Independent Directors Council
Promoting Excellence in Fund Governance

The 401(k): Building on an American Success Story

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President’s Address

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Thank you Ed [Bernard], and welcome to one and all as we open our 50th General Membership Meeting. We have an exceptional line-up of speeches, panel discussions, exhibits, and entertainment scheduled over the next two-and-a-half days. I think this will be our best GMM ever.

Our theme for this meeting is “Our Foundations, Our Future.” What knits our past, present, and future together most tightly, I think, is what our shareholders hope for and expect when they invest in our funds. Of greatest importance to them is financial security in retirement.

When one thinks about celebrated dates in American history, the list might include 1776, when America declared its independence from Great Britain; 1862, when Lincoln issued the Emancipation Proclamation; 1945, when World War II ended; and 1969, when Neil Armstrong stepped onto the moon.

My list would also include the year 1981, for three reasons. It was the year when Ronald Reagan became President. It was the year when IBM unveiled the personal computer. And it was the year when the IRS issued a regulation allowing workers to divert a portion of their pre-tax wages to a 401(k) plan.

Each of those events led – directly or indirectly – to profound social, economic, and political changes that no one foresaw at the time: the collapse of the Soviet Empire, the advent of the Internet, and the creation of a retirement system that would grow to include more than 50 million American workers and $3 trillion in assets – so far – and inspire the adoption of similar retirement systems around the world.

This is something to celebrate. And celebrate we should, notwithstanding current conditions in the financial markets and the general economy. By their nature, all markets – in stocks, bonds, and, yes, real estate – move both up and down. For retirement investors, the key in times like this – as President Reagan once urged – is to “stay the course.”

In fact, if you look at the experience of 401(k) participants who did just that between 1999 and 2006, you see that their average account balance went from $67,800 to $121,000, an increase of almost 80 percent. That’s despite one of the worst bear markets since the Great Depression. And if you look at 401(k)s on a system-wide basis, assets increased 55 percent during this period.

As I said, the 401(k) system’s inventors, in Congress and the Executive Branch, could not have foreseen the extraordinary success that it’s achieved. They clearly did not envision that it would become the dominant private-sector device for retirement savings. You might call that an unintended consequence. But it’s no accident.

The success of the 401(k) reflects the commitment of thousands of employers to the long-term financial welfare of their workers. It also reflects the collaborative efforts of mutual fund companies and myriad other financial service providers.

The result is a flexible retirement system that offers participants a strong menu of investment choices; a system that allows workers to take their savings with them from one employer to the next, or to roll them over into an IRA; investment options for hands-on investors and for those who would rather rely on a professional money manager. And all this comes at exceedingly low cost. 401(k) participants whose assets are in mutual funds – and about half of those assets are – pay only about 71 cents a year on every $100 invested.

The 401(k) represents one part of a national system for retirement preparedness that also includes Social Security and personal savings. The 401(k) does not stand alone. But it and similar arrangements are of growing importance, and that is a good thing indeed.

Why? Partly because of the declining role of traditional defined benefit plans. In policy circles, this has occasioned no little nostalgia for a bygone era in which private pensions played a much larger role and retirement planning was much simpler.

It reminds me of a story about Oscar Wilde. While on a lecture tour of the United States after the Civil War, Wilde was attending a party in Charleston one evening and remarked to another guest, “How beautiful the moon is." The other guest replied, "Yes, Mr. Wilde, but you should have seen it before the war."

The fact is that defined benefit pension plans never did shine as brightly in reality as they do in some people's memories. In that landmark year of 1981 – the year 401(k)s arrived on the scene – fewer than one in five individuals over 65 received benefits from a private pension plan. For those who did receive them, the median annual benefit was less than $6,000 in today's dollars.

Contrast that with the social insurance system that is Social Security. Social Security is a contract between government and all the working people in America – the bedrock of our retirement system. And that contract is particularly valuable to workers with low to moderate income; it provides about 80 percent of their retirement income, a share that has barely changed in the past 30 years.

As the Social Security trustees have documented, though, the system faces a shortfall between its promises and its resources. So, it's crucial that Congress and the Executive Branch take all the necessary steps – difficult as they may be – to keep Social Security solvent.

As I said, another important contributor to retirement preparedness is personal saving. People who can save should be doing more of it. But getting to the end of the month with money left over is hard for a lot of working people to do. The challenges to Social Security and to individual savings make it ever more crucial that we continue refining and improving the employment-based system. And our principal goal must be the enrollment of more workers. In this effort, there are roles and responsibilities for government and for the private sector.

Government policy-makers should look at the obstacles that keep so many employers from offering 401(k) plans – and make every effort to remove them.

Any employer thinking about offering a 401(k) plan today encounters a profusion of regulatory requirements, head-scratching complexities, and sobering legal liabilities. In the last 25 years, the IRS and the Labor Department have added hundreds of pages of rules that an employer running a 401(k) plan has to follow. The trend is not a plan sponsor's friend.

It's safe to assume that the more red tape policy-makers introduce, the harder it is for an employer to adopt a 401(k) plan. Today, 56 percent of small private sector employers do not offer a pension plan, in part because of the administrative complexity involved. Unfortunately, this point seems lost on those in Congress who favor new and cumbersome mandates that are likely to retard broader coverage of these important retirement plans.

As it is, about 30 percent of workers who have access to 401(k) plans don't take advantage of them. Congress passed the Pension Protection Act in 2006 to make it easier for employers to automatically enroll their employees in 401(k)s. That may increase enrollment substantially – but only at businesses that offer 401(k)s.

That first step – getting more employers to sponsor plans – is vital. We can help by giving employers clear and concise information about what it means to sponsor a 401(k) plan. They need to know what services they're buying, who's providing them, how much they cost, who will pay for them, and what economic relationships the various service providers have. Most well informed employers have that information now, and the Labor Department has proposed some good standards for ensuring that all employers get it.

There is also a pressing need to improve the quality of information provided to plan participants – information about all the investment options in their plans. The Labor Department is working on that, too. With respect to funds, which hold about half of the assets in 401(k) plans, we hope their work will dovetail with that of the SEC, as it develops a summary mutual fund prospectus. We look forward to seeing what they propose.

But the onus for perfecting the system doesn't lie entirely on government's shoulders. We in the private sector have our jobs to do, as well.

The fund industry, as you know, has led the way in offering new and innovative ways for retirement-minded workers to invest their money. We'll continue to do our part, and I'm sure other financial service providers with a stake in the retirement system will, too.

But I also hope the various industries involved will resist the temptation to try to impose their particular ways of doing business on others, by lobbying Congress for legislation to enshrine one approach over others. The question ought to be what's best for the employers who sponsor plans and for the employees who participate in them. Answer that, and you'll find what's best for our businesses.

Provided government, employers and the financial services industry work together to chart the right course, I'm confident that more and more American workers will embrace the opportunity to save for their retirement.

Why? Because when all is said and done, a 401(k) plan is a great deal. On top of the tax advantages it offers, most employers match some part of their employees' contributions. And participants who move from one job to another can carry those assets with them or roll them over into an IRA.

But there's a more fundamental reason. Americans are by nature independent and self-reliant. Whether it's a home, or a piece of land, or an investment account, to own something – in the root sense of having mastery over and possessing it – gives us a sense of accomplishment and personal dignity.

For many Americans of previous generations, ownership of securities was a privilege reserved for the affluent. But 401(k) plan participation turns savers into investors. It gives them unqualified ownership of stock or bonds or both and the power to manage them as they wish.

Who wouldn't want that?

There are millions of Americans who would like to join the ranks of investors through access to 401(k) plans, and thousands of businesses that would like to accommodate them.

If all interested parties in government and the private sector maintain a single-minded determination to make it easier for employers and workers to get into the game, then I think we'll see phenomenal growth in 401(k) participation in the coming years.

Finally, some of you may be wondering – why do ICI and Paul Stevens talk about this so much? I'll tell you why. It's because in this decade alone Americans have entrusted our industry with $4.6 trillion in retirement assets and have added $900 billion of new retirement savings.

So, it is an awesome and sobering responsibility that working Americans have given us. It's a responsibility we should all feel proud to bear. And we owe it to them to do our level best.

I thank you all for listening. We have a terrific conference in store, so I'll give the podium back to Ed Bernard, who will introduce Google Vice President and Chief Internet Evangelist Vinton Cerf.
