

RETIREMENT Plan Trends



A benefits update

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Target-Date Funds Gaining Traction Among 401(k) Plan Participants

A growing number of 401(k) plan participants who are offered the option of investing in target-date funds are moving at least some of their accounts into these funds, a trend that is likely to continue as plan sponsors and policymakers increase their efforts to encourage participants to invest in a balanced portfolio, according to a study released by the Employee Benefit Research Institute (EBRI).

The issue brief, "Use of Target-Date Funds in 401(k) Plans, 2007," was written by economist Craig Copeland. Using data from the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project, which includes 21.8 million retirement plan participants, the study examined the percentages and

demographic characteristics of employees investing in target-date funds in 2007.

Target-date funds, sometimes referred to as "life-cycle funds," are mutual funds that "automatically rebalance their asset allocation following a predetermined pattern over time to a specified target retirement date, typically rebalanc-

ing to more conservative and income-producing assets as the participant's retirement target date approaches," Copeland explained.

These funds have become increasingly important since they were among the mutual fund types specifically approved under the Pension Protection Act of 2006 (PPA) for use as a "default" investment choice by plan sponsors introducing automatic enrollment and other automated features to their 401(k) plans.

Of the 401(k) plans included in the database, 67.3% offered target-date funds as an investment option, and 7% of total assets were held in target-date funds in 2007. Of the 401(k) plan participants who were in plans that offered target-date funds, 37% had a least some fraction of

In This Issue

- Examining Fiduciary Responsibilities
- 401(k) Plan Savings Rates Show Signs Of Stalling

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In addition, the findings indicated that participants with earnings of less than \$40,000 a year were more likely to invest in target-date funds than those with higher salaries.

their account assets in these funds in 2007. An examination of the demographic characteristics of participants revealed that participants in target-date plans were younger than average: 43.7% of participants under age 30 had assets in target-date funds in 2007, compared with 27% of participants aged 60 or older. Target-date investors were found to be 2.5 years younger on average than participants who do not invest in target-date funds.

In addition, the findings indicated that participants with earnings of less than \$40,000 a year were more likely to invest in target-date funds than those with higher salaries. The average target-date fund investor was found to earn about \$11,000 less per year than those who do not have assets in target-date funds. The analysis also showed that target-date fund investors have an average of \$25,000 less in their account than other participants.

While noting that the database does not contain specific information on whether a retirement plan has automatic enrollment, Copeland reported that the analysis undertook an algorithm to create a proxy for those who could be identified as automatically enrolled. Auto-enrollees were identified as participants who had fewer than two years of tenure, had 90% or more of their account balance in target-date funds and company stock, and were enrolled in plans in which at least 60% of participants with fewer than two years of tenure were 90% or more invested in target-date funds.

Using this methodology, 7.2% of participants who invested in target-date funds were determined to be auto-enrollees. Like target-date fund investors in general, auto-enrollees were found to be younger and have lower salaries than average. Specifically, the analysis showed that 33.3% of auto-enrollees were younger than age 30, compared with 13.7% of participants who were not automatically enrolled, and 50% of auto-enrollees had annual salaries of less than \$20,000, compared to 15% of

non-auto-enrollees. In addition, 73.8% of these participants were found to have a total equity allocation of 75% to 89%, while only 40.2% of non-auto-enrollees were shown to have equity allocations in this range.

In conclusion, Copeland found that, while the use of target-date funds varies widely, investment in these funds “tends to move participants’ overall asset allocations in 401(k) plans away from all-or-nothing allocations in equities and provides for greater rebalancing of assets toward more conservative investments as the participant ages, when compared with 401(k) participants’ voluntary investment decision-making.”

Examining Fiduciary Responsibilities

Retirement plan sponsors are adjusting their plan designs in response to changes in the law and growing pressure to help participants save more effectively for retirement, according to a survey conducted by accountancy firm Grant Thornton and benefits consultancies Drinker Biddle & Reath and Plan Sponsors Advisors. However, the survey also suggested that many sponsors lack a thorough understanding of their fiduciary duties.

The survey of 275 retirement plan sponsors found that the passage of the Pension Protection Act of 2006 (PPA) has caused sponsors to revisit their plan’s default investments. Only 25% of respondents in the 2009 survey said they were using a money market fund or stable value product as the default investment for their defined contribution plan, compared to 55% of respondents in the 2008 survey. Meanwhile, 52% in 2009 reported that participants were defaulted into a target-date or life-cycle fund, compared to 17% in 2008.

Researchers also asked plan sponsors about the procedures they have in place to ensure that they are meeting their

fiduciary duties under ERISA. Some 58% of 2009 respondents reported that minutes of relevant meetings are maintained, down from 79% last year; just 27% in 2009 indicated that they use an independent party to analyze plan fees, compared with 45% in 2008; and just 29% in 2009 said their organization has a clear chain of authority for their plan's governance committee, down from 41% in 2008.

Given these results, researchers cautioned, "our respondents this year would have difficulty supporting the prudence of their fiduciary decisions in the face of a DOL (Department of Labor) audit." For example, the survey revealed that 65% of plan sponsors do not require management to periodically sign conflict-of-interest statements, "which is especially alarming given the importance the DOL places on the 'exclusive benefit' rule."

At the same time, however, 81% of the plan sponsors said they have in place an Investment Policy Statement (IPS), or a guide for the investment committee that documents investment strategy and monitoring methods. When asked how frequently the IPS is updated, 49% said as needed, and 25% said annually. In addition, 54% monitor the plan's investments on a quarterly basis, and 11% monitor annually.

Observing that managing the risks associated with ongoing retirement plan operations continues to be an area of concern for plan sponsors, researchers asked the sponsors if they have conducted an independent review of basic plan function and operations. Slightly more than half (51%) in 2009 said they have, up from 41% in 2008.

When asked about plan design, 42% of plan sponsors said their plans offer automatic enrollment, up from 39% last year. Of those plans that have automatic enrollment, 47% enroll participants at 3%, and 24% enroll participants at 2%. Nearly two-thirds (64%) with automatic enrollment reported they automatically enroll new hires only, while

31% said they enroll both new hires and currently eligible employees. In addition, 22% have implemented automatic contribution increases, up from 18% in 2008. Of those plans that have automatic increases, 82% have set them at 1% per year, and 11% have set them at 2% annually.

The survey also asked plan sponsors about their efforts to educate participants about their investment choices. Some 62% said they currently offer investment advice to plan participants, and 8% said they are considering offering advice in the future. Moreover, 68% said they provide some form of targeted participant education, such as mailings or group meetings.

401(k) Plan Savings Rates Show Signs Of Stalling

A combination of legislative changes and improved awareness among both retirement plan sponsors and plan participants about how workers can save effectively for retirement led to higher participation and contribution rates in 2007, but the arrival of the recent economic downturn could represent a major setback in these upward trends, according to a study published by the Center for Retirement Research at Boston College.

The report, "An Update on 401(k) Plans: Insights From the 2007 SCF" was written by Alicia H. Munnell, Francesca Golub-Sass, and Dan Muldoon. With the goal of reassessing the role played by 401(k)s in the provision of retirement income, the authors analyzed data from the Federal Reserve's 2007 Survey of Consumer Finances (SCF), a triennial survey of a nationally representative sample of U.S. households. But the authors noted that the environment in which the survey was conducted, when the stock market and house prices were near peak levels, no longer



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exists, and retirement saving trends have likely changed since the survey was conducted in the fall of 2007.

Yet, as of 2007, SCF survey results suggested that the rate of non-participation in 401(k) plans among eligible workers was declining: Just 20% of eligible workers indicated that they did not participate in their employer's plan in 2007, compared to 21% in 2004, 26% in 2001, 35% in 1993, and 43% in 1988. The authors speculated that this most recent decline in non-participation rates could be due in part to the movement to automatic enrollment.

With the maximum tax-deductible contribution defined as the lower of \$15,500 or 25% of salary, the 2007 SCF found that 7.7% of participants made maximum contributions to their 401(k) accounts that year. But the only category of earners in which more than 5% of participants contributed the maximum amount was that of workers who earned more than \$100,000 a year, among whom 29.9% reported making maximum contributions.

The survey also found that, while 58% of 401(k) plan participants reported having a diversified investment portfolio with a mixture of stocks and bonds, 14% said they held no equities in their accounts, and 28% said they had their entire account in equities.

Of those 2007 SCF respondents who have ever received a lump-sum distribution from a retirement plan, 40% said they did not roll the money over into another tax-deferred savings vehicle. However, the authors noted, most of the workers who cashed out were younger people who had saved relatively small amounts. Generally, they added, the percentage of 401(k) assets that have been cashed out has been on a downward trend in recent years.

Despite these improvements, the authors observed that, even in 2007, the cumulative retirement savings held in 401(k) accounts by workers approaching retirement was, on average, far below what is needed to finance a comfortable retirement.

The 2007 SCF showed that the typical worker aged 55–64 had saved just \$78,000 in his or her 401(k) account, up only slightly from \$73,000 in 2004.

Moreover, the authors emphasized that the recent downturn in the financial markets and the accompanying impact on households appears to have darkened the retirement savings picture. The number of hardship withdrawals from 401(k) accounts has shown signs of rising. The sharp fall in the stock market has led to substantial losses for nearly all savers: Between October 2007 and October 2008, the value of equities held in retirement accounts fell by almost \$4 trillion. Thus, the authors observed, the typical 401(k) plan participant who had savings of \$78,000 in October 2007 would have seen the value of his or her assets decline 30% to \$56,000 by October 2008.

The authors further observed that a growing list of employers have announced the suspension of their 401(k) matches as the recession continues. But, they added, provided the suspensions are temporary, the effects of these suspensions could prove to be modest, as inertia suggests that most plan participants are likely to remain enrolled during the suspension period.

Nonetheless, with 401(k) savings rates still below recommended levels, the authors concluded that, “the time may have come to consider returning 401(k) plans to their original position as a third tier on top of Social Security and employer-sponsored pensions.”



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