

October 5, 1995

The Honorable E. Olena Berg
Assistant Secretary
Pension and Welfare Benefits Administration
U.S. Department of Labor
200 Constitution Avenue
Room 52524
Washington, D.C. 20210

Re: **Key Savings and Investment Concepts for
Participant Education in Defined Contribution Plans**

Dear Olena:

Thank you for your initiatives to encourage savings and investment education for defined contribution plan participants. This is an area of considerable importance to CIEBA members and one that is important to the nation as a whole. We would like to reiterate our commitment to work with you towards the following goals:

- To increase the national savings rate and reduce the forecasted shortfall in the country's retirement system by encouraging plan participants to meet their personal retirement savings needs.
- To assist plan sponsors by defining some basic investment information/education materials that can be provided to defined contribution plan participants.
- To clarify for plan sponsors the distinction between investment information/education and investment advice, providing a safe harbor under the Employee Retirement Income Security Act (ERISA) and applicable securities laws.

To provide a foundation for our joint efforts, we thought it would be useful to identify the concepts which CIEBA members have found most important in educating their defined contribution plan participants.

Background

As you know, a number of CIEBA companies have already undertaken comprehensive participant education efforts. Examples have been shared with you and your staff over the past year. Many companies, however, are hesitant to provide such extensive guidance for fear of crossing the line between participant education and investment information into the area of investment advice. To the extent that the Department, alone or in conjunction with the Securities and Exchange Commission (SEC), is able to provide specific examples which distinguish investment education and information from investment advice, more plan sponsors and their service providers will feel free to provide information. It is in this regard that a safe harbor would be very useful to plan sponsors.

Key Savings and Investment Concepts

We have broadly grouped key educational concepts under savings and investment areas.

Savings concepts include:

- the importance of saving for retirement;
- the advantages of defined contribution plan participation;
- and, goal setting before and during retirement.

Investment concepts include:

- asset allocation;
- managing risk and return;
- and, understanding the objectives and characteristics of defined contribution plan investment options.

We have also included a number of examples which could be used to illustrate the key concepts.

Savings Concepts

The Importance of Saving for Retirement:

- put defined contribution plan savings in perspective *by providing tools* to estimate individual retirement needs and how they may be met by a combination of Social Security, employer provided defined benefit and/or defined contribution plans, and outside savings including Individual Retirement Accounts (IRAs).

The Advantages of Defined Contribution Plan Participation:

- the convenience and discipline of saving by systematic payroll deductions;
- the added savings from automatic or matching employer contributions;
- the advantages of tax-deferral on before-tax contributions to 401(k) plans;
- the benefits of tax-deferred compounding of investment earnings inside 401(k) and other defined contribution plans;
- the availability of plan loans as an alternative to savings-depleting withdrawals;
- the ability to leave balances in your plan or take advantage of portability and rollover opportunities to other employers' plans or IRAs when changing jobs and at retirement.

Goal Setting Before and During Retirement:

- how much defined contribution plan savings can grow over time;
- the benefits of starting to save as soon and as much as possible and continuing to do so throughout one's working years - the sooner you start and the more systematically you continue to do so during your working career, the more retirement savings you can accumulate;
- how even small amounts can grow into large balances over time;
- the importance of not dipping into your retirement savings before retirement;
- recognizing that retirement savings must last a lifetime and should be kept *effectively invested* during your many post-retirement years, and not withdrawn all at once upon retirement or before it is needed during retirement;
- the importance of keeping ahead of inflation both before and during retirement.

Examples that would serve to reinforce these messages would include graphic projections of:

- **Growth of Systematic Savings Amounts:** how much retirement money would accumulate if "A,B,C" amounts are contributed each month over "D,E,F" years to retirement earning at "G,H,I" rates versus inflation;
- **Point to Point Growth of Even Small Amounts:** how small to large "A,B,C" amounts of defined contribution plan account balances earning at "D,E,F" rates would grow by retirement versus inflation if left in the plan or rolled over when changing jobs, and how much retirement savings are depleted by prematurely withdrawing and spending the money;
- **Advantages of Tax-Deferred Compounding:** higher tax-deferred growth of "A,B,C" amounts over "D,E,F" years earnings at "G,H,I" rates in defined contribution plans versus lower growth if investment earnings currently taxed at "J,K,L" rates;
- **Making Savings Last a Lifetime:** life expectancies at various retirement ages and illustrations of how long savings would last if "A,B,C" amounts are withdrawn monthly after retirement and balances continue to be invested at "D,E,F" tax-deferred earnings rates versus inflation, both until and beyond average life expectancy (many people live longer than statistically expected) or in the event of disappointing investment performance.

Investment Concepts

Asset Allocation:

- generally means how much should be allocated to equity (stock) or fixed income (bond, money market and "stable value") investments, and depends on your investment objective, your tolerance for risk and your investment time horizon;
- historically higher long term equity returns compared to fixed income returns and inflation;
- more volatile (subject to larger and more frequent ups and downs) equity returns over

short periods;

- volatility of bond returns - bond prices fall when interest rates rise, and vice-versa;
- money market and other stable value investment returns are typically nonvolatile but only slightly ahead of inflation;
- reminder that the available equity, fixed income and stable value options each have their own risk and reward characteristics. *Useful illustrations would include:*
 - **"Wealth Charts"** showing long term growth of money invested in equities (e.g., S&P and/or small stock indices), bonds (5 and/or 20 year Treasuries), Treasury Bills and inflation over 10, 20 or 30 year time frames;
 - **"Rolling Returns Charts"** showing 1, 5, 10, 20 or 30 year returns on such asset classes and inflation each year-end since, (e.g., 1970 or a later year);
 - **"Bar Charts"** showing 10 to 20 recent quarterly or annual returns for relevant asset classes to better illustrate short-term volatility.

Investment Time Horizons:

- the farther you are from retirement, or the less apt you are to need to borrow or make withdrawals during your working career, the more short term risk you may be willing to take to maximize your returns and stay farther ahead of inflation over the long term;
- inflation becomes a bigger enemy when you retire and stop working;
- with increased life expectancies, "younger" retirees have a greater capacity to take short term risk and a greater need for higher longer term returns than "older" retirees; no hard and fast, infallible asset allocation formulae - depends on factors such as age, investment objectives, tolerance for risk, other assets and sources of income, and need for funds. *Hypothetical examples might include:*
 - Young worker: up to 100% equities
 - Older retiree: up to 100% fixed Income
 - In between: 80%/20%, 60%/40%, 40%/60%, 20%/80%, some other mix, or even a simple rule of thumb such as a fixed income allocation percentage no larger than your age.

Managing Risk and Return:

- re-evaluate your asset mix and investment goals at least annually or as your personal financial circumstances change, and rebalance your assets accordingly
- diversify your investments so as not to put all your eggs in one basket;
- use dollar-cost-averaging - buying or selling fixed dollar amounts of volatile investments on a set monthly, quarterly or other regular basis - to diversify over time and avoid buying at highs and selling at lows (you use a form of dollar-cost-averaging when you direct your contributions each month, and also after retirement when you withdraw part of your funds on a monthly basis and leave the balance invested in the plan or an IRA);
- think hard before you engage in market timing - even investment professionals have

found it impossible to predict short term market movements on a consistent basis.

Useful illustrations would include the following or other examples:

- **Historical Returns:** historical (e.g., recent or rolling 1, 5, 10, 20 year) returns on different asset mixes and inflation, e.g., 70% stocks/20% bonds/10% bills, 50⁰/30%/20%, 20%/30%/50%, 10%/20%/70%, or other mixes;
- Dollar-Cost-Averaging: hypothetical illustrations of dollar-cost-averaging in up, down, sideways markets;
- **Market Cycles:** examples of market cycles comparing the effect of "good" timing (buying at the bottom and selling at the end of up cycles), "bad" timing (buying at the top and selling at the end of down cycles), and riding out up and down cycles or following a systematic program such as dollar cost-averaging.

Understanding the Objectives and Characteristics of Defined Contribution Plan

Investment Options:

- descriptive and statistical materials on each investment option similar to those enunciated in the ERISA 404(c) Regulations and the SEC's recent Profile Prospectuses initiative, such as:

Goals and Objectives:

- brief description of each option's goals or objectives;

Investment Strategies:

- brief description of each option's investment policies, including a short description of the types of securities in which it invests or will principally invest and any special investment practices or techniques it employs;

Risks:

- brief narrative description of each option's principal risk factors; bar chart and numerical past performance data to illustrate risk/volatility;

Appropriateness:

brief description of any characteristics that might make an option unsuitable for inclusion in certain participants' portfolios (e.g., special risks, investment time horizon, high volatility);

Fees, Commissions and Expenses*:

- explanation of the class of shares purchased in the defined contribution plan and the extent to which any front-end or deferred loads or other sales charges are

- waived on plan investments;
- quantification as a percentage of assets of any unwaived load or other sales charges and of recent fund operating expenses;
- commissions, if any, charged on purchases or sales of company stock, expressed in cents per share;

Past Performance*:

- a table showing each option's annual total returns in numerical form, for: each of the last 10 calendar years (or shorter periods if 10 years not available);
- year-to-date, calendar quarter, 1, 5 and 10 years (to the extent available) as of the end of the most recent calendar quarter, exclusive of any front-end or deferred sales charges (where such charges are not waived, the fact that they are not reflected should be disclosed);

Yields*:

- for money market and other stable value fixed income options such as GIC/BIC funds, the fund's yield, current as of the end of the most recent calendar quarter.

*Some CIEBA companies furnish such up to date information on fees and expenses, commissions, performance and yields with quarterly participant account statements, and front-end and deferred sales charges are typically waived.

Conclusion

Although 99% of CIEBA members sponsor both defined benefit and defined contribution plans, published studies indicate that few, if any, new defined benefit plans have been established in recent years. The number of defined contribution plans has increased substantially, however.

The growing reliance on defined contribution plans in providing retirement income increases the importance of adequate education and information for plan participants. The Department's assistance in distinguishing between investment information and investment advice will enable and encourage plan sponsors and their service providers to provide the kinds of education and information that plan participants need to save and invest effectively for their retirement.

Thank you for consideration of CIEBA's Defined Contribution Savings and Investment Concepts. We look forward to working with you on this issue.

Sincerely,

Myra R. Drucker
Chair