

RETIREMENT Plan Trends



A benefits update

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Many 401(k) Account Balances Have Been Recovered

Many participants in 401(k) and other defined contribution plans have seen their retirement account balances restored to the levels reached before the financial downturn, but plan sponsors may need to continue communicating to employees the value of making contributions to their accounts even as the market recovers, according to a study released by benefits administration outsourcing provider Mercer.

Based on a survey of nearly 1.2 million defined contribution plan participants, the study found that, as of year-end 2009, nearly 70% of participant balances had returned to levels prior to the stock market declines of 2008 and early 2009. Researchers observed that these gains represent a dramatic improvement compared to

year-end 2008, the low point of the recent economic downturn.

The study compared the account balances of workers at year-end 2008 and 2009 with the balances accrued before the downturn started, at year-end 2007. Results showed that, among all participants, 64% had balances below 2007 levels in 2008, but

only 31% had lower balances by the end of 2009. The findings indicated that retirement plan participants under the age of 30 were, on average, least affected by the market downturn: 41% of participants in this age group had lower balances at year-end 2008, and just 16% had lower balances by the end of 2009. However, the survey also found that workers aged 55 and older have met challenges in recovering their 2007 balances: 70% of older participants had lower balances at year-end 2008, and 36% still had lower balances at year-end 2009.

The results thus indicated that, between year-end 2007 and year-end 2009, the average account balance of participants aged 30 and under increased 81%, while the average account balance of participants aged

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The survey showed that participants steadily increased their own contributions every month after June 2009, when the average contribution rate reached a low of 6.83%. By the end of 2009, the contribution rate had risen to 6.86%.

55 and older declined 2%. According to researchers, this discrepancy between the two age groups may be attributed to a number of factors, including the likelihood that younger participants, who generally have smaller account balances, saw a greater impact from making ongoing account contributions. They further observed that 7% of participants aged 55 and older lost more than 30% of their account value, and the majority of participants aged 55 and older who realized a gain in their accounts over the period studied generally had smaller account balances. Potentially exacerbating the problem was the fact that nearly half of participants aged 55 and older who lost more than 30% of their account value withdrew funds from their accounts.

“While the improvement in account balances is certainly encouraging, many participants have essentially lost two years in accumulating retirement savings,” said Dave Tolve, retirement business leader for Mercer’s outsourcing business. “For those closest to retirement, these lost years are particularly troubling given that most experts agree this group lacked adequate retirement savings even before the market downturn and now have that much less time to recover.”

At the same time, the survey findings suggested that retirement plan participants have been regaining confidence in their 401(k) plans in line with the market improvements that occurred in 2009. The survey showed that participants steadily increased their own contributions every month after June 2009, when the average contribution rate reached a low of 6.83%. By the end of 2009, the contribution rate had risen to 6.86%. Yet, researchers pointed out that this average contribution rate is still well below the 2007 rate of 7.46%. Among participants under age 30, the contribution rate fell from 4.86% in 2007 to 4.04% at year-end 2009, while the average contribution rate among workers aged 55 and over declined from 9.49% to 8.86% over the same period.

“Many of our plan sponsor clients and their participants gave a collective

sigh of relief at the end of 2009, given the dire outlook at the beginning of the year,” said Tolve. “We should keep in mind, however, that ‘better than feared’ is not the same as plan participants being financially prepared for retirement. Now more than ever, plan sponsors need to work with their administration providers to clearly communicate the benefits of saving for retirement and the many resources available to help them do so.”

Trends In Target-Date Funds Since 2008

Despite scrutiny in the wake of the 2008 stock market downturn, target-date funds continue to be a favored vehicle for retirement saving, with more than \$45 billion in new cash flowing into these funds in 2009 alone, according to a survey conducted by independent investment research firm Morningstar, Inc.

Morningstar’s 2010 Target-Date Series Industry Survey is based on the firm’s research on 20 of the largest target-date series. The survey examined trends in target-date fund design, costs, and asset flows since the 2008 market downturn; the strengths and weaknesses of target-date funds; and the funds’ returns to investors.

“Target-date funds have been the subject of unprecedented regulatory, governmental, and media criticism in the wake of 2008’s market slide, but that has not deterred millions of investors from making these funds the centerpiece of their retirement savings,” said Laura Pavlenko Lutton, editorial director for Morningstar’s mutual fund research group.

Lutton added that “target-date funds have become the retirement vehicle of a generation, and for some good reasons.” She observed that the funds have structural advantages over traditional mutual funds, including generally lower costs and dynamic asset allocation that automatically grows more conservative as investors age.

The survey looked at investor returns, which reflect monthly flows in and out of funds and the returns earned, and which therefore represent a typical shareholder's experience. The analysis showed that, with target-date funds, investor returns over the past three years exceeded the funds' total returns in every target-date category except for one, and far exceeded the typical shareholder's experience of owning a traditional mutual fund.

"Mutual fund shareholders usually reward funds that treat them well by staying put, and investors have been successful owners of target-date funds over the past three years," Lutton observed.

However, while individual investors appear to remain confident in target-date funds, many fund companies are taking steps to reduce the risk of losses, according to the report. Results indicated that there was a general move among the fund families to cut costs by lowering expense ratios or introducing cheaper indexed series. Researchers further noted that several fund series took steps to reduce risk by lowering the funds' equity allocations, which caused steep losses in 2008, while others introduced or increased exposure to sub-asset classes in an effort to smooth returns.

Lutton noted that lower fees directly benefit investors, "but changes to the funds' equity exposure could leave the industry open to charges that it is fighting the last market battle, and not positioning the funds correctly for the future." Indeed, she added, some funds that were aggressively positioned in 2008 "were whipsawed when they turned conservative prior to the market rebound in 2009."

The survey also examined whether "open architecture" target-date series, which make up about one-third of the series included in the survey, showed a performance advantage. Researchers noted that, in the aftermath of the market downturn, some members of Congress and the media questioned series with managers who are independent of the fund's advisors, as is the case with open architecture target-date series. The survey found

no advantage or disadvantage to open architecture.

In addition, the survey looked at whether fund companies provided the disclosure recommended by its own industry association, the Investment Company Institute (ICI), as well as the details investors need to understand the target-date funds' potential risks and rewards. The findings indicated that, while funds have varying levels of disclosure, many fail to communicate adequately with shareholders. Researchers recommended that a more stringent set of disclosure requirements be imposed on target-date funds. For example, they argued that funds should be required to disclose publicly and prominently to shareholders the investment rationale behind the strategic asset-allocation path used in the target-date series, and in a fund-of-funds structure, complete information about the underlying funds should be provided.

The survey also investigated fund managers' level of personal investment in their funds to determine if the fund managers' own financial interests were aligned with those of the shareholders. The findings showed that only a minority of the managers of the target-date funds studied currently have sizable personal investments in the funds they manage, though the failure to invest could have to do with administrative barriers that make it difficult for these individuals to invest in the funds.

Retirement Plan Participation Rising Among Recent Generations

Participation in tax-deferred retirement plans has risen dramatically in recent decades, with younger generations becoming increasingly likely to contribute to retirement plans as they near retirement age, a study recently published by the



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University of Michigan Retirement Research Center has shown.

The working paper, "Participation and Contributions in Tax-deferred Retirement Accounts: Evidence from Social Security Records," was written by economists Marjorie Honig of Hunter College and Irena Dushi of the Social Security Administration. The authors used information from Social Security Administration W-2 records to study the participation of older workers in tax-deferred retirement plans between 1984 and 2003. These W-2 records were then compared with the tax-deferred contribution profiles of three birth cohorts born between 1931 and 1953 who were among the respondents in the Health and Retirement Study (HRS). The HRS is a longitudinal, nationally representative survey of Americans over the age of 50.

This information was used to determine whether younger cohorts saved relatively more at the same stage of the life cycle than had older cohorts. Specifically, the authors said, their objective was to ascertain the participation rates and the annual contribution amounts of older workers, the latter both in absolute terms and as a percentage of earnings.

The study looked at data for three separate cohorts: those in the first cohort were aged 50–55 in 1991, those in the second were aged 50–55 in 1997, and those in the third were aged 50–55 in 2003. Generally, the study found that participation in tax-deferred retirement plans increased substantially for all cohorts from 1984 to 2003. In all three cohorts, participation rates and median contributions were shown to increase with education and earnings. In addition, married respondents, whites, and males were found to be more likely to participate in retirement plans and to make larger annual contributions. Finally, the participation rates

of each of these cohorts was shown to increase as the members aged, peaking in their fifties and then declining, presumably as workers moved into lower-paying or part-time jobs.

However, differences were found between cohorts. The analysis showed that, at the same age, respondents in later years were more likely to participate in tax-deferred plans than those in earlier years. For example, participation was found to range at ages 53–55 from a rate of about 10% for the cohort born in 1931–32 to a rate of 50% for the cohort born in 1945–47. The authors noted that this pattern may reflect the effect of either period or cohort differences, or a combination of both influences.

Meanwhile, the findings indicated that median annual contributions increased for all cohorts as they aged, from about \$1,500 in their early thirties to about \$3,000 in their late fifties, after which contribution amounts declined sharply. However, in contrast to the pattern observed for participation rates, no substantial differences were found between cohorts with respect to median contribution rates, which ranged from 4% of participants' earnings in their early forties to 7% of earnings in their early sixties.

In addition, the authors pointed out that, while the overall participation rate increased throughout the period studied, the rate remained unchanged at below 20% for respondents in the lowest two earning quartiles, and that the median annual contributions of those in the lowest three quartiles remained at \$2,000 or less. By comparison, they noted, the participation rates of those in the highest quartile increased from about 20% in 1984 to 60% in 2003, and the median annual contribution increased from about \$2,000 to \$6,000.



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