May 2002
Vol. 23 Number 5

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Notes

Defined Contribution Plans With Rate-of-Return Guarantees

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Introduction

The growth of defined contribution (DC) plans among retirement systems throughout the world is a notable development in retirement income security over the past 20 years. One key characteristic that sets DC plans apart from more traditional defined benefit (DB) plans is their treatment of investment risk: DC participants assume *all* investment risk associated with retirement plan benefits directly related to investment returns, whereas in DB plans the plan sponsor bears the investment risk.[1] Because employers do not guarantee a specific benefit level to DC plan participants, the amount of risk assumed by workers in these plans is a growing concern for some, as illustrated by the bankruptcy of Enron Corp. and the losses that many Enron workers subsequently experienced in their DC individual accounts.

A number of changes have been suggested in light of concern over downside equity risk. Strategies include:

- Changing investment options, such as mandatory portfolio diversification, restricting portfolio choice to relatively low-risk alternatives, and investing in guaranteed-return products.
- Government oversight and regulation of retirement funds.
- Requirements that participant risk be shared by some other party (e.g., the plan sponsor or an insurance company).
- Incorporating a rate-of-return guarantee in the plan design.

Generally, countries permit or encourage some combination of these approaches, depending in part on the level of economic development and the role DC plans play in the overall retirement income system.[2] This article examines the last strategy mentioned above—rate-of-return guarantees—in DC plans around the world. Since some advocates in Congress and elsewhere argue that Enron has demonstrated the need for some sort of "insurance" for American workers' 401(k) retirement accounts, it is relevant and informative to explore how other systems have already addressed this issue.

Mandatory DC Plans With Guarantees

Defined contribution plans in other nations are sometimes mandated for all or most wage and salary workers as well as for employees of a particular employer, industry, or for those covered by a collective bargaining agreement (Turner and Rajnes, 2001). These plans can be conveniently separated into two categories: those with a

Figure 1

RATE OF RETURN GUARANTEES IN MANDATORY DEFINED CONTRIBUTION PLANS FOR SELECTED COUNTRIES, BY GUARANTEE LEVEL

Country/Type of Guarantee	Guaranteed Level of Return
Absolute Level Guarantee	
Malaysia	2.5% nominal – government.
Singapore	2.5% nominal – government.
Switzerland	4% nominal – employer, central government fund.
Uruguay (state-run only)	2% real – government.
Relative Guarantee	
Argentina (private sector)	Lower of 70% of average nominal return for all plans or 2% below the average return.
Argentina (state-owned bank)	Higher of private-sector guarantee or a cumulative rate for savings accounts at the state-owned bank.
Chile	Lower of 50% of average real rate of return for all plans or 2% below that average return.
Colombia	Minimum level of return based on composite average return of all pension funds plus performance of the three national stock exchanges.
Hungary	Minimum rate set each year, depending in part on expected market rates.
Poland	Lower of 50% of average nominal rate of return for all plans or 4% below that average return.
Uruguay (private sector)	Lower of 2% real rate of return or the average return for all pension funds minus 200 basis points.

Source: Adapted from John Turner and David Rajnes, "Rate of Return Guarantees for Defined Contribution Plans," *International Social Security Review* (October–December 2001: 49–66).

relative guaranteed return, and those with an *absolute* rate-of-return guarantee. This distinction is illustrated in Figure 1. Without exception, mandatory DC plans with relative guarantees (lower half of Figure 1) operate as a privatized component of social security systems. The usual framework entails licensing pension funds that compete to manage assets for participants in the social security system. A fairly restrictive regulatory environment is applied to limit the risk exposure of plan participants.

By comparison, the DC plans identified as having absolute level guarantees (upper portion of Figure 1) are more diverse, and include provident funds,[3] nationwide employment-based systems, and publicly managed pension funds that compete with private-sector funds in partially privatized social security systems. Determination of the guarantee tends to be in an ad hoc fashion that gives administrators room for discretion.

Plans With Relative Rate-of-Return Guarantees—A relative guarantee provides a specified return relative to an index. Such an index may consist of the yield on one or more government securities and/or the average rate of return for all pension funds. These guarantees usually are structured so that the rate of return credited to a worker must fall within a band around the index, regardless of the actual rate of return earned by the plan's portfolio, with the excess return above the band being placed in a reserve fund to be used when the portfolio return falls below the minimum. The end result is a smoothing of returns to the portfolio over time.

These design features can be demonstrated by examining the approach adopted in Chile. In the early 1980s, the Chilean system replaced a traditional DB social security system with a network of pension fund management companies. The system provides a relative guarantee that has been a model for much of Latin America and some countries in Europe (Figure 1). The guarantee is based on the average return for all pension funds for the previous 36 months, varying monthly according to a 36-month rolling average, and equals 50 percent of the average real rate of return or 2 percentage points less than the average—whichever is lower. If fund performance falls below the minimum required, then the worker's pension account is credited with the minimum rate rather than the actual rate of return earned.

The Chilean guarantee has multiple sources of financing. Should the rate of return on a pension fund fall below the guaranteed rate, the fund manager is required to make up the difference through the pension fund's reserve fund. Should that fund prove inadequate, the pension fund must make up the difference from its own internal resources. If these resources are insufficient to cover the guarantee, the shortfall is made up by the government from general tax revenues, the pension fund management company is liquidated, and the pension fund accounts are disbursed to other pension fund management companies.

Other countries share this basic approach with modifications. In Colombia, the system functions in many respects like Chile's, but with one difference: The index consists of a combination of average pension fund industry performance and a

composite index of financial sector performance (Queisser, 1997). Poland uses a 24-month (rather than 36-month) averaging period on which the guarantee is based, and the index bandwidth extends to 4 percent (instead of 2 percent) below the pension industry average. Also, there is an additional financing source for the guarantee when fund-specific sources are inadequate: a national guarantee fund, with assets from pension fund payments and a portion of their investment income. A national guarantee fund also exists in Hungary; somewhat differently, the minimum and maximum rates of return credited to a Hungarian worker's account are arbitrarily set each year. If a pension fund's investments exceed the maximum rate of return in any quarter, a portion of the surplus is transferred to the pension fund's reserve fund. When a fund's performance falls short of the required minimum, money from the reserve fund is transferred to worker accounts.

Chilean-style guarantee frameworks exist also in Argentina and Uruguay, but are unusual in that they permit the operation of both private-sector and public-sector funds. In Uruguay's partially privatized social security system, the government guarantees a real rate of return of 2 percent annually for a competing state-owned and managed company fund. For private-sector companies in Argentina, the minimum rate of return is similar to Chile's but defined in nominal instead of real terms. A state-owned bank, Banco de la Nacion, manages a pension fund management company that provides an additional guarantee, not available in the private sector, in an amount equal to what would have accumulated for contributions into a standard savings account (less administrative fees). Guarantee reserve funds are required as in Chile, and the government remains the guarantor of last resort.

Mandatory Plans With Absolute Guaranteed Returns—The guarantee framework for these plans is much less complicated than that of DC plans with relative guarantees, and the guarantee is set in a more straightforward way.

National provident funds in Singapore and Malaysia provide an absolute guaranteed return equal to a nominal 2.5 percent a year (upper portion of Figure 1). In most years, these funds pay above this minimum rate. In Malaysia, the return is decided in advance on a monthly basis; in Singapore, the interest rate paid to members of the fund is an average of the 12-month deposit and month-ending savings rate of the four major local banks—subject to the minimum guarantee. While both funds rely on the government as a guarantor, the financial backing arrangements differ somewhat. The Malaysian government directly makes up any shortfall to pay the guaranteed return to participants of the Employees Provident Fund; in Singapore, the Central Provident Fund invests exclusively in government funds that pay a return set at the guaranteed rate.

Switzerland guarantees a minimum nominal rate of return of 4 percent for pension plans that have been a part of its mandatory employment-based pension system since 1985.[4] This guarantee is backed first by the employer and then by a privately managed central guarantee fund supported by mandatory contributions from all pension funds. The investment income credited to the worker's account is not directly linked to the performance of pension fund portfolios, which have tended to contain a sizable equity component. Because of the recent fall in global equity markets, Swiss companies have begun to use their own reserves to make up the shortfall—and as a result, proposals are being made for a more flexible application of the guarantee (Watson, 2002; White, 2002).

Voluntary DC Plans With Guarantees

Voluntary DC plans with guarantees are not subject to the regulatory burden associated with relative guarantees in mandatory plans, but share the smoothing of portfolio performance feature by maintaining a reserve. Through smoothing, some of the volatility risk can be transferred back to the retirement fund. In years of poor investment performance, declared rates can rely on this reserve. In years of good investment performance, some of the return is held back in the reserve. This section examines voluntary DC plans with guarantee features for two groups: plans in countries outside the

Figure 2
VOLUNTARY DEFINED CONTRIBUTION PLANS WITH GUARANTEES, SELECTED COUNTRIES

Country and Plan Design	Noteworthy Features of the Guarantee
Brazil	
Open pension funds	Required real rate of return 6% per annum; excess return paid into workers' account based on tenure; no longer available on new accounts.
Denmark	
Occupational plans	Insurance contracts provide a guaranteed rate with a maximum set by the government and further restricted by the European Union; participant may receive excess yields above allocation to reserve funds; maximum guaranteed rate declining in recent years with fall in market interest rates.
Germany	
Occupational plans	Guaranteed minimum rate of return available in some industries.
Japan	
New supplementary plans	New system (2001) mandates that participants have three investment options, including guaranteed total principal.
New Zealand	
National Provident Fund	Primarily for employees of local governments, it is now closed to new entrants; the fund credits member accounts a nominal rate of return equal to 4% per annum financed through conservative asset allocation and use of a reserve fund; government backs any shortfall.
Sweden	
Supplemental plans	Negotiated by blue-collar trade unions and employers; minimum guarantee is one option with return set historically in a range of 3%—4%.
United Kingdom	
Combined DB-DC plan	Worker receives the higher of the two plan benefits calculated.

Source: Author's compilation.

United States (Figure 2), and voluntary plans in the United States (Figure 3).

Plans With Guarantees in Selected Countries—Brazil does not mandate DC plans, as do many Latin American countries with privatized social security systems. However, the majority of pension assets in voluntary pension plans in Latin America (both DB and DC) are held in Brazil. When pension funds are available to any worker or firm, they are referred to as "open" pension funds. These plans can operate on either a group or individual plan basis. For DC plans, a guaranteed real rate of return of 6 percent per annum has been required in the past, with any excess return made available to the worker as an annual payment or allowed to accumulate in the worker's account (Kane, 1998; World Bank, 2000). A decline in real rates of return has meant that these guarantees are no longer provided on new accounts.

A number of countries have voluntary plans tied to collective bargaining agreements (Figure 2). In Denmark, most employees are members of trade unions and covered by pensions that are mandated by labor agreements. These occupational pension funds are almost exclusively DC plans that purchase insurance contracts, which generally provide a guaranteed rate of return. The Danish government sets a ceiling on the guaranteed rate allowed. A participant may receive a higher rate of return if the fund's investment experience permits paying such a rate. Excess yields above the guaranteed rate, however, are first allocated to reserve funds. Reserve funds are used to meet the guarantee when the rate of return falls below the guarantee level, but they also pay for bonuses above the guarantee level, depending on the reserve fund level. Maximum guaranteed rates have been steadily declining—from 4.5 percent nominal during much of the 1990s to 2 percent or less on new insurance policies—due to the downturn in financial markets.

Other countries have pension arrangements based on collective bargaining. Sweden's supplemental pensions for blue-collar workers, which are negotiated between the national trade union confederation and the Swedish employers' confederation, offer a guaranteed rate of return as an option (EIRO, 1998). The option consists of an insurance fund that provides a stable rate of return with a guaranteed minimum set by a national supervisory board. The minimum rate of return is set periodically in the range of 3 percent to 4 percent. In Germany, some sectors (construction industry) and certain large employers (e.g.,

Figure 3

VOLUNTARY DEFINED CONTRIBUTION PLANS WITH GUARANTEES—UNITED STATES

Sector and Plan Design	Noteworthy Features of the Guarantee
Church and Other Nonprofit Plans	
United Methodist Church	Interest credit set annually by oversight board and backed by a reserve fund financed by a portion of returns in better-than-average years.
Young Men's Christian Association	Guarantee set annually by board of trustees for the following year and backed by a reserve fund; if fund reserves warrant, trustees may declare extra interest credits to active participants and even retirees.
Public-Sector/State Retirement Systems	
State of Indiana Guaranteed Fund	DC plan option available to all state employees; backed by funds of DB plan in which all employees are required to participate; guaranteed under Indiana state law; principal growth based on interest credit rate determined each year by the board of trustees.
Ohio State Teachers Sec. 401(a) plan	New plan option (2001) offering a 7.75% return p.a. backed by the system's DB plan; initial entrants must remain in the option for five years, whereas future participants may receive a higher or lower guaranteed return; excess returns on investment are placed in the DB plan.
Texas' Counties Alternate Plans	Investments in fixed income marketable securities provide a guaranteed minimum nominal rate of 4% with workers and the insurer sharing any excess returns.
For-Profit, Private-Sector Plans	
Nonqualified executive plans	Method of increasing compensation to executive employees.
Floor offset plans	Provide a guaranteed minimum benefit by linking returns from a DB and a DC plan.

Source: Author's compilation.

Volkswagen) guarantee a rate of return in the same range (EIRO, 2001).

Defined contribution plans with guaranteed returns are also offered outside of nationwide collective bargaining agreements. In Japan, voluntary DC plans have been available since December 2001 (IBIS, 2002). These require that workers have three investment options to choose from—one of which must be a guarantee of the contributions made to the plan. In the United Kingdom, some employers offer a defined benefit and defined contribution plan in combination (*The Economist,* 2002),[5] and the worker receives the higher of the two benefits. If the DC plan provides a low rate of return relative to the DB plan, then the worker receives the benefit promised by the DB plan. Thus, the guarantee is that the worker will receive the benefit provided by the defined benefit plan, with the worker receiving the benefit from the defined contribution plan if that is higher.

The National Provident Fund in New Zealand—established primarily for the employees of local governments, but now closed to new members—operates a reserve fund, as in Denmark, whereby in good investment years part of the investment returns are placed in a reserve fund, which can be drawn on when investment returns fall below 4 percent nominal (the rate of return guaranteed by the fund). When the worker leaves the plan, the actual amount in the plan is compared with the amount that would have been in the worker's account if the worker had received a rate of 4 percent during the entire period. If the actual amount is less, the government makes up the difference.

Plans With Guarantees in the United States—Voluntary DC plans with guaranteed returns in the United States exist in at least three sectors: church and other nonprofit plans; public-sector retirement systems; and nonqualified private-sector plans that do not receive preferential tax treatment from the Internal Revenue Service (Figure 3). These plans are not governed by the Employee Retirement Income Security Act of 1974 (ERISA), the primary federal law governing most private-sector benefit plans.

- ***Among church plans,*** the United Methodist Church sponsors a DC plan with a guaranteed return. The level of the guarantee credited is declared annually. The guarantee is backed by a reserve fund financed in part by the return received on the fund in years when the rate of return exceeds a fixed amount. If the actual rate of return exceeds the guaranteed rate (6.5 percent for many years but reduced to 3 percent in 2001), the excess goes into the reserve fund (GBOPHB, 2002). Twice a year, the reserve fund is evaluated; if it exceeds the target level, an extra distribution is made to the accounts of participants.

- ***Among non-profit organizations,*** the Young Men's

Christian Association (YMCA) provides a guarantee for its Sec. 401(a) retirement plan that also has a reserve fund (YMCA Retirement Fund, 2002). Trustees meet in November of each year to set the rate of return that will be credited to participant accounts for the following year. If the trustees decide that the reserves are sufficiently large, it declares extra interest credits to active participants in addition to the amount that it guarantees for the following year, and may make extra payments to retirees. Like the Methodist Church plan, the YMCA also utilizes a reserve fund to allow for rate-of-return smoothing over time.[6]

- ***Among Public-Sector Retirement Systems,*** there are several that offer DC plans with guarantee features. In 2001, the Sec. 401(a) plan of the Ohio State Teachers' Retirement System (Ohio STRS) began providing a guaranteed 7.75 percent annual rate of return backed by the system's DB plan as one of the options available to participants in the DC plan.[7] The guarantee is offered only to participants who agree to leave their money in the option account for five years. The asset allocation of the option's investment portfolio parallels that of the system's DB plan, and any shortfall is made up from the funds of the defined benefit plan, while any excess is placed in the DB plan (Kennedy and Jacobius, 2001). Indiana is another state retirement system that offers a guarantee as one of several options for workers participating in the DC plan. In this case, a guaranteed return is tied to the actuarially assumed rate used for the state's DB retirement fund—the guarantee (net of fees and expenses) has been fixed at 8.25 percent since 1997 (Turner, 2000). The rate of return for the Guaranteed Fund is backed by the funds of the DB plan, which all employees are required to participate in and which is guaranteed under Indiana law. Another public-sector arrangement with a guarantee feature is the Alternate Plans operated by Galveston, Mattagorda, and Brazora counties in Texas. In 1981, these three counties replaced their Social Security programs for county workers with a system of individual accounts. The Alternate Plans provide employees a guaranteed minimum nominal rate of return of 4 percent,[8] by purchasing Group Fixed Annuity Contracts from a life insurance company.

- ***Among Private-Sector Firms,*** rate-of-return guarantees are sometimes provided to top executives, tied to deferred executive compensation programs. For example, nonqualified DC plans offered to executives may include a rate-of-return guarantee feature. Frequently, these programs are not funded; they are bookkeeping accounts. Another arrangement—available to nonhighly compensated employees as well—is the "floor offset" plan, which provides a guaranteed minimum benefit. A floor offset plan is actually a combination of a defined benefit plan and a defined contribution plan that are linked.[9] Often, they are structured so that in most cases the worker receives a benefit only from the defined contribution plan, with the DB plan making up the difference only if the DC plan fails to provide the guaranteed minimum benefit.

Plan Design Issues and Policy Considerations

The range of guarantee features for DC plans suggests a wide variety of conditions and motivations at work. Major factors contributing to these different outcomes could include: the nature of the plan sponsor, significance of the plan in overall retirement income security, regulatory environment, and level of economic development. For example, it can be argued that governments often establish guarantees for mandatory DC systems partly out of concern for fairness as much as for minimizing participant risk. In the case of privatized social security systems and provident funds, guarantees limit the range of rates of return received by participants. Moreover, guarantees are also a means of monitoring and controlling

Figure 4
KEY FACTORS AND DESIGN CONSIDERATION FOR RATE-OF-RETURN GUARANTEES

Factor	Design Consideration
Measurement	Absolute or indexed. Real or nominal rate. Averaging period.
Determination process	Fixed rule or discretion.
Insurance provided by guarantee	Mandatory or voluntary. Risk sharing. Risk of guarantee changing. Individual or plan basis.
Financial backing	Level of funding. Party(ies) financing the guarantee. Party(ies) backing the guarantee. Guaranteed product or plan guarantee.
Financial costs	Administrative costs. Expected return. Restrictions.

Source: Adapted from John Turner, "The Design of Rate of Return Guarantees for Defined Contribution Plans," *Journal of Pensions Management*, Vol. 7 (2001): 55–63.

the performance of pension funds, assuring that no pension fund receives a rate of return significantly worse than the rest (Turner and Rajnes 2001). Such multiple objectives are much less likely to play a role in the establishment of voluntary DC plans, where a single plan sponsor (employer) is apt to be more focused on attracting and retaining a skilled work force in a cost-effective manner.

Figure 4 summarizes the range of guarantee features that can be incorporated into plan design. Five major issues can be mentioned in this context: measuring the guarantee; discretion allowed in guarantee specification; level of insurance provided by the guarantee; financial backing available; and financial costs.

- ***Measuring the guarantee.*** While *relative* rate-of-return guarantees are often used in mandatory DC plans, *absolute* rate-of-return guarantees are commonly used in voluntary plans. Nearly all voluntary DC plans with a guarantee appear to guarantee a nominal rate. Mandatory plans sometime establish the rate of return in nominal terms, although this is more likely with absolute guarantees, where the relatively low levels observed are less costly to the plan sponsor. While averaging periods for calculating the rate can range from 12 months to 36 months with relative guarantees (Latin America), a longer period may occur for returns earned on a cumulative basis (Argentina, New Zealand). An interesting variation on this theme is the requirement to retain participants' funds in the plan for a minimum period of time (Ohio STRS).

- ***Specification of the guarantee.*** A more subjective approach to setting the guaranteed rate occurs with voluntary DC plans dependent on a supervisory board. By contrast, a fixed rule applies to mandatory plans—with both flexible and absolute guarantees—although the variability in the rate for flexible guarantees is higher by definition.

- ***Insurance provided by guarantee.*** Risk-sharing possibilities vary according to the arrangements. In the case of a reserve fund, the guarantor (institution or employer) may capture excess returns above the guarantee level or pass them along to the plan participant. The presence of minimum and maximum guarantee levels is another feature that complicates the design. The ability to shift risk may be flexible, depending on the mandate. In mandatory defined contribution plans, the guarantee feature is nearly always mandated and not optional. By comparison, the guarantee can be offered as one of several investment options in some voluntary contribution plans (Denmark, Japan, Indiana). Even in these voluntary plans, the participant does not control the choice of the investments in the DC account. Thus, the guarantee may apply to a plan totally or to individuals who select the guarantee option. Accepting the guarantee assures a given rate of return that may be above or below what the participant would actually have received with investment options.

- ***Financial backing***. Voluntary plans that provide a guarantee generally have only a single source of backing for the guarantee, such as a reserve fund. By

contrast, the guarantees for mandatory plans generally involve multiple sources of backing for the guarantee, such as a reserve fund, a claim on the assets of the pension fund provider, a central fund, and a government guarantee. Reserve funds may not be appropriate in every case (e.g., qualified retirement plans covered by an ERISA-type statute). In voluntary plans, the government may provide a guarantee, but then only if it is guaranteeing a fund for its own employees (such as Indiana). Both voluntary and mandatory plans generally use advance funding to back a guarantee and frequently do so through a reserve fund. When guarantees are provided through a reserve fund, investment earnings from the pension fund are generally put in the reserve fund to be used later to back the guarantee when rates of return on the pension portfolio exceed certain levels above the guarantee. Alternatively, associated DB plans are sometimes used to back the guarantee. These may play either an active role (floor-offset type of arrangement) or a more passive role (Ohio STRS).

- ***Financial Costs.*** Both mandatory and voluntary types of guarantees entail financial costs to participants as well as plan sponsors. While these features may reduce the financial risk (that is, the possibility of actual asset losses) in portfolios, they also may lower the expected return received. In addition, they may entail administrative costs of compliance as well—again, reducing the net return received by workers. Finally, DC plans with guarantees may restrict the range of portfolios available to plan participants, thus limiting the choices available to workers with differing degrees of willingness to bear financial market risk.

Conclusion

An examination of DC plan rate-of-return guarantees implemented in the United States and in other countries reveals several points relevant to the current debate in Congress over limiting investment flexibility in American workers' 401(k) accounts.

First, there are different ways that have been tried—but all of them involve a cost. The tradeoff for greater investment safety seems likely to entail less investment choice, lower investment returns, and higher administrative expenses. An illustration of this point for 401(k) accounts is instructive (VanDerhei, 2002). Recent simulations of the EBRI/ERF Retirement Income Projection Model show that for plan participants born between 1956 and 1970, if employers were forced to guarantee a minimum rate of return of 5 percent nominal for a suitable investment instrument (e.g., such as a guaranteed investment contract) for all existing 401(k) balances and contributions, then the average expected 401(k) account balances available at retirement would decrease between 25 percent and 35 percent. Such an outcome is likely to be unpopular with at least some young employees and other plan participants with a greater risk tolerance and higher expectation of returns to their portfolios who are more willing to accept greater exposure to financial market risk.

Second, whatever type of rate-of-return guarantee that is used often depends significantly on the presence or absence of a defined benefit retirement plan *in addition to* a defined contribution retirement plan. While an associated DB plan can lend support to the guarantee feature in a DC plan, sometimes the plan sponsor may feel that the arrangement provides inadequate support and opt for additional measures to ensure account stability. This can take the form of restrictions or penalties such as requiring the plan participant to maintain the funds in the account for a specified period of time or pay a penalty for early withdrawal.

Third, the "minimum" or "guaranteed" benefit is likely to fluctuate (i.e., shrink), depending on economic conditions. Such volatility can be observed with guarantees in both mandatory and voluntary DC plans. Among mandatory DC plans, relative rate-of-return guarantees are naturally more volatile, but the ongoing dialogue in Switzerland about modifying their guarantee for occupational pension plans suggests that "absolute return" guarantees are far from permanent. Also, there

is ample evidence to indicate how rate-of-return guarantees have changed or disappeared entirely for voluntary DC plans in some countries following a downturn in financial markets. Modification of the guarantee based on an annual review appears to be common for voluntary DC retirement plans that utilize a reserve fund for income smoothing, but the potential for a negative impact on participant returns should be noted.

Lastly, at some point the government ultimately is likely to become the insurer of last resort. This was observed for all mandatory DC plans with guaranteed return features and in certain public-sector voluntary DC plans in the United States. Proposals to transfer part or all of the investment risk inherent in DC plans from the employee to another entity, such as the employer, a government agency, or a private insurance company, have recently been suggested.[10] Based on the evidence, a mandatory guaranteed return would involve one or more of these sources to back the guarantee in addition to the federal government. If the federal government were to become involved in providing some type of insurance rather than requiring employers to do so, it would necessitate the creation of some sort of pooled fund with a centralized administration (Schieber, 2002). Although such a framework operates in certain European countries, it is not clear that U.S. policymakers would be willing to impose such a framework for guaranteed returns on participants.[11]

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Endnotes

[1] See VanDerhei and Copeland (2001) for a summary comparing other aspects of DB and DC plans.

[2] For example, when DC plans serve as a mandatory component of the social security system, they tend to encourage risk reduction policies more than when they act as a supplement in a conventional social security system.

[3] A provident fund is a DC plan in which the fund is managed by the public sector. These funds collect contributions that then are invested largely in government securities.

[4] This system complements a traditional DB social security system.

[5] Similar to a floor offset plan in the United States.

[6] A reserve fund is not permitted by the Employee Retirement Income Security Act of 1974 (ERISA) because the statute stipulates that all investment earnings must be allocated to the accounts of the individual participants.

[7] Participants choosing the option in future years may be offered a higher or lower guarantee.

[8] The Alternate Plans are a secondary source of retirement income for these workers. Their primary retirement benefit is provided under the Texas County and District Retirement System, another defined contribution plan (U.S. General Accounting Office, 1999).

[9] Technically, this is a hybrid design since it shares features of both DC and DB plans.

[10] Jefferson (2002) discusses how stable-value investment contracts play a role in insuring against market fluctuations and offers a detailed proposal for defined contribution plan insurance.

[11] For example, the recent Social Security Commission chose not to include any return guarantees suggested for the individual accounts created in the Social Security reform options (Schieber, 2002).

Washington Update

401(k) Reforms Await Congressional Action

On April 11, the House of Representatives passed and sent to the Senate legislation to change some of the rules for 401(k) plans, in response to perceived problems in the wake of the Enron bankruptcy. The House action resolved jurisdictional disputes in that chamber by blending three different bills coming out of the tax-writing House Ways and Means Committee, the Education and Workforce Committee, and the Financial Services Committee.

As passed by the House, the bill would give employers the option of allowing employees to diversify company stock holdings either after three years participation in the plan (as President Bush's proposal called for) or after holding shares for three years. It also would exempt employers from liability for employee investment advice provided by the same financial institution that administers the 401(k) plan, as long as conflicts of interest and relevant fees are disclosed.

But at this writing things remain unclear in the Senate, where the Health, Education, Labor, and Pensions Committee narrowly approved a far more restrictive bill that goes significantly beyond administration proposals, as sought by committee Chairman Edward Kennedy (D-MA). However, Sen. Max Baucus (D-MT), chairman of the tax-writing Senate Finance Committee, was pushing a bill much closer to the House approach, which leaves the Senate at odds over crafting a consensus bill for the full chamber to vote on. Given the wide differences that exist on Capitol Hill, it is uncertain (at best) if any 401(k) legislation will be enacted this yearædespite the Enron bankruptcy and intense media attention being given to the issue.

Congress Delays, Treasury Juggles on Debt Ceiling

Because Congress has declined to act on President Bush's request to raise the federal debt limit, the Treasury Department has resorted to borrowing money from a federal employees' retirement fund in order to avoid a government default. Repeating a technique first used in 1996, this temporary move was designed to bridge the gap until massive tax payments were received by the April 15 income tax deadline. But the problem will recur by July unless Congress acts.

Raising the debt limit is always politically difficult, no matter which party is in power. House Republican leaders want to tack the request onto "must pass" legislation on other issues so as guarantee a majority, but Senate Democratic leaders say they'd prefer to pass a bill dealing solely with this issue. The administration and analysts tend to see the vote as needed fiscal housekeeping, but legislators view it as an opportunity to make political hay. But the financial markets may get nervous if the government's borrowing authority is put at risk.

The current debt ceiling is $5.95 trillion. Treasury Secretary Paul O'Neill solved the early April problem by borrowing from the Government Securities Investment Fund, an element of the civil service retirement plan. As in the past, the money would be replaced with interest when the cash crunch eased.

The Congressional Schedule

Although it may seem like Congress has just started its session this year, in fact there is relatively little time remaining for it to do a lot of work. Because of the upcoming November elections, lawmakers plan to quit shortly after the start of the government's new fiscal year on Oct. 1 so they can go home to campaign. And given the month-long August recess, that leaves only four months of scheduled legislative session. But if last year is any guide, lawmakers may have to return late in the year (this time for a "lame-duck" post-election session) to finish their work. Major items to be addressed are the Fiscal 2003 federal budget, raising the federal debt ceiling, and (possibly) enacting new 401(k) regulations.

Social Security Trustees Project Insolvency Delay

The Social Security Trustees recently updated their annual report on the solvency of the Social Security and Medicare trust funds, finding that payments from employees and employers will be adequate to fund promised Social Security benefits until 2017, a year later than what was projected last year. Long term, the Social Security solvency problem could be resolved by reducing benefits by 13 percent or increasing the current tax from 12.4 percent to 14.3 percent of covered payroll, the trustees noted (although they're not recommending either course).

The day of reckoning for the Medicare program is projected to arrive in 2016, when benefit payments would first exceed tax revenues. A 75-year fix for Medicare would require increasing taxes by 70 percent or reducing outlays 38 percent from what is now anticipated, the trustees noted.

NPR Finds Support for Social Security IAs

While it seems extremely unlikely that Congress will act on Social Security this year, a new poll by National Public Radio shows public support for changes that would allow individuals to invest some of their Social Security taxes in equities. By a 55 percent–40 percent margin, respondents backed a plan that would allow such investments. Among those under age 65, 63 percent say they'd choose to participate in such a plan if it were available. The bipartisan pair of pollsters who conducted the survey for NPR also asked whether they thought their anticipated retirement benefits would be adequate; nearly three in four (72 percent) were concerned they wouldn't be.

HHS Proposes Relaxation of Medical Privacy Rules

With the comment period due to close late last month (April), the Department of Health and Human Services is now expected to go ahead with a proposal to relax medical privacy rules adopted by the Clinton administration. As currently proposed by HHS, providers would be allowed to share medical information needed for treatment or reimbursement without prior patient consent. HHS Secretary Tommy Thompson sided with hospitals and pharmacists who say that failing to amend the current rule delays patient care. Many privacy advocates oppose the change.

EBRI in Focus

EBRI Education on the Road

EBRI President and CEO Dallas Salisbury continued his series of presentations on EBRI research findings in April, including these events:

- A speech to The Conference Board in San Diego April 4–5, focusing on impact on benefits of public policy and demographic and economic volatility. The meeting explored major new issues facing benefits planners and administrators.
- The keynote presentation to the Midwest Business Group on Health in Chicago April 9–10, on the topic "Is There a Future for Retiree Health Benefits?"
- *A speech on "Benefits Trends" at the Fidelity Conference in Orlando, FL, April 17.*
- A briefing on the upcoming 2002 Small Employer Retirement Survey (SERS), and a review of larger pension issues, provided to members of Congress at the House Small Business Roundtable, held April 18.

In addition, Salisbury attended (as a member) the second meeting of the General Accounting Office Advisory Board in Washington, DC, April 16, to provide input on current and emerging issues for GAO reports. GAO is the investigative arm of Congress.

On health issues, EBRI Senior Research Associate Paul Fronstin presented results of EBRI

research on trends in health benefits, the uninsured, and health care costs, at the BlueCross BlueShield Florida Lecture Series, held April 2 in Jacksonville, FL. On April 16, he spoke at the National Managed Health Care Congress CEO Summit on consumer-driven health care and managed care.

ASEC Spring 2002 Partners' Meeting

ASEC held its Spring 2002 Policy Board and Partners' meetings on April 24–25, respectively, in Washington, DC. Items on the agenda included a report on the 2002 White House/Congressional National Summit on Retirement Savings; the 2002 Retirement Confidence Survey, the RetireMint' Conference in New York City on May 17–18, 2002 (www.RetireMint.com); an update on the "Save for Your Future" partnership with the Social Security Administration and the SEC Investors Town Meeting in June; and other partner updates.

ASEC Participates on NPR Show

ASEC President Don Blandin was interviewed on National Public Radio's "Diane Rehm Show" April 9 about the importance of preparing financially for retirement. The segment can be heard at: www.wamu.org (click on "The Diane Rehm Show" and look for the "Financing Retirement" segment that aired on April 9). The program is produced in Washington, DC, and nationally syndicated on NPR.

New Publications & Internet Resources

[*Note: To order publications from the U.S. Government Printing Office (GPO), call (202) 512-1800; to order congressional publications published by GPO, call (202) 512-1808. To order U.S. General Accounting Office (GAO) publications, call (202) 512-6000; to order from the Congressional Budget Office (CBO), call (202) 226-2809.*]

Employee Benefits

Buck Consultants. Year-End 2001 FAS 87 and FAS 106 Assumptions. $50. Buck Consultants, Inc., National Survey Center, 500 Plaza Dr., Secaucus, NJ 07096-1533, (201) 553-6400.

John Hancock Financial Services, Inc., produces Country Profiles on CD ROM. For further information regarding the 2001 IGP Country Profiles, please contact Rita Distel, International Group Program, Floor T-23, John Hancock Financial Services, Inc., John Hancock Plaza, Boston, MA 02117, (617) 572-8661.

U.S. Chamber of Commerce. Statistics and Research Center. The 2001 Employee Benefits Study. Chamber members, $50; nonmembers, $75. U.S. Chamber of Commerce, Publications Fulfillment, 1615 H St., NW, Washington, DC 20062, (800) 638-6582.

Financial Planning

Gollier, Christian. The Economics of Risk and Time. $50. The MIT Press, Five Cambridge Center, Attn: Order Dept., Cambridge, MA 02142, (617) 253-2889.

International Society of Certified Employee Benefit Specialists. New Kid on the Block: Financial Planning as an Employee Benefit: Survey Results, December 2001. $25. International Society of Certified Employee Benefit Specialists, P.O. Box 209, 18700 W. Bluemound Rd., Brookfield, WI 53008-0209, (262) 786-6710, ext. 8588, fax: (262) 786-8650, e-mail: iscebs@iscebs.org.

Financial Services

Insurance Information Institute and Financial Services Roundtable. The Financial Services Fact Book 2002. Single copies free to libraries; $27.50 + $2.50 P&H. Insurance Information Institute, Attn: Publications Dept., 110 William St., 24th Floor, New York, NY 10038, (212) 669-9200.

Health Care

Academy for Health Services Research and Health Policy. Shifting Responsibilities: Models of Defined Contribution. Free. Academy for Health Services

Research and Health Policy, 1801 K St., NW, Suite 701-L, Washington, DC 20006, (202) 292-6700, www.ahsrhp.org.

Aventis Pharmaceuticals. Medical Group Practice Digest. $95. Aventis Pharmaceuticals. 399 Interpace Pkwy, P.O. Box 663, Parsippany, NJ 07054, (973) 394-6000.

U.S. Congress. Joint Committee on Taxation. Overview of Present-Law Federal Tax Provisions Relating to Health Care and Selected Health Care Tax Proposals Providing Aid to Displaced Workers and Other Uninsured Individuals. Order from GPO.

William M. Mercer. National Survey of Employer-Sponsored Health Plans: A Stratified Random Sample of All U.S. Employers With 10 or More Employees. Report and tables, $1,000; Report only, $500. Tara Lewis, William M. Mercer Inc., 1166 Avenue of the Americas, 28th Floor, New York, NY 10036, (212) 345-2451.

Human Resource Management

Gilley, Jerry W., Steven A. Eggland, and Ann Maycunich Gilley. Principles of Human Resource Development. Second edition. $45. Perseus Publishing, Eleven Cambridge Ct., Cambridge, MA 02142, (617) 252-5200.

Society for Human Resource Management and University of Maryland, Robert H. Smith School of Business. A Study of Effective Workforce Management. $99.95; SHRM members, $79.95. Society for Human Resource Management, 1800 Duke St., Alexandria, VA 22314-3499, (800) 444-5006.

Pension Plans/Retirement

Mitchell, Olivia S., et al. Innovations in Retirement Financing. $49.95. University of Pennsylvania Press, P.O. Box 4836, Hampden Station, Baltimore, MD 21211, (800) 445-9880, fax: (410) 516-6998.

U.S. Congress. Joint Committee on Taxation. (1) Present Law and Background Relating to Employer-Sponsored Defined Contribution Plans and Other Retirement Arrangements. (2) Present Law and Background Relating to Employer-Sponsored Defined Contribution Plans and Other Retirement Arrangements and Proposals Regarding Defined Contribution Plans. Order from GPO.

Watson Wyatt Worldwide. 2001 Survey of Actuarial Assumptions and Funding: Pension Plans With 1,000 or More Active Participants. $50. Watson Wyatt Worldwide, 1717 H St., NW, Suite 800, Washington, DC 20006, (202) 715-7000.

Social Security

Dixon, John, and Mark Hyde. The Marketization of Social Security. $65. Quorum Books, 88 Post Road West, P.O. Box 5007, Westport, CT 06881-5007, (203) 226-3571, fax: (203) 222-1502.

Work

Golden, Lonnie, and Deborah M. Figart. Working Time: International Trends, Theory and Policy Perspectives. $100. Routledge Customer Service, 7625 Empire Dr., Florence, KY 41042, (800) 634-7064, fax: (800) 248-4724.

Meiksins, Peter, and Peter Whalley. Putting Work in Its Place: A Quiet Revolution. $25. Cornell University Press, Sage House, 512 East State St., Ithaca, NY 14850, (607) 277-2211.

GAO Reports

U.S. General Accounting Office. (1) Medicare+Choice: Recent Payment Increases Had Little Effect on Benefits or Plan Availability in 2001. (2) Pension and Welfare Benefits Administration: Opportunities Exist For Improving Management of the Enforcement Program. Order from GAO.

Documents Available on the Internet

2002 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds

www.ssa.gov/OACT/TR/TR02/tr02.pdf

2002 Annual Report of the Boards of Trustees of the Federal Hospital Insurance Trust and Federal Supplementary Medical Insurance Trust Funds
www.hcfa.gov/pubforms/tr/2002/tr.pdf

2002 Defined Benefit Survey
www.plansponsor.com/surveys/db2002/index_popup.html

Company Stock and Retirement Plan Diversification
prc.wharton.upenn.edu/prc/PRC/WP/WP2002-4.pdf

Health Insurance Coverage in America: 2000 Data Update
www.kff.org/content/2002/4007/

The NCQA Quality Dividend Calculator
www.ncqacalculator.com/Ncqa/Index.asp

Report of the Department of the Treasury on Employer Stock in 401k Plans
www.treas.gov/press/releases/docs/401(k).pdf

Shifting Responsibilities: Models of Defined Contribution Health Plans
www.hcfo.net/pdf/definedcontribution.pdf

Status of the Social Security and Medicare Programs
www.ssa.gov/OACT/TRSUM/trsummary.html

Survey of Fortune 500 Company Benefits Policies for Reserve and National Guard Member Callups
www.roa.org/pdf/home/01_f500_list.pdf

Census Data and Demographic Sites

American FactFinder
factfinder.census.gov/

AmeriStat
www.ameristat.org/

City Population
www.citypopulation.de/

Current Population Survey
www.bls.census.gov/cps/

FedStats
www.fedstats.gov/

International Data Base
www.census.gov/ipc/www/idbnew.html

PopNet
www.prb.org/PopTemplate.cfm

Social Science Data Analysis Network (SSDAN)
www.ssdan.net/

U.S. Census Bureau
www.census.gov/

United Nations Population Information Network
www.un.org/popin/

United States Historical Census Data Browser
fisher.lib.virginia.edu/census/

The World Gazetteer
www.gazetteer.de/

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