

The Nationwide
Retirement
Education
InstituteSM

America's Retirement
Voice

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Trends in Public Sector Retirement Plans
Executive Summary



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About the Nationwide Retirement Education Institute Panel of Advisors

Nationwide Retirement Solutions launched the Nationwide Retirement Education Institute (REI or the “Institute”) to evaluate the degree of retirement readiness of public sector employees. The Institute’s mission is to provide a credible, unbiased forum for thought leadership and research that improves the state of public sector employees’ retirement.

Thank you to REI’s Panel of Advisors. Their passion and support enhance the lives of both plan sponsors and public employees. The panel’s collaborative energy and insight inspired this publication.

Retirement Education Institute Panel of Advisors

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America’s Retirement Voice does not reflect the views of individual REI panel members or their firms, but is a compilation of research and findings from viable industry organizations and resources. It is the hope of Nationwide and the REI that *America’s Retirement Voice* is both comprehensive and provocative in its presentation of industry-wide research.



Section 1. Executive summary

Public sector overview

Historically, public sector employees have counted on employer-funded benefits to provide most, if not all, of their retirement income. Today this mindset is changing as there is increasing awareness of employees' personal responsibility for their financial needs, both now and in the future. As a result, there is a renewed effort to promote and enhance the supplemental retirement programs — 457, 403(b) and 401(k) plans — to help employees be financially ready for retirement.

Personal savings is becoming even more important in the private sector since the number of defined benefit plans that are being closed and replaced with 401(k) plans is increasing. Today, pension benefits continue to play an important role in the benefits package provided to state and local government employees. But there is growing concern about their ability to be the single source of retirement income. Continuing budget pressures are causing some public entities to examine alternatives, including:

- Establishing a hybrid or defined contribution plan as an option or alternative to the current defined benefit pension
- Modifying the existing defined benefit plan structure by increasing the retirement age (for full benefit eligibility) or reducing benefit levels for new employees



There are also uncertainties about public employers' ability to continue supporting retiree health care coverage. Employers face significant program costs as well as new accounting rules that begin in 2007. The new rules will require disclosure of long-term retiree health care liabilities on financial statements. Reporting these liabilities could potentially raise entities' borrowing rates. As a result, more state and local government employers are exploring and/or implementing cost-saving measures such as increasing retirees' share of premiums, establishing caps on premiums paid by the employer and imposing additional limits on eligibility requirements.

Due to increasing budget pressures of defined benefit plans and health care, state and local government employees will likely need to save more to meet their retirement needs. This places greater emphasis on supplemental retirement plans in the public sector. As a result, employers are focusing on increasing employee plan participation by simplifying both the enrollment and investment selection processes. An additional priority in both the public and private sectors is to help employees manage their assets and income streams throughout their retirements.

457 participant activity shows positive progress...

Since the first *America's Retirement Voice* report was released in 2004, we have seen several positive trends within public sector supplemental retirement plans, starting with participation rates. In 2003, about 30% of employees, on average, had an account in their employer-sponsored 457 plan. In two years, this participation rate increased more than 4% to about 34% of employees. Other positive trends include:

- Average account balances increased 12% and annual deferral, 8%.
- The difference between the average public and private sector annual deferral is narrowing (\$3,800 versus \$3,956, respectively).
- Improvements in diversification are dramatic as the percentage of participants investing in three or more asset classes has increased from 19% in 2000 to 39% in 2005.
- Although public sector employees lean towards more conservative investments, the use of asset allocation funds is significantly increasing. This is particularly evident among younger participants (ages 18 to 35) since three in ten are choosing to invest in a lifestyle or lifecycle fund as their single investment choice, up from one in ten in 2003.

...Still work to be done

While public employees are making progress with their savings, there are still concerns about their retirement readiness. While participation rates have increased over the last two years, more than 65% of employees are still not taking advantage of their 457 plans.

Participants' conservative approach to asset allocation is also concerning, especially given the fact that the majority of participants have pensions that are conservatively invested.

Overall, the lack of employee involvement in their deferred compensation plans suggests even greater simplification is needed, including "do-it-for-me" services such as managed accounts, asset allocation funds and automatic enrollment and increases.



Participants investing in three or more asset classes is up 20% from 2003 to 2005.

General attitudes and service preferences

When creating education and service models to meet employees' needs, it's important to understand the attitudes and behaviors behind their financial decisions. Nationwide conducted a comprehensive consumer study of private and public sector employees that compared participants versus non-participants in their employer-sponsored retirement plans. The findings included:

- Only one-quarter of all employees identified that saving for retirement is a priority goal, while four in ten participants (both public and private sector) identified retirement savings as a priority goal.
- Almost half of public sector participants feel they are better prepared for retirement than most people their age, compared to four in ten private sector participants and about one-third of all employees who believe they are better prepared.
- More than half of all workers say they use the Internet for consumer purchases, but less than one in ten use the Internet to research or buy *financial* products or services. Employees who participate in either a 457 or 401(k) plan are slightly more likely than non-participants to use the Internet to research financial products.

The research on participant activity within the plans points to the consistent need for educational services to be provided through multiple mediums. Many participants prefer to make investment decisions face-to-face or by phone, but there is also increased use of plan web sites for both information and transactions.

While participants prefer to use multiple mediums to manage their accounts, no single medium dominates (as evidenced by the statistics shared below from Figures 39, 40 and 41 of this report). For simple needs, such as changing an address, participants are more likely to contact a call center or use the plan's web site. For help with more complex questions, such as changing their account's asset allocation, face-to-face help or assistance by phone becomes more important to participants.

- Seven in ten participants prefer personal contact whether by phone or face-to-face.
- Four in ten participants prefer face-to-face contact when completing more complex service transactions, such as changing their account's asset allocation.

Although Internet usage continues to increase each year, most online inquiries are often for informational purposes only (e.g., obtaining account balance information) and less frequently to execute transactions.

- Eight in ten customer service contacts (e.g., obtaining account balance) are handled through the web.
- Only three in ten participants use the web for more complex transactions (e.g., fund exchanges).



More than 80% of participants access the web for customer service.

The payout phase: retirement income management

For decades, the industry's focus has been on helping employees' accumulate assets. As baby boomers retire, employers and plan administrators are challenged with helping employees shift into the payout phase — managing their assets and generating income throughout their retirement.

The traditional scenario — retiring at age 65 and collecting a pension and Social Security — isn't so simple anymore. Retirement is becoming more complex. Today's workers are planning a longer, more active lifestyle that often includes working into retirement years before entering full retirement. Potential changes to Social Security, Medicare and pension benefits also cause uncertainties.

Providers servicing the public and private sector defined contribution markets are responding to this change with a variety of products and services geared to participants who are near, or in, their retirement years. *Retirement income management* services are being developed to help participants understand their choices (e.g., to rollover or not to rollover) and how to invest and withdraw assets to ensure they last throughout their lifetime.

In regard to products, immediate income annuities are being explored as a desirable feature of employer-sponsored defined contribution plans to provide participants an option to establish a guaranteed level of income for life. Annuities outside of a retirement plan that guarantee principal, income, or both, are additional examples of solutions to help retirees receive adequate and reliable income. Products like these will continue to expand and evolve as the baby boomer generation moves into retirement.

Looking ahead

Over the past few years, retirement has become the “hot topic” for policy makers, regulators and media. In Washington, lawmakers proposed several initiatives during 2005 to enhance employer-sponsored defined contribution plans and encourage workers to save for retirement. Retirement and investment issues are covered daily in magazines, newspapers and on TV, creating a new awareness among workers of the importance of adequately planning for their financial future.

Although there are positive trends occurring within the 457 plans of state and local government employers, more work needs to be done to ensure employees are prepared for their retirement years. The data and analyses within this report can be used by plan sponsors, policy makers and industry supporters to understand today's plans and participants and establish creative solutions to improve public sector employees' retirement readiness.

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