hope will happen with regard to strengthening retirement security and making it both easier and more rewarding for American households to save for retirement.

As most of you know, there has been a lot of momentum recently for automatic savings vehicles, and that is going to be a major topic of discussion throughout the morning. The momentum raises several questions: Where are we now? What does the new pension legislation which facilitated further corporate adoption of automatic 401(k)s mean? What other steps should we be taking to move along the path of automatic savings vehicles? And then also, what is the potential impact on important indicators like net national saving? And that is what I want to talk about briefly before introducing our other panelists.

You should have on your seats what the Retirement Security Project is releasing with estimates of several proposals that we have embraced including the automatic 401(k) and what they would do in a rough ballpark sense to net national saving. This type of exercise requires a variety of assumptions, approximations and other guesstimates, and so I do not want to be pinned down to the precise number, but I do want to put forward at least an indicative indicator of the potential impact.

We estimate that the proposals that we could discuss could raise net national saving by about $75 billion a year which is roughly a quarter of the current net national saving rate of about $325 billion a year. That is .6 percent of GDP, and a very significant impact that could come from the aggregate effects of these proposals taken as a whole. In other words, what we are talking about this morning not only matters for individual retirement balances, but could also have macroeconomic consequences.

We broke down or tried to trace where that $75 billion number comes from. Most of it comes from the automatic 401(k), that is, making 401(k) plans more automatic through automatic enrollment, automatic escalation of contribution rates, and a few other steps. A significant part of the impact from the automatic 401(k) in turn comes from automatic escalation, that is, contribution rates that automatically increase over time unless workers opt out of the increases, has a very significant impact on net contributions and net saving.

Another concept that we have embraced, and Mark Iwry and David John are both with us this morning and they have written about, is the automatic IRA. An automatic 401(k) is great for people who are offered a 401(k) in the first place, but roughly 50 million workers are not offered a 401(k) or defined benefit plan at work, and so the question is what to do about them. The automatic IRA concept would offer those workers an opt out payroll deduction IRA at firms that do not offer some other form of qualified savings vehicle, and we estimate that that would also increase net national saving by roughly $10 billion a year.

The saver's credit is a provision of the tax law that was enacted as part of the 2001 tax cut, and it was just made permanent and indexed to inflation under the recent pension legislation. We embrace changes to that that would make it available to moderate and low-income workers who do not owe income tax liability, and that would smooth some of the current cliffs that occur in the design of the saver's credit. When you move in very small income increments, the credit rate itself can drop dramatically which is a kind of cliff in the tax law that is not an attractive feature.

Furthermore, the credit would be redesigned as a match that actually went into an account rather than back into someone's pocket because we have at least some suggestive evidence that that kind of match would work better than an existing credit. If you put all that together, our estimates suggest about another $10 billion.

Then finally, starting in 2007, the IRS will allow households to take part of their tax refund and put part into a checking or other kind of immediate liquidity account and part into a savings account or a retirement savings account. That would help to boost saving because for many households, that tax refund is the biggest lump sum payment they receive all year, and most households need part of it for immediate needs. Currently it is very difficult to take part of it and put it into a checking account. Then in order to part into a savings account, you would have to deposit it all into a checking account and then take some of it and put it into an IRA. The split refund will make it a lot easier to put directly into an IRA and part into a checking account, and that should help to

make the savings account option more viable and easier for households. Put that all together and again we are looking at about $75, or .6 percent of GDP. The details behind all of those figures are contained in the paper that we handed out, and I would be happy to answer questions about them.

I think we will now move to a deeper discussion about automatic savings vehicles and what has been happening, and we are going to get perspectives from the corporate side of things, from a leading academic on the topic, and from someone who recently just served in government and is now the director of research at a major pension consulting firm.

First we will hear from Greg Burrows who is the Vice President and Chief Marketing Officer for Retirement and Investor Services at Principal Group, and he is going to talk about their experience with automatic savings vehicles. Then we will hear from Brigitte Madrian who is currently the Aetna Professor of Public Policy and Corporate Management at Harvard University. She is one of the pioneers in the academic world in automatic enrollment and the automatic 401(k), having co-authored perhaps the leading study on its effects in the 401(k) space. Then finally we will hear from Mark Warshawsky who is now the Director of Retirement Research at Watson Wyatt, the international pension consulting firm. Prior to joining Watson Wyatt, he was the Assistant Secretary for Economic Policy at the Treasury Department, and he played a key role in the enactment in the Pension Protection Act of 2006 which he will also discuss.

With that, if could have Greg, that would be terrific.

MR. BURROWS: Thank you. Good morning, and thank you very much, Peter, for that introduction. My contribution to this panel today is to provide a perspective on the role of the employer in facilitating and providing access to retirement benefits for workers across the United States, and also how we view the automation and some of the attributes of automatic enrollment, auto escalate, and how that will help facilitate it.

I do need to start off though and let you know that yesterday as I was preparing to travel out here, one of my co-workers noticed and mentioned to me that I happened to be the only panelist without a Ph.D. after his name. I quickly corrected him and said I have actually attended university probably as many years, I just don't have the same number of degrees. So that's my comment about that.

(Laughter)

MR. BURROWS: With that, let's go ahead and get started.

The first thing I would like to do is establish a little bit about who Principal is and why we think we can contribute to the discussion. The Principal Financial Group is a retirement-based organization that really does specialize in providing retirement services to small- and medium-sized businesses across the United States. We have a leadership position in the industry, helping employers provide retirement plans and defined-contribution/defined-benefit, ESA plans, and nonqualified deferred compensation plans. As a result of our position in the industry, I think we have the ability to provide some insight as to what is actually

happening in the marketplace and how do some of these things that we are going to talk about today potentially play out in the marketplace.

You are going to hear me talk a little bit about the era of personal responsibility today, and we think that this is an important component of the discussion in how automatic features fit into the era of personal responsibility. But as we look at the benefits world over the last 50 years, we start off with what we refer to as the era of paternalism, the 1950s and 1960s where employers provided a significant amount of health and welfare and pension benefits on behalf of their employees. Then we moved into the era of ERISA and the results, regulations and fiduciary responsibilities and the sponsorship role that evolved the employer's role in how they played an active role in providing benefits.

The 1990s brought the era of cost, and it is an interesting dilemma because employees ask for more and employers really started the feel the cost impact of health and welfare plans and pension plans. As we view the marketplace today and we work with our clients, we really see a shift to what we call the era of personal responsibility, both on the health and welfare side and also on the pension side. Just think about defined contribution as the era of personal responsibility where employees need to have a more active role in managing toward a more positive outcome, and also on the health and welfare side through HSAs and plan designs we are seeing the era of personal responsibility cut across there. So I think it does tie naturally, and you will hear me refer back to that throughout the discussion.

An historical look on the importance of employer-provided retirement plans and the accumulation of assets over the years, and this a look at both the public and the private sector, but it does give a couple of interesting insights. One of them is you see the significant shift of the increase in the defined contribution assets today in 2005 made up of defined contribution employer based plans and individual IRAs. Once again, from our perspective, fueling the growth of personal responsibility that employees have to take for managing a better outcome, so that is an important thing.

The other thing I would like to point out here is that the growth in IRAs in today's market is really triggered by distributions from qualified employer based plans rather than individuals contributing voluntarily to the plan, and that is I think one of the things we are going to talk about a little bit today. Generally speaking today, the funding ratio for IRAs today is nearly a 20 to 1 ratio of dollars coming out retirement plans versus voluntary contributions. So when we see the growth in IRAs, it is really fueled by distributions from qualified retirement plans rather than personal contributions increasing.

This slide we think is a very important slide and it talks about the active role that the employer plays. The employer is not simply a facilitator, the employer plays an important role in sponsoring on behalf of their employees and really trying to play an active part in managing better outcomes for employees. The employer is responsible and has fiduciary oversight for investments, plan operations, services and fees, and very critically plays a very important role in facilitating education for employees to understand why they should participate, to

what extent they should participate, and more about how to prepare for retirement, and the employer plays a very, very critical role. We think that any sort of policy changes around retirement plans really need to take into account the importance of the employer role and build on the best practices that the employer plays in facilitating access for employees and helping people save for retirement.

A little bit of an historical perspective here in the buildup of assets, and this is 1985 to 2005. It really shows a couple of things here. First of all, this is made up of both private and public numbers, so this would include assets from both governmental plans and then the private sector plans. What we do see is a very important growth in assets, also in growth of participants. What we do not see necessarily is growth in plan coverage. One of the other things that you will see here is the shift from the defined benefit to the defined contribution. The largest number of plan growth comes through 401(k) plans and the 401(k) defined contribution, and the largest amount of participant coverage comes through the defined contribution world, once again driving the increase for personal responsibility for employees. There are nearly about 100 million workers covered all sorts of employer based retirement plans from our view.

As to the era of personal responsibility, some of the things that we think are driving that, health care costs are a big item. As we work with employers, the budgetary thought process that they have on how to fund for pension plans is really heavily influenced by health and welfare plans. Benefit costs are an important component and employers have to manage both sides of that equation, and both kinds of plan designs are really moving towards a defined

contribution kind of a model, so that is an important component from that perspective.

What that leads to us is the employee, all of us in this room at the same time, is going to play a much more active role in managing toward our outcome rather than having our outcome provided to us from an employer perspective, and we think that is going to be key especially as we talk about some of the features of PPA.

Once again, this is a slightly different look, but a pretty dramatic look in the shift. This is a private sector look, and these numbers represent the percentage of private sector workers covered under a defined benefit or a defined contribution plan. The only takeaway I want you to have here is that there is a significant shift as far as the number of workers who are covered under one or the other, and these numbers do not look at these as additive. There is some overlap in there, so it does not represent exactly 70 percent coverage of workers in the private sector, but there is some overlap. The most important thing once again is there is a shift toward the defined contribution where the individuals need to take a much more active role in managing for a positive outcome.

The employers' likely direction of a shift of responsibility of risk to employees fuels defined contribution plans and fuels voluntary benefits and consumer directed health care. We see that on both sides of the equation. What is also important to note is that the employer looks to organizations like us to help provide for guidance and help provide for education. The employers' role is very critical. They help select, the sponsor, they help fund, they help the education

process, and they help the encouragement of employees to participate in their own well-being. So once again, the employer plays a very active role. There is an important shift that is occurring now and all of us have to recognize how that impacts some of the policies that we roll out as far as employees and help them get started.

The number of workers in participating in plans, this really speaks to the effectiveness of the industry in part and also the popularity and understanding of 401(k) plans as far as the percentage of workers who have learned to participate. Back in the early 1980s when they started, it was less than 40 percent. Today that number is somewhere between 70 and 75. You still see numbers move around a little bit in large part because of how those numbers are actually defined, but as an generally as an industry generally today, about 7 in 10 workers participate in 401(k)s.

I think we have two opportunities ahead of us. One is how do we try to make the 7 in 10 workers' experience a better experience and make the plan more effective for them. And the other opportunity is how to get the other 3 in 10 who have it available to actively participate and actually get involved in managing for their own outcome.

Deferral rates, and what you can see here there is a fairly stagnant movement on deferral rates over about the last 10 years. There are a couple of things to understand here. These numbers are industry average numbers and these numbers would include those who are eligible who do not participate. So when you develop the averages and you have zeroes in there at the same time. But

think of it this way, the average industry rate is somewhere around 5-1/2 to 6 percent. Those who are actively participating in those rates would generally be a little bit higher. The averages are brought down by those who do not participate. The point here is auto escalate can be a component to help drive additional salary deferrals and help people contribute more as we go forward.

I think this is a very interesting slide because what it does is it takes averages, but it uses them in two ways and let me explain what this does. The yellow bar, the lighter colored bar, is an industry average of all those eligible under 401(k)s plan and average account balances. What I would like to do is take a look at 2002 to 2005, and we see the number of 39,000 moving up to about 58,000, so we see some good increase from average account balances for individuals.

The other bar though I think tells a slightly different story. That focuses on individuals who actively participated on a consistent basis throughout that period of time. What you see there is that the 401(k) plan is working quite well for those who understand the value and participate in it and continue to contribute. So when we see averages and understand that the way the industry cuts numbers, it will in more often than not a lot of times include those who are eligible who do not participate and they can distort the averages in that situation. For those who really take advantage of it though, you can see that there are some good numbers that are increasing for them at the same time.

I think this is probably the most important slide that I can share with you as research is done in the industry. What you do see here is that workers

are actually very receptive to having automation as part of the plan. The bottom line is workers are saying I need help, I want help, and I am willing to accept help. Automatic enrollment features, automatic escalation features and default features are things that the workforce is willing to embrace from that perspective. So I think as we talk about the Pension Protection Act and some of the automation aspects of it today, there is a pretty good landscape out there for acceptance for us to be able to build on.

Following with the acceptance of automation, these next couple of slides are going to show you some numbers about the automation of investment in default actions. First of all, life cycle funds, life cycle/lifestyle funds, have significantly gained in popularity over the last decade. Nearly half of the plans today, employer based private sector plans, are offering these automated solutions. We think that that is an important thing and we think that trend will contribute. Next I will show you some numbers about the actual cash flows into plans and how those assets are accumulated. At The Principal we have over 70 percent of our clients who have automated lifetime or life cycle funds available as an offering in their plans, and they are gaining in popularity significantly.

What this slide will do is show you over the last decade the asset growth which reinforces the popularity of these automated funds. The top fund is a target date fund, and that is based on a presumed retirement date. It is much more simple and much more common to use in an employer based retirement setting from an education and communication standpoint, and you can see the rapid growth in target date based funds. The bottom are what we call target risk

funds in which individuals fill out risk questionnaires and then we determine the right investment risk fund for them based on the questionnaire. What you do see is they are prevalent within in retirement plans and IRAs at the same, but also are very prevalent in the advisory driven community on investing outside of the retirement plans.

The other thing I would say from an IRA perspective, back to previous comment that I made, the IRA growth is fueled by distributions from qualified plans primarily in today's world. So we are seeing the acceptance of IRAs as the rollover investment choice at the same time for many people as they become comfortable with them. I think it speaks to a worker's desire to have help either in getting in the plan, how to participate in the plan, and also how to invest in the plan.

The last side that I will share with you at this point is what we might consider as some best practices for employers. The first thing I would say is that while the automation features are very, very positive and will be very well accepted, they are not for everybody. There are certain industries with high turnover rates and certain situations where the automation aspect will not be embraced and maybe in a lot of ways should not be embraced. But we do think that there are some important best practices as we work with our clients in the marketplace, and one of them continues to be the employer as a strong advocate and the sponsor of the plan. We think that is a critical component, obviously, an employer match to help facilitate contributions, and the prevalence of do it for me solutions which are here to talk about today, auto enrollment and automatic

payroll deduction is part of that process, deferral increases, acceleration, because auto enrollment by itself is not going to get people where they need to be, but auto enrollment tied to automatic escalation is what really needs to happen in order to get people to contribute. And then the automated investment solutions as the default option or on the platform for people.

The last piece is critical. All these things get people in, all these things get people started and get them on the right path. It needs to be supported by education and understanding for how much is the right number I need to build toward, and then at the same time, when I reach retirement, how do I manage an income stream, how do I take an accumulation of assets and make that last for me over time in retirement, so that is another important component. Those things are facilitated well through the employer marketplace and the employer plays a very important role in that, so we think on best practices with the employer is very, very critical.

With that I am going to go ahead and wrap up and move on to the next speaker.

(Applause)

MS. MADRIAN: I am going to show you some of the evidence about how effective some of these automatic savings features can be in improving savings outcomes for individuals.

I am going to first talk about automatic enrollment. In a typical defined contribution 401(k) style savings plan, if you do nothing, you will not be in the plan, and I am going to call that standard enrollment, but many companies

have started adopted automatic enrollment where if you do nothing, you will automatically be in the plan at a default rate and in an asset allocation chosen by the employer unless you opt out. I am going to show you some evidence from one particular company, but these results generalize fairly well across the many companies I have looked at, and I am sure that Greg has seen similar results with many of his clients.

This is a company that in December 2000 switched from standard enrollment to automatic enrollment. They did this with a 3 percent default contribution rate, putting the money into a money market fund, applying this to new hires going forward. Interestingly, they also applied it to existing employees with the company who were not already participating. Then several months later, almost a year later in October 2001, they rethought things and decided to increase the default contribution rate to 6 percent of pay rather than 3 percent of pay.

What happens? This line right here, the greenish line, shows you the relationship between tenure on the X axis and the fraction of employees who were participating in the 401(k) on the Y axis. What you can see is that when employees walk in the door, very few of them sign up on day one, but over the first few months quite a few of them sign up, then over time you get a slow but steady increase, and after about 2-1/2 years you have at this company about 80 percent of employees who are in the savings plan. Eighty percent is actually a fairly high number. I think Greg mentioned that the industry average participation rate was about 70 percent, so this is a company that has higher than average participation rates in the absence of automatic enrollment.

Then the company adopted automatic enrollment with a 3 percent default, and that is this dark blue line. What you can see that participation jumps in the first 2 months to almost 95 percent, and you get this big jump over 2 months because this company gives employees to opt out before they automatically enroll them in. Then you can see that once you are up at 95 percent there is not a lot of room to go up, but certainly participation rates are not going down, and if anything, you have very slow slightly higher increases in participation over time.

One interesting question to ask is what happens when they go to 6 percent? If you default people into a higher savings rate, will more of them decide that they are going to in fact opt out? I think some employers have had a concern along those dimensions and that has led to many companies when they pick a default contribution rate under automatic enrollment to pick a fairly low number like 2, 3, or 4 percent. The answer is, at least going up to 6 percent does not appear to negatively impact participation. If anything, the participation rates at the 6 percent default under automatic enrollment are slightly higher than they were at 3 percent. I do not think the differences there are significant in any meaningful statistical sense, but they certainly do not suggest that if you give employees at least a somewhat higher default contribution rate that more of them are going to decide to opt out of the plan.

One reason that 6 percent may not be a deterrent at this company is that the employer was providing a matching contribution of up to 6 percent of pay. So if you were not contributing 6 percent, you were leaving money on the

table and that would be an inducement for employees to want to at least stay in at least 6 percent of pay.

It is also going to create some interesting incentives for how much employees actually will be saving, so the next slide here shows you the relationship between the contribution rate that employees are saying and the default contribution rate chosen by the company under automatic enrollment. This is the same company, and as I just mentioned, they provide a match up to 6 percent of pay. So when the default under automatic enrollment is 6 percent of pay, what do you see? You see that about half of the employees are contributing 6 percent of pay. That was the default under automatic enrollment, and it happens to be the match threshold. The employees who are not contributing 6 percent of pay tending to be contributing more rather than less. That is, the employees who are automatically enrolled at 6 percent of pay, if they move, if they change, they tend to pick a higher contribution rate rather than something lower.

The distribution of contribution rates when the default is 3 percent looks very different. Here it is when the default is 3 percent, and now you can see that the modal contribution rate, the contribution rate where most of the employees are is not longer 6 percent of pay, it is now 3 percent of pay which has 28 percent of the employees rather than 4 percent of the employees when the default was 6 percent. The point of this slide is to illustrate that the default contribution rate that is chosen by employers has a bit impact on how much employees end up saving at the end of the day, and they end up saving more if

you choose a higher default contribution rate than if you choose a lower default contribution rate.

Automatic enrollment also can have a potentially large impact on asset allocation for the same reason that it has a big effect on contribution rates which is that individuals just tend to stick with the default contribution rate or the default asset allocation chosen by the employer. So at this particular company the default asset allocation was a money market fund. A money market fund is a very safe investment if you do not want to lose any money, but it is not going to provide you a very big return. Because of this, a lot of people would not have the money market fund as their first asset of choice because there is not a huge potential for big returns.

So with this particular company, if you look at employees who were hired before automatic enrollment, you can see that the default fund is not particularly popular, so only 10 percent of employees have any of their money in the default fund, only 1 percent of them have everything in the default fund, and the zero percent there is kind of meaningless, that is just telling you that nobody picked the default fund, everything in the money market fund in conjunction with what the company subsequently chose as its default contribution rate under automatic enrollment. The main point here is that the default fund is not particularly popular for employees who were hired before automatic enrollment and who are not impacted by the default.

If you look at the asset allocation of employees who were hired after automatic enrollment, you can see that much more of the money in the plan

is in the default fund. So now 34 percent of employees have any balances in the default fund, 26 percent have everything in the default fund relative to one for those not impacted by automatic enrollment, and 18 percent have everything in the default fund and are still at the default contribution rate chosen by the employer.

If you look at what happens when the default contribution rate was 6 percent, even more money is in the default fund. So now we have about half of employees have anything in the default, 40 percent have everything in the default, and 33 percent have the default asset allocation and the default contribution rate. You might wonder why is the default asset allocation so much more persistent when I change the default contribution rate? What is the relationship there between the contribution rate and the asset allocation? Why is there any link between the two? The reason is, on the previous slide that I showed you with the distribution of contribution rates, remember that more people are moving away from the default contribution rate when the employer picks the lower 3 percent contribution rate than the higher 6 percent contribution rate. When people get their acts together to go in and change the default contribution rate, they might also change the asset allocation at the same time. So when you pick a contribution rate that more employees like, the 6 percent because it gets you all of the matching contributions, fewer individuals feel like they need to go in and change their contribution rate, and fewer of them go in and change their asset allocation at the same time.

What is the lesson between this slide and the previous slide on contribution rates? The lesson is that the default that is chosen by the employer, the default contribution rate and the default asset allocation, have a strong influence on what you observe at the end of the day in terms of how much employees are saying and what their asset allocation actually looks like, and this makes it really important for employers to think carefully about what those defaults look like.

A second automatic feature that some employers have started adopting and the Pension Protection Act encourages is the use of contribution escalation, and Shlomo Benartzi of UCLA and Dick Thaler of the University of Chicago, they probably have a patent on this idea don't they? I have no idea. They sell this as the Save More idea concept and the idea is to get employees to commit today to save more in the future and to make those contribution increases in the future automatic so that you do not have to keep on taking action, you just decide today that every year in the future I am going to increase my savings rate by 1 percent of pay, and it just happens automatically.

I am going to show you some evidence from one particular company, I think this is the first company that implemented this type of contribution escalation, and what kind of impact it has on contribution rates escalation rates, but to understand that slide I have to tell you how they did it.

At this particular company which is a small manufacturing company, the owner of the company brought in a financial planner to sit down individually with all of the employees. That is an extravagance in the real world.

Most companies are not bringing in financial planners to sit down one on one with their employees, so keep that in mind, although it perhaps would be a valuable thing for individual employees.

The financial planner sat down with the employees, and invariably most of the people he sat down with were not saving as much as they should be saving to ensure the type of retirement they wanted, so the financial planner told them you ought to be saving more. Some individuals upon hearing this news said, okay, let's go ahead and increase my contribution rate today. Those are the group A employees, the employees who were willing to raise their contribution rate today.

Most of them, however, were like, oh my word, there is no way I can save as much as I should be saving right now today. For those people, they were offered the option to sign up for automatic contribution escalation, meaning sign up today and every time you get a pay raise in the future, we will increase your contribution rate, and in this company it was increased by 3 percent of pay which is a fairly aggressive increase in contribution rates relative to what most individuals do when they do it on their own. This slide right here shows you the impact of this Save More Tomorrow option.

Before meeting with the financial planner, the average savings rate, and this includes the employees who are not participating, they are included as saving zero. Greg pointed out that the average contribution rate across the whole industry if you include the nonparticipants as a zero was about 5-1/2 of pay. In this company it is even lower. Of the employees who said they were

willing to save more today, it was 4.4 percent, and the employees who said I cannot really do it today, it is even lower at 3.5 percent. It is low, and if anything, the people who are unwilling to save more today have an even lower contribution rate.

What happens? If you follow this company over the next four pay increases, you can see what the contribution rates of these employees look like. For those who were willing to save more today, their contribution rate is in fact higher, it almost doubles from 4.4 to 8.6 percent of pay. It is now shown in this slide because this combines 4 years of data, but most of that increase happened right away. So they sat down with the financial planner and the planner said save more today, and they did it. They went from 4.4 to 8.6 today, and then they stayed at 8.6 on and on, with a total increase of 4.4 percent.

The employees in group B who were offered the Same More Tomorrow option started out at 3.5 percent, but each year in the future their savings rate goes up by 3 percent, a few of them opting out but not very many, and after four pay raises, their total savings rate has gone up from 3-1/2 percent to 13.6 percent, almost quadruple what it was in the first place, at 10 percent increase, and much bigger than the increase experienced by the employees who were not offered the option to Save More Tomorrow. So this showed you the power and the potential impact on savings from allowing employees to have the option to sign up today for a series of automatic increases in the future that makes saving more easier to get to and also makes it more palatable.

Another somewhat conceptually similar idea, one that is not necessarily offered any favorable protections under the Pension Protection Act but one that I think some employers might find attractive especially given Greg's comment that the automatic solutions although they are viewed as an industry best practice are not necessarily appropriate for all companies in all situations, is an elective default which is what Save More Tomorrow at least has been in the companies that have implemented it so far. In most cases it is an elective default and not something that takes automatically.

Another idea is to give employees a simplified way to enroll by choosing a partial default for them. So we are not going to automatically enroll you in the plan, but we will give you an easy way to pick a bundle, a contribution rate and an asset allocation bundle, so you do not have to pull your hair out at night thinking about how to evaluate, and in my case at Harvard University, I just moved there over the summer, I had 259 funds to choose from. If you do not have a good sense of which of those 259 funds you would have, maybe you would like the option where the employer picks a fund for you.

I am going to show you quickly some evidence from two different companies that adopted this type of a mechanism where you give employees a postcard or they can do this online, check here and we will dump you in at this contribution rate and this particular asset allocation.

The first company, company B, did this in a couple of different implementations. They did it for new hires during employee orientation, and then they also did it for existing employees at the company who were not in fact

participating, and had a huge increase in participation. You can see that most of it is happening between those two gray bars. You can see before the first gray bar that the overall participation rate at this company is about 55 percent, so this is really low relative to the industry average which is about 75 percent, and 55 percent is really low. Over an 18 month period, their overall participation rate increases by almost 10 percentage points in a relatively short period of time. The only thing that even comes close to increasing participation that much is automatic enrollment, and this is not automatic, this is elective. It is not as effective as automatic enrollment at increasing participation, but if you wanted something short of automatic enrollment, this is a very good next best alternative.

This slide here is from a company that did not offer this option to new hires, but sent out mailings every year to all of the employees who were not participating and had a little postcard, check this box, send it back in and we will sign you up for the plan at this particular contribution rate, this particular asset allocation. They did it 3 years in a row which is what you see in this chart, and the bottom three lines here show you the baseline of what would have happened if you did not do this. This is sent to nonparticipants, so at baseline and time equals zero, no one is participating because that is the definition of who gets the postcard, so we are going up from zero. And if you went back before the company did this and said if we take participants at any point in time and just track over time how many of them eventually find out, that is what those bottom lines are showing you. And the top turquoise bluish line shows you what happens if you take the nonparticipants and then every year you send them a postcard that

says check here and we will sign you up for the savings plan, and what you are going to see is that every 12 months you have this big increase in participation rates, and after 3 years, the fraction of those nonparticipants who have signed up is doubled what it was, about 45 percent relative to about 22 percent. So this is an easy and relatively inexpensive way to get individuals into the plan by simplifying the process for them.

Why is that mechanisms like this and mechanisms like Save More Tomorrow and mechanisms like automatic enrollment have such a big effect on outcomes? I think there are two big reasons.

The first one is there is a natural tendency for individuals to procrastinate, why do today what you can put off until tomorrow. Why is procrastination such a problem when it comes to savings? I think there are two key reasons. The first one is, it is a really complicated decision, and as Greg pointed out, most people do not feel particularly comfortable doing it. Seventy-five percent of people say they like some help with this decision, so things like automatic enrollment and Save More Tomorrow and these elective defaults that get you into the plan simplify the process and get things done.

The second reason why there is a lot of procrastination is that there is no immediate gratification. There is no compelling reason, there is urgency, there is nothing about savings that says do it today, do it today, and there is every reason to put it off into the future.

The second reason there is such a big effect particularly from the choice of defaults is that because many individuals are not financially literate,

they are looking for cues in the world for what they should be doing. Think about your employee looking at their employee plan. This benefit plan is supposed to be operated for the benefit of the employees, and a logical inference might be if the employer picks the money market fund as the default, the employer must have thought about this and decided that the money market fund is the most appropriate fund for most of the employees in the plan. That is not in fact what most companies are thinking when they choose their default fund. They are thinking about things like how do I minimize my legal liability and things like that. So if you have financially unsophisticated individuals who are looking for cues, anything that the employer does that looks reasonable is going to be construed as some sort of an endorsement and it will be sending some sort of a signal whether or not that was the intention of the employer or of the government as well since the government regulates some of these things.

Let me offer you a few concluding thoughts. The most important point is that the automatic 401(k) is potentially an extremely powerful way to increase retirement savings. This means first of all that appropriate defaults are paramount. Given that there is an endorsement in fact, given that there is so much persistence at the default, we need to have employers thinking seriously about how do I choose defaults that are going to lead my employees to a financially secure retirement, and we need to have regulations that encourage employers to adopt those kinds of defaults, and the Pension Protection Act has some provisions that I think will help employers and employees get there.

Nonetheless, there is still some room for improvement, and one area in which there is room for improvement is the default fund for automatic rollover. Greg noted that most of the money going into IRAs these days is rolling over from 401(k) plans rather than new individual contributions, and in some cases, individuals are picking their own asset allocation, and in many cases it is just going to roll over into the default fund, and the government regulations for what constitutes an appropriate default fund for these IRA regulations is something on the order of a money market fund or a stable value fund where there is very little risk, but along with that there is very little potential for a high rate of return. So that is one area where I think there is room for improvement.

Another area where I think there is room for improvement, largely because I don't think a lot of thought has gone into it so far, is what happens when individuals retire? In a traditional defined benefit pension plan, you just start getting a check every month much like Social Security. I think the industry and I think the government rightly so have been concerned over the last several years with how do we get people to accumulate the right amount for retirement, and I think that the thinking now needs to turn to how do we establish the institutions and the incentives that help people consumer the wealth that they have accumulated after they have retired so that they don't run out before that die. That is a whole other can of worms and it is going to take a lot of thought on how to do that, but I think that is the logical next step.

The last point is that simplifying the whole process is an important and complementary tool to all of these automatic features that have been discussed and are increasingly being adopted by employers. Thank you.

(Applause)

MR. WARSHAWSKY: Thank you very much, and I appreciate the invitation to come here to talk about automatic enrollment. What I plan to do, number one, is to discuss the provisions of the Pension Protection Act that apply to defined contribution plans, but particularly focus on automatic enrollment.

I am going to give some thoughts, we will call them critical thoughts. They are not criticisms, but they are just observations about questions of policy effectiveness in this area, and also the appropriateness of the policy. In other words, what do we want to accomplish; are the tools that have been put into law going to be effective to achieve that policy; and then even more importantly, is the policy the right policy. Then I will conclude with a brief summary of a survey which we did at Watson Wyatt of plan sponsors about automatic enrollment and in particular, we actually focused on the use of default investments. The motivation was that as part of the Pension Protection Act, the Department of Labor was required and in fact has proposed a regulation about what is allowed as a default investment, and were curious as to what our clients and others who receive our publications were doing in default investments and what their opinion was on the Department of Labor's proposed regulation. That is what I will cover today.

Starting in terms of the actual provisions of the PPA with regard to automatic enrollment, it does remove legal barriers. There were not many companies that were willing to take the legal risks of putting in automatic enrollment, and many held back because there were legal risks. One legal risk was that some thought that state garnishment laws would prevent automatic enrollment. In point of fact, no state actually implemented these laws vis-à-vis automatic enrollment plans, or at least none that I am aware of, but I think many companies were concerned about that.

Another concern that companies had was what happens if people come in, they are automatically enrolled and change their minds quickly? What the law allowed is a quick distribution of small amounts within the first 90 days without any excise tax.

Probably the major area in the law that pertains to automatic enrollment is a safe harbor. There are things called nondiscrimination testing, and I will describe that in a little more detail in the next slide. If automatic enrollment is combined with specified matching contributions and automatic increases, then the plan is waived through nondiscrimination testing and it certainly removes an administration burden on the plan's sponsor, and for some instances it may be an advantage as well particularly for the higher paid people in the plan in terms of contributing whatever they want because there is no longer the nondiscrimination barriers.

There are also in terms of issues concerning how the Act works, there are notice requirements that have to be put in. That is effective in the 2008

plan year. Relevant I think to some of the prior discussions, the law requires automatic enrollment not just to new hires, but to current employees as well. There is a little subtlety as to who made an affirmative election not to be in the plan and who did not, but that needs to be worked through.

In terms of the safe harbor, with nondiscrimination testing the basic concept is, there are ADP tests, ACP tests, top heavy tests, and the basic idea is that the lower paid workers should be getting contributions from their employer and should be participating in a plan in rates and in ratios that are comparable to the higher paid. It is actually a fairly complex area, but that is the general motivation. So if there is automatic enrollment then this is a safe harbor and the plan sponsor can totally do away with those numerical tests.

What is required? What is required is that employees be enrolled at least 3 percent of compensation initially, that there be automatic 1 percent increases annually to at least 6 percent, but not more than 10 percent of pay, and that the minimum matching contributions be subject to 2 year vesting, and there is a choice that the employer has of an employer match of 100 percent on the first 1 percent of pay, and 50 percent on the next 5 percent, or just a 3 percent nonelective contribution. So ultimately at 6 percent, and assuming that the employer chooses to match, the employer's contribution is 3-1/2 percent of pay.

There are other safe harbors in the law, and it is important to note that terms of the plan sponsor's choice, this is one way of doing it to avoid the nondiscrimination testing. But there are other safe harbors in the law and so there will be choices that employers have to make, do I want to go this route, do I want

to use the safe harbor, or do I want to continue the ACP/ADP and top heavy testing.

Another part of PPA as I mentioned was the default investment issue. I think another reason why some employers did not want to go the route of automatic enrollment is that they were concerned about where do they put the employee's money. It was indicated that money market or stable value was a very common choice, and again, when we look at the survey evidence, I think for automatic enrollment there was a trend away from that, but many plan sponsors were nervous about this issue. What the law says is that the Department of Labor has to issue a regulation saying what is allowable as a default investment and that it is providing fiduciary relief. I think an important point is that the regulation that the Department of Labor has issued is actually broader than automatic enrollment. It also applies to any situation where the employee has not selected an investment, it could apply for administrative purposes, a temporary change in investment options or providers by the employer, where is the holding asset, and as proposed, the DOL has given the green light to three types of funds, the life cycle fund which we have discussed, the balanced fund which I guess is the same as the lifestyle, I am not sure, and professionally managed accounts.

The Department of Labor was very firm on not allowing money market and stable value for the default investments for any of these purposes, and as we will discuss in the survey results, this is a big change. It would require a very large change by employers. This is on a very fast period. The comment period on the proposal has just been concluded, there were 88 responses, so it has

elicited quite a bit of interest in the employer community and the investment community, and everyone says that they are going to turn this very quickly, perhaps by the end of the year.

Let me quickly go through some other PPA provisions related to define contribution plans. It was mentioned that the law really has not dealt with the distribution phase, but one very small aspect is a modest encouragement to -- annuities in defined contribution plans by removing a DOL regulation on the safety available annuity which in practice meant that there were very few insurance companies that could provide annuities to plans under the safest available. That has been removed, and I think it will increase competition in this area.

They also required a diversification from employer securities, and all the extra provisions were made permanent. One which I happen to think is a very good policy is the catch-up contributions for those above age 50. We will discuss this when we talk a little bit about policy, but there are all sorts of we will call them life cycle situations where people have income that goes up or down, they have family situations, but I think a very normal situation in terms of life cycle is people's families decline with age as children grow up and go to college and leave college, and also incomes go up with time. So people have the wherewithal to make contributions to pension plans, and their wherewithal improves dramatically as they age, and they might need to catch up. So that is a provision, and I think it is a very important one.

I want to caution the discussion, and no claim has been made along this line, but I think perhaps made this claim that with automatic 401(k)s, we have solved the problem of the decline in defined benefit plans. There are certainly a lot of good features of automatic 401(k)s, the automatic enrollment, the life cycle default investments, higher contributions for older workers and so on, but it does not match the benefits of a defined benefit plan because the 401(k) even with an automatic feature still places a risk of investment performance, of the point in time of the annuity purchase price which also is very volatile, opt outs, cash outs, and so on, on plan participants, so it is not a one-for-one substitute for a defined benefit plan. And I think as was also mentioned, we always have to consider the human resources interests and the financial interests of the plan's sponsor because they are often very involved in this area.

Now let me go to the policy, both effectiveness and appropriateness. The question is, and we are going to find out in the next couple of years, will automatic enrollment be a significant factor in the D.C. system. I think, and it has been noted, that for some plan sponsors this will be much more costly and administratively than other safe harbor approaches because if there is high turnover in the workforce, you have a small accounts where the money is going in, but then it is coming out. There have been an example of one large employer who do automatic enrollment but decided it was just too costly and also administratively burdensome, and costly is in terms of the matches that would be required. And we do not know yet in terms of a large scale experiment what the outcomes will be, particularly among lower income workers. With opt out, with

potential for once they are in, is the money going to stay in the plan in terms of loans, in service hardship distributions and cash outs over time. So we need a lot more information, and I think that that is something that we will be looking for very carefully.

In terms of the appropriateness of the policy goals, as I indicated, there are a lot of situations of workers and employees among life phases, in terms of income groups and so on, and I think particularly when we are focusing on lower income workers we also have to consider in the mix the public social insurance programs that are generally progressive in nature, and so we also have to include them in the mix. When we talk about these programs, I think it is very important to say are we talking about lower income workers, are we talking about middle to higher income. I think we need to be quite specific.

Then in terms of the national savings rate, there is a raging debate among academics on that subject concerning observed savings rates, are they adequate for getting people to finance retirement, and I will just say that there is a raging debate and there has been very impressive evidence on both sides of the equation.

Similarly, there has been a raging debate on appropriate investments in pension plans, and I think it is fair to say that there is not a consensus in the academic community on those topics. I think the default investment regulations could be important even beyond automatic enrollment, and I want to ask this question, do we see evidence of a spillover beyond just those who were automatically enrolled. There is some evidence of this. In Sweden

where they actually have 700 choices, I guess you should be fortunate that you do not have to make 700 selections, 90 percent of new participants are defaulting to the government managed account. So I think there is such a thing as overload and too much choice, and people just shut down and go to the default. In the federal government workers' TSP they have been very aggressive in terms of promoting life cycle funds and very successfully promoting them. Ninety-percent of the participants and 6 percent of assets were invested in life cycle funds just one year after their introduction, and they are marketed as cruise control. I think there is even an image of a car.

My personal prediction is that as the DOL proposes default investments, and it is important if there is no active plan sponsor efforts to the contrary, I think there would be a tendency to go to the default investment, and I think that that is both positive and negative. I think there would be less trading in the accounts which I think is largely a positive, but there may be a tuning out of interest absent the plan sponsor's efforts. Therefore, the default investment of the choice of the plan sponsor and the DOL's own regulation will be I think very important in 2007.

I have one particular concern about the DOL reg as proposed. As written and as stated, it actually could impede financial product innovation because it is very specific. It has three types of funds and that is it, and we all know how difficult it is to open up a reg once it is closed. So I think that that is something that the DOL should think very, very carefully about.

Let me conclude with a few results on our survey. I am not going to claim this was a representative sample, I will just state the results as they were. There were 95 respondents and they were mainly large employers in manufacturing services. Many of them had a defined benefit plan. There were many very large companies in this survey, with a total of about 1-1/2 employees and about $100 billion in plan assets in the defined contribution plans.

They gave a lot of choices, not quite 270, but the median was 15 and the average was 23. About a third said they had automatic enrollment either for new employees or for everybody. For those that did not have automatic enrollment, when we asked why they did not, most said they were either dissuaded by cost or by legal liability. So legal liability is something that is addressed in PPA, so, therefore, many are considering automatic enrollment right now.

Nearly all have a default investment of some sort in their plans, but as I indicated before, it is not just used for asset allocation, it is used for all of these purposes, and so I think that is an important issue also when we think about the DOL regulation.

The most common default investment is a life cycle fund, at 38 percent among these companies, followed by a stable value at 26 percent, money market at 18, and a balanced fund at 8 percent. What is interesting is when we looked at equity based funds, in other words, the life cycle and the balanced fund, it was much more commonly used when there was automatic enrollment, at 70 percent. I do not know if this is The Principal's experience, these are larger

companies so there may be a distinction there, but companies that did go even before the PPA and decided to do automatic enrollment were willing to go to default investments and equity funds more commonly as opposed to when they did not have automatic enrollment and they were using default investments for all these sundry purposes, they were much less likely to use an equity based fund, at only 47 percent.

We asked what they would do if the regulation as proposed had to be put in place, and 48 percent would have to change the default. That is almost numerically required by the results in the first bullet. And 53 percent, so actually even a few more, said they would do it anyway. The first choice among the DOL options was the life cycle fund at 94 percent. Nevertheless, some preferred to remain in the stable value and money market, respectively, if it would be allowed by the DOL. And again, doing a simple correlation, that answer was more likely if the respondent said that they had, and we asked them as a self-assessment, do you have a lot of outflows from your plans for loans and in service distributions and so on, and those that said, yes, that is a significant aspect of the plan, seemingly they were more concerned about the issue of getting away from the stable value or money market.

I hope this information is helpful as we talk about this very important subject. Thank you.

(Applause)

MR. ORSZAG: We have lots of topics to discuss. I know we have things following-up from the various presentations, but you all have been

sitting there patiently, so let's get you into the discussion and then come back to some of the questions that were raised during the various panelists' remarks.

QUESTION: Could you explain what is in the Brookings proposal that is not included in the Pension Protection Act in terms of automatic enrollment? What are the new legislative things that will be required in your proposal? I am not quite sure I understand, given the legislation that passed this year, what more you are suggesting be required. I understand the part about employers who do not offer plans at all, but is there an additional burden upon employers now who have existing plans?

MR. ORSZAG: No. The paper that were distributed or released today combines the effects of policy changes that have already been made to embrace the automatic 401(k) concept with policy changes that we are proposing to expand along different dimensions those automatic savings and increasing the incentives to save, and that is in terms of the saver's credit or saver's match, for example. So there are not at this point any additional legislative steps that are necessary with regard to at least automatic enrollment.

You could raise questions about whether quick enrollment or easy enrollment steps would require any further legislative movement, but I think the main thing at this point is corporate take-up of what is now more clearly legally permissible rather than further statutory changes, at least with regard to automatic enrollment and automatic 401(k) concepts.

QUESTION: Are you referring now to the $44 billion is essentially what would be expected from current law?

MR. ORSZAG: A reasonable estimate of take-up that we anticipate from the changes that have already been made.

MR. SPREGINS: My name is John Spregins (?). I work for Congressman Jim Cooper. I was curious if anybody wants to respond to Mark's critical thought about the lack of information not just on improving the savings rate, but among low income people, savers particularly. Then the second question is, what does each of your employer do when it comes to auto enrollment or where are they heading? Harvard was an interesting example, and I was just curious.

MR. ORSZAG: Brigitte, do you want to tackle that question?

MS. MADRIAN: Let me answer what Harvard does first. Harvard is one of these funny institutions, nonprofit, so they offer not a 401(k), but a 403(b) type of thing. They make a contribution on behalf of all employees whether they are participating or not, and it happens to be a very, very generous contribution. So we have actually been asked, we being me and my co-author David Laibson who are now both at Harvard, should we be encouraging the universities to adopt automatic enrollment, and we waffle back and forth because the nonautomatic plan is actually fairly generous, and so it is not actually clear whether everyone should be arm twisted into saving more than what the universities are already putting in on their behalf. So Harvard is not a good example from which to generalize.

Of course now after answering that, I have forgotten the first half of your question.

MR. ORSZAG: Talk about what we think we might know or not know about the impact of automatic features on low income people, not just contributions, but fundamentally retirement asset accumulation.

MS. MADRIAN: The answer is we know a little, not a lot. In companies that have automatic enrollment, the opt-out rates are higher for low income people, so the opt out rate increases steadily with income. However, if you look at the fairly low paid employees, saying employees who are earning less than $20,000 a year, the participation rate under automatic enrollment is still extremely high for those employees. I would have to go double-check specific numbers, but off the top of my head I am thinking 70 to 75 percent relative to say 95 percent for very, very highly paid employees.

MR. ORSZAG: Brigitte, I can quote you from -- for workers with $20,000 or less in earnings, for new employees, you go from under 15 percent to 80.

MS. MADRIAN: So without automatic enrollment, 15 percent are participating, and with it it is up to 80, so you get a huge increase in participation rates.

What happens to their long term after the accumulation over time depends a lot on what the default contribution rate is and what the default asset allocation is, and also what would have happened to these workers over time. But if you are in a company with a 2 percent default contribution rate and putting everything in a money market fund, yes, they may accumulate something over time, but it is not going to be a huge amount. In fact, in some companies where

we have done projections, I call those lousy defaults, and I know that word might be too strong for some people. Employees can actually be worse off in the long run from that kind of a default because it is so persistent, particularly for employees who are not really financially sophisticated. If they would have gotten around to doing something better on their own, say in 3 or 4 years on their own they would have signed up at 6 percent and put the money in an index fund or something, you can actually get the perverse outcome where a few years down the road they could in fact be worse off. That is why I made the point that getting the default right is so important, and that is because it is a two edged sword. Defaults work well if you have good defaults, and defaults do not work quite so well if they are not chosen carefully.

MR. ORSZAG: Let me add two quick other thoughts to that. One is with regard to the impact on retirement assets, the aggregate amount of retirement assets, I think there is an interesting question. Many employers have adopted liquidity provisions, loan provisions and facilitated hardship withdrawals in order to encourage participation in contributions in the first place, and there have been some studies from the Government Accountability Office and others suggesting that those effects are significant, in other words, they do have a substantial impact on enrollment and contribution rates.

In the presence of automatic enrollment, the dynamic may be different, and so it at least raises the question as to whether if you have automatic enrollment, those liquidity provisions still at the margin have the same effect on

participation and contribution rates, so it may be something that employers may want to reexamine as they move towards automated plans.

The other point though is whatever happens to aggregate retirement asset balances, there is a deep and ongoing debate over whether there are other corresponding changes or other offsetting changes either in terms of debt or other asset accumulation. So the question of what happens to household net worth and whether it goes up when retirement assets go up or whether it goes up dollar for dollar or how much is I think a central question that we still have not gotten a clean, randomized experiment kind of answer to. I know that we at the Retirement Security Project are very interested in exploring in different settings to try to get at that.

MS. MADRIAN: What do you assume on that in the projections?

MR. ORSZAG: We have assumed offsets.

MS. MADRIAN: How big?

MR. ORSZAG: Something like a quarter, that kind of range. But with the lack of randomized evidence, we are making that up.

MR. WARSHAWSKY: To answer your question on my employer, Watson Wyatt, we have a defined benefit plan and we also have a 401(k). It is not automatic enrollment, and I am not aware that the powers that be are thinking of it. But of course, everyone is in the defined benefit plan and that is automatically enrolled so that there is less of a need, therefore.

MR. BURROWS: I will just round that out for you and say that at Principal we do have a defined benefit plan and a cash balance plan for

employees. We do utilize automatic enrollment. We implemented it in 1997 and moved participation rates at that point from about 77 percent up to the current 93 percent. Employees are moved in at 8 percent deferral which coincides with our match and default to a targeted date fund.

QUESTION: I wanted to follow-up on asset accumulation for low income workers. The question I have is how much data do we have about if they are automatically enrolled, when they leave that job are they taking the money and not rolling it over into an IRA but instead just cashing it out and thinking of it as a job windfall?

MS. MADRIAN: I do not know that anyone has looked at that specifically for low income workers, but what I can tell you is that when it comes to what happens when you leave your job, the default is really important, and the default depends on how big your balances are. So if your balances are greater than $5,000, it will sit at your former employer unless you do something. So if you just leave and go down the street to another company and don't touch the money, it is just going to sit there, you will keep on getting statements every quarter, and it will just sit there until you decide to do something to it.

If your balances are less than $1,000, the company is legally authorized to send you a check, and because it is costly to keep a small account on the books, almost all companies will do that. So after 60 days you will get a cash distribution in the mail. It will be about half of what you had because the company has to withhold taxes and they have to withhold a 10 percent tax penalty on the tax distribution.

If it is between $1,000 and $5,000 effective I think at the beginning of this year, the company has the option once again to either keep it in their plan, or they can automatically roll it over into an IRA for you. If they roll it over into an IRA, the default fund which the company can choose but it is not regulated by the Department of Labor and under the DOL regulations it has to be something very conservative.

Past evidence on what happens when employees leave their companies suggests that what happens is the default. So if it is more than $5,000, the money will stay in the previous employer's plan most of the time. If it is less than $5,000, and all the research was done when the $1,000 limit used to be $5,000 for a cash distribution, the answer was almost everyone got a cash distribution. And of the people who got cash distributions, depending on the estimates, between 60 and 85 percent of that money was spent rather than turned into savings.

In terms of what happens to low income workers, it depends on how high their turnover rate is. If you are low income worker but you stay in your job for 20 years, by the time you leave you are going to have more than $5,000 and it will probably sit there and it will continue to accumulate. If you are a low income worker, so it is accumulating very slowly and you turn over often which is true of some low income jobs, the answer is you are going to get a check every year or two and most of it will probably be consumed. But that problem has been greatly mitigated because companies used to be able to send out a check

for balances of less than $5,000, and that threshold has been pulled down to less than $1,000.

MR. ORSZAG: I have seen a couple of stats recently, and maybe this will help because I agree with what Brigitte said, approximately 15 percent of the actual distributions are turned into cash. That represents about 7 percent of the assets that are distributed, so by nature it is small accounts being forced out. I have not seen stats that will drill down to talk about income levels associated with that, but I would imagine they are a higher proportion.

QUESTION: I was wondering if you could tell us what kind of anecdotal evidence you are seeing as far as employee education and communication on how some of these rather complex concepts are being communicated to the low income worker, things like the importance of the default investment and what they can expect when they leave their jobs.

MR. ORSZAG: That is a good question. I will speak about that in the context of the employer retirement plan program. Regardless of income levels, employees have the opportunity for education. Part of that education program consists of why you should enroll, appropriate levels to defer and contribute to, and then also the investment allocation approach that you can take.

In addition to that, it also tries to help focus on looking ahead, because I think one of the things that Brigitte said earlier is we are speaking about the accumulation phase which is critical, and it will not be very long before we all start talking about how do we manage the income in retirement. So it really starts

to look ahead also to how much is an appropriate amount to try to build toward from that perspective.

We have brought and delivered to our clients a variety of simplified automated solutions to get employees in a plan and involved. Some of them are automatic enrollment, and we think that will increase. But also an approach is what we call a simplified enrollment where it is option for the employee to participate so they have to opt in versus the automatic enrollment, but it still maintains a lot of the other aspects about the employer has preselected a deferral limit or deferral amount that generally coincides with the match, also an auto escalate feature, and then also a default investment option from that perspective. So the encouragement really is around educating people how to get in, take advantage of and maximize at this point with an eye toward looking at accumulation so that they have more to retire on.

MR. WARSHAWSKY: I will answer the question unfortunately not by income level, but just in general terms. Watson Wyatt had conducted research in the past about the effectiveness of matching versus pretty strong and aggressive education campaigns by employers to participate in plans and often times the education is as effective or in some instances even more effective than the match. So certainly education can play a very important role in terms of participants enrolling in the plan and contributing to the plan.

QUESTION: There is a friend of mine here from the British Embassy here and I am going to ask a question that relates to the British policy, and that is in Great Britain they have proposed going a couple of steps further

which would be that all employers would be required to offer payroll withholding and have automatic enrollment for them. I wondered what would be the reaction of the panel to that type of proposal.

MR. ORSZAG: Let me jump into that. The automatic IRA proposal which David John and Mark Iwry have put forward does that, so except for the very smallest employers, there would be a requirement that employers would automatically enroll workers in a payroll deduction with an opt out feature. It was interesting that there was an op-ed in The Wall Street Journal about this last week from a very close friend of the administration. There is definitely interest among both Republicans and Democrats on Capitol Hill as to this idea. And while things often take a while to reach enactment stage, this is something that at least the vibes I am getting are very, very positive about from everyone except perhaps the very small businesses.

MR. WARSHAWSKY: John, of course, in the United States we do have automatic payroll deductions and that is of course as you know for Social Security. When I was in the administration, my response to the proposal is that it would be nice to be able to deal with that problem which is an enormous problem and is very important to the discussion that we are having right now which is of course to enable to retire with a comfortable income and security. Right now they do not have that with Social Security because as we know the system is not financially viable going forward.

MS. MADRIAN: Let me add one more comment on that. You had asked whether you think this is a good idea to require it of all companies, and

I am a big proponent of automatic enrollment because I think there are a lot of people who could benefit from it. But as I noted in my answer to a previous question, there are companies that are actually providing fairly generous pensions and you would be hard pressed to look at their workers and say they need to have another 3 percent automatically deducted from their paycheck for savings. So I am wary of legislation that requires acts of everyone without some thought about whether the act is actually appropriate for everyone even if it might be appropriate for a lot of people.

MR. ORSZAG: And I should probably clarify consistent with that that Iwry-John or John-Iwry proposal applies only in cases where the firm does not offer a qualified plan, so Harvard University would not be covered.

QUESTION: (Off mike)

MR. ORSZAG: I think we have time for one last question. Let's go over in the back there.

QUESTION: Diane -- from Congressman Pomeroy's office. Mark, in your survey that Watson Wyatt did you indicated that life cycle funds were the most prominent default option. Do you have any data in that survey on how many of those life cycle funds are ones that those large employers create on their versus using an off the shelf one at a higher expense?

MR. WARSHAWSKY: Yes, we actually did that. That was not included here, but we did ask that exact question and my recollection is three-quarters used the off the shelf versus one quarter which put it together themselves.

MR. ORSZAG: We are going to have to wrap up. I think we have handed out a document that talks a bit about what the Retirement Security Project is going to be focusing on in 2007, and that includes automatic IRA, a proposal that we have heard described, it includes addressing the asset test under means tested benefit programs like food stamps and supplemental security income. Those rules were written 20 to 30 years ago when 401(k)s and IRAs were not part of the pension landscape and they largely exempt defined benefit plans but count 401(k)s and IRAs, so that is an anomaly that we think needs to be addressed.

The savers credit as I already mentioned has been made permanent and indexed, but it could be revamped and made even stronger. Then finally, as Brigitte mentioned in her presentation and has come up a few times, what we do on the withdrawal stage and whether and how to encourage more lifetime annuitization will also be high on our agenda. I just wanted to mention those four things and thank our panelists for the discussion and thank all of you for coming.

(Applause)

* * * * *