INTRODUCTION

Over the past two decades there has been a shift in private-sector pensions away from defined-benefit (DB) plans toward defined-contribution (DC) plans, to the point where, today, more assets are held by 401(k) plans than are held by private-sector DB plans. Indeed, at year-end 2006, 401(k) plans held $2.7 trillion in assets, compared with $2.3 trillion in private-sector DB plan assets (Figure 1). About 50 million workers were active participants in 401(k) plans in 2006, compared with about 20 million active participants in private-sector DB plans. Individual retirement accounts (IRAs) represent more than a quarter of the $16.4 trillion in total retirement assets at year-end 2006. Many of these assets were rolled over from the employer-sponsored plans (both DB and DC). Nearly 4 out of 10 U.S. households, or 42.2 million, owned IRAs as of mid-2006.

As the focus of private-sector employer-sponsored retirement planning has shifted to this account-based approach, where benefits accrue more evenly and balances are portable, research has increasingly focused on analyzing the retirement savings process. This shift in the composition of retirement accumulations toward individual accounts raises (at least) four questions: (1) Are people aware of the responsibility to save for retirement? (2) How well poised for retirement are current pre-retirees compared to previous generations of pre-retirees? (3) How are workers managing in this increasingly account-based environment? and (4) How are retirees managing these accounts in retirement? This paper draws from a variety of data sources to address these questions.

SAVING FOR RETIREMENT, AN IMPORTANT FINANCIAL GOAL

The Survey of Consumer Finances (SCF), a household survey conducted triennially by the Board of Governors of the Federal Reserve System, is used to explore the first question, whether people are aware of the responsibility to save for retirement. Households increasingly indicate saving for retirement is their “most important” savings goal. According to the SCF, the percent of all households indicating saving for retirement is their “most important” goal increased from about 19 percent in 1989 to nearly 35 percent in 2004 (Figure 2).

The importance of the goal of saving for retirement varies by age, as one would expect. In 2004, 17 percent of households whose head was younger than 35 years old indicated that saving for retirement was their most important savings goal, compared with 55 percent of households age 55 to 64 and 31 percent of households age 65 to 74 (Figure 2). Across all age groups, there tends to be increases in the percent of households indicating saving for retirement is their “most important” savings goal since 1989.

Households who indicate that saving for retirement is their “most important” savings goal are more likely to own tax-qualified retirement assets. In 2004, 65 percent of households saying retirement saving was “most important” have retirement assets, compared with 41 percent of households who did not indicate that retirement was their “most important” goal for saving (Figure 2). Generally, the retirement-saving-focused households have higher balances in their tax-qualified retirement assets—a median of $60,000 in 2004—compared with the other households (a median of $25,000 in retirement accounts).

RETIREMENT ACCOUNTS ON PRE-RETIREE'S BALANCE SHEETS

The SCF is also well suited to address the second question posed as to how well poised for retirement are current pre-retirees compared to previous generations of pre-retirees. Balance sheet information for households age 55 to 64, drawn from the SCF, indicates an upward trend in the percentage of pre-retiree households who hold retirement account assets. Indeed, in 2004, 63 percent of pre-retiree households have retirement account accumulations as compared with less than half of the same age group in 1989 (Figure 3).
in retirement accounts by these households has also increased, rising to $83,000 in 2004 compared with $35,200 in 1989 (in real 2004 dollars).7

It is difficult to answer the question of the preparedness of any given household for retirement without knowing the risks and expenses the household faces.8 An ICI (2000b) survey of households who had retired with a DC plan account between 1995 and 2000 found that 34 percent of these recently retired households were “very concerned” about paying for health care needs and another 39 percent were “somewhat concerned” (Figure 4). Maintaining a comfortable standard of living in retirement was the second largest area of concern among retirees, with 28 percent “very concerned” and 41 percent “somewhat concerned.”

**TRENDS IN 401(k) PLAN ACCUMULATION ACTIVITY**

**A Look at the Past**

The trends in 401(k) plan accumulation activity can shed light on how workers are managing in this increasingly account-based environment. There are several positive trends in place in this arena: (1) rates of offering of 401(k) plans and participation once offered are rising, (2) automatic enrollment is beginning to catch on, (3) investment options in 401(k) plans cater to the full range of investor know-how and engagement, (4) loan availability generally increases participation and contributions, but most participants haven’t borrowed from their 401(k) accounts; and (5) the bulk of 401(k) assets are rolled over at retirement.9

There is a rising trend in the offering and uptake of 401(k) plans. Current Population Survey (CPS) data10 indicate that about half of workers in 2003 worked for employers sponsoring 401(k)-type salary reduction plans, compared with 37 percent a decade earlier and only 8 percent in 1983. The participation rate among workers conditional on working for an employer that sponsors a plan also has risen dramatically, to 70 percent in 2003 compared with 38 percent in 1983. Poterba, Venti, and Wise (2007) analyze Survey of Income and Program Participation (SIPP) data to explore trends

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**Figure 1: U.S. Retirement Saving Has Many Components (assets at year-end 2006)**

- **Total: $16.4 Trillion**
  - **Annuities**: $1.6 trillion
  - **Federal, State, & Local Government Plans**: $4.2 trillion
  - **Private Defined-Benefit Plans**: $2.3 trillion
  - **401(k) Plans**: $2.7 trillion
  - **IRAs**: $4.2 trillion
  - **Other Defined- Contribution Plans, 403(b) and 457 plans**: $1.4 trillion

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1 Annuities include all fixed and variable annuities at life insurance companies less annuities held in IRAs, 403(b) plans, 457 plans, and private pension funds (including 401(k) plans).

Figure 2:  Rising Trend in Households Saving for Retirement (percent of households)

<table>
<thead>
<tr>
<th>Age of Head of Household (years)</th>
<th>Yes</th>
<th>No</th>
<th>Yes</th>
<th>No</th>
<th>Yes</th>
<th>No</th>
<th>Yes</th>
<th>No</th>
<th>Yes</th>
<th>No</th>
<th>Yes</th>
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</tr>
</thead>
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<td>Percent Saying Retirement Most Important</td>
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<td>1989</td>
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<td>81.3%</td>
<td>19.4%</td>
<td>80.6%</td>
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<td>65.3%</td>
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<tr>
<td>Percent With Retirement Assets</td>
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<td>38.4%</td>
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<td>70.2%</td>
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<td>$13,200</td>
<td>$32,900</td>
<td>$13,200</td>
<td>$34,500</td>
<td>$16,000</td>
<td>$40,600</td>
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<td>$47,900</td>
<td>$21,300</td>
<td>$60,000</td>
<td>$25,000</td>
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<tr>
<td>Percent Saying Retirement Most Important</td>
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<td>94.6%</td>
<td>7.2%</td>
<td>92.8%</td>
<td>10.6%</td>
<td>89.4%</td>
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<td>17.4%</td>
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<td>$4,800</td>
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<td>32.7%</td>
<td>67.3%</td>
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<td>68.4%</td>
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<td>Percent With Retirement Assets</td>
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<td>23.9%</td>
<td>74.7%</td>
<td>25.3%</td>
<td>73.1%</td>
<td>26.9%</td>
<td>69.3%</td>
<td>30.7%</td>
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<td>$22,000</td>
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<tr>
<td>45 to 54</td>
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<td>33.8%</td>
<td>66.2%</td>
<td>43.5%</td>
<td>56.5%</td>
<td>42.8%</td>
<td>57.2%</td>
<td>46.3%</td>
<td>53.7%</td>
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<tr>
<td>Percent With Retirement Assets</td>
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<td>74.9%</td>
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<td>73.2%</td>
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<td>78.0%</td>
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<td>31.9%</td>
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<td>$44,800</td>
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<td>$52,200</td>
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<td>$69,200</td>
<td>$34,100</td>
<td>$75,000</td>
<td>$36,000</td>
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<tr>
<td>55 to 64</td>
<td>33.6%</td>
<td>66.4%</td>
<td>40.4%</td>
<td>59.6%</td>
<td>35.4%</td>
<td>64.6%</td>
<td>49.4%</td>
<td>50.6%</td>
<td>48.4%</td>
<td>51.6%</td>
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<tr>
<td>Percent With Retirement Assets</td>
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<td>76.6%</td>
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<td>77.1%</td>
<td>26.9%</td>
<td>74.3%</td>
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<td>$29,300</td>
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<td>$32,900</td>
<td>$53,400</td>
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<td>$59,700</td>
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<td>$70,900</td>
<td>$32,200</td>
<td>$90,000</td>
<td>$60,000</td>
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<tr>
<td>65 to 74</td>
<td>22.8%</td>
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<td>26.2%</td>
<td>73.8%</td>
<td>28.1%</td>
<td>71.9%</td>
<td>27.6%</td>
<td>72.4%</td>
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<td>68.7%</td>
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<tr>
<td>Percent With Retirement Assets</td>
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<td>57.5%</td>
<td>49.4%</td>
<td>50.6%</td>
<td>61.5%</td>
<td>38.5%</td>
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<td>$22,000</td>
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<td>$30,800</td>
<td>$81,200</td>
<td>$31,300</td>
<td>$85,200</td>
<td>$55,400</td>
<td>$100,000</td>
<td>$60,000</td>
</tr>
<tr>
<td>75 and up</td>
<td>20.9%</td>
<td>79.1%</td>
<td>20.6%</td>
<td>79.4%</td>
<td>23.7%</td>
<td>76.3%</td>
<td>21.9%</td>
<td>78.1%</td>
<td>22.1%</td>
<td>77.9%</td>
<td>28.0%</td>
<td>72.0%</td>
</tr>
<tr>
<td>Percent With Retirement Assets</td>
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<td>87.1%</td>
<td>19.5%</td>
<td>80.5%</td>
<td>28.2%</td>
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<td>32.7%</td>
<td>67.3%</td>
<td>37.1%</td>
<td>62.9%</td>
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<td>$26,400</td>
<td>$36,900</td>
<td>$15,800</td>
<td>$32,000</td>
<td>$25,900</td>
<td>$40,600</td>
<td>$34,800</td>
<td>$45,800</td>
<td>$49,000</td>
<td>$23,000</td>
<td>$35,700</td>
</tr>
</tbody>
</table>

¹Median retirement assets among households with retirement assets. Retirement assets consist of IRAs, Keoghs, and account-type pension plans (such as 401(k), 403(b), 457 plans, and supplemental retirement annuities). Source: Tabulation of 1989–2004 Federal Reserve Board Surveys of Consumer Finances.
Figure 3: **Pre-Retirees’ Tax-Advantaged Savings** (share of pre-retirees with tax-advantaged savings and median balance in 2004 dollars; households with a householder 55 to 64 years old (n varies by year), selected years)

Note: Tax-advantaged savings include assets in IRAs and DC plan accounts.
in eligibility and participation by worker age. They find an increase in eligibility for 401(k) plans over time for families of a given age. In addition, the SIPP data show an increase in participation rates given eligibility, especially among younger age groups.

Employers use plan design—whether to have matching contributions, whether to allow loans, the number and which types of investment options, whether to implement automatic enrollment—to encourage employees to participate in the 401(k) plan.11 For example, an employer match attracts many workers to contribute to the plan.12 The Profit Sharing/401k Council of America (2003, 2004, 2005, and 2006) reports a rising trend in 401(k) plans adopting automatic enrollment. In 2002, only about 7 percent of 401(k) plans had implemented automatic enrollment, compared with 17 percent in 2005. Automatic enrollment increases participation, particularly among lower-income workers.13 In addition, depending on the default contribution amount and default investment option, automatic enrollment can significantly increase projected accumulations at retirement.14

**A Look to the Future**

After 25 years in existence, at year-end 2006, 401(k) plans had $2.7 trillion in assets. Individual participants hold a range of account values. Younger participants and those who have not been at their current jobs very long tend to have smaller account balances, while older and longer tenure workers tend to have larger account balances.15 It is not possible to judge the ability of 401(k) plans to provide retirement income based on these average balances because even today’s pre-retirees have not had access to 401(k) plans for a full career.16 Thus, it is necessary to look to the future.

To explore what 401(k) accumulations might provide future retirees, the Employee Benefit Research Institute (EBRI)17 and ICI developed a model to simulate future career paths for a group of 401(k) plan participants who were in their late twenties and early thirties in 2000. Holden and Van-Derhei (2002) summarize the model, which uses 401(k) behaviors observed among current participants to project future saving activity for this group out to retirement at age 65 between 2030 and 2039. Because no one knows the future, many different projection scenarios were considered (e.g., varying participants’ behaviors, rates of return assumptions, and 401(k) coverage assumption).18 The “baseline case” (where a current 401(k) participant always has a job, always has the offer of a 401(k) plan, and experiences historical investment returns) finds significant replacement rates in retirement. More than half of these 401(k) participants were projected to replace more than half of their pre-retirement income using their 401(k) accumulations. Poterba, Venti, and Wise (2007) make projections of future 401(k) assets and find significant increases in real 401(k) accumulations.

**RETIRED ACCOUNT DISTRIBUTION ACTIVITY**

The final step in the retirement savings process is managing assets and income in retirement. The final question posed in the introduction is how well are retirees managing these accounts in retirement. Copeland (2005a) reports several positive trends with respect to cash-out and rollover behavior over

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**Figure 4: Issues of Concern in Retirement (percent of respondents)**

<table>
<thead>
<tr>
<th>Issue</th>
<th>&quot;Very Concerned&quot;</th>
<th>&quot;Somewhat Concerned&quot;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paying for Health Care Needs</td>
<td>34%</td>
<td>39%</td>
</tr>
<tr>
<td>Maintaining a Comfortable Standard of Living</td>
<td>28%</td>
<td>41%</td>
</tr>
<tr>
<td>Protecting Your Family from the Unexpected</td>
<td>25%</td>
<td>44%</td>
</tr>
<tr>
<td>Having the Value of Your Investments</td>
<td>21%</td>
<td>47%</td>
</tr>
<tr>
<td>Eroded by Inflation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Managing Financially Should You Become</td>
<td>19%</td>
<td>47%</td>
</tr>
<tr>
<td>Sick or Disabled</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Paying Taxes</td>
<td>15%</td>
<td>31%</td>
</tr>
<tr>
<td>Outliving Your Money</td>
<td>12%</td>
<td>35%</td>
</tr>
<tr>
<td>Managing Financially Should You Lose</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Your Spouse or Partner</td>
<td>10%</td>
<td>26%</td>
</tr>
<tr>
<td>Leaving an Inheritance</td>
<td>8%</td>
<td>27%</td>
</tr>
</tbody>
</table>

time at job change and retirement. For example, among workers taking lump-sum distributions and making a decision with respect to the entire balance, there is a rising trend toward rolling over to another tax-qualified account (an IRA, another employer plan, an annuity).

Looking specifically at recent retirees with DC plan balances, ICI (2000a) finds that 47 percent of retirees chose to take a lump-sum distribution of some or all of their account balance, among those with choice (Figure 5). Twenty-six percent of respondents who had choice indicated they deferred distribution, that is, left some or all of the account balance in the plan. Twenty-three percent annuitized some or all of their DC plan balance and 10 percent chose installment payments from their DC accounts. In addition, 92 percent of those taking a lump-sum distribution reinvested some or all of the balance, typically in IRAs. Indeed, Brady and Holden (2006a) report that the SCF data indicate that about half of traditional IRA assets resulted from rollovers from employer-sponsored (DC and DB) plans.

It is instructive to take a look at IRA withdrawal activity to see what people have then done with their IRAs in retirement. Bershadker and Smith (2006) analyze taxpayer panel data tracked from 1987 to 1996 and find that 42 percent of taxpayers who were age 57 to 63 in 1987 tapped their IRAs “on-time,” which they define as within two years of retirement. Another 45 percent of these taxpayers were “late tappers” waiting until later in retirement to withdraw from their IRAs and only 12 percent tapped their IRAs more than two years prior to retirement. Tabulating ICI household survey information, Holden, Ireland, Leonard-Chambers, and Bogdan (February 2005) find that the most commonly cited reason for taking a traditional IRA withdrawal is to meet required minimum distribution (RMD) rules, which generally dictate withdrawals from traditional IRAs once the taxpayer turns 70½. Experience thus far suggests that retirees postpone taking IRA withdrawals as late as possible in retirement.

For retirees with these accounts, the retirement income generated will typically be just a piece of the retiree’s total income in retirement. Indeed, analysis of the income composition of current households age 65 or older compared with earlier generations of retirees using CPS data finds that Social Security represents half or more of retirees’ income for about 60 percent of retirees (Figure 6). The composition of retirees’ income varies by income quartile. Also analyzing CPS data, Whitman and Purcell (2006) find that among the lowest

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**Figure 5:** Nearly Half of Defined Contribution Plan Participants Opt for Lump-Sum Distribution at Retirement (percent of respondents who had multiple distribution options—multiple responses)

<table>
<thead>
<tr>
<th>Distribution Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lump-Sum Distribution</td>
<td>47</td>
</tr>
<tr>
<td>Deferral of Distribution</td>
<td>26</td>
</tr>
<tr>
<td>Annuity</td>
<td>23</td>
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<td>Installment Payments</td>
<td>10</td>
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</tbody>
</table>

income quartile of people age 65 or older in 2005, 87 percent of their income came from Social Security; 5 percent from public assistance; 3 percent from asset income; 3 percent from pensions; 1 percent from earnings; and 1 percent from “other.” Among the highest income quartile, Social Security is only 20 percent of their income; earnings are 36 percent; pensions, 23 percent; asset income, 18 percent; and “other,” 3 percent.

**CONCLUSIONS**

A trend toward saving for retirement through individual accounts, whether sponsored through the employer (such as 401(k) plans) or focused on the individual (IRAs), is in place in the United States. Developments in the 401(k) plan arena have moved these plans from supplemental in nature to stand-alone plans, with innovation and regulatory changes aiming to further expand their usage. After a 25-year history, 401(k) plans hold $2.7 trillion in assets and there are some 50 million active participants in such plans. Projection models suggest that 401(k) plans have the ability to generate significant balances and income at retirement for future retirees. These accumulations will be just one component of retirees’ income.

**Notes**

1 For a discussion of research analyzing this shift in composition, see Holden, Brady, and Hadley (2006a), which summarizes research results from Aaronson and Coronado (2005); Coronado and Copeland (2004); Papke (1999); Ippolito (1997); Kruse (1995); Ippolito (1995); Gustman, Mitchell, and Steinmeier (1994); and Gustman and Steinmeier (1992).


3 The U.S. Department of Labor (2007) reports there were 20.6 million active private-sector DB plan participants in 2004. It should also be noted that among private-sector wage and salary workers participating in pension plans, some have both defined-benefit (DB) and defined-contribution (DC) plans. For example, in 1980, 83 percent of private-sector pension participants were in DB plans; 40 percent were in DC plans; and 23 percent had both. In 1999, 42 percent of private-sector pension participants were in DB plans; 87 percent were in DC plans; and 28 percent had both. See U.S. Department of Labor (2004).


5 For summary highlights from the SCF, see Bucks, Kennickell, and Moore (2006).

6 The share of retirement assets in households’ financial assets has also risen over time. In 1975, total retirement...
assets (including DB as well as DC) represented 13 percent of households’ financial assets (see Brady and Holden (2006a)). By year-end 2006, retirement assets ($16.4 trillion, reported in Figure 1) represented 39 percent of household financial assets ($42.1 trillion, see Board of Governors of the Federal Reserve System (2007)).

7 For a much more detailed analysis of trends in household wealth, see Gale and Pence (2006).

8 Whitman and Purcell (2006) note that poverty rates among the elderly (age 65 and older) fell between the mid-1960s and mid-1970s in the wake of increases in Social Security benefits. They report that the poverty rate among the elderly fell to about 15 percent in 1975 and was 10 percent in 2005.

9 For a full discussion of these points, see Holden, Brady, and Hadley (2006a).

10 See Holden, Brady, and Hadley (2006b) and Copeland (2005b).

11 For a discussion of the how the various aspects of plan design influence behavior see a review of research in Holden, Brady, and Hadley (2006a). Also see Mitchell and Utkus (2004).

12 See Mitchell, Utkus, and Yang (2005) for analysis of the effectiveness of the employer match on increasing participation. See Holden and VanDerhei (2001) for 401(k) participant contribution behavior around the employer contribution match points.


14 See Holden and VanDerhei (2005).

15 See Holden and VanDerhei (2006b, 2006c).

16 It was November 10, 1981 when the Internal Revenue Service issued proposed rules for Section 401(k) plans. See Holden, Brady, and Hadley (2006a) for a complete history of 401(k) plans.

17 EBRI is a nonprofit, nonpartisan, public policy research organization, which does not lobby or take positions on legislative proposals.

18 See Holden and VanDerhei (2002a, 2002b, 2005, 2006a) for all of the different projection scenarios.


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