

# RETIREMENT Plan Trends



A benefits update

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## Investment Assistance Can Lead To Better 401(k) Returns

Defined contribution plan participants who take advantage of the professional investment assistance provided by their employer—such as target date funds, managed accounts, and online advice—generally have better returns on their retirement investments than those who do not make use of the help available, according to a joint study by human resources consultancy Hewitt Associates and independent investment advisor Financial Engines.

The study, “Help in Defined Contribution Plans: Is it Working and for Whom?” examined the behavior and portfolio risk of more than 400,000 401(k) plan participants to determine whether participants using

professional investment help experienced better financial results than those who did not.

The results of the analysis revealed that, on average, the median annual return for participants using

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investment help was almost 2% (186 basis points, net of fees) higher than those who did not. For example, the study showed, an individual at age 45 who utilizes professional investment assistance will save 47% more by age 65 than if he or she does not use help, assuming the almost 2% higher median annual return is maintained over the 20-year period.

Researchers noted that the difference becomes even more pronounced if the initial investment is made at a younger age. The analysis showed, for example, that an individual at age 25 who uses professional investment assistance when investing \$10,000 could accumulate savings of \$105,800 by age 65, compared with \$52,100

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if he or she does not use help. This represents a 103% increase, again assuming the higher median annual return is maintained over the entire 40-year period.

The study’s authors cited past research showing that investment help is becoming increasingly standard with 401(k) plans, with half of companies (50%) now offering employees some type of 401(k) investment advice, compared to just 17% a decade ago.

When examining the types of investment help currently used by 401(k) participants, the study identified a number of key predictors. Younger, less-tenured participants with lower salaries, contribution rates, and account balances were found to be more likely to use target date funds. On the other hand, older, more-tenured participants with higher salaries, contribution rates, and account balances were shown to be more likely to select managed accounts. The analysis showed that the average participant enrolled in a target date fund was 38 years old with 3.8 years of tenure, a contribution rate of 4.1%, and a plan balance of \$6,295. By contrast, the average participant enrolled in a managed account was 49 years old with 12.5 years of tenure, a contribution rate of 5.7%, and a plan balance of \$45,816.

The study also found that plan participants who take advantage of online investment advice tend to have higher account balances, salaries, and contribution rates than other participants. The average participant using online investment advice was shown to be 41 years old with 9.4 years of tenure, a contribution rate of 7.1%, and a plan balance of \$69,057.

“Employers offer workers investment help like target date funds, online advice, and managed accounts because they help participants make smart investment decisions with minimal effort or expertise,” said Pam Hess, director of retirement research at Hewitt. The new research shows that these features can really pay off for participants, and that simply taking advantage of them can equate to thousands of dollars in additional retirement savings over time, Hess added.

“These findings trended the way we expected,” Hess observed. “Younger workers are more likely to use target date funds, since their financial needs generally are simpler and similar to others in their age group. On the other hand, enrollment in managed accounts increases as workers near retirement because these employees have more complex and individualized needs. It’s important for employers to offer a wide range of professional investment help to meet the retirement needs of their diverse workforce.”

According to the study, participants who use professional investment assistance follow a more appropriate glide path, where risk starts out higher early in their careers and “glides” downward as they approach retirement. The findings also showed that their portfolio allocations were more efficiently invested. By contrast, those participants who do not use help were found to have higher risk levels, on average, and a minimal reduction in risk as they approach retirement. Researchers noted that this was most apparent in near-retirees’ and retirees’ portfolio performance. The study found that participants aged 55 and older who do not use investment assistance have risk levels that have actually increased with age, which suggests that they are taking on more risk as they draw closer to retirement.

Christopher Jones, chief investment officer at Financial Engines, commented, “Participants can’t be expected to go it alone. For the 401(k) to succeed as an adequate retirement savings vehicle, different kinds of help need to be available to every participant in the plan.”

## Workers Are Delaying Retirement And Spending Less

With the economy in flux, many workers are preparing for retirement by continuing to work and cutting back on current spending, but not by increasing

their retirement saving, according to a recent study by the Center for Retirement Research (CRR) at Boston College.

The study, “Workers’ Response to the Market Crash: Save More, Work More?” was written by Steven A. Sass, Courtney Monk, and Kelly Haverstick. The findings are based on a CRR survey of a nationally representative panel of 1,317 workers aged 45 to 59 that was conducted in the summer of 2009. In addition to asking workers about any changes they have made in retirement saving and their anticipated retirement date, the survey inquired about a wide range of factors that could affect how workers might respond to the current economy, including financial and employment characteristics, emotional reactions, and financial literacy.

Results showed that older workers especially had experienced a loss of retirement wealth, with two-thirds reporting that they had less retirement savings than before the economic downturn. About 40% of respondents said they expect to retire later than planned, most by four or more years. Some 60% of respondents reported that they are reacting to the loss of savings by spending less.

Despite the reported shortfalls in their retirement savings, two-thirds of workers reported that they had made no change in how much they save for retirement in 401(k)s, IRAs, or other accounts. Of those respondents with retirement accounts, around 30% indicated they are changing the allocation of assets in their accounts or contributions to these accounts, with most of those who are making changes reallocating away from stocks.

At the same time, however, the survey showed that 43% of respondents had neither changed their planned retirement age nor the amount they save as a result of the downturn. Researchers noted that those respondents who made no changes tended to have higher incomes, and may therefore feel better positioned to weather the downturn. Meanwhile, those who said they had lost more than 10% of their retirement assets were shown to be more likely to work longer, and younger workers

were less likely to take action than those who had originally planned to retire within five years’ time.

To investigate the effects that financial advice might have on the retirement planning decisions of older workers, the survey also included a financial literacy experiment. Following the initial survey, a subsample of respondents were asked to consider what actions they would take if a finance professor told them that implementing certain changes should fully offset their losses. Depending on the circumstances of the respondents, such as their expected reliance on their financial assets for retirement income and how close they were to retirement, respondents were given specific advice, such as that by saving more now they would only have to work one or two additional years, instead of five. After considering the advice offered, the percentage of respondents who said they intended neither to work longer nor to save more fell from 41% to 24%, the percentage who said they would only save more rose from 10% to 18%, the percentage who said they would only work longer declined from 36% to 28%, and the percentage who said they expect both to save more and work longer increased from 13% to 30%.

“The rational response to a sharp decline in retirement wealth is to spread the pain—save more, work longer, and consume less in retirement—to the point where the incremental pain from each response is the same,” the authors said. “The extent to which workers are absorbing a portion of the loss by saving more and working longer is thus critical for assessing their retirement prospects.”



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## Automatic Enrollment Leads To Higher Employer Matches

Most employers that have implemented automatic enrollment in their 401(k) plans have also increased the company

match to participants' accounts, with many plan sponsors raising the match significantly since adding the feature, according to a study by the Employee Benefit Research Institute (EBRI).

The study was based on data from 225 large defined contribution plans that had adopted automatic enrollment 401(k) plans by 2009, but did not have the feature in 2005. Thus, the first data set was collected prior to the Pension Protection Act of 2006 (PPA), which made it easier for employers to implement automatic enrollment, and the second data set was collected several years after the legislation went into effect. The study analyzed the default contribution rates for each automatic enrollment plan in 2009, the entire match rate contribution formulas for both years, and all non-elective contributions paid to 401(k) participants by employers.

The analysis showed that the average 2009 first-tier match rate was 87.78%, while the average 2005 first-tier match rate was 81.26%. According to the study's authors, this difference of 6.52 percentage points suggests that sponsors that had adopted automatic enrollment were more generous to 401(k) participants than they were before implementing the feature.

The findings further revealed that the average effective match rate for 2009 was 4.32% of compensation, compared with 4.00% of compensation in 2005. Researchers asserted that the increase of 0.32 percentage points again indicates that sponsors that had added an automatic enrollment feature were contributing more to the 401(k) accounts of employees.

Finally, the average total employer contribution rate for 2009 was shown to be 6.35% of compensation, up from 5.46% of compensation in 2005. Researchers observed that the increase

of 0.89 percentage points once more suggests that those sponsors that had automatic enrollment were more generous to 401(k) participants.

The authors of the 2009 study then combined this information with the results of a 2007 study conducted by EBRI, which found that most sponsors of defined benefit plans that had frozen or closed their traditional pension plans had enhanced their 401(k) contributions. This study found, for example, that the change in the total employer contribution rate for all frozen plans was 1.64% of compensation, compared with 0.89% for the overall average. Employers that had closed their defined benefit plans to new employees reported an even larger average improvement of 2.82% of compensation.

"Our recent analysis of plan-specific data shows that, at least among large 401(k) plans, plan sponsors actually increased the generosity of their contribution rates," said Jack VanDerhei, EBRI research director and author of the analysis. He added that EBRI has published three separate simulation studies since 2005 showing the potential importance of automatic enrollment for future retirement account accumulation, even under the assumption that employer contribution rates would not change when the 401(k) plan was modified.

"The modifications to 401(k) plans made by sponsors in response to the Pension Protection Act of 2006 will be very important for retirement income adequacy in this country," VanDerhei said. "Adding these more realistic assumptions to our simulation model will allow us to more accurately demonstrate the relative improvements in retirement accounts, especially for young and low-income workers."



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