Save the date: SVIA National Fall Forum, October 13-15, 2014 in Washington, DC

Outlook and Trends in Defined Contribution Plans

By Randy Myers

Stocks have been racing higher since 2009, attracting investor attention at the very time that low interest rates have been depressing fixed-income returns. Meanwhile, target-date funds have been attracting an ever-growing share of the money being saved in defined contribution plans, including money that once flowed into stable value funds. But a survey by asset manager PIMCO of the nation's leading DC-plan advisors suggests the outlook for stable value may be bright nonetheless.

To be sure, the industry faces challenges, said Stacy Schaus, executive vice president and head of defined contribution practice for PIMCO. Participant contributions to DC plans could continue to flow more rapidly into other investment options, she observed, particularly if plan sponsors become more aggressive about reenrolling employees into their plans and directing them into their default investment options. Consultants broadly support reenrollment, although relatively few plan sponsors have embraced it so far.

Stable value also could be threatened if Baby Boomers continue the current trend of rolling their DC-plan assets into Individual Retirement Accounts when they retire, since stable value funds are not available in IRAs. But, Schaus said, there are reasons to believe that plan sponsors and providers will find ways to make DC plans so attractive that participants won't want to leave them for IRAs.

PIMCO has surveyed retirement plan consultants annually for the past eight years. Its 2014 poll garnered responses from 49 leading consulting firms serving more than 7,800 clients—clients whose DC-plan assets totaled $2.8 trillion, or about half the DC marketplace. The survey found strong support among consultants for stable value funds. For example, every one of them said the core investment offerings in a DC plan should include a capital preservation option, which historically has meant either a stable value or money market fund. In addition, more than 70 percent said they were at least somewhat likely to recommend that clients replace their money market fund with a stable value fund if federal regulators follow through with their proposal to have net asset values for money market funds fluctuate with market values. All this, Schaus said, suggests the stable value industry has an opportunity to retain its place on the menu of core investment options in DC plans.

Nonetheless, she said, the stable value industry must find a way to have its products incorporated more broadly into target-date funds and other asset-allocation investment options, including managed accounts that have become the most popular default investment options in DC plans. Many managed account programs, as well as custom target-date funds created by larger plans, already utilize stable value funds, but off-the-shelf target-date funds generally do not.

"How well the industry weaves stable value into default (investment options) will largely determine where the future of stable value may go," Schaus said.

Here, too, the survey results were encouraging, with 39 percent of consultants actively promoting custom target-date strategies to their clients and another 43 percent supportive of client interest in the idea. (Figures for managed accounts weren't quite as strong. Still, 37 percent of consultants said they actively promote managed accounts or support client interest in them.)

Consultants like stable value in target-date funds in part because it can reduce the potential for losses without compromising returns—an especially important concern when participants are at or near retirement age. Consultants on average say participants should not be exposed to more than a 10 percent loss in their retirement account at age 65, Schaus said. Yet PIMCO looked at the 40

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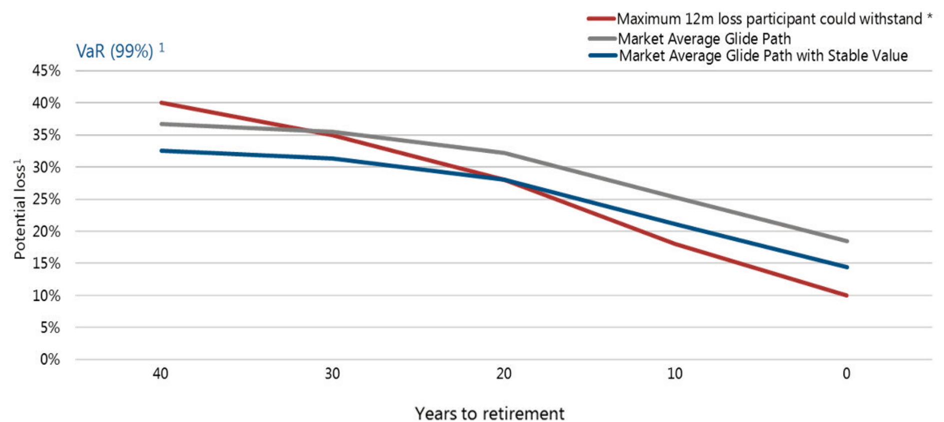
Case For Stable Value in Glide Path: Reduce Potential Loss



As of 31 MARCH 2014					
	VaR (99%)[1]				
Years to Retirement	**40**	**30**	**20**	**10**	**0**
Market Average Glide Path	36.8%	35.6%	32.4%	25.4%	18.5%
Market Average Glide Path with Stable Value	32.5%	31.3%	28.0%	21.0%	14.3%

* From 2014 PIMCO DC Consultant Survey
1 Value-at-Risk (VaR) is an estimate of the minimum expected loss at a desired level of significance over a 12m time horizon. Shown as positive percentage.The sample of risk factors is from January 1970 through the present date.

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The Quest to Expand the Use—and Value—of Defined Contribution Plans

By Randy Myers

For employers worried about enrolling employees in their defined contribution retirement plans automatically at contribution levels that are too high, here's a counterintuitive finding: they should probably be worried about setting them too low.

Automatic enrollment effectively forces workers to save for retirement unless they make a conscious choice to opt out of their plan. It is widely credited with improving plan participation rates. Fidelity Investments has reported that among the more than 21,000 plans for which it provides recordkeeping services, auto-enroll plans enjoy participation rates of 84.3 percent of eligible workers, versus 68 percent for all of its plans. What's more, sponsors that automatically enroll participants at higher contribution rates tend to keep more participants in their plans than those with low contribution rates. Speaking at the SVIA's 2014 Spring Seminar, Elizabeth Heffernan, a vice president in the Fidelity Employer Services Center, said plans that set the automatic participant contribution rate at 3 percent of salary have average participation rates of 85.8 percent. Those that set the rate at 5 percent have average participation rates of 90.3 percent. Even at an automatic 6 percent deferral rate, 88.7 percent of eligible employees participate. "People are more committed at those higher savings rates," Heffernan observed.

Despite these telling figures, only a minority of plan sponsors have embraced automatic enrollment, and many continue to set deferral rates low. Among Fidelity plans, just 26 percent use auto enrollment. Those plans represent 59.6 percent of Fidelity's total participant base, however, indicating that auto enrollment is more popular among larger plans. Still, nearly 75 percent of all plans offering automatic enrollment set the base deferral rate at 3 percent of salary or less.

"Our default path is much too low," Heffernan said. "We need to get more plan sponsors comfortable with auto enrollment at 6 percent, at 7 percent, of salary."

Beyond boosting automatic deferral rates, Heffernan said plan sponsors could take several other measures to help employees achieve better results from their defined contribution plans, including adopting a policy of automatically boosting deferral rates on an annual basis. While 77.1 percent of Fidelity plans give participants the option to increase their deferral rates annually, only 12 percent increase them automatically.

In addition, Heffernan said, plan sponsors could boost plan participation by automatically enrolling not just new employees but also existing employees who aren't in the plan, a process known as reenrollment. "That's an area where we have a huge opportunity to do better as an industry," she said.

Some sponsors, Heffernan conceded, have embraced reenrollment not just to boost participation rates but also to automatically steer participants into more diversified investment portfolios. About 15 percent of participants in Fidelity-run plans have 100 percent of their assets in either stocks—generally considered the riskiest asset class available—or in the most conservative investment option, such as a stable value or money market fund. "There are not many situations where that is appropriate," she said.

Finally, Heffernan said, plan sponsors could help plan participants by offering products or services that assist them in converting retirement savings to income once they stop working. While most sponsors seem to have little appetite for offering guaranteed-income products, she said, they have shown interest in programs that would allow participants to take regular withdrawals from their accounts, and in guidance programs designed to help participants better understand their retirement-income options. SVIA

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largest target-date funds aimed at 65-year-olds and calculated the actual value at risk over a 12-month time horizon was closer to 20 percent. By contrast, a comparable fund that included an allocation to stable value put only about 10 percent of the participant's account value at risk.

Beyond expanding into target-date funds, Schaus said the stable value industry can help to solidify its future by convincing plan sponsors to educate plan participants to keep their money in their DC plans after retirement. Right now, she said, only a small minority of sponsors actively seek to retain those assets.

For retirees who do stay in their employers' retirement plans, Schaus said, the most important post-retirement need relating to that plan will be retirement income modeling and education, including one-on-one retirement counseling. The stable value industry can play a role in that, she said, by ensuring that the people and organizations creating retirement income models understand stable value and account for it properly in their models. SVIA