SIA RESEARCH
REPORTS

Volume VI, No. 7 July 29, 2005

AUTOPILOT 401(K)S: HOW TO BOOST U.S. RETIREMENT SAVINGS

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MONTHLY STATISTICAL REVIEW

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AUTOPILOT 401(K)S: HOW TO BOOST U.S. RETIREMENT SAVINGS

Introduction

In a recent issue of *SIA Research Reports*, SIA asked whether Americans are sufficiently well prepared for their retirement.[1] This article follows up on that discussion by looking at mechanisms that can boost the most important source of retirement savings: workplace savings plans such as 401(k)s.

Our first article drew two key conclusions: (1) most Americans need to save more to maintain their standards of living in retirement; and (2) many Americans have unrealistic expectations about their retirement prospects. If current trends continue, Americans can be grouped into three distinctive categories of roughly equal size (one-third each):

— Those who are ***on track*** to provide adequately for themselves in retirement, providing they continue to use all of the savings options and incentives available to them;

— Those who are playing ***catch-up*** and will likely experience moderate declines in their living standards during retirement unless they take steps now to save more; and,

— Those who have ***fallen behind*** in preparing for retirement and face a less secure future. This group must do all it can to save more now.

While significant capital gains from the mid 1990s to date – in equities and more recently in real estate – have helped form the bedrock of many Americans' retirement savings, there is little confidence that future capital gains will continue in the double-digits. The implication is that saving on a regular basis throughout one's working life is more important than ever.

Yet many Americans have unrealistic expectations about their retirement prospects and may, therefore, not fully recognize the need to save. Surveys show that there is a mismatch between workers' expectations of retirement income and reality. According to one recent survey, only 62% of workers are currently saving for retirement and 56% of workers accept that they are either a 'little behind' or a 'lot behind' schedule in saving for their retirement.[2] In another survey, two-thirds of participants admitted that they were not saving enough for retirement.[3]

A majority, however, are confident of their prospects, with 65% either 'somewhat confident' or 'very confident' that they will have enough money to live comfortably through their retirement years. Even 37% of workers who have not saved at all for retirement are nonetheless confident in having a comfortable retirement.[4] When quizzed as to why they are so confident despite knowing that they have done little to save for retirement, many say that they expect employers, family and friends, or Social Security to come to the rescue, or they anticipate being able to work in retirement. Simply stated, many workers are reluctant savers who fail to make decisions that are critically important for their own retirement security.

[1] F. Fernandez, R. Mills and E. Rives, "Are U.S. Retirement Savings Adequate?," *SIA Research Reports*, Vol. VI, No. 2, March 8, 2005, http://www.sia.com/research/pdf/RsrchRprtVol6-2.pdf, p. 4.

[2] Employee Benefit Research Institute (EBRI), 2005 Retirement Confidence Survey results, reported in *EBRI Issue Brief No. 280*, April 2005, http://www.ebri.org/surveys/rcs/2005/, pp. 13, 15.

[3] Cited in "Lessons From Behavioral Finance," The Vanguard Center for Retirement Research, 2004, p. 6.

[4] EBRI 2005 Retirement Confidence Survey, op. cit., p. 20.

Why Are People Not Saving?

Surveys reveal a range of reasons that shed light on why people do not save more for their retirement. The following sketches capture some of them:

1) "*I really mean to do it, but I just never seem to get around to it*" – inertia and procrastination are major issues for many would-be savers, who fail to find the time to sit down and make active savings decisions.
2) "*I can't afford to save*" – for many people, current expenditure accounts for almost all – or more than – their income. There is simply no money left at the end of the month to put into a savings account of any sort.
3) "*I don't know where to turn for help*" – in some cases, people recognize that retirement savings are an important issue, but feel that they do not possess enough knowledge to take active steps to address the situation.
4) "*Someone else will provide for me*" – some are confident that things will work out, even if they are not actively saving. This is true in certain cases, particularly for low-income earners for whom Social Security will replace a large proportion of their earned annual income, or for those who will benefit from a defined-benefit (DB) corporate pension. In other cases, it is wishful thinking.
5) "*I'm simply not interested*" – for some people, retirement is a prospect so far in the future that it is simply not worth worrying about.

Individuals do not necessarily fall into just one of these groups – for many, it is a combination of several reasons or different reasons becoming more or less relevant over time.

This broad range of reasons as to why people fail to save also suggests that merely putting money into awareness-raising – either by government or by employers – is *not* in and of itself the solution to raising retirement-savings rates. As we noted above, many workers already know that they are not saving enough, and efforts by employers to encourage greater participation in retirement planning help, but are often not enough to spur people into action. One survey found that one-out-of-five workers who received retirement-planning literature from or attended seminars through their employer modified their retirement planning as a result,[5] but another provides stark evidence of how inertia stymies workers' best intentions. Following company-organized retirement-planning meetings, researchers asked eligible non-participants what changes they intended to make to their retirement planning – and then monitored their actual behavior.

The Role of Inertia in Affecting Retirement Savings[6]

Action	% intending to make the change	% actually making the change
Enroll in company 401(k) plan	100%	14%
Increase 401(k) contributions	28%	8%
Change 401(k) fund selection	47%	15%

5 EBRI 2005 Retirement Confidence Survey, op. cit. p. 12.

6 Choi, Laibson, Madrian, and Metrick, 2001, cited in The Vanguard Center for Retirement Research, 2004, op. cit., p. 7.

Most workers know that they are not saving enough – the challenge is figuring out how to help them overcome the obstacles that prevent them from saving. The good news is that there are a variety of methods that have proven successful in helping workers save more for their retirement.

Workplace Retirement Savings Schemes Are Effective

Nearly half of workers do not have access to an employer-sponsored retirement plan, but of those who do, 82% choose to participate.[7] By contrast, only 31% of workers have an individual retirement account (IRA) established with money saved outside of an employer's retirement plan.[8]

Defined-benefit retirement plans, where retirees benefit from a pre-determined and guaranteed level of retirement income, have been in decline in the United States for decades. Once the most common form of workplace savings plan, only 20% of all workers were covered by a DB plan in 2003.[9] But since workers are automatically covered and the employer makes all contributions in most DB schemes, participation is extremely high (100% in 2003).[10]

Concurrent with the decline of DB pension plans has been the rise of defined-contribution (DC) plans, in particular 401(k) plans. According to recent data 43-million plan participants had accumulated $2.1 trillion in plan assets as of year-end 2004.[11] Corporate retirement-savings plans are a vital resource for a secure retirement for millions of Americans. While federal regulations place some limits on the structure of DC retirement plans, employers maintain broad discretion over the design of their plans, and the correct planning can do much to boost their employees' retirement-savings prospects. A recent study examined the role that 401(k) accumulations might play in retirement by analyzing certain factors that influence actions for 401(k) participants.[12] Broadly speaking, DC plan design could increase employees' retirement savings if it considered how to: (1) raise the participation rate among eligible workers; (2) increase the amount contributed to the plan by participants; and, (3) improve the asset allocation choices.

Goal 1: Increasing the Percentage of Workers Enrolled in Workplace Savings Plans

Survey data shows that roughly 20% of workers eligible for participation in their company's 401(k) plan simply fail to sign up.[13] The figure is higher still for younger workers. By one

[7] "47th Annual Survey of Profit Sharing and 401(k) Plans," Profit Sharing/401(k) Council of America, 2005, www.psca.org/data/47th.html. The Bureau of Labor Statistics reports a participation rate of 78% for defined-contribution plans in 2003. See "Automatic Enrollment in Section 401(k) Plans," Congressional Research Service Report for Congress, October 2004, p. 2.

[8] EBRI 2005 Retirement Confidence Survey results, op. cit., p. 7.

[9] Congressional Research Service Report for Congress, op. cit., p. 1.

[10] Unless specifically stipulated, all references to retirement-savings plans in this article are to defined-contribution workplace 401(k) plans.

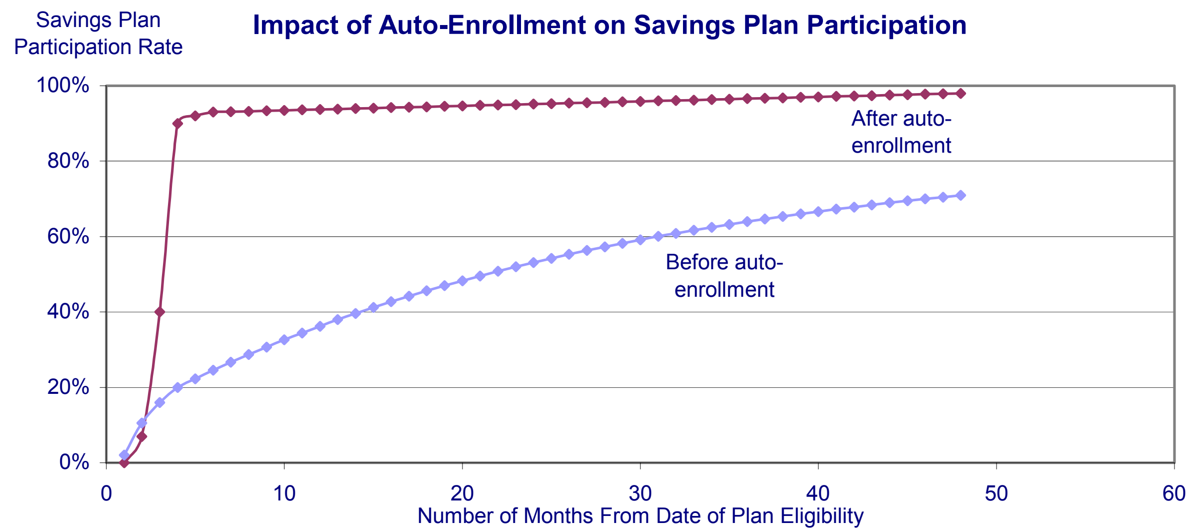
[11] S. Holden and J. VanDerhei, "The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement," Investment Company Institute's *Perspective*, Vol. 11, No. 2, July 2005, www.ici.org/pdf/per11-02.pdf, p. 1.

[12] Ibid.

[13] "Automatic Enrollment: Benefits and Costs of Adoption," The Vanguard Center for Retirement Research, May 2001, p. 2.

estimate, 55% of eligible employees age 20 to 29 fail to participate.[14] The principal reason appears to be inertia. Because participation in a 401(k) plan has traditionally been voluntary, the default option is not to be enrolled.[15]

One approach that has been shown to dramatically increase participation in 401(k) plans is automatic enrollment. In an 'auto-enrollment' workplace retirement-savings plan, new employees are automatically enrolled in the plan unless they choose not to participate. Enrollment is hence the default option. Auto-enrollment changes the 401(k) plan enrollment process from requiring active input to enroll to requiring active input *not* to enroll. This means that inertia helps boost participation, rather than hold it back. The effects can be startling. The following chart compares the enrollment rate at a company that switched from a standard, voluntary enrollment regime to an auto-enrollment regime.



Source: J. Choi, D. Laibson and B. Madrian, "Plan Design and 401(k) Savings Outcomes," *NBER Working Paper 10486*, May 2004, Figure 1A.

This outcome can be disaggregated into two separate effects: *faster* participation and a higher overall *rate* of participation. As would be expected, auto-enrollment pushes up participation rates much faster than the traditional voluntary approach. But it is also striking that even after three years of job tenure, workers hired under an auto-enrollment regime have participation rates at least 30 percentage points higher than the standard, voluntary regime.[16]

Evidence suggests that most workers are receptive to an auto-enrollment plan. From a survey of workers who do not participate in their employer's 401(k) plan, two-thirds said that they would be likely to stay in a retirement plan if their employer automatically enrolled them in one. Only 22% said that they would be not at all likely to stay in the plan if automatically enrolled.[17]

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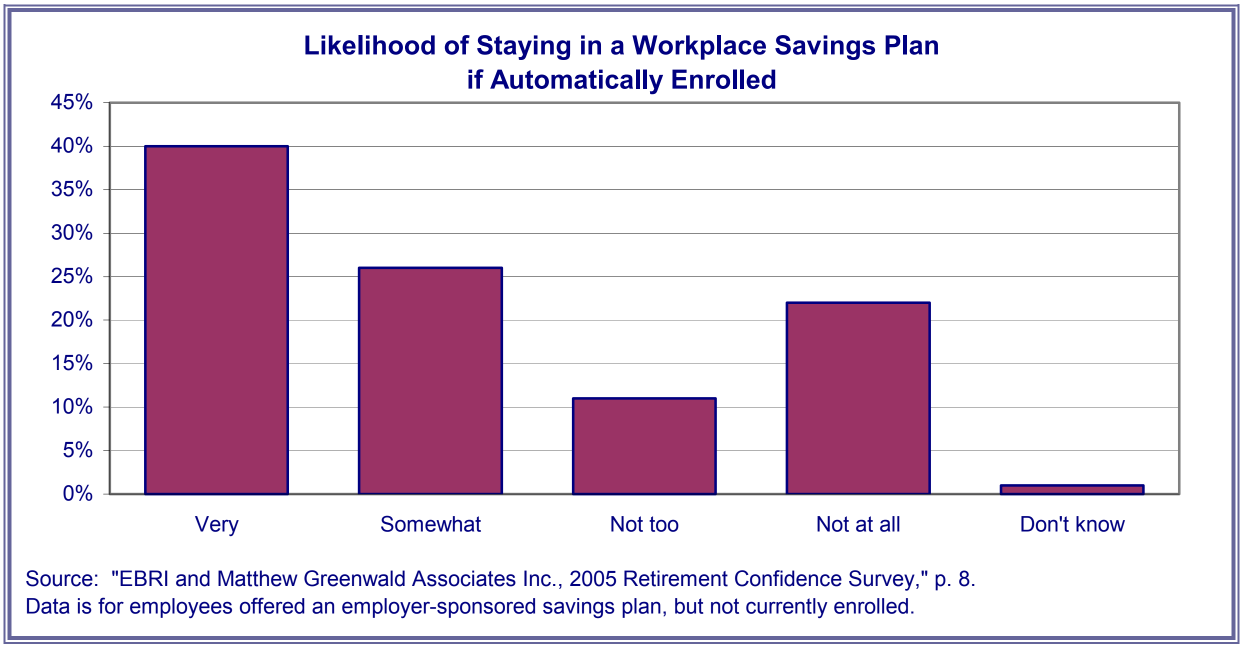
[14] Hewitt Associates, "The New Reality of Retirement Income Adequacy," June 2004, http://was4.hewitt.com/hewitt/resource/spkrsconf/subspkrsconf/teleconferences/tapes/06-30-04exec.pdf, p. 2.

[15] Not all 401(k) plans are voluntary. However, in some states, participation must be voluntary, because state law requires active permission from a worker before any payroll deductions can be made, other than those required by law, such as Social Security and Medicare.

[16] J. Choi, D. Laibson and B. Madrian, "Plan Design and 401(k) Savings Outcomes," *NBER Working Paper 10486*, May 2004, figure 1A.

[17] EBRI 2005 Retirement Confidence Survey, op. cit., p. 8.



Despite the evidence for both the effectiveness of automatic enrollment in boosting participation rates and the receptiveness of employees to the concept, many firms have been wary of defaulting employees into their retirement-savings plan. According to recent estimates, only 8% of firms have adopted some form of auto-enrollment.[18] The main reasons for this are cost, lack of awareness, and the inability of auto-enrollment to help deal with non-discrimination testing issues.[19]

The financial impact of automatic enrollment can be significant. The addition of a large number of low-revenue, low-balance accounts can substantially erode a plan's economics with high recordkeeping, account services, and education costs. The impact is especially pronounced if a plan's participation rate is low and automatic enrollment is extended to all eligible employees.[20]

On the positive side, the Internal Revenue Service (IRS) has taken steps over the last few years to encourage auto-enrollment by clarifying certain regulatory aspects. A regulatory notice in 2000 included provisions requiring employers to give workers:

— Advance notice of an auto-enrollment feature and their right to opt out;

— Annual notification of the default contribution rate and their right to change it; and,

— The option to stop or change future contributions.[21]

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[18] 47th Annual Survey of Profit Sharing and 401(k) Plans, op. cit. Hewitt Associates estimates that nearly 20% of large U.S. firms automatically enroll employees, quoted in J. Opdyke, "Retirement Plans Go Automatic to Boost Returns," *Wall Street Journal*, July 20, 2005, p. D1.

[19] Employer-sponsored retirement plans must not violate federal non-discrimination rules. A plan may be deemed to violate the non-discrimination rules if qualified benefits are disproportionately received by highly compensated participants, even if the benefits are made available to all on a non-discriminatory basis.

[20] "Automatic Enrollment: Benefits and Costs of Adoption," Vanguard Center for Retirement Research, 2001, op. cit.

[21] IRS Revenue Ruling 2000-8, Internal Revenue Bulletin No. 2000-7, February 14, 2000, p. 617.

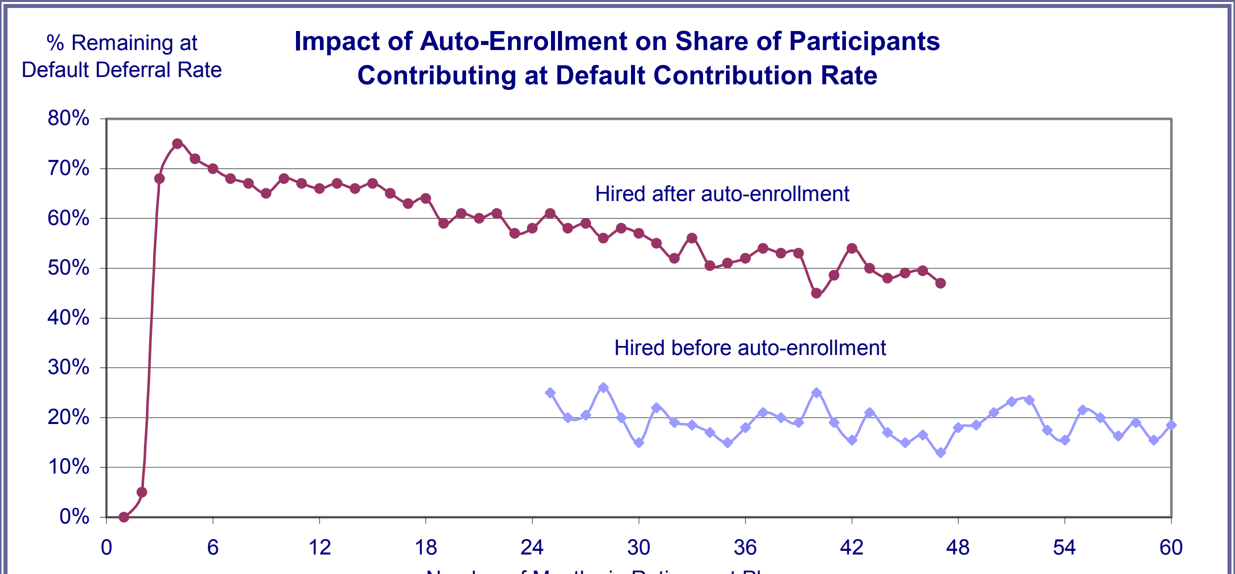
Goal 2: Increasing the Contribution Rate and Improving Investment Return Rates

The size of participants' contributions and the choice of financial instruments in which their contributions are being invested are also important factors in the goal of increasing workers' retirement savings.

The contribution rate is the percentage of pre-tax income that an individual contributes to a DC plan. In a voluntary DC savings plan, participants choose a contribution rate upon joining the plan. Contribution rates in these traditional schemes average 8.3% according to one study.[22] In an auto-enrollment plan, by contrast, there is a default contribution rate whereby a pre-set percentage of pre-tax salary is transferred into participants' 401(k) accounts unless they choose otherwise.

The problem with default contribution rates is that they are often set at a very low level. Two studies found that one-half to three-quarters of retirement plans with auto-enrollment had default contribution rates of only 3%.[23] Workers who do not make an active decision to enroll in the first place are unlikely to make an active decision to change their contribution rate, further exacerbating the problem of high plan costs.

The chart below shows how, in one company, more than 70% of newly auto-enrolled participants initially contributed at the plan's default contribution rate. The percentage dropped over time as some participants elected for higher deferral rates, but even after three years, more than 50% of participants remained at the default rate. This contrasts with workers at the same company who had chosen to participate in the savings plan prior to auto-enrollment. Few of these workers chose to remain at the plan's default rate – instead, the majority chose to contribute at a significantly higher rate. This result is actually quite intuitive. When individuals actively choose to enter a 401(k), they are then more likely to go on to actively select a contribution rate that reflects their retirement-savings needs, which is likely to be higher than the low default rate.

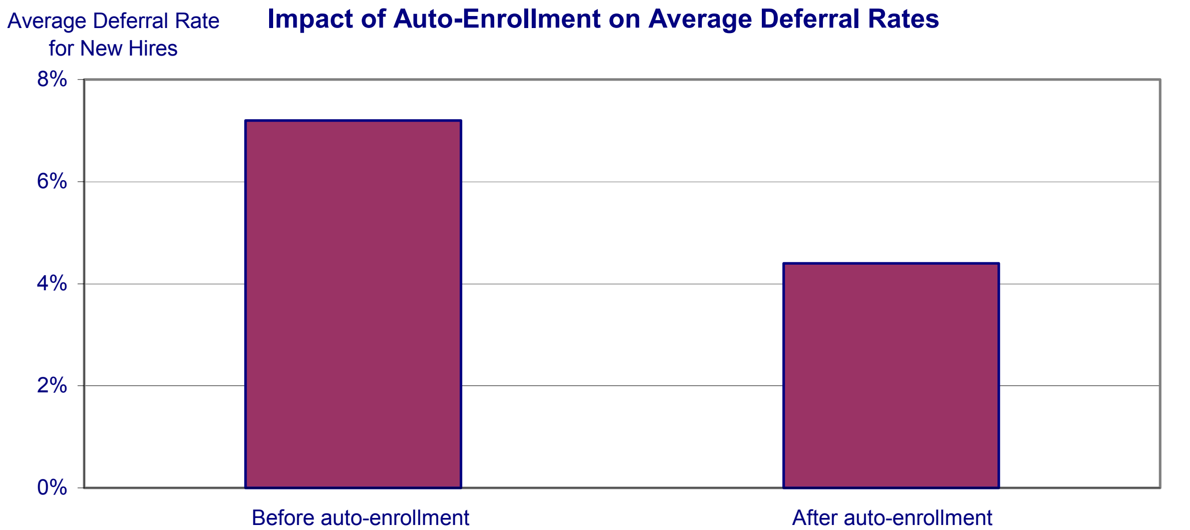


Source: Choi et al., 2004, Figure 4A.

[22] "Automatic Enrollment: Benefits and Costs of Adoption," Vanguard Center for Retirement Research, 2001, op. cit., footnote 9.

[23] "Automatic Enrollment: Vanguard Client Experience," Vanguard Center for Retirement Research, 2001, https://institutional3.vanguard.com/iip/pdf/CRR_automatic_enrollment_clientexp.pdf, p. 4.

Auto-enrollment can thus have the unintended effect of actually reducing the average contribution rate among new retirement-plan participants. In one study, after auto-enrollment the average contribution rate fell by nearly three percentage points. This result can be accounted for by the fact that the default savings rate under automatic enrollment was 3%. In consequence, new participants entering the savings plan were defaulted to the 3% contribution rate, even though some of them might have otherwise voluntarily elected a higher contribution rate.



Source: B. Madrian and J. Shea, 2001, cited in Vanguard Center for Retirement Research, 2004, op. cit., p. 5.

A default contribution rate below 4% can lead to significant shortfalls in retirement income levels. Research shows that if a 3% default contribution rate is used in a company plan, then the savings shortfall, as a percent of salary, can be as high as 7.5%.

Retirement Savings Shortfall With 3% Contribution Rate[24]

	Worker Salary		
	$25,000	**$50,000**	**$75,000**
Target Savings Rate (% of salary)	8%	10%	12%
Savings Shortfall (% of salary)	3.5%	5.5%	7.5%

A closely linked issue is the choice of the default investment instrument. This is often a very conservative instrument such as a money market fund or capital preservation fund. A study of default investment options in auto-enrollment retirement plans showed that more than three-quarters of them were stable value or money market funds. Only 24% were in funds that held out the possibility of significant capital growth over the course of the plan.[25] Nearly 80% of all

[24] "Automatic Enrollment: Benefits and Costs of Adoption," Vanguard Center for Retirement Research, 2001, op. cit. p. 5. Target savings rate is based on 75% replacement income ratio, retirement at age 67 with full Social Security benefits, and average DC investment returns. Calculations assume a 50% employer match rate.

[25] 44th Annual Survey of Profit Sharing and 401(k) Plans, Profit Sharing / 401(k) Council of America, 2001, cited in Choi et al., 2004, op. cit., footnote 19.

traditional DC assets are, by contrast, invested in equity-oriented funds.[26] And in the same way that participants automatically enrolled in their company plan tend to stick with the default contribution rate, most workers remain in the default investment fund.[27]

The evidence presented in this section suggests that while auto-enrollment relies on inertia (since the default is to enroll in the DC program) to boost participation rates, the same inertia means that workers continue to contribute at low default contribution rates and invest in conservative default investment instruments. This is particularly a concern for those workers who would have elected voluntarily to participate in the plan and who – were it not for the plan's default contribution rate and default investment funds – would have chosen a higher contribution rate and more appropriate investment funds for their retirement needs.

One study has explicitly tried to calculate how the advantages of auto-enrollment stack up against its disadvantages. It finds that while the higher participation rates due to auto-enrollment help promote wealth accumulation, this effect is approximately offset by the default settings.[28] In other words, auto-enrollment by itself does little to increase aggregate savings.

To boost workers' retirement savings, employers need to ensure that auto-enrollment is accompanied by a higher default contribution rate – a 5% contribution rate would come close to eliminating the savings shortfall, at least for low-income workers[29] – and a default investment fund(s) that will be more likely to generate capital gains over the long term than a money-market or capital preservation fund. This does not, of course, mean that all workers should be defaulted into a relatively high-risk / high-return equity fund. Inertia, procrastination and lack of knowledge mean that many people will not actively switch out of a default fund over the course of their careers. For this reason, balanced funds or 'lifecycle' funds that are tailored to individual workers' age and income, and which automatically rebalance retirement portfolios to lower-risk / lower-return investments as workers approach retirement, are appropriate default options.

These types of funds are offered by relatively few firms – 24% according to one estimate.[30] In 2004, nearly 1,200 employers added one financial services company's lifecycle funds to their 401(k) plans, and 850 of them made it the default option.[31] As with auto-enrollment, many companies are wary of changing the default investment fund from a very conservative option because of concerns about potential legal liability as plan fiduciaries if the funds they have selected decline in value. However, lifecycle funds appear to have the potential to be very popular. Where a lifecycle fund option is available, more than 90% of plan participants use them. Where a lifecycle fund option is not offered, 68% of workers surveyed said that they would be either very or somewhat likely to use them.[32]

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[26] "Automatic Enrollment: Benefits and Costs of Adoption," Vanguard Center for Retirement Research, 2001, op. cit., footnote 9.

[27] One study shows that 65-87% of new plan participants under auto-enrollment invest exclusively in the default fund. Choi et al., 2001, op. cit., p. 5.

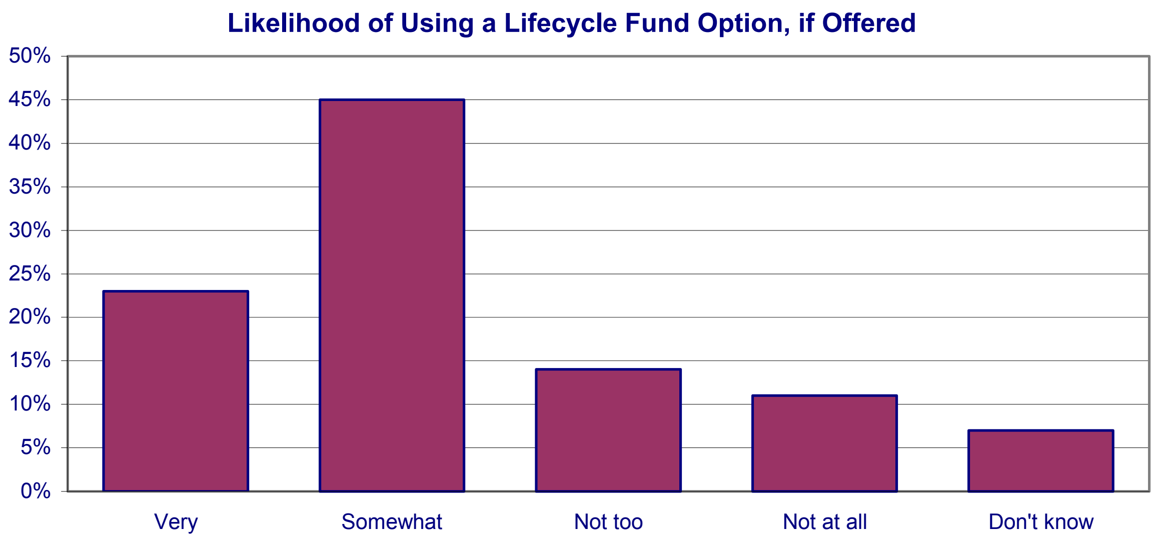
[28] Choi et al., 2001, op. cit., p. 2. Auto-enrollment alone does, however, dramatically improve the 'distribution' of savings among workers by making it less skewed to higher-income workers. Lower-income workers are disproportionately likely not to sign up for a voluntary company 401(k) plan. Auto-enrollment eliminates this effect and thus increases the amount of savings in the lower tail of the distribution of savings within a plan. See Choi et al., 2001, op. cit., p. 5.

[29] Based on calculations in "Automatic Enrollment: Benefits and Costs," Vanguard Center, 2001, op. cit., p. 5.

[30] EBRI 2005 Retirement Confidence Survey, op. cit., Figure 5, p. 9.

[31] Retirement Plans Go Automatic, op. cit., p. D1.

[32] EBRI 2005 Retirement Confidence Survey, op. cit., pp. 8-9.



Source: EBRI and Matthew Greenwald Associates Inc., 2005 Retirement Confidence Survey, p. 9.
Data is for employees participating in a workplace retirement savings plan, but not currently offered a lifecycle fund option.

Higher contribution rates and more appropriate investment choices are keys to increasing the replacement rate from 401(k) accumulations. A recent study projects that raising the default contribution rate to 6% from 3% would improve the replacement rate from 401(k) accumulations for workers of all income levels, and adding a switch to a lifecycle fund from a money market fund would be an even better plan design.[33]

Increasing Contribution Rates Over Time

As we saw above, inertia can mean that once an income contribution rate has been set, either by default or choice, few workers later revisit what they can afford to contribute. As a result, increases in workers' earnings throughout their career are not accompanied by increases in their income contribution rate.

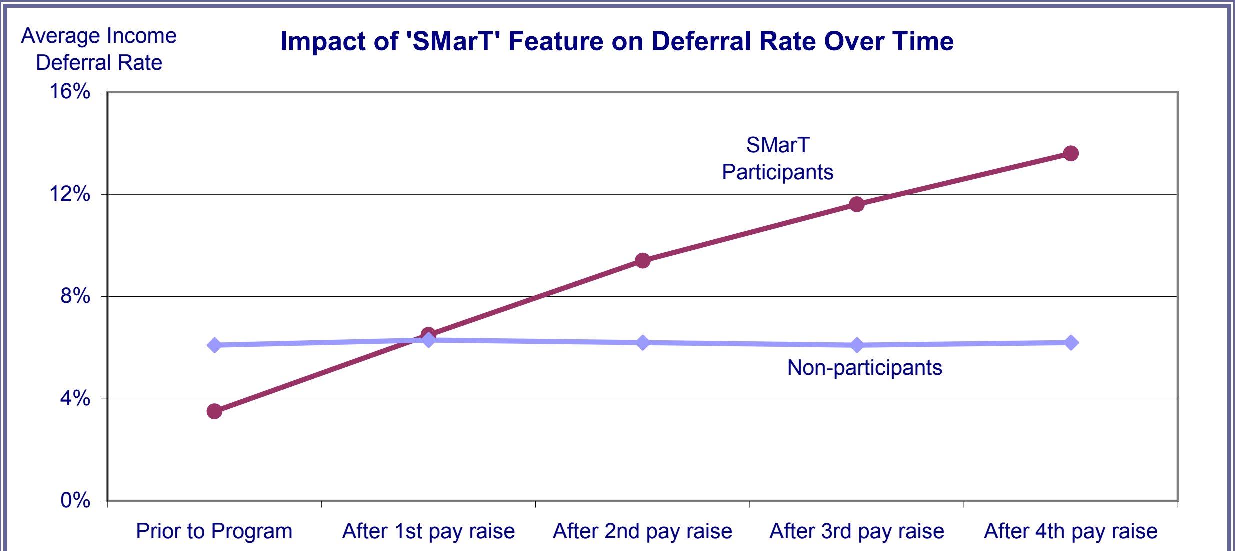
One solution is an approach that automatically increases the rate of contribution over time without the need for workers' input. One version of this has been dubbed the SMarT – or Save More Tomorrow – feature.[34] Piloted as part of savings plans at several companies, participants agree that their income contribution rate will automatically increase annually by a given amount – usually between 1% and 3% – up to a pre-set ceiling. In the SMarT plan, contribution rates are increased at the time of an annual pay raise. This has the advantage of offsetting any 'pain' from the higher contribution rate with the 'gain' of the pay increase: the contribution rate increase is set so that net take-home pay is not reduced, but merely rises less than it would have otherwise. Participation thus has no immediate costs and does not require employees to change behavior. As with other automatic mechanisms, it is also entirely voluntary – workers can opt out whenever they wish.

Research has shown that a SMarT approach can rapidly increase average contribution rates. One study has shown that those joining a SMarT-type plan increased their average contribution rates almost fourfold over the space of 40 months, with participants' average contribution rates

[33] The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions, op. cit., p. 14.

[34] A. Benartzi and R. Thaler, "Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving," *Journal of Political Economy*, Vol. 112, No. 1, February 2004 (earlier version available at http://www.anderson.ucla.edu/faculty/shlomo.benartzi/savemore.htm).

rising to 13.6% of pay from 3.5%.[35] By contrast, those who chose not to participate saw no change in their average contribution rates over the same period.



Source: R. Thaler & S. Benartzi, "Save More Tomorrow: Using Behavorial Economics to Increase Employee Saving," 2001

Available data suggests that relatively few workers participate in retirement plans that automatically ratchet up the amount of income deferred whenever workers receive a pay raise, if desired. One survey estimates that 20% of workers are in firms with a SMarT-like feature in their savings plan.[36] However, as with auto-enrollment, many workers appear receptive to the idea. Among survey participants *not* currently offered this option, 60% said that they would be either very or somewhat likely to use this option if it were made available.[37] Among participants in one study who *were* offered the feature, 78% elected to use it. Of these a very large number stayed with the scheme: 98% who joined were still in the scheme two pay raises later, and 80% stayed in the scheme through three pay raises.[38] For those who did drop out, the SMarT scheme still had a lasting effect on their retirement savings, as almost none chose to drop back to a contribution rate at or below the original level.

Goal 3: Providing Greater Incentives to Increase Participation and Savings Rates

As we saw above, inertia and procrastination are not the only drivers of less-than-optimal retirement-savings behavior. In particular, workers may not be presented with sufficient incentives to save more for their retirement – or, put another way, the opportunity cost of *not* saving more is quite low.

Many 401(k) plans feature an employer-matching scheme whereby the employer matches the worker's contribution with an additional contribution up to a ceiling. In an employer-matching scheme, the employer would match some percent of the amount a worker contributes into a

[35] Ibid. Data also cited in Vanguard 2004, op. cit., p. 8.

[36] EBRI 2005 Retirement Confidence Survey, op. cit., p. 8.

[37] Ibid., p. 8.

[38] A. Benartzi and R. Thaler, op. cit. See p. 1 of 2001 online version.

401(k) plan up to a ceiling percent of the employee's gross salary (or a given dollar value of annual employee contributions to the plan).

Evidence shows that both the match rate and the match ceiling are important incentives for workers' contributions to retirement-savings plans. The higher the match rate, the more likely workers are to participate — because not doing so is, in effect, foregoing free money from their employer.[39] For example, in a survey of workers *not* participating in their employer's retirement-savings plan, 51% of respondents said that they would be either much more or somewhat more likely to participate if their employer offered a matching contribution of up to 3% of salary. However, if the employer were to offer a matching contribution of up to 5% of salary, then 72% of the same respondents would be more likely to participate.[40] The match ceiling also influences the average amount of income deferred.

Conclusion

The evidence presented shows how workers' savings behavior is heavily influenced by the features of their employers' retirement plans and that employers have significant latitude to shape these features.

— By implementing auto-enrollment, employers can influence the participation rate in their company's savings plan and how quickly employees begin saving.

— By changing the default contribution rate, employers can affect the average percentage of salary that employees save for their retirement.

— Through the choice of a default investment fund, employers can shape their employees' retirement-savings asset allocations; and,

— Through match rates and ceilings, employers can also encourage employees to participate in, and save more via, their plans.

Given the evidence that two-thirds of American workers are under-saving for their retirement, this should be a call to action for American employers. Through a series of simple changes, employers can do much to increase the prospects of a comfortable retirement for millions of Americans. The same factors that keep employees from signing up for a 401(k) plan, remaining in a default option, or not increasing their rate of income contribution can be turned to the worker's favor.

Autopilot 401(k)s are unlikely to take root and spread by themselves. Public policymakers have a critical role to play in encouraging the types of automated features that we have outlined and in clarifying legal uncertainty.

A significant reform that could boost retirement saving would be to provide special relief from the non-discrimination testing standards for employers that adopt automatic enrollment and an automatic savings feature in their 401(k) plans. Legislation has already been introduced in the U.S. Senate and House of Representatives that provides relief for employers. H.R. 1960 and H.R. 1961, introduced by former Representative Rob Portman (R-OH) and Representative Ben Cardin (D-MD), provide a safe harbor for employers who automatically enroll participants in a

39 See, for example, Gary Engelhardt and Anil Kumar, "Employer Matching and 401(k) Saving: Evidence from the Health and Retirement Study," Syracuse University Working Paper, 2003.

40 EBRI 2005 Retirement Confidence Survey, op. cit., p. 9.

401(k) plan at a deferral rate of 3%, with an annual increase to 10%. A similar proposal is included in S. 1359, sponsored by Senators Gordon Smith (R-OR) and Kent Conrad (D-ND).

It is also critical that policymakers clarify that automatic enrollment and automatic savings features are covered by the *Employee Retirement Income Security Act* (ERISA), and not state-labor laws.

Finally, employers also need clarity that the use of a more diversified default investment option, such as a lifecycle or balanced fund, is consistent with Section 404 protection under ERISA.

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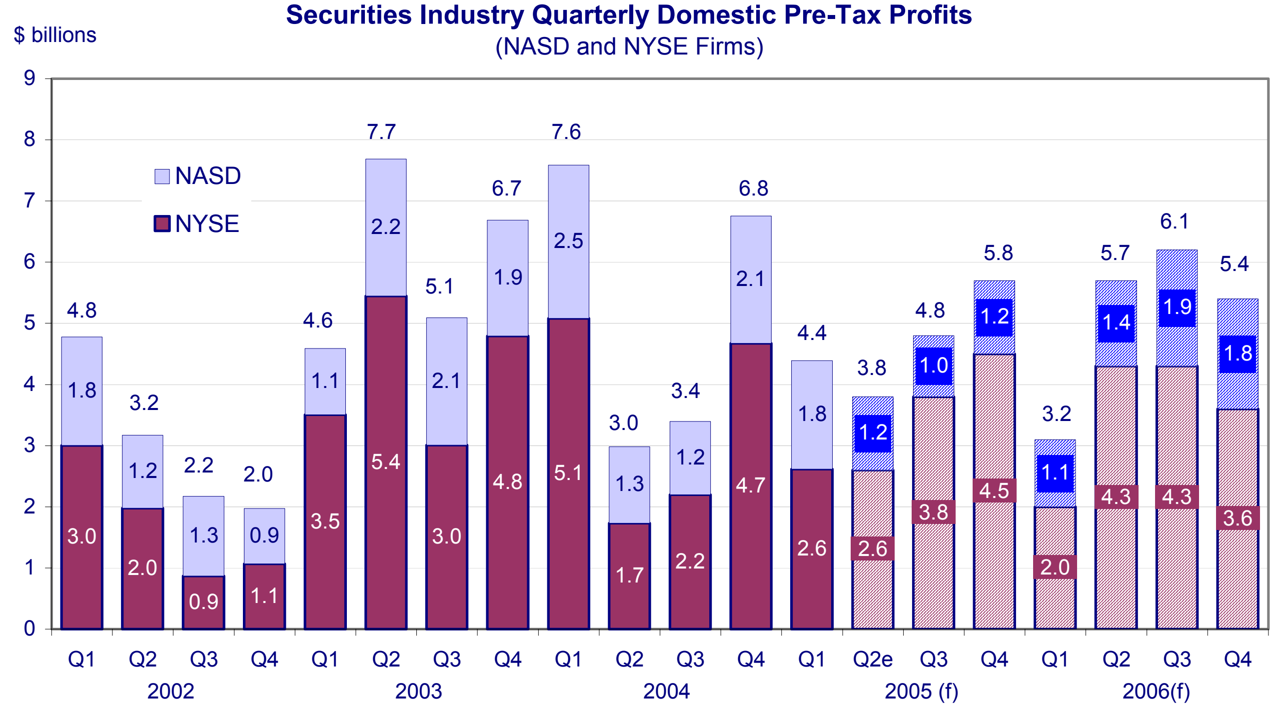
SECURITIES INDUSTRY MID-YEAR UPDATE: 2005

Summary

Weaker first-half profits from the securities industry strongly suggest that full-year 2005 results will be below those of last year, and below SIA's original forecast. For the first half of 2005, estimated profits[1] for all U.S. securities firms doing a public business fell to $8.19 billion, well below the $10.57 billion earned in the first half of last year and the $10.15 billion recorded in the second half. Net revenues[2], which surged in the final quarter of 2004, fell 6% in 1Q'05 and an estimated 5% sequentially in 2Q'05. Net revenue growth resumed in June relative to May, and is expected to be positive in the second half, but not enough to offset these first-half declines. For 2005 as a whole net revenues are expected to fall 0.3% from 2004 levels, while non-interest expenses should rise 0.9%. As a result, securities industry profits are forecast to reach $18.74 billion, 9.5% below the $20.72 billion earned in 2004 and 22.1% below profits of $24.05 billion registered in 2003, but still well above results endured during the industry downturn in 2001-2002.

First-quarter industry profits of $4.39 billion were below expectations, as net revenues of $45.19 billion were 6% below the exceptionally strong results recorded in both the immediately preceding quarter and the same, year-earlier period. The decline in net revenues reflected the continued rapid rise in interest expenses and the slower growth in gross revenues.



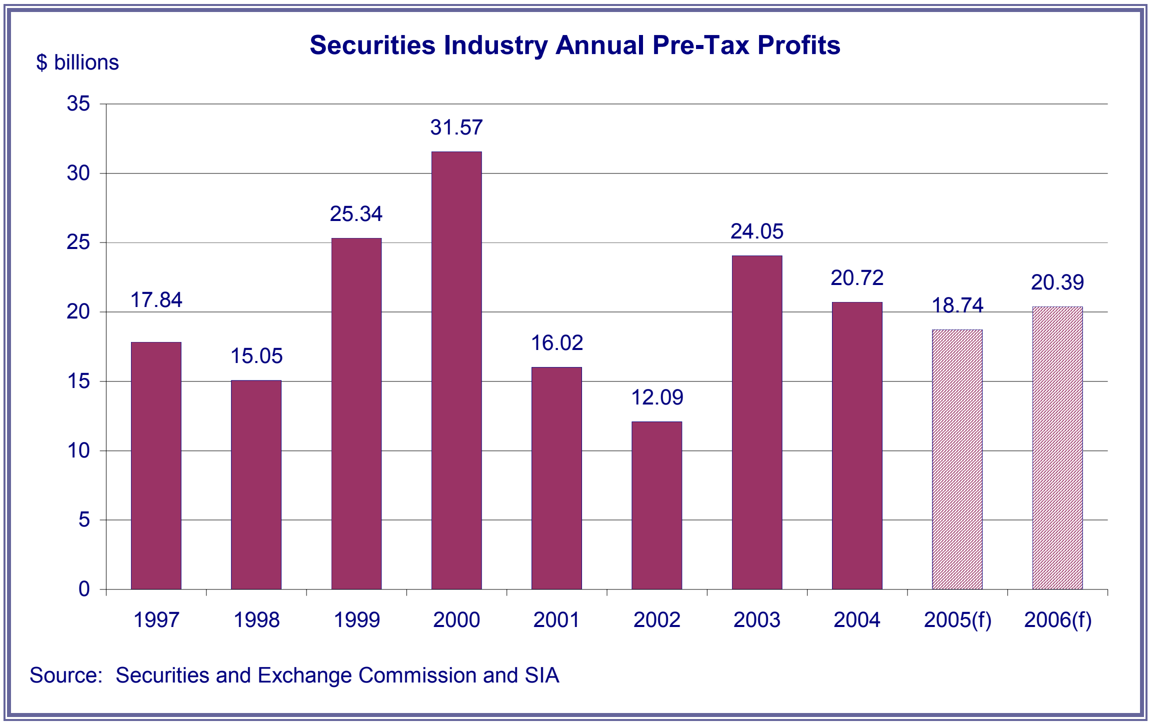
Securities Industry Quarterly Domestic Pre-Tax Profits
(NASD and NYSE Firms)

Source: SIA DataBank
Subtotals may not add to totals due to independent rounding.

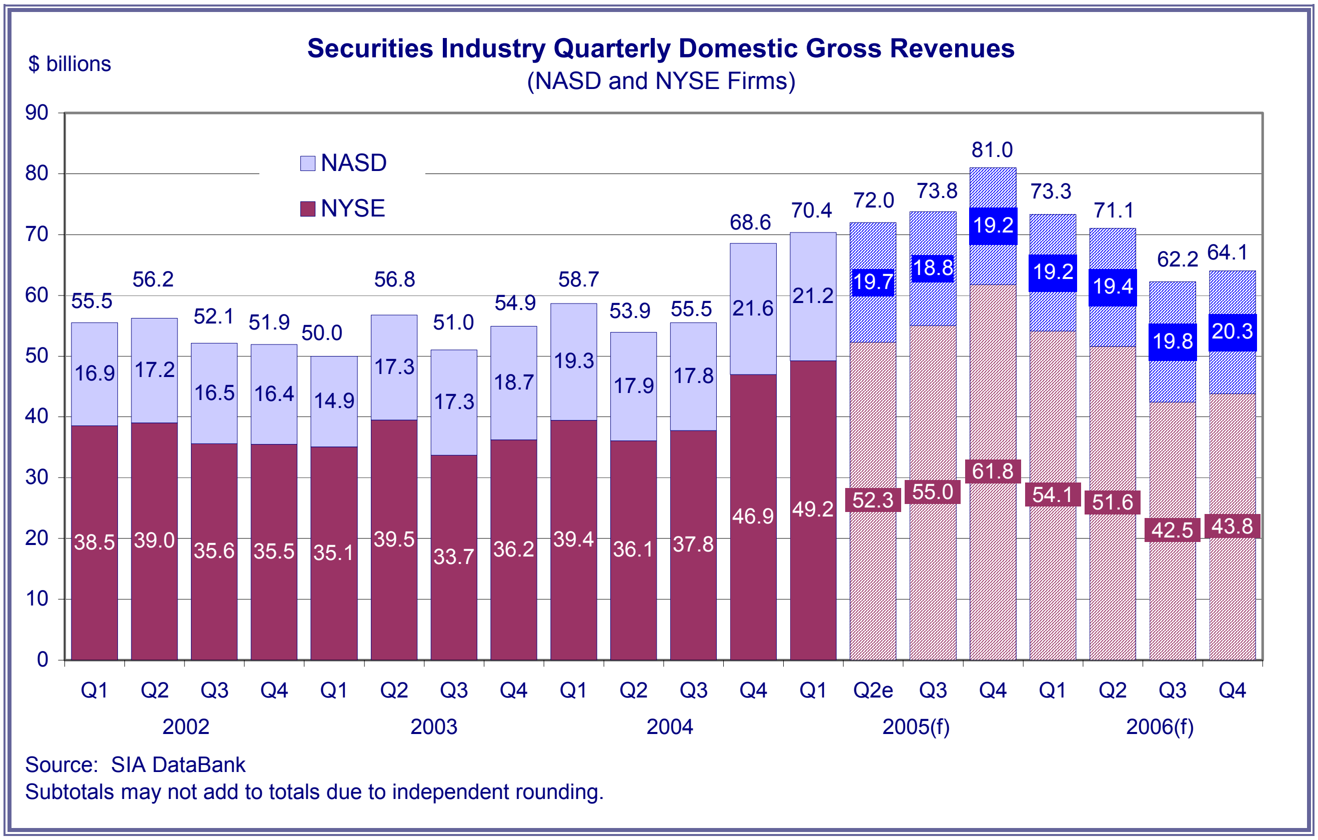
[1] Pre-tax net income of all 277 NYSE-reporting and 4,964 NASD-reporting firms during 1Q'05.

[2] Gross (total) revenues net of interest expense.

Total expenses in 1Q'05 reached $65.98 billion, 6.7% above the preceding quarter and 29.1% higher than during 1Q'04, driven by a dramatic increase in interest expense. Interest expense of $25.18 billion in 1Q'05 was 22.8% higher than in 4Q'04 and 136.2% above 1Q'04 as borrowing rates more than doubled over the same period. Compensation was held in check, up only 1.4% from the immediately preceding quarter and down fractionally, 0.8%, from 1Q'04; this was in line with seasonal patterns. Headcount declined 3.5% relative to 4Q'04, but was 2.5% above employment levels at end-1Q'04. Expenses other than interest and compensation fell 4.2% compared to the final quarter of 2004 and were only 3.0% higher than during the same, year-earlier period.

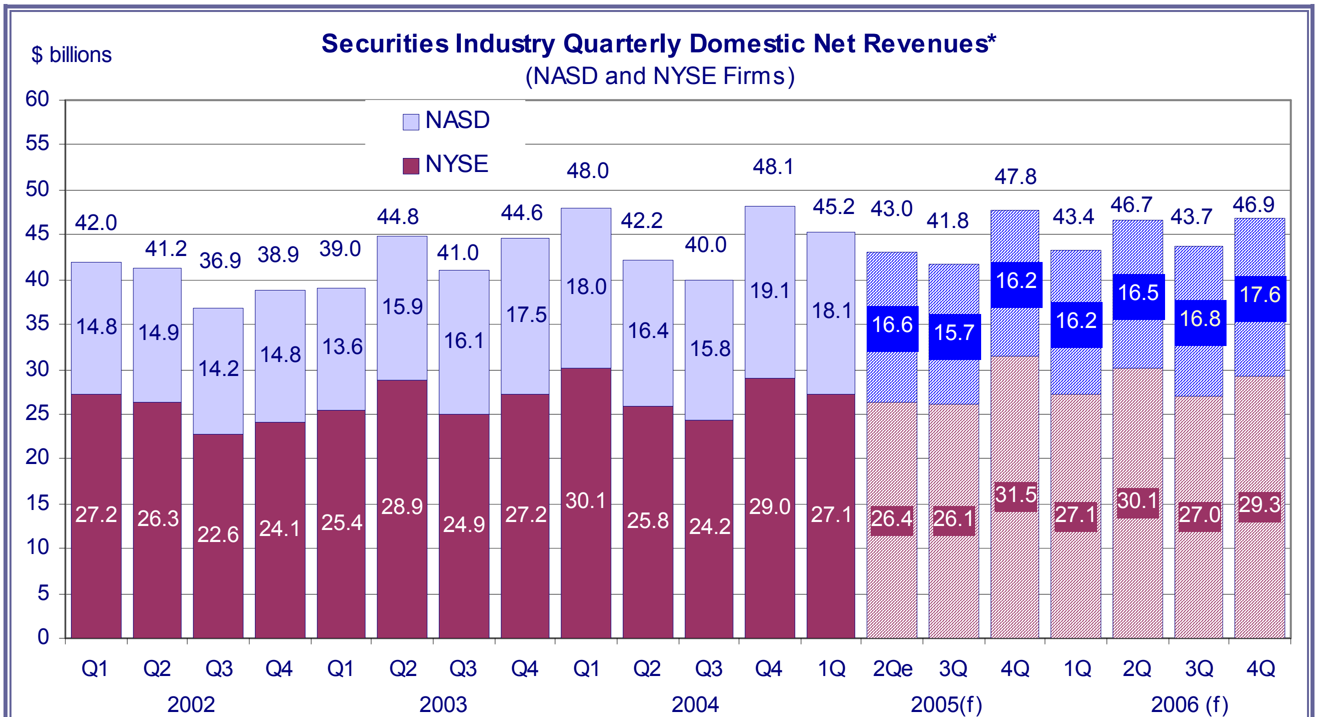


Gross revenues in 1Q'05 were $70.37 billion, 19.9% above year-earlier results, but only 2.6% higher than in 4Q'04. Commission income, underwriting revenues, and trading gains all fell in 1Q'05. The growth of revenues from asset management operations reflected slower net fund inflows, lower average fees and declining equity markets. This largely offset still strong, albeit slowing, growth in "other revenue related to the securities business," which includes business lines such as prime brokerage activities, derivative and structured products, and corporate financial advisory work including mergers-and-acquisitions (M&A) and leveraged buyout (LBO) activity.

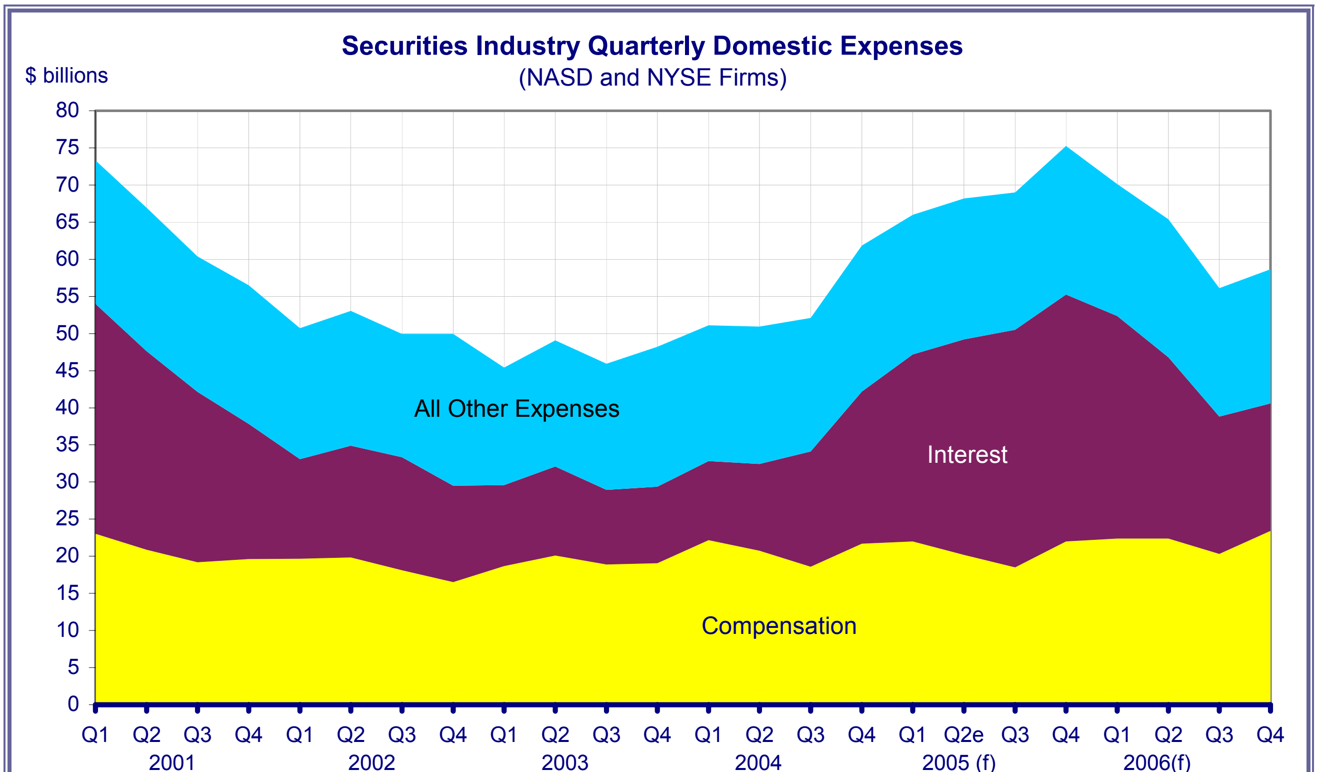


Market conditions weakened in the second quarter. Estimated 2Q'05 profits of $3.8 billion were 13.5% below the industry's 1Q'05 result, but still higher than the $2.98 billion of pre-tax net income earned in 2Q'04. Gross revenues of $72.0 billion are estimated for 2Q'05, and although this is 34% higher than in the same year-earlier period, it represents only a 2.3% rise from 1Q'05. Unfortunately this growth was too weak to offset the continued rapid rise in interest expenses and net revenues fell further. Estimated 2Q'05 net revenues of $43.0 billion were $2.2 billion or 4.8% less than in the first quarter, but 1.9% above 2Q'04 levels.

Most product and service lines produced weak revenues in 2Q'05. The few bright spots where revenue growth remained firm included M&A advisory, prime brokerage services, and commodities and derivatives. Interest expenses rose to an estimated $29 billion in 2Q'05, 15.2% higher than in 1Q'05 (as average borrowing rates were estimated to be 13% higher) and nearly two-and-a-half times larger than a year earlier. Interest expense dominated the growth in total expenses (estimated at 3.4% relative to 1Q'05) as compensation fell (in line with seasonal patterns and weaker net revenues), and all other expenses, as a whole, were held in check.



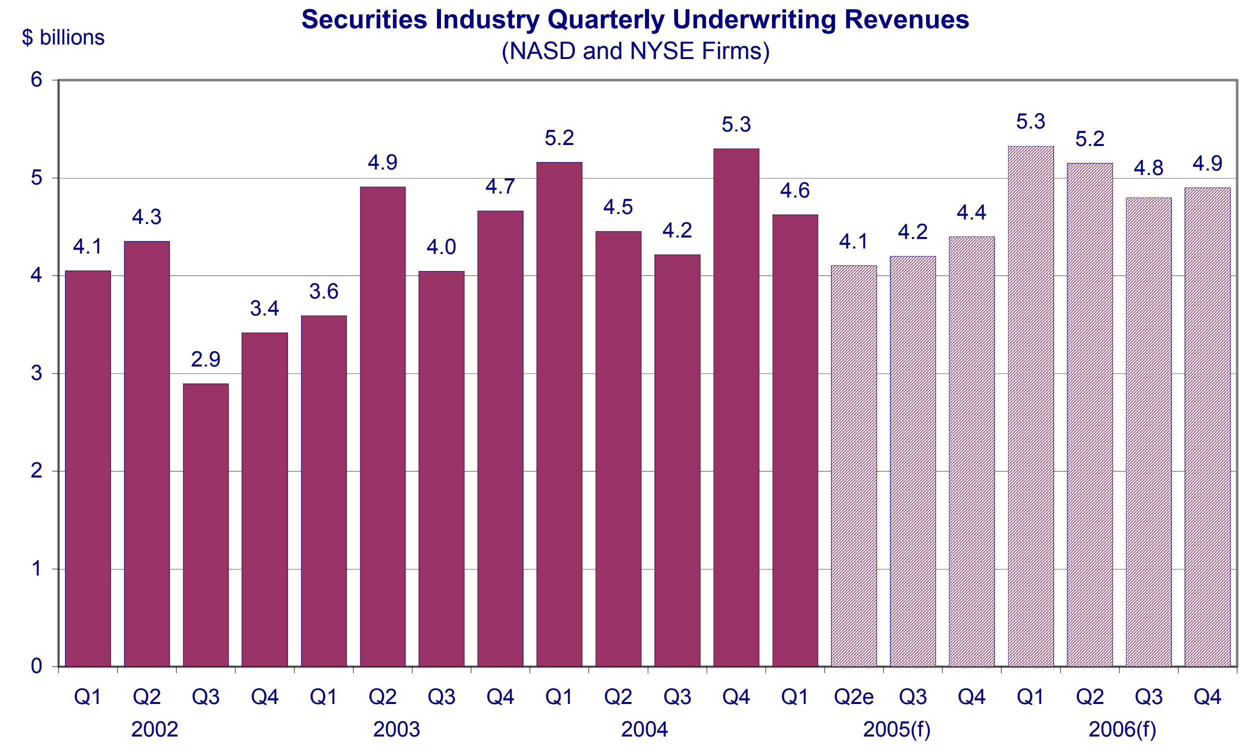
*Net of interest expense
Source: SIA DataBank
Subtotals may not add to totals due to independent rounding.



Source: SIA DataBank

Individual Business Line Results

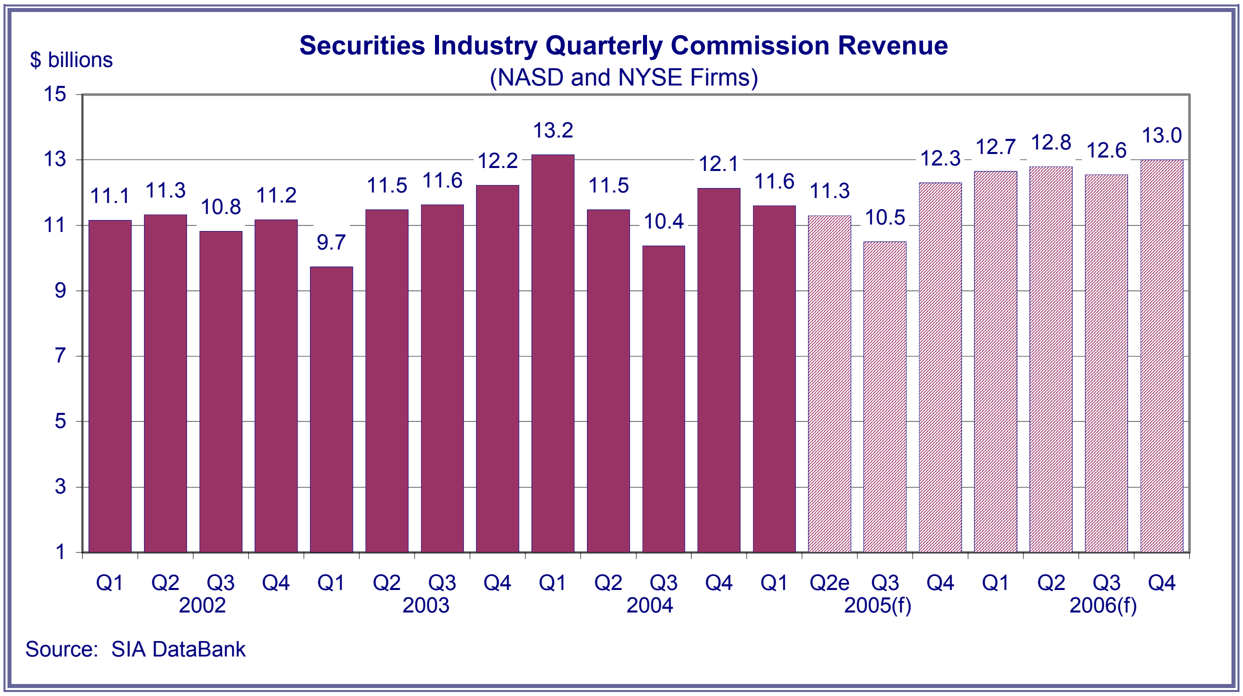
Underwriting revenues of $4.62 billion in 1Q'05 were down 12.8% on a sequential quarterly basis and 10.4% relative to 1Q'04. Both 1Q'04 and 4Q'04 recorded strong rebounds in equity capital markets, with total volumes only marginally below 2000's record. Similar declines are estimated for 2Q'05. The value of corporate debt issuance in the U.S. fell 0.8% on a sequential quarterly basis in 2Q'05, as a 13.9% drop in the value of straight debt issuance was largely offset by a 10.1% increase in the value of asset-backed debt placements. The value of total equity issuance fell 4.7% in 2Q'05 relative to 1Q'05, led lower by "true" IPOs, which were down 24.5%. However, conditions improved in June and early July, as both debt and equity pipelines began to fill, giving hope for stronger 3Q'05 results.



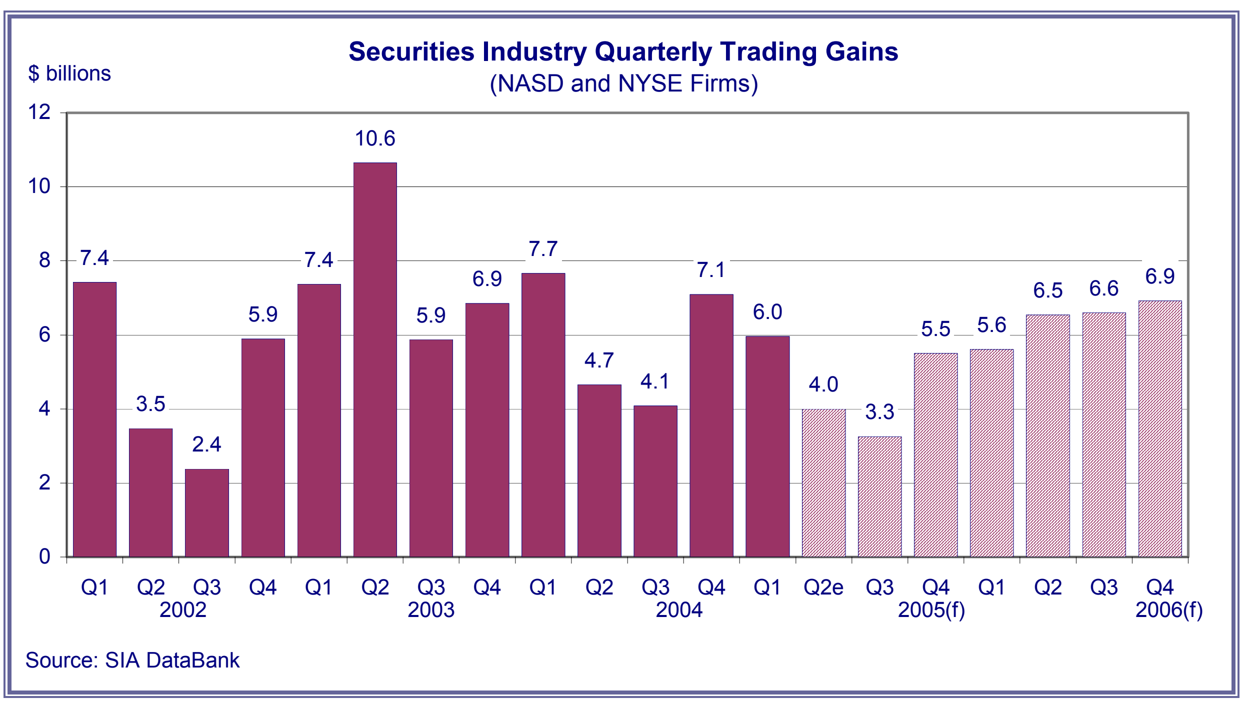
Source: SIA DataBank

Commission income fell to $11.61 billion in 1Q'05, down 4.4% from 4Q'04 and 11.8% below 1Q'04. The decline occurred despite an 11% increase in the volume of tickets processed and a 7.3% increase in the daily average share volume traded on the principal stock markets[3], relative to 4Q'04. This decline in revenue in the face of higher turnover reflects more than just the long-run trend of steadily lower average commission rates. Weakness in retail investor activity, an increasing percentage of fee-based accounts, and a higher volume of lower-cost institutional trades combined to reduce total commission income. Disappointing results continued in 2Q'05, as retail investors remained on the sidelines. Commission income is estimated to have fallen to $11.3 billion, down 2.6% on a sequential basis and 1.6% compared with the same year-earlier period, reflecting a continued decline in the value of trading in major equity markets.

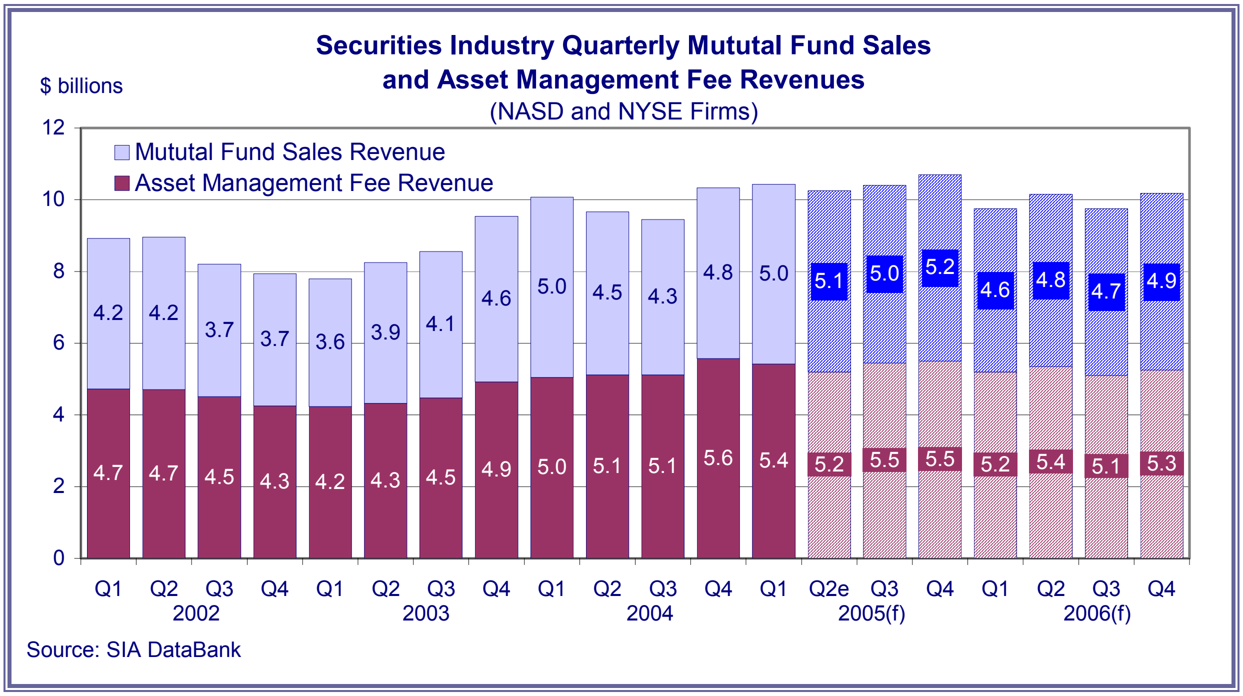
[3] New York Stock Exchange (NYSE), NASDAQ, and American Stock Exchange (Amex).



Trading gains, which largely reflect securities firms' proprietary operations, fell to $5.96 billion, down 15.9% and 22.2%, respectively, from 4Q'04 and 1Q'04 (which both recorded extraordinary gains). The overall industry decline occurred despite a number of firms registering record trading gains. A still weaker environment prevailed in 2Q'05, particularly for fixed income, while volatility remained low in largely range-bound equity markets. Trading gains are estimated at $4.0 billion in 1Q'05: one-third lower than 4Q'05; 14% below 2Q'05; and, the lowest quarterly result in three years. ***Investment account gains***, which along with trading gains make up securities firms' principal accounts, fell to $339 million in 1Q'05, down sharply from $1.31 billion in 4Q'04, which was the best result for this line item since 2Q'03.



Mutual fund sales revenue and ***asset management fees*** showed a slight gain in 1Q'05, in line with expectations. Mutual fund sales revenue rose to $5.0 billion, 5.1% above 4Q'04 results, but 0.5% below 1Q'04, largely due to small net new inflows into equity mutual funds. This line item is estimated to have been unchanged in 2Q'05 on a sequential basis. Asset management fees in 1Q'05 were $5.42 billion, 2.7% lower than in 4Q'04, but 7.6% ahead of the same, year-earlier period, reflecting the change in the value of net assets under management and a gradual secular decline in asset management fees. During 2Q'05, asset management fees are estimated to have fallen to $5.2 billion, 4.1% below the preceding quarter, but still 1.7% above year-earlier results.



Revenues from margin interest rose to $2.7 billion in 1Q'05, 11.9% above 4Q'04 and were more than double (up 101.7%) the income realized in 1Q'04. The strong result solely reflected higher interest rates, as customers' margin use drifted lower in a lackluster trading environment, while net interest margins remained largely unchanged. During 2Q'05, a similar pattern emerged as margin revenue rose to an estimated $2.9 billion, up 7.4% sequentially and 96% above 2Q'04, as steadily rising interest rates more than offset declining customer borrowing.

Commodities revenue, a highly volatile revenue line, contributed $1.24 billion in 1Q'05, after a loss of $275 million in 4Q'04, and nearly matched total revenue for this line item for all of last year. During 2Q'05, commodities revenues reached an estimated $0.95 billion, and appear solidly on track to produce the best year for these operations since 2002.

Other revenues and ***other revenues related to the securities business***, which include a broad range of securities industry activities that are increasingly important to industry profitability, are enjoying double-digit quarterly growth rates and are, to a certain degree, the revenue counterpart of rapidly rising interest expense. The sum of these two revenue line items rose to $33.45 billion in 1Q'05, 10.6% above 4Q'04 results and 66.4% higher than a year earlier. During 2Q'05, this rapid growth continued, reaching an estimated $37.8 billion, a 13% sequential quarterly increase.

Principal among these fast-growing lines are: M&A and LBO advisory revenues; prime brokerage services provided to the rapidly growing hedge fund industry; fees for tailoring structured financial transactions for clients; and, securities lending operations. The value of announced U.S. M&A deals in 2Q'05 was 22.0% higher than during 1Q'05, while global M&A activity increased 12.3%. For the first half of 2005, the value of announced M&A deals totaled $590.5 billion, well on its way to the $1 trillion forecast we made in 2004 for all of this year. Ongoing expansion in the number of hedge funds and the value of assets under their management should translate into continued strong growth in prime brokerage revenue.

The Summary Outlook

Results for the second half of 2005 are expected to show substantial improvement over those registered in the first semester of this year. Net revenue growth resumed in June and is expected to be positive in the second half but not enough to offset first-half declines. For 2005 as a whole net revenues are expected to fall 0.3% from 2004 levels, while non-interest expenses will rise 0.9%. As a result, securities industry profits are forecast to reach $18.74 billion, 9.5% below the $20.72 billion earned in 2004 and 22.1% below profits of $24.05 billion registered in 2003.

Most of the improvement is expected to be delayed until the final quarter of the year, as the end of the current monetary tightening bolsters investor sentiment, retail participation, and equity markets. This rise will lift commission fee income, mutual fund sales revenue, and asset management fees. Continued strong growth in prime brokerage services; M&A and LBO activity; and commodities, derivatives, and structuring fee revenues will persist to support overall profitability into 2006.

However, 2006 is expected to be distinctly more challenging and the outlook is more difficult to discern. Risk has risen and industry results are expected to be more volatile in 2006, but on balance, somewhat better than this year. U.S. securities industry profits are forecast to rise to $20.4 billion in 2006, from the $18.74 billion forecast for 2005. Details of the industry outlook and the expected macroeconomic environment that drives it will be examined in an upcoming issue.

Frank A. Fernandez
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TOTAL NYSE + NASD FIRMS INCOME STATEMENT

$ Millions

	QUARTERLY										ANNUALLY		
	2004				2005				% chg, Q1'05 vs.		2004	2005	% chg
	Q1	Q2	Q3	Q4	Q1	Q2 (e)	Q3(f)	Q4(f)	Q4'04	Q1'04		(forecast)	05(f) v. 04
REVENUE:													
Commissions	13,154.6	11,479.2	10,371.0	12,136.2	11,606.3	11,300.0	10,500.0	12,300.0	-4.4%	-11.8%	47,140.9	45,706.3	-3.0%
- Commissions - Listed Equity on an Exchange	5,372.3	4,553.1	4,105.3	4,878.2	4,704.5				-3.6%	-12.4%	18,908.9		
- Commissions - Listed Equity OTC	871.0	728.7	617.7	855.5	816.2				-4.6%	-6.3%	3,072.9		
- Commissions - Listed Options	611.9	424.6	370.5	555.3	433.5				-21.9%	-29.2%	1,962.3		
- Commissions - All Other	6,299.2	5,772.8	5,277.4	5,847.2	5,652.1				-3.3%	-10.3%	23,196.6		
Trading Gain (Loss)	7,667.0	4,655.5	4,085.3	7,093.4	5,963.1	4,000.0	3,250.0	5,500.0	-15.9%	-22.2%	23,501.2	18,713.1	-20.4%
- Gain from OTC Market Making	468.3	165.9	127.9	217.7	206.6	205.0	150.0	75.0	-5.1%	-55.9%	979.9	636.6	-35.0%
- - Gain from OTC Market Making in Listed Equity	8.0	4.0	1.0	5.1	4.0				-21.9%	-50.6%	18.1		
- Gain from Debt Trading	4,960.0	3,156.5	5,079.4	4,237.3	4,596.3	2,695.0	2,000.0	3,800.0	8.5%	-7.3%	17,433.3	13,091.3	-24.9%
- Gain from Listed Options Market Making	-29.7	114.3	5.5	177.1	-77.9	0.0	100.0	75.0	-144.0%	NM	267.2	97.1	-63.7%
- Gain from All Other Trading	2,268.4	1,218.8	-1,127.6	2,461.2	1,238.1	1,100.0	1,000.0	1,550.0	-49.7%	-45.4%	4,820.8	4,888.1	1.4%
Investment Account Gain (Loss)	751.4	221.2	387.0	1,309.9	339.3	650.0	600.0	700.0	-74.1%	-54.9%	2,669.4	2,289.3	-14.2%
- Realized Gain	984.9	-566.0	540.9	557.9	578.2				3.6%	-41.3%	1,517.7		
- Unrealized Gain	-530.1	726.4	-148.2	445.5	-302.0				-167.8%	NM	493.5		
Underwriting Revenue	5,159.7	4,452.1	4,213.6	5,298.6	4,622.0	4,100.0	4,200.0	4,400.0	-12.8%	-10.4%	19,124.1	17,322.0	-9.4%
- Equity Underwriting Revenue	1,087.3	1,017.3	931.1	1,199.3	996.5	900.0	1,050.0	1,150.0	-16.9%	-8.4%	4,235.1		
Margin Interest	1,337.3	1,480.9	1,722.8	2,409.1	2,696.9	2,900.0	3,200.0	3,400.0	11.9%	101.7%	6,950.1	12,196.9	75.5%
Mutual Fund Sale Revenue	5,024.9	4,543.1	4,327.6	4,760.3	5,002.0	5,050.0	4,950.0	5,200.0	5.1%	-0.5%	18,655.8	20,202.0	8.3%
Fees, Asset Management	5,042.1	5,115.1	5,118.7	5,571.5	5,423.7	5,200.0	5,450.0	5,500.0	-2.7%	7.6%	20,847.4	21,573.7	3.5%
Research Revenue	59.4	53.5	54.7	43.6	34.6	55.0	55.0	55.0	-20.7%	-41.8%	211.2	199.6	-5.5%
Commodities Revenue	382.8	708.6	669.8	-274.8	1,240.6	945.0	950.0	1,200.0	NM	224.1%	1,486.4	4,335.6	191.7%
Other Revenue Related to the Securities Business	13,695.7	14,280.5	17,312.8	22,331.1	25,219.9	28,800.0	31,345.0	32,745.0	12.9%	84.1%	67,620.1	118,109.9	74.7%
Other Revenue	6,402.8	6,938.4	7,248.6	7,907.9	8,226.2	9,000.0	9,300.0	10,000.0	4.0%	28.5%	28,497.7	36,526.2	28.2%
TOTAL REVENUE	**58,677.7**	**53,928.2**	**55,511.8**	**68,586.7**	**70,374.4**	**72,000.0**	**73,800.0**	**81,000.0**	2.6%	19.9%	**236,704.4**	**297,174.4**	25.5%
Net Revenue	48,017.2	42,208.4	39,978.9	48,086.3	45,190.6	43,000.0	41,800.0	47,750.0	-6.0%	-5.9%	178,290.9	177,740.6	-0.3%
EXPENSES:													
Total Compensation	22,158.4	20,727.1	18,597.7	21,681.8	21,979.7	20,200.0	18,500.0	22,000.0	1.4%	-0.8%	83,165.0	82,679.7	-0.6%
- Registered Representative Compensation	7,906.7	7,614.1	6,914.0	7,808.6	8,139.1				4.2%	2.9%	30,243.4		
- Clerical Employee Compensation	10,035.8	9,101.6	7,948.7	9,400.2	9,812.9				4.4%	-2.2%	36,486.2		
- Voting Officer Compensation	902.2	840.7	764.5	1,102.0	846.6				-23.2%	-6.2%	3,609.3		
- Other Employee Compensation (FOCUS IIA Only)	3,313.5	3,170.7	2,970.5	3,371.0	3,181.1				-5.6%	-4.0%	12,825.8		
Total Floor Costs	4,319.2	4,223.1	3,951.1	4,255.9	4,307.7	4,300.0	4,000.0	4,400.0	1.2%	-0.3%	16,749.3	17,007.7	1.5%
- Floor Brokerage Paid to Brokers	373.2	386.2	383.2	328.6	353.7				7.7%	-5.2%	1,471.2		
- Commissions & Clearance Paid to Other Brokers	995.5	915.8	827.1	933.5	976.8				4.6%	-1.9%	3,672.0		
- Clearance Paid to Non-Brokers	287.7	299.9	313.3	342.8	347.5				1.4%	20.8%	1,243.8		
- Commissions Paid to Broker-Dealers (FOCUS IIA Only)	2,662.7	2,621.2	2,427.5	2,650.9	2,629.7				-0.8%	-1.2%	10,362.3		
Communications Expense	1,065.1	1,145.7	1,177.9	1,285.2	1,217.2	1,200.0	1,250.0	1,300.0	-5.3%	14.3%	4,673.8	4,967.2	6.3%
Occupancy & Equipment Costs	1,552.4	1,567.0	1,621.2	1,733.3	1,563.9	1,625.0	1,675.0	1,800.0	-9.8%	0.7%	6,473.9	6,663.9	2.9%
Promotional Costs	572.0	569.8	540.0	658.4	583.5	550.0	550.0	550.0	-11.4%	2.0%	2,340.2	2,233.5	-4.6%
Interest Expense	10,660.5	11,719.7	15,532.8	20,500.4	25,183.8	29,000.0	32,000.0	33,250.0	22.8%	136.2%	58,413.4	119,433.8	104.5%
Losses from Error Accounts & Bad Debts	87.6	84.3	59.8	101.8	90.9	87.5	87.5	87.5	-10.7%	3.8%	333.4	353.4	6.0%
Data Processing Costs	817.6	789.4	771.1	848.7	830.9	775.0	750.0	775.0	-2.1%	1.6%	3,226.9	3,130.9	-3.0%
Regulatory Fees & Expenses	330.7	377.5	340.6	409.1	325.5	300.0	300.0	300.0	-20.4%	-1.6%	1,457.9	1,225.5	-15.9%
Non-Recurring Charges	107.3	176.7	187.4	209.3	38.5	100.0	100.0	100.0	-81.6%	-64.1%	680.7	338.5	-50.3%
Other Expenses	9,422.0	9,563.2	9,337.8	10,148.0	9,859.9	10,062.5	9,787.5	10,687.5	-2.8%	4.6%	38,471.1	40,397.4	5.0%
TOTAL EXPENSES	**51,092.8**	**50,943.6**	**52,117.5**	**61,831.8**	**65,981.7**	**68,200.0**	**69,000.0**	**75,250.0**	6.7%	29.1%	**215,985.7**	**278,431.7**	28.9%
PRE-TAX NET INCOME	**7,584.9**	**2,984.6**	**3,394.3**	**6,754.9**	**4,392.7**	**3,800.0**	**4,800.0**	**5,750.0**	-35.0%	-42.1%	**20,718.7**	**18,742.7**	-9.5%

Source: SIA DataBank

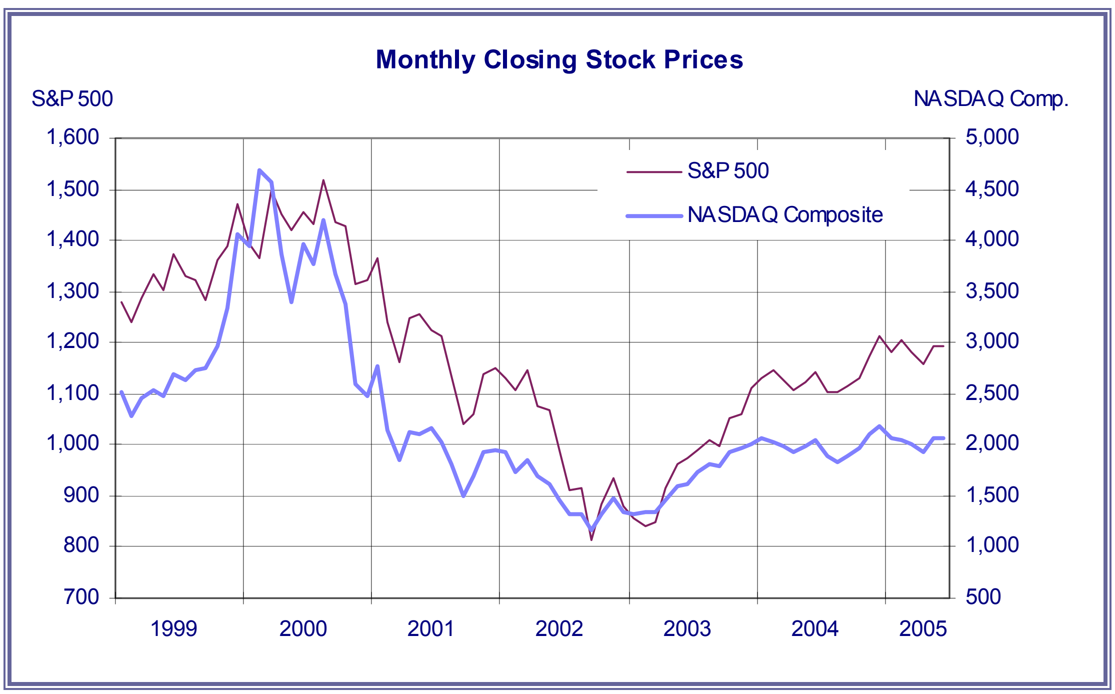
MONTHLY STATISTICAL REVIEW

U.S. Equity Market Activity

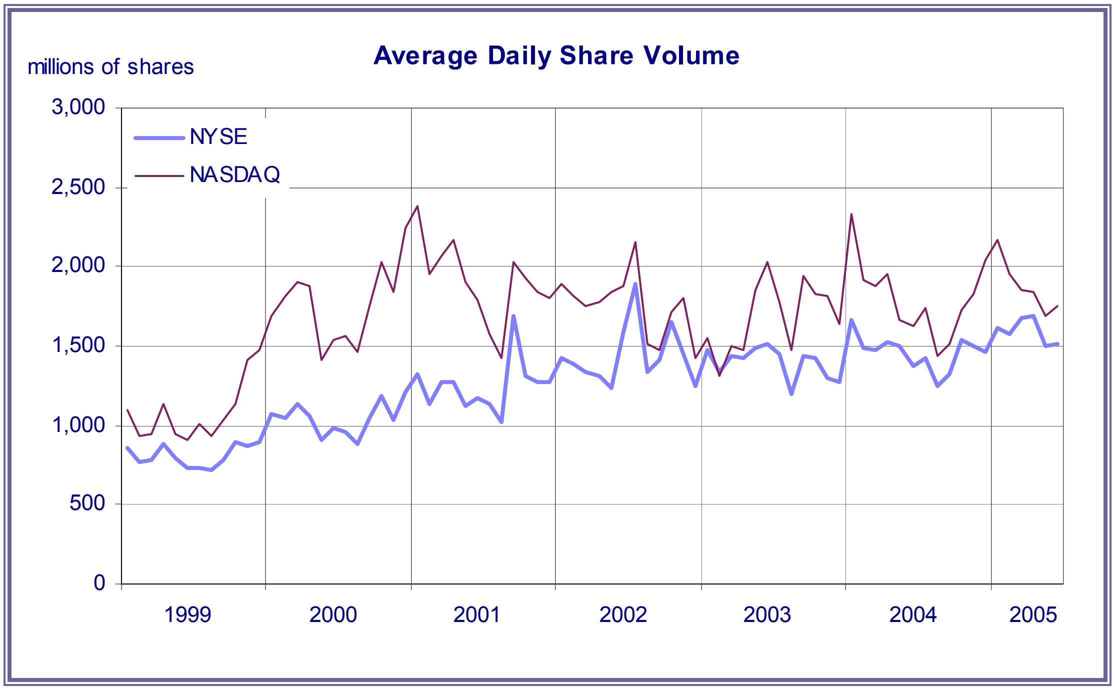
Stock Prices – The stock market's advance from recent lows in late April continued through mid-June, driven by lower longer-term interest rates, solid corporate earnings and economic growth, and subdued inflation. The rally faltered in late June, however, largely attributable to a spike in crude oil prices to $60 a barrel. Stock prices were further pressured when the Federal Open Market Committee indicated that it would likely continue to raise rates at a "measured" pace when it announced its ninth consecutive quarter-point increase in the federal funds rate to 3.25% on June 30.

For the month of June, the Dow Jones Industrial Average dropped 1.8% to close at 10,274.97, the NASDAQ Composite edged down 0.5% to 2,056.96, while the S&P 500 Index was basically flat, down a mere 0.01% to 1,191.33. That left the Dow with a loss of 2.2% for the second quarter overall, its second consecutive quarterly decline. Meanwhile, the S&P 500 inched up 0.9% while the NASDAQ Composite climbed 2.9% for the quarter.

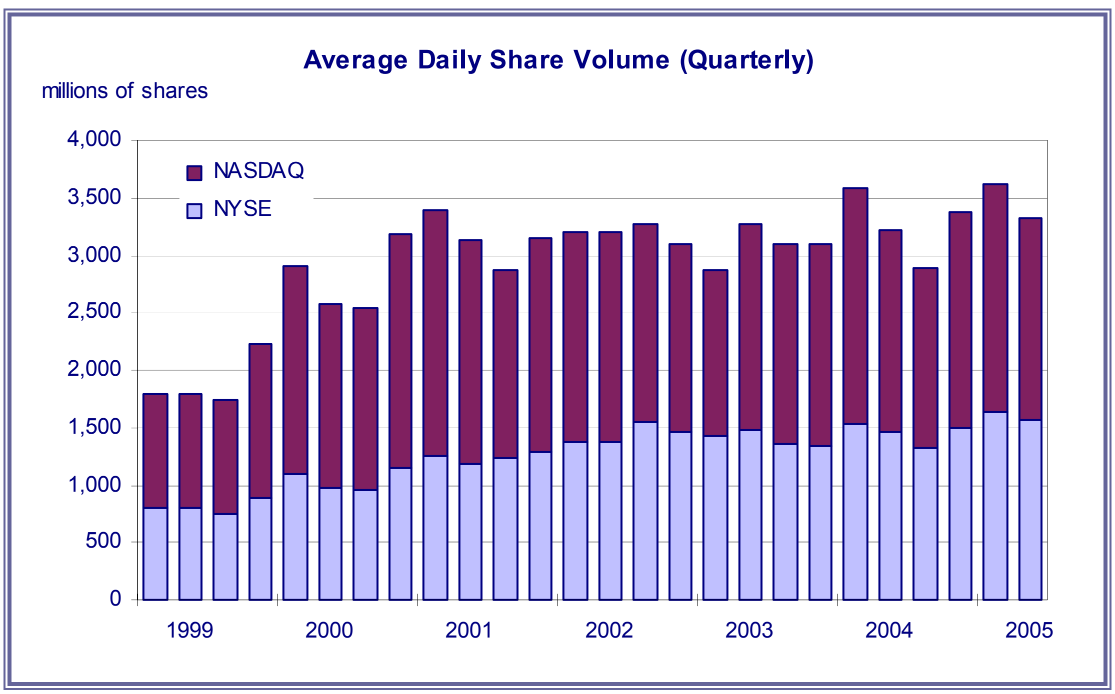
However, all of the major stock indices remained in negative territory year-to-date. The NASDAQ Composite fell 5.4%, the Dow lost 4.7%, and the S&P 500 shed 1.7% through the first half of 2005.



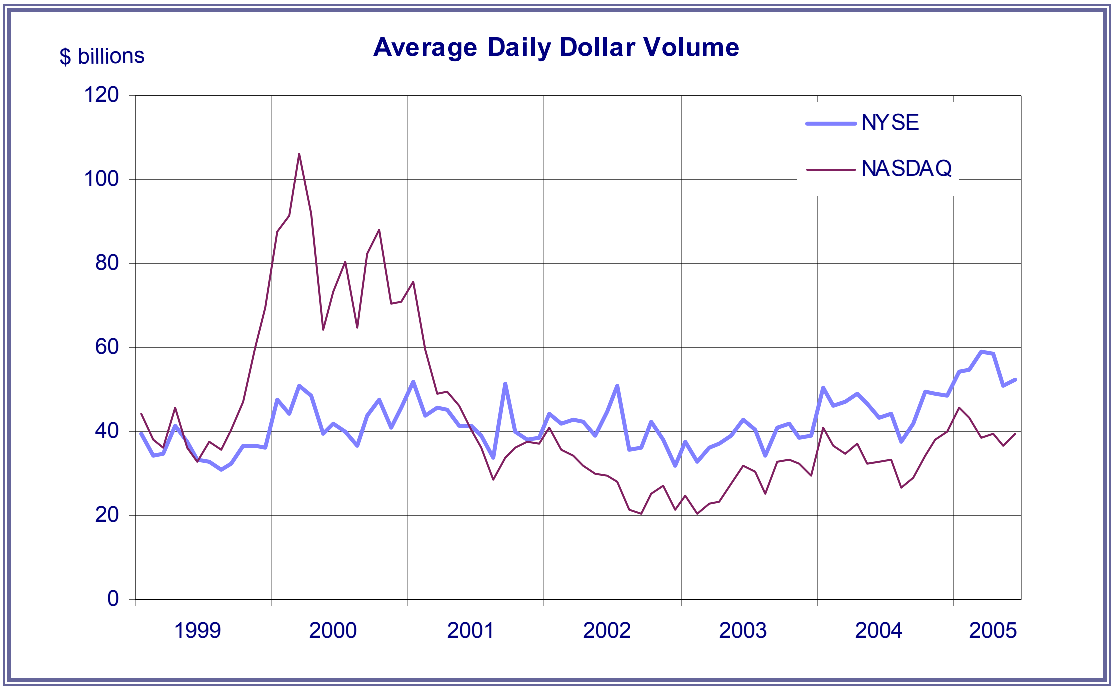
Share Volume – Although trading activity on both the New York Stock Exchange and NASDAQ stock market picked up after sinking to new 2005 monthly lows in May, June still marked the second-slowest month of trading so far this year. Average daily share volume on the NYSE rose 0.9% in June to 1.52 billion, while NASDAQ volume increased 3.7% for the month to 1.75 billion. Nevertheless, share volumes in the second quarter of 2005 were down 3.7% and 11.5% on the NYSE and NASDAQ, respectively, from the first quarter 2005.



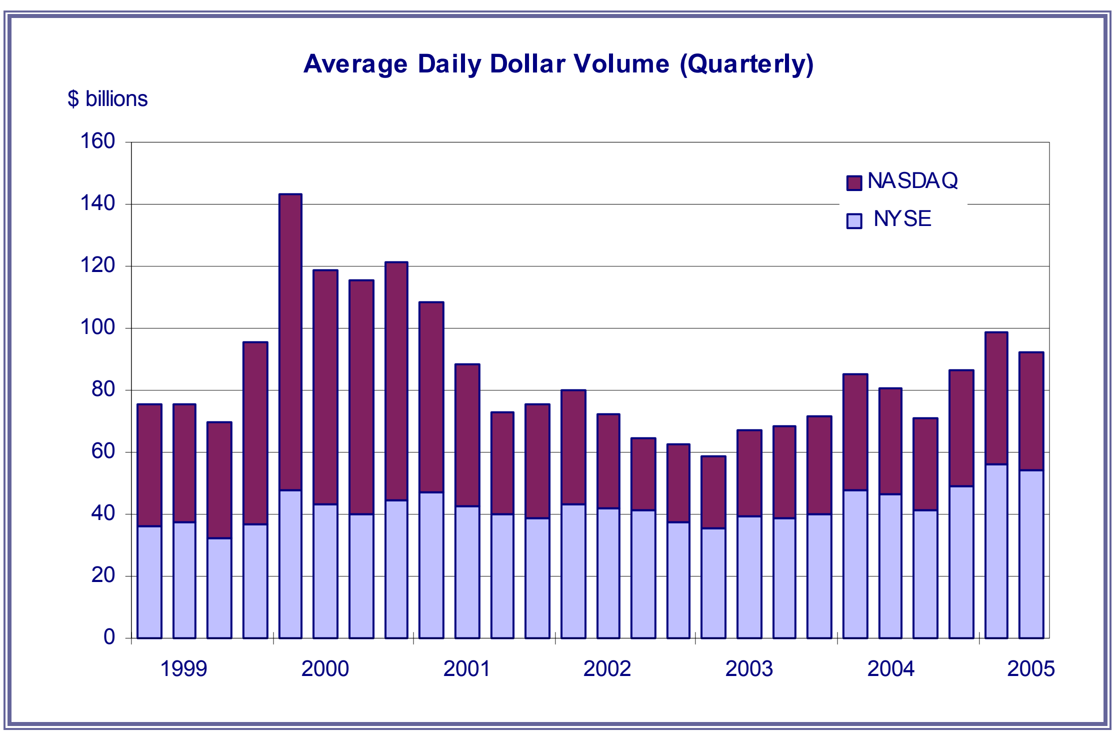
Although down quarter-to-quarter, year-to-date NYSE average daily share volume of 1.60 billion was up 6.4% compared to 1.50 billion in the same period last year. NASDAQ daily share volume averaged 1.87 billion year-to-date, just 1.2% short of the 1.89 billion daily pace in last year's first six months.



Dollar Volume – The value of trading in NYSE and NASDAQ stocks also increased in June from 2005 monthly lows in May. NYSE average daily dollar volume rose 3.3% from May's level to $52.5 billion in June, while NASDAQ volume jumped 7.7% for the month to $39.4 billion.

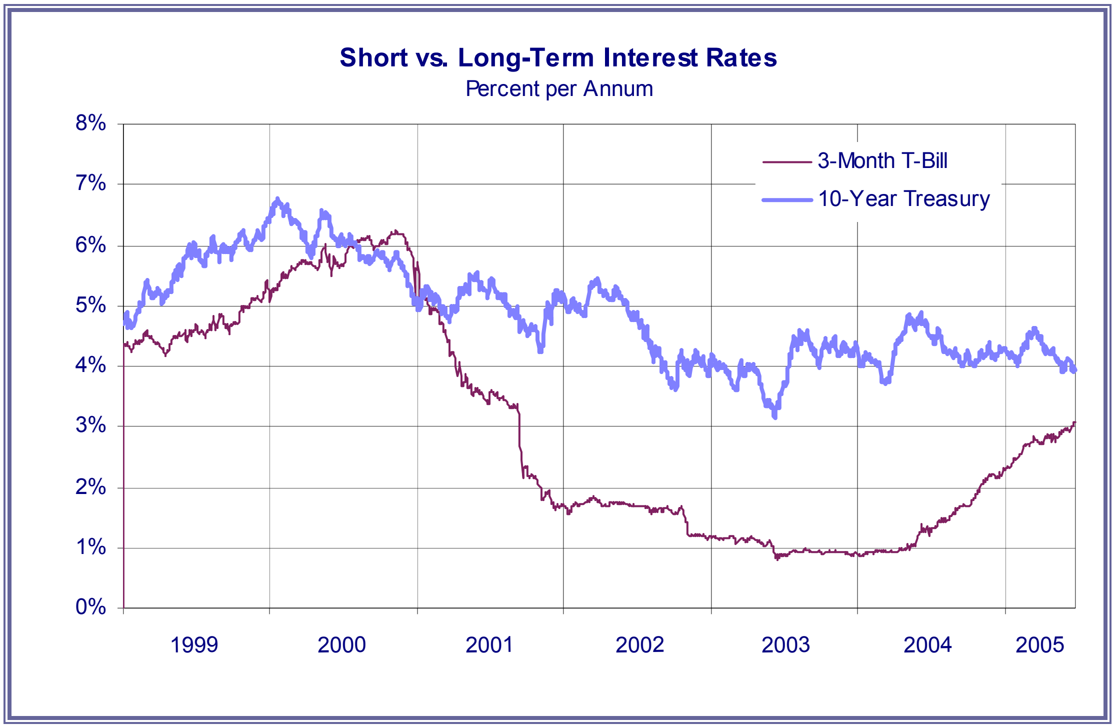


Despite June's gain, dollar volume in the second quarter was weaker relative to the previous quarter. Nonetheless, due to a strong first quarter, average daily dollar volume on the NYSE through the first half of 2005 reached $55.0 billion, representing a 16.5% increase over year-ago levels. NASDAQ dollar volume averaged $40.4 billion daily year-to-date, up 13.1% from $35.7 billion in the comparable period last year but still 50% below the record $80.9 billion daily pace set in 2000.



Interest Rates – Long-term Treasury yields continued to trend downward over the past three months despite persistent rate hikes by the Federal Reserve. After ending March at 4.50%, the yield on 10-year Treasury notes fell to a 15-month low of 3.89% on June 2 and settled at 3.94% by June's end. With two additional quarter-point increases in the key federal funds rate by the Fed during the second quarter of 2005, yields on three-month Treasury bills climbed above 3% for the first time since September 2001 and closed June at 3.06%.

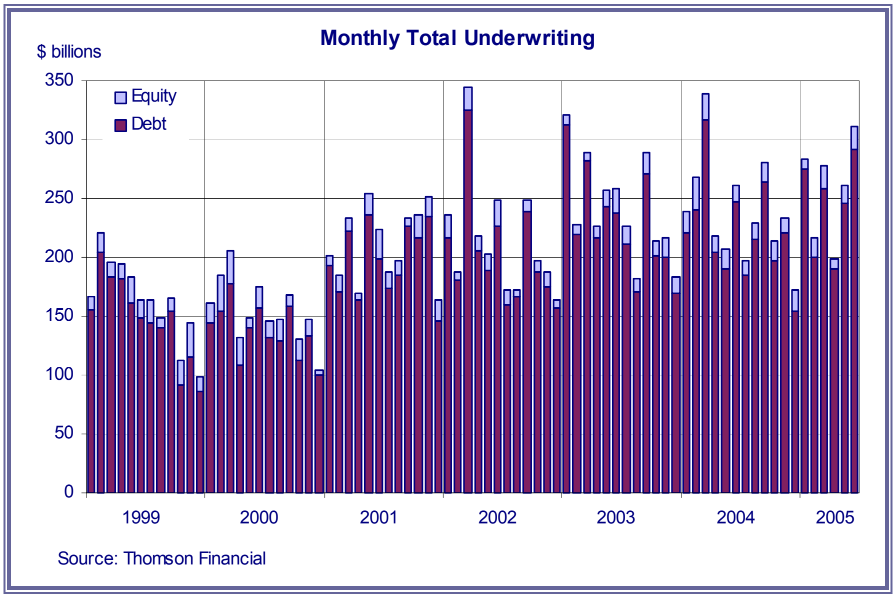
As a result, the spread between short- and long-term interest rates was cut in half from 177 basis points (bps) at the end of 1Q'05 to 88 bps in 2Q'05, the smallest gap since March 2001.

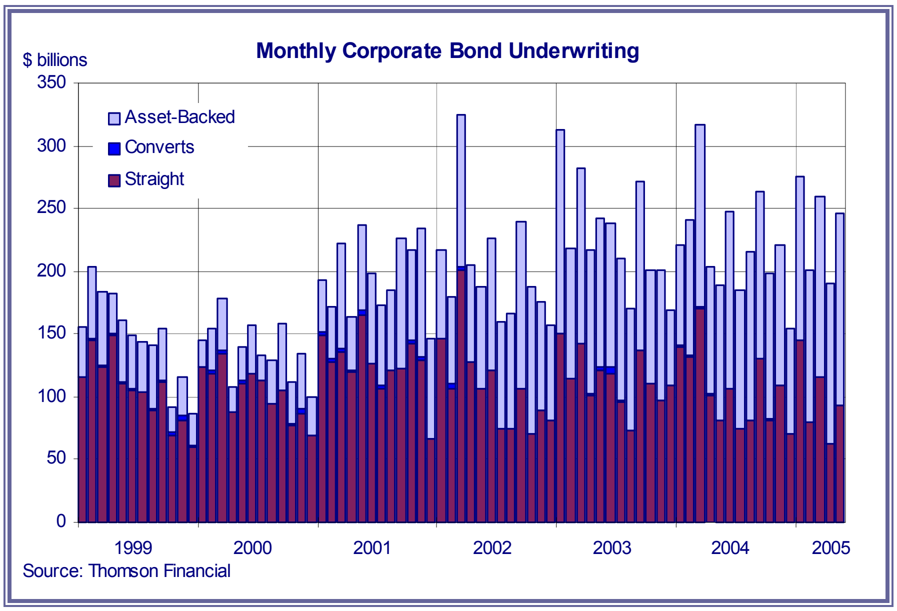


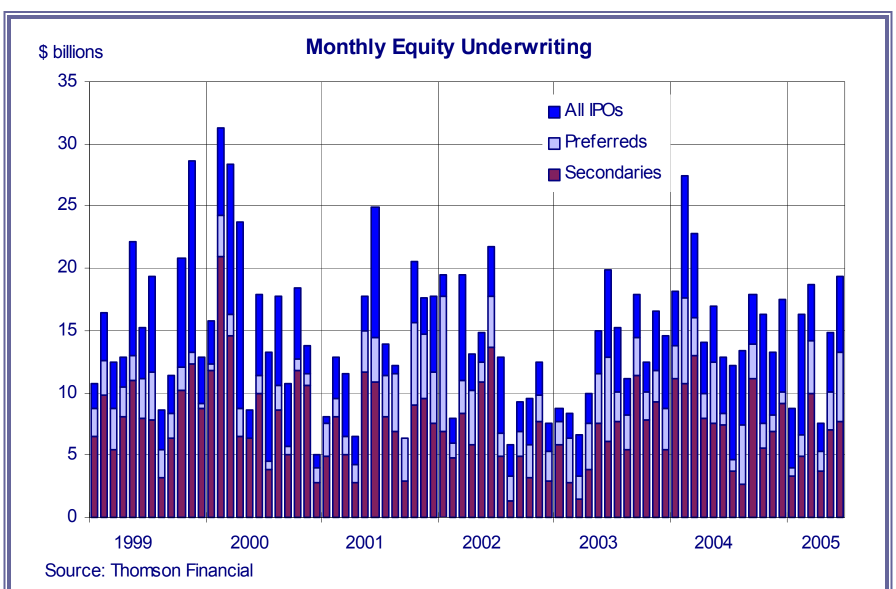
U.S. Underwriting Activity

The primary market witnessed a spurt in activity during June, with total domestic corporate underwriting volume increasing 18.9% to $310.6 billion from $261.2 billion in May. June's result was the best of the year and the fourth highest on record for the U.S. markets.

Robust corporate bond sales drove the overall total, as issuance rose 18.2% in June to $291.2 billion -- the highest amount underwritten in 15 months. Total equity issuance also reached a 15-month high in June, surging 31.1% from May's level to $19.4 billion.

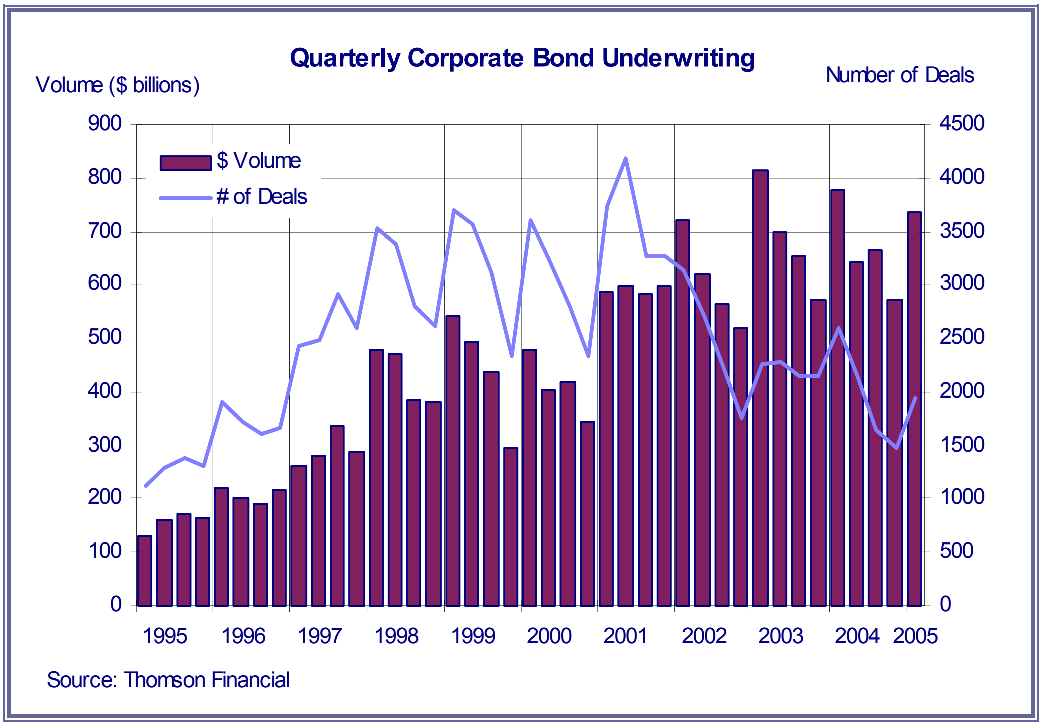

Monthly Total Underwriting
$ billions
350
300
250
200
150
100
50
0
Equity
Debt
1999
2000
2001
2002
2003
2004
2005
Source: Thomson Financial

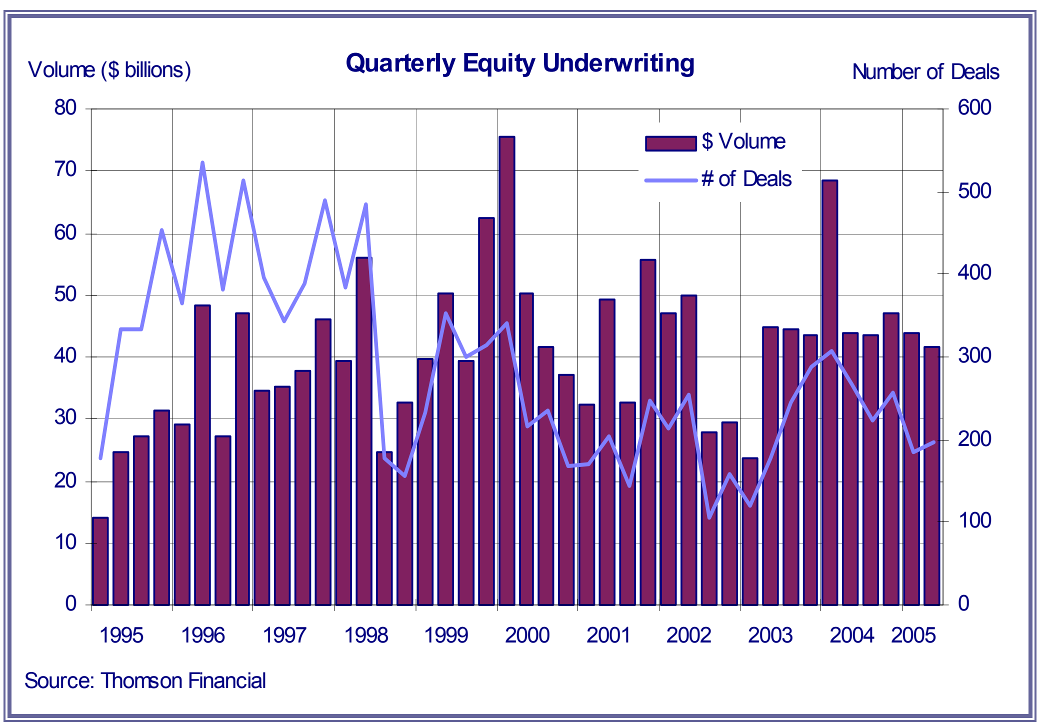

Monthly Corporate Bond Underwriting
$ billions
350
300
250
200
150
100
50
0
Asset-Backed
Converts
Straight
1999
2000
2001
2002
2003
2004
2005
Source: Thomson Financial


Monthly Equity Underwriting
$ billions
35
30
25
20
15
10
5
0
All IPOs
Preferreds
Secondaries
1999
2000
2001
2002
2003
2004
2005
Source: Thomson Financial

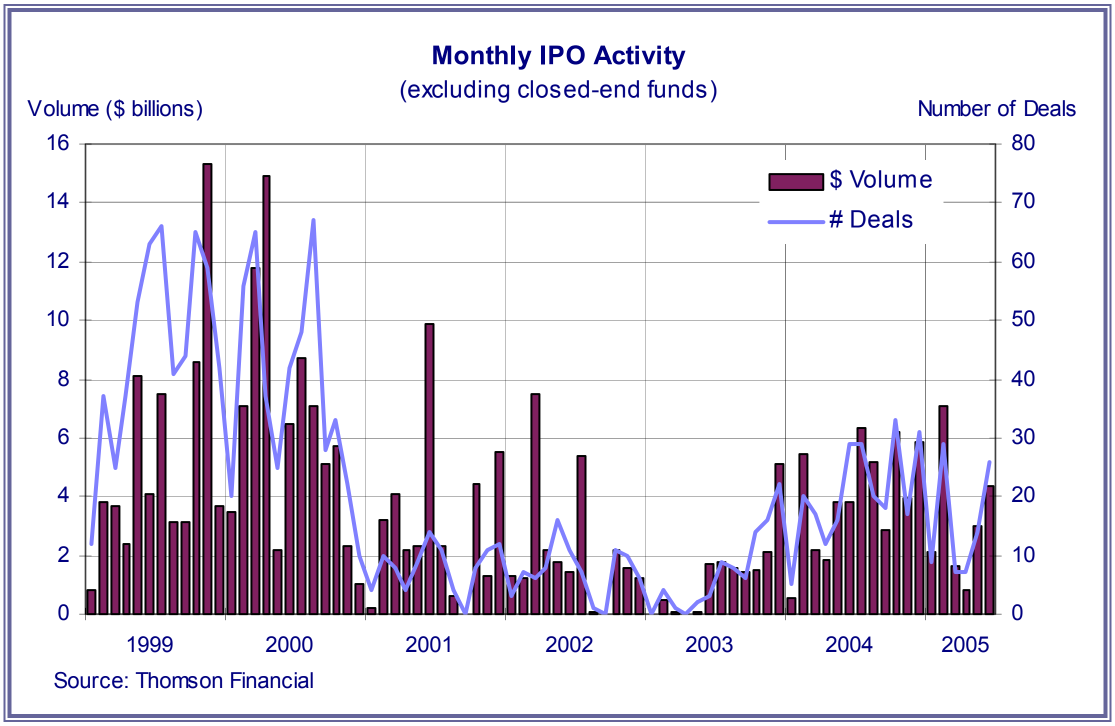
Quarter-to-quarter this year, total corporate underwriting was pretty even with just over $770 billion issued in the first and second quarters. The debt/equity mix was also about the same for each quarter, with activity in both segments slightly lower during the second quarter.

On a year-to-date basis, first half 2005 underwriting volume of $1.55 trillion was up a slim 1.1% over the $1.53 trillion total in the first half of 2004. However, bond syndications accounted for the uptick in overall volume this year, as a 3.1% increase in debt issuance ($1.46 trillion vs. $1.42 trillion) overcame a 23.8% decline in equity issuance ($86 billion vs. $112 billion in 2004's first half).

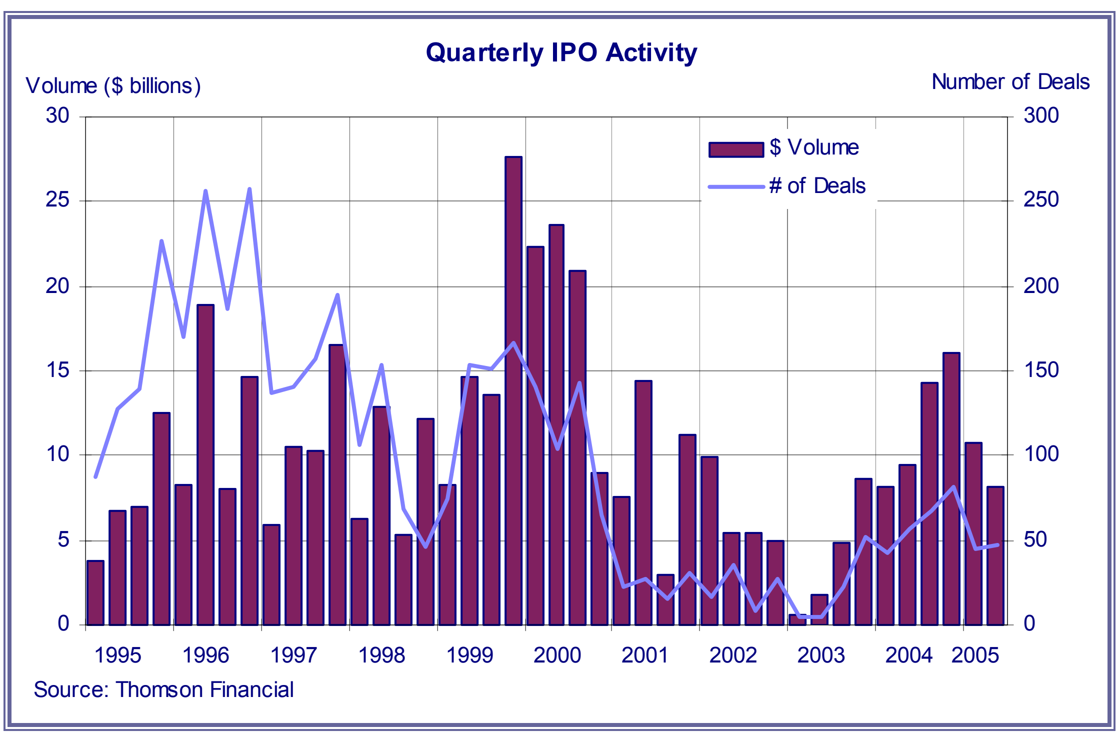




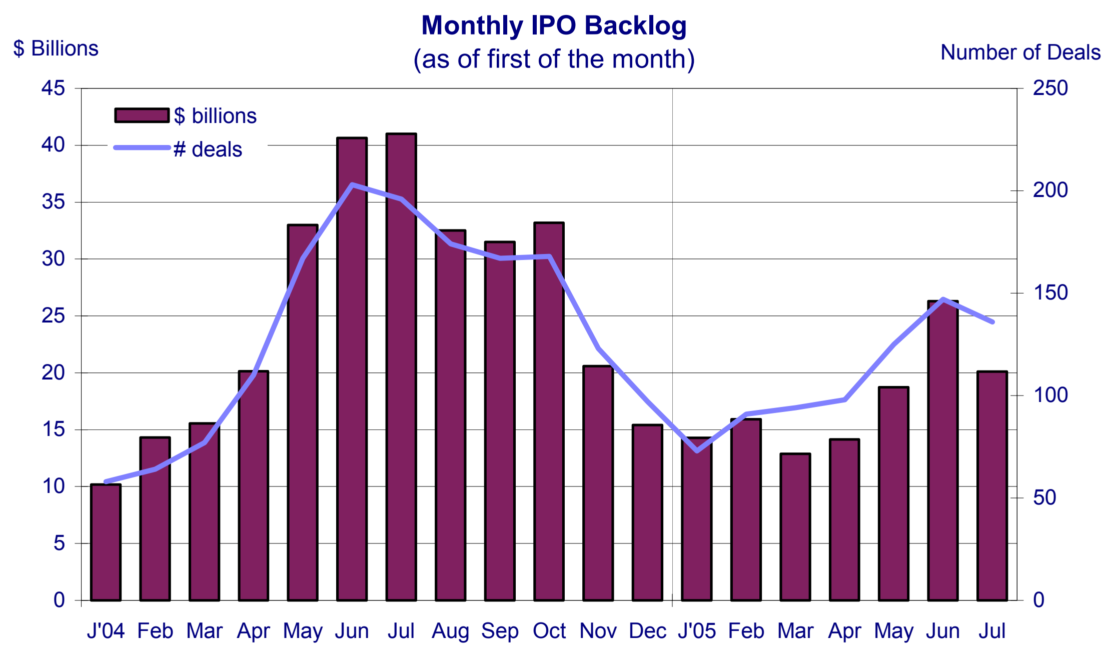
Initial Public Offerings (IPOs) – Dollar proceeds from IPOs (excludes closed-end funds) surged 43.3% above May's level to $4.3 billion in June, its second-best monthly showing this year behind February's strong total of $7.1 billion. Despite June's increased activity, the quarterly IPO syndication trend is decidedly downward. After climbing to $16.0 billion in last year's fourth quarter, the busiest period in four years, IPO volume fell back to $10.8 billion in 1Q'05, then slowed further to $8.2 billion in 2Q'05, its lowest level in more than a year.



Although down quarter-to-quarter, year-to-date IPO volume of $18.9 billion was 7.8% higher than last year's first-half total of $17.6 billion.



The backlog of filed U.S. IPOs declined 23% month-to-month to $20.1 billion as of July 1, as completed deals have yet to be replenished. Still, IPO activity is expected to pick up going forward, given the rebound in the stock market and the strong aftermarket performance of recent IPOs.



Source: Dealogic

Grace Toto
Vice President and Director, Statistics

U.S. CORPORATE UNDERWRITING ACTIVITY

(In $ Billions)

	Straight Corporate Debt	Con-vertible Debt	Asset-Backed Debt	**TOTAL DEBT**	Common Stock	Preferred Stock	**TOTAL EQUITY**	All IPOs	"True" IPOs	Secondaries	**TOTAL UNDER-WRITINGS**
1985	76.4	7.5	20.8	104.7	24.7	8.6	33.3	8.5	8.4	16.2	138.0
1986	149.8	10.1	67.8	227.7	43.2	13.9	57.1	22.3	18.1	20.9	284.8
1987	117.8	9.9	91.7	219.4	41.5	11.4	52.9	24.0	14.3	17.5	272.3
1988	120.3	3.1	113.8	237.2	29.7	7.6	37.3	23.6	5.7	6.1	274.5
1989	134.1	5.5	135.3	274.9	22.9	7.7	30.6	13.7	6.1	9.2	305.5
1990	107.7	4.7	176.1	288.4	19.2	4.7	23.9	10.1	4.5	9.0	312.3
1991	203.6	7.8	300.0	511.5	56.0	19.9	75.9	25.1	16.4	30.9	587.4
1992	319.8	7.1	427.0	753.8	72.5	29.3	101.8	39.6	24.1	32.9	855.7
1993	448.4	9.3	474.8	932.5	102.4	28.4	130.8	57.4	41.3	45.0	1,063.4
1994	381.2	4.8	253.5	639.5	61.4	15.5	76.9	33.7	28.3	27.7	716.4
1995	466.0	6.9	152.4	625.3	82.0	15.1	97.1	30.2	30.0	51.8	722.4
1996	564.8	9.3	252.9	827.0	115.5	36.5	151.9	50.0	49.9	65.5	979.0
1997	769.8	8.5	385.6	1,163.9	120.2	33.3	153.4	44.2	43.2	75.9	1,317.3
1998	1,142.5	6.3	566.8	1,715.6	115.0	37.8	152.7	43.7	36.6	71.2	1,868.3
1999	1,264.8	16.1	487.1	1,768.0	164.3	27.5	191.7	66.8	64.3	97.5	1,959.8
2000	1,236.2	17.0	393.4	1,646.6	189.1	15.4	204.5	76.1	75.8	112.9	1,851.0
2001	1,511.2	21.6	832.5	2,365.4	128.4	41.3	169.7	40.8	36.0	87.6	2,535.1
2002	1,303.2	8.6	1,115.4	2,427.2	116.4	37.6	154.0	41.2	25.8	75.2	2,581.1
2003	1,370.7	10.6	1,352.3	2,733.6	118.5	37.8	156.3	43.7	15.9	74.8	2,889.9
2004	1,278.4	5.5	1,372.3	2,656.2	169.6	33.2	202.7	72.8	47.9	96.7	2,859.0
2004											
Jan	139.4	1.4	80.3	221.1	15.6	2.6	18.2	4.4	0.5	11.2	239.2
Feb	132.2	0.7	108.1	240.9	20.5	6.9	27.4	9.8	5.4	10.7	268.2
Mar	170.5	0.6	145.2	316.2	19.8	3.1	22.8	6.7	2.2	13.0	339.1
Apr	101.6	0.3	101.9	203.9	12.0	2.1	14.1	4.1	1.8	7.9	218.0
May	81.4	0.1	108.1	189.6	12.2	4.8	17.0	4.6	3.8	7.6	206.6
June	107.0	0.0	140.6	247.6	11.8	1.0	12.9	4.5	3.8	7.4	260.5
July	74.2	0.0	110.7	184.9	11.2	1.0	12.2	7.5	6.3	3.7	197.1
Aug	81.0	0.0	134.7	215.7	8.6	4.8	13.4	6.0	5.2	2.6	229.1
Sept	130.5	0.6	132.1	263.2	15.2	2.7	17.9	4.0	2.8	11.2	281.1
Oct	81.0	1.1	115.6	197.7	14.4	1.9	16.3	8.8	6.2	5.6	214.0
Nov	108.7	0.4	111.7	220.9	11.8	1.3	13.1	5.0	4.0	6.9	234.0
Dec	70.9	0.3	83.5	154.6	16.5	1.0	17.5	7.4	5.8	9.1	172.1
2005											
Jan	144.6	0.2	130.2	274.9	8.1	0.7	8.8	4.9	2.1	3.3	283.7
Feb	80.3	0.0	120.1	200.4	14.7	1.7	16.4	9.8	7.1	4.9	216.7
Mar	115.7	0.5	142.8	259.0	14.4	4.3	18.7	4.4	1.6	10.0	277.7
Apr	62.3	0.8	127.8	190.9	6.0	1.5	7.5	2.2	0.8	3.8	198.4
May	92.7	0.0	153.7	246.4	11.9	3.0	14.8	4.8	3.0	7.0	261.2
June	138.1	1.9	151.3	291.2	13.9	5.5	19.4	6.2	4.3	7.7	310.6
YTD '04	732.1	3.1	684.1	1,419.3	91.9	20.5	112.3	34.2	17.6	57.7	1,531.6
YTD '05	633.6	3.4	825.9	1,462.8	68.9	16.7	85.6	32.3	18.9	36.6	1,548.4
% Change	-13.5%	10.0%	20.7%	3.1%	-25.0%	-18.6%	-23.8%	-5.4%	7.8%	-36.6%	1.1%

Note: IPOs and secondaries are subsets of common stock. “True” IPOs exclude closed-end funds.
Source: Thomson Financial

MUNICIPAL BOND UNDERWRITINGS
(In $ Billions)

INTEREST RATES
(Averages)

	Compet. Rev. Bonds	Nego. Rev. Bonds	**TOTAL REVENUE BONDS**	Compet. G.O.s	Nego. G.O.s	**TOTAL G.O.s**	**TOTAL MUNICIPAL BONDS**	3-Mo. T Bills	10-Year Treasuries	SPREAD
1985	10.2	150.8	161.0	17.6	22.8	40.4	201.4	7.47	10.62	3.15
1986	10.0	92.6	102.6	23.1	22.6	45.7	148.3	5.97	7.68	1.71
1987	7.1	64.4	71.5	16.3	14.2	30.5	102.0	5.78	8.39	2.61
1988	7.6	78.1	85.7	19.2	12.7	31.9	117.6	6.67	8.85	2.18
1989	9.2	75.8	85.0	20.7	17.2	37.9	122.9	8.11	8.49	0.38
1990	7.6	78.4	86.0	22.7	17.5	40.2	126.2	7.50	8.55	1.05
1991	11.0	102.1	113.1	29.8	28.1	57.9	171.0	5.38	7.86	2.48
1992	12.5	139.0	151.6	32.5	49.0	81.5	233.1	3.43	7.01	3.58
1993	20.0	175.6	195.6	35.6	56.7	92.4	287.9	3.00	5.87	2.87
1994	15.0	89.2	104.2	34.5	23.2	57.7	161.9	4.25	7.09	2.84
1995	13.5	81.7	95.2	27.6	32.2	59.8	155.0	5.49	6.57	1.08
1996	15.6	100.1	115.7	31.3	33.2	64.5	180.2	5.01	6.44	1.43
1997	12.3	130.2	142.6	35.5	36.5	72.0	214.6	5.06	6.35	1.29
1998	21.4	165.6	187.0	43.7	49.0	92.8	279.8	4.78	5.26	0.48
1999	14.3	134.9	149.2	38.5	31.3	69.8	219.0	4.64	5.65	1.01
2000	13.6	116.2	129.7	35.0	29.3	64.3	194.0	5.82	6.03	0.21
2001	17.6	164.2	181.8	45.5	56.3	101.8	283.5	3.39	5.02	1.63
2002	19.5	210.5	230.0	52.3	73.1	125.4	355.4	1.60	4.61	3.01
2003	21.1	215.8	236.9	54.7	87.7	142.4	379.3	1.01	4.02	3.00
2004	17.2	209.8	227.1	51.5	77.7	129.2	356.3	1.37	4.27	2.90
<u>2004</u>										
Jan	0.7	10.4	11.1	3.6	5.7	9.3	20.4	0.88	4.15	3.27
Feb	1.0	13.0	14.1	4.8	7.7	12.5	26.5	0.93	4.08	3.15
Mar	2.7	19.7	22.4	5.6	10.5	16.1	38.5	0.94	3.83	2.89
Apr	1.0	18.1	19.0	3.5	8.2	11.8	30.8	0.94	4.35	3.41
May	1.4	28.0	29.5	3.1	4.7	7.8	37.2	1.02	4.72	3.70
June	1.3	24.0	25.3	4.5	5.4	9.8	35.1	1.27	4.73	3.46
July	1.8	14.6	16.5	5.1	3.7	8.9	25.3	1.33	4.50	3.17
Aug	0.6	15.5	16.1	4.0	7.6	11.6	27.7	1.48	4.28	2.80
Sept	1.7	13.2	14.9	5.3	4.8	10.1	25.0	1.65	4.13	2.48
Oct	2.4	17.7	20.0	5.3	6.5	11.8	31.9	1.76	4.10	2.34
Nov	1.1	17.2	18.3	2.3	4.6	6.8	25.1	2.07	4.19	2.12
Dec	1.5	18.5	20.0	4.5	8.3	12.7	32.7	2.19	4.23	2.04
<u>2005</u>										
Jan	1.0	11.7	12.6	3.2	6.6	9.8	22.4	2.33	4.22	1.89
Feb	1.5	15.6	17.1	4.5	9.2	13.6	30.7	2.54	4.17	1.63
Mar	1.2	24.0	25.1	7.1	12.5	19.7	44.8	2.74	4.50	1.76
Apr	1.9	16.7	18.5	5.1	8.0	13.1	31.6	2.76	4.34	1.58
May	1.4	21.5	22.9	4.0	9.4	13.5	36.4	2.84	4.14	1.30
June	2.4	22.3	24.7	6.9	8.7	15.6	40.3	2.97	4.00	1.03
YTD '04	8.2	113.2	121.4	25.0	42.2	67.3	188.6	1.00	4.31	3.31
YTD '05	9.3	111.7	121.0	30.9	54.4	85.3	206.3	2.70	4.23	1.53
% Change	13.7%	-1.3%	-0.3%	23.5%	28.8%	26.8%	9.4%	170.6%	-1.9%	-53.8%

Sources: Thomson Financial; Federal Reserve

	STOCK MARKET PERFORMANCE INDICES (End of Period)				STOCK MARKET VOLUME (Daily Avg., Mils. of Shs.)			VALUE TRADED (Daily Avg., $ Bils.)	
	Dow Jones Industrial Average	S&P 500	NYSE Composite	NASDAQ Composite	NYSE	AMEX	NASDAQ	NYSE	NASDAQ
1985	1,546.67	211.28	1,285.66	324.93	109.2	8.3	82.1	3.9	0.9
1986	1,895.95	242.17	1,465.31	348.83	141.0	11.8	113.6	5.4	1.5
1987	1,938.83	247.08	1,461.61	330.47	188.9	13.9	149.8	7.4	2.0
1988	2,168.57	277.72	1,652.25	381.38	161.5	9.9	122.8	5.4	1.4
1989	2,753.20	353.40	2,062.30	454.82	165.5	12.4	133.1	6.1	1.7
1990	2,633.66	330.22	1,908.45	373.84	156.8	13.2	131.9	5.2	1.8
1991	3,168.83	417.09	2,426.04	586.34	178.9	13.3	163.3	6.0	2.7
1992	3,301.11	435.71	2,539.92	676.95	202.3	14.2	190.8	6.9	3.5
1993	3,754.09	466.45	2,739.44	776.80	264.5	18.1	263.0	9.0	5.3
1994	3,834.44	459.27	2,653.37	751.96	291.4	17.9	295.1	9.7	5.8
1995	5,117.12	615.93	3,484.15	1,052.13	346.1	20.1	401.4	12.2	9.5
1996	6,448.27	740.74	4,148.07	1,291.03	412.0	22.1	543.7	16.0	13.0
1997	7,908.25	970.43	5,405.19	1,570.35	526.9	24.4	647.8	22.8	17.7
1998	9,181.43	1,229.23	6,299.93	2,192.69	673.6	28.9	801.7	29.0	22.9
1999	11,497.12	1,469.25	6,876.10	4,069.31	808.9	32.7	1,081.8	35.5	43.7
2000	10,786.85	1,320.28	6,945.57	2,470.52	1,041.6	52.9	1,757.0	43.9	80.9
2001	10,021.50	1,148.08	6,236.39	1,950.40	1,240.0	65.8	1,900.1	42.3	44.1
2002	8,341.63	879.82	5,000.00	1,335.51	1,441.0	63.7	1,752.8	40.9	28.8
2003	10,453.92	1,111.92	6,440.30	2,003.37	1,398.4	67.1	1,685.5	38.5	28.0
2004	10,783.01	1,211.92	7,250.06	2,175.44	1,456.7	65.6	1,801.3	46.1	34.6
2004									
Jan	10,488.07	1,131.13	6,551.63	2,066.15	1,663.1	83.5	2,331.7	50.3	40.9
Feb	10,583.92	1,144.94	6,692.37	2,029.82	1,481.2	75.6	1,917.2	46.3	36.5
Mar	10,357.70	1,126.21	6,599.06	1,994.22	1,477.5	77.3	1,880.6	47.1	34.9
Apr	10,225.57	1,107.30	6,439.42	1,920.15	1,524.7	78.3	1,950.8	49.0	37.3
May	10,188.45	1,120.68	6,484.72	1,986.74	1,500.0	72.1	1,663.6	46.9	32.3
June	10,435.48	1,140.84	6,602.99	2,047.79	1,371.4	57.4	1,623.3	43.5	32.9
July	10,139.71	1,101.72	6,403.15	1,887.36	1,418.1	54.1	1,734.8	44.1	33.2
Aug	10,173.92	1,104.24	6,454.22	1,838.10	1,243.5	49.9	1,431.0	37.7	26.7
Sept	10,080.27	1,114.58	6,570.25	1,896.84	1,322.2	52.7	1,510.7	41.8	29.1
Oct	10,027.47	1,130.20	6,692.71	1,974.99	1,543.5	61.3	1,730.7	49.5	34.5
Nov	10,428.02	1,173.82	7,005.72	2,096.81	1,494.4	68.5	1,827.6	49.0	38.0
Dec	10,783.01	1,211.92	7,250.06	2,175.44	1,463.3	63.3	2,042.2	48.4	39.9
2005									
Jan	10,489.94	1,181.27	7,089.83	2,062.41	1,618.4	62.5	2,172.3	54.1	45.5
Feb	10,766.23	1,203.60	7,321.23	2,051.72	1,578.2	62.7	1,950.2	54.5	43.2
Mar	10,503.76	1,180.59	7,167.53	1,999.23	1,682.6	66.7	1,849.0	59.1	38.8
Apr	10,192.51	1,156.85	7,008.32	1,921.65	1,692.8	61.7	1,839.2	58.8	39.6
May	10,467.48	1,191.50	7,134.33	2,068.22	1,502.1	52.9	1,685.6	50.8	36.6
June	10,274.97	1,191.33	7,217.78	2,056.96	1,515.8	58.0	1,747.9	52.5	39.4
YTD '04	10,435.48	1,140.84	6,602.99	2,047.79	1,501.6	74.0	1,892.3	47.2	35.7
YTD '05	10,274.97	1,191.33	7,217.78	2,056.96	1,598.5	60.7	1,869.2	55.0	40.4
% Change	-1.5%	4.4%	9.3%	0.4%	6.4%	-18.0%	-1.2%	16.5%	13.1%

MUTUAL FUND ASSETS
($ Billions)

MUTUAL FUND NET NEW CASH FLOW*
($ Billions)

	Assets: Equity	Assets: Hybrid	Assets: Bond	Assets: Money Market	**TOTAL ASSETS**	Cash Flow: Equity	Cash Flow: Hybrid	Cash Flow: Bond	Cash Flow: Money Market	**TOTAL**	Total Long-Term Funds
1985	116.9	12.0	122.6	243.8	495.4	8.5	1.9	63.2	-5.4	68.2	73.6
1986	161.4	18.8	243.3	292.2	715.7	21.7	5.6	102.6	33.9	163.8	129.9
1987	180.5	24.2	248.4	316.1	769.2	19.0	4.0	6.8	10.2	40.0	29.8
1988	194.7	21.1	255.7	338.0	809.4	-16.1	-2.5	-4.5	0.1	-23.0	-23.1
1989	248.8	31.8	271.9	428.1	980.7	5.8	4.2	-1.2	64.1	72.8	8.8
1990	239.5	36.1	291.3	498.3	1,065.2	12.8	2.2	6.2	23.2	44.4	21.2
1991	404.7	52.2	393.8	542.5	1,393.2	39.4	8.0	58.9	5.5	111.8	106.3
1992	514.1	78.0	504.2	546.2	1,642.5	78.9	21.8	71.0	-16.3	155.4	171.7
1993	740.7	144.5	619.5	565.3	2,070.0	129.4	39.4	73.3	-14.1	228.0	242.1
1994	852.8	164.5	527.1	611.0	2,155.4	118.9	20.9	-64.6	8.8	84.1	75.2
1995	1,249.1	210.5	598.9	753.0	2,811.5	127.6	5.3	-10.5	89.4	211.8	122.4
1996	1,726.1	252.9	645.4	901.8	3,526.3	216.9	12.3	2.8	89.4	321.3	232.0
1997	2,368.0	317.1	724.2	1,058.9	4,468.2	227.1	16.5	28.4	102.1	374.1	272.0
1998	2,978.2	364.7	830.6	1,351.7	5,525.2	157.0	10.2	74.6	235.3	477.1	241.8
1999	4,041.9	383.2	808.1	1,613.1	6,846.3	187.7	-12.4	-5.5	193.6	363.4	169.8
2000	3,962.0	346.3	811.1	1,845.2	6,964.7	309.4	-30.7	-49.8	159.6	388.6	228.9
2001	3,418.2	346.3	925.1	2,285.3	6,975.0	31.9	9.5	87.7	375.6	504.8	129.2
2002	2,667.0	327.4	1,124.9	2,272.0	6,391.3	-27.7	8.6	140.3	-46.7	74.5	121.2
2003	3,684.8	436.7	1,240.9	2,051.7	7,414.1	152.3	32.6	31.0	-258.5	-42.6	215.8
2004	4,384.1	519.3	1,290.3	1,913.2	8,106.9	177.7	42.6	-10.6	-156.8	52.9	209.7
2004											
Jan	3,804.2	440.7	1,256.6	2,032.1	7,533.7	43.0	5.4	-0.3	-19.5	28.7	48.2
Feb	3,893.5	452.7	1,267.2	2,015.2	7,628.6	26.2	5.0	1.5	-20.9	11.8	32.7
Mar	3,885.1	455.7	1,277.7	2,006.8	7,625.4	15.6	4.8	7.5	-9.0	18.8	27.8
Apr	3,811.3	452.5	1,245.7	1,964.2	7,473.7	23.0	4.6	-7.8	-44.1	-24.3	19.8
May	3,855.0	457.1	1,223.3	1,974.6	7,510.0	0.4	2.3	-16.2	8.6	-4.9	-13.5
June	3,948.0	467.0	1,220.9	1,954.3	7,590.3	10.0	2.4	-7.5	-21.3	-16.4	4.9
July	3,796.9	462.4	1,229.2	1,953.6	7,442.2	9.4	3.0	-1.2	-2.0	9.2	11.2
Aug	3,804.1	469.9	1,253.4	1,944.5	7,471.8	1.2	2.6	4.2	-10.3	-2.3	8.0
Sept	3,916.5	479.0	1,263.9	1,903.6	7,563.0	10.3	3.0	2.8	-42.4	-26.3	16.1
Oct	3,994.1	487.4	1,277.8	1,891.4	7,650.7	7.2	3.5	3.6	-14.1	0.1	14.2
Nov	4,222.3	504.5	1,276.5	1,920.2	7,923.5	21.4	4.1	2.0	26.5	54.0	27.6
Dec	4,384.1	519.3	1,290.3	1,913.2	8,106.9	10.2	1.9	0.8	-8.1	4.9	13.0
2005											
Jan	4,289.2	516.7	1,302.0	1,892.9	8,000.8	10.0	5.3	4.6	-27.5	-7.6	19.9
Feb	4,416.8	529.9	1,304.6	1,875.6	8,126.9	22.2	4.4	2.6	-18.9	10.2	29.2
Mar	4,348.8	526.4	1,294.1	1,875.8	8,045.0	15.1	3.9	-1.3	-2.3	15.5	17.8
Apr	4,247.1	523.7	1,305.7	1,842.7	7,919.2	8.6	2.6	1.2	-35.4	-23.0	12.4
May	4,406.9	535.9	1,321.5	1,859.3	8,123.5	11.2	2.3	3.6	13.8	30.9	17.1
YTD '04	3,855.0	457.1	1,223.3	1,974.6	7,510.0	108.1	22.1	-15.3	-84.8	30.1	114.9
YTD '05	4,406.9	535.9	1,321.5	1,859.3	8,123.5	67.1	18.6	10.7	-70.4	26.0	96.3
% Change	14.3%	17.2%	8.0%	-5.8%	8.2%	-37.9%	-16.0%	NM	NM	-13.7%	-16.2%

* New sales (excluding reinvested dividends) minus redemptions, combined with net exchanges
Source: Investment Company Institute

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