



Retire?.. What's "Meant"?

The Role of
Defined Contribution
Plans in Today's

New (Retirement) World Order



401(k) and other Defined Contribution plans offer retirement saving and investing opportunity to millions of individuals. Current economic conditions and the impending retirement needs of the Baby Boomers are a call for us to think hard about how to build upon and improve the way we save for retirement at work. In this piece, we explore a number of those proposals.

Our economy has changed in ways that we never could have imagined 30+ years ago, when 401(k) plans first burst on the scene, a byproduct of the Employee Retirement Income Security Act of 1974, and a technical amendment to the Internal Revenue Code made in 1978.

And, now, it appears as if 401(k)s – and their cousin 403(b) and 457 plans – are taking an unfair share of the blame for a situation they did not create. For clarity's sake, we write about employer-sponsored retirement investment programs in aggregate, meaning “plans that enable employees to invest their own money for retirement, through payroll deduction, and receive tax advantages on that investment, and its earnings, until they retire. Amounts withdrawn from the plans are subject to income tax. Amounts withdrawn before retirement age are subject to additional penalty tax.¹ These – except when otherwise noted – are “Defined Contribution” or DC plans.

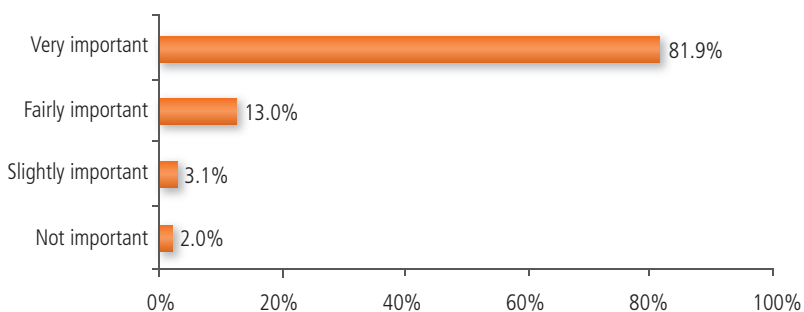
Defined Contribution (DC) – an employer-sponsored retirement investment plan (most popularly 401(k), 403(b) and 457 plans) into which employees invest, tax deferred. What’s “Defined” is the “Contribution,” or the money that goes into the plan through employee, and sometimes employer, investments.

Defined Benefit (DB) – what’s traditionally thought of as a “Pension” plan, in which an employer invests on behalf of employees. What’s “Defined” is the “Benefit,” or the amount that an employee will receive in retirement benefit payments. This benefit is based on a complex formula involving salary and years of service, and is dependent on an employer remaining solvent.

Defined Benefit	Defined Contribution
Funding: Primarily Employer	Funding Responsibility: Primarily worker (potential for employer matching; some (less utilized) arrangements, such as Profit Sharing, are employer-funded)
Participation Decision: Employer	Participation Decision: Primarily worker (potentially loses employer match in choosing not to participate)
Initial and Ongoing Investment Decisions: Employer	Initial and Ongoing Investment Decisions: Worker (within options available under the plan)
Payout Formulas: Employer, potentially with some worker choice as to form	Payout Method: Worker decides

Matter of Opinion²

Those who do invest in employer-sponsored retirement plans find these plans to be a key part of their retirement planning. ING asked, “How important to you is your employer’s plan (i.e. 401(k), 403(b) / 457) to you when it comes to investing for retirement.” Our customers responded...



1 With the exception of Roth 401(k)s and 403(b)s, which provide investment of after-tax dollars with tax-free investment growth. The “Roth” provision is relatively new and not widely adopted among current DC plans.

2 ING-conducted on-line customer survey, April 10 – May 21, 2009, of 747 current retirement plan participants in ING-managed 401(k), 403(b), 457(b) and other IRC plans.

People invested in these plans and, for what might seem to be the first time (but is not), they have lost money. They can't retire, or can't retire as well as they may have planned. Or so say many headlines, making it seem so clear cut...people who saved through their employer's plans are now in trouble because they did so.

Less publicized are other questions:

- Where, would or could these individuals have saved otherwise?
- Is what's left better than nothing at all? (Only five percent of individuals who do not have access to a DC plan at work invest in an Individual Retirement Account³.)
- In those plans with an employer match, has the immediate return of that match been factored into reported "negative" returns?
- To what extent do "negative" returns represent originally invested dollars – versus returns on original investments?

DC plans have taken a reputational hit because, over the years, tectonic shifts in our society have given them a role they were never intended to play: Solely – or even largely – responsible for fulfilling the retirement income needs of their investors. So, when these plans fall short – of something they were never expected to be – in conjunction with the enormous challenges we face in virtually all aspects of the economy today, it becomes clear that we need to examine our retirement system in general.

A "Perfect Storm" situation brings attention to the Defined Contribution system and asks it to do even more⁴:

- Stocks slide
- Home values are down
- Consumer credit tightens
- Healthcare costs rise
- People are living longer

Part of the Problem (s)

We start with the consideration that DC plans were "invented" as a way for workers to supplement Social Security and their employers' pensions. And yet "between 1979 and 1999 there was a 17 percentage point decline in the proportion of employees covered by traditional Defined Benefit (DB) plans and a 12 percentage point rise in the share of employee covered by Defined Contribution (DC) plans.⁵" A number of factors can help account for this shift, among them:

- Shorter employment relationships
- The rise of women in the workforce
- Weaker attachments to specific employers and greater demand for more portable pensions
- Falling union membership
- Rising proportion of white-collar workers⁶

The gradual shift from wide(r)spread DB to DC retirement coverage

certainly had its roots in these and other changes in society; also consider that DC plans are easier and less expensive for employers to offer and it's clear to understand how the shift began to occur.

Shorter – and more – employment relationships can vastly decrease (or eliminate) the benefits of a DB plan for an individual. DC plans give these individuals an alternative that, while tied to their employment, can move with them.

Also, DC plans first began to gain popularity during a long bull market with a strong economy. (Remember the talk about "401(k) millionaires" during the late eighties?)

Certainly DC asset have taken hits in the past, but this time, the "hits" are widely publicized and occurring when the first of the Baby Boomers are starting to think about retiring. In the past "stay the course" messages and strategies helped individuals cope; loss isn't loss while it's still on paper. Today, however, those losses can be startlingly real for individuals on the cusp of actually needing their investment.

Next, is the consideration that a great many American workers don't have access to a DC plan in the first place. Small employers are less likely to offer these plans than are large employers... and more than half of U.S. workers are employed by establishments with less than 100 employees; 43 percent in establishments with fewer than 50 employees. The largest employers, with 1000 or more employees, employ only 11% of the U.S. workforce⁷.

3 "More Workers are Preserving Retirement Assets", 401khelpcenter, January 15, 2009

4 "Big Slide in 401(k)s Spurs Calls for Change," Eleanor Lase, the Wall Street Journal, January 8, 2009

5 "Are Firms or Workers behind the Shift away from DB Plans?" Stephanie Aaronson and Julia Coronado, Finance and Economics Discussion, Division of Research Statistics at Monetary Affairs, Federal Reserve Board, Washington, DC, 2005-17, February, 2005.

6 Ibid.

7 "Business Employment Dynamics: Tabulations by Employer Size," U.S. Bureau of Labor Statistics, Working Paper, Working Paper 385, December 2005

Hard for Small Employers: Reality or Myth?

Popular belief holds that 401(k) and similar plans are too expensive, complicated and potentially liability-inducing for “small” employers, or those who lack the resources for dedicated plan oversight and/or consultation.

In fact, smaller employers have more options than they may realize:

- Retirement plan specialists can help obtain proposals and bids, wade through options and design plans
- Several providers offer simpler, low-cost alternatives to complicated plan design and fund menus, as well as on-line and other tools to help analyze funds, compare plan features, manage plan operations, etc
- Fiduciary protections, from warranties to actual contractual arrangements, can help minimize – or eliminate – an employer from action on the part of investment-angry employees.
- SAR SEP, SIMPLE IRAs; Solo, Individual-, and SBO-k; Money Purchase; Profit Sharing and more... different plan arrangements can offer flexibility and affordability to employers

Various recordkeeping and testing requirements, fiduciary and administrative concerns, and expense, often make providing a DC plan daunting for a smaller employer, who does not have the expertise, or dedicated benefits resources, to manage these plans.

Making retirement investment more broadly available is a cornerstone of nearly every proposal currently on the table, whether it's easing the perceived burden on employers, or encouraging more broadly pooled accounts, or increased government contribution and/or sponsorship.

On the Table

This material highlights key issues of several initiatives. Lawmakers and industry organizations are giving serious attention to a number of proposals and bills. This piece offers no predictions about the likelihood that any of these proposals will be enacted. This information is provided as guidance and general information. It is not tax or legal advice.

Several “fixes” have been proposed, ranging from scrapping the entire DC universe and replacing these plans with government-run

programs, to various degrees of government and employer involvement, to plan design changes that encourage broader availability and better utilization by those who do invest.

Government Guaranteed Retirement Accounts Mandatory for all Workers

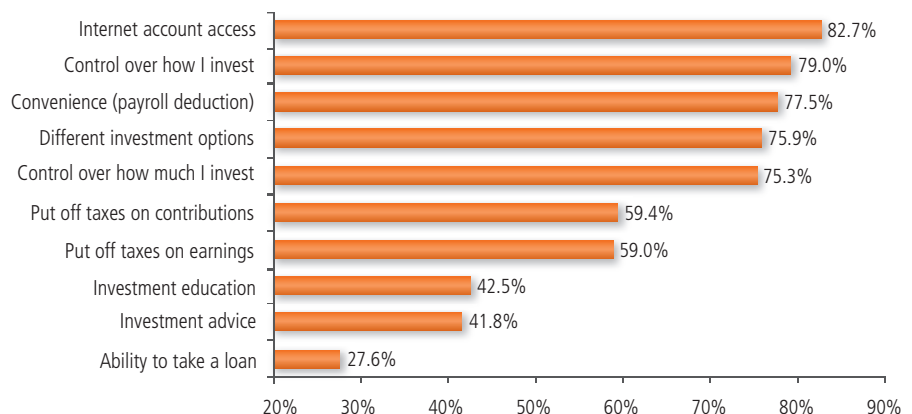
One “new” system proposes government-sponsored Guaranteed Retirement Accounts, in which every worker would be required to contribute 5% of salary. The government would match the contribution with a \$600 contribution, and also guarantee a 3% inflation-indexed return. Withdrawals before retirement would not be allowed and, at retirement, a maximum percentage of the account could be withdrawn as a lump sum; the balance would become an annuity. The government “contribution” (as in most plans that call for a government contribution) would be funded by eliminating or reducing the current tax benefits afforded to Defined Contribution investors.

Super Simple Plans Reduce Employer Administrative Responsibility

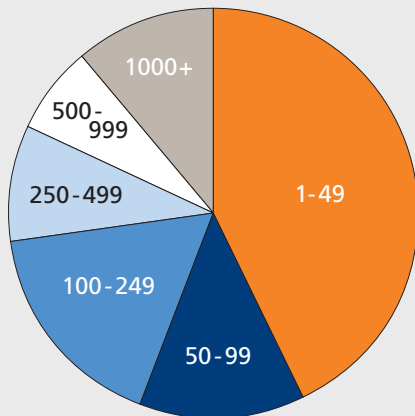
Super Simple programs are another proposal, which would eventually

Control and Convenience top the List⁸

What do retirement investors value most about their employer’s – plans? Answering **very important...**



⁸ ING-conducted on-line customer survey, April 10 – May 21, 2009, of 747 current retirement plan participants in ING-managed 401(k), 403(b), 457(b) and other IRC plans.



Most Americans are Employed by Small Companies

Employees:

1 - 49	43%
50 - 99	13%
100 - 249	16%
250 - 499	9%
500 - 999	7%
1000+	11%

Source: "Business Employment Dynamics: Tabulations by Employer Size," U.S. Bureau of Labor Statistics, Working Paper, Working Paper 385, December 2005

replace all current DC plans with plans that require none of the testing that often makes DC plans challenging for employers. The employer would be required to contribute three percent, employees would be automatically enrolled at four percent, with contributions automatically escalating by one percent to a maximum of eight percent. This would eliminate the currently inflation-indexed maximum contribution limits currently imposed on these plans, and government "contribution" would consist of retaining the tax-deferral benefits of contributions, and an enhanced Savers Credit for low- and middle-income investors. Employees could opt out and take loans – but only against their own contributions.

Automatic IRAs

Companies with 10 or more employees, that don't offer a regular DC plan, would have to automatically deduct employee contributions into an IRA. Employees would be automatically enrolled, but free to opt out.

State K / Universal Retirement Account: Economies of Scale at the State Level

This proposal in the state of Washington gives small employers access to a lower cost plan alternative by using the state's Department of Retirement Systems to administer 401(k) accounts and IRAs for small businesses and the self-employed.

Common themes emerge; shared by many proposals:

- Increased government involvement – in the form of sponsorship and/or contributions, usually funded by eliminating tax benefits for DC plans in the current environment
- Automatic features – Automatically enrolling employees in available plans, periodically increasing contributions, making annuity or annuity-like income payments during retirement an automatic plan feature

While early buzz about "killing the 401(k)" has receded dramatically, what's clear is that change is required. The reality of today's world is that DC plans have to play a vastly expanded role in helping create income for tomorrow's retirees and that their current state of availability, utilization and design elements may not support the new expectations.

ING and the ING Institute for Retirement Research welcome the opportunity to help research and build a new state of retirement that could result in improved retirements for individuals and the financial health of our society overall.

Popular Belief

- Retirement is a responsibility shared between individuals, government and employers
- The government should
 - Strengthen Social Security
 - Make it easier for employers to offer pensions
 - Give / keep tax incentives to save
- People Want
 - Portability
 - Employer contributions
 - Benefits continuation for spouses
 - A guaranteed stream of income they can't outlive (Guarantees are based on the claims-paying ability of the issuing insurance company.)

Source: "Pensions & Retirement Security: A Roadmap for Policy Makers," Mathew Greenwald & Associates, National Institute on Retirement Security, January 14, 2009

In all likelihood, there's no single proposal or "fix," but rather the solution will come from a combination of what's already been proposed...

- Government Match
 - Government Sponsorship
 - Expand the Saver's Credit
 - Keep Tax Deferral
 - Get rid of Tax Benefits
 - Better Education
 - Index Investing
 - Automatic Enrollment
 - Automatic Escalation
 - Automatic Annuity
 - Mandate Employer Contributions
- ... and quite possibly other tactics and solutions we haven't even thought of yet.
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Employee retirement investment plans – whatever the form and whatever the features – have a critically important role in retirement planning for individuals and for those who employ them. During this time of change in the retirement plan world, it's advisable to align yourself with a strong, strategic provider, such as ING, who strives to be at the forefront of monitoring and adjusting to the changes we will likely see in the coming months and years.

www.ing-usa.com www.ingretirementplans.com

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