

RETIREMENT Plan Trends



A benefits update

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403(b) Plans Thriving Amid New Regulations

Even amid challenging economic conditions and new IRS regulations, the balances of 403(b) retirement plan participants remain high, and 403(b) plan sponsors are adjusting well to the new regulations, according to a survey released by the Profit Sharing/401k Council of America (PSCA).

Results of the 2010 survey were based on responses to questions about the 2009 plan year from 552 403(b) plan sponsors from across the country. Data showed that nearly 57% of plan sponsors made changes to their 403(b) plans because of the new regulations, which is more than the percentage (41%) that had planned to make changes according to a similar survey conducted in 2008. The findings also indicated that the overall participation rate of 75.8% for employees eligible to participate in a 403(b) plan was unchanged from

a similar survey conducted in 2008 regarding the 2007 plan year.

Of the plan sponsors surveyed, 83.2% reported that their organizations make contributions to the plan. According to the findings, the most common formula for these contributions is a guaranteed percentage of participant's pay only (17.0% of plans), followed by a stated employer match

only (13.9% of plans), and a fixed match only (8.9% of plans). Nearly all respondents (97.3%) said their plans allow participant contributions.

The survey results further indicated that 76.2% of plans provide immediate vesting for non-matching contributions, and 65.3% of plans provide immediate vesting for matching contributions. Among plans that do not provide immediate vesting, graduated vesting was found to be the most common arrangement for matching contributions, and cliff vesting was found to be the most common arrangement for non-matching contributions.

The survey also asked 403(b) plan sponsors whether they used automated features to encourage participation. Results showed that 11.5% of plans have an automatic enrollment feature, and automatic enrollment is more common among plans with 1,000 or more

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In addition, the survey found that catch-up contributions for participants aged 50 and over are permitted in 94.5% of plans, and 16.1% of eligible participants made catch-up contributions.

participants, with 21.9% of these plans using automatic enrollment. Of the plans with automatic enrollment, 43.5% have a default deferral of 3% of pay, and 19.6% have a default deferral of 2% of pay. The most common default option was a target-date fund, used by 38.8% of plans. Researchers noted that this represents a shift away from the money market fund, which was the most common default option in 2007 and is currently used by 30.2% of plans.

When asked if they allow participants to make Roth contributions with after-tax dollars, 13.9% of the plan sponsors indicated they permit Roth contributions, up from 10.9% in 2007. The percentage of larger plans offering the Roth contribution option also increased significantly, from 17.0% in 2007 to 29.4% in 2009 for plans with 1,000 or more participants and from 5.6% in 2007 to 19.0% in 2009 for plans with 200–999 participants.

In addition, the survey found that catch-up contributions for participants aged 50 and over are permitted in 94.5% of plans, and 16.1% of eligible participants made catch-up contributions. However, results also indicated that, of the organizations that permit catch-up contributions, only 16.4% match them.

The poll also indicated that, on average, 84.2% of employees are eligible to participate in their organization's plan, up slightly from 83.5% in 2007. Plans with more than 1,000 participants were found to have the highest average percentage of eligible employees, or 88.8%.

More than three-quarters of the plan sponsors (75.9%) said they allow participants to take hardship withdrawals. Of this group, 88% reported allowing hardship withdrawals to pay for medical expenses, 72% said they allow withdrawals to pay for post-secondary education, and 50.7% indicated they allow withdrawals for the purchase of a primary residence or to prevent eviction or foreclosure.

Similarly, nearly three-quarters of respondents (72.7%) said they allow participants to borrow against their plan assets,

with 48.7% saying they permit loans for any reason and 24% indicating they allow loans only in hardship situations. In addition, 36.8% said they permit participants to have more than one loan outstanding.

The findings further showed that, on average, the plan sponsors surveyed offer 20 funds for organization contributions and 21 funds for participant contributions. However, the 27.7% of plans offer 26 or more funds for participant contributions. Moreover, 43.5% of respondents indicated that their organizations provide investment advice to participants, and the most common type of advice offered is one-on-one counseling in person, which is provided by 79% of organizations.

Defined Contribution Plan Design Can Be Improved

Defined contribution (DC) retirement plans could be changed to better meet the needs of the millions of workers worldwide who are saving for retirement using these plans, with fiduciaries making greater efforts to protect participants from investment risks that can have a severe impact on account balances in a downturn, a study by human resources consultancy Towers Watson has advised.

The study, "Journey well, arrive better," looked at the defined contribution plan designs around the world, especially in the United States, the United Kingdom, and Australia, where the trend away from defined benefit plans and toward defined contribution plans is becoming universal. The report noted that DC assets now comprise 42% of global pension assets, up from 32% in 1999, and a significant number of multinational companies now have global policies of offering employees only defined contribution plans.

While observing that it has become accepted practice among DC plan sponsors to encourage plan members to take

control of the investment decisions for their retirement savings, the study's authors cautioned that many savers are unwilling or unable to make appropriate investment choices. Even where they have made some initial choices, they have generally adopted a "set it and forget it" approach.

The report identified three basic categories of DC plan members: the "true-defaulters," who have no financial expertise and are entirely disengaged from their pension savings; the "guided-selectors," who have some financial knowledge and the potential to become more engaged in making decisions about their retirement savings; and the "self-selectors," who are financially literate and motivated to make investment decisions.

Given that most savers fall into the first two categories, the report recommended that plan members be provided with the tools, structure, and guidance they need to make appropriate investment and savings decisions, as well as a framework of education and proactive communication that enables them to monitor their progress. Researchers advised that the information must be presented in a form that plan members can understand and use. They also recommended that plan members be encouraged to set a retirement income target, as a means of helping them become more focused and gain control of their retirement savings, and to use online tools to develop a journey plan against which they can chart their progress.

Additionally, the report advised plan sponsors to take advantage of lifecycle investment strategies, as they provide automated, risk-controlled allocation for plan members' portfolios, which helps ensure an appropriate balance of risk and return. However, they also cautioned fiduciaries to take into account the profile of the typical member when implementing these strategies.

Specifically, researchers suggested that plan fiduciaries develop an investment plan designed to provide a satisfactory rate of return over the course of each plan member's savings life, to offer sufficient

protection to members against downside volatility of the market, and to give sufficient consideration to the personal circumstances and preferences of each member.

Finally, the study's authors pointed out that growth funds can be improved by adding to the diversity of asset classes and by ensuring that appropriate use is made of active or passive management, based on individual beliefs or governance principles.

"There is no doubt that being a member, or a fiduciary, of a DC plan is challenging, but more thinking is producing better practices," said Gary Smith, senior investment consultant at Towers Watson.

"Indeed many DC members now realize that they need to better address their own investment risk while plan fiduciaries are reviewing their investment strategies and default arrangements to redress the balance of risk and return," Smith continued. "Against this backdrop, and with much greater awareness of and engagement with the issues, we are confident that a more robust DC proposition is emerging."

Household Characteristics And Retirement Savings

While assets in 401(k) and other individual retirement accounts are concentrated in families with common characteristics, including higher incomes and higher educational attainment, retirement plan assets appear to be less concentrated than overall financial assets in many of the same demographic categories, according to a study released by the nonpartisan Employee Benefit Research Institute (EBRI).

The report, "Total Individual Account Retirement Plan Assets, by Demographics, 2007, With Market Adjustments to March 2010," was written by EBRI senior research associate Craig Copeland. The study examined the distribution of



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total assets held in 401(k)-type plans, individual retirement accounts (IRAs), and Keogh plans across various demographic characteristics of U.S. families, based on the latest data from the Federal Reserve's Survey of Consumer Finances.

In general, households with certain characteristics—including higher net worth, higher income, higher educational attainment, and older, white, non-Hispanic heads—were found to be more likely to have retirement savings than other types of households. At the same time, however, results indicated that retirement plan assets are less concentrated than overall financial assets in some demographic categories.

For example, the study found that families with white, non-Hispanic heads owned 85.1% of active employment-based individual account retirement plan assets, compared with 91.9% of all financial assets. Further, families in the top 10% of net worth held 50% of these active employment-based retirement assets, compared with 72.3% of all financial assets.

"Families with more assets have the ability to accumulate the most assets in an individual account plan due to other sources of assets and higher average incomes," said Copeland. "Furthermore, these same individuals are more likely to be offered a retirement plan through an employer, so they may find it easier to save due to the automatic savings created by participating in an employment-based retirement plan. Therefore, these assets have grown significantly for the higher-resource groups."

The study also noted that individual account retirement assets amounted to \$8.979 trillion in 2007, with employment-based plan assets (\$4.823 trillion) exceeding IRA/Keogh account assets (\$4.157 trillion) by \$0.666 trillion. The analysis showed that, in 2007, 70% of the employment-based retirement plan assets

were held by families with heads aged 45–64, while the greatest concentration of IRA and Keogh assets were owned by families with heads in the next oldest age group, or 55–74, who held just over 60% of these assets.

Based on an analysis of earlier data, the study reported that the distribution of individual account retirement plan assets by the family net worth percentile and race of the family head remained relatively constant from 1992 to 2007. Results indicated, for example, that in 1992, families headed by a white, non-Hispanic individual accounted for 91.9% of the individual account retirement plan assets, compared with 89.3% in 2007.

The findings also suggested, however, that families headed by older and the most highly educated individuals, or those with the highest incomes, acquired larger shares of these individual account assets over this period. For example, households headed by individuals aged 55 and older held 58.6% of all assets in 2007, compared to 44% in 1992. Similarly, the share of assets owned by families headed by individuals with a college degree had risen to 74.8% in 2007, compared to 69.3% in 1992, and the share of IRA assets owned by families with incomes of \$150,000 or above had increased to 49.9% in 2007, from 39.1% in 1992.

But Copeland also pointed out that, while the fraction of total assets is smaller in the individual account plans of those with lower net worth and lower income, and among those who are younger, these assets comprise a significant portion of their total financial assets, more than one-third in many cases. "Consequently," he concluded, "for those with fewer assets using these plans, these retirement plans have been effective in helping them accumulate assets they otherwise may not have been able to save."



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